Tax Matters

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The team at JMP Advisors is pleased to bring to you a gist of some of the significant developments in the direct tax space during December 2022:

Income tax rulings

- **Absent tax auditor's suggestion in the tax audit report, Provident Fund disallowance not 'prima facie adjustment'**

  - M/s P R Packaging Service v. ACIT[1]

The taxpayer had deposited employees' contribution to the Provident Fund ('PF') into the PF accounts of the employees, beyond the due date as specified in the PF Act but had deposited it before the due date of filing the income tax return. This fact of delayed remittance by the taxpayer had been disclosed by the tax auditor in the tax audit report in clause 20(b) of Form 3CD. While processing the return under section 143(1) of the Income-tax Act, 1961 ('the Act'), the Centralized Processing Centre ('CPC'), Bengaluru disallowed the employees' contribution to the PF under section 143(1)(a)(iv), basis the disclosure in the tax audit report. Section 143(1)(a)(iv) enlists the types of adjustments permitted while processing return by the CPC. Aggrieved by the same, an appeal was preferred by the taxpayer before the National Faceless Appeal Centre ('NFAC') which upheld the disallowance made by CPC. Aggrieved by the order of the NFAC, the taxpayer preferred an appeal before the Mumbai Tribunal.

The Mumbai Tribunal held that the provisions of section 143(1)(a)(iv) of the Act will come into operation when the tax auditor had suggested disallowance, but it was not considered by the taxpayer while computing the total income in the return of income.

In the tax audit report, the auditor merely records the information and expresses his opinion. A statement made by the tax auditor in tax audit report is only 'indicative' and cannot be construed as the basis for disallowance of expenditure.

Relying on the decision of the co-ordinate bench in the case of Kalpesh Synthetics Pvt. Ltd[2]. v. DCIT, the Mumbai Tribunal observed that unlike the old scheme of 'prima facie adjustments' under section 143(1) of the Act, the present scheme under section 143(1) of the Act does not involve a unilateral exercise. The response received from the taxpayer needs 'to be' considered before making any adjustments, makes the entire process of making adjustments interactive and cerebral process. In view of the above, the impugned adjustment in the course of processing of return under section 143(1) of the Act is vitiated in law.

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[1] ITA No 2376/Mum/2022 (Mumbai Tribunal)

[2] Kalpesh Synthetics Pvt Ltd v DCIT [195 ITD 142 (Mum)]

Section 143(1)(a) of the Act allows CPC to only carry out restrictive adjustments to the return of income filed by the taxpayer. Disclosure in the audit report is just a factual report about the facts of payments and is not an expression of opinion. Therefore, reporting of payment beyond due date in tax audit report shall not be constituted as "a disallowance of expenditure indicated in tax audit report but not taken into account in computation of income" as a sine qua non for disallowance under section 143(1)(a)(iv) of the Act.

JMP Insights *– The CPC had placed reliance on the Supreme Court ('SC') ruling in case of Checkmate Services[3] wherein the disallowance was made in the context of assessment made under section 143(3) of the Act. Section 143(1)(a) of the Act provides for specific cases in relation to which the CPC can make adjustment to the return of income filed by the taxpayer. Only when the tax auditor has suggested disallowing an expenditure which has not been given effect to in the income tax return, can CPC disallow such expenditure. Where the auditor only mentions the due date of payment and the actual date of payment without contemplating to disallow such expenditure, such a case shall not fall within the ambit of section 143(1)(a) of the Act.*

Further, proviso to section 143(1) of the Act provides for procedure and timeline to be followed prior to making any adjustments in the return of income. A proper notice needs to be served on the taxpayer and any responses submitted by the taxpayer need to be considered prior to passing any order.

A contrary view is taken by the Pune Tribunal in the case Cemetile Industries[4]. Relying on the SC decision in the case of Checkmate Services, the Pune Tribunal has held that the disallowance arising from 'indication' in the audit report about delayed remittance of employees' contribution to PF squarely falls under section 143(1)(iv) of the Act. An indication in the tax audit report has a wider amplitude. As far as indication is not vague, the CPC is empowered to make a disallowance based on the information provided in the tax audit report.

- **Re-opening of concluded original assessment cannot be made after 16 years for taxing undeclared foreign income/non-reporting of foreign asset**

  - DCIT v. Smt. Deval D. Thakkar[5]

The income-tax authorities conducted a search and seizure operation at the residential premises of Dilip Thakkar (i.e. taxpayer's father). Certain incriminating documents during the search indicated that the taxpayer was linked to an offshore bank account. The tax officer alleged that the income from an asset located outside India had escaped assessment. The tax officer reopened the assessment of FY 1998-99 by issuing a notice

[3] Checkmate Services Pvt Ltd v CIT (143 Taxmann.com 178)(SC)
[4] TS-933-ITAT-2022(PUN)(Pune Tribunal)
[5] I.T.A. No. 968/Mum/2020 & I.T.A. No. 974/Mum/2020

under section 148 of the Act dated 27 March 2015 and made the addition of INR 69,01,200 to the taxpayer's total income.

