

Legal and Practical Issues in Tax Audit Report

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Road Map of Discussion

- Tax Audit – Is a Audit and the AS are applicable.
- ICDS and its implementation
- Section 145A – Stock valuation
- Depreciation Issues
- Capital or Revenue issues
- Sec 40A(3) & Explanation 37(1)
- Section 14A –Rule 8D
- Section 269SS, 269T & 269ST
- Section 40(a)(i)/(ia)
- Section 2(22)(e)
- S 40A(9)-Disallowance

Tax Audit – Applicability of AS

- **Audit in case of non-corporate entities**

1. Entire audit to be conducted and 3CD details to be certified
2. True and Fair view of FS

- **Audit in case of Corporates**

1. Only details of Form 3CD to be certified
 2. Reliance to be placed on the work of statutory auditors. SA 600 using the work of other professional
 3. Some additional verification to be made.
 4. Co-relation with the details in the Audit of companies.
- Article clerk is most important in the quality of audit conducted.

ICDS –Brief History

- Finance Act, 2014 amended section 145(2) of the Act to substitute “accounting standards” with “income computation and disclosure standards” (ICDS). Committee appointed to suggest ICDS.
- Circular no. 10/2017 dated 23.03.2017 was issued giving certain clarifications in respect of ICDS.
- Hon’ble Delhi High Court in case of Chamber of Tax Consultants vs. UOI (400 ITR 178) vide order dated 08.11.2017, quashed certain ICDS and certain portion of other ICDS and read down the powers of the Government u/s.145(2).
- Amendments brought out by Finance Act, 2018 w.r.e.f. AY 2017-18 to over rule the judgment of the Hon’ble Delhi High Court.

Applicability of ICDS

- **ICDS will apply to:**
 - An assessee
 - Following mercantile system of accounting
 - Computing taxable income under the following heads of income:
 - Profit and gains of business or profession
 - Income from other sources
- No Net worth or Turnover Criteria prescribed for applicability
- Not for the purpose of maintenance of books of account
- In case of conflict between ICDS and Act, the Act shall prevail

List of Notified ICDS

ICDS	Income Computation and Disclosure Standards	Equivalent AS
ICDS I	Accounting Policies	AS-1
ICDS II	Valuation of Inventories	AS-2
ICDS III	Construction contracts	AS-7
ICDS IV	Revenue Recognition	AS-9
ICDS V	Tangible Fixed Assets	AS-10
ICDS VI	Effects of Changes in Foreign Exchange Rates	AS-11
ICDS VII	Government Grants	AS-12
ICDS VIII	Securities	AS-13
ICDS IX	Borrowing Costs	AS-16
ICDS X	Provisions, Contingent Liabilities and Contingent Assets	AS-29

Disclosure in form 3CD 13(e)

Sr No.	ICDS	Increase in profit (Rs)	Decrease in profit (Rs)	Net Effect (Rs)
I	Accounting Policies			
II	Valuation of Inventories			
III	Construction Contracts			
IV	Revenue Recognition			
V	Tangible Fixed Assets			
VI	Changes in Foreign Exchange Rates			
VII	Government Grants			
VIII	Securities			
IX	Borrowing Costs			
X	Provisions, Contingent Liabilities and Contingent Assets			
XI.	Total			7

ICDS 1- Accounting Policies

- **ICDS recognizes three accounting concepts – going concern, consistency and accrual**
- **Materiality and prudence are absent as considerations for selection of accounting policies. A negative provision has in fact been made in the ICDS by stating that prudence is not to be followed unless it is followed.**
- **Accounting policy can be changed only if there is reasonable cause to do so**
- **Mark-to-market (MTM) or expected loss shall not be recognized unless provided by Act. ICDS I which does away with the concept of prudence is contrary to the Act and the supreme court decided judgments**

Amendment in Finance Act 2018

- **36.** (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—
 - (xviii) marked to market loss or other expected loss as computed in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145.
- **40A(13)** No deduction or allowance shall be allowed in respect of any marked to market loss or other expected loss, except as allowable under clause (xviii) of sub-section (1) of section 36.

