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Direct Tax Newsletter

Tax Digest

- Recent case laws

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INCOME TAXATION REGIMES LIKELY TO BE SIMPLIFIED AND LOWERED IN UPCOMING BUDGET

As the Indian economy grapples with the problem of flagging consumption, policymakers in the government are in favour of rationalising the existing income tax structure, especially at lower income levels. Discussions have taken note that the rise in marginal income tax is "too steep" in the existing tax structure.

A relief is likely in the upcoming Budget for taxpayers in the lowest slab owing to high level of inflation in the country.

Source: indianexpress.com ; hindustantimes.com

1. Reassessment Justified if AO Ignored Provisions of Sec. 14A and Circular No. 5/2014 While Completing Assessment

In the instant case[1], the petitioner was the proprietor of M/s. Greenland Condiments. He was also the managing director of a limited company that was involved in manufacturing wood, cork, straw, and plaiting materials. The petitioner filed returns of his income for the relevant assessment years.

Subsequently, the case was reopened under Section 147, and the assessment was completed by disallowing the interest paid on the loan availed for investment in the company in which the petitioner was the Managing Director. Such disallowance was made by the Assessing Officer (AO) by invoking Section 14A.

Aggrieved by the order, the petitioner filed a writ petition to the Kerala High Court.

The High Court held that section 14A had been amended with effect from 01.04.2022 by the Finance Act 2022. Before the amendment was incorporated, Circular No. 5/2014 clarified the position that in certain cases, where no income has been earned by an assessee who has been claimed as exempt during the financial year under Section 14A, the said expenditure would be disallowed even when the taxpayer in a particular year had not earned any income.

Section 14A was added by the Finance Act, 2001, with retrospective effect from April 1, 1962, and was amended in 2007 and again in 2022 by introducing a non-obstante clause for clarification. Subsections (2) and (3) were added by the Finance Act, 2006, effective from April 1, 2007, requiring that if the Assessing Officer (AO) is not satisfied with the accuracy of the assessee's claim regarding expenses related to income that does not form part of the total income under the Act, AO shall determine the amount of such expenditure using a prescribed method.

Further, rule 8D of the Income Tax Rules, 1962, prescribing the methodology for determining the amount of the expenditure in addition to income not includible in total income, was inserted with effect from 24-3-2008 to implement sub-sections (2) and (3) of section 14A. It is a clear indicator that a new method for computing the expenditure was brought in by the Rules, which was to be utilised for computing the expenditure for the assessment years 2007-08 and onwards.

In the instant case, the AO had disallowed the interest the assessee paid on loans from Banks as business expenditure. The assessee had claimed a deduction of interest paid to the Bank on property loan. The said amount also included the interest paid on the loan availed for investment in the petitioner's other business concern.

If the assessments concluded are not in accordance with the law, it is not a change of opinion but a valid reason for reopening the assessments. The AO had ignored the mandatory provision of Section 14A and Circular No. 5/2014 while completing the assessments, which were reopened.

Therefore, the AO had not committed an error of law or jurisdiction, and accordingly, the writ petition was dismissed.

2. ITAT Set-aside Order Passed by Addl. CIT as No Separate Order Was Passed Authorizing Him to Perform Functions of AO

[1] T.K.Salim vs. Union Of India - [2024] (High Court of Kerala)

In the instant case[2], the assessee raised additional grounds challenging the jurisdiction of the Additional Commissioner of Income Tax (Addl. CIT) in passing the assessment order under section 143(3). The assessee contended that the Addl. CIT was not authorized to issue the assessment order. It was submitted that the Addl. CIT passed the assessment order without the jurisdiction conferred on him vide order under section 120(4)(b) and also in the absence of an order transferring the jurisdiction under section 127.

The matter then reached before the Mumbai Tribunal.

The Tribunal held that the term "Assessing Officer" has been defined under section 2(7A) of the Act. According to Section 2(7A), the Addl. CIT can exercise the powers of the Assessing Officer under the Act if the direction in this respect has been issued under section 120 (4)(b) of the Act. As per section 120(4)(b) of the Act, CBDT may, by general or special order, empower the authorities mentioned under the provision to issue orders in writing that the powers and functions assigned to the Assessing Officer shall be exercised or performed by the Addl. CIT.

In the instant case, the assignment orders have neither been furnished to the assessee nor been placed on record. Thus, nothing has been brought on record to suggest that the ACIT was authorized to perform the functions and exercise the powers of an Assessing Officer in the assessee's case.
Further, the assessee can question the jurisdiction of the Assessing Officer only within one month after the receipt of notice under section 142(1) or section 143(2) or after the completion of the assessment, whichever is earlier.

[2] Tata Steel Ltd. v. ACIT [2024] (Mumbai-Trib.)

However, said time limit for objecting to the jurisdiction of AO prescribed under section 124(3) relates to AO's territorial jurisdiction. The time limit would not apply to a case where the assessee contends that the action of AO is without authority of law.

Therefore, in the absence of separate orders passed under section 120(4)(b) authorizing the ACIT to perform the functions and exercise the powers of an Assessing Officer, and also in the absence of an order transferring the jurisdiction under section 127, the assessment order was passed without any jurisdiction.