The litigation stems from the divergent views on time limit for reopening assessments. Earlier, section 149 of the Act stated that even in cases where the income escaping assessment exceeded INR 1 lac, notice for reassessment cannot be issued beyond a period of six years. With effect from 1 July 2012, section 149 of the Act provided that the time limit to reopen the concluded assessment is –

- five years but not more than seven years from the end of the relevant financial year in case of income which has escaped assessment for an amount or likely to an amount of INR 1 lac; and

- five years but not more than seventeen years from the end of the relevant FY in case of income in relation to any asset located outside India which has escaped assessment.

An explanation to section 149 of the Act clarified that the aforementioned provision would also be applicable for "any financial year beginning on or before the 1st day of April, 2011".

In the case of Brahma Dutt v. ACIT[6], the Delhi High Court ('HC') had held that the reassessment could not be reopened beyond the period of seven years in terms of section 149 of the Act as applicable at the relevant time. Section 149(1)(c) of the Act had to be applied prospectively. Unless the terms of a statute expressly so provide or necessarily require it, the retrospective operation should not be given to a statute so as to take away or impair any existing right or create a new obligation or impose a new liability. The SC had dismissed the Special Leave Petition ('SLP') filed by the Revenue against the decision of the Delhi HC in the case of Braham Dutt.

Mumbai Tribunal noted two SC rulings namely, K.M.Sharma v. ITO[7] and S.S.Gadgil v. Lal & Co.[8] wherein it has been held that once the period of limitation ends, it is not open to the Revenue to revisit issues that have attained finality. The law of limitation confers certainty and finality to the legal proceedings and seeks to avoid exposure to risk of litigation to taxpayer for indefinite period on future unforeseen events.

Applying the ratio laid down by the SC in the aforementioned judgements to the facts of the taxpayer, and as per the time limit prevailing then, the Mumbai Tribunal held that reassessment for FY 1998-99 could not be made beyond 31 March 2006 i.e. by the end of seventh year from the end of the relevant FY.

The Mumbai Tribunal held that the extended time limit of 17 years came into effect from 1 July 2012. The time limit for issuing notice under section 148 for FY 1998-99 had already expired. The assessment cannot be reopened in the year 2015 as the period of 16 years does not apply and that the proceedings initiated by the tax officer under section 147/148

[6] (2018) 100 taxmann.com 324 (Del) (Delhi HC)
[7] 254 ITR 772 (SC)
[8] [1964] 53 ITR 231 (SC)

of the Act had become time barred prior to 1 July 2012 which could not have been revived by the amended section 149(1)(c) of the Act.

JMP Insights: *The Mumbai Tribunal in the case of DCIT v. Dilip J Thakkar*[9] *(taxpayer's father) has held that section 149(1)(c) of the Act as amended in the year 2012 is* ***retrospective*** *as the Explanation to section 149 of the Act clarified that section 149 of the Act would also be applicable for "any financial year beginning on or before the 1st day of April, 2011". The Mumbai Tribunal further noted that in Brahma Dutt's case, the Delhi HC had not considered the Explanation introduced to section 149 of the Act. Further, the dismissal of the SLP by the SC does not amount to a decision on the law. Hence, the Mumbai Tribunal upheld reassessment.*

There are contrary rulings of the Mumbai Tribunal on this issue and on similar set of facts i.e. in taxpayer's case and her parents case. The analysis of the issue by the higher courts/forums is thus awaited.

- **Successor steps into predecessor's shoes on amalgamation; Allows predecessor's capital loss to successor**

  - Capgemini Technology Services India Limited v. DCIT, Circle-11[10]
  - ACIT, Circle-11 v. Capgemini Technology Services India Limited[11]

Both the taxpayer and the tax officer have filed an appeal against the order passed by the Commissioner of Income-tax Appeals ['CIT(A)'] in relation to FY 2012-13. The taxpayer amalgamated with iGate Computer System Limited ('ICSL') under the scheme approved by the HC ('Scheme'). The Scheme provided that all benefits including entitlements and incentives of any nature including tax concessions [not limited to income tax, unexpired credit for MAT, Fringe Benefit Tax ('FBT'), Sales Tax] of the amalgamating company will be transferred to the amalgamated company. Based on the scheme, taxpayer carried forward Long Term Capital Loss ('LTCL') and MAT credit that was available to the erstwhile ICSL.