ICDS-2 Inventory Valuation

- 145A –amended retrospectively by finance Act 2018 from 1-4-2017.
“(i) the valuation of inventory shall be made at lower of actual cost or net realisable value computed in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145;”
- Stock valuation as prescribed by the ICDS is cost or market value which ever is lower.
- Auditor will also have to take in to consideration the landed cost, auditor should be careful to include all costs in valuation.
(British Paints India Ltd –**SC-1991 AIR 1338**)

ICDS-2 Inventory Valuation

- Supreme Court had struck down that in case of dissolution of a partnership firm whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realisable value, Shakti trading co. 250 ITR 871(SC). However Clause 24 of ICDS-2 requires the inventory to be valued at Net realisable value. Does this mean that the SC ruling is not applicable?
- S 145A applies to service industries
- Securities to be valued category wise(at cost or market value which ever is lower),
- unlisted shares to be valued at cost.

Construction Contracts ICDS -3

The ICDS does not apply to builders.

- Percentage completion method to be followed (even for service contract)
- Retention money to be included in revenue and cannot be excluded.
- Incidental income like interest income cannot be deducted from borrowing cost.
- The estimated losses and expenses booked and allowed under AS 7 are specifically excluded (Para 20)

-AMENDMENT TO THE ACT

43CB. *(1) The profits and gains arising from a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145*

Revenue Recognition-ICDS 4

- Scope of ICDS-IV is limited to sales of goods, rendering of services and use of resources by others yielding interest, royalties or dividends.(view that lease rentals are outside the purview of ICDS –IV)
- Interest to be taxed even in absence of reasonable certainty is held to be valid. (To be taxed on accrual basis)
- Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim for escalation of price and export incentives, revenue recognition in respect of such claim shall be postponed to the extent of uncertainty involved.
- Service contracts of more than 90 days ,to be recognised based on percentage completion method.

Amendment to the law for ICDS 4

145B. (2) *Any claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.*

(3) The income referred to in sub-clause (xviii) of clause (24) of section 2 shall be deemed to be the income of the previous year in which it is received, if not charged to income-tax in any earlier previous year.]

Fixed Assets and Exchange difference -ICDS

- ICDS for fixed asset is on the same lines as AS 10 and disclosures are on same lines as provided under form 3CD so reference may be made to clause 18.
- Spares for machinery where maintained and can be used only for a machine and use of which is uncertain to be capitalized

Issue:- Treatment of expenses incurred after the conduct of the test runs and experimental production. PARA 8 OF THE ICDS – V provides for capitalization of expenses till the commercial production which is contrary to National Thermal Power corpn vs CIT 357 ITR 253(DEL HC)

ICDS 6 Foreign Exchange transactions

- ICDS for foreign exchange was entirely struck down by the Delhi HC
- New section 43AA introduced.
- The difference in the treatment of transactions entered for trading or speculation or that are entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast. Forward Contract profit / loss to be recognized only on the settlement of contract. (mark to mark contracts)

43AA. (1) *Subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be, and such gain or loss shall be computed in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145.*

ICDS – 6 law amended

43AA -(2) For the purposes of sub-section (1), gain or loss arising on account of the effects of change in foreign exchange rates shall be in respect of all foreign currency transactions, including those relating to—

- (i) monetary items and non-monetary items;*
- (ii) translation of financial statements of foreign operations;*
- (iii) forward exchange contracts;*
- (iv) foreign currency translation reserves*

Government Grants ICDS 7

- Grants to be recognised only when there is reasonable certainty of receipt or not later than actual receipt of grant.
- One needs to look at section 2(24)(xviii) as all grants are now taxable unless the same is related to a capital assets and reduced from the cost of capital asset.
- Amendment in section 145B(3)

ICDS on securities held as stock in trade

- The securities have to be recognised at cost or net realizable value whichever ever is lower.
- The market values has to be calculated based on category of securities as for example
 - Shares
 - Bonds
 - Mutual funds
- The unlisted securities are to be valued at at cost.
- Section 145A is amended.

ICDS -9 on borrowing cost

- The major issue is that the cost of borrowing till the asset is first put to use is to be capitalised. The definition of qualifying asset includes inventories that require a period of twelve months or more to bring them to a saleable condition.
- The ICDS provided for both the capitalisation of specific borrowing like term loan for acquisition or generation of asset and general borrowing like cash credit on proportionate basis. (specific formula provided in para 6).
- Practical difficulty for big companies with multiple borrowings and different blocks and asset purchase dates.

Provisions, Contingent Liabilities and Contingent Assets

AS - 29	ICDS
❖ Provisions shall be recognised if it is <u>probable</u> that outflow of economic resources will be required.	❖ Provisions shall be recognised if it is <u>reasonably certain</u> that outflow of economic resources will be required.

