Direct Tax Vista

Your weekly Direct Tax recap

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By Vivek Jalan, Partner, Tax Connect Advisory Services LLP

1. Assessments of EPC contractors cannot be done merely by assuming and comparing accounts with Form 26AS same is applicable even for professionals

EPC contractor's business is a typical business which includes manufacture, trading as well as provision of services. The cash flows happen at the very beginning of the project and maximum purchases happen at the very beginning. Biling is done and GST accrues as per Schedule of Biling as approved by the principle/client. The goods move to the site of the principle as per requirement and the Recognition of income is in accordance with the percentage completion method as prescribed by AS-9 issued by ICAI. Hence, the matching of the cash flows, GST records and Accounting records for Income Tax purposes requires many reconciliations.

Many a times of Income Tax Authorities adopt a simplistic way of determining an estimated income of the EPC Contractors vide comparison of GP Ratio/ Form 26AS/etc although the assessee maintains voluminous details of the transactions carried out to run the business which are even audited. Wholesale rejection of books of accounts is not warranted just on the basis of Form 26AS or even low GP ratio as against average of last few years. While running a business, especially such a complicated business, it is not possible to maintain astatic graph of profit in all the years. The earning of profit depends upon several market conditions as well as the mode and manner in which the business has been carried out and incase assessee can demonstrate the same as comparable by reasonable means, the same cannot be rejected without substantive reasons.

Further, in most EPC contracts, there are disputes at the end of the project with the principle which is settled only by arbitration and hence after the project is completed

the principles do not co-operate. Every year of assessment is a separate year and has its own specific and peculiar transactions. While making assessments, additions cannot be made only on account of fall in GP without any other basis and going into the books of accounts. The same was held in the case of TOTAL INTEGRATED DESIGN (INDIA) PVT. LTD Vs ITO, WARD-25(3), NEW DELHI [2023-VIL-1019-ITAT-DEL].

Even incase of professionals, many a times recognition of income is on cash basis whereas the recognition of the expense by the clients and deduction of TDS is on due basis. For example, incase of audit fees which is generally provided at the end of the year by the company on provisional basis. But the same is recorded by the auditor in the subsequent year on receipt basis resulting in mismatch of details of TDS contained in Form 26AS. At the time of payment, the company/auditor renegotiates the provision which has been created and a lesser/more payment is made but the TDS return filed for the previous year is not revised resulting in mismatch with Form 26AS. Hence the service Industry's books cannot be rejected only on the basis of Form 26AS without going into the evidences.

2. Offshore supplies in India by parent company and onshore supplies by Project offices – what is taxed in India and what is outside India?

Global Companies have project offices in India wherein they undertake contracts which have offshore supplies by parent companies and onshore supplies for the same project by project offices. Following the Doctrine of Territorial Nexus, the profits arising from offshore supplies should not result in any profit attribution to India even through the assessee's PEs in India. Where the PE of the assessee is not involved in manufacturing or procurement of the offshore supplies, there can be no question of attribution of any profit arising thereon on the Indian PEs, under the Income Tax Act.

The Apex Court in the case of Ishikawajima - Harima Heavy Industries Ltd. - Vs. Director of Income tax, Mumbai (228 ITR 408 SC), has also held that consideration for supply of Plant & Equipment, from outside India was not liable to tax in India.

While the above the are broad principles, yet what came to the rescue of the taxpayer in HITACHI LTD Vs ACIT, CIRCLE INT. TAX. 2(1)(1), NEW DELHI [2023-VIL-1022-ITAT-DEL] is the fact that what can be attributed is a profit and when globally there is a loss which is incurred, then there is no question of attribution of a profit on an assumed basis.

3. TDS on freight/charter hire always u/s 194C and not u/s 194I

TDS non-deduction certificates are issued to many shipping companies by AOs and in the current context it is a settled position now that the expression “work” means carriage of goods and passengers by any mode of transport other than by railways and for this reason, tax from freight payments has to be deducted under Section 194C of Income Tax Act. Provisions of Section 194-I of the Act are applicable only in respect of rent for land or building, furniture, fittings or any other machinery attached thereto and not for anything else like ships, transport vehicles and freight/charter hire payments thereto. However, even for the period before 2009, The Bombay High Court in the case of INDIAN NATIONAL SHIP OWNERS ASSOCIATION Vs THE COMMISSIONER OF INCOME TAX [2023-VIL-83-BOM-DT], has held that TDS for freight/charter hire payments have to be made u/s 194C.

