PARTNERS BEYOND BOUNDARIES

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In this edition of our thought leadership publication, we have tracked the progress of some significant cases decided by the appellate forums across the country and important circular and press release issued by the Central Board of Direct Taxes.

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Transfer Pricing

Case Law 1: Agilis Information Technologies International (P.) Ltd Vs. Income Tax Officer, Ward-1(4), Range-1, New Delhi ([2017] 88 taxmann.com 6 [TDel])

In a case where the assessee was rendering software development services to the Associated Enterprise ('AE'), a company engaged in developing its own software products could not be accepted as comparable.

Further, a company in whose case extraordinary event of amalgamation took place during relevant year, could not be acceptable as comparable.

Also, a company earning revenue from software development services as well as developing its own software products for which no segmental information was available, could not be accepted as comparable.

Facts of the case:

The assessee company is established in India to undertake software development and installation of computerized systems, conduct feasibility studies, systems analysis and design as well as design of special software and system and application of software. It is also engaged in the business of rendering technical services related to tabulation, coding and software development.

During the year under consideration, the assessee provided software development services and support services to its AE. The assessee used Transactional Net Margin Method as the method and Operating Profit/Total Cost (*'OP/TC'*) as the Profit Level Indicator (*'PLI'*).

On conducting the transfer pricing analysis, the assessee's margin worked out to be slightly higher than the average margin, however, it was in the range and therefore the assessee concluded the transaction to be at arms length.

The Transfer Pricing Officer (*'TPO'*) issued a show-cause notice to the assessee, and the assessee responded to the notice by way of submissions. The TPO rejected the assessee's submissions and made an addition by computing an updated margin, by applying certain qualitative and quantitative filters.

Aggrieved, the assessee filed an appeal before the Dispute Resolution Panel (*'DRP'*). The adjustment made by the TPO was upheld by the DRP.

Aggrieved, the assessee filed an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal observed the facts of the case. The Hon'ble Tribunal ruled in favour of the assessee and disregarded the updated margin computed by the TPO including the new list of comparable companies on the following grounds:

- As the assessee was rendering software development services to AE, a company engaged in developing its own software products could not be accepted as comparable company;
- A company in whose case extraordinary event of amalgamation took place during relevant year, was not acceptable as comparable company even though it was functionally comparable to the assessee company;
- A company engaged in product development, product design and analysis services was not acceptable as comparable on account of functional difference; and
- As the assessee was rendering software development services to AE, a company dealing with software testing, software development services and healthcare services for which no separate segmental data was available, could not be accepted as a comparable company.

Thus, on the above grounds, the Hon'ble Tribunal disregarded the updated margin computed by the TPO on account of non-comparability of the companies for the purpose of such computation, thereby ruling in favour of the assessee.

Case law 2: Maruti Suzuki India Ltd v. Additional Commissioner Of Income Tax ([2017] 87 taxmann.com 119 [TDel])

Royalty payments for use of licensed information is in the nature of revenue irrespective of the term of the agreement.

Assessee-company was producing fuel-efficient vehicles primarily for sale in the Indian market and some markets across the globe. During the relevant AY, the assessee had paid royalty to its AE in Japan for use of licensed information for the engineering, design and development, manufacture, testing, sale and after sales service of products and parts per the license agreement between the assessee and its AE valid for 10 years.

In respect of the royalty payment to its AE, a reference was made to the TPO u/s 92CA(1) of the Income tax Act. 1961 ('the Act').

On analysing the facts and circumstances, the TPO noted that the license agreement was providing an enduring benefit and therefore, the royalty should have been capitalized. In this contention, the TPO made an adjustment on account of royalty claimed as expenses and passed the draft assessment order. The assessee filed its objections with the DRP. Pursuant to the directions of the DRP, the assessing officer (‘*AO’)* passed the final assessment order which included the aforementioned disallowance of expense in the nature of royalty.

Aggrieved by the decision, the Assessee preferred an appeal with the Hon’ble Delhi Tribunal.

Against the order of the AO, the Assessee representative put forward the following arguments.

- The royalty was paid for the use of licensed information as per the licensing agreement;
- Per the clause of the agreement, the AE did not transfer any specific patents or copyrights or some other secret or protected information or knowhow to make the assessee an owner/proprietor of the same; and
- Per the license agreement, the assessee was merely granted permission for use of technical knowhow and therefore, the payment made had to be regarded as revenue in nature irrespective of the tenure of the agreement.

