



**National Conference on  
Income-tax and Tax Audit  
WIRC of ICAI**

**Legal Issues in Tax Audit**

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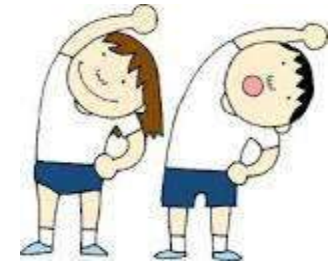
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# Proposed Coverage

- ▶ Applicability of Tax Audit under Presumptive Taxation Scheme
- ▶ Legal Issues arising out of amendments to Form 3CD as carried out in 2018 – Select clauses of significance
- ▶ Relevant Amendments by Finance Act 2021 and Finance Act 2020
- ▶ Some regular legal issues that arise

# Let's Warm Up ....



- ▶ Purpose of Tax Audit
- ▶ Scope of Tax Audit
- ▶ Relevance of Accounting and Auditing Standards and Principles of commercial accounting
  - Materiality
  - Prudence
  - Substance Vs. Form
- ▶ ICDS notified in September 2016 applicable from A.Y. 2017-18
- ▶ Concept of Test Check
- ▶ True & Fair Vs. True & Correct
- ▶ Guidance Note issued by ICAI – Implementation Guide issued on 23-8-18

# Relaxation of Limits for Tax Audit

- ▶ Section 44AB – Amendments by FA 2020 and FA 2021
- ▶ Proviso to 44AB (a) – Conditional Relaxation of ceiling to 5 Cr / 10 Cr
  - Aggregate of all amount received **including** Sales /Turnover / Gross Receipt in cash – Not to exceed 5% of said amount
  - Aggregate of all payments **including** expenditure in cash – Not to exceed 5% of said Amount
- ▶ Including Includes what ?
  - Cash introduced / withdrawn by partners
  - Withdrawals / Deposits from bank
  - Loans accepted or repaid
  - Debtors / Creditors transactions
  - Sale /Purchase of Fixed Assets
- ▶ **FA 2021 Amendment – A cheque which is not A/c. Payee deemed to be in cash – Implication of this**
- ▶ No Change in limit for Professionals – 50 Lakhs

# Applicability of Audit

S 44AB(a) Business other than 44AD	S 44AB(b) Profession	S 44AB(c) Business under (S. 44AE, 44BB, 44BBBB)	S 44AB(d) Profession (other than 44ADA)	S 44AB(e) Business covered u/s 44AD(4)
<p>If Turnover or gross receipts exceeds Rupees 1 Crore. From A Y 2021-<u>22</u> The limit has been increased to 10 Cr. For persons who have less than 5% of receipts and 5% of payments</p>	<p>If Gross Receipts exceed INR 50 lakhs.</p>	<p>If profit offered to tax is lower than the profits or gains so deemed to be the profits and gains of his business under the S 44AE, 44BB &amp; 44BBB</p>	<p>Profits offered by a person is lower than the profits so deemed to be the profits and gains of his profession u/s 44ADA</p>	<p>If provision of 44AD(4) is applicable and the income exceeds the maximum amount not chargeable to tax in the previous year</p>

# Applicability to Partner of a Firm

- ▶ Section applies to Every person carrying on business or profession
- ▶ Difference between carrying on business and income assessed under head of P & G of B or P
- ▶ Sales / Turnover / Gross Receipts – Principle of Eiusdem Generis
- ▶ CIT Vs. R.M. Chidambaram Pillai 106 ITR 292 (SC) – Salary is profit known by different name – Prior to 1992 amendment
- ▶ Contra Decisions of Tribunal on the subject
- ▶ Anandkumar Vs. ACIT 430 ITR 391 (Mad.) – 44AD – Interest and Remuneration cannot be said to be gross receipts to be eligible under section 44AD
- ▶ Bonafide view – Sec. 273B – Reasonable cause

# S 44AD(4) (From A Y 2017-18)

Where an eligible assessee declares profit for any previous year in accordance with the provisions of this section

**AND**

He declares profit for any of the five assessment years relevant to the previous year succeeding such previous year not in accordance with the provisions of sub-section (1)

- Then : Not eligible to claim benefit of this section for 5 A.Y.s subsequent to AY in which the profit has not been declared in accordance with the provisions of sub-section (1). [Example : If default in A Y 2020-21 then will not be able to claim benefit till 2025-26]

# S 44AD (5)(From A Y 2017-18)

An Eligible Assessee to whom sub sec. (4) applies

**AND**

Whose total income exceeds the maximum amount which is not chargeable to tax

- ▶ Then : Assessee will have to maintain books as per Sec. 44AA(2) and get his books of accounts audited as provided under section 44AB.

