Direct Tax Vista

Your weekly Direct Tax recap

Edn. 55 – 25th April 2023

By Vivek Jalan, Partner, Tax Connect Advisory Services LLP

1. Transfer Pricing Cases can be taken up by High Court when it can be proved that a matter of fact gives rise to a question of law

ALP determination is an art and not a science. Transfer Pricing exercise is a valuation exercise. The question thus arises whether a Transfer Pricing case can be referred to the High Court. The answer is that if the arm's length price is determined by the Tribunal de hors the guidelines stipulated under the Act and the Rules, more particularly Rules 10A to 10E of the Rules, the determination can be said to be perverse which is always subject to the scrutiny by the High Court in an appeal under Section 260A of the Act. However, the perversity has to be demonstrated and pleaded with material on record, as has been held in the case of Vijay Kumar Talwar v. CIT, (2011) 1 SCC 673 and Sir Chunilal V. Mehta and Sons Ltd. v. Century Spinning and Manufacturing Co. Ltd., reported in AIR 1962 SC 1314

In every writ under Article 226 of The Constitution of India, a question of law has to be framed. A finding of fact may give rise to a substantial question of law, in the event the findings are based on

(i) no evidence; and/or
(ii) while arriving at the said finding, relevant admissible evidence has not been taken into consideration or inadmissible evidence has been taken into consideration; or
(iii) legal principles have not been applied in appreciating the evidence; or
(iv) when the evidence has been misread.

The questions of law in TP Cases can be –

i. where the issue relates to whether at all a transaction falls within the definition of 'international transaction'
ii. whether two enterprises are 'associated enterprises' as per the definition under the IT Act.

However the following are matters of facts –

i. The question of comparability of two companies or selection of filters.
ii. View taken on the basis of the particular set of facts in one case as different from another case
iii. Benchmarking of controlled transactions with uncontrolled transactions

Hence it was held by The Apex Court in the case of **SAP LABS INDIA PRIVATE LIMITED Vs INCOME TAX OFFICER, CIRCLE 6, BANGALORE** [2023-VIL-11-SC-DT] that High Court's have to examine whether in each case while determining the arm's length price the guidelines laid down under the Act and the Rules, are followed or not and whether the findings recorded by the Tribunal while determining the arm's length price are perverse or not. To this extent the TP matters can be taken up in High Court. Counsel's and taxpayers may thus take up matters accordingly, even before the Tribunal Stage so that incase of adverse ITAT judgement, the matter of law can be taken up at the High Court Level. The Department too is taking note!

2. Orders/Notices without DIN are liable to be quashed

Circular No. 19/2019 holds that no communication shall be issued by any income-tax authority unless a computer-generated DIN has been allotted and is duly quoted in the body or such communication -

i. Relating to assessment, appeals, orders, statutory or otherwise, exemptions, enquiry, investigation, verification of information, penalty, prosecution, rectification, approval etc.
ii. Issued To the assessee or any other person,
ii. Issued On or after the 1st day of October, 2019

Exceptional circumstances for relaxation of the Circular after following the due process and post facto regularization –

(i) Where non DIN communication is issued due to technical difficulties
(ii) When non-DIN communication is issued by IT Authorities who is outside the office
(iii) When due to delay in PAN migration PAN is lying with non- jurisdictional Assessing Officer;
(iv) when PAN or assessee is not available and where a proceeding under the Act (other than verification under section 131 or section 133 of the Act) is sought to be initiated;
(v) When the functionality to issue communication is not available in the system,

Para 4 of The Circular is most important to note. It states that "*4. Any communication which is not in conformity with Para-2 and Para-3 above, shall be treated as invalid and shall be deemed to have never been issued.*" Furthermore as per Para 7, in all pending assessment proceedings, where notices were issued manually, prior to issuance of this Circular, the income-tax authorities should have identified such cases and should have uploaded the notices in these cases on the Systems by 31th October, 2019.

It is also important to note about the binding nature of CBDT circular on the Income-tax Authorities which has been held as per the decision of Hon'ble Supreme Court in the case of CIT v. Hero Cycles [1997] 228 ITR 463 (SC) wherein it was held that circulars bind the ITO but will not bind the appellate authority or the Tribunal or the Court or even the assessee.

