



**J. B. Nagar CPE Study Circle  
of WIRC of ICAI**

**Legal Issues in Tax Audit**

**CA Ketan Vajani**

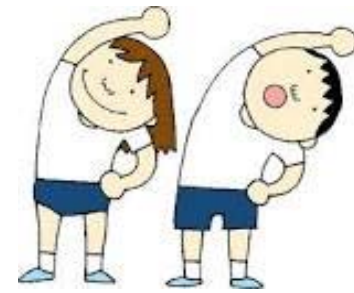
**[caketanvajani@gmail.com](mailto:caketanvajani@gmail.com)**

**21<sup>st</sup> November, 2021**

# Proposed Coverage

- ▶ Applicability of Tax Audit vis-à-vis presumptive tax provisions
- ▶ Amendments to Form 3CD as carried out in 2018 – Select clauses of significance
- ▶ Relevant Amendments by Finance Act 2021 and Finance Act 2020
- ▶ Some regular legal issues that arise

# Let's Warm Up ....



- ▶ Purpose of Tax Audit
- ▶ Scope of Tax Audit
- ▶ Relevance of Accounting and Auditing Standards and Principles of commercial accounting
  - Materiality
  - Prudence
  - Substance Vs. Form
- ▶ ICDS notified in September 2016 applicable from A.Y. 2017-18
- ▶ Concept of Test Check
- ▶ True & Fair Vs. True & Correct
- ▶ Guidance Note issued by ICAI – Implementation Guide issued on 23-8-18

# Applicability of Tax Audit

- ▶ Section 44AB – Amendments by FA 2020 and FA 2021
- ▶ Proviso to 44AB (a) – Conditional Relaxation of ceiling to 5 Cr / 10 Cr
  - Aggregate of all amount received **including** Sales /Turnover / Gross Receipt in cash – Not to exceed 5% of said amount
  - Aggregate of all payments **including** expenditure in cash – Not to exceed 5% of said Amount
- ▶ Including Includes what ?
  - Cash introduced / withdrawn by partners
  - Withdrawals / Deposits from bank
  - Loans accepted or repaid
  - Debtors / Creditors transactions
  - Sale /Purchase of Fixed Assets
- ▶ **FA 2021 Amendment – A cheque which is not A/c. Payee deemed to be in cash – Implication of this**
- ▶ No Change in limit for Professionals – 50 Lakhs

# Applicability of Audit

S 44AB(a) Business other than 44AD	S 44AB(b) Profession	S 44AB(c) Business under (S. 44AE, 44BB, 44BBBB)	S 44AB(d) Profession (other than 44ADA)	S 44AB(e) Business covered u/s 44AD(4)
<p>If Turnover or gross receipts exceeds Rupees 1 Crore.</p> <p><u>From A Y 2021-22</u></p> <p>The limit has been increased to 10 Cr. For persons who have less than 5% of receipts and 5% of payments</p>	<p>If Gross Receipts exceed INR 50 lakhs.</p>	<p>If profit offered to tax is lower than the profits or gains so deemed to be the profits and gains of his business under the S 44AE, 44BB &amp; 44BBB</p>	<p>Profits offered by a person is lower than the profits so deemed to be the profits and gains of his profession u/s 44ADA</p>	<p>If provision of 44AD(4) is applicable and the income exceeds the maximum amount not chargeable to tax in the previous year</p>

# Applicability to Partner of a Firm

- ▶ Section applies to Every person carrying on business or profession
- ▶ Difference between carrying on business and income assessed under head of P & G of B or P
- ▶ Sales / Turnover / Gross Receipts – Principle of Eiusdem Generis
- ▶ CIT Vs. R.M. Chidambaram Pillai 106 ITR 292 (SC) – Salary is profit known by different name – Prior to 1992 amendment
- ▶ Contra Decisions of Tribunal on the subject
- ▶ Anandkumar Vs. ACIT 430 ITR 391 (Mad.) – 44AD – Interest and Remuneration cannot be said to be gross receipts to be eligible under section 44AD
- ▶ Bonafide view – Sec. 273B – Reasonable cause

# S 44AD(4) (From A Y 2017-18)

Where an eligible assessee declares profit for any previous year in accordance with the provisions of this section

**AND**

He declares profit for any of the five assessment years relevant to the previous year succeeding such previous year not in accordance with the provisions of sub-section (1)

- Then : Not eligible to claim benefit of this section for 5 A.Y.s subsequent to AY in which the profit has not been declared in accordance with the provisions of sub-section (1). [Example : If default in A Y 2020-21 then will not be able to claim benefit till 2025-26]

# § 44AD (5)(From A Y 2017-18)

An Eligible Assessee to whom sub sec. (4) applies

**AND**

Whose total income exceeds the maximum amount which is not chargeable to tax

- ▶ Then : Assessee will have to maintain books as per Sec. 44AA(2) and get his books of accounts audited as provided under section 44AB.

Issues :

- ▶ Partnership Firms in Loss ?
- ▶ As provided in Sec. 44AB – what about cases less than 1 Cr ? – Sec. 44AB (e) – meaning of eligible business as per section 44AD



# Examples

Turnover of the assessee A Y 20-21	90,00,000/-	90,00,000/-	1,50,00,000/-
Profit percentage	5%	4%	2%
Total Income	3,50,000	5,00,000	200,000
Exemption claimed under section 44AD from A Y 17-18	Yes	No first year of business	Yes
Audit Applicable u/s 44AB	Yes [44AB(e)] as the assessee falls under 44AD(4)/(5)	No. Not covered by 44AD(4) nor by 44AB	Yes. Since T/o is less than 2 Crores, Sec. 44AD will independently apply

# Examples

Turnover of assessee for A Y 20-21	95,00,000/-	1,75,00,000/-	1,95,00,000/- (No cash receipts or payments )
Profit %	3%	1%	4 %
Total Income	-150,000	3,50,000 (including interest 1,75,000)	7,00,000
Exemption claimed under S 44AD from A Y 2017-18	Yes	Yes	Yes
Audit applicable u/s 44AB	No. As the income is not higher than the maximum amount not chargeable to tax	Yes . S 44AD(4)/(5)	Yes. S 44AD(4)/(5) Benefit of provisio to 44AB(1) not available.

The Hon'ble Kerala High Court had made a very interesting observation on Income Tax Laws

[Kanan Devan Hills Plantations Company Pvt. Ltd. Vs ACIT (Kerala High Court)]

"The Income Tax Act is one enactment that can shatter anybody's linguistic confidence or competence. Each provision—inevitably, though—runs into pages, superordinate, subordinate, and sub-subordinate clauses piling up in syntactic curlicues. With annual addition, the provisions lose coherence and defy comprehension.

Neither a lawyer nor a Judge can claim with comfort, if not with confidence, that he could comprehend the provision at least on a rereading; the taxpayer is surely lost in in a maze of meandering phrases.

It is therefore time for the Revenue to host on their website a plain English version of the enactment—only a suggestion, however."