Issues :

- ▶ Partnership Firms in Loss ?
- ▶ As provided in Sec. 44AB – what about cases less than 1 Cr ? – Sec. 44AB (e) – meaning of eligible business as per section 44AD



# Examples

Turnover of the assessee A Y 20-21	90,00,000/-	90,00,000/-	1,50,00,000/-
Profit percentage	5%	4%	2%
Total Income	3,50,000	5,00,000	200,000
Exemption claimed under section 44AD from A Y 17-18	Yes	No first year of business	Yes
Audit Applicable u/s 44AB	Yes [44AB(e)] as the assessee falls under 44AD(4)/(5)	No. Not covered by 44AD(4) nor by 44AB	Yes. Since T/o is less than 2 Crores, Sec. 44AD will independently apply

# Examples

Turnover of assessee for A Y 20-21	95,00,000/-	1,75,00,000/-	1,95,00,000/- (No cash receipts or payments )
Profit %	3%	1%	4 %
Total Income	-150,000	3,50,000 (including interest 1,75,000)	7,00,000
Exemption claimed under S 44AD from A Y 2017-18	Yes	Yes	Yes
Audit applicable u/s 44AB	No. As the income is not higher than the maximum amount not chargeable to tax	Yes . S 44AD(4)/(5)	Yes. S 44AD(4)/(5) Benefit of provisio to 44AB(1) not available.

The Hon'ble Kerala High Court had made a very interesting observation on Income Tax Laws

[Kanan Devan Hills Plantations Company Pvt. Ltd. Vs ACIT (Kerala High Court)]

"The Income Tax Act is one enactment that can shatter anybody's linguistic confidence or competence. Each provision— inevitably, though— runs into pages, superordinate, subordinate, and sub-subordinate clauses piling up in syntactic curlicues. With annual addition, the provisions lose coherence and defy comprehension.

Neither a lawyer nor a Judge can claim with comfort, if not with confidence, that he could comprehend the provision at least on a rereading; the taxpayer is surely lost in in a maze of meandering phrases.

It is therefore time for the Revenue to host on their website a plain English version of the enactment— only a suggestion, however."



## Clause 31 – Section 269ST

- ▶ Receipt of Amount exceeding 2 Lakhs
  - Otherwise than by cheque or draft or Electronic clearing system – 31(ba)
  - If cheque / DD is not account payee cheque – 31(bb)
- ▶ **Payment of Amount** exceeding 2 Lakhs in violation of Section 269ST
  - Otherwise than by cheque or draft or Electronic clearing system – 31(bc)
  - If cheque / DD is not account payee cheque – 31(bd)
- ▶ Similarly clause (d) and (e) requires reporting which affects the opposite party
  - **Repayment made** by assessee's borrower – Section 269T

# Clause 31 – Details Required

- ▶ Name, Address and PAN (if available with assessee) of payer / receiver
- ▶ Nature of Transaction (*See Note below*)
- ▶ Amount of Receipt / Payment
- ▶ Date of Receipt / Payment (*See Note below*)

*Note : Nature of Transaction and Date of Transaction not required where the transaction is by cheque / draft but not account payee cheque / draft*

# Restriction on Cash Transactions



- Section 269ST – w.e.f. 1-4-2017
  - Receipt of an amount of Rs. 2 Lakhs or more prohibited Otherwise than –
    - Account Payee cheque / draft / Electronic clearing system
  - In aggregate from a person in a day
    - Different bills totalling to Rs. 2 Lakhs or more
  - In respect of a single transaction
    - A bill more than 2 Lakhs – payment on each day less than 2 Lakhs in cash
  - In respect of transaction relating to one event / occasion from a person
    - *Same person receiving more than Rs. 2 Lakhs by cash in respect of a single event.*
    - *Type of product or services may be same or different.*

# Restriction on Cash Transactions



- Excluded–
  - Receipts by Government,
  - Receipts by any banking company, post office savings bank or co-operative bank
  - Transactions of the nature referred to in Sec. 269SS
  - Any other person or class of persons to be notified – Notification No. 57 Dt. 3-7-2017 (Mainly banking Industry)
- Relaxation
  - For NBFC and Housing Finance Companies – Each Installment is a transaction – Circular No. 22 Dt. 3-7-17
- Section 271DA
  - Penalty equal to amount of receipt
  - No penalty if proved that there are good and sufficient reasons for contravention – Proviso to 271DA – also section 273B
  - Penalty to be levied by Jt. Commissioner

# Issues ????



- Transactions by Journal Entries
  - CIT Vs. Triumph International Finance Ltd. ITA No. 5745 of 2010 (Bom. HC)
  - CIT Vs. Noida Toll Bridge Co. Ltd. (2003) 262 ITR 260 (Del.)
  - CIT Vs. Bombay Conductors & Electricals Ltd. (2008) 301 ITR 328 (Guj)
  - **Implementation Guide : Such adjustments are not receipt / payment under section 269ST – Need not be reported but suitable note may be given**
- Cash Withdrawn from Bank ?
  - Notification No. 28/2017 Dt. 5-4-17
- Partnership and Partners
  - Cash withdrawn from partnership firm for Drawings or otherwise
  - Cash brought in by partners as capital
  - Cash taken for Expense purposes – Balance to be replenished.