Impact:

- ❖ The criterion for recognition of provisions on the basis of the test of ‘probable’ (i.e. more likely than not criterion) replaced with the requirement of ‘reasonably certain’.
- ❖ In the absence of definition and scope of ‘reasonably certain’ criterion, an ambiguity would arise on assessment of ‘reasonably certain’ criterion.
- ❖ In the Act, there is no specific provision for recognition of provisions. However, provisions are allowed based on accrued liabilities as per ordinary principles of commercial accounting.

Recognition of provisions

Impact:

- ❖ Provision for Warranty is allowed as an expenditure upholding the test of ‘probable’ warranty obligation in the following judgments.
 - Rotork Controls India P. Ltd. (2009) 314 ITR 62 (SC) (extract on next slide)
 - Himalaya Machinery (P) Limited v DCIT 334 ITR 64
 - CIT vs. Luk India P. Ltd. 52 DTR 117.
 - Siemens Public communication Networks Limited v CIT
 - CIT v Indian Transformer Limited. 270 ITR 259

Impact of ICDS

As in AS 29 there is no clarification in ICDS for allowing provisions on business experience , therefore Provisions made on obligations recognized out of customary business practices or voluntary obligations may not be allowed. (e.g. informal refunds policy to dissatisfied customers, employee welfare, etc.)

(The CBDT has clarified that provisioning for employee benefit which are otherwise covered by AS 15 shall continue to be governed by specific provisions of the Act and are not dealt with by ICDS –X)

Disclosures required in clause 13(f)

Clause	Disclosure as per ICDS
I	ICDS I- Accounting Policies
II	ICDS II- Valuation of Inventories
III	ICDS III-Construction Contracts
IV	ICDS IV- Revenue Recognition
V	ICDS V-Tangible Fixed Assets
VII	ICDS VII-Government Grants
IX	ICDS IX- Borrowing Costs
X	ICDS X- Provisions, Contingent Liabilities and Contingent Assets

Disclosures -I

ICDS	Disclosure requirement
ICDS- 1	All significant accounting policies Any change in accounting Policy with the effect
ICDS -2	The accounting policies adopted in measuring inventories including cost formulae used. (Method of valuation and the process followed should be disclosed eg. FIFO , Weighted Average, or Specific allocation.) IF standard costing method is followed : -details of such inventories and a confirmation of fact that standard cost approximates the actual cost. The carrying amount and its classification
ICDS -3	The amount of revenue recognised as revenue in the period and the method used to determine stage of completion. For contracts pending : - a) Amount of cost incurred and recognised profits (less loss upto the reporting date., b) Amount of advances received c) The amount of retentions.

Disclosures -II

ICDS	Disclosure requirements
ICDS -4	<ol style="list-style-type: none">1. Total sales not recognized due to lack of certainty of receipt and the nature of uncertainty2. Amount of receipts of Service contracts recognised as revenue during the previous year3. Service contracts in progress at the end of the year . A)Details of cost incurred and profits recognised for each project , B)Amount of advance received and C)Amount of retentions.
ICDS-5	Requirements are same as in clause 18 reference can be made to it
ICDS-6	No Specific requirements
ICDS-7	<ol style="list-style-type: none">1. Nature and extent of grants reduced from cost of assets during the previous year2. Nature and extent of grants recognized as income3. The nature and extent of govt. grants not recognized as income nor reduced from the cost of assets.

Disclosures-III

ICDS	Disclosure requirements
ICDS - 8	No specific disclosure requirements
ICDS -9	<ol style="list-style-type: none">1. The accounting policy adopted for borrowing cost2. The amount of borrowing costs capitalised during the previous year.
ICDS-10	<p>For each class of Provision</p> <ol style="list-style-type: none">1. Brief description2. Carrying amount at end & Beginning3. Additional provision made4. Unused reserves5. Expected Reimbursement.

Closing Stock Valuation S.145A

- 145A :-(*ii*) the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation;
- The AS 2 and the guidance note provide for net method to be followed.
- The Guidance note for accounting of MODVAT/ CENVAT, provides that the ultimate impact on profit is nil.