Further, the assessee relied on the Central Board of Direct Taxes (‘*CBDT*’) circular which mentioned that if only a license is obtained for user of technical knowledge from a foreign participant for a limited period together with or without the right to use the patents and trademarks of the foreign party, the payment would not bring into existence an asset of enduring advantage to the Indian party. Further, the assessee relied on the decision rendered by the Hon’ble Delhi High Court in case of CIT v. Lumax Industries Limited 173 taxman 390 wherein similar royalty payment was allowable as revenue deduction in lines with the text of this circular.

Other decisions relied upon by the assessee were as under:

- Alembic Chemical Works Co. Ltd v. CIT: 177 ITR 377 (SC);
- CIT v. Shriram Pistons and Rings Limited (SC) wherein the SLP filed by the revenue was dismissed against the order of the Delhi High Court in ITA No. 167/2008); and
- Shriram Refrigeration Industries Ltd v. CIT: 127 ITR 746(Del).

There were other decisions which iterated and reiterated the issue of allowability of royalty payments as revenue expenditure in favour of the assessee. The Hon’ble Tribunal based on the findings of the assessee and the decision of Hon’ble Tribunal in favour of the assessee in prior AYs highlighting a similar issue, allowed the royalty payment as expenditure.

Therefore, the decision was in favour of the assessee and the expense was fully allowed.

International Tax

Case Law 1: Assistant Director of Income Tax (International taxation) v. Timken Company ([2017] 88 taxmann.com 21 [TKol])

The sum is not chargeable to tax if it does not include any profit element or mark up u/s 44D read with 115A of the Act.

Facts of the case:

The assessee was incorporated in the United States and was in the business of manufacturing and sale of bearings. Since the assessee was a multinational entity, it performed various functions for fellow subsidiaries and group companies. These services are referred to as ‘Intra Group Services’. The assessee entered into an agreement with one of the Indian group companies to render services outside India and the compensation was on a cost-to-cost basis i.e., without any profit element payable outside India itself. As per the agreement, the services rendered by the assessee were provided by a centralized unit and the same was provided to all subsidiaries and group companies. After that, the costs were allocated to the subsidiaries based on the cost sharing/allocation agreement and cost centres.

The Indian subsidiary had not deducted any tax at source since the payment to the assessee was on a pure cost-to-cost basis. The assessee therefore moved to Authority of Advance Ruling (‘*AAR*’) to understand the applicability of TDS provisions on the payment to the assessee. Also, the payments made to the assessee were not taxable under the India–USA Double Taxation Avoidance Agreement (‘*DTAA’)*. Also, if the payments were considered to be ‘Fees for technical services (‘*FTS’*) within the meaning of section 9(1)(vii) of the Act, then section 44D and 115A of the Act, provides for a gross basis for taxation of such fees. A similar presumptive basis of taxation on gross basis has been contained u/s 43AC of the Act.

Before the AAR, the assessee relied on the decision of the Hon’ble Supreme Court in case of **Union Of India v. A Sanyasi Rao & Ors 219 ITR 330 (SC)** wherein it held that in case of presumptive basis of taxation, the option for computation of profits u/s 28 to 43C of the Act should be also applied to Section 44AC. Extending the applicability of the decision, the assessee pleaded that similar option should be also read in the provisions of section 44D of the Act. Against this, the AAR did not rely on the arguments of the assessee and the Indian subsidiary and strongly construed that the decision of the Hon’ble supreme court cannot be applied to the provisions of section 44D.

The decision of the AAR was relied upon by the AO in the relevant AY and the entire payment to the assessee by the Indian subsidiary was taxed in India. The said amount was chargeable to tax per the India-USA DTAA being in the nature of fees for technical / included services. Aggrieved by the decision, the assessee reiterated its submission before the Hon’ble CIT(A) that the sum referred to is reimbursement of actual cost and did not include any profit or mark-up and therefore, the same was not chargeable to tax. Against the argument of fees of technical services, the assessee stated that there was no make available service per the agreement and therefore, the payment is out of the ambit of the provisions of Article 12 of India-USA DTAA. Lastly, it stated that the said income should be treated as business income and therefore, it would not be taxable in India since there was no permanent establishment (‘*PE’*) of the assessee in India. Since there is no PE in India, the sum referred to cannot be brought to tax in India as per Article 5 read with 7 of the India-USA DTAA.

The Hon’ble CIT(A) did not deal with the above specific submissions of the assessee and confirmed the order of the AO and taxed the sum as FTS. The Hon’ble CIT(A) stated the nature of services mentioned in the agreement constituted FTS and therefore the same were taxable irrespective of the profit element.