# Amendments to Form 3CD – 2018

## ▶ Amendments to Existing Clauses

- Micro Amendments
- Substantial Amendments
  - Clause 31 – Section 269ST
  - Clause 34(b) – TDS Compliance

## ▶ New Clauses Added

- Clause 29A – Sec. 56(2)(ix)
- Clause 29B – Sec. 56(2)(x)
- Clause 30A – TP Adjustments – Sec. 92CE
- Clause 30B – Section 94B– Limitation on Interest Deduction
- ~~▪ Clause 30C – GAAR – Section 96 – Deferred~~
- Clause 36A – Deemed Dividend – Section 2(22)(e)
- Clause 42 – Form No. 61 / 61A / 61B
- Clause 43 – Sec. 286 – Country by Country Reporting
- ~~▪ Clause 44 – Break up of Total Expenditure – Registered Dealer / Not Registered Dealer under GST – Deferred~~

# Implementation Guide – Preamble



- ▶ The audit is in respect of profits & gains of business or profession
- ▶ The reporting requirements under clauses relating to heads other than “profits and gains of business or profession” can be only in relation to entries made in books of account
- ▶ Reporting requirement does not extend to transactions not recorded in books of account
- ▶ As per Para 11.10 of the Guidance Note on Tax Audit particulars in Form 3CD are the responsibility of the assessee and the tax auditor is merely verifying the correctness of the particulars
- ▶ Tax Audit is also subject to Peer Review hence auditor is required to retain working papers and other documents that demonstrate the work done by him and support the stand taken by him while reporting



WE DO NOT  
ACCEPT CASH

# Clause 31 – Section 269ST

- ▶ Receipt of Amount exceeding 2 Lakhs
  - Otherwise than by cheque or draft or Electronic clearing system – 31(ba)
  - If cheque / DD is not account payee cheque – 31(bb)
- ▶ **Payment of Amount** exceeding 2 Lakhs in violation of Section 269ST
  - Otherwise than by cheque or draft or Electronic clearing system – 31(bc)
  - If cheque / DD is not account payee cheque – 31(bd)
- ▶ Similarly clause (d) and (e) requires reporting which affects the opposite party
  - **Repayment made** by assessee's borrower – Section 269T

# Clause 31 – Details Required

- ▶ Name, Address and PAN (if available with assessee) of payer / receiver
- ▶ Nature of Transaction (*See Note below*)
- ▶ Amount of Receipt / Payment
- ▶ Date of Receipt / Payment (*See Note below*)

*Note : Nature of Transaction and Date of Transaction not required where the transaction is by cheque / draft but not account payee cheque / draft*

# Restriction on Cash Transactions



- Section 269ST – w.e.f. 1-4-2017
  - Receipt of an amount of Rs. 2 Lakhs or more prohibited Otherwise than –
    - Account Payee cheque / draft / Electronic clearing system
  - In aggregate from a person in a day
    - Different bills totalling to Rs. 2 Lakhs or more
  - In respect of a single transaction
    - A bill more than 2 Lakhs – payment on each day less than 2 Lakhs in cash
  - In respect of transaction relating to one event / occasion from a person
    - *Same person receiving more than Rs. 2 Lakhs by cash in respect of a single event.*
    - *Type of product or services may be same or different.*



# Restriction on Cash Transactions



- Excluded–
  - Receipts by Government,
  - Receipts by any banking company, post office savings bank or co-operative bank
  - Transactions of the nature referred to in Sec. 269SS
  - Any other person or class of persons to be notified – Notification No. 57 Dt. 3-7-2017 (Mainly banking Industry)
- Relaxation
  - For NBFC and Housing Finance Companies – Each Installment is a transaction – Circular No. 22 Dt. 3-7-17
- Section 271DA
  - Penalty equal to amount of receipt
  - No penalty if proved that there are good and sufficient reasons for contravention – Proviso to 271DA – also section 273B
  - Penalty to be levied by Jt. Commissioner

# Issues ????



- Transactions by Journal Entries
  - CIT Vs. Triumph International Finance Ltd. ITA No. 5745 of 2010 (Bom. HC)
  - CIT Vs. Noida Toll Bridge Co. Ltd. (2003) 262 ITR 260 (Del.)
  - CIT Vs. Bombay Conductors & Electricals Ltd. (2008) 301 ITR 328 (Guj)
  - **Implementation Guide : Such adjustments are not receipt / payment under section 269ST – Need not be reported but suitable note may be given**
- Cash Withdrawn from Bank ?
  - Notification No. 28/2017 Dt. 5-4-17
- Partnership and Partners
  - Cash withdrawn from partnership firm for Drawings or otherwise
  - Cash brought in by partners as capital
  - Cash taken for Expense purposes – Balance to be replenished.



# Issues ????



- Cash Gift Received
  - From Relatives
  - At the time of marriage
  - From Non relatives but source can be explained
- Cash received by cultivators
  - Circular No. 27 Dt. 3-11-17 says no violation if it is less than 2 Lakhs
- Jewellery purchased from time to time by a person from jeweller for wedding
- Sale of Capital Assets

# Clause 31 – Impl. Guide



- ▶ Government Vs. Government Company
  - No reporting required in case of receipt from / payment to a government company (due to language of Note below clause 31)
  - For payments made to government – no disclosure – give a suitable note
- ▶ No difference between revenue and capital account
- ▶ For clauses 31(bb) and 31(bd) – in absence of evidences the guidance given under para 49.6 of guidance note under similar circumstances shall apply here also
- ▶ Information to be retained in working paper for all clauses is given in Implementation guide

# Section 269SS and 269T – Other Issues

- ▶ Loan in the name of a deceased person – Transferred in the names of Legal Heirs
  - Whether this is repayment of loan and acceptance of fresh loan ?
  - Whether to be reported
  - How to be reported
- ▶ Conversion of Loan into Debentures / Shares
  - Whether violation of sec. 269T ?
  - Whether to be reported
  - How to be reported

# Clause 34(b) – Amendment

- ▶ Information required about the statement of TDS / TCS like Type of Form, Due Date of Furnishing, Actual Date of Furnishing etc.
  - Post 2018 amendment Information is required to be given once the assessee is required to furnish the statements of TDS / TCS – even if Statements filed in time
- ▶ Prior to 2018 – Tax Auditor was only required to state whether all the transactions which are required to be reported are reported or not in the TDS statement – Yes or No

# Clause 34(b) – Amendment

- ▶ Tax Auditor will also need to prepare a comprehensive list of all the transactions which were required to be reported but not actually reported.
- ▶ What about the concept of Test Check ??
- ▶ Whether all the transactions have to be reported here or only the transactions in which TDS is deducted ?
  - No Deduction due to certificates / Forms
  - No Deduction due to threshold limit not exceeded

# Clause 34(b) – Impl. Guide



- ▶ The auditor should take into consideration relevant sections, rules, notifications, circulars and various judicial pronouncements in relation to transactions of relevant payments or collections. – As stated in Para 59.2 of Guidance Note on Tax Audit
- ▶ If tax auditor does not agree with the interpretation/view taken by the auditee, → Report about the views as observation in clause (3) of Form No. 3CA or clause (5) of Form No. 3CB, as the case may be.