Closing Stock Valuation S.145A

- Clause 14(b)/ 26/ 27 requires specific disclosure as to whether the valuation as per S. 145A is followed. One needs to state “No” in clause 14(b) and state that the impact is nil.
- The Bombay High court in the case of CIT vs Daimond Dye Chem LTd ITA 146/2015(BOM) has held that the net method or gross method the impact on profit would be nil. A clear disclosure of reliance on a judgment would help.

Depreciation on Assets not in Name of Company / Partnership

- Car Registered in Partner's / Director's name – Reflected in Firm / Company's Balance Sheet
 - CIT Vs. Aravali Finlease Ltd. 341 ITR 282 (Guj)
 - Edwise Consultants P. Ltd. Vs. DCIT 44 ITR 236 /45 CCH 392 (Mum. Trib.)
- Depreciation on vehicles for personal use
 - Microsoft Corporation India P. Ltd. Vs. Addl CIT 37 ITR 290 (Del. Trib.) – No Personal use in the case of companies
 - Difference in section 32 and section 37(1)
 - **However, there is the issue of perquisite value not added to the Director and short deduction of TDS on salary.**

Depreciation Clause 18 Issues

- **Functional Test for deciding whether plant or building**
 - ACIT Vs. Victory Aqua Farm Ltd. 379 ITR 335 (SC) –Ponds for breeding prawnns
 - CIT Vs. Anand Theatres 244 ITR 192 (SC)-Cinema theatres not plant
 - CIT Vs. Dhampur Sugar Mills Ltd. 375 ITR 296 (All) – Tubewell held to be plant
 - CIT Vs. Express Resorts & Hotels Ltd. 230 Taxman 424(Guj) – Electrical Installations and Sanitary Fittings in hotel treated as plant
- **Depreciation on Individual assets which are not used but forming part of block of asset**
 - CIT Vs. G. R. Shipping Ltd. – ITA No. 598 of 2009 (Bom HC)
 - CIT Vs. Sonic Hiochem Extraction P. Ltd. 94CCH 99 (Bom.)
 - DCIT Vs. Boskalis Dredging India P. Ltd. 53 SOT 17 (Mum.)

Depreciation Clause 18 Issues

- 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)
 - **Compensation paid to retiring partner is goodwill and eligible for depreciation** – Pr. CIT Vs. Swastik Industries 240 Taxman 510 (Guj)
 - **Excess amount paid over Net asset value for acquiring business is goodwill** – Triune Energy Services P. Ltd. Vs. Dy. CIT 129 DTR 422 (Del. HC)
 - **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.)

Clause – 21 Capital or Revenue Expenses

- Few Relevant Tests – Para 30.2 of GN of ICAI
 - Creation of New Asset or Enduring Benefit
 - Fixed Capital or Fixed Asset Vs. Working Capital or Current Asset
 - Whether it relates to basic framework of business
 - Acquisition of an Intangible Asset

Capital or Revenue -Principles

- Royalty paid to Foreign Collaborator for technical know how fees
 - No business in existence – Capital Expenditure - Honda Siel Cars India Ltd. Vs. CIT (2017) 99 CCH 39 (SC)
 - Subsequent years – business in existence – Royalty paid for improvement in the business – Revenue Expense – CIT Vs. Hero Honda Motors Ltd. 372 ITR 481 (Del.)
- Expense incurred for carrying on existing business in a more efficient manner incidentally resulting in enhancement of capacity - Revenue in nature – No enduring benefit or creation of income generating apparatus – *CIT Vs. Television Eighteen India Ltd. 364 ITR 605 (Del.)*
- Expenses on upgradation of application software
 - Revenue Exps. : *ACIT Vs. Sanghvi Savla Stock Brokers Ltd. 152 ITD 820 (Mum.)*

Capital or Revenue – Principles

- Construction Expenditure incurred on an abandoned project is allowable as revenue expenditure – No asset is created – *Binani Cement Ltd. Vs. ACIT 380 ITR 116 (Cal.)*
- Fees paid for technical collaboration agreement which had to be terminated – Capital in nature – *Oriental Seritech Ltd. Vs. CIT 149 ITD 350 (Mum.)*
- Assessee engaged in production of audio cassettes and CDs – payment made for purchase of copyrights of sound tracks of films – Revenue Expenditure – *ITO Vs. Five Star Audio 143 ITD 288 (Chennai)*.
- DCIT Vs. Gujarat Narmada Valley Fertilizers Co. Ltd. 215 Taxman 72 (Guj)
 - Loan taken for the purpose of business – Expenditure incurred on restructuring of such loan is revenue in nature
 - Premium on Redemption of Debentures which were issued for working capital requirements – Revenue Expenditure