Aggrieved by the order of the Hon’ble CIT(A), the assessee filed an objection before the Hon’ble Tribunal.

Decision of the Hon’ble Tribunal:

The Hon’ble Tribunal examined the relevant Articles of the DTAA and stated that the argument in contention is that whether the payment for FTS is actually made available by the assessee to the Indian Subsidiary. The make available clause actually determines the taxability of the sum paid and coverage of the amount within the ambit of Article 12 of the India USA DTAA.

Per the submissions on record, there was no concrete evidence that the services were made available by the assessee. Also, the assessee brought to the notice of the Hon’ble Tribunal that the assessee had filed a writ petition against the AAR ruling in earlier years before the Hon’ble High Court of Calcutta. The Hon’ble HC by its judgement rendered that the presumptive basis of taxation u/s 43AC could also be applied to section 44D.

In view of the above facts, the Hon’ble Tribunal directed the AO to delete the impugned additions and reverse the additions of the Hon’ble CIT(A) as well.

Therefore, the decision was in favour of the assessee.

Case Law 2: Johnson Matthey Public Ltd Company Vs. DCIT (IT) ([2017] 88 taxmann.com 127 [TDel])

Commission paid for provision of bank guarantee cannot be considered to be in the nature of ‘interest’ as per the Double tax Avoidance Agreement or the Income Tax Act, 1961.

Facts of the case:

The assessee is the ultimate parent company of both JMIPL and JMCIPL. The assessee provides various types of guarantees in relation to the business of its subsidiary companies. In the relevant assessment year the assessee provided guarantees to support credit facilities extended to JMIPL and JMCIPL by banks in India. While filing its return of income, the assessee treated the Guarantee fees received from Indian subsidiaries to be in the nature of Interest Income under Article 12 of India UK Double Taxation Avoidance Agreement (‘*India UK Tax Treaty*’) and offered it to tax @ 15%. However, during the scrutiny assessment, the AO treated the alleged guarantee fee as taxable under Article 23 - Other Income of the India UK Tax Treaty @ 40% *(plus surcharge and education cess)*.

Aggrieved by these two additions, the assessee preferred an appeal before the Hon’ble Delhi Tribunal.

Arguments before the Hon’ble Tribunal:

It was argued on behalf of the assessee that the assessee is a tax resident of UK and in absence of any PE in India, the income earned in the form of fees charged for providing Bank Guarantee/Corporate Guarantee, in the normal course of business, would not be chargeable to tax in India. However, out of utmost caution, the assessee has offered the guarantee fee to tax as Interest in terms of the provisions of the Act and Article 12(5) of the India UK Tax Treaty. The assessee submits that the term ‘interest’ has been defined under the domestic law u/s 2(28A) of the Act to include any moneys borrowed or debt incurred including a deposit, claim or other similar right or obligation and also any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized. However, ‘interest’ under Article 12(5) of India UK tax treaty has been defined to include debt-claims of every kind, which is exhaustive and covers all kinds of income regarded as ‘interest’ in domestic law, and thus, the corporate guarantee fee is covered under the definition of ‘interest’. However, according to the revenue, this definition of interest is not wide enough to cover corporate guarantee recharge and bank guarantee recharge because there is no relationship of lender-borrower in this transaction.

Decision of the Hon’ble Tribunal:

The Hon’ble Tribunal explained that the term ‘interest’, with its widest connotations, indicates the payments, whatever may be the name they are called with, relate to the payments made by the receiver of some amount, pursuant to a loan transaction. Loan transaction is also a species of contract. Article 12(5) of the India UK tax treaty and section 2(28A) of the Act extends the scope of such payments. However, payment or re-payment pursuant to any loan to be qualified as ‘interest’, necessarily has to be within the context of loan and shall relate to the parties to the privity of contract. In this context only, the expressions "claims of any kind", "service fee or other charge" have to be understood. So also the expression "whether or not there is the relationship of creditor-debtor or lender-borrower exists". It is only in the context and privity of contract, the payments covered by Article 12(5) of the India UK treaty or 2(28A) of the Act would be qualified to be treated as interest, even if there is no semblance of relationship between the parties like that of creditor-debtor exists.

However, the Hon’ble Tribunal clarifies that it does not take into its fold any payments made to stranger to the privity of loan transactions, though such payments have to be made incidentally in relation to such loan. Undoubtedly, the assessee in this case is a stranger to the privity of loan transactions inasmuch as the contract of loan is different from the contract of guarantee. The Hon'ble Tribunal states that in their considered opinion, the expression of "debt claims of any kind" or "the service fee or other charge in respect of moneys borrowed or debt incurred" does not stand extended to the payment of guarantee commission received by the assessee in India.

