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DIRECT TAX REVIEW

OCTOBER 2015

Inside this edition

TDS to be deducted u/s 194J on doctor's remuneration paid by hospitals and not under 192

Facts of the case

The assessee is a hospital running Indoor and Outdoor Patients departments (IPDs and OPDs) employing professional doctors as employees to provide full time services to the patients as per contract for service and deducted TDS u/s 194J. The AO concluded that there existed an employer and employee relationship between the respondent company and the doctors and held that tax should have been deducted under section 192 of the Act and not under Section 194J of the Act.

Ruling of the High Court

The High Court ruled in favor of the assessee confirming TDS deduction u/s 194J on grounds that the professional doctors are not entitled for LTC, concession in medical treatment of relatives, PF, leave encashment and retirement benefits like gratuity. They are required to follow some defined procedure to maintain uniformity in action and some administrative discipline but this does not mean that they have become employees of the hospital. Further, the department had not taxed the payments received by any of the doctors from the assessee under the head 'income from salary'. On consideration of the agreements, no employer-employee relationship existed between the assessee and the doctors.

Source: CIT vs. Ivy Health Life Sciences Pvt. Limited

High Court of Punjab & Haryana, ITA 42 of 2013

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Year under trial run qualifies as initial AY for section 80IC deduction

Facts of the case

The assessee company has not claimed that its new unit at Dehradun is covered under Section 80IC of the Income Tax Act, 1961 on the basis the unit was under trail run and had not commenced commercial production. The Assessing Officer held that the unit is covered under Section 80IC of the Income Tax Act, 1961 and would have no impact on the taxable income in the year under consideration but would have effect on the remaining year for which the unit would be eligible to claim deduction under Section 80IC of the Income Tax Act.

Ruling of the Tribunal

The Tribunal held that whenever any undertaking or the enterprise begins its commercial manufacturing and production of articles, it comes under the purview of Section 80IC. Though, the assessee company has claimed that it was under trial run and there was no commercial production took place during the year, but the facts are different altogether. The assessee was taking purchase orders from various parties and complying with the said purchase orders in the usual manner and there was no defect or complaint made by the purchasers at any point of time. Huge wastage is not a criteria for determining for non-applicability of 80IC.

Source: ACIT vs. Phonix Lamps India Ltd.

C.O .No.-21/Del/2009 dated 23-10-2015

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HC : Lays down principles for refund adjustment u/s 245, no set-off against stayed demand

Facts of the case

The question under consideration was whether refund was to be adjusted from demand pending in appeal or granted to the assesse where no stay had been requested/ granted but previous appeals were decided in favor of the assessee.

Ruling of the High Court

The High Court held that the officer is duty bound not to invoke Section 245 without application of mind. The relevant considerations, in this case, would be the fact that there is no stay obtained by the assessee in the appeal against the assessment for the year 2015-2016; but that, for the AYs 2010-11 to 2012-13, the Tribunal has ruled in favour of the assessee for the same issue.

If it is found that the issue considered by the Tribunal the above years is absolutely the same in current year particularly when it is not stayed by the High Court in the appeal pending against the same, it may amount to abuse of the discretionary power to satisfy the demand under the assessment order, which, though not stayed, has not been accepted by the assessee, but, instead, challenged before the competent forum. It is for the authority concerned to look into all these aspects and decide whether it should invoke the power under Section 245 of the Act. If it is of the view that the power should be invoked; then alone, in view of the requirement of giving prior intimation, which we have held entails compliance with natural justice, appellants must issue a notice indicating the proposal to invoke Section 245. A decision should be taken after giving an opportunity of being heard to the assessee to refund the amount due, along with due interest within 10 days, or invoke Section 245 for adjustment of the refund with the demand due within a period of two weeks from the date of affording an opportunity to the writ petitioner.

Source: CIT vs. State Bank of India & another

High Court of Uttranchal, Special Appeal No. 525 of 2015 dated 12-10-2015

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Even if a search is declared illegal the material found at the time of search can be utilized for the purposes of assessment, therefore once proceeding under Section 153C was dropped, proceeding u/s 147 could be initiated.

