

A.C. BHUTERIA & Co.

CHARTERED ACCOUNTANTS

16, STRAND ROAD
DIAMOND HERITAGE, ROOM 703
KOLKATA - 700001

PH: 033-46002382/ 40042183
EMAIL: INFO@ACBHUTERIA.COM

www.acbhuteria.com

Direct Tax Newsletter

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- **CBDT Extends Time Limit To Process Refund Claimed ITRs for AYs 2018-19 to 2020-21 to January 31, 2024 : F. NO. 225/132/2023/ITA-II dated 01-12-2023**

1. Loss Claimed in Belated ITR to be C/F; AO to Disallow Set Off in Subsequent ITRs in which it was Claimed

In the instant case¹, the assessee filed its return of income declaring total income at NIL and claiming to carry forward the current year's business losses claimed under section 35AD. The return was filed after the expiry of the due date of furnishing of the original return. While processing the return of income under section 143(1), the Assessing Officer (AO) denied business losses to be carried forward as the return was filed belatedly.

Assessee contended that the language provided in section 80 was "carry forward and set off". Therefore, these phrases must be co-jointly read and cannot be segregated. It is only in the year in which the assessee claims the set-off that the provisions of Section 80 may be invoked by the AO in the subsequent assessment year.

The matter reached before the Chandigarh Tribunal.

The Tribunal held that Section 73A(2) provides that any loss computed with respect to any specified business referred to in section 35AD that has not been wholly set off shall be carried forward to the following assessment year. It shall be set off against the profits and gains of any specified business carried on by him assessable for that assessment year. The right of the assessee to carry forward and set off losses has been made subject to provisions of Section 80 of the Act.

Section 80 provides that no loss which has not been determined in pursuance of a return filed as per

section 139(3) shall be carried forward and set off under section 73A(2). Section 139(3) provides that where a person has incurred a loss in any previous year under the head "profits and gains of business or profession" and claims that such loss should be carried forward in terms of section 73A(2), he may furnish the return of income within the time prescribed u/s 139(1) of the Act.

In the instant case, there were two aspects of the matter. Firstly, the determination of loss of the specified business by the AO and the carry forward of the said losses to the subsequent assessment year. The AO for the impugned assessment year has to determine the loss from the specified business and notify the same assessee of accepting the loss as claimed by the assessee or suggesting any variation thereof.

For the carry forward of loss, the Tribunal held that there was no legal and justifiable basis for the AO/CPC to deny the assessee the carry forward of current year business loss of specified business for being set off against eligible profits in the subsequent years. It is for the AO examining the return of income for the subsequent year where the assessee seeks set off of the brought forward losses to take into consideration whether the return of income for the year of incurrance of losses of the specified business has been filed within prescribed due date or not and then, take appropriate action as per law.

Therefore, the Tribunal set aside the original order and directed the AO/CPC to allow the carry forward of losses.

¹ International Fresh Farms Products India Ltd vs. ITO - [2023] (Chandigarh - Trib.)

2. No Disallowance u/s 40A(2)(b) on Interest Paid to Related Party Without Comparing It With FMV of Rate of Interest

In the instant case², the assessee was a wholesale and distributor of mobile phones and accessories. During the assessment proceedings, it was observed that the assessee has paid interest at a rate ranging from 9% to 18% on the unsecured loans. It was further observed that the assessee had paid interest at 18% to a related party as per section 40A(2)(b) on an unsecured loan taken and repaid during the year.

Contending the provisions of section 40(b)(iv), which restricts allowance of payment of interest to the partner of the firm to 12% per annum, the Assessing Officer (AO) held that interest payment above 12% to related parties is squarely hit by the provisions of section 40A(2)(a). Accordingly, interest payment over 12% was disallowed, and additions were made to the assessee's income.

On appeal, CIT(A) upheld the additions made by the AO. Aggrieved by the order, the assessee filed an appeal before the Mumbai Tribunal.

The Tribunal held that as per section 40A(2)(a), if, in the opinion of the AO, the payment made by the assessee to any related person is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made, so much of the expenditure as is considered excessive or unreasonable by the AO shall not be allowed as deduction. Therefore, the AO is required first to determine the fair market

value of the goods, services or facilities for which the payment was made.

However, in the instant case, the Assessing Officer considered the interest rate as allowed under section 40(b)(vi), wherein payment of interest to any partner is allowed up to 12 per cent, as the fair market value of the rate of interest.

Thus, without finding the comparative fair market value of the rate of interest for the loan taken by the assessee, the AO proceeded to make the part disallowance.