4. Some non-integral cases arising out of search action shall not be transferred to the Central Charges

If the income tax department has conducted a survey u/s 133A of Income Tax Act on the basis of the tax return filed, then compulsory scrutiny is unavoidable except where the book of accounts, documents etc. were not collected. Further, where the income tax authorities have done search & seizure either prior to April 1, 2021 or after that, the case will be picked for complete scrutiny. They will also be transferred to Central Charge u/s 127. However, there may be smaller cases which are picked up during the course of Search & Seizure action wherein information relating to some other persons maybe gathered. Where these persons have substantial transactions with the person on whom survey/search/scrutiny action has happended, then they would also be transferred to Central Charge. However, those who may have one-off/very few or limited financial transaction(s) with the main assessee group covered in the search u/s 132/132A of the Act and incase such

persons are not integrally connected with the core business of the main assessee searched and do not belong to the same business group, then such cases shall be dealt with by the jurisdictional AO for assessing them u/s 148 (for searches conducted/requisition made after 01.04.2021) of the Income- tax Act, 1961. The same was clarified by CBDT Order dated 3rd August 2023.

5. Non-residential use of residential house would not disentitle from claim u/s 54F

Construction of a very small residential house on a very big piece of land, assessee not residing in the residential house, the residential house not being fit as per the status of the assessee and even Non-residential use of residential house would not render a property ineligible for benefit u/s 54F of Income Tax Act. If residential house is constructed, whatever might be the use it had been put to, the assessee can be said to have fulfilled the conditions envisaged u/s 54F. Also incase a new residential house is let out for commercial use, it would not lose exemption under s. 54F. Further even if the size of the constructed portion is very small, the exemptions benefits cannot be denied to the land appurtenant. In case electricity/water bills and other evidences for the property also display that it is a residential property, then it would be an icing on the cake and help the court pass a favourable order as it did in the case of GIRISH MOHAN Vs ACIT, CIRCLE-1(1), GURGAON [2023-VIL-990-ITAT-DEL].

6. Form 3AF for Preliminary Expenses to be furnished 1 month before ITR

One of the conditions for claiming a deduction of expenses u/s 35D is that the work in connection with activities for which preliminary expenses are incurred should be carried out within the organization of the assessee. Where it is entrusted to an outside concern, that concern should be approved by the CBDT. The Finance Act 2023 eased the condition for claiming amortization of such preliminary expenses. The amendment was made to make it mandatory for the assessee to furnish a statement containing the particulars of this expenditure within the prescribed period to the prescribed authority in the prescribed Form and manner. The CBDT inserted Rule 6ABBB requiring the assessee to furnish the statement in Form No. 3AF. The Form is required to be furnished one month before the due date for furnishing the

return of income as specified under section 139(1) of Income Tax Act. This form has been notified vide Notification No. 54/2023. The amendment also replaces Form No. 3AE in the Income-tax Rules, 1962, with new forms to be used for audit reports under section 35D(4)/35E(6) of the Income-tax Act, 1961. These changes are aimed at ensuring proper record-keeping and transparency in the deduction of preliminary expenses.

7. Exemption from TDS for lease rents paid to units of ship leasing companies in IFSC...Lessee to scrutinize Form 1 furnished by the lessor carefully

The CBDT has exempted the tax deduction at source under section 194-I of Income Tax Act on lease rent or supplemental lease rent received by a unit operating within an International Financial Services Centre (IFSC) for the lease of a ship. However, certain conditions must be met, including the submission of Form 1 by the lessor and the non-deduction of tax by the lessee. However, the lessee shall furnish the particulars of all the payments made to lessor on which tax has not been deducted. This means that the entire burden lies on the lessee to ensure that the Form 1 is correct. Important to note that 10 AYs declaration is required to be made by the lessor in Form 1.

(*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*)