Facts of the case

During search and seizure operations, incriminating material against the assessee was found at their factory premises and also at the premises of one person of 'P' Group. During the course of the proceeding, the ITO had found that the warrant of authorization was issued u/s 132 in the name of a wrong entity, the proceedings initiated u/s 153A was dropped. On the basis of the incriminating material seized at the assesses factory premises, the AO had reasons to believe that some income had u/s 147 should be initiated. Pursuant to the proceeding initiated under Section 147 of the Act, an assessment order was passed.

Ruling of the High Court

The High Court held that it was found that proceeding u/s 153C was initiated on different set of documents and on separate satisfactory note recorded whereas the proceedings which were initiated against the assessee u/s 147 was based on

different set of documents. Assessee was trying to confuse two issues in order to gain undue benefit which cannot be permitted.

It is a settled principle of law that even if a search was declared illegal the material found at the time of search can be utilized for the purposes of assessment. Therefore, the co-ordinated post-search investigation and meaningful assessment has to take place. It may be that on account of search being declared illegal, the block assessment under section 158BC cannot be made but the regular assessment or the reassessment contemplated under the Act can be made. The contention that once proceeding under Section 153C was dropped, proceeding u/s 147 could not be initiated, was patently erroneous.

Source: Shivam Gramodyog Sanstan Vs.Commissioner Of Income Tax High Court Of Allahabad, ITA No. 243 Of 2015 dated 14-10-2015

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Go Green! CBDT's initiative to go paperless to improve taxpayer services

CBDT has gone on board a new initiative to use 'electronic mail' based communication to introduce a paperless environment for carrying assessment proceedings. Accordingly, a pilot project is proposed to be launched in five cities namely, Delhi, Mumbai, Bengaluru, Ahmedabad and Chennai with non-corporate charge, meaning those dealing with assessments of individuals, Hindu Undivided Families and partnerships. Initially,100 cases would be identified for e-hearing in each of these five regions and major part of assessment processing would be conducted in electronic mode and only those cases that had been taken up for scrutiny will be covered under the pilot project. This eliminates the necessity for income-tax payers to make rounds of income tax offices easing the sometimes cumbersome process of assessments without necessitating the physical presence of an officer.

Source: Press Release, Dated: 19-10-2015

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E-verify all returned filed after 01-04-2015

As per the latest release from the income tax department, now all returns which e-filed on or after 01-04-2015 can be e-verified via EVC on the Income Tax Portal. These may be returns pertaining to AY 2014-15 or a return filed in response to any notice or as a condonation of delay under section 119 of the income tax act.

Source: Order, Dated: 06-10-2015

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Business expenditure incurred to keep suspended business alive in the hope of reviving the same, is a business expenditure allowable

Facts of the case

The AO disallowed expenditure incurred on temporarily suspended beverage business with the hope of revival of business.

Ruling of the Tribunal

The Tribunal held citing decisions of the Delhi and Madras High Courts that in case of temporary suspension of business, there was nothing to show that the business had been abandoned permanently and expenditure incurred to keep the business alive in the hope of reviving the same was business expenditure allowable u/s 37(1). The business of beverage unit was temporarily suspended since AY 2002-03 and the assessee was making efforts to settle the dispute with another company for whom the assessee was doing bottling work and had to incur expenditure in question for maintaining the unit in operational condition. The expenditure in question was genuine business expenditure of the assessee. The tribunal accordingly dismissed the appeal of the revenue.

Source: DCIT vs.Dempo Industries Pvt. Ltd.

Panaji Tribunal, ITA 58 & 59/PNJ/2015 dated 07-10-2015

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Addition justified in case where no justification offered on purpose of cash withdrawals and deposits with same bank.

Facts of the case

AO had made addition of cash deposit as unexplained deposit in the bank account to the total income of the assessee on grounds of failure of assesee to give explanation.

