Direct Tax Vista

Your weekly Direct Tax recap

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1. Income Tax Dept. can share taxpayer's information with UIDAI

The CBDT vide *Notification No. 99/2023 dated November 21, 2023*, designated the Deputy Director General (Tech Development Division) of the Unique Identification Authority of India (UIDAI), under Section 138(1)(a)(ii) of the Income-tax Act, 1961. Section 138(1) facilitates the exchange of information about tax evaders by the Income-tax Department with other tax authorities or enforcement authorities. The CBDT has notified Deputy Director General (Tech Development Division), Unique Identification Authority of India (UIDAI), Government of India to share information.

Taxpayers and stakeholders should stay informed about the evolving landscape of information management in the financial domain as The Government further streamlines the process of accessing and disclosing taxpayer information, to bring in greater efficiency.

2. Supreme Court again interprets the term 'derived from'

The term 'derived from' has a definite but narrow meaning - It cannot receive a flexible or wider connotation like the word 'relates to' or 'attributable to'. The Supreme Court in the case of SHAH ORIGINALS Vs COMMISSIONER OF INCOME TAX-24, MUMBAI [2023-VIL-28-SC-DT] rejected the interpretation proposed by the assessee, asserting that gains from price fluctuations are not inherently linked to the export income of the assessee. The deduction u/s 80HHC of The Income Tax Act pertains exclusively to profits derived from the export of goods or merchandise.

While the decision is only in the matter of Section 80HHC, it lays down important jurisprudence.

3. Resale method appropriate in Transfer Pricing where there is no Value Addition to traded goods by the distributor

Incase of a pure trading company involved in the distribution activity without adding any value to the purchased product, RPM is the most appropriate method in Transfer Pricing as was held by The ITAT Delhi in the case of KARCHER CLEANING SYSTEMS PRIVATE LIMITED Vs ADDL. CIT, NEW DELHI [2023-VIL-1550-ITAT-DEL].

For the purpose of application of Resale Price Method (RPM) in Transfer Pricing cases, what is relevant is to see as to whether there is any value addition or not to the goods purchased for resale. In case, there is no value addition and the finished goods which are purchased from the AE are resold in the market in the same form, then the gross profit margin earned on such transactions becomes the determinative factor for benchmarking the international transaction of the assessee with its AE by taking RPM as the most appropriate method.

The following points are essential for a pure distributor relationship -

1. The assessee is engaged in trading of goods only.
2. Assessee does not add value to the goods purchased (even from related parties).
3. 'Relationship', is defined in the distributor agreement as being that between a manufacturer and distributor and not between that of an agent and principle.
4. Reseller may perform the functions of advertising, marketing, distribution and guaranteeing the goods, financing the stocks and warranty risk.

The characterization of a reseller, who does not add value to the purchased product would not change owing to the mere fact that the tested party and comparables have incurred varying levels of employee costs, or selling and distribution, or marketing and promotion expenses for boosting company's own sales volume. In a comparable uncontrolled transaction scenario also a normal distributor will undertake all such functions which are related to sales of a product viz. market research, sales and marketing, warehousing, inventory control, quality control etc., and would also bear risks viz. market risk, inventory risk, credit risk etc.

It is a fact that principle's employees do help the distributors in setting up of business. Hence even if the AEs expats came to help the assessee to set up its business and employee costs included an exceptional expenditure for its expatriate employees towards payment for salaries and other expenses for the purpose of stabilizing the business in India being the first year of the company's operations, it cannot change the relationship.

4. Reopening is an extreme step and must be initiated only on the basis of tangible, concrete and fresh evidence not appraised earlier

The Supreme Court in the case of A.L.A. Firm vs. CIT reported in 102 ITR 622 held that where the AO had not considered the material and subsequently come by the material from the record itself, then such a case would fall within the scope of section 147 of the Income Tax Act.

However, where it is on record that the Assessing Officer has mentioned to have examined the record furnished by the assessee; There is no further fresh tangible material available with the Assessing Officer to reopen the assessment; No reopening can be made based on the audit objections or for 'thorough verification' of those records which already existed at the time of the assessment as held by The ITAT Hyderabad in the case of THE DEPUTY COMMISSIONER OF INCOME TAX Vs M/s DRS LOGISTICS PRIVATE LIMITED [2023-VIL-1556-ITAT-HYD].