# New Clause 29A – Sec. 56(2)(ix)

- ▶ Section 56(2)(ix) : Forfeiture of Advance received for Transfer of Capital Asset where transfer eventually does not take place is IFOS – Inserted w.e.f. A.Y. 2015–16
- ▶ Clause 29A – Details required for such forfeiture – Nature of Income and amount to be reported.
- ▶ Clauses 28, 29, 29A, 29B etc. expands the Scope of Tax Audit to Income from Other Sources
  - Preamble to Implementation Guide restricts the reporting requirements
- ▶ How to detect that an amount has been forfeited in absence of accounting entry ?
- ▶ Year of taxability of long standing credit

# New Clause 29A – Implementation Guide



- ▶ No reporting required for forfeited amount in respect of a **personal capital asset** where no entries are recorded in the books of account.
- ▶ Reporting required only if an advance is outstanding for a **considerable period of time**.
- ▶ No reporting unless it is forfeited by an act of the assessee – Should be a **positive Act**
- ▶ No reporting required for Forfeiture of amount in respect of **stock in trade** – will get covered u/s. 28(i)
- ▶ There should be a **right to forfeiture** as per the contract – Unilateral write back without such right will not be valid forfeiture

# New Clause 29A – Impl. Guide



- ▶ A mere notice of forfeiture contested by other party will not amount to forfeiture
- ▶ If not written back by assessee – not to report giving stand of the assessee
- ▶ Where contingencies that permit forfeiture has occurred but yet assessee contends that amount is not forfeited then the auditor shall look at **totality of developments** and may obtain MR.
- ▶ Write back without forfeiture – Generally unlikely – Auditor should use professional judgment

# Sec. 56(2)(x) – Statutory Amendments

- ▶ Section 56(2)(x) : Merger of Erstwhile Section 56(2)(vii) and 56(2)(viia) w.e.f. 1-4-17
- ▶ 56(2)(vii)
  - Applicable to Individual / HUF
  - For Money / Immovable Property / Other Property for no consideration or inadequate consideration
- ▶ 56(2)(viia)
  - Applicable to Firm / CHC
  - For shares of a CHC for no consideration or inadequate consideration
- ▶ 56(2)(x) – Applies to All assesseees for Money / Immovable Property / Other Property

# Clause 29B – Sec. 56(2)(x)

- ▶ Earlier clause 28 – covered details of transactions u/s. 56(2)(viia) – 56(2)(vii) not to be reported
- ▶ Clause 29B – Details to be given for Incomes referred in sec. 56(2)(x)
- ▶ Nature of Income and amount to be reported.
- ▶ Expands scope of reporting to cases hitherto covered by 56(2)(vii)
- ▶ Change in Permissible variation from AY 2020–21
  - 20% if the transaction covered by 43CA(1) 2<sup>nd</sup> proviso – AY 21–22
    - Residential unit
    - Transaction between 12–11–2020 to 30–6–2021
    - First Allotment
    - Consideration < 2 Crores
  - 10% in other cases

# Sec. 56(2)(x) – Issues

- ▶ Whether fresh issue of shares is covered
  - Khoday Distilleries Ltd. Vs. CIT 307 ITR 312 (SC) – Allotment of shares is appropriation out of unappropriated share capital – Does not amount to transfer
  - Transfer Vs. Receipt Vs. Allotment of Shares
- ▶ Whether Bonus shares received will be covered
  - CIT Vs. Dalmia Investment Co. Ltd. 52 ITR 567 (SC) – No payment Vs. No Consideration
- ▶ Whether Right Shares subscribed at less than FMV will be covered
  - Proportionate allotment
  - Disproportionate allotment
    - Sudhir Menon HUF Vs. ACIT 148 ITD 260 (Mum.)
- ▶ Whether buy-back of shares at less than FMV covered
  - Vora Financial Services P. Ltd. Vs. ACIT 53 CCH 289 (Mum.)

# Sec. 56(2)(x) – Rule 11UA Issues

- ▶ FMV of unquoted equity shares to be made as per formulae in Rule 11UA(1)(c)(b) – Rule amended w.e.f. 1-4-2018 i.e. A.Y. 2018-19
- ▶ Value as per amended Rule =  $(A+B+C+D-L) \times (PV) / (PE)$
- ▶ If company A's shares are to be valued and Company A holds shares of company B, C & D then the FMV of all these has to be found for valuing shares of A
  - One needs to compute value of each step down companies in the process.
  - Difficulties in cases where shares of many companies are owned by the company whose shares are to be valued.
  - Difficulties in getting the data for the step down companies which are not group companies.
  - Difficulties in case of cross holdings – where do you start from ?
  - No threshold provided – Even if one share of an unlisted company is owned – calculation is necessary

# Section 56(2)(x)

- ▶ Interest free Loan received – Whether taxable
  - CIT Vs. Mridu Hari Dalmia 133 ITR 550 (Del.) clubbing provisions applied
  - Chandrakant H. Shah Vs. ITO 28 SOT 315 (Mum.)
    - CIT Vs. Chandrakant H. Shah – ITA No. 3154 of 2009 (Bom.) –Department appeal dismissed
  - CIT Vs. Saranpal Singh HUF 237 CTR 50 (P & H)
- ▶ Waiver of Loan – whether taxable
  - Panna S. Khatau Vs. ITO 154 ITD 790 (Mum.) – Constructive receipt – Sec. 68 and 56(2)(vi) – Relying on CIT Vs. T. V. Sundaram Iyengar & Sons Ltd. 222 ITR 344 (SC)
  - CIT Vs. Kasturi & Sons Ltd. 237 ITR 24 (SC) – Money in 41(2) do not include Money's worth
  - CIT Vs. Mahendra & Mahendra Ltd. 404 ITR 1 (SC) – dealing with section 28 and 41(1)



# Receipt from and by HUF

## ▶ Receipt by HUF

- Vineetkumar Raghavjibhai Bhalodia V ITO 46 SOT 97 (Rajkot) – HUF is a group of relatives
- Members of HUF are relatives of HUF – FA 2012
- Post 2012 – difficult to take a view that relative of each member is relative of HUF

## ▶ Receipts from HUF

- Group of Relatives – Singular includes plural
- Each member has interest in property of HUF – can not be said to be without consideration
  - Smt. Sudha V. Iyer V. ITO 48 SOT 173 (Mum.)
- For Monetary transaction – Distribution of Income exempt u/s. 10(2)
- CIT Vs. N. S. Getti Chettiar 82 ITR 599 (SC) – under Gift tax Act

# Receipts on Partition of HUF

- ▶ Partition has to be full partition
  - Qua Members
  - Qua Properties
- ▶ Section 171 (9) derecognises partial partition
- ▶ Partition can be unequal
- ▶ Not considered as transfer u/s. 47(i)
- ▶ Clause (IX) of proviso to 56(2)(x) exempts such receipts