Ruling of the Tribunal

The Tribunal held it was found that the assessee has submitted cash deposit and withdrawals statement at the paper book, which shows that the assessee has

shown to have withdrawn the cash by issuing cheques, but it was not clear from the statements that the amounts deposited by the assessee on various dates was the same as withdrawn. Assessee also could not unveil the purpose for which the cash was withdrawn and then the same was deposited with the same bank. It was absurd to believe that somebody will withdraw cash from the bank, keep it idle with him and then deposit the same in the bank, particularly when no purpose for withdrawal was declared by the assessee before the authorities below. Accordingly, the appeal of the assessee was dismissed.

Source: Maninder Singh Bedi vs. ACIT

ITAT, Delhi, ITA No. 5118/Del./2012 dated 05-10-2015

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Clarification on Measurement of the distance for the purpose of section 2(14)(iii)(b) of the income-tax act for the period prior to assessment year 2014-15

Throwing light on the provisions of section 2(14)(Iii)(B), CBDT in its circular dated 06-10-2015 clarified that measurement of distance from the municipal limits for the purpose of this section to

ascertain whether a given land is agricultural or not prior to AY 2014-2015 will be the shortest road distance measure and not the aerial measuring. The circular comes as clarification and acceptance of the many court cases which had taken a similar stance recently.

Source: Circular No. 17/2015, Dated: 06-10-2015

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CBDT accepts Bombay HC order allowing cost of production of abandoned feature film as revenue expenditure

Providing major relief for Film Producers, CBDT has explained that Rule 9A treating cost of production of films as capital expenditure does not apply in the case of abandoned films and accordingly, the expense incurred in such cases is allowable as revenue expenditure. The circular comes in compliance with the decision of the Bombay High Court in the case of Venus Records and Tapes Pvt. Ltd. ITA 310 of 2013. ***Source: Circular No. 16/2015, Dated: 06-10-2015***

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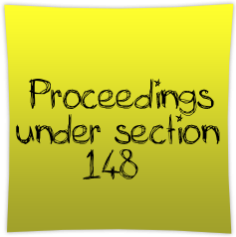
Reassessment merely on basis of information received from Investigation Wing without independent application of mind annuls jurisdiction to reopen the assessment u/s 147/148. No addition can be made in absence of credible evidence to prove that entries pertaining to the loan from third party were bogus or accommodation entries.



Facts of the case

The case was re-opened by the AO u/s 148 based on information received from the Investigation Wing that the assessee had obtained accommodation entries from certain entry operators during the relevant period. The AO recorded as a reason to believe that the income of the assessee for AY 2001-02 had escaped assessment. An assessment order making addition on account of unexplained cash credit in the name of third party was made. Both, CIT(A) and the Tribunal ruled in favor of the assessee. Issue was whether the AO could assume jurisdiction to reopen the assessment based on the information received from the Investigation Wing of the department?

Ruling of the High Court

The High Court held that it was now well settled that the AO can reopen the assessment if he has reason to believe that the assessee's income had escaped assessment. However AO's reasons to believe must not be based on surmises, conjectures or occasioned by change in opinion but must be based on some tangible and credible material on the basis of which a reasonable belief could be formed that income of an assessee has escaped assessment. Also, the material on which the AO forms his opinion must not be the same material which had been considered at the time of the initial assessment, as in that case, the proceedings u/s 147 would amount to reviewing the assessment order merely on a change of opinion, which is not permissible.

As the AO did not confront the assessee with any new material or examine any other evidence other than what was already available in the initial assessment period. The AO had not applied his mind to the material available including the records of the earlier assessment proceedings. Indisputably, the entries relating to funds availed by the assessee from third party during the relevant year had been scrutinized by the AO during the regular assessment proceedings and had been explained by the Assessee. It was impermissible for the AO to reopen the assessment unless the AO, on the basis of credible and tangible material, which was not in his possession during the initial assessment, believes that income of the assessee has escaped assessment

Further, addition was made to the taxable income of the assessee as unexplained credit u/s 68. Although the AO had reopened the assessment, the AO did not produce any material or confront the Assessee with any credible evidence that could lead to the inference that the entries pertaining to the loan from third party were bogus or accommodation entries. In the absence of such material, it was clearly not permissible for the AO to take a view contrary to one taken by the AO during the initial assessment. Assessee on the other hand produced ample evidence to indicate that the entries in question were genuine. On examination of the evidence, the CIT(A) rightly came to the conclusion that no addition u/s 68 in respect of the transaction was sustainable.