# Issues ????



- Cash Gift Received
  - From Relatives
  - At the time of marriage
  - From Non relatives but source can be explained
- Cash received by cultivators
  - Circular No. 27 Dt. 3-11-17 says no violation if it is less than 2 Lakhs
- Jewellery purchased from time to time by a person from jeweller for wedding
- Sale of Capital Assets

# Clause 31 – Impl. Guide



- ▶ Government Vs. Government Company
  - No reporting required in case of receipt from / payment to a government company (due to language of Note below clause 31)
  - For payments made to government – no disclosure – give a suitable note
- ▶ No difference between revenue and capital account
- ▶ For clauses 31(bb) and 31(bd) – in absence of evidences the guidance given under para 49.6 of guidance note under similar circumstances shall apply here also
- ▶ Information to be retained in working paper for all clauses is given in Implementation guide

# Section 269SS and 269T – Other Issues

- ▶ Loan in the name of a deceased person – Transferred in the names of Legal Heirs
  - Whether this is repayment of loan and acceptance of fresh loan – Constructive repayment ?
  - Whether to be reported
  - How to be reported
  
- ▶ Conversion of Loan into Debentures / Shares
  - Whether violation of sec. 269T ?
  - Whether to be reported
  - How to be reported

# Clause 29A – Sec. 56(2)(ix)

- ▶ Section 56(2)(ix) : Forfeiture of Advance received for Transfer of Capital Asset where transfer eventually does not take place is IFOS – Inserted w.e.f. A.Y. 2015–16
- ▶ Clause 29A – Details required for such forfeiture – Nature of Income and amount to be reported.
- ▶ Clauses 28, 29, 29A, 29B etc. expands the Scope of Tax Audit to Income from Other Sources
  - Preamble to Implementation Guide restricts the reporting requirements
- ▶ How to detect that an amount has been forfeited in absence of accounting entry ?
- ▶ Year of taxability of long standing credit

# Clause 29A – Implementation Guide



- ▶ No reporting required for forfeited amount in respect of a **personal capital asset** where no entries are recorded in the books of account.
- ▶ Reporting required only if an advance is outstanding for a **considerable period of time**.
- ▶ No reporting unless it is forfeited by an act of the assessee – Should be a **positive Act**
- ▶ No reporting required for Forfeiture of amount in respect of **stock in trade** – will get covered u/s. 28(i)
- ▶ There should be a **right to forfeiture** as per the contract – Unilateral write back without such right will not be valid forfeiture

# Clause 29A – Impl. Guide



- ▶ A mere notice of forfeiture contested by other party will not amount to forfeiture
- ▶ If not written back by assessee – not to report giving stand of the assessee
- ▶ Where contingencies that permit forfeiture has occurred but yet assessee contends that amount is not forfeited then the auditor shall look at totality of developments and may obtain MR.
- ▶ Write back without forfeiture – Generally unlikely – Auditor should use professional judgment

# Sec. 56(2)(x) – Statutory Amendments

- ▶ Section 56(2)(x) : Merger of Erstwhile Section 56(2)(vii) and 56(2)(viia) w.e.f. 1-4-17
- ▶ 56(2)(vii)
  - Applicable to Individual / HUF
  - For Money / Immovable Property / Other Property for no consideration or inadequate consideration
- ▶ 56(2)(viia)
  - Applicable to Firm / CHC
  - For shares of a CHC for no consideration or inadequate consideration
- ▶ 56(2)(x) – Applies to All assesseees for Money / Immovable Property / Other Property

# Clause 29B – Sec. 56(2)(x)

- ▶ Earlier clause 28 – covered details of transactions u/s. 56(2)(viia) – 56(2)(vii) not to be reported
- ▶ Clause 29B – Details to be given for Incomes referred in sec. 56(2)(x)
- ▶ Nature of Income and amount to be reported.
- ▶ Expands scope of reporting to cases hitherto covered by 56(2)(vii)
- ▶ Change in Permissible variation from AY 2020–21
  - 20% if the transaction covered by 43CA(1) 2<sup>nd</sup> proviso – AY 21–22
    - Residential unit
    - Transaction between 12–11–2020 to 30–6–2021
    - First Allotment
    - Consideration < 2 Crores
  - 10% in other cases



# Sec. 56(2)(x) – Issues

- ▶ Whether fresh issue of shares is covered
  - Khoday Distilleries Ltd. Vs. CIT 307 ITR 312 (SC) – Allotment of shares is appropriation out of unappropriated share capital – Does not amount to transfer
  - Transfer Vs. Receipt Vs. Allotment of Shares
- ▶ Whether Bonus shares received will be covered
  - CIT Vs. Dalmia Investment Co. Ltd. 52 ITR 567 (SC) – No payment Vs. No Consideration
- ▶ Whether Right Shares subscribed at less than FMV will be covered
  - Proportionate allotment
  - Disproportionate allotment
    - Sudhir Menon HUF Vs. ACIT 148 ITD 260 (Mum.)
- ▶ Whether buy-back of shares at less than FMV covered
  - Vora Financial Services P. Ltd. Vs. ACIT 53 CCH 289 (Mum.)