# Clause 29B – Implementation Guide



- ▶ *“The tax auditor should obtain a certificate from the assessee regarding any such receipts during the year, either received in his business or profession or recorded in the books of account of such business or profession.”*
  - Receipts in Personal accounts or not recorded in business books – suggestively out of purview of reporting
- ▶ If valuation disputed by assessee before the stamp authorities, and dispute is pending as on the date of finalisation of the audit → Mention about the facts giving
  - (a) value adopted by stamp authorities and
  - (b) value claimed by the assessee to be the correct value
- ▶ In case of any doubt about valuation – advisable to refer to registered valuer

# Deemed Dividend – Clause 36A

- ▶ Deemed Dividend taxable in the hands of shareholders till A.Y. 2018
- ▶ For A.Y. 19–20 & A.Y. 20–21 – Due to amended sec. 115–O, deemed dividend made subjected to DDT – Exempt u/s. 10(34)
- ▶ A.Y. 2021–22 – 115–O is non-operative now – Deemed Dividend again taxable in the hands of shareholder

# Deemed Dividend – 2(22)(e)

- ▶ Applicable in case of
  - Advance or Loan by Company to Shareholder (Not Less than 10% of Voting Power)
  - Advance or Loan by company to concern where share holder has substantial interest (20%)
  - Payment on behalf or for individual benefit of the shareholder
- ▶ Deemed dividend to the extent company possess accumulated profit
- ▶ Accumulated profits to be seen as on date of distribution or payment

# Clause 36A – Deemed Dividend

- ▶ Information to be given for Amount of Deemed Dividend as per sec. 2(22)(e) and date of receipt
- ▶ Subject of Deemed Dividend is prone to tremendous litigation
- ▶ Practical Difficulties
  - How to find out accumulated profit of the payer company
  - Possession of Accumulated Profits on the date of transaction
  - Difficulty in identifying the payments made on behalf of the share holder
  - Accumulated profits which can be distributed and which cannot be distributed – Bifurcation to be made

# Clause 36A – Impl. Guide



- ▶ Obtain certificate from assessee containing list of closely held companies where assessee is beneficial owner of shares carrying not less than 10% of voting power
- ▶ Obtain list of “concerns” taking loans from CHCs
- ▶ Appropriate remarks in 3CA / 3CB about inability to independently verify the information and reliance on the certificates
- ▶ Payments made by CHC on behalf of assessee
  - Difficult to have any records – Remark shall be given in 3CA / 3CB
  - If already taxed in the hands of assessee as perquisite etc. – cannot be again taxed as deemed dividend – Not to be reported

# Clause 36A – Impl. Guide



- ▶ Verify Form 26AS to find deduction made by companies u/s. 194 – This will indicate the view taken by the CHC
- ▶ Appropriate Remark where beneficial share holder is not the registered shareholder
- ▶ Accumulated profit on the date of transaction may be determined on **time basis** with appropriate remarks in 3CA/3CB
- ▶ Give remarks as regards the decisions relied upon for taking any stand on any legal issue



# Clause 36A – Issues

- ▶ Who is to be taxed – Registered share holder or beneficial share holder
  - ACIT Vs. Bhaumik Colour Pvt. Ltd. 118 ITD 1 (Mum. SB)
  - CIT Vs. Universal Medicare Pvt. Ltd. 324 ITR 263 (Bom.)
  - CIT Vs. Ankitech Pvt. Ltd. 340 ITR 14 (Del.) – Approved by SC in CIT Vs. Madhur Housing Development Co. 401 ITR 152 (SC)
  - CIT Vs. National Travel Services 347 ITR 305 (Del.)
  - National Travel Services Vs. CIT 401 ITR 154 (SC) – Issue referred to a larger bench
  - Gopal and Sons HUF Vs. CIT 145 DTR 289 (SC) – Loan given to HUF treated as deemed dividend

# Clause 36A – Deemed Dividend

## ▶ Loans Vs. Deposits

- Inter corporate deposits are not loans – not subject to 2(22)(e) – Bombay Oil Industries Ltd. Vs. DCIT 28 SOT 383 (Mum.)

## ▶ Advances made in the ordinary course of business for business exigencies

- CIT Vs. Ambassador Travels P. Ltd. (Del.) 318 ITR 376 (Del.)
- CIT Vs. Creative Dyeing & Printing P. Ltd. 318 ITR 476 (Del.)
- Sri Satchidanand S. Pandit V. ITO 19 SOT 213 (Mum.)
- NH Securities Ltd. V. DCIT 11 SOT 302 (Mum.)

## ▶ Transactions in the nature of Current Account

- ITO Vs. Gayatri Chakraborty 45 ITR 197 (Kol.)(Trib.) – affirmed by Kol HC in CIT Vs. Gayatri Chakraborty 94 taxmann.com 244 (Kol.)
- CIT Vs. India Fruits Ltd. 274 CTR 67 (AP)
- CBDT Circular No. 19/2017 Dt. 12-6-2017

# Clause 36A – Deemed Dividend

## ▶ Inclusions and Exclusions

- Accumulated Profits shall be commercial profits and not assessed income – CIT Vs. P. K. Badiani 105 ITR 642 (SC)
- Capital Profits not to be included – Tea Estate India Pvt. Ltd. Vs. CIT 103 ITR 785 (SC)
- Profit earned u/s. 41(2) is not part of Accumulated Profit – CIT Vs. Urmila Ramesh 230 ITR 422 (SC)
- Revaluation Reserve – Book entry – May not be included
- Development Rebate Reserve and Investment Allowance Reserves – to be included
- Share Premium and Share forfeiture – Capital Reserves – Dy. CIT Vs. Maipro India Ltd. 116 TTJ 791 (Del.) / Jaikishan Dadlani Vs. ITO 4 SOT 138 (Mum.)
- Amount treated as Deemed Dividend in past is to be excluded for determining Accumulated Profits CIT Vs. G. Narsimhan 118 ITR 60 (Mad.)

# Clause 36A – Deemed Dividend

- ▶ Exception – Substantial part of Company's Assets and Income from money lending business
  - CIT Vs. Parle Plastics Ltd. 332 ITR 63 (Bom.) – Substantial does not mean More than 50% – If it is not trivial then exception applies
  - CIT Vs. Jayant H. Modi 232 Taxman 337 (Bom.)
  - CIT Vs. Shree Balaji Glass Manufacturing P. Ltd. 386 ITR 128 (Cal.)
  - Tanuj Holdings (P.) Ltd. V DCIT 46 ITR (T) 420 (Kolkata – Trib.)
  - Mrs. Rekha Modi Vs ITO 13 SOT 512 (Delhi)
  - DCIT Vs. Kishori Lal Agarwal 150 ITD 741 (Luck)

# Clause 30A – TP Adjustment

- ▶ Clause 30A – Information about primary adjustment and consequential secondary adjustment – Repatriation of amount of primary adjustment to India – Interest on amount not repatriated etc.
  - Time limit available for repatriation is 90 days from the due date of Return
  - Primary adjustment made by AO will be known only at the stage of assessment – How to report at audit stage ? Whether to report for the earlier year's adjustment made ?