Source: Commissioner Of Income Tax Vs.Multiplex Trading & Industrial Co. Ltd. High Court Of Delhi, ITA 356/2013

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No addition against lower generation of scrap when scrap generation was less in comparison to the upward growth in GP rate.

Facts of the case

Assessee declared scrap sale whose ratio to sales dropped in current year as against the previous year. AO, noticing a drop in the scrap sale, made an addition by applying percentage to total turnover for the year.

Ruling of the Tribunal

The Tribunal held that scrap was ordinarily considered with reference to production and percentage of scrap to production may not remain consistent over the years. The way in which addition was made by the AO was not proper. AO had gone by the percentage of scrap sale to turnover, which was not a relevant factor. If the gross profit rate of the assessee was better than that of the preceding year, but, the generation of scrap was less, there cannot be any separate addition for lower generation of scrap because this would show the higher economies availed by the assessee due to better performance or good quality of raw material etc. When the gross profit rate itself had registered an increase of over 1 percent in the current year, then no addition on account of lower scrap sale could be made as a percentage of turnover.

Source Hema Engineering Industries Ltd. Vs ACIT

ITAT Delhi Tribunal, ITA No. 1027/Del/2013, dated 23-10-2015

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AO cannot make fresh inquiry for entries in books of accounts when books in accordance with Companies Act

Facts of the case

Question under consideration before the court was that whether the AO was empowered to disallow depreciation where as per section 115J, the net profit shown in PL account was in accordance with part II and III of Schedule VI to Companies Act, 1956 but not in consonance with 350 of Companies Act and disallowed depreciation.

Ruling of the High Court

The High Court held that net profit shown in the profit and loss account of the company was prepared in accordance with Parts II and III of Schedule VI to the Companies Act. Once this finding had been given, the Assessing Officer could not go behind the net profit shown in the profit and loss account except to the extent provided in the Explanation to Section 115J of the Act. The provision of Section115J does not empower the Assessing Officer to embark upon a fresh inquiry in regard to the entries made in the books of account of the company. The Supreme Court had categorically held in Apollo Tyres Case that there cannot be two incomes, one for the purpose of the Companies Act and another for the purpose of income-tax.

Source: CIT vs J.K Synthetics Ltd.

High Court of Allahabad, ITA 451 Of 2009 dated 01-10-2015

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Revised and Updated Guidance for Implementation of Transfer Pricing Provisions

The Central Board of Direct Taxes (CBDT) has issued Instruction No. 15 of 2015 on 16 October 2015. This instruction replaces Instruction No. 3 of 2003 which had been issued by CBDT on 20 May 2003. The old instruction had been issued to provide guidance to Transfer Pricing Officers (TPO) and Assessing Officers (AO) to operationalize the transfer pricing provisions and to ensure procedural uniformity. However, due to a number of legislative, procedural and structural changes carried out over the last few years, the old instruction is being now replaced with the new one to provide updated and adequate guidance in relation to international transactions. The new instruction mentions that similar guidance is also under consideration by CBDT for specified domestic transactions. The major modifications made by the new instruction are as follows:

Transfer pricing Scrutiny

There is now no requirement of selecting or referring a case for transfer pricing scrutiny on the basis of the value of international transaction(s), because transfer pricing cases are now being selected for scrutiny on the basis of risk parameters. The only exception to this would be in a case where the AO comes to

know that the taxpayer has entered into an international transaction(s), but has either not filed an Accountant's Report (AR) under section 92E of the Act, or not declared the transaction(s) in its AR. In such a case, irrespective of the value of international transactions, the AO may refer the matter to the TPO after giving an opportunity of being heard to the taxpayer. It may be noted that the new instruction specifically mentions that this guidance would also apply in case of specified domestic transactions.