3. HC Justified Invoking GAAR as Issuance of Bonus Shares Was an Artificial Arrangement to Avoid Tax Obligations

In the instant case[3], the assessee sold the shares of a company to a private limited company. Before the sale, the company issued bonus shares to its shareholders. Due to the issuance of bonus shares, the face value of each share of the company was reduced. The sale of shares resulted in a short-term capital loss to the assessee.

The assessee set off the short-term capital loss against the long-term gains made on another transaction of the sale of shares. The Assessing Officer (AO) treated said transaction as an impermissible avoidance arrangement as per the General Anti-Avoidance Rules (GAAR) under Chapter X-A starting from Section 95-102 of the Income Tax Act.

Assessee filed writ petition before the Telangana High Court.

[3] Ayodhya Rami Reddy Alla v. PCIT - [2024] (High Court of Telangana)

Assessee contended that the transactions resulting in bonus stripping were subject to the specific provisions of Section 94(8), which is a Specific Anti Avoidance Rule (SAAR). Any loss incurred on account of the purchase and sale of shares, resulting in bonus stripping, must be computed as per Section 94(8). However, the AO sought to treat the transactions as impermissible avoidance arrangements as per the GAAR.

Assessee also relied upon 2012 Shome Committee Report. It was submitted that the Committee have recommended that where SAAR is applicable to a particular transaction, then GAAR should not be invoked to look into that element.

The High Court held that the assessee's argument was rooted in the belief that the Specific Anti Avoidance Rules (SAAR), particularly Section 94(8), should take precedence over the General Anti Avoidance Rule (GAAR). This contention, however, was fundamentally flawed and lacked consistency.
Given the multiple transactions that the taxpayer had undertaken, the case should fall under the umbrella of Chapter X-A and not Chapter X. Section 94(8) might be relevant in a simple, isolated case of the issuance of bonus shares, provided such issuance has an underlying commercial substance. However, this provision did not apply to the current case, as the issuance of bonus shares here was evidently an artificial avoidance arrangement that lacked any logical or practical justification.

It was clear that the assessee's arrangement was primarily designed to sidestep tax obligations in direct contravention of the principles of the Act. The landmark Vodafone judgment provides crucial insight into this issue. The judgment implies that the business intent behind a transaction could be strong evidence that the transaction isn't a deceptive or artificial arrangement. The commercial motive behind a transaction often reveals the true nature of the transaction.

The GAAR chapter, which comprises sections 95 to 102, provides a detailed account of various types of transactions that could be considered illegal tax avoidance arrangements. This Chapter lists these transactions and provides an extensive definition of conditions that render a transaction or arrangement devoid of commercial substance.

Furthermore, Section 100 of this Chapter clarifies that this Chapter is applicable in addition to or as a substitute for any other existing method of determining tax liability. This provision emphasizes the legislative intention that the GAAR provisions should act as an all-encompassing safety net. It's designed to capture all illicit arrangements, ensuring that tax on these arrangements is calculated using the provisions of this Chapter.

Further, the Committee's stance that SAAR should generally supersede GAAR mainly pertains to international agreements, not domestic cases. This stand, as per the report, is further substantiated by the Finance Minister's declaration, made on January 14, 2013. During this announcement, the Minister stated that the applicability of either GAAR or SAAR would be determined on a case-by-case basis.

Therefore, the assessee's contention that the case should have otherwise fallen under Section 94(8) was not acceptable. It was clear and convincing that the entire arrangement was intricately designed to evade tax. Assessee, on his part, hadn't been able to provide substantial and persuasive proof to counter this claim. Accordingly, the writ petition was dismissed, and AO was allowed to proceed.

4. No TDS on Interest Part Allowed to Be Retained by NBFC on Loans Purchased by SBI Under Direct Assignment Route

In the instant case[4], the assessee-State Bank of India, a public sector bank, purchased loans from Non-Banking Financial Companies (NBFCs) through the Direct Assignment route. The assessee purchased 90% of the pool of assets at a reduced interest rate. The remaining 10% interest was retained by the NBFCs.

The Assessing Officer (AO) contended that the interest retained by the NBFCs should be considered as the assessee's income. Thus, the assessee should have deducted tax at source under section 194A.

On appeal, the CIT(A) held that the part interest retained by the NBFCs on the 90% pool purchased by the assessee was for the services rendered by the NBFCs to the assessee. Therefore, the tax must be deducted under sections 194A, 194J or 194H. The matter was reached before the Mumbai Tribunal.

The Tribunal held the assessee purchased a part of the loan by making the upfront payment and allowing the originating NBFCs to retain part interest on such loan paid by the borrowers. There was no material available to show that the assessee borrowed any funds or incurred any debt from the NBFCs. Therefore, the part interest allowed to be retained back with the originating NBFC cannot be said to be interest within the meaning of section 2(28A) of the Act. Thus, the assessee was not obligated to deduct tax at source under section 194A.

Further, when a specific tripartite agreement was entered into between the parties, requiring payment of service fees to the NBFC for various services rendered, and the issue was not the determination of the arm's length price of these service fees, the interest retained by the NBFC in respect of the pool of assets purchased by the assessee could not be considered fees for services rendered by the NBFC. Therefore, the assessee had no liability to deduct TDS under section 194J on such amounts.

Since the NBFC was not acting as an agent of the assessee with respect to loans advanced to borrowers, there was no requirement for the deduction of tax at the source under section 194H.

[4] Lava International Ltd. v. Central Board of Direct Taxes - [2024] (High Court of Delhi)