# Direct Tax Vista

**Your weekly Direct Tax recap**

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## 1. Bank Accountholders undertaking specified transactions to be alert as PMLA Act becomes more stringent for Banking / NBFC / Financial and other Entities

The Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 provides for maintenance of records of the nature and value of transactions, the procedure and manner of maintaining and time for furnishing of information and verification of records of the identity of the clients, of reporting entities like banking companies, financial institutions and intermediaries. Like every law, there has to be a person who would be held responsible for compliances. Under PMLA Rules also a 'principal officer' of a 'reporting entity' is responsible for maintenance of records. Like in every Organisation, people at senior levels generally wish to delegate the critical and risky functions down the line, so also under PMLA Act, the management officers of reporting entities delegated this function of maintenance of records to juniors. Whenever there was non-compliance, then these junior officers were summoned by the PMLA Authorities and the summons yielded no fruitful results. In this backdrop, the Ministry of Finance issued a notification outlining several amendments to the Prevention of Money-laundering (Maintenance of Records) Rules, 2005 vide Prevention of Money-laundering (Maintenance of Records) Second Amendment Rules, 2023. Before understanding the changes, let us understand the intricacies.

Every "reporting entity" as per Section 2(wa) of the PMLA Act, i.e. a banking company, financial institution, intermediary or a person carrying on a designated business or profession shall, as per Section 11, verify the identity of its clients and the beneficial owner.

As per Section 2 (fa) beneficial owner" *means an individual who ultimately owns or controls a client of a reporting entity or the person on whose behalf a transaction is*

*being conducted and includes a person who exercises ultimate effective control over a juridical person.*

As per Section 2 (ha) "client" *means a person who is engaged in a financial transaction or activity with a reporting entity and includes a person on whose behalf the person who engaged in the transaction or activity, is acting.*

Rule 2 (f) defines the "Principal Officer" as an officer designated by a reporting entity. Now this amendment requires that such Principal officer shall be an officer at the management level only. This Officer's name, designation and address shall be communicated to the Director under the PMLA Act. The Principal Officer shall furnish the information as required under Rule 3 of such PMLA Rules.

Further, for a company, a beneficial owner for the purposes due diligence u/r 9 shall be a person who controls (by anyway) more than 10% (and not 15%) of shares or capital or profits of the company. Similarly incase of partnerships due diligence u/r 9 shall be done of persons who own or control (management or policy decision) more than 10% (and not 15%) of the share of the partnership. Thus, the client due diligence norms become more stringent. Furthermore, incase of trusts, the reporting entity shall ensure that trustees disclose their status at the time of commencement of an account-based relationship or when carrying out specified transactions. Under Rule 10, the process of analysing and determining the beneficial owner should also be recorded and maintained for future purposes.

Every reporting entity shall verify the identity of its clients and the beneficial owner as per powers granted u/s 11A. The Ministry of Finance has also permitted 3 reporting entities to perform authentication under the Aadhaar Act, 2016. The permission is granted only for the purpose of Aadhar authentication as required u/s 11A of the Money-laundering Act, 2002. Sec 11A requires the verification of the identity of reporting entities' clients and beneficial owner by way of aadhaar authentication. These entities are Fedbank Financial Services Limited, Amrit Malwa Capital Limited and Nissan Renault Financial Services India Private Limited. More notifications in this regard may follow.

**2. Puja Expenses to allowed/disallowed as business expenditure? High Courts may decide as the same ITAT is divided in opinion**

Business is an integral part of the society and has to run following societal norms. In India, every person is in some way connected to some religion, it may be a person with blood and flesh or it may be an artificial person too. Infact, India's first war or independence happened due to hurt of sentimental belief of people. Hence, where a Country is so connected to religion, every business needs to also comply with the sentiments and act accordingly. Therefore, in the case of DCIT v. Godawari Power & Ispat Ltd. and Anr. reported in [2022] 193 ITR 0869 (Raipur-Trib.), the co-ordinate Bench of the ITAT Raipur held that expenses incurred on the occasion of any Pooja & Festival expenses are in the nature of business expenditure and thus, allowable as deduction. However, the same ITAT in the case of M/s ALOK FERRO ALLOYS LTD Vs THE DY. COMMISSIONER OF INCOME TAX, CIRCLE-1(1), RAIPUR [2023-VIL-1188-ITAT-RPR], decided to act on the contrary. It held that the company, which is a creation by legal fiction and not a real person made up of flesh and blood, cannot profess any religion and therefore, performance of Puja cannot be said to be need of the business and disallowed the deduction towards Puja expenditure under The Income Tax Act. This judgement would impact almost all assesses and hence it would be interesting to see whether it is contested in higher forums.

**3. AO has to refer case to valuation officer u/s 50C incase of difference between stamp value and sale value… he cannot decide the case only by himself**

Under The Income tax Act, the AO cannot himself accept the sale consideration of a property declared by assessee and ignore the valuation of stamps authority even if the entire amount of sale consideration is re-invested by the assessee and as such capital gain is fully exempt. He has to refer the case to a valuation officer u/s 50C of The Income tax Act. The very fact that he has not done the same would entitle the case to be re-opened u/s 263 as was held in the case of SHRI DILIP CHANDRASENRAO MAHADIK Vs PR.CIT-2, INDORE [2023-VIL-1191-ITAT-IND].