# Cl. 30A – Impl. Guide

- ▶ Primary adjustments may not necessarily be confined to year under consideration
- ▶ Disclosure to be made for each and every type of PA irrespective of the year to which it pertains
- ▶ Certificate from assessee about
  - TP adjustments made in Return of Income filed during the year (May be more than one)
  - Advance Pricing Arrangement entered
  - TP Adjustments made in assessment / confirmed in appeals
  - Agreement arrived at under Mutual Agreement Procedure
- ▶ Obtain a MR for information to be True and accurate
  - Disclose about MR in Report – Primary onus on management

# Cl. 30A – Impl. Guide



- ▶ If the PA amount not repatriated – Imputed Interest income to be computed
- ▶ Obtain Certificate for SBI / LIBOR Rate and provide computation – Verify the computation
- ▶ Interest to be computed upto the end of the FY and not upto the date of completion of audit – If Interest computed upto date of audit report – give break up upto FY and beyond
- ▶ Imputed Interest Income may relate to PAs made in more than one year → Only to report the Interest pertaining to PAs made during the year under audit

# Clause 30B – Sec. 94B – Thin Capitalisation

- ▶ Applicable to Indian Company or PE of a foreign company
- ▶ Applies to Expenditure by way of Interest or of similar nature exceeding one crore paid to non-resident Associated Enterprise
- ▶ Expense to be restricted to 30% of EBITDA
  - Similar information in Form 3CEB – Duplication of work
- ▶ Exception : Business of Banking or Insurance
- ▶ Excess payment to be carried forward upto 8 years



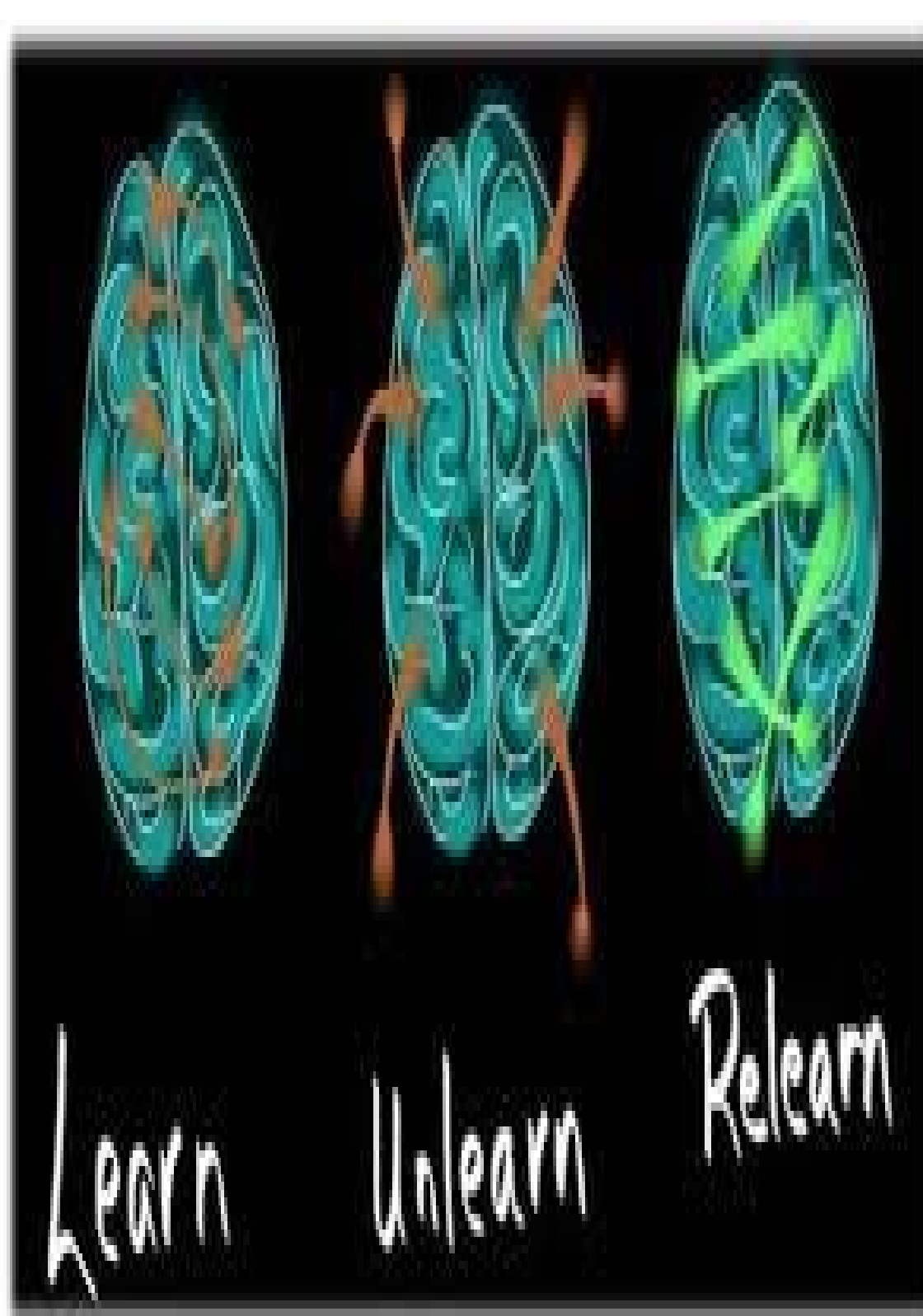
# Clause 30B – Impl. Guide



- ▶ “Expenditure of similar nature” as per section 94B would include discount or premium on securities, finance cost component of lease rentals or other finance charges
- ▶ For computing the limit of Rs. 1 Crore, interest and expenditure of similar nature, disallowable under other sections like 14A, proviso to 36(1)(iii), 40(a)(i) or 40A(2) should not be considered. – Also Interest disallowed on TP adjustment should not be considered
- ▶ Recognises two views – whether limit of 1 Cr. is for each AE or all AEs together – Appropriate disclosure as per view taken by assessee
- ▶ Computation of disallowance of Interest shall be only in respect of Non-resident AEs and not for Resident AEs.
- ▶ EBITDA to be computed on final audited stand alone accounts

# Clause 43 – CBC Reporting

- ▶ International groups required to furnish country by country report – Section 286(2)
- ▶ Clause 43 – If Sec. 286 applicable – give details
  - Whether report furnished by assessee or parent entity or alternate reporting entity
  - Name of Parent entity
  - Name of alternate reporting entity (if applicable)
  - Date of furnishing report
- ▶ Time limit available u/s. 286 is 12 months from end of accounting year – Report may not have been filed though applicable



Amendments by  
FA 2021 / FA  
2020 and its  
impact

# Sec. 36(1)(va) and Sec. 43B

- ▶ Section 2(24)(x) – Employees' contribution is Income
  - Section 36(1)(va) – Deduction allowable if paid within Due date under relevant law
- ▶ Section 43B
  - Non-obstante clause overriding all other provisions
  - Clause (b) – sum payable by an assessee as employer by way of contribution to funds
  - First proviso to 43B – Nothing in the section to apply if paid by due date of Return of Income
  - Amendment by FA 2003 – deletion of second proviso and amendment of first proviso – Contribution to funds on par with Tax / Duty / Cess etc.

