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Direct Tax Newsletter

Sep 18, 2023

NEWS FEED

- **CBDT Notifies 'Multi Commodity Exchange Investor (Client) Protection Fund Trust' for Sec. 10(23EC) Exemption**
- **CBDT Notifies 'Units of Investment Trust & EFTs of IFSC' for Sec. 47(viiab) Exemption**

1. Cognizant's Rs. 19,000 Crores Buyback via Court-approved Scheme is a Colourable Device; DDT Leviable

In the instant case[1], the assessee-Cognizant Technology had purchased its own shares from non-resident shareholders in a 'Scheme of Arrangement & Compromise' sanctioned by the High Court of Madras in terms of provisions of Section 391-393 of the Companies Act, 1956.

In accordance with the scheme, the assessee purchased 94,00,534 equity shares from its shareholder at the price of Rs.20,297/- per share and paid a total consideration of Rs.19,080.26 crores.

The share capital of the assessee company was held by four non-resident shareholders, out of which three shareholders are residents of the USA, and one shareholder is a tax resident of Mauritius. The net effect of the scheme was that post-sanction of the scheme, the only shareholder left was Cognizant Mauritius Ltd.

Assessing Officer (AO) held that consideration paid by the assessee to its shareholders for the purchase of its own shares was liable to tax as deemed dividend under section 2(22)(d). Consequently, the assessee was liable to pay Dividend Distribution Tax (DDT) under section 115-O.

On the other hand, the assessee submits that 'Scheme of Arrangement & Compromise' was sanctioned by the High Court of Madras in terms of Sections 391 to 393 of the Companies Act, 1956. It cannot be considered as buyback of shares in terms of provisions of Section 77A or reduction of capital in terms of Sections 100-104/402 of the Companies Act, 1956.

On appeal, the CIT(A) upheld the findings of AO. The matter reached before the Tribunal.

The ITAT held that :

A. Applicability of section 2(22)(d)

Two essential prerequisites must be satisfied in order to come within the ambit of section 2(22)(d), i.e., there must be a distribution to the shareholders on the reduction of the capital and further, it must be to the extent that the company possess accumulated profits.

In the present case, it was evident from the audited financial statement that the share capital has been reduced by around Rs.9.4 Crs. equivalent to 54.70% of the total paid-up share capital.

The Supreme Court, in CIT v. G. Narasihan 236 ITR 327, has clarified that Section 2(22)(d) is automatically attracted once these parameters are satisfied. Further, Clause 7 of the scheme clarifies that the distribution of money will be out of the general reserves and accumulated credit balance in the profit and loss account. Thus, both conditions are satisfied to treat the transaction within Section 2(22)(d).

B. Purchase through offer and acceptance is also "distribution"

Assessee also argued that the scheme of purchase of own shares was made through offer and acceptance. This involves an element of quid pro quo, and thus, there was no 'distribution of the purpose of section 2(22)(d).

[1] M/s. Cognizant Technology-Solutions India Pvt. Ltd., Vs. ACIT - [2023] (Chennai-Trib.)

The Tribunal held that the definition of 'distribution' does not contain any aspect of quid pro quo or lack thereof. The prerequisites for distribution are that there must be payment, and the disbursal must be made to more than one person. Section 2(22)(d) does not distinguish whether the reduction of share capital is the intended result of the resultant consequence of the scheme.

C. Purchase of own shares would be "reduction of capital" if it is not buyback

The assessee's transaction would either fall under section 391-393 r.w.s. 77 and Sec.100 of the Companies Act, 1956 or sections 391- 393 r.w.s. 77A of the Companies Act, 1956. The scheme clearly states that it is not a buyback under section 77A.

Therefore, once the assessee states it is not buyback under section 77A, it should automatically fall back to section 77 r.w.s sections 100-104 of the Companies Act, 1956. If said sections are applied, then said transaction was nothing but the reduction of capital and distribution of accumulated profits.

D. Reduction of capital vs. Buy Back

The assessee also contended that Section 115QA was amended in 2016, and the present transaction would only be taxable per the amended provisions.

The arguments of the assessee were not accepted for two reasons. Firstly, there is a distinction between the purchase of own shares upon reduction of share capital and buyback. Buyback' is a term used only in respect of transactions covered u/s 77A. If all conditions of Section 115-O r.w.s. 2(22) are satisfied; the same cannot be impliedly excluded based on the amendment to Section 115QA.

E. Scheme was a colourable device to try to avoid payment of tax

The assessee claims to have implemented the scheme to rationalize its shareholding and capital structure. The four reasons given were that:

(i) To increase earnings per share;

(ii) To streamline corporate ownership;

(iii) To optimize the overall capital structure and

(iv) To reduce the risk in terms of foreign currency fluctuations in respect of rupee funds.

On closer examination of the scheme's true purpose, it becomes evident that it primarily serves two objectives: (i) transferring the capital base of the company to shareholders based in Mauritius and (ii) distribution of the company's accumulated profits to non-resident shareholders, all while avoiding the scope of any provisions related to the taxation of payments made for the purchase of its own shares.

It was undoubtedly clear that the scheme was only a colourable device intended to evade legitimate tax dues.