On noting the provisions of section 72A of the Act, tax officer denied carry forward of LTCL to the taxpayer on the grounds that section 72A of the Act covered only unabsorbed depreciation and business loss. Similarly, in case of MAT credit, tax officer denied MAT credit in the hands of the taxpayer in absence of any specific provision entitling the amalgamated entity to avail MAT credit of amalgamating entity. Further the tax officer disallowed the deduction towards FBT claimed by the taxpayer. The tax officer also did not allow credit for Foreign Tax Credit ('FTC').

[9] ITA No. 966/Mum/2020 (Mumbai Tribunal)
[10] ITA No 1857/PUN/2017 (Pune Tribunal)
[11] ITA No 1935/PUN/2017 (Pune Tribunal)

Decision by Tribunal:

LTCL:

The Pune Tribunal observed that section 72A of the Act only prescribes conditions to be fulfilled to claim benefit of carry forward business loss and unabsorbed depreciation, which may be otherwise available to the amalgamated company. There are no specific provisions in the Act prohibiting the taxpayer to claim set off of capital loss transferred to the amalgamated company under the Scheme. Accordingly, the Pune Tribunal held that the taxpayer shall be eligible to claim set off of the capital loss. Relying on the principle of succession, the Pune Tribunal observed that since the business of amalgamating company under amalgamation continues uninterruptedly by the amalgamated company, the benefit of carry forward and set off earned by the business of amalgamating company has to be allowed as per section 74 of the Act to the amalgamated company (i.e. taxpayer).

MAT Credit:

Pune Tribunal took a similar view in respect of MAT credit of the erstwhile ICSL. Section 115JAA(7) of the Act contains a specific prohibition which provides that MAT credit shall not be available to a successor LLP where it is converted from a private company or unlisted public company. Since no specific prohibition is specified in case of amalgamation, it appears that position of allowing MAT credit to the amalgamated company have been accepted by the Legislature.

Deduction for FBT:

With regards to FBT, Pune Tribunal held that section 40(a)(ic) of the Act only deals with disallowance of FBT under Chapter-XIIH of the Act. FBT paid by the taxpayer in Australia cannot be construed as FBT under Chapter-XIIH of the Act. Further, the Central Board of Direct Taxes (‘CBDT’) vide Circular[12] had clarified that prohibition of claiming deduction in respect of FBT does not apply in computation of book profits under section 115JB of the Act. Reliance was placed on Bombay HC ruling in case of Reliance Infrastructure Limited[13] wherein it was held that tax paid in Saudi Arabia was allowed as deduction in computation of income provided that no benefit was taken under section 90 or section 91 of the Act. Based on the above submissions, taxpayer was eligible to claim deduction of FBT paid in Australia under normal computation of income as well as computation of book profits.

Benefit of FTC:

The FTC disallowed by the tax officer comprises of two parts:

(i) FTC on local corporation tax paid in Japan; and

[12] Circular No. 8/2015

[13] (2017) 390 ITR 271 (Bom) (Mumbai HC)

(ii) Proportionate disallowance of FTC in respect of sales made under section 10AA of the Act.

As per the CIT(A) order, FTC on local corporation tax paid in Japan is allowed to the taxpayer as deduction under section 37 of the Act.

With regards to point (ii) above, Pune Tribunal held that allowability of FTC on taxes paid in other countries will depend on the provisions of their respective DTAAs with India.

- In respect of DTAAs with Canada and Australia, benefit of FTC is available to the taxpayer only if the income is taxed in both the countries. Since no tax is paid in India on sale of units under section 10AA of the Act, FTC of taxes paid in Australia and Canada will not be available to the taxpayer.

- In respect of DTAAs with Belgium, Japan, Switzerland and Malaysia, benefit of FTC is available to the taxpayer if the income is chargeable to tax irrespective of any exemption or deduction available to the taxpayer. Therefore, FTC on taxes paid in Belgium, Japan, Switzerland and Malaysia shall be available to the taxpayer. Further, Pune Tribunal held that where benefit of FTC is not available to the taxpayer, the same shall be allowed as deduction under section 37 of the Act.

JMP Insights *– The decision of the Pune Tribunal is a welcome one based on the general principles of succession. In the above ruling, the Pune Tribunal has held that the laws of succession puts the successor in the shoes of the predecessor as a result of which all the liabilities and assets of the predecessor falls upon or vest in the successor, subject to specific stipulations under the relevant statutes. Reliance is placed on SC ruling in case of T. Veerabhadra Rao[14] wherein SC laid down that it is not imperative that the predecessor shall be identical to the successor. The judgement emphasizes the point that the successor becomes entitled to all the entitlements and deductions which were due to the predecessor subject to specific provisions contained in the Act.*

The decision also highlights that a distinction be drawn between amalgamation and winding up of a company. Whereas in winding up, the entity as such comes to an end along with the business which it is carrying on, in amalgamation, only the taxpayer carrying on the business ceases to exist but the business continues, albeit, in the hands of another entity. It is imperative to draw a line of distinction between 'business' of an entity and the 'entity'. When the business of an entity continues despite closure of the entity of business, then all the obligations and privileges attached to the business of the erstwhile entity, must go along with the business in the hands of the new entity carrying on such business, save as otherwise provided under the Act.