# Sec. 36(1)(va) and 2(24)(x) – Decisions

- ▶ CIT Vs. Sabari Enterprises 298 ITR 141 (Kar.) – *affirmed in Alom Extrusions (SC)*
- ▶ CIT Vs. Mark Auto Industries Ltd. 358 ITR 43 (P & H)
- ▶ CIT Vs. Alom Extrusions Ltd. 319 ITR 306 (SC) – Amendment to first proviso to section 43B by Finance Act 2003 – Held retrospective
- ▶ CIT Vs. Hindustan Organics Chemicals Ltd. 366 ITR 1 (Bom)
- ▶ CIT Vs. Ghatge Patil Transports Ltd. 368 ITR 749 (Bom.) – Both Employer and Employee Contribution is covered by the decision of SC in Alom Extrusions Ltd.

# Sec. 36(1)(va) and 2(24)(x) – Decisions

## ▶ Contra View

- CIT Vs. Merchem Ltd 378 ITR 443 (Ker.)
- Popular Vehicles & Services Pvt. Ltd. 406 ITR 150 (Ker.)
  - Sec. 43B is a restrictive provision – Deletion of proviso to 43B cannot make Explanation to 36(1)(va) otiose – 43B takes care of only Employer's contribution
  - Alom Extrusions did not deal with Employees' Contribution
- Unifac Management Services India Pvt. Ltd. Vs. DCIT 409 ITR 225 (Mad)
- CIT Vs. Gujarat State Road Transport Corporation 265 ITR 64 (Guj)

# Amendments by Finance Act

- Explanation – 2 added to section 36(1)(va)
- **For the removal of doubts**, it is hereby clarified that :
  - The provisions of section 43B shall not apply
  - AND
  - **Shall be deemed never to have been applied** for the purposes of determining the “due date” under this clause
- Explanation – 5 added in section 43B
  - For the removal of doubts, it is hereby clarified that
    - the provisions of this section shall not apply and
    - **Shall be deemed never to have been applied** to a sum received by the assessee from his employees u/s. 2(24)(x)
- Memorandum states – Amendments will apply from A.Y. 2021–22 and subsequent assessment years

# What about earlier years?

- Whether the amendment is prospective or retrospective in nature ?
  - CIT Vs. Vatika Township P. Ltd. 367 ITR 466 (SC)
- Can there be any doubts where the jurisdictional HC has already taken a view of the matter on either side ?
- Whether the earlier amendment made by FA 2003 can be said to be meaningless
- Held to be Prospective in nature
  - Salzgitter Hydraulics P. Ltd. vs. ITO (2021) 189 ITD 676 (Hyd.)
  - Indian Geotechnical Services vs. ACIT – ITA No. 622/Del. /2018 – dated 27-08-2021



# Depreciation on Goodwill

- Depreciation permissible on Tangible and Intangible assets
- CIT Vs. Smifs Securities Ltd. (2012) 348 ITR 302 (SC)
  - Difference in Net Asset Value and cost of acquisition is goodwill and it is intangible asset eligible to depreciation
- Memorandum explaining the provisions
  - Goodwill can be acquired :
    - By payment – Goodwill is generally not depreciable
    - Restructuring of Business – There is no cost of acquisition – Really ?

# Amendments made

- Sec. 32(1)(ii) – Goodwill of a business shall not be considered as an asset for the purpose of depreciation
- Sec. 2 (11) – Block of Asset shall not include Goodwill
- Sec. 50 – Where goodwill formed part of block of assets and depreciation has been obtained – WDV of block of asset and Short Term Capital Gains shall be determined in the manner to be prescribed – **Rule 8AC prescribed**
- Section 55
  - For the Goodwill acquired by payment – Actual cost Less Depreciation claimed till AY 2020–21
  - Self acquired Goodwill – NIL

# Rule 8AC

- ▶ The goodwill have to be removed from the block of assets as on 1-4-2021 such value will be the cost of goodwill less the depreciation claimed till date.
- ▶ Only asset in the block – No impact – Reduction will be to the extent of WDV
- ▶ Where there are other assets – possibility of the value of the block turning negative – This will lead to computation of Short Term Capital Gains – Section 50.
- Whether the Goodwill on which depreciation is stopped being charged can be taken out of Block and be treated as Long Term after three years?
  - Smt. Meena Pamnani Vs. CIT 86 taxmann.com 175 (Bom)