Thus, the Hon'ble Tribunal holds that this payment, in the absence of any specific provision dealing with corporate/bank guarantee recharge, has to be taxed in India as per the provisions of the Act under the head of 'income from other sources'.

Domestic Tax

Case Law 1: Associated Law Advisers vs. Income Tax Officer, Ward 37 (3), New Delhi ([2017] 87 taxmann.com 148 [TDel])

It is justified that any money received in the fiduciary capacity for discharging the obligation on or on behalf of the participant/client cannot be reckoned as income.

Where no expenditure is incurred to earn the exempt income, law does not envisage that expenditure has to be disallowed.

Facts of the case I:

The assessee is a law firm rendering services predominantly to its foreign clients and follows cash system of accounting. During the relevant year, the assessee received certain advance payments from its clients for making payment of fees to Senior Advocates to appear on behalf of the clients before High Courts and Supreme Courts and for incurring expenditure on behalf of the clients.

The AO contested that since the assessee was following cash system of accounting, any income actually received and any expenditure actually incurred in a particular year had to be treated as income or expenditure of that year. Accordingly, the AO added the entire advance amount to assessee's taxable income.

Aggrieved, the assessee filed an appeal before the Hon'ble CIT(A). Hon'ble CIT(A) confirmed the said addition. Further aggrieved, the assessee filed an appeal before Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal held that every receipt cannot be treated as an income as it has to fall in the category of income first, chargeable to tax and under a relevant head. Money received as trust or in a fiduciary category cannot *ipso facto* be recognized as income belonging to the assessee, chargeable to tax.

The Hon'ble Tribunal ruled in favour of the assessee and directed to delete the advance payments added by the AO to taxable income.

Thus, the amounts appearing under the head 'current liabilities' received in advance cannot be taxed as income in relevant year and the same cannot partake the character of income since the assessee received advance payments for discharging various legal obligations on behalf of its clients and held the money in fiduciary capacity.

Facts of the case II:

The assessee earned dividend income and income from mutual funds during the relevant year which were claimed as exempt from tax under section 10(34) and 10(35) of the Act and no expenses were incurred in relation to the exempt income.

In the course of assessment proceedings, the assessee was required to give details of the same. The assessee submitted that from perusal of the profit and loss account, balance sheet and bank statements, no expenditure had been incurred for the purpose of earning of exempt income. However, the AO did not find the assessee's response satisfactory and worked out the disallowance under section 14A of the Act, in accordance with Rule 8D(2)(iii) of 1962 Rules.

Aggrieved, the assessee filed an appeal before the Hon'ble CIT(A). The said disallowance was confirmed by the Hon'ble CIT(A).

Further aggrieved, the assessee filed an appeal before Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Delhi Tribunal relying on the principle laid down in the case of **H.T. Media Ltd vs. CIT ([2017] 85 taxmann.com 113)**, held that the AO cannot make disallowances under section 14A of the Act where he fails to establish a direct nexus between the exempt income earned and expenses incurred in relation to earning the exempt income.

The law does not envisage that wherever there is an exempt income, expenditure has to be disallowed, as it is required to be seen, whether expenditure has been incurred by the assessee in relation to the earning of exempt income or not and this can be examined having regard to the accounts of the assessee and the nature of expenditure debited.

Therefore, the Hon'ble CIT(A) ruled in favour of the assessee and directed to delete the disallowance made by AO.

Thus, it is mandatory and incumbent upon the AO to record such satisfaction and in the absence of such 'satisfaction' no disallowance can be made under section 14A.

Case Law 2: Deputy Commissioner of Income Tax, CC4(3) v. Growmore Leasing & Investment Ltd ([2017] 87 taxmann.com 294 [TMum])

In a case where short term capital loss on sale of securities arises to an entity not engaged in the business of wholly or partly dealing in securities, the entity shall be eligible to claim set-off of such losses.

Facts of the case:

The assessee had purchased tax-free IRFC bonds from a broker in FY 1991-92 and sold these bonds within a short period of 15 days in the same financial year at loss, thereby claiming short term capital loss in the return of income. During this period, the assessee received tax-free interest from these IRFC bonds.

Since these bonds were held for less than a month, the AO claimed that the transaction was entered into with an intention of earning tax-free interest thereby disallowing the same on grounds that the assessee was in the business of dealing in securities.