# Section 56(2)(x)

- ▶ Interest free Loan received – Whether taxable
  - Chandrakant H. Shah Vs. ITO 28 SOT 315 (Mum.)
    - CIT Vs. Chandrakant H. Shah – ITA No. 3154 of 2009 (Bom.) –Department appeal dismissed
  - CIT Vs. Saranpal Singh HUF 237 CTR 50 (P & H)
- ▶ Waiver of Loan – whether taxable
  - Panna S. Khatau Vs. ITO 154 ITD 790 (Mum.) – Constructive receipt – Sec. 68 and 56(2)(vi) – Relying on CIT Vs. T. V. Sundaram Iyengar & Sons Ltd. 222 ITR 344 (SC)
  - CIT Vs. Kasturi & Sons Ltd. 237 ITR 24 (SC) – Money in 41(2) do not include Money's worth
  - CIT Vs. Mahendra & Mahendra Ltd. 404 ITR 1 (SC) – dealing with section 28 and 41(1)

# Receipt from and by HUF

## ▶ Receipt by HUF

- Vineetkumar Raghavjibhai Bhalodia V ITO 46 SOT 97 (Rajkot) – HUF is a group of relatives
- Members of HUF are relatives of HUF – FA 2012
- Post 2012 – difficult to take a view that relative of each member is relative of HUF

## ▶ Receipts from HUF

- Group of Relatives – Singular includes plural
- Each member has interest in property of HUF – can not be said to be without consideration
  - Smt. Sudha V. Iyer V. ITO 48 SOT 173 (Mum.)
- For Monetary transaction – Distribution of Income exempt u/s. 10(2)
- CIT Vs. N. S. Getti Chettiar 82 ITR 599 (SC) – under Gift tax Act

# Receipts on Partition of HUF

- ▶ Partition has to be full partition
  - Qua Members
  - Qua Properties
- ▶ Section 171 (9) derecognises partial partition
- ▶ Partition can be unequal
- ▶ Not considered as transfer u/s. 47(i)
- ▶ Clause (IX) of proviso to 56(2)(x) exempts such receipts

# Clause 29B – Implementation Guide



- ▶ *“The tax auditor should obtain a certificate from the assessee regarding any such receipts during the year, either received in his business or profession or recorded in the books of account of such business or profession.”*
  - Receipts in Personal accounts or not recorded in business books – suggestively out of purview of reporting
- ▶ If valuation disputed by assessee before the stamp authorities, and dispute is pending as on the date of finalisation of the audit → Mention about the facts giving
  - (a) value adopted by stamp authorities and
  - (b) value claimed by the assessee to be the correct value
- ▶ In case of any doubt about valuation – advisable to refer to registered valuer

# Deemed Dividend – Clause 36A

- ▶ Deemed Dividend taxable in the hands of shareholders till A.Y. 2018–19
- ▶ For A.Y. 19–20 & A.Y. 20–21 – Due to amended sec. 115–O, deemed dividend made subjected to DDT – Exempt u/s. 10(34)
- ▶ A.Y. 2021–22 – 115–O is non-operative now – Deemed Dividend again taxable in the hands of shareholder
  - Clause 36 – Information about DDT – Now Redundant
  - Clause 36A – Deemed Dividend – Again relevant

# Deemed Dividend – 2(22)(e)

- ▶ Applicable in case of
  - Advance or Loan by Company to Shareholder (Not Less than 10% of Voting Power)
  - Advance or Loan by company to concern where share holder has substantial interest (20%)
  - Payment on behalf or for individual benefit of the shareholder
- ▶ Deemed dividend to the extent company possess accumulated profit
- ▶ Accumulated profits to be seen as on date of distribution or payment

# Clause 36A – Deemed Dividend

- ▶ Information to be given for Amount of Deemed Dividend as per sec. 2(22)(e) and date of receipt
- ▶ Subject of Deemed Dividend is prone to tremendous litigation
- ▶ Practical Difficulties
  - How to find out accumulated profit of the payer company
  - Possession of Accumulated Profits on the date of transaction
  - Difficulty in identifying the payments made on behalf of the share holder
  - Accumulated profits which can be distributed and which cannot be distributed – Bifurcation to be made



# Clause 36A – Issues

- ▶ Who is to be taxed – Registered share holder or beneficial share holder
  - ACIT Vs. Bhaumik Colour Pvt. Ltd. 118 ITD 1 (Mum. SB)
  - CIT Vs. Universal Medicare Pvt. Ltd. 324 ITR 263 (Bom.)
  - CIT Vs. Ankitech Pvt. Ltd. 340 ITR 14 (Del.) – Approved by SC in CIT Vs. Madhur Housing Development Co. 401 ITR 152 (SC)
  - CIT Vs. National Travel Services 347 ITR 305 (Del.)
  - National Travel Services Vs. CIT 401 ITR 154 (SC) – Issue referred to a larger bench
  - Gopal and Sons HUF Vs. CIT 145 DTR 289 (SC) – Loan given to HUF treated as deemed dividend

# Clause 36A – Deemed Dividend

## ▶ Loans Vs. Deposits

- Inter corporate deposits are not loans – not subject to 2(22)(e) – Bombay Oil Industries Ltd. Vs. DCIT 28 SOT 383 (Mum.)
- Dhariya Construction Pvt. Ltd. – ITA No. 1440/Pune/2015 – A Loan colored as Inter Corporate Deposit – Held Deemed Dividend provisions apply

## ▶ Advances made in the ordinary course of business for business exigencies

- CIT Vs. Ambassador Travels P. Ltd. (Del.) 318 ITR 376 (Del.)
- CIT Vs. Creative Dyeing & Printing P. Ltd. 318 ITR 476 (Del.)
- Sri Satchidanand S. Pandit V. ITO 19 SOT 213 (Mum.)
- NH Securities Ltd. V. DCIT 11 SOT 302 (Mum.)