The Hon'ble Supreme Court in the case of ACIT vs. ICICI Securities dealership reported in 348 ITR 299 held that where accounts were furnished by assessee when called upon and thereafter the assessment was completed u/s 143(3), subsequently on a mere re-look of the said account earlier furnished by the assessee it is not permissible u/s.147 to reopen the assessment. Similarly, the Hon'ble Bombay High Court in Hindustan Lever Ltd vs. R.B. Wadker reported in 268 ITR 332 held that the Assessing Officer must disclose in the reasons as to which fact or material was not disclosed by the assessee to establish the vital link between the reasons and evidence.

5. The amount of disallowance under section 14A of the Income Tax Act cannot be more than exempt income

Where an assesses make investments that result in tax-free income, generally the amount that is disallowed under section 14A of the Income Tax Act read with Rule 8D(2)(iii), is 0.5% of the average value of investment. However, it has been held by The Hon'ble jurisdictional High Court in Nirved Traders (P.) Ltd. v/s Dy. CIT, I.T. Appeal No.149 of 2017, vide judgement dated 23/04/2019, that the amount of disallowance under section 14A of the Act cannot be more than exempt income. The same was also reiterated in the case of M/s GCV SERVICES LTD Vs DY. COMMISSIONER OF INCOME TAX [2023-VIL-1557-ITAT-MUM].

6. Excess payment to related parties can be distinguished by substantive evidence and not self-serving documents

Excess payment to directors can be distinguished and may be allowed incase following is established –

1. Business advantages accrued to the assessee due to conditions of payment to directors, as against third parties.
2. Any additional compensatory payments made or expenditure done for third parties as against similar transactions with directors.

For example, incase hiring charges of vehicles paid to directors is more than such charges paid to third parties, the same can be substantiated by the following –

1. The fact that directors' vehicles were exclusively meant for the Company as against third party vehicles, which caused advantages in terms of Round the trip economies.
2. Third parties were paid maintenance expenses also which was not paid for directors' vehicles.

However, the above need to be proved by substantive evidence and not self-serving documents like a board resolution or quotations from related vendors, due to the deficiency of which, the order was passed against the assessee by disallowing such excess expenditure u/s 40A(2) of The Income Tax Act in the case of CMR

TRANSPORT CONTRACTORS COMPANY PRIVATE LIMITED Vs DY. COMMISSIONER OF INCOME TAX [2023-VIL-1555-ITAT-VPT]

7. Determination of date of transfer of capital asset before and after AY 2017-18... where two AYs are involved

On and from AY 2017-18, Special provisos were added to Section 50C(1) of Income Tax Act, for full value of consideration in certain cases. The Section with the provisos hold that –

Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by any stamp valuation authority, the value so adopted for assessment shall be deemed to be the full value of the consideration received or accruing as a result of such transfer.

> *[**Provided** that where the date of the agreement fixing the amount of consideration and the date of registration for the transfer of the capital asset are not the same, the value adopted or assessed or assessable by the stamp valuation authority on the date of agreement may be taken for the purposes of computing full value of consideration for such transfer:*
>
> ***Provided further** that the first proviso shall apply only in a case where the amount of consideration, or a part thereof, has been received by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a **[**bank account or through such other electronic mode as may be prescribed**]**, on or before the date of the agreement for transfer.]*

However, these provisos are applicable w.e.f. AY 2017-18. Earlier, the decision of Hon'ble Supreme Court in case of Seshasayee Steels (P.) Ltd. v. AIT reported in (2020) 115 taxmann.com 5 in this respect lays down that in order to attract provisions of section 53A of the Transfer Of Property Act The transferee must, in part performance of the contract, have taken possession of the property or any part thereof. The transferee (developer) must have performed or be willing to perform

his part of the agreement. Further, a registered deed must be executed. It should not be a mere a license to enter the property for the purpose of carrying out development. As per the decision of The Hon'ble Karnataka High Court in case of CIT vs. Dr. T.K. Dayalu reported in (2011) 14 taxmann.com 120, capital gains will arise in the year in which full control and possession of land in question is given.

Another issue raised many a times is that say in the above example, the entire consideration was paid by the buyer in Year 1 after deduction of TDS u/s 194IA, then would the proposition change and the Capital Gain or Capital Loss be assessed in Year 1 as it would be deemed that the transfer took place in year 1 itself. The answer still will not change as transaction shall be treated as transfer only when possession has been taken or retained by buyer. Since possession of property has been handed over to buyer in Year 3, transfer would be considered to have taken place in Year 3 only.