Aggrieved by the AO's order, the assessee filed an appeal before the Hon'ble CIT(A).

On appeal, the Hon'ble CIT(A) confirmed the action of the AO.

Aggrieved, the assessee filed an appeal with the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal observed that as per the provisions of the Act it was clear that if the interest due on the securities is receivable by any person other than the owner of such securities *(i.e. the assessee)*, such interest shall be deemed to be the income of such owner *(i.e. the broker)*.

In the instant case, the IRFC bonds were owned by the broker and the assessee purchased and sold the same back to him within a short period of 15 days. In this process the assessee also received tax-free interest from these IRFC bonds. By virtue of the provisions of the Act, the interest will form a part of the broker's income.

On applying the provisions of the Act for the purpose of evaluation of loss sustained on account of this transaction, it is clarified that since the purchase and sale of the bonds does not categorize as a business activity for the assessee, tax shall not be payable on the said interest by the assessee.

On the above grounds, the Hon'ble Tribunal directed the AO to allow the claim of set-off of loss suffered from the IRFC bonds against the profit from sale of other shares received by the assessee.

Therefore, ruling in favour of the assessee, the Hon'ble Tribunal held that the assessee was eligible to claim set off of losses incurred from the sale of IRFC bonds.

Case Law 3: Bimal Kishore Paliwal Vs. Commissioner of Wealth Tax, [2017] 87 taxmann.com 40 (SC)

It is not mandatory to follow income capitalization method for valuing property in all cases where the property is being used for running the business.

It is justified to use the land and building method where the property can easily obtain best price in the open market.

Facts of the case:

The assessee is a partner of a firm that is engaged in the business of running a cinema theatre in the premises that was purchased by the firm in a semi-constructed condition and later the building construction was completed.

The Wealth Tax Officer on account of pending assessment of Wealth Tax of one of the partners made a reference for valuation of the cinema to Department Valuation Officer ('DVO') and the AO relied on the Valuation Report submitted by the DVO and valued the property on the basis of land and building method. To the contrary, the assessees got the property valued by an approved Valuer adopting income capitalization method.

On appeal, the Assistant Commissioner affirmed the assessment made by the AO.

Aggrieved, the assessee filed an appeal before the Hon'ble Tribunal.

The Hon'ble Tribunal ruled in favour of the assessee stating that since the building could be used only for film exhibition, the method of its valuation had to be necessarily different from the one normally adopted in the case of buildings which were capable of being used as commercial buildings. Therefore, valuing the cinema building based on capitalization of income method was justified.

Aggrieved, the revenue filed an appeal before the Hon'ble High Court. The Hon'ble High Court ruled in favour of the revenue and held that yield/rent capitalization method would not be correct method of valuation of the property in question.

Aggrieved, the assessee filed an appeal before the Hon'ble Supreme Court.

Decision of the Hon'ble Supreme Court:

The Hon'ble Supreme Court was of the view that although it is at the discretion of the Wealth Tax Officer to apply the income capitalisation method in valuation of a property used for running a business under section 7(2)(a) of the Wealth Tax Act, 1957, this in itself does not make it mandatory for the Wealth Tax Officer to apply income capitalization method in all cases.

Since the cinema building was in the ownership and possession of the assessee, the property could have easily obtained the best price in the open market and in such cases the land and building method is appropriate method to be adopted for valuing the property.

Therefore, on the above grounds, the Hon'ble Supreme Court ruled in favour of the revenue stating that the valuation of the cinema hall building done by the AO on the basis of land and building method was justified.

Case Law 4: Chamber of Tax Consultants Vs. Union of India [2017] 87 taxmann.com 92 (HC)(Del)

Income Computation and Disclosure Standards ('ICDS') are intended to prevail over the judicial precedents that are contrary. Section 145 of the Act permits Central Government to notify ICDS but not to bring about changes to settled principles laid down in judicial *precedents which seek to interpret and explain statutory provisions contained in the Act.*

Facts of the case:

A writ petition was filed by the Chamber of Tax Consultants and Mr. C.S. Mathur to seek a declaration of the constitutional invalidity of Notification No. 87/2016 dated September 29, 2016 issued by the CBDT notifying 10 ICDS.

It was argued by the petitioners that the impugned notification notifying ICDS is contrary to the settled law since its implementation would nullify the judgments of the Supreme Court and the High Courts. On the other hand, the respondents argued that the changes brought about are only aimed at bringing uniformity and clarity in the computation of income and that there should be no reason why an attempt to codify standards for computation of income for greater clarity and to act as a check on the powers of the AO should be objected to.