# Depreciation – Clause 18

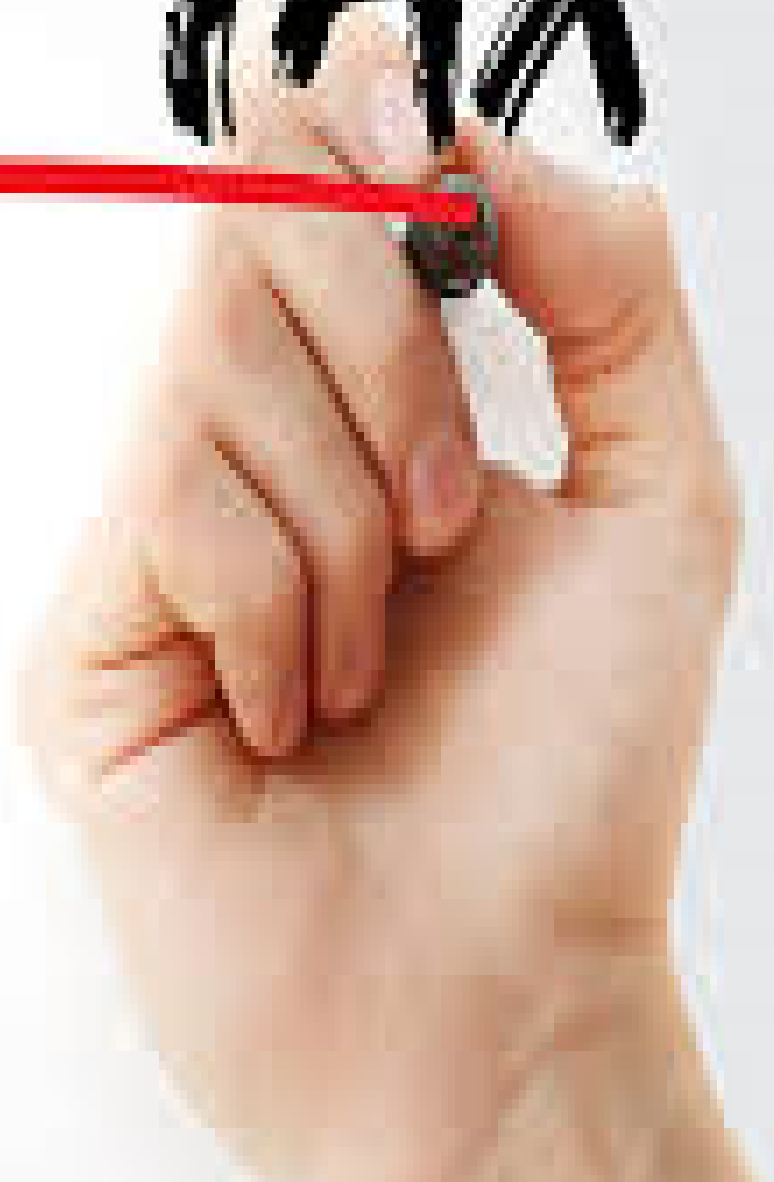
## ▶ Depreciation on Intangibles

- ~~Goodwill – CIT Vs. Smifs Securities Ltd. 348 ITR 302(SC)~~
- Stock Exchange Card – Techno Shares & Stocks Ltd. Vs. CIT 327 ITR 323 (SC)
- SEBI Registration Fees – DIT Vs. HSBC Asset Management India Pvt. Ltd. 228 Taxman 365 (Bom.)
- One time Licence Fees – ACIT Vs. GKN Sinter Metal P. Ltd. 153 ITD 311 (Pune)
- Non Compete Fees
  - Medicorp Technologies India Ltd. – (2009) 30 SOT 506 (Mad)
  - Srivastan Surveyors P. Ltd – (2009) 318 ITR 283 (Chennai Trib.)
  - ACIT Vs. Real Image Tech P. Ltd. 120 TTJ 983 (Chennai Trib).

# INCOME TAX

---

**New Section  
206C(1H)**



# TCS by seller of Any Goods – Section 206C – (1H) – Provisions

- Every person being a seller who
- Receives any amount as consideration for sale of any goods exceeding Rs. 50 Lakhs in any previous year
- Liable to collect **at the time of receipt of such amount**
- TCS @ 0.1% (0.075% till 31-3-21) **of sale consideration exceeding Rs. 50 Lakhs** as Income-tax
- If PAN or Aadhar not furnished – rate will be 1% (0.75% till 31-3-21)

# TCS by seller of Any Goods – Section 206C – (1H) – Provisions

- Excluded Goods
  - Goods exported out of India – (Deemed exports not covered)
    - Not applicable to Fuel supplied to Non-resident Airlines at Airports in India – Para 4.7 of Circular No. 17
  - Goods covered by sub section (1) or (1F) or (1G)
- No TCS if Buyer is liable to deduct TDS and has actually deducted
- Excluded Buyers
  - **Importer**
  - Central / State Government / Local Authorities / Embassy etc.
  - Persons to be Notified

# TCS by seller of Any Goods – Section 206C – (1H) – Provisions

- Seller Means a person whose
  - Total Sales, gross receipts or turnover from the business carried on by him exceed
  - Ten Crore Rupees during the financial year immediately preceding financial year
  - In which sale of goods is carried out
- Sellers can be notified by Government for exclusion with conditions specified



# TCS by seller – Summary

- TCS is to be collected at the time of receipt of the amount
- However, TCS is to be computed as a % of sale consideration
- Basic Threshold of Rs. 50 Lakhs is provided – TCS to be collected only on amount in excess of 50 Lakhs
- Export and Import transactions are excluded – FA amendment
- Government as a buyer is excluded but government companies as seller is not excluded
- Applicable where sales, turnover, gross receipts in business of seller exceeded 10 Crore in immediately preceding financial year
- Lower collection certificate is not possible – Not covered by sub. Section 9
- If TDS deducted by buyer – TCS does not apply – Availability of trail

# Applicability in various situations

Sales		Receipt		Amt. subjected to TCS	Reason
Upto 1-10-20 (Including earlier FY)	After 1-10-20	April to Sept 2020	After 1-10-20		
15 Lakh	45 Lakh	10 Lakh	39 Lakh	Nil	Receipts < 50 Lakh
60 Lakh	30 Lakh	55 Lakh	35 Lakh	35 Lakh	Receipt > 50 Lakh but applicable only on amt from 1-10-20
60 Lakh	30 Lakh	85 Lakh (inc. Adv)	10000	10000	Advance received earlier will be considered as consideration for sales post 1-10-20 when actual sales is made

# Applicability in various situations

Sales		Receipt		Amt. subjected to TCS	Reason
Upto 1-10-20 (Including earlier FY)	After 1-10-20	April to Sept 2020	After 1-10-20		
64 Lakh	Nil	10 Lakh	54 Lakh	14 Lakh	Receipts > 50 Lakhs - No sales post 1-10-20 is irrelevant
30 Lakh	55 Lakh	Nil	35 Lakh	Nil	Receipts < 50 Lakhs - Sales post 1-10-20 is more than 50 Lakh is irrelevant
Nil	Nil	Nil	55 Lakh (Adv)	Nil (As per Cir No. 17 - 5 Lakhs)	Not received as consideration for sale of goods

# Some Issues which arise on Regular basis

# Section 41 – Clause 25



- ▶ Liability which is time barred but not written back in the accounts
  - CIT Vs. Vardhman Overseas Ltd. 343 ITR 408 (Del)
  - CIT Vs. Bhogilal Ramjibhai Atara 88 CCH 49 (Guj)
  - Contra view : ITO Vs. Shailesh D. Shah – Mum ITAT – itatonline.org – doubting genuineness
- ▶ Liability reflected in signed Balance Sheet is acknowledgement of debt – Not time barred
  - CIT Vs. Smt. Sitadevi Juneja 325 ITR 593 (P & H)
- ▶ Refund of excise duty / sales tax etc. where the department is in appeal at higher forums – whether section 41 gets attracted ?
  - CIT Vs. Hindustan Housing and Land Development Trust Ltd. 161 ITR 524 (SC) – Regarding compensation for land acquisition
- ▶ If liability disallowed u/s. 43B or 40(a)(ia) etc. whether the same can be added as income u/s. 41



## 40(a)(i) – 40(a)(ia)

- ▶ Can Auditor rely on Certificates issued u/s. 195 or he should examine all the documents / treaties etc.
- ▶ Section 40(a)(i) – Whether deduction is required to be made when the relevant income is not taxable in India due to DTAA
  - GE India Technology Centre Pvt. Ltd. Vs. 327 ITR 456 (SC)
- ▶ EMIs paid to NBFC – position of TDS deduction
- ▶ Deduction of TDS at lesser rate – Whether disallowance to be made u/s. 40(a)(ia)
  - DCIT Vs. Chandabhoy and Jassobhoy 49 SOT 448 (Mum.)
  - DCIT Vs. S. K. Tekriwal 48 SOT 515 (Cal.) – confirmed in CIT Vs. S. K. Tekriwal 361 ITR 432 (Cal.)
  - Contra View – CIT Vs. PVS Memorial Hospital Ltd. 380 ITR 284 (Ker)