Capital or Revenue – Principles

- Cyanamid Agro Ltd. Vs. ACIT 148 ITD 606 (Mum.)
 - Payment made for avoiding competition over a reasonable long period of time – Capital in nature
 - If the period is uncertain and competition can again start any time – Revenue Expenditure
- Rent Income assessed as Business Income – Payment of compensation to existing tenant to obtain vacant possession of building so as to earn higher rent – Revenue Expenditure – *Shyam Burlap Co. Ltd. Vs. CIT 380 ITR 151 (Cal.)*
- Expenses on Medical treatment of Eyes in the case of an advocate – Personal in nature – *Dhimant Hiralal Thakkar Vs. CIT 380 ITR 275 (Bom.)*
- Expenses to perfect the title of the land is capital expenditure – No Depreciation is allowable since do not pertain to Building – *Sandvik Asia Ltd. Vs. DCIT 378 ITR 114 (Bom.)*

Section 40A(3)

- Rule 6DD – Exceptions to be taken care of
- 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.)
 - Anupam Tele Services Vs. ITO 366 ITR 122 (Guj)
 - Harshila Choradia Vs. ITO 298 ITR 349 (Raj.) – Rule 6DD has to be liberally construed.

Expln 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 Sales Tax, Excise, Service Tax etc
- Penalties for Late filing of VAT Returns / Late filing Fees for Service Tax

Expln 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.)*
 - Advocate Fees – *T & T Motors Vs. Addl CIT 154 ITD 306 (Del.) – against*
 - Ransom Money

Expln. 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)*

Section 14A – Rule 8D

- Rule 8D - Significance of the phrase “having regard to”
- Conclusive finding necessary
 - Godrej & Boyce Mfg. Co. Ltd. Vs. DCIT (2010) 328 ITR 81 (Bom.)
 - Maxopp Investment Ltd. Vs. CIT (2011) 347 ITR 272 (Del) – recently approved by SC
 - CIT Vs. I. P. Support Service India P. Ltd. – 94 CCH 37 (2015) (Del)
- No Disallowance in absence of exempt income :
 - CIT Vs. Delite Enterprises – ITA No. 110 of 2009 (Bom) – itatonline.org
 - CIT Vs. Shivam Motors Pvt. Ltd. – (2015) 230 Taxman 63 (All)
 - CIT Vs. Corrttech Energy Pvt. Ltd. 223 Taxman 130 (Guj)
 - Cheminvest Ltd. Vs. CIT (2015) 378 ITR 33(Delhi)(HC) – SB decision overruled

Section 14A – Rule 8D

- Meager Dividend Income
 - DCM Ltd. Vs. DCIT (Del. Trib) – ITA No. 4467/Del/2012 Dated 1-9-15 - following HC decision in Cheminvest
- Disallowance cannot be in excess of expenditure incurred
 - ACIT Vs. Iqbal M. Chagla – 67 SOT 123 (Mum)(URO)
 - Gillete Group India P. Ltd. 22 taxmann.com 61
 - Haresh S. Jhaveri – ITA No. 8518/Mum/2010

14A in MAT Scenario

- 115JB is a self contained code – Book Profit as per Explanation
- Clause (f) – Expenses in connection with incomes exempt u/s. 10, 11 and 12
- Expense to be added back “if debited to P & L A/c.” – Only Actual Expenses – No scope for Rule 8D
- **Decisions**
 - Essar Teleholdings Ltd. Vs. DCIT – ITA No. 3850/M/2010 (Mum.)
 - Quippo Telecom Infrastructure Ltd. Vs. ACIT – ITA No. 4931/Del/2010 (Del.)
 - Everest Kanto Cylinders Ltd. Vs. ACIT 167 TTJ 204 (Mum.)
- Clause (f) will not be applicable in case of no exempt income earned during the year - Minda Sai Ltd. Vs. ITO 114 DTR 50 (Del. Trib)

S 14A:-Subsidiaries / Strategic Investments / Stock in Trade

- Purpose of Investment
- Recently Settled : Maxopp Investment Ltd. Vs. CIT SC - itatonline.org – Dt. 12-2-18
 - Purpose is not relevant
 - Applies to both Stock in Trade and Investments
 - However only proportionate disallowance to be made
 - AO has to record finding how the disallowance made by assessee is incorrect