Decision of the Hon’ble Delhi High Court:

The Hon’ble High Court noted the following legal proposition as laid down by Hon’ble Supreme Court in the case of **Shri Prithvi Cotton Mills Limited Vs. Broach Borough Municipality (1969) 2 SCC 283**:

It is not sufficient to declare merely that the decision of the Court shall not bind, for that is tantamount to reversing the decision in exercise of judicial power which the legislature does not possess or exercise. A Court's decision must always bind unless the conditions on which it is based are so fundamentally altered that the decision could not have been given in the altered circumstances.

The Hon’ble High Court notes that Article 265 of the Constitution of India states that no tax shall be levied or collected except under the authority of law. Section 145(2) of the Act does not permit changing the basic principles of accounting that have been recognized in various provisions of the Act unless, of course, corresponding amendments are carried out to the Act itself. In case the ICDS seeks to alter the system of accounting, or to accord accounting or taxing treatment to a particular transaction, then the legislature has to amend the Act to incorporate desired changes. The Hon’ble High Court opines that the Central Government cannot do what is otherwise legally impermissible.

The Hon’ble High Court went on to discuss each ICDS that had been challenged. The decision of the Hon’ble High Court in respect of each of the ICDS discussed has been summarized as under:

- **ICDS I**: It does away with the concept of 'prudence' which is contrary to the Act and to binding judicial precedents. Therefore, it is unsustainable in law.
- **ICDS II**: It pertains to valuation of inventories and eliminates the distinction between a continuing partnerships in businesses after dissolution from the one which is discontinued upon dissolution. It essentially sidesteps the decision as laid down in Shakti Trading Co. Vs. CIT (2001) 250 ITR 871 (SC) wherein it was held that on the dissolution of a firm, where the business of firm is not discontinued and is taken over by other partners, the stock-in-trade of the firm can be valued at cost or market value, whichever is lower. However, ICDS II insists that the stock-in-trade of the firm in both scenarios would have to be valued at market price irrespective of whether the business discontinues or not. It fails to acknowledge that the valuation of inventory at market value upon settlement of accounts on a partner leaving is distinct from valuation of the inventory in the books of the business which is a continuing one. It was thus held to be an exercise of excessive delegation of legislative power which is impermissible in law.
- **ICDS III:** Para 10 of ICDS III states that retention money would be a part of the contract and the same has to be assessed to tax based on ‘proportionate computation’ method. It was opined by the Hon’ble Delhi High Court that the treatment of retention money under Paragraph 10(a) in ICDS III will have to be determined on a case-to-case basis by applying settled principles of accrual of income. Deploying ICDS III in a manner that seeks to bring to tax the retention money, the receipt of which is uncertain/conditional, at the earliest possible stage, irrespective of the fact that it is contrary to the settled position in law, is ultra vires the provisions of the Act and binding judicial precedents. Further, para 12 of ICDS III, read with para 5 of ICDS IX, dealing with borrowing costs, makes it clear that no incidental income can be reduced from borrowing cost. This is contrary to the decision of the Hon’ble Supreme Court in CIT Vs. Bokaro Steel Limited [1999] 102 Taxman 94 (SC). Thus it was held that to the extent that ICDS III is interpreted and applied in a manner contrary to the law settled by the various decisions of the Hon’ble Supreme Court and the Hon’ble High Courts, it cannot be sustained.
- **ICDS IV:** It deals with the bases for recognition of revenue arising in the course of ordinary activities of a person from sale of goods, rendering of services and use by others of the person's resources yielding interest, royalties or dividends. Para 5 of ICDS IV requires an assessee to recognize income from export incentive in the year of making of the claim, if there is 'reasonable certainty' of its ultimate collection. This is contrary to the decision of the Hon’ble Supreme Court in Excel Industries [2013] 38 taxmann.com 100 (SC). As far as para 6 of ICDS IV is concerned, the proportionate completion method as well as the contract completion method have been recognized as valid methods of accounting under the mercantile system of accounting by the Hon’ble Supreme Court in CIT Vs. Bilhari Investment Pvt Ltd [2008] 168 Taxman 95 (SC). Therefore, it was held that to the extent that para 6 of ICDS IV permits only one of the methods, i.e., proportionate completion method, it is contrary to the above decisions, and thus was held to be ultra vires.
- **ICDS VI:** It states that marked to market loss/gain in case of foreign currency derivatives held for trading or speculation purposes are not to be allowed. The same is not in consonance with the ratio laid down by the Hon’ble Supreme Court in Sutlej Cotton Mills

Limited Vs. CIT [1979] 116 ITR 1 (SC).