# Clause 36A – Deemed Dividend

- ▶ Transactions in the nature of Current Account
  - Exotica Housing & Infrastructure Company – ITA No.5188/Del./2019
    - Assessee and its subsidiary engaged in same business
    - Money received has been used in ordinary course of business
    - Money was squared off during the year
    - Held it is in the nature of current account transactions
  - ITO Vs. Gayatri Chakraborty 45 ITR 197 (Kol.)(Trib.) – affirmed by Kol HC in CIT Vs. Gayatri Chakraborty 94 taxmann.com 244 (Kol.)
  - CIT Vs. India Fruits Ltd. 274 CTR 67 (AP)
  - CBDT Circular No. 19/2017 Dt. 12-6-2017

# Clause 36A – Deemed Dividend

## ▶ Inclusions and Exclusions

- Accumulated Profits shall be commercial profits and not assessed income – CIT Vs. P. K. Badiani 105 ITR 642 (SC)
- Capital Profits not to be included – Tea Estate India Pvt. Ltd. Vs. CIT 103 ITR 785 (SC)
- Profit earned u/s. 41(2) is not part of Accumulated Profit – CIT Vs. Urmila Ramesh 230 ITR 422 (SC)
- Revaluation Reserve – Book entry – May not be included
- Development Rebate Reserve and Investment Allowance Reserves – to be included
- Share Premium and Share forfeiture – Capital Reserves – Dy. CIT Vs. Maipro India Ltd. 116 TTJ 791 (Del.) / Jaikishan Dadlani Vs. ITO 4 SOT 138 (Mum.)
- Amount treated as Deemed Dividend in past is to be excluded for determining Accumulated Profits CIT Vs. G. Narsimhan 118 ITR 60 (Mad.)

# Clause 36A – Deemed Dividend

- ▶ Exception – Substantial part of Company's Assets and Income from money lending business
  - CIT Vs. Parle Plastics Ltd. 332 ITR 63 (Bom.) – Substantial does not mean More than 50% – If it is not trivial then exception applies
  - CIT Vs. Jayant H. Modi 232 Taxman 337 (Bom.)
  - CIT Vs. Shree Balaji Glass Manufacturing P. Ltd. 386 ITR 128 (Cal.)
  - Tanuj Holdings (P.) Ltd. V DCIT 46 ITR (T) 420 (Kolkata – Trib.)
  - Mrs. Rekha Modi Vs ITO 13 SOT 512 (Delhi)
  - DCIT Vs. Kishori Lal Agarwal 150 ITD 741 (Luck)

# Clause 36A – Impl. Guide



- ▶ Obtain certificate from assessee containing list of closely held companies where assessee is beneficial owner of shares carrying not less than 10% of voting power
- ▶ Obtain list of “concerns” taking loans from CHCs
- ▶ Appropriate remarks in 3CA / 3CB about inability to independently verify the information and reliance on the certificates
- ▶ Payments made by CHC on behalf of assessee
  - Difficult to have any records – Remark shall be given in 3CA / 3CB
  - If already taxed in the hands of assessee as perquisite etc. – cannot be again taxed as deemed dividend – Not to be reported

# Clause 36A – Impl. Guide



- ▶ Verify Form 26AS to find deduction made by companies u/s. 194 – This will indicate the view taken by the CHC
- ▶ Appropriate Remark where beneficial share holder is not the registered shareholder
- ▶ Accumulated profit on the date of transaction may be determined on time basis with appropriate remarks in 3CA/3CB
- ▶ Give remarks as regards the decisions relied upon for taking any stand on any legal issue



Amendments by  
FA 2021 / FA  
2020 and its  
impact



# Sec. 36(1)(va) and Sec. 43B

- ▶ Section 2(24)(x) – Employees’ contribution is Income
  - Section 36(1)(va) – Deduction allowable if paid within Due date under relevant law
- ▶ Section 43B
  - Non-obstante clause overriding all other provisions
  - Clause (b) – sum payable by an assessee as employer by way of contribution to funds
  - First proviso to 43B – Nothing in the section to apply if paid by due date of Return of Income
  - Amendment by FA 2003 – deletion of second proviso and amendment of first proviso – Contribution to funds on par with Tax / Duty / Cess etc.

## Sec. 36(1)(va) and 2(24)(x) – Decisions

- ▶ CIT Vs. Sabari Enterprises 298 ITR 141 (Kar.) – *affirmed in Alom Extrusions (SC)*
- ▶ CIT Vs. Mark Auto Industries Ltd. 358 ITR 43 (P & H)
- ▶ CIT Vs. Alom Extrusions Ltd. 319 ITR 306 (SC) – Amendment to first proviso to section 43B by Finance Act 2003 – Held retrospective
- ▶ CIT Vs. Hindustan Organics Chemicals Ltd. 366 ITR 1 (Bom)
- ▶ CIT Vs. Ghatge Patil Transports Ltd. 368 ITR 749 (Bom.) – Both Employer and Employee Contribution is covered by the decision of SC in Alom Extrusions Ltd.