Reference to TPO

Where an AR has been filed by a taxpayer, the AO can (as he could earlier), on the basis of details provided in the AR, arrive at a prima facie belief that a reference to the TPO is necessary. However, in a few situations, before making a reference to the TPO or determining arm's length price (ALP) on his own, the AO must, as a jurisdictional requirement, under section 92CA(1) of the Act under section 92C(3) of the Act record his satisfaction (after giving an opportunity of being heard to the taxpayer) that there is an income or a potential of an income arising and / or being affected on the determination of ALP. These situations are as follows:

- where the taxpayer has not filed an AR, or not declared international transactions, but the international transactions come to the notice of the AO
- where the taxpayer has declared the international transaction(s) in the AR filed by it, but has made certain qualifying remarks to the effect that the said transaction(s) are not international transactions, or they do not impact the income of the taxpayer.

If no objection is raised by the taxpayer to applicability of Chapter X (sections 92 to 92F) of the Act, then the AO's view would be sufficient before making a reference to the TPO. However, where any objection is raised by the taxpayer on the applicability of Chapter X of the Act, then such objections should be considered and specifically dealt with.

Prior approval for Passing TP Assessment Order

If a TPO is the rank of an Additional / Joint Commissioner of Income-Tax (CIT),

then he shall obtain approval of the jurisdictional CIT (TP) before passing the TP assessment order. On the other hand, if a TPO is the rank of a Deputy/ Assistant CIT, then he shall obtain the approval of the jurisdictional Additional/ Joint CIT before passing the TP assessment order.

Limiting the number of cases per TPO

The jurisdictional CIT (TP) would assign a limited number of important and complex cases, not exceeding 50, to the Additional/ Joint CIT (TPOs) working in the same jurisdiction. Appropriate guidelines shall be framed for selection of such important and complex cases.

Rational step towards qualitative assessments

So far, selection of cases based on a monetary threshold has led to a significant number of cases being selected for TP audits. As a result, the focus had shifted

from a quality investigation to quantity investigations, the repercussions of which were evident in cumbersome audits, both for taxpayers and revenue authorities. Therefore, introduction of risk based scrutiny is a very rational step taken by the Indian Government which will certainly streamline the TP audit process. With such an enormous dispute resolution burden, coupled with growing pendency of cases and already strained Revenue resources, risk based selection of cases for TP audits was undoubtedly called for. Revenue authorities will now hopefully spend less time and costs on too many audits and valuable time of the judiciary will be effectively spent on meaningful cases. Taxpayers can also now focus their energies on high risk areas and deploy their own risk assessment techniques in order to strengthen their documentation and defense files such that they are able to effectively manage compliance. However, the choice and transparency around risk parameters would determine how this policy change would be implemented on-ground.

Situations in which AO must record his satisfaction before reference to TPO

The CBDT acknowledges that there could be situations where taxpayers either do not file an AR, or do not declare a transactions in their AR, or declare the transaction with qualifying statements to the effect that the transaction is itself not an international transaction, or that no income arises therefrom. To address these situations, the CBDT has put the onus on the AO to put on record why he believes that the international transactions impacts, or has the potential to impact income. This would provide the taxpayer with an additional opportunity to present its position, and may prevent occurrence of unwarranted litigation, provided AOs are given sufficient guidance to implement this, as such issues have, in the past, been highly debated at higher judicial fora. This is undoubtedly a very rational and legally appropriate approach adopted by the CBDT, which will serve as a reminder for the tax authorities that TP is not beyond fundamentals of taxation. On an overall basis, this approach also ties in with the underlying intent of the Indian TP regulations, i.e., that of avoiding erosion of tax base in India. The fact that the onus has been put on the AO to record why he believes that an international transaction impacts or has the potential to impact income, provides testimony to the fact that the Indian Government is putting in checks and balances to avoid arbitrary use of authority by first level assessing officers. This may also prevent taxpayers from being saddled with unnecessary adjustments and protracted litigation thereafter, at least on issues relating to applicability or otherwise of Chapter X per se. This is yet another welcome move by the Government to invigorate the investment climate in India.

Source: Instruction No. Oct 14, 2015 of 2015 dated 16-10-2015

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