2. Extended Time Limit Provided by TOLA isn't Applicable for Sanction of Notice u/s 151

In the instant case[2], the assessee was a Non-Banking Finance Company and classified as an Asset Finance Company. On June 2021, it received Section 148 notice stating that there was reason to believe that income chargeable to tax for AY 2016-2017 had escaped.

Later, Assessing Officer (AO) referred order of the Supreme Court in the case of Union of India vs. Ashish Agarwal (2022) 138 taxmann.com 64 (SC) and treated section 148 notice as show cause notice in terms of Section 148A(b). Later, an order was passed under section 148A(d).

Assessee contented that the Finance Act 2021 amended section 151, which provides for sanction for issue of notice. AY 2016-2017, three years elapsed on 31st March 2020; hence, the provisions of amended Section 151(i) and 151(ii) would have to be fulfilled, which have not been complied with. The matter reached before the Bombay High Court.

The Bombay High Court held that the Taxation and Other Laws (Relaxation and Amendment of certain provisions) Act, 2020 [TOLA] provided for a relaxation of certain provisions of the Income-tax Act, 1961. Where any time limit for completion or compliance of an action, such as completion of any proceedings or passing of any order or issuance of any notice, fell between the period 20th March 2020 to 31st December 2020, the time limit for completion of such action stood extended to 31st March 2021.

Thus, TOLA only seeks to extend the limitation period and does not affect the scope of section 151. AO cannot rely on the provisions of TOLA and the notifications issued thereunder as Finance Act, 2021, amended section 151, and the provisions of the amended section would have to be complied with by AO, w.e.f., 1st April 2021.

Hence, the Assessing Officer cannot seek to take the shelter of TOLA as subordinate legislation cannot override any statute enacted by the Parliament. Further, the notification extending the dates from 31st March 2021 till 30th June 2021 cannot apply once the Finance Act 2021 is in existence.

The sanction of the specified authority has to be obtained in accordance with the law existing when the sanction is obtained; therefore, the sanction must be obtained by applying the amended section 151(ii). Since the sanction was obtained in section 151(i), the impugned order and notice were bad in law and should be quashed and set aside.

3. Recovery from Director Couldn't be Made Without Indicating What Steps Were Taken to Trace Assets of Co.

In the instant case[3], the deceased assessee was a director of a company. An assessment order was passed, making several additions to company income and tax demand. The stay application filed by the company was rejected. Thereafter, an order under section 179 was passed upon the assessee raising tax demand from him.

[2] Siemens Financial Services (P.) Ltd. v. DCIT - [2023] (High Court of Bombay)

[3] Manjula D. Rita v. Principal Commissioner of Income-tax - [2023] (High Court of Bombay)

The assessee filed a revision petition against said order passed under section 179, which was rejected. Assessee writ petition before the Bombay High Court.

The Bombay High Court held that there was no evidence to indicate even any notice was issued to the deceased. The affidavit stated that only letters were issued through speed post, and the same were not returned undelivered. Thus, the Assessing Officer (AO) attempted to find out the whereabouts of the assessee.

There was no evidence annexed to show that even such a letter was prepared or the letter was sent by speed post, or a query was sent to the Post Master to find out the status of the delivery of the said letter. In the circumstances, the Court will have to proceed because no letter or notice was sent to the deceased before the order under section 179 came to be passed.

There is also nothing to indicate what steps were taken to trace the company's assets. Moreover, the order passed under section 179 does not satisfy any of the ingredients required to be met. Further, the deceased has not even been allowed to establish that the non-recovery cannot be attributable to any of the three factors on his part, i.e., gross neglect, misfeasance or breach of duty. The gross negligence, etc., is to be viewed in the context of non-recovery of tax dues of the company and not with respect to the general functioning of the company.

Once the director, after being given an opportunity, places material on record to establish that non-recovery cannot be attributed to gross negligence, misfeasance or breach of duty, the Tax Recovery Officer must apply his mind and come to definite findings. Therefore, considering the facts of the case, the order passed for commencing proceedings under section 179 upon the assessee was to be quashed and set aside.

4. Provision Made in Respect of Payment to be Made to Employees Based on Co's Financial Performance is to be Allowed

In the instant case[4], during the year under consideration, the assessee made a provision in respect of payment to be made to the employees. Such payment was made based on the employee's performance. The assessee paid 80% of the performance pay as an incentive, and the remaining 20% is paid based on the company's financial performance.

Considering such payment as a contingent liability, the Assessing Officer (AO) disallowed the provision made by the assessee in respect of payment to be made to employees. Assessee argued that it was a liability which the company would know at the time of closure of books of account, i.e., on 31st March of the relevant financial year. Thus, the disallowance of the provision was incorrect.

The matter then reached the Karnataka High Court.

The High Court held that the objection raised by the AO that there are possibilities of employees leaving the company and not getting paid was untenable. The percentage of the employees leaving their employment will be minimal, and in such an event, the assessee was duty bound to reverse the entry in the following year.

Since the provisions made were ascertained figures, the disallowance made by the AO and confirmed by

[4] **CGI Information Systems and Management Consultants (P.) Ltd. v. Income-tax Officer - [2023] (High Court of Karnataka)**

the two authorities was perverse and unsustainable.