# Sec. 36(1)(va) and 2(24)(x) – Decisions

## ▶ Contra View

- CIT Vs. Merchem Ltd 378 ITR 443 (Ker.)
- Popular Vehicles & Services Pvt. Ltd. 406 ITR 150 (Ker.)
  - Sec. 43B is a restrictive provision – Deletion of proviso to 43B cannot make Explanation to 36(1)(va) otiose – 43B takes care of only Employer's contribution
  - Alom Extrusions did not deal with Employees' Contribution
- Unifac Management Services India Pvt. Ltd. Vs. DCIT 409 ITR 225 (Mad)
- CIT Vs. Gujarat State Road Transport Corporation 265 ITR 64 (Guj)

# Amendments by Finance Act

- Explanation – 2 added to section 36(1)(va)
- **For the removal of doubts**, it is hereby clarified that :
  - The provisions of section 43B shall not apply
  - AND
  - **Shall be deemed never to have been applied** for the purposes of determining the “due date” under this clause
- Explanation – 5 added in section 43B
  - For the removal of doubts, it is hereby clarified that
    - the provisions of this section shall not apply and
    - **Shall be deemed never to have been applied** to a sum received by the assessee from his employees u/s. 2(24)(x)
- Memorandum states – Amendments will apply from A.Y. 2021–22 and subsequent assessment years

# What about earlier years?

- Whether the amendment is prospective or retrospective in nature ?
  - CIT Vs. Vatika Township P. Ltd. 367 ITR 466 (SC)
- Can there be any doubts where the jurisdictional HC has already taken a view of the matter on either side ?
- Whether the earlier amendment made by FA 2003 can be said to be meaningless
- Held to be Prospective in nature
  - Salzgitter Hydraulics P. Ltd. vs. ITO (2021) 189 ITD 676 (Hyd.)
  - Indian Geotechnical Services vs. ACIT – ITA No. 622/Del. /2018 – dated 27-08-2021

# Depreciation on Goodwill

- Depreciation permissible on Tangible and Intangible assets
- CIT Vs. Smifs Securities Ltd. (2012) 348 ITR 302 (SC)
  - Difference in Net Asset Value and cost of acquisition is goodwill and it is intangible asset eligible to depreciation
- Memorandum explaining the provisions
  - Goodwill can be acquired :
    - By payment – Goodwill is generally not depreciable
    - Restructuring of Business – There is no cost of acquisition – Really ?

# Amendments made

- Sec. 32(1)(ii) – Goodwill of a business shall not be considered as an asset for the purpose of depreciation
- Sec. 2 (11) – Block of Asset shall not include Goodwill
- Sec. 50 – Where goodwill formed part of block of assets and depreciation has been obtained – WDV of block of asset and Short Term Capital Gains shall be determined in the manner to be prescribed – **Rule 8AC prescribed**
- Section 55
  - For the Goodwill acquired by payment – Actual cost Less Depreciation claimed till AY 2020–21
  - Self acquired Goodwill – NIL

# Rule 8AC

- ▶ The goodwill have to be removed from the block of assets as on 1-4-2021 such value will be the cost of goodwill less the depreciation claimed till date.
- ▶ Only asset in the block – No impact – Reduction will be to the extent of WDV
- ▶ Where there are other assets – possibility of the value of the block turning negative – This will lead to computation of Short Term Capital Gains – Section 50.
- Whether the Goodwill on which depreciation is stopped being charged can be taken out of Block and be treated as Long Term after three years?
  - Smt. Meena Pamnani Vs. CIT 86 taxmann.com 175 (Bom)



# Depreciation – Clause 18

## ▶ Depreciation on Intangibles

- ~~Goodwill – CIT Vs. Smifs Securities Ltd. 348 ITR 302(SC)~~
- Stock Exchange Card – Techno Shares & Stocks Ltd. Vs. CIT 327 ITR 323 (SC)
- SEBI Registration Fees – DIT Vs. HSBC Asset Management India Pvt. Ltd. 228 Taxman 365 (Bom.)
- One time Licence Fees – ACIT Vs. GKN Sinter Metal P. Ltd. 153 ITD 311 (Pune)
- Non Compete Fees
  - Medicorp Technologies India Ltd. – (2009) 30 SOT 506 (Mad)
  - Srivastan Surveyors P. Ltd – (2009) 318 ITR 283 (Chennai Trib.)
  - ACIT Vs. Real Image Tech P. Ltd. 120 TTJ 983 (Chennai Trib).