Interest Disallowance - Mixed Funds

- Common Funds – Sufficient funds available for making Tax Free Investment
 - Woolcombers of India Ltd v. CIT 134 ITR 219 (Cal) / East India Pharmaceutical Works Ltd v. CIT 224 ITR 627(SC)
 - CIT Vs. Reliance Utility and Power Ltd. 313 ITR 340 (Bom) - section 36(1)(iii)
- CIT V. HDFC Bank Ltd. 366 ITR 505 (Bom.) – section 14A – applying ratio of Reliance Utility
- Similar view : CIT Vs. UTI Bank Ltd. 215 Taxman 8 (Guj) / CIT Vs. Torrent Power Ltd. 363 ITR 474 (Guj)

Profit from Partnership Firm

Vishnu Anand Mahajan Vs. ACIT 137 ITD 189 (Ahd. SB)

- Funds are borrowed and Introduced as Capital in Firm
- Also other expenses are incurred by partner – Motor Car Expenses – Car Depreciation etc.
- Partner earns Remuneration + Interest + Share of Profit from Firm
- Section 14A applies to Interest and Other Expenses
- Disallowance to be made by apportionment
- Section 14A do not apply to depreciation

(Other judgments to be considered on the topic–Dharam Singh Popat ITA 7534 /M/2004 & Delite Enterprises ITA 110 of 2009)

Section 43CA or 50C – Clause 17

- Whether reporting is at all required for items covered by Section 50C
 - Scope shall be confined to Business Income
 - Clause 28 and 29 deals with Section 56(2)(viia) and 56(2)(viib)
- Clause 17 :
 - Details in respect of the land or building or both transferred during the year for a consideration less than value adopted or assessed or assessable by *authority of state government referred to in section 43CA or 50C*.
- Clause talks about authority referred to in section 50C and not the transactions referred to in section 50C.
- Ghai Constructions Vs. State of Maharashtra – Bom HC – Order Dt. 30-4-2007
 - Requirement of compulsory audit is only in respect of business carried on by the person and not in respect of his income from other sources.

Section 43CA – Issues

- Section 43CA – whether applies in the case of Percentage completion method
 - Section 43CA applies in the year of transfer
 - Whether transfer is complete on entering agreement or registration ?
- Whether section 43CA has to be considered for computing deduction u/s. 80-IBA
- Sub-section (3) of section 43CA : Whether payment by journal entries will get the benefit of valuation on date of agreement
 - Sub-section (4) : “Any mode other than Cash”

Section 50C – New Developments

- New provisos w.e.f. A.Y. 2017-18
 - Value as on date of agreement to be taken where there is difference in date of agreement and date of registration
 - Condition : consideration or part thereof has been received by A/c. payee cheque or Draft or ECS on or before the date of agreement
 - Difference between second proviso and 43CA(4) – A/c. payee cheque / Draft / ECS Vs. Other than cash
 - Provisos held to be retrospective – *Dharmshibhai Sonani Vs. DCIT 161 ITD 627 (Ahd.)*
- Amendment by FA 2018 – **w.e.f. A.Y. 2019-20**
 - If Stamp Valuation is not more than 105% of consideration, → no adjustment will be made for computation
 - If variation is beyond 5% - Stamp Duty value will be treated as Consideration – 5% is not a standard deduction

50C – Applicability and Non-Applicability

- Tenancy Right – Kishori Sharad Gaitonde – ITA No. 1561/M/09 Dated 27-11-09 – itatonline.org
- Leasehold Rights – Atul G. Puranik Vs. ITO 132 ITD 499 (Mum). / Greenfield Hotels & Estates P. Ltd. – ITA No. 735/2014 - Bom. HC – Order dated 24-10-16 – itatonline.org
- TDR / FSI – ITO Vs. Prem Ratan Gupta 31 CCH 384 (Mum.)
- Development Rights – Chiranjeev Lal Khanna Vs. ITO 132 ITD 474 (Mum) – Peculiar facts – May not apply to Co. Op. Societies

50C- Applicability ?

