DIRECT TAX – RECENT JUDGMENT

CA. Paras Savla, CA. Ketan Vajani

Registration of Trust under section 12AA and section 80G – Misuse of registrations – Cancellation of registration held to be justified

The assessee was a trust registered u/s. 12AA and also section 80G of the Act. A survey was conducted on another entity namely SHGP, who had donated amounts to the assessee trust, u/s. 133A of the Act. During the course of the survey a prima facie information was gathered that the donations given by the SHGP were ploughed back by the assessee trust in cash or by Hawala transactions. The department issued a questionnaire to the assessee trust for making the inquiries in the matter. During the course of reply to the questionnaire, the managing trustee of the trust admitted that a major part of the donations, which were shown as corpus donations, received by the trust during F.Y. 2011-12 and 2012-13 were in the nature of accommodation entries and the trust has made payment to various entities against such donations. The payments made were shown as towards capital expenditure of the trust. The purpose of these accommodation entries was to show higher capital reserve with a view to obtain loan for construction of college building for the trust. On the basis of the replies given by the managing trustee, the CIT (Exem.) cancelled the registration of the trust u/s. 12AA(3) of the Act. The same was also confirmed by the Tribunal also. However, the Calcutta High Court set a side the order of the CIT (Exem) and directed to restore the registration. The High Court held this for the reason that the trust could not have verified the source of the donations given by the donors and was not required to do so. The department has not brought on records material to suggest that the activities of the trust were not genuine.

The judgment of the Calcutta High Court was challenged before the Supreme Court by the department. The Supreme Court held that the answers given to the questionnaire by the Managing Trustee of the Trust show the extent of misuse of the status enjoyed by the Trust by virtue of registration under section 12AA of the Act. These answers also show that donations were received by way of cheques out of which substantial money was ploughed back or returned to the donors in cash. The facts thus clearly show that those were bogus donations and that the registration conferred upon it under sections 12AA and 80G of the Act was completely being misused by the Trust. An entity which is misusing the status conferred upon it by Section 12AA of the Act is not entitled to retain and enjoy said status. The authorities were therefore, right and justified in cancelling the registration under sections 12AA and 80G of the Act.

CIT (Exemptions) Kolkatta Vs. Batanagar Education Research Trust (2021) 129 taxmann.com 30 (SC)

Section 43B : – Debentures issued in lieu of Interest accrued to Financial Institutions – Impact of Explanation 3C to section 43B

For assessment year 1996-97, the assessee claimed deduction of Rs. 2,84,71,384/- under section 43B in respect of the Interest on loans from Financial Institutions. The deduction was claimed based on the issue of debentures in lieu of interest accrued and payable to financial institutions. The Assessing Officer rejected the claim by holding that the issuance of debentures was not as per the original terms and conditions on which the loans were granted, and that interest was payable, holding that a subsequent change in the terms of the agreement would be contrary to Section 43B(d), and would render such amount ineligible for deduction.

The CIT(A) took cognisance of the fact that the original agreement with the financial institutions provided for conversion of 20% of the amount in default into equity at the option of the lender and also provided for repayment of interest and principle as per revised terms and conditions stipulated by the lender at the time of the default. Since the assessee was not in a position to make the payment of interest it had approached the financial institution for rehabilitation plan and the debentures were issued in pursuance of such rehabilitation plan. This amounted to the payment of interest to the financial institution. He accordingly allowed the claim of the assessee which was also confirmed by the Tribunal. The Tribunal observed that the section was introduced to curb the mischief of withholding tax payment by the assessee, while at the same time claiming deduction thereof in the income-tax assessments. But when both the parties, creditor and debtor, agree that the conversion of the outstanding interest liability into fully paid debentures would be accepted by them as discharge of the liability then it is not open to the income tax authorities to say that the interest liability has not been discharged. The Tribunal also observed that unlike the payment for PF / ESIC etc., there was no specific mention as regards the mode of payment in relation to the interest on loans to financial institutions. However, the Delhi High Court allowed the appeal of the

revenue primarily on the basis of Explanation 3C to section 43B which was inserted by Finance Act 2006 with retrospective effect from 1-4-1989. – [CIT Vs. M. M. Aqua Technologies Ltd. (2016) 72 taxmann.com 171 (Del.)]

On appeal by the assessee, the Supreme Court held that the heart of the introduction of Explanation 3C was misuse of the provisions of Section 43B by not actually paying interest, but converting such interest into a fresh loan. On the facts found in the present case, the issue of debentures by the assessee was, under a rehabilitation plan, to extinguish the liability of interest altogether. No misuse of the provision of Section 43B was found as a matter of fact by either the CIT or the ITAT. Explanation 3C, which was meant to plug a loophole, cannot therefore be brought to the aid of Revenue on the facts of this case.

