Direct Tax Vista

Your weekly Direct Tax recap

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By Vivek Jalan, Partner, Tax Connect Advisory Services LLP

1. Non-residents can Invest in Government-issued SGBs through 'Fully Accessible Route' for F.Y. 2023-24

The RBI vide Circular No. RBI/2023-24/81 FMRD.FMID.No. 04/14.01.006/2023-24, Dated 08.11.2023 has decided to designate all Sovereign Green Bonds issued by the Government in the fiscal year 2023-24 as 'specified securities' under the Fully Accessible Route (FAR). Vide circular dated 30.03.2020, the RBI has notified that all new issuances of Government securities of 5-year, 10-year and 30-year tenors from the financial year 2020-21 to be eligible for investment under the FAR as 'specified securities'. Thereafter through circular dated 07.07.2022 and circular dated 23.01.2023, Government securities of 7-year & 14-year tenors and Sovereign Green Bonds were included as 'specified securities' under the FAR.

This decision aligns with The Govt's efforts towards encouraging investments in green projects and initiatives. Non-resident investors can now participate in the Government Securities market without restrictions, making it an attractive prospect for those interested in this evolving area.

2. Does the Income Tax Law debar a charitable institution from getting registered until it is registered under another Law?

Consider a society or any other charitable institution or a mere association of persons formed for public welfare. Does the Income Tax Law debar it from getting registered until it is registered under another Law? This question of law was answered in favour of the dept. by The ITAT in the case of INCOME TAX APPELLATE TRIBUNAL BAR ASSOCIATION, SURAT Vs COMMISSIONER OF INCOME TAX, (EXEMPTION), AHMEDABAD [2023-VIL-1478-ITAT-SRT]. However, considering the vide ramifications of the case for Charitable Institutions, it seems that this matter will travel to higher forums. Understanding the case further in detail, Rule 17A(2)(c) of Income Tax Rules requires the assessee to furnish certified copy with registration of companies, or registration of farm or society or registrar of public trust, as the case may be for registration u/s 12A as a charitable institution and reads as under–

> *"(2) The application under sub-rule (1) shall be accompanied by the following documents, as required by Form Nos.10A or 10AB, as the case may be, namely:-*
> *(c) self-certified copy of registration with Registrar of Companies or Registrar of Firms and Societies or Registrar of Public Trusts, as the case may be;"*

The question is whether the registration in other law as per requirement in Rule 17A(2)(c) is mandatory to get a registration u/s 12A of The Income Tax Act as a charitable institution. What about a case when the Institution is not so registered as they are not otherwise required to be so registered under those laws. It does seem that the mandatory provision laid down under Rule 17A(2)(c), that institution should be registered with registrar of Companies or registration of firms or society or registrar of Public Trust, is defective as it bars an association from to get registered under Income Tax Act unless it is registered under another act. Can an assessee not get the benefit of exemption from Income Tax just because it is not registered under another law, whereas its object is the same as another such entity which may be registered? Can The Income Tax Act compel a person to avail registration under another law? These are questions of law which may be needed to be tested.

The Ld.DRs contention is that incase such entity is not registered under any other law, there will not be any legal obligation on the part of trust or institution to maintain any record of the activities; that there would be no control on the activities of such unregistered entities. However, it is a fact that the Income Tax Act itself requires that the same will be tested every five years while renewing the registration.

Hence it does seem that there is still some water to flow under the bridge unless the matter is set to rest.

3. Provision for sales incentive determined on a scientific basis cannot be regarded as a contingent liability and disallowed under the Income Tax Act

It is a settled position that sales incentive determined on a scientific basis cannot be regarded as a contingent liability and disallowed under the Income Tax Act. However, again and again the disallowances are made by the AOs possibly due faulty understanding or due to deficient representation. Hence matters travel to tribunal every year and leads to additional litigation burden on the dept. as well as assessees, as was in the case of M/s HAVELLS INDIA LTD Vs DCIT(LTU) [2023-VIL-1477-ITAT-DEL], wherein it was held that provision made by assessee in respect to 'Shahenshah Scheme' was on a scientific basis and it was ordered accordingly following the decision of Co-ordinate bench in assessee's own case.