- Shares of the company holding immovable property – Irfan Abdul Kadar Fazlani Vs. ACIT 56 SOT 12 (Mum.)
- Impact of Section 50CA and Rule 11UA w.e.f. A.Y. 2018-19
- Depreciable Asset – ITO Vs. United Marine Academy 130 ITD 113 (Mum. SB) – Interplay between Section 50C and section 50
- Slump Sale – Section 50B – Dy. CIT Vs. Summit Securities Ltd. 135 ITD 99 (Mu. SB) - Undertaking as a whole not Land or building or both

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
- 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

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)
 - **CIT Vs. Modipon Ltd. (SC) – itatonline.org - Advance deposit of central excise duty in the Personal Ledger Account (PLA) constitutes actual payment of duty within the meaning of s. 43B and the assessee is entitled to the benefit of deduction of the said amount**
 - **107 Taxmann.com 177 Glaxo Smithkline Consumer Healthcare Ltd. (2019)**
- Both Employer and Employee Contribution is allowable as deduction in the year of actual payment if not allowed earlier – *CIT Vs. Ghatge Patil Transports Ltd. 368 ITR 749 (Bom.)*
- Circular No. WSU/9(1) 2013/ Settlement – Dt. 8-1-16 – Availability of 5 days of grace has been discontinued

269ST Receipt of Cash > 2 Lakhs

- Section 269ST
 - 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 in 269SS/269ST/269T

- 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)
 - **Recently SLP admitted by SC in case of Shakti Foundation 107 Taxmann.com 460 . Though it had rejected an SLP in Adinath Builders earlier. 102 Taxmann.com 57**
- Cash Withdrawn from Bank ? – CBDT Press Release 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.

Clause 31-S 269SS/ 269T/ 269ST

269SS-Receipt
(Cl.a & b)

(a)Receipt of
loans

(b)Receipt of
specified sum

269ST
(Cl.ba to bd)

Cl. ba &bb
Receipt(Above
Rs 2 Lakhs)

Cl. bc & bd
Payment(Above
Rs 2 Lakhs)

269T-
Repayment
(Cl.c)

Repayment of
Loan
Details

269T-
Receipt
Cl. d & e

Receipt of
Loan
given
earlier in
cash or
otherwise
then
account
payee
cheque

Recent Amendment in form 3CD for 269SS/269ST/269T

- New reporting requirement: Consequent to substitution of section 269SS by the Finance Act 2015 including within its scope specified sum receivable in relation to transfer of an immovable property, sub-clause (b) of new clause 31 requires reporting of particulars of each specified sum in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year.

Recent Amendment in form 3CD for 269SS/269ST/269T

- New reporting requirement – The reporting requirement in respect of section 269T was earlier required only in case of the person making the repayment of loan or deposit or any specified advance. Under the new clause 31, reporting is also to be done by the recipient. The recipient has to furnish the name, address and PAN (if available with him) of the payer and the amount of loan or deposit or any specified advance received
- (1) under sub-clause (d), in case the repayment is received otherwise than by a cheque or bank draft or ECS
- (2) under sub-clause (e), in case repayment is received by a cheque or bank draft, which is not an account payee cheque or account payee bank draft.

Clause 21(b) – Disallowance under 40(a)

- In clause (i) details of payment to non resident where TDS is deductible but has not been deducted, or
- Where tax is deducted but not paid to the government before due date provided under S200(1).
- Is the auditor required to disclose all cases where tds is not deducted due to the fact that the tax was not payable as per law?

The auditor is required to consider each payment to see if tax was deductible and report if the same is not deducted or if deducted and not paid. (Disallowance is 100%)

Clause 21(b)-40(a)(ia)

- In case of domestic payments, the auditor is required to report all cases where
 - TDS was deductible but is not deducted, or
 - deducted and not paid before due date of filling return.
- The concept of test check, is it valid?
- Whether all the transactions to be reported or only those on which tds is deducted?
 - Where TDS is not deducted (due to the fact that there is form 15G or 15H or where NIL TDS deduction certificate is issued or payment is below the limit prescribed) is it required to disclosed in the table?