Further, In Circular No. 10 of 2017, in the answer to Question No. 16 the CBDT has clarified that Foreign Currency Translation Reserve Account balance as on April 1, 2016 has to be recognized as income/loss of the previous year relevant to the AY 2017-18. The Hon'ble Delhi High Court opined that the losses/gains arising by valuation of monetary assets and liabilities of the foreign operations as at the end of the year cannot be treated as real income. It is only in the nature of notional or hypothetical income which cannot be even otherwise subject to tax.

- **ICDS VII:** It provides that recognition of governmental grants cannot be postponed beyond the date of accrual receipt. This is in conflict with the accrual system of accounting. To this extent, ICDS VII is held to be ultra vires.
- **ICDS VIII:** It pertains to valuation of securities. For those entities which aren't governed by the RBI to which Part A of ICDS VIII is applicable, the accounting prescribed by the AS has to be followed which is different from the ICDS. In effect, such entities are required to maintain separate records for income tax purposes for every year, since the closing value of the securities would be valued separately for income tax purposes and for accounting purposes. It was pointed out that under similar circumstances, ICDS II which deals with valuation of inventories does not prescribe such a 'bucket approach'. Thus, the respondents themselves have adopted separate approaches at different places for the purpose of valuation of securities. It was thus held that this change is therefore not possible to be effectuated without a corresponding amendment to the Act and to that extent Part A of ICDS VIII is held ultra vires the Act.

Thus, in finality, to the extent the specific ICDS' have been struck down as ultra vires the Act, the impugned notification Nos. 87 and 88 dated September 29, 2016 and Circular No. 10 of 2017 issued by the CBDT were also held to be ultra vires the Act and struck down as such.

Case Law 5: Sreema Mahila Samity Vs. Deputy Commissioner of Income Tax, Circle-Nadia [2017] 86 taxmann.com 216 (TKol)

When the assessee being a charitable institution and engaged in a money lending business provides loans to public and Self Help Groups ('SHG') earning interest income thereon, the business as well as the interest earned shall constitute to be a charitable purpose.

Facts of the case:

The assessee was a charitable institution engaged in the business of providing loans to the general public and SHG through 11 branches, earning interest income on the same. The AO contended that such interest income from money lending business should be treated as income. The AO opined that although such business fell under advancement of any other object of general public utility as stated under the recent amendment to Section 2(15) of the Act, by charging an interest income, it was carrying out an activity in the nature of trade, commerce or business not having a charitable object, which has been specifically excluded from the purview of the aforementioned section.

Aggrieved by the AO's order, the assessee filed an appeal before the Hon'ble CIT(A).

The Hon'ble CIT(A) held that profit had been generated by financing SHG at higher rates and since such income was earned on commercial lines, upheld the AO's order.

Aggrieved, the assessee filed an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

- The Hon'ble Tribunal noted that although the assessee had declared excess income over expenditure, the same had not been charged to tax on grounds of being a charitable institution;
- Further, it was also observed that the assessee had raised loans on commercial lines as evidenced by its non-lending to beneficiaries directly and lendings to SHG at a higher rate of interest;
- Prior to adding proviso to section 2(15), the entities which got registration under section 12AA engaged in commercial activity claimed exemption on the ground that such activities were for advancement of objects of general public utility in terms of 4th limb of definition to section 2(15). The said benefit was taken away by adding proviso to section 2(15), wherein it explains that the advancement of any other object, general public utility shall not be charitable purpose;
- However, the assessee contended that as in his case, the registration u/s 12AA had been granted and the aforementioned proviso had been added post registration of the assessee as a trust, assessee argued that benefits accruing to such registration could not be withdrawn; and
- The Hon'ble Tribunal held that the AO and Hon'ble CIT(A) have rightly opined that the assessee had indeed conducted his activities on commercial lines in the nature of trade, commerce or business and have followed the statutory provisions for computation of total income of the assessee.

Therefore, ruling in favour of the revenue, the Hon'ble Tribunal held that the assessee could not claim exemption from tax on the interest income earned on commercial lines through money lending.

Case Law 6: Pramod Kumar Sapra Vs. Income Tax Officer [2017] 87 taxmann.com 98 (TDel)

In a case where the assessee has been deputed outside India for the purpose of employment, the salary income though credited to the assessee's Indian bank account, shall not be taxable in India if the assessee is a non-resident in India for the relevant assessment year.