The Supreme Court further held that if there be any ambiguity in the retrospectively added Explanation 3C, at least three well established canons of interpretation come to the rescue of the assessee in this case as under :

- Since Explanation 3C was added in 2006 with the object of plugging a loophole - i.e. misusing Section 43B by not actually paying interest but converting interest into a fresh loan, bona fide transactions of actual payments are not meant to be affected.
- a retrospective provision in a tax act which is "for the removal of doubts" cannot be presumed to be retrospective, even where such language is used, if it alters or changes the law as it earlier stood. For this the Supreme Court relied on its judgment in the case of Sedco Forex International Drill. Inc. v. CIT, (2005) 12 SCC 717
- any ambiguity in the language of Explanation 3C shall be resolved in favour of the assessee

M. M. Aqua Technologies Ltd. Vs. CIT (2021) 129 taxmann.com 145 (SC)

Faceless Assessment Proceedings – Failure to follow Principles of Natural Justice – Section 144B of the Act

During the course of the assessment on the petitioner for A.Y. 2017-18, the assessee received a draft assessment order cum show-cause notice dated 25-3-2021 proposing various additions. The compliance date was given as 26-3-2021. The notice mentioned that the assessee may request for personal hearing through video conferencing. The assessee sought for adjournment since the time allowed was too short for compliance. The assessee also requested for hearing through video conferencing. The assessee also made submissions on 7th April 2021 and 8th April 2021. The assessee again received a draft assessment order dated 22-4-2021 where the assessment unit continued again proposed most of the additions originally proposed. The assessment unit also observed that no further time can be allowed to the assessee for this. The assessee challenged the draft assessment order in a writ petition before the Bombay High Court.

In a detailed order after considering the arguments of both the sides, the High Court held that Sub-section (7) of section 144B provides that in case where variation is proposed in draft assessment order, an opportunity is to be provided to the assessee by serving a notice to show-cause and the assessee or his representative can request for personal hearing so as to make his oral submissions or to present his case before the income-tax authorities in any unit. Further sub-section (7) provides under clause (ix) for hearing through video conferencing. When an assessee approaches with response to show cause notice, the request made by an assessee, as referred to in clause (vii) of sub section 7 of section 144B, would have to be taken into account and the principles of natural justice would have to be followed. Accordingly, the court allowed the petition and stayed the operation of draft order dated 22-4-2021. The court directed that the proceedings shall continue after giving opportunity of hearing to the petitioner.

Piramal Enterprises Ltd. Vs. Addl/Jt. /Dy. / Asst. Commissioner of Income-tax Delhi (2021) 129 taxmann.com 18 (Bom.)

Rule 8D(2)(ii) – No application where interest income outweighs interest expenditure

During the year, the assessee had earned dividend income of which was received from its subsidiary company and from the mutual fund. The assessee had not made any disallowance of expenses u/s. 14A of the Act. The assessing officer made disallowance of Rs. 4,51,72,278/- in pursuance to the provisions of section 14A r.w. rule 8D of the Act which included disallowance on account of interest under Rule 8D(2)(ii) to the extent of Rs. 3,84,43,112/-. The disallowance on account of interest was restricted by the CIT (A) to Rs. 16,86,977/-. On appeal to the Tribunal, the assessee contended that the interest income exceeded interest expenditure claimed in the profit and loss accounts and accordingly since there was no interest expenditure claimed by the assessee in the profit and loss account, no disallowance under Rule 8D can be made in respect of the interest. The assessee relied on the decision of the Gujarat High Court in the case of Pr.CIT Vs. Nirma Credit & Capital (P.) Ltd. (2017) 85 Taxmann.com 72 (Gujarat) in support of this contention. Following the said judgment of the Gujarat High Court the Tribunal allowed the claim of the assessee. On further appeal to the Gujarat High Court, the High Court observed that the view of the Tribunal cannot be faulted with and accordingly refused to admit the question in relation to

the disallowance under Rule 8D(2)(ii). The High Court has admitted the appeal of the department on another question arising out of section 115JB of the Act.