Therefore, while partly disallowing the interest paid by the assessee, AO had not followed the provisions of section 40A(2)(a). Accordingly, there was no basis in upholding the partial disallowance of interest payment made by the assessee, and the same is directed to be deleted.

3. Net Profit Declared By Assessee to Be Accepted by AO If He Didn't Dispute Audited Financial Statement

In the instant case³, the assessee, an individual engaged in business, e-filed its return of income. The case of the assessee was selected for limited scrutiny through CASS because large amounts of cash were deposited in bank accounts. The Assessing Officer (AO) issued notices under sections 143(2) and 142(1) and called for the details of the bank account.

In response, the assessee furnished a detailed statement explaining the source of cash sales made during the year. The AO accepted the details but noticed that the assessee had filed ITR-3, claiming it to be a non-account case despite a turnover of

² Genxt Mobile LLP vs. ACIT - [2023] (Mumbai-Trib.)

³ D.M. Kathir Anand v. N.S. Phanidharan, Assistant Commissioner of Income-tax - [2023] (High Court of Madras)

approximately Rs. 14.28 crores. The AO applied Section 44AD and estimated net profit at 8% of gross receipts, adding to the assessee's income.

On appeal, CIT(A) confirmed the additions of AO, and the matter reached the Kolkata Tribunal.

The Tribunal held that the assessee had achieved a turnover of Rs. 14.28 crore during the year, and in the preceding year, the total turnover was Rs. 16.20 crore. The net profit rate declared in the audited financial statement for the year under appeal was 2.5% against 1.26% in the preceding financial year.

Regarding section 44AD, the same relates to a special provision for computing profits and gains of business on a presumptive basis in the case of an eligible assessee engaged in an eligible business. As per the Explanation to section 44AD, eligible business consists of

(i) any business except the business of plying, hiring, or leasing goods carriages referred to in section 44AE; and

(ii) whose total turnover or gross receipts in the previous year does not exceed an amount of two crore rupees.

Because the assessee's turnover was Rs. 14.29 crore, the provisions of section 44AD cannot be applied in the assessee's case. Regarding estimating profits, complete details of the audit report under section 44AB were available, wherein the assessee stated that it was covered under section 44AB and that a Chartered Accountant had audited books of account.

The facts were very much available in the income tax return copy placed before the AO. He ought not to have directly resorted to the provisions of section 44AD. He should have examined the tax audit report and, if necessary, should have

converted the limited scrutiny to complete scrutiny. He then conducted the assessment proceedings to examine the complete books of account. If any discrepancy could have been noticed, then the estimation of profits could have come into the picture.

The assessee maintained proper audited books of account. Without disputing the audited financial statement, the AO unreasonably estimated a net profit rate of 8%, while the declared rate by the assessee was 2.5%. Accordingly, the additions were deleted.

4. Deduction Under the Income-tax Act is Allowable If Assessee Claims it Following AS Prescribed by ICAI

In the instant case⁴, the assessee was engaged in the business of providing hire purchase and finance. It had claimed deduction for transfer to lease equalization charges from the lease rental. Assessing Officer (AO) disallowed the claim of the assessee.

On appeal, the CIT(A) upheld the disallowance made by AO which was further confirmed by the Tribunal. Aggrieved-assessee filed the instant appeal before the High Court.

The High Court held that the issue was no longer *res integra* as the same had been answered by the Supreme Court in CIT v. Virtual Soft Systems Ltd. (2018) 6 Supreme Court Cases 584. In the decision, the Supreme Court examined the guidelines issued by the Institute of Chartered Accountants of India (ICAI). Also, it referred to section 211 of the Companies Act, 1956 to emphasize that Accounting

⁴ [Sehgal Easing Nvestments Ltd. v. DCIT - \[2023\] \(Telangana\)](#)

Standards prescribed by ICAI shall prevail until the Central Government prescribes them.

The Supreme Court held that the accounting method derived from the ICAI Guidance Note is valid for capturing real income based on the substance of the finance lease transaction. The rule of substance over form is a fundamental principle of accounting.

The Supreme Court held that the bifurcation of the lease rental is, by no stretch of imagination, an artificial calculation. Thus, lease equalization is an essential step in the accounting process to ensure that real income from the transaction in the form of revenue receipts only is captured for the purposes of income tax.

Further, the assessee is entitled to bifurcation of lease rental as per the accounting standards prescribed by the ICAI. Moreover, the IT Act has no express bar regarding applying such accounting standards. That being the position, the Tribunal was not correct in law in disallowing the lease equalization charge claimed by the assessee.