Facts of the case:

The assessee is an individual, who is employed with an MNC in India. The assessee was deputed to Iraq during the relevant assessment year for the purpose of employment. The assessee resided in Iraq for more than 182 days in the relevant assessment year. However, the salary was received by the assessee in his India bank account. The assessee, in his return of income, claimed the salary income to be exempt.

The AO initiated scrutiny proceedings. However, the AO via an assessment order accepted the returned income filed by the assessee including the claim of deduction of salary.

Further, the Principal Commissioner of Income Tax ('*CIT*') during revisionary proceedings, noticed the claim made by the assessee. The Principal CIT was of the view that the said claim was invalid. Owning to the provisions of the Act, though the assessee was a non-resident for the relevant assessment year, income of a non-resident accrued in India shall be liable to tax India.

Aggrieved, the assessee filed an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

In the light the above facts, the revenue contended that not only salary has been credited in India but also the TDS has been deducted by the employer. Such salary income credited to the bank account of assessee in India shall be deemed to be income received in India and, therefore, the same is chargeable to tax under the scope of total income as per the provisions of the Act.

On the other hand, the assessee contended the salary was received by the assessee on foreign deputation being employed for work being carried out in foreign country, and the same cannot be taxed in India even if salary has been credited to the bank account of the assessee in India as the assessee was a non-resident in India for the relevant assessment year.

The Hon'ble Tribunal observed that the provisions of the Act which provide that if the income of the non-resident has been received or accrued in India or deemed to be received or accrued in India, the same shall be treated as total income of that person of that previous year. However, the said provision does not envisage that the income received by a non-resident for services rendered outside India can be reckoned as part of total income in India. In the present case, the assessee has received salary during his employment in Iraq for the activities carried out in Iraq and therefore, no such income has been received by the assessee for carrying out any activity in India or source of income is from India which could be reckoned as income received or accrued in India.

Thus, the Hon'ble Tribunal ruled in favour of the assessee stating that the salary income of the assessee cannot be held to be taxable as the assessee was not resident in India for the relevant AY.

Recent important Circular and Press Releases issued by the CBDT

1. Circular no 27/2017: Clarification on cash sale of agriculture produce by cultivators and agriculturist

It is clarified that cash sale of the agricultural produce by its cultivator to the trader for an amount less than Rs 2 Lakh will not:-

- result in any disallowance of expenditure under section 40A (3) of the Act in the case of trader;
- attract prohibition under section 269ST of the Act in the case of the cultivator; and
- require the cultivator to quote his PAN/ or furnish Form No.60.

The link to visit the circular is provided hereunder:

http://www.incometaxindia.gov.in/communications/circular/circular27_2017.pdf

2. PIB Press Release, dated December 13, 2017

Extension of date for linking Aadhar number with PAN

After considering various representations received and inputs received from banks, it has been decided to notify March 31, 2018 or six months from the date of commencement of account based relationship by the client, whichever is later, as the date of submission of the Aadhaar number, and Permanent Account Number or Form 60 by the clients to the reporting entity. Necessary notification in this regard has been issued.

The link to visit the press release is provided hereunder:

http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/676/Press-Release-CBDT-extends-date-Linking-Aadhaar-with-PAN-8-12-2017.pdf

3. CBDT Press Release, dated December 8, 2017

Actions taken against harassing officers

Income Tax department suspends specified officer of Income Tax posted at Surendranagar in Gujarat region for harassing a taxpayer in a scrutiny case with mala fide intention.

The link to visit the press release is provided hereunder:

http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/677/Press-Release-Income-Tax-Department-suspends-officer-harassing-taxpayer-8-12-2017.pdf

4. Indian Advance Pricing Agreement Regime moves forward with signing of two more 'APAs' by CBDT in Nov 2017.

The Central Board of Direct Taxes *('CBDT')* has entered into 2 Bilateral Advance Pricing Agreements *('APA's)* during the month of November 2017. These Agreements are the first ever Bilateral APAs with The Netherlands. With the signing of these Agreements, the total number of APAs entered into by the CBDT has gone up to 186. This includes 171 Unilateral APAs and 15 Bilateral APAs.

These two APAs pertain to the Electronics and Technology sectors of the economy. The international transactions covered in these agreements include Distribution, Provision of Marketing Support Services, Provision of Business Support Services, etc.

The link to visit the press release is provided hereunder:

http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/675/Press-Release-Indian-Advance-Pricing-Agreement-regime-moves-forward-1-12-2017.pdf

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