Another important learning which comes out of the case is that the very fact that the assessee kept changing its figures before various authorities also worked against him. Hence, it is important that submissions are prepared with due care.

**4. A merged entity is non-operational and non-existent from the date of its merger**

It is important that new entity replies to all communications made in the name of the merged entity even after the merger. Otherwise, it can lead to unnecessary litigation and cost. A merged entity is non-operational and non-existent from the date of its merger. Any sum received by such entity from any entity post that AY can only be in the name of the new entity and not in the name of the erstwhile entity. Thus, even if an amount has been reflected in the Form 26AS or AIR of the merged entity under The Income Tax Act, the same cannot be added without an enquiry as was held in the case of MACCAFERRI ENVIRONMENTAL SOLUTIONS PVT Vs ASSTT. COMMISSIONER OF INCOME TAX [2023-VIL-1179-ITAT-MUM]. However, incase the new entity does not reply to notices of the dept. in the name of the erstwhile entity, then such kind of cases crop up and litigation cost is incurred.

**5. Works Contract Business is different from a pure product business: not maintaining stock register cannot be a ground to reject books of accounts, profits have to be determined on a reasonable basis**

Works Contract business is different from a pure product driven industry, wherein the margins per product are more or less fixed. In a works contract business, the nature of job, number of jobs depends on the wear and tear of asset which is repaired. The business has to keep a team of workers for whole the year, whether work is there or not. The quantum of job is not continuous, whereas overheads are constant in nature. Hence the profit margin or profit ratio cannot be directly linked with turnover of the business. In this kind of industry, the quantum of job is not continuous, whereas overheads are constant in nature. Hence profit margin or profit ratio cannot be directly linked with turnover. Maintenance of inventory too may not be very scientific incase of a service industry as compared to a product driven company. The details of materials may be many in nature, with different types, size, etc. and hence scientific maintenance of inventory may not be possible. Scientific

Maintenance of consumption records may also be a challenge. The Gujarat High Court in the case of J Stick Intermediaries Pvt. Ltd. Vs. ACIT reported in 242 taxmann.com 319 (Guj.) held that “not maintaining of day-to-day stock register was not a ground to reject books of accounts”. In this regard, the ITAT Ahmedabad in the case of BARODA INDUSTRIAL ELECTRICAL PRODUCTS PRIVATE LIMITED Vs THE INCOME TAX OFFICER [2023-VIL-1177-ITAT-AHM], held accordingly that considering the nature of business involved, it is not correct to outright reject the books of accounts, but to consider GP as per reasonable means under The Income tax Act.

**6. Revenue Vs Capital Expenditure & Depreciation on Capital expenditure – the argument continues**

By terminating the services of a vendor, an assessee may intend to save the expense that it would have had to incur in the relevant previous year as well as for few more years going ahead. However, it cannot be said that this saving is an enduring benefit or has resulted in creating an asset. Thus, payment made for termination of contract by way of compensation would be an allowable deduction under The Income Tax Act, in computing the total income of assessee as was held in the case of Commissioner of Income Tax V/s. Ashok Leyland Ltd. [(1972) 86 ITR 549 (SC)]. If assessee got rid of its liability to pay the commission it was required to pay under the agreement not only during the accounting year but also for a few years more, the expenditure thus saved undoubtedly swelled the profits of the company and where the termination was on business considerations and as a matter of commercial expediency it cannot be stated that by terminating the agreement, assesee acquired any enduring benefit or any income yielding asset was held in the case of COMMISSIONER OF INCOME TAX – 14, MUMBAI Vs MUSIC BROADCAST PRIVATE LIMITED [2023-VIL-105-BOM-DT].

Now in a case where the contrary is correct, i.e., when an expenditure does result in creating an enduring benefit or a capital asset, the question arises that can depreciation be claimed on this expenditure by taking it as an intangible asset. On perusal of the meaning of the categories of specific ‘intangible assets’ referred to in section 32(1)(ii) of the Income Tax Act, preceding the term "business or commercial

rights of similar nature" it is seen that intangible assets are not of the same kind and are clearly distinct from one another. The legislature thus did not intend to provide for depreciation only in respect of the specified intangible assets but also to other categories of intangible assets which may not be possible to exhaustively enumerate. Thus, an assessee who acquires commercial rights to sell products under the trade name and through the network created by the seller for sale in should be entitled to deprecation.

Non-compete fees paid to an ex-employee or any other person creates rights which gives not only enduring benefit but also protects an assessee's business against competition. Hence the same must be considered as intangible asset and depreciation be allowed on the same was held by The Bombay High Court in the case of PR. COMMISSIONER OF INCOME TAX – 14, MUMBAI Vs MUSIC BROADCAST PRIVATE LIMITED [2023-VIL-105-BOM-DT]

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