# Some Issues which arise on Regular basis

# Relevance of Accounting Standards

- ▶ Relevance of Accounting Standards
- ▶ Conflict between Accounting Standards and Provisions of Act
- ▶ DCIT v. Cornerstone Property Investment Pvt. Ltd. 185 ITD 202 (Bang.)
  - Amount borrowed for acquisition of land held as stock in trade
  - Deduction claimed u/s. 36(1)(iii)
  - AS-16 – Borrowing cost – cost to be capitalized
  - Proviso to section 36(1)(iii)
  - Held : Allowable – followed India Cement v. CIT 60 ITR 52 (SC)

# Section 41 – Clause 25



- ▶ Liability which is time barred but not written back in the accounts
  - CIT Vs. Vardhman Overseas Ltd. 343 ITR 408 (Del)
  - CIT Vs. Bhogilal Ramjibhai Atara 88 CCH 49 (Guj)
  - Contra view : ITO Vs. Shailesh D. Shah – Mum ITAT – itatonline.org – doubting genuineness
- ▶ Liability reflected in signed Balance Sheet is acknowledgement of debt – Not time barred
  - CIT Vs. Smt. Sitadevi Juneja 325 ITR 593 (P & H)
- ▶ Refund of excise duty / sales tax etc. where the department is in appeal at higher forums – whether section 41 gets attracted ?
  - CIT Vs. Hindustan Housing and Land Development Trust Ltd. 161 ITR 524 (SC) – Regarding compensation for land acquisition
- ▶ If liability disallowed u/s. 43B or 40(a)(ia) etc. whether the same can be added as income u/s. 41

## 40(a)(i) – 40(a)(ia)



- ▶ Can Auditor rely on Certificates issued u/s. 195 or he should examine all the documents / treaties etc.
- ▶ Section 40(a)(i) – Whether deduction is required to be made when the relevant income is not taxable in India due to DTAA
  - GE India Technology Centre Pvt. Ltd. Vs. 327 ITR 456 (SC)
- ▶ EMIs paid to NBFC – position of TDS deduction
- ▶ Deduction of TDS at lesser rate – Whether disallowance to be made u/s. 40(a)(ia)
  - DCIT Vs. Chandabhoy and Jassobhoy 49 SOT 448 (Mum.)
  - DCIT Vs. S. K. Tekriwal 48 SOT 515 (Cal.) – confirmed in CIT Vs. S. K. Tekriwal 361 ITR 432 (Cal.)
  - Contra View – CIT Vs. PVS Memorial Hospital Ltd. 380 ITR 284 (Ker)

## 40(a)(i) – 40(a)(ia)



- ▶ No TDS on Reimbursement of Expenses – *CIT Vs. DLF Commercial Project Corporation 379 ITR 538 (Del.)* ; *Hightension Switchgears P. Ltd. Vs. CIT 385 ITR 575 (Cal.)*
- ▶ Tax Deducted and Paid but no TDS Return filed – whether disallowance is to be made
- ▶ Form 15G / 15H not filed with Department – Whether Disallowance to be made
- ▶ No Disallowance where the expenditure is capitalised in the books of accounts – *CIT Vs. Mark Auto Industries Ltd. 358 ITR 43 (P & H)*
- ▶ No Liability to deduct tax on transport charges where primary contract is for supply and Transport is incidental – *CIT Vs. Krishak Bharati Co. Op. Ltd. 349 ITR 68 (Guj)*

## 40(a)(i) – 40(a)(ia)



- ▶ No TDS on Overseas Commission to Foreign Agent
  - Circular No. 23 of 1969
  - Circular No. 7 Dated 22-10-2009
  - CIT Vs. Toshoku Ltd. 125 ITR 525 (SC)
  - CIT Vs. Gujarat Reclaim & Rubber Products Ltd 383 ITR 236 (Bom.)
  - Sesa Resources Ltd. Vs. DCIT 287 CTR 89 (Bom.)
- ▶ Second proviso to Section 40(a)(ia) – No disallowance if
  - Tax paid by the recipient and
  - Income declared in Return filed
  - Declaration given to the effect

## 40(a)(i) – 40(a)(ia)

- ▶ Cost Sharing arrangements – No deduction of TDS required if it is purely on actual basis
  - CIT Vs. Ask Wealth Advisors P. Ltd. 168 DTR 349 (Bom.)
- ▶ Target Incentives to Distributors not liable for deduction of TDS – Not a commission
  - PCIT Vs. Shalimar Chemical Works Ltd. 257 Taxman 590 (Cal.)
- ▶ Free subscription to consumers is discount and not commission – TDS not deductible
  - Tata Sky Ltd. v. ACIT 119 taxman.com 424 (Mum.)



## 40(a)(i) – 40(a)(ia)

- ▶ Credit Card commission paid to Bank is in the nature of bank charges and not commission – No deduction required –
  - Velankani Information System Ltd. Vs. DCIT 173 ITD 19 (Bang.)
- ▶ No Disallowance where income offered under presumptive scheme u/s. 44AD
  - Shri Bipinchandra Hiralal Thakkar v. ITO 187 ITD 477 (Surat)

# Section 40A(3)

- ▶ Rule 6DD – Exceptions to be taken care of
- ▶ Section 40A(3) and 40A(3A) – Limits independent or composite ?
- ▶ Genuine Payments made in excess of the prescribed limit may still not be disallowed if they are made to meet the business exigencies and the payee can be identified
  - Honey Enterprises Vs. CIT 381 ITR 258 (Del.)
  - ITO Vs. Samwon Precision Mould Mfg. India P. Ltd. 401 ITR 486 (Del.)
  - Anupam Tele Services Vs. ITO 366 ITR 122 (Guj)
  - Harshila Choradia Vs. ITO 298 ITR 349 (Raj.) – Rule 6DD has to be liberally construed.
- ▶ Cash Deposited directly in the bank account of the supplier – Disallowance held to be valid
  - Ajai Kumar Singh Khaldelial 421 ITR 6 (All)