On these grounds, the order u/s 263 of IT Act passed by Commissioner which does not bear DIN was quashed in the case of G.P. TRONICS PVT. LIMITED Vs ASSISTANT COMMISSIONER OF INCOME TAX, CIRCLE-2(1), KOLKATA [2023-VIL-482-ITAT-KOL]

3. Whether GST ITC balance can be added to Closing stock?

Many a times, a confusion is there in the minds of the AOs whether the ITC/CENVAT Balance at the year-end shall be added to the closing stock u/s 145A as unutilzed balance of taxes. Now, there can be 2 methods to account for ITC/CENVAT Closing balance –

1. Inclusive method – Including the GST/Excise Duty in the value of purchase as well as stock
2. Exclusive method – Not Including the GST/Excise Duty in the value of purchase as well as stock

Incase the assessee follows the exclusive method the ITC/CENVAT balance cannot be added to the value of closing stock. In the exclusive method of accounting, the excise duty, GST etc. are excluded both from purchase as well as from the sales and closing stock remaining at the end of financial year and therefore the financial results continue to reflect true and correct picture without any under-reporting of income. Once the closing stock determined by exclusive method is distorted by increase in its value on account of excise duty component etc. the corresponding adjustments will have to be necessarily made in sales as well as in purchases and opening stock etc. to make it inclusive. Thus, such exercise has no impact on the ultimate financial results.

Hence, like earlier judgements, even in the case of THE DCIT, CIRCLE-4(1)(2), AHMEDABAD Vs VOLTAMP TRANSFORMERS LTD [2023-VIL-493-ITAT-AHM], it was held that no addition can be made under Section 145A of the IT Act of ITC/CENVAT Balance at the year end.

4. Interest on delayed payment of TDS / Income Tax / GST / Customs / Service Tax / Central Excise / Sales Tax – Allowed as a deduction?

It is now a settled principle that the payment of interest takes colour from the nature of the levy with reference to which such interest is paid. Incase interest is paid under Section 201(1A) of the IT Act, it would not assume the character of business expenditure and cannot be regarded as a compensatory payment. The Supreme Court in the case of Bharat Commerce & Industries Ltd. vs. CIT (198) 230 ITR 733 (SC), held that interest on late payment of Income Tax was not allowable. It held

that the interest levied u/s. 139 and section 215 of the Income-tax Act was not deductible as a business expenditure u/s. 37(1) of the Act.

On the same principles, In another judgement, The Hon'ble Supreme Court in the case of Lachmandas Mathuradas vs. CIT (2002) 254 ITR 799 (SC) held that interest on arrears or on outstanding balance of sales tax is compensatory in nature and would be allowable as deduction in computing profits of a business. Similarly, GST/Service Tax/Central Excise/Customs delayed payment are allowable as a deduction to the assessee and hence the delayed payment of Interest also should be allowable as a deduction in these cases.

5. For a Project Company, Director's salary is a revenue expenditure and not a capital Expenditure

When a project is in process, the AOs contention is that the director's is the epic centre of all the construction and development activities carried out by the assessee. The strategy for construction of project, planning, finance and other project related activities are discussed and determined in the office of the director therefore the director's office is entirely involved in the project activity. Hence atleast some part of the expenses of The Director's office should be capitalised.

However, it is to be noted that according to AS-2 it is not permissible to inventorize administrative costs, as they are not related to bringing the inventory to the present location. The director's office expenses cannot be included in the cost of the project, being administrative expenses. Director's salary is incurred in order to run the businesses smoothly and is purely in the nature of revenue expenses and not related to the construction activity only. Hence it was held in the case of DCIT, CC-7(3) Vs M/s MACROTECH DEVELOPERS LIMITED [2023-VIL-499-ITAT-MUM] that Director's office expenses cannot be capitalised and has to be allowed as an expenditure in the year of incurrence.

6. Forex Fluctuation loss on account of loan taken for purchase of a capital asset is to be capitalized

Incase Machinery is imported with a loan obtained from foreign banks and which is repayable in foreign currency, the increased liability on account of fluctuation in the

rate of foreign exchange in respect of outstanding loan amount is to be added to the actual cost of acquisition of assets for the purpose of depreciation for the relevant A.Y. The Hon'ble Supreme Court in the case of Sutlej Cotton Mills Ltd vs. CIT (1979) 116 ITR 1 held the same. It is now a settled principle and was followed in the case of KAMINENI HEALTH SERVICES (P) LTD Vs DY. C. I. T. CIRCLE 2(1) HYDERABAD [2023-VIL-503-ITAT-HYD].

(*The author is a CA, LL.M & LL.B and Partner at Tax Connect Advisory Services LLP. The views expressed are personal. The author is The Lead - Indirect Tax Core Group of CII- ER and The Chairman of The Fiscal Affairs Committee of The Bengal Chamber of Commerce. He has Authored more than 15 books on varied aspects of Direct and Indirect Taxation. E-mail - vivek.jalan@taxconnect.co.in*)