Now consider the case where where the date of agreement fixing the amount of consideration and the date of registration of property is different, value adopted by stamp valuation authority on the date of agreement has to be taken for purposes of computing full value of consideration of such transfer incase the control/possession has been transferred as on the date of fixing the consideration as held in the case of SMT. NEELA REDDY MORAMREDDY GARU Vs INCOME TAX OFFICER [2023-VIL-1551-ITAT-HYD]

To sum up, prior to AY 2017-18 the capital gains should be offered to tax in the year in which the following conditions are satisfied –

1. The year in which the transferee has taken physical possession of the property or any part thereof.
2. The year in which transferee has performed or is willing to perform his part of the agreement.

A mere a license to enter the property for the purpose of carrying out development work would not be sufficient. But, as per the decision of The Hon'ble Karnataka High Court in case of CIT vs. Dr. T.K. Dayalu reported in (2011) 14 taxmann.com 120,

capital gains will arise in the year in which full control and possession of property in question is given.

8. Transfer Pricing adjustments for mere reimbursements

Consider a case of reimbursement which is merely recovered without any mark up. The same would be debited and then netted off with the receipts and not result in a line item of the financials. A pass-through transaction is thus only a balance sheet item for an assessee in terms of payables or receivable.

The question is that why would a person render services merely on cost-to-cost basis, just charging a reimbursement. In this regard, it needs to be understood that often the price the recipient is willing to pay for the service does not exceed the cost of supply to the service supplier and still a supplier accepts the arrangement due to the reasons such as economies of scale. For example, in many cases, the services provided through intra-group arrangements are administrative or ancillary in nature, and the participants would only have been prepared to centralize the activity if they could share in the cost savings. Cost may represent an arm's length charge in such situations.

Hence for determining whether a mark-up is appropriate, requires careful consideration of factors such as: -

- the nature of the activity;
- the significance of the activity to the group;
- the relative efficiency of the service supplier; and
- any advantage that the activity creates for the group.

Notwithstanding the above, such savings to the related party due to economies of scale can be a TP adjustment as came out in the case of UPS EXPRESS PVT LTD Vs DCIT-3(1)(1) [2023-VIL-1547-ITAT-MUM]. However, the arguing Counsel took an escape route that even if this argument is accepted, by benchmarking this transaction in the transactional net margin method, no adjustment can be made if the assessee has better margins compared to the comparable companies.

9. An order rejecting a low / NIL TDS deduction application should be a speaking and well-reasoned order

Rule 28AA of Income Tax Rules requires that an Assessing Officer, on an application made by a person under Rule 28(1) should satisfy himself that existing and estimated tax liability of a person justifies the deduction of tax at lower rate or no deduction of tax, as the case may be, and thereafter shall issue a certificate in accordance with the provisions of Section 197(1) of The Income tax Act for deduction of tax at such lower rate or no deduction of tax.

As it comes out from the judgement in the case of Mohinder Singh Gill v. Chief Election Commr., (1978) 1 SCC 405, an order should be a speaking and well-reasoned order so as to satisfy the mandate of Rule 28AA of the IT Rules, especially when it rejects an application for lower/NIL deduction of tax. Non-application of mind while rejecting a Section 197 application will result in grave prejudice to the deductee as was held in the case of SHREYASH RETAIL PRIVATE LTD Vs DEPUTY COMMISSIONER OF INCOME TAX TDS CIRCLE 77(1) & ANR [2023-VIL-143-DEL-DT]

10. It is for the assessee to decide whether the debt has become bad or not... There is no relevance and compulsion to put any effort for recovery

Many a times a debt has to be written off due to business reasons. Say a regular customer disputes one invoice and pays off the others – in this case a business call needs to be taken that for business purpose, such invoice has to be written off as bad debt. Such a write off has to be allowed as was held in the case of THE DY. C.I.T., NEW DELHI Vs M/s COMFORT NET TRADERS (I) PVT LTD [2023-VIL-1532-ITAT-DEL]. It is for the assessee to decide whether the debt has become bad or not and whether the write off has to be made in its books of account or not. There is no relevance and compulsion on the assessee to put any effort for recovery of the debt as was considered by The Hon'ble Supreme Court in the case of TRF Limited 323 ITR 397 and Vijaya Bank 323 ITR 166, the ld. CIT(A) while deleting the addition of write off on this basis.

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