# Section 40A(3)

- ▶ Expenses incurred in Foreign Currency – whether covered by Section 40A(3)
  - Ramlord Apparels v. ACIT – ITA No. 7349/Mum/2018
    - Limit is prescribed in Rupee Terms
    - Anomalous situation on Interpretation
- ▶ Purchase of Capital Asset by cash
  - No disallowance – Shalom Charitable Ministries of India 171 ITD 338 (Cochin)
  - To be ignored while computing Actual Cost u/s. 43

# Expln – 1 to 37(1)



- ▶ Penalty or fine for violation of any law for the time being in force
  - Penalty paid for delay in supply of material – Whether allowable
  - Penalty for procedural lapses in compliance of Rules & Regulations of associations etc
    - LKP Securities 36 CCH 93 (Mum)
    - Dy. CIT Vs. Kisan Ratilal Choksey Shares & Securities Pvt. Ltd. 41 (ITR Trib) 114 (Mum.)
- ▶ Prakash Cotton Mills P. Ltd. Vs. CIT 201 ITR 684 (SC)
  - AO Should examine the scheme of the relevant statute to decide the nature of the particular levy to decide whether it is compensatory in nature or penal in nature – Nomenclature is not relevant while deciding the issue. In case of composite payment – amount is to be bifurcated appropriately
- ▶ Penal Interest Vs. Compensatory Interest under various laws like GST, Sales Tax, Excise, Service Tax etc
  - Velankani Information Systems Ltd. Vs. DCIT 173 ITD 19 (Bang.) – Interest on Service Tax Compensatory in nature

# Expln -1 to 37(1)



- ▶ CIT Vs. Ahmedabad Cotton Mfg. Co. Ltd. 205 ITR 163 (SC)
  - Penalty for infraction of law is not permissible but payment in obedience of law as a measure of business expediency can not be subject to disallowance. Payment made towards exercise of option given by the scheme is not to be disallowed.
  
- ▶ Expense for any purpose which is an offence or which is prohibited by law
  - Compounding Fees / Consent Fees for settling Dispute – *ITO Vs. Reliance Share & Stock Brokers P. Ltd. 67 SOT 73 (Mum.) ; DCIT Vs. Anil Dhirajlal Ambani 171 ITD 144 (Mum.)*
  - Advocate Fees – *T & T Motors Vs. Addl CIT 154 ITD 306 (Del.) – against*
  - Ransom Money

# Expln.- 1 to Sec. 37 (1)



- ▶ Compromise payment made to landlord to protect the Leasehold right – not an offence – allowable – *CIT Vs. Sports Field Amusement 231 Taxman 252 (Bom.)*
- ▶ Assessee guaranteed payment by third party – Third party failed – Decree executed against assessee – Payment made to avoid defamation of name – Held allowable – *CIT Vs. Hitachi Koki India Ltd. 230 Taxman 643 (Karn.)*
- ▶ Additional Filing Fees paid to ROC – Compensatory in nature – Allowable – *Cummins Turbo Technologies Ltd. Vs. DCIT 169 TTJ 358 (Pune)*

# Clause 26 – Section 43B

- ▶ Section 43B is a disallowance section – Taxes paid in advance though not due as per law not allowable as deduction on payment basis
  - Gopikrishna Granites India Ltd v. DCIT (251 ITR 337)(AP)
  - Hindustan Lever limited v. V.K. Pandey, JCIT, (251 ITR 209) (Bom)
- ▶ Explanation 3C to section 43B – Introduced by FA 2006 w.r.e.f. 1-4-1988
  - Conversion of outstanding interest into loans – Not to be considered as payment of Interest – Purpose to avoid misuse of the provisions
  - Genuine Debt restructuring plan by issue of debenture will not be affected by Explanation 3C in absence of any malafide intention – M. M. Acqua Technologies Ltd. v. CIT 129 taxmann.com 145 (SC)
  - Decision for A.Y. 1996–97 – Ratio still relevant

# Clause 32 – Section 79

- ▶ Past losses are not allowed to be set off in a case where the change in shareholding results in diversion of voting power to the extent of more than 51%
- ▶ CIT Vs. Amco Power Systems Ltd. 379 ITR 375 (Kar).
  - What is relevant is voting power and not shareholding pattern
  - Change of shareholding between the existing shareholders will not have any impact



# Date of Audit Report

- ▶ Language of Section 44AB
- ▶ Audit Report to be obtained before the due date and Return to be filed on or before due date
- ▶ If Audit Report Dated – 30<sup>th</sup> September – whether 44AB violated ?
  - Chandra Kumar Seth Vs. ITO 62 ITD 106 (All.)
  - Chopra Properties Vs. ACIT ITA No. 6199/Del/2015 – itatonline.org