Hence during the adjudication stage itself it should be ensured that evidences be produced depicting that provision for sales incentive have a scientific co-relation with sales of respective years and they should not be a mere average of figures of different years. Simple average of sales incentive expenses of certain no. of years may not be considered a scientific method for arriving at a certain percentage or an amount. This could lead to a distortion of sales incentive cost as a percentage to revenue. Provision for sales incentive should ideally be computed on the basis of historical trend and scientific methodology. Hence these provisions should also see the claims made also on an actual basis over the past few years. Other factors too should be taken into consideration when creating a provision which can be allowed as a deduction u/s 37 of The Income Tax Act. Representation, with evidences should be made accordingly.

4. Where the AO elaborately gives a factual finding on incriminating material, the assessee has to controvert on merits

A seized document partakes the nature of incriminating material relevant for making assessment when it is established that the transaction is undisclosed or unexplained and the income earned out of such transaction has escaped the scope of taxation while it should have been assessed to tax had it been disclosed in the right manner. Hence, incase the authorities arrange the documents systematically and analyse the documents; The documents are sorted assessee wise, AY wise and premises wise; the documents are financially relevant, and are not explainable through books of accounts or other details available with the department of income tax; then the onus is on the assessee to substantiate with merits as to why a document should not be termed as incriminating document.

Where the AO or the Ld. CIT(A) elaborately considers each and every seized material and gives a factual finding as to why they are considered as incriminating material, the same has to be controverted by the assessee on merits. Mere representation that they are not incriminating material does not succeed as has happened in the case of DYNASTY CONSTRUCTION PVT. LTD Vs ACIT CENTRAL CIRCLE-25 NEW DELHI [2023-VIL-1472-ITAT-DEL]

5. Business expense cannot be disallowed merely because the assessee had not set up/started its business activities during the year

AOs cannot disallow expenses as there is no substantial income in one year, by considering that expenditures are not incurred wholly and exclusively for the purpose of business. Such cases sometimes come up when the concerned authorities either do not reflect sufficiently on accounting and business principles. It is an easy understanding that the AO has to give any finding and appreciate the accounts filed by the assessee before disallowing the expenses against the business income shown by the assessee. So long as the expenses are incurred for the purpose of business, it should be allowable as deduction and it is not necessary that the expenditure may result in income or there must be substantial income. The same was held in the case of ACIT Vs M/s EMCIPI ELECTRONICS PVT. LTD. [2022-VIL-857-ITAT-DEL]

Again, recently a business expense was disallowed merely because the assessee had not set up/started its business activities during the year under consideration and the intangible asset i.e. software license purchased was not put to use by the assessee company during the year under consideration. The same was also set asideby The Hon'ble Delhi High Court in the case of PRINCIPAL COMMISSIONER OF

INCOME TAX, CENTRAL-3, DELHI Vs HIKE PRIVATE LIMITED [2023-VIL-137-DEL-DT].

6. Disallowance cannot be made on an adhoc basis

Disallowance cannot be made on an adhoc basis as held by The Hon'ble Supreme Court of India in the case of Pr. CIT vs. R.G. Buildwell Engineers Ltd. (2018) 99 taxmann.com 283 (Del).

In a distribution business model, each of the persons in the supply chain has to be pampered and patronized so that his all-out efforts are channelized for the expansion of the business of the principle. The persons so engaged in the multi-level marketing business are remunerated by way of payment of commission on sales made by them or by way of incentives on higher sales made by them. Such incentives are accounted as business promotion expenses. Hence before disallowing these, some valid reason has to be cited by the AO. Just mentioning that some addresses of agents were not present would not be sufficient.

Again, expenses cannot be denied merely due to the fact that vouchers are self-made. How would a businessman get a bill for say an individual packaging expert. In such cases self-made vouchers are prepared to account for the expenses incurred, since no regular bills can be procured while incurring these expenses. Even many a times employees incur expenses such as conveyance, purchase of food and beverages, purchase of small petty items from nearby small shopkeepers so on and so forth. Merely because the AO finds that some vouchers are self-made or are paid in cash cannot be a reason to make any ad hoc addition. The AO has to categorically specify the expenses and the reason for disallowance of the same as was held in the case of DCIT Vs M/s GLAZE TRADING INDIA PVT LTD [2023-VIL-1467-ITAT-DEL]

(*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*)