## 40(a)(i) – 40(a)(ia)

- ▶ No TDS on Reimbursement of Expenses – *CIT Vs. DLF Commercial Project Corporation 379 ITR 538 (Del.)* ; *Hightension Switchgears P. Ltd. Vs. CIT 385 ITR 575 (Cal.)*
- ▶ Tax Deducted and Paid but no TDS Return filed – whether disallowance is to be made
- ▶ Form 15G / 15H not filed with Department – Whether Disallowance to be made
- ▶ No Disallowance where the expenditure is capitalised in the books of accounts – *CIT Vs. Mark Auto Industries Ltd. 358 ITR 43 (P & H)*
- ▶ No Liability to deduct tax on transport charges where primary contract is for supply and Transport is incidental – *CIT Vs. Krishak Bharati Co. Op. Ltd. 349 ITR 68 (Guj)*



## 40(a)(i) – 40(a)(ia)

- ▶ No TDS on Overseas Commission to Foreign Agent
  - Circular No. 23 of 1969
  - Circular No. 7 Dated 22-10-2009
  - CIT Vs. Toshoku Ltd. 125 ITR 525 (SC)
  - CIT Vs. Gujarat Reclaim & Rubber Products Ltd 383 ITR 236 (Bom.)
  - Sesa Resources Ltd. Vs. DCIT 287 CTR 89 (Bom.)
- ▶ Second proviso to Section 40(a)(ia) – No disallowance if
  - Tax paid by the recipient and
  - Income declared in Return filed
  - Declaration given to the effect



## 40(a)(i) – 40(a)(ia)

- ▶ Cost Sharing arrangements – No deduction of TDS required if it is purely on actual basis
  - CIT Vs. Ask Wealth Advisors P. Ltd. 168 DTR 349 (Bom.)
- ▶ Target Incentives to Distributors not liable for deduction of TDS – Not a commission
  - PCIT Vs. Shalimar Chemical Works Ltd. 257 Taxman 590 (Cal.)
- ▶ Credit Card commission paid to Bank is in the nature of bank charges and not commission – No deduction required –
  - Velankani Information System Ltd. Vs. DCIT 173 ITD 19 (Bang.)

# Depreciation

- ▶ Section 32(1)(iii) – Write off of assets discarded / demolished / destroyed → WDV as reduced by Scrap value realised is allowable as deduction
  - If no amount is realised entire WDV is available as deduction provided asset is written off in books of accounts
    - CIT (E) Vs. Bhatia General Hospital 405 ITR 24 (Bom.)
- ▶ Machinery utilised for Trial Run is entitled to depreciation
  - PCIT Vs. Larsen & Toubro Ltd. (2018) 403 ITR 248 (Bom)
  - SLP Dismissed in : PCIT Vs. Larsen & Toubro Ltd. 259 Taxman 79 (SC)

# Expln to 37(1)



- ▶ Penalty or fine for violation of any law for the time being in force
  - Penalty paid for delay in supply of material – Whether allowable
  - Penalty for procedural lapses in compliance of Rules & Regulations of associations etc
    - LKP Securities 36 CCH 93 (Mum)
    - Dy. CIT Vs. Kisan Ratilal Choksey Shares & Securities Pvt. Ltd. 41 (ITR Trib) 114 (Mum.)
- ▶ Prakash Cotton Mills P. Ltd. Vs. CIT 201 ITR 684 (SC)
  - AO Should examine the scheme of the relevant statute to decide the nature of the particular levy to decide whether it is compensatory in nature or penal in nature – Nomenclature is not relevant while deciding the issue. In case of composite payment – amount is to be bifurcated appropriately
- ▶ Penal Interest Vs. Compensatory Interest under various laws like GST, Sales Tax, Excise, Service Tax etc
  - Velankani Information Systems Ltd. Vs. DCIT 173 ITD 19 (Bang.) – Interest on Service Tax Compensatory in nature

# Expln to 37(1)



- ▶ CIT Vs. Ahmedabad Cotton Mfg. Co. Ltd. 205 ITR 163 (SC)
  - Penalty for infraction of law is not permissible but payment in obedience of law as a measure of business expediency can not be subject to disallowance. Payment made towards exercise of option given by the scheme is not to be disallowed.
  
- ▶ Expense for any purpose which is an offence or which is prohibited by law
  - Compounding Fees / Consent Fees for settling Dispute – *ITO Vs. Reliance Share & Stock Brokers P. Ltd. 67 SOT 73 (Mum.) ; DCIT Vs. Anil Dhirajlal Ambani 171 ITD 144 (Mum.)*
  - Advocate Fees – *T & T Motors Vs. Addl CIT 154 ITD 306 (Del.) – against*
  - Ransom Money

# Expln. to Sec. 37 (1)



- ▶ Compromise payment made to landlord to protect the Leasehold right – not an offence – allowable – *CIT Vs. Sports Field Amusement 231 Taxman 252 (Bom.)*
- ▶ Assessee guaranteed payment by third party – Third party failed – Decree executed against assessee – Payment made to avoid defamation of name – Held allowable – *CIT Vs. Hitachi Koki India Ltd. 230 Taxman 643 (Karn.)*
- ▶ Additional Filing Fees paid to ROC – Compensatory in nature – Allowable – *Cummins Turbo Technologies Ltd. Vs. DCIT 169 TTJ 358 (Pune)*

# Clause 26 – Section 43B

- ▶ Section 43B is a disallowance section – Taxes paid in advance though not due as per law not allowable as deduction on payment basis
  - Gopikrishna Granites India Ltd v. DCIT (251 ITR 337)(AP)
  - Hindustan Lever limited v. V.K. Pandey, JCIT, (251 ITR 209) (Bom)
- ▶ Explanation 3C to section 43B – Introduced by FA 2006 w.r.e.f. 1-4-1988
  - Conversion of outstanding interest into loans – Not to be considered as payment of Interest – Purpose to avoid misuse of the provisions
  - Genuine Debt restructuring plan by issue of debenture will not be affected by Explanation 3C in absence of any malafide intention – M. M. Acqua Technologies Ltd. v. CIT 129 taxmann.com 145 (SC)
  - Decision for A.Y. 1996-97 – Ratio still relevant

# Clause 32 – Section 79

- ▶ Past losses are not allowed to be set off in a case where the change in shareholding results in diversion of voting power to the extent of more than 51%
- ▶ CIT Vs. Amco Power Systems Ltd. 379 ITR 375 (Kar).
  - What is relevant is voting power and not shareholding pattern
  - Change of shareholding between the existing shareholders will not have any impact

# Date of Audit Report

- ▶ Language of Section 44AB
- ▶ Audit Report to be obtained before the due date and Return to be filed on or before due date
- ▶ If Audit Report Dated – 30<sup>th</sup> September – whether 44AB violated ?
  - Chandra Kumar Seth Vs. ITO 62 ITD 106 (All.)
  - Chopra Properties Vs. ACIT ITA No. 6199/Del/2015 – itatonline.org







## Vajani & Vajani Chartered Accountants

-  : 022 4978 9831-32
-  : 09820525972
-  : [caketanvajani@gmail.com](mailto:caketanvajani@gmail.com)
-  : @KetanVajani