Pr. CIT Vs. Adani Infrastructure & Developers Pvt. Ltd. (2021) 129 taxmann.com 54 (Gujarat)

Service of Notice on deceased person – Validity of Reassessment in pursuance thereof

Ms. KM, the assessee expired on 16-4-2017. Her son Mr. KS informed the assessing officer about her demise vide letter dated 13-6-2017. On 25-3-2019, the assessing officer issued a notice u/s. 148 of the Act in the name of KM. The notice u/s. 148 was followed by certain reminders to the assessee. On 19-12-2019, KS the son of the deceased assessee raised objection against the proceedings interalia on the ground that the notice was issued in the name of the deceased and the fact of the death was intimated to the assessing officer. The assessing officer, however, completed the assessment u/s. 144 r.w.s. 147 of the Act. The assessing officer also brought Mr. KS as the legal heir of the deceased for all the purposes subsequent to completion of the assessment. On writ petition before the High Court, the High Court held that since the fact of death of Ms. KM was known to the assessing officer, the notice issued u/s. 148 was without jurisdiction and consequently all actions taken in pursuance thereof are also without jurisdiction.

K. Suresh Vs. ACIT 129 taxmann.com 67 (Madras)

Consequence of Failure to deduct tax – Section 201 of the Act – Applicability in absence of Income chargeable under the Act

Assessee was a subsidiary of a Japanese holding company. The assessee, in conformity with Accounting Standard 29, had made provision towards marketing, overseas and general expenses during the year on an estimated basis in respect of works/contracts/services, which were in progress of completed but vendor was yet to submit bills to ascertain closest amount of profits/loss. Subsequently, as and when invoices are received from the vendors the invoice amount is debited to provision already made with corresponding credit at the respective vendors account. At this point, the assessee deducted TDS as required under the provision of the Act and remitted the same along with interest to the government. The amounts in respect of which a provision was made and which remained un-utilized was reversed in the books of accounts in the same financial year as the same was not payable to anyone and therefore, no tax could be levied on an amount which was payable to anyone and did not accrue in any income. The assessing officer initiated proceedings u/s. 201 of the Act and held that the assessee should have deducted tax as per the rates applicable under the respective section. He accordingly treated the assessee as Assessee in default in respect of the tax and the applicable interest thereon. The appeal filed by the assessee before the CIT (A) and Tribunal subsequently were dismissed by both the appellate authorities.

On appeal to the High Court, the assessee contended that no tax liability can be fastened on the assessee on account of an entry made in the books of accounts in the absence of any income and a machinery provision in a taxing statute has to be interpreted with reference to the taxing event. It is further submitted that in the fact situation of the case neither provision of Section 201 nor Section 201(1A) could have been invoked. Against this the revenue contended that TDS on the gross amount has to be deducted as soon as the provision is made and on the basis of the entries made in the books of accounts. The High Court referred to the judgment of the Hon. Supreme Court in the case of CIT v. Shoorji Vallabhdas & Co. (1962) 46 ITR 144 (SC) where it has been held that income tax is a levy on income and the Act takes into account two points of time at which the liability to tax is attracted i.e., accrual of income or its receipt but substance of the matter is the income. It has further been held that if the income does not result at all, there cannot be a levy of tax even though in book keeping entry is made about a hypothetical income which does not materialize. The High Court also referred to the judgment of the Delhi High Court in the case of DIT v. Ericsson communications Ltd. (2015) 378 ITR 395 (Del.) for the proposition that in the absence of any accrual of income there is no obligation on the part of the assessee to deduct tax at source. The High Court accordingly held that the assessing officer erred in law in holding that assessee should have deducted tax as per the rate applicable along with interest. The authorities under the Act ought to have appreciated that in the absence of any income accruing to anyone under the Act the liability to deduct TDS on the assessee could not have been fastened and consequently the proceeding under section 201 and 201(1A) could not have been initiated.

Toyota Kirloskar Motor Pvt. Ltd. Vs. ITO (TDS) 128 taxmann.com 266 (Karnataka)

Employees' Contribution to PF / ESIC etc. – Amendment to section 43B and section 36(1)(va) made by the Finance Act 2021 – Prospective in nature

For assessment year 2019-20, the contributions received from Employees towards PF / ESIC etc were deposited by the assessee before the due date of Return of Income as provided u/s. 139(1) of the Act, though beyond the due date as provided in the respective statute. The same was disallowed by the assessing officer and the CIT (A) also confirmed the action of the assessing officer on this point. On further appeal to the Tribunal, the department relied on various judgments of the High Court in support of the disallowance. The SMC

bench of the Tribunal, however, relied on the amendment made to sections 36(1)(va) and section 43B by the Finance Act, 2021 and concluded that the legislature has not only incorporated necessary amendments in Sections 36(va) as well as 43B vide Finance Act, 2021 to this effect but also the CBDT has issued Memorandum of Explanation that the same applies w.e.f. 1-4-2021 only. Keeping in mind the fact that the same has been clarified to be applicable only with prospective effect from 1-4-2021, the Tribunal held that the impugned disallowance is not sustainable in view of all these latest developments even if the Revenue's case is supported by judgments of some of the High Courts on the subject.

