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Direct Tax Newsletter

October 23, 2023

CBDT Notifies Form No. 56F to Be Furnished by Assessee Claiming Deduction u/s 10AA

Time Limit for Processing of All Validly Filed Returns Up to AY 2017-18 with Refund Claims Extended to 31-01-2024

1. Assessee Can Adopt Provisions of Act for One Source of Income and Apply DTAA Provisions for Another Source

In the instant case[1], the Assessee-company, a tax resident of Mauritius, was engaged in investment activities in India through the Foreign Direct Investment Route or through subsidiaries. During the year, it had earned gains and incurred losses on the alienation of shares of Indian companies.

It had claimed Short Term Capital Gain (STCG) as exempt from tax in India in accordance with article 13(4) of the India Mauritius DTAA. It sought to carry forward the Long Term Capital Loss (LTCL) under section 74(1).

The Assessing Officer (AO) rejected the assessee's claim, observing that since capital gains derived by the assessee in India were exempt, the question of carrying forward capital losses from similar transactions doesn't arise.

On appeal, the CIT(A) upheld the decision of the AO. Aggrieved by the order, an appeal was filed to Mumbai Tribunal.

The Tribunal held that with regard to Choice of Act or Treaty Provisions is qua stream of Income, in terms of section 90(2), the assessee is eligible to apply the provisions of the Act or the Treaty, whichever is more beneficial to it. As per Article 13 of the India-Mauritius Treaty, gains derived by a resident of Mauritius from the alienation of shares shall be taxable only in Mauritius.

It is observed that the classification of capital assets between long-term and short-term is determined depending on the holding period. Further, taxation of Short Term Capital Gain (STCG) and Long Term Capital Gain (LTCG) is also governed under different sections being 111A in case of STCG and 112/112A in respect of LTCG. Accordingly, the scheme of the Act itself recognizes STCG/STCL and LTCG/LTCL to be separate and distinct sources of Income.

This distinction is highlighted upon perusal of section 70 governing intra-head set-off of current-year losses. Section 70 clarifies that the STCL can be carried forward or adjusted intrahead while the LTCL can be carried forward, but intra-head adjustment cannot be made against the STCL/STCG. Therefore, the Legislature has kept this difference in carry forward and intra-head adjustment separate for LTCG/LTCL and STCG/STCL.

On further perusal of section 70 to section 74, it can be seen that the Legislature has recognized LTCG/LTCL and STCG/STCL as two distinct sources owing to computational dissimilarities. Accordingly, the assessee, under the provisions of section 90(2), is eligible to claim the beneficial provisions of the Treaty in respect of STCG and with regard to LTCL, the assessee has the option to apply the provisions of section 74, accordingly chose to carry forward LTCL.

Therefore, the assessee was allowed to claim beneficial provisions of the India-Mauritius DTAA in respect of STCG and carry forward the LTCL as per section 74.

[1] **Indium IV (Mauritius) Holdings Ltd. V. DCIT - [2023] (Mumbai-Trib.)**

2. Section 269SS Does Not Apply to a Cash Loan Obtained by a Company from Its Director

In the instant case[2], Assessee-company received loans in cash from its director to purchase lands in its name. Assessing Officer (AO) issued a notice seeking an explanation for receipt of a loan over Rs. 20,000 otherwise than by Account payee Cheque/Bank Draft in contravention of provisions of section 269SS.

In response, the assessee contended that it did not have any bank account at the given time, and the land sellers were residing in remote places and insisted on cash payments. However, AO considered invoking section 269SS and continued to levy penalty under section 271D.

On appeal, the CIT(A) sustained the penalty levied by the AO. Aggrieved by the order, the assessee filed an appeal to the Chennai Tribunal.

The Tribunal held that section 273B deals with reasonable cause. If there is a reasonable cause in accepting loans in violation of provisions of section 269SS, then such transactions need to be taken out of the rigorous of section 271D. The assessee's explanation needs to be considered to consider whether there is a reasonable cause in violation of relevant provisions. If the assessee's explanation is bonafide and reasonable, then said explanation needs to be considered in light of reasonable cause as provided under section 273B.

In the instant case, based on the assessee's explanation, there appeared to be a reasonable cause for accepting a loan from the director in contravention of provisions of section 269SS for two reasons. Firstly, the entire amount of the loan was utilized to acquire capital assets for the business of the company. Secondly, the assessee and the director both had disclosed transactions in their books of accounts for the relevant previous year. Further, the director explained the loan source given to the assessee.

Since, all these paramount's were satisfied, the genuineness of the transactions was not in doubt. Moreover, it was a case of loan between the director and the company. Although the company and its director were separate legal entities, they cannot be considered separate for these transactions. If there are transactions between the company and director, then said transactions inter-se cannot be considered as loans or deposits within the meaning of section 269SS. This principle was also supported by the decision of the Delhi High Court in the case of CIT v. M/s. Muthoot Financiers in ITA No. 336/2002, dated 3-2-2015.