Common errors

- The section 194A –TDS on interest, allows exemption for scheduled banks and cooperative banks.
- Loans from NBFC, Interest and loan processing fees?
- The payment of PMC paid to portfolio manager. Applicable only in certain cases

40(a)(i) – 40(a)(ia)

- Can Auditor rely on Certificates issued u/s. 195 or he should examine all the documents / treaties etc. (AS 600)
- 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)
- 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. – ITA No. 2116 of 2013 – Order dated 8-12-2015 / 94 CCH 148 (Bom.)
 - Sesa Resources Ltd. Vs. DCIT 287 CTR 89 (Bom.)
- Second proviso to Section 40(a)(ia) – If tax paid by the recipient – No disallowance to be made Form 26A
- Amount of Disallowance – Restricted to 30% w.e.f. A.Y. 2015-16
 - Deduction allowed in subsequent year on payment basis – w.e.f. 2015-16 also restricted to 30%
 - Disallowance in earlier year @ 100% and deduction now @ 30%

Clause 32 – Explanation to Sec. 73

- Explanation applies where any part of business of company includes buying and selling of shares of company
- Exceptions carved out
- Amendment – Company whose principle business is trading in shares also covered in exception w.e.f. A.Y. 2015-16
- What about set off of the losses of past in similar transaction – whether speculative or non speculative ?
 - Fiduciary Share & Stock P. Ltd. Vs. ACIT 159 ITD 554 (Mum.)

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

Clause 33 – Chapter VI A

- Section 80-IB – “Derived from Vs. Attributable to”
- Liberty India Vs. CIT 317 ITR 218 (SC) – DEPB Licence not entitled to deduction u/s. 80-IB
- CIT Vs. Meghalaya Steels Ltd. 383 ITR 217 (SC) – Transport subsidies / Power Subsidies / Interest Subsidy
- Excise Duty Refund
 - CIT Vs. Dharmpal Premchand Ltd. 317 ITR 353 (Del.)– Pre Liberty India
 - CIT Vs. Meghalaya Steels Ltd. 332 ITR 91 (Gau.) – Post Liberty India
- Exchange Rate Difference – *CIT Vs. Rachna Udhyog 230 CTR 72 (Bom.)*
- VAT Incentive - M/s. Diamond Tools Industries Vs. JCIT – ITA No. 136/Mum/2009 – Order dated 14-12-2011
- First Degree nexus necessary for claiming deduction

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 / Company(public are not interested)
 - For shares of a Company(public are not interested) for no consideration or inadequate consideration
- 56(2)(x) - Applies to All assesseees for Money / Immovable Property / Other Property

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
- Whether Bonus shares received will be covered
 - CIT Vs. Dalmia Investment Co. Ltd. 52 ITR 567 (SC) – Bonus shares are without payment but not without 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.)

Sec. 56(2)(x) – Rule 11UA Issues

- FMV of unquoted equity shares to be made as per formulae in Rule 11UA(1)(c)(b) - Rule amended w.e.f. 1-4-2018 i.e. A.Y. 2018-19
- Value as per amended Rule = $(A+B+C+D-L) \times (PV) / (PE)$
- If company A's shares are to be valued and Company A holds shares of company B, C & D then the FMV of all these has to be found for valuing shares of A
 - One needs to compute value of each step down companies in the process.
 - Difficulties in cases where shares of many companies are owned by the company whose shares are to be valued.
 - Difficulties in getting the data for the step down companies which are not group companies.
 - No threshold provided – Even if one share of an unlisted company is owned – calculation is necessary

Clause 36A – Deemed Dividend

- New clause 36A requires 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
 - 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.)
 - 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.)
- Advances made in the ordinary course of business for business exigencies
 - CIT Vs. Ambassador Travels P. Ltd. (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.)
- Transactions in the nature of Current Account
 - 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 must be from money lending business
 - ❖ Substantial does not mean More than 50% - If it is not trivial then exception applies – CIT Vs. Parle Plastics Ltd. 332 ITR 63 (Bom.)
- Deemed Dividend u/s. 2(22)(e) brought within the purview of 115O with effect from A.Y. 2019-20 – Will it not be appropriate to call for these details from the auditor of payer companies.

Disallowance 40A(9)

S. 40A(9): The provision is not meant to hit genuine expenditure by an employer for the welfare and the benefit of the employees. Even contributions to unapproved and unrecognized funds have to be allowed as a deduction if they are genuine in nature

- PCIT vs State Bank of India(Bombay High Court)
- CIT vs Bharat petroleum Corporation LTD 252 ITR 43(BOM)
- CIT vs Indian petrochemicals Corporation LTD 261 taxman 251(BOM)

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 – 30th September – whether 44AB violated ?
 - Chandra Kumar Seth Vs. ITO 62 ITD 106 (All.)
 - Chopra Properties Vs. ACIT ITA No. 6199/Del/2015 – itatonline.org

Broad Message.

CA – **C**onsistent **A**chiever

Change is the only constant.

Learn , Unlearn and Relearn



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