Salzgitter Hydraulics Pvt. Ltd. Vs. ITO (2021) 128 taxmann.com 192 (Hyderabad Trib.)

Payments made for surrogacy charges – Applicability of provisions of section 194C, section 194J and section 195 r.w.s. section 40(a)(ia) / 40(a)(i) of the Act

The assessee company was running an infertility clinic. The company made payment to a person to be paid to surrogate mothers. The person was acting as the suppliers of the surrogate mothers. The assessing officer took a view that his services were that of a consultant and accordingly the payments made to him are covered by section 194J of the Act. This was considered as a fees for technical services. The assessee company also made payments to the surrogate mothers for the services rendered by them. The assessing officer treated the payments made to the surrogate mothers as the income in the hands of the surrogate mothers and held that the same is subjected to the provisions of section 194C of the Act. Similarly, some payment was also made to a non-resident for the purpose of arranging for the surrogate mothers. Since the assessee had not made deduction of tax in respect of either of these payments, the assessing officer disallowed both these payments u/s. 40(a)(ia) of the Act. The action of the assessing officer on both the points was confirmed by the CIT (A).

On further appeal to the Tribunal, the assessee contended that the payments to the surrogate mothers are made on behalf of the genetic parents and the assessee is not a party to the transaction between the genetic parents and the surrogate mothers. Accordingly, the provisions of section 194C are not applicable to the assessee. The Tribunal referred to the assessee's sample surrogacy agreement in this regard and observed that the introductory portion thereof duly contains the clause that the same is 'by and among' the genetic parents, surrogate mothers and the assessee in other words. Not only this, 'material breach' clause therein also suggests that it is the infertility centre/physician only 'who shall reimburse intended parents for all sums expended plus interest at the maximum allowable rate'. On the basis of all these clauses, the Tribunal negated the assessee's stand that it is neither a party to the surrogacy agreement nor any right or liability flows thereof on its role as an infertility clinic. Referring to the statement of the person arranging for the surrogate mothers, the Tribunal recorded a finding that although he had been receiving the corresponding amount from the assessee/infertility centre since 2008 through banking channels but he had not maintained any proper account for the corresponding expenditure incurred on surrogate mothers. This payee further admitted that he had entered into an agreement with assessee and also that no surrogate mother had given him any consent for accepting and receiving money on their behalf from the infertility centre. On the basis of this and referring to the entire process of surrogacy, the Tribunal concluded that so far as the application of 194C r.w.s. 40(a)(ia) is concerned, the assessee's all other arguments regarding taxability of the surrogate mothers also deserve to be rejected since its payee himself had admitted that it had not maintained any accounts of the payments made to the surrogate mothers. Thus, the disallowance u/s. 40(a)(ia) in respect of the same was confirmed.

As regards the payment made to the person arranging for the surrogate mothers, the Tribunal gave a finding that no technical service element is involved in all this surrogacy process involving the recipient or the surrogate mothers attracting the clinching statutory expression(s) of managerial, professional and technical services u/s.194J. Thus the Tribunal reversed the action of the lower authorities invoking Section 194J in facts of the instant case. However, the Tribunal made clear that the later adjudication has no bearing on final outcome of the impugned 40(a)(ia) disallowance as the same already stands confirmed u/s.194C of the Act.

As regards the payments made to the non-resident, the Tribunal held that it is clear that the non-resident recipient has not performed any services in India herself even if egg donation activity is taken as a technical service. What all she has done is to arrange overseas egg donor's not on salary or contractual assignment but on free-lancer basis only. There is further no indication that assessee's egg donor payments per head exceed the threshold limit u/s. 194J (1) 1st proviso as well. On the basis of this, the Tribunal concluded that these payments are not taxable in India so as to be held liable for TDS deduction u/s. 195 of the Act. Accordingly, the disallowance in respect of the payments made to the oversees payees was deleted.

The Tribunal also observed that the facts lead to a belief that the poor and destitute women's womb's exploitation is evident herein in most heinous manner. To address this, the Tribunal directed that the CIT-DR shall forward a copy of the detailed discussion to the

Secretary, Ministry of Woman and Child Welfare, Government of India, New Delhi and the corresponding department in the State of Telangana so that such practices are altogether curbed.

Kiran Infertility Central P. Ltd. Vs. ITO (2021) 129 taxman.com 7 (Hyderabad Trib.)