Therefore, it was opined that the transactions between the assessee and director were in the nature of current account transactions, which did not come under the purview of loan and deposit as per section 269SS. Accordingly, the penalty levied under section 271D was deleted.

3. Annual Licence Fee Paid by Airtel to DoT is a Capital Expenditure Amortizable Under Section 35ABB

In the instant case[3], the assessee company was engaged in the business of telecommunication services and value-added related services. It initially

[2] **Thamira Green Farm (P.) Ltd. v. Additional Commissioner of Income-tax - [2023] (Chennai-Trib.)**

[3] **Commissioner of Income-tax v. Bharti Hexacom Ltd. - [2023] (SC)**

procured a licence from the Government for telecommunication services under the 1994 agreement, which New Telecom Policy, 1999 subsequently governed. In terms of the licence agreement, the assessee had to pay an entry fee payable up to 31-7-1999, and, thereupon, the licence fee was payable as a percentage of gross revenue under the licence effective from 1-8-1999.

The Delhi High Court apportioned the licence fee as partly revenue and partly capital by dividing the licence fee into two periods, i.e. before and after 31-7-1999. Accordingly, it was held that the licence fee paid or payable for the period up to 31-7-1999, i.e., the date set out in the Policy of 1999, should be treated as a capital expense, and the balance amount payable on or after the said date should be treated as a revenue expense.

On appeal, the Supreme Court held that as per the Policy of 1999, there was to be a multi-licence regime since any number of licences could be issued in a given service area. Further, the licence was for a period of twenty years instead of ten years as per the earlier regime. The migration to the Policy of 1999 was on the condition that the entire policy must be accepted as a package, and consequently, all legal proceedings and disputes relating to the period up to 31-7-1999 were to be closed. If the migration to the Policy of 1999 was accepted by the assessees herein or the other service providers, then all licence fee paid up to 31-7-1999 was declared as a one-time licence fee as stated in the communication dated 22-7-1999 which was treated to be a capital expenditure.

The licence granted under the Policy of 1999 was non-transferable and non-assignable. More importantly, if there was a default in the licence fee payment, the entire licence could be revoked after sixty days' notice.

The view of the Delhi High Court was not right in apportioning the expenditure incurred towards establishing, operating and maintaining telecom services as partly revenue and partly capital by dividing the licence fee into two periods, that is, before and after 31-7-1999 and holding that the licence fee paid for the period upto 31-7-1999 should be treated as capital and the balance amount payable on or after the said date should be treated as revenue.

The nature of payment being for the same purpose cannot have a different characterisation merely because of the change in the manner or measure of payment or, for that matter, the payment being made on an annual basis. Therefore, the nomenclature and the manner of payment are irrelevant.

The payment post 31-7-1999 was a continuation of the payment pre 31-7-1999, albeit in an altered format, which does not take away the essence of the payment. It was a mandatory payment traceable to the foundational document, i.e., the license agreement as modified post-migration to the 1999 policy. The consequence of non-payment would result in the ouster of the licensee from the trade. Thus, this is a payment which is intrinsic to the existence of the licence as well as trade itself.

Accordingly, variable annual licence fees paid by the assessees to the DoT under the Policy of 1999 are capital in nature and may be amortised in accordance with section 35ABB.

4. No Section 40A(2) Disallowance Without Examining Qualification, Experience, and Work Profile of Related Parties

In the instant case[4], during the year under consideration, the assessee paid salaries to its relatives specified under Section 40A(2). Meanwhile,

[4] **Mehra Jewel Palace (P.) Ltd. v. Principal Commissioner of Income-tax - [2023] (Delhi)**

in the assessment proceedings, the AO called upon the assessee to justify the payments made to specified persons. Unsatisfied with the explanation, AO made additions to the income of the assessee.

The matter reached the Delhi High Court.

The High Court held that the assessee tried to justify the payment of salaries to the persons concerned. No evidence at all was adduced before any of the authorities by the assessee regarding the educational qualification, experience, and work profile of any of the persons concerned, which could be taken as their contribution to the growth of the business of the assessee.

The provision under Section 40A(2)(a) of the Act clearly shows that before recording disallowance, AO has to form an opinion regarding the legitimate needs of the business or benefit derived or even what would be the fair payment outgo for services rendered. Such an opinion cannot be arrived at without adducing necessary evidence. Thus, AO was duty-bound to provide an opportunity for the assessee to place on record the requisite evidence to justify its claim.

But all that the AO did was to ask the assessee to justify the salaries paid and, without seeking relevant evidence, simply rejected the claim.

Therefore, the assessee must be granted an opportunity to adduce appropriate evidence, documentary or otherwise, before the AO to establish its claim regarding educational qualification, experience, work profile, and, in particular, the duties discharged by the concerned persons to justify the claim of the assessee with respect to payment of salary to the persons concerned.