Further, this decision highlights that where the benefit of FTC is not available to the taxpayer, the same shall be allowed as deduction under Section 37 of the Act to the taxpayer in its computation of income.

[14] (1985) 155 ITR 152 (SC)

- **Test of 'splitting up or reconstruction of business' already in existence needs to be applied only at the time of formation of unit in Special Economic Zone to deny claim of deduction**

  - Infosys Ltd. v. ACIT[15]

The tax officer denied the deduction claimed under section 10AA of the Act) to the Special Economic Zone ('SEZ') units of the taxpayer for the FY 2011-12 on the basis that the projects undertaken by the taxpayer's new SEZ units were based on Master Service Agreements ('MSAs') which were entered by the taxpayer before the formation of these new SEZs; thus alleging that the new SEZ units were formed by splitting up and reconstruction of the business.

The taxpayer was allowed the deduction under section 10AA of the Act for FY 2005-06, which was the first year of claim of deduction. The CIT(A) had held that the new SEZ units were not formed by splitting up or reconstruction of the existing business for FY 2006-07 to FY 2008-09. Further, the Revenue department had not appealed against deduction allowed for FY 2006-07 to 2008-09.

The taxpayer contended that the CBDT had issued a Circular[16] wherein it was clarified that Master Services Agreement (MSA) is an initial general agreement between a foreign client and the Indian software developer setting out the broad and general terms and conditions of business under the umbrella of which specific and individual Statement of Works (SOW) are formed. The Statement of Work ('SOW') emanating from the MSA prevails over the MSA in determining the eligibility of deduction under section 10AA of the Act. While the MSAs outline the general relationship between the taxpayer and the client, the actual work is performed as per the SOW. The SOWs describes the scope of work, deliverables, timelines, etc.

The conditions of splitting up and reconstruction was made effective from 10 February 2006. However, the SEZ unit was formed and had commenced its operations on 16 July 2005 and had claimed deduction from FY 2005-06. The unit, when it was formed, duly fulfilled the requirements that was applicable at the relevant time. There is no factual finding that at the time of formation of the unit, business already in existence was splitted up or reconstructed. Therefore, the eligibility of the claim of deduction stands verified in the year of its formation.

The test of splitting up or the reconstruction of a business already in existence has to be applied only at the time of formation of a unit. Since deduction for FY 2005-06 has been allowed, the same cannot be denied on that ground in the subsequent years.

The Bangalore Tribunal placed reliance on the decision of CIT v. Tata Communications Internet Services Ltd[17] wherein the Delhi HC has held that the compliance with the eligibility conditions of unit being formed by splitting up or reconstruction, for claiming

[15] IT(TP)A No. 718/Bang/2017 (Bangalore Tribunal)
[16] Circular No. 1/2013
[17] [2012] 17 taxmann.com 241 (Del HC)

deduction under section 80-IA(3) of the Act, is to be considered only in the first year in which deduction is claimed.

Based on the CIT(A)'s specific observation that the units have not been formed by splitting up or restructuring for FY 2006-07 to FY 2008-09 which has not been challenged by the Revenue, the Tribunal held that the issue has attained finality. Therefore, the tax officer is directed to grant the deduction claimed by the taxpayer.

JMP Insights: *Due to the sunset clause, the deduction under section 10AA of the Act is not available to new units set up in SEZ. However, the decision is helpful for matters which are pending in litigation and will have a persuasive value for claiming deduction with similar eligibility conditions.*

DID YOU KNOW?

Due to the representations received on the then prevailing COVID-19 pandemic and its resultant restrictions, CBDT via Circular No 1 of 2023 dated 6 January 2023 has granted relief to the taxpayers by extending the due date for making investments, deposits, payment, acquisition etc for claiming exemption under Section 54 to 54GB of the Act from 28 February 2022 to 31 March 2023.

Should you wish to discuss any of the above issues in detail or understand the applicability to your specific situation, please feel free to reach out to us on coe@jmpadvisors.in.

JMP Advisors Private Limited

12, Jolly Maker Chambers II, Nariman Point, Mumbai 400 021, India
T: +91 22 22041666, E: info@jmpadvisors.in, W: www.jmpadvisors.com

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