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An e-newsletter from
Lakshmikumaran & Sridharan, India

January 2022 / Issue–88

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Article

Reassessment notices issued under old regime – An attempt to revive a dead law?

By **Devashish Jain**

Introduction

The Covid-19 pandemic severely impacted the functionality of both government and citizens right from early 2020. Due to lockdowns and other preventive measures announced by the Government of India (‘**GOI**’), both taxman and taxpayers were unable to function normally.

Keeping these difficulties in mind, GOI introduced the Taxation and Other Laws (Relaxation of Certain Provisions) Ordinance, 2020 to relax certain timelines which were approaching, *inter alia,* under the Income-tax Act, 1961 (‘**IT Act**’). Subsequently, this Ordinance received presidential assent and was enacted as Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 (‘**TOLA**’).

Section 3 of the TOLA empowered GOI to extend certain timelines by issuance of notifications. In legal terms, the notifications issued in exercise of delegated powers by GOI are referred to as delegated legislation. In exercise of this power, Ministry of Finance extended the timeline for issuing re-assessment notices till 30 June 2021[1].

Meanwhile, by the Finance Act, 2021, the entire re-assessment law underwent a significant revamp. By Finance Act, 2021, the existing re-assessment provisions were substituted by a new set of provisions. The new provisions were made effective for all reassessments on or after 1 April 2021.

[1] Notification No. 1432 dated 31March 2021 and Notification No. 1703 (E) dated 27 April 2021.

Issue in hand

In the above background, the key question which has gathered the attention of the entire tax fraternity is:

After enactment of new reassessment law from 1 April 2021, whether reassessment notice can still be issued under the old law till 30 June 2021 and whether the old law still remains alive for such cases?

The Taxman has taken a position that the reassessment notices can be served under the old law till 30 June 2021 and the proceedings for such cases shall continue to be governed by the old provisions. This is because of the extension granted under TOLA read with the subsequent notifications.

As one could expect, the above position did not receive the assent of huge mass of taxpayers who received reassessment notices under the old law especially post 1 April 2021. Thus, the taxpayers questioned the validity of such notices by filing writ petitions before the jurisdictional High Courts.

So far, the petitions have been adjudicated and the final orders have been passed by the Chhattisgarh High Court, the Allahabad High Court, the Rajasthan High Court, and the Delhi High Court. Adding fuel to the raging fire, different High Courts have expressed contrary views on the issue. While the Chhattisgarh High Court has dismissed the writ petitions, other High

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Courts have allowed the petitions and have quashed the issuance of such reassessment notices. With two diverging views, the question is, which view is legally sound and expected to be adopted by other High Courts and most importantly, the Apex Court.

It is apposite to look at the reasoning given by both the Chhattisgarh High Court and the other High Courts while ruling as above.

Chhattisgarh High Court's ruling (Single bench)[2]

In view of the High Court, as a result of the notification issued by the Ministry of Finance for extending the time limit for issuance of notices, the individual identity of Section 148, which was prevailing prior to substitution, was insulated and saved till 30 June 2021.

According to the High Court, the notifications were issued by the Ministry of Finance by way of conditional legislation in the peculiar circumstances which arose during the pandemic and lockdown and the Central Government cannot be said to have encroached upon the turf of the Parliament.

Allahabad High Court's ruling (Division bench)[3]

The High Court gave the following reasoning for allowing the writ petitions:

- In the absence of any clause to save the old provisions, taxman could only initiate a re-assessment proceeding on or after 1 April 2021, under the new law. This is because, old provisions cannot survive once they have been replaced by new provisions, except for things done or already undertaken to be done or things expressly saved to be done.
- High Court also observed that delegated legislation (i.e., Notification) cannot overreach any principal legislation (i.e., Finance Act, 2021). Thus, it would be incorrect to refer to notifications issued under TOLA to interpret the provisions of the Finance Act, 2021.
- Harmonizing the new legislation and the notifications issued under the old legislation, the High Court noted that extended deadline of 30 June 2021 should be applicable only where the proceedings under old law have commenced prior to 1 April 2021. Cases where the proceedings have not been initiated by 1 April 2021, the amended law alone will apply.

In view of the aforesaid reasoning, the Allahabad High Court also expressly dissented from the view expressed by the Chhattisgarh High Court.

Rajasthan High Court's ruling (Single bench)[4]

The High Court relied upon the aforementioned decision of the Allahabad High Court for allowing the writ petitions and quashing the reassessment notice issued under Section 148 of the IT Act. However, it allowed assessing authority to initiate reassessment proceedings in accordance with the provisions of the Finance Act, 2021.

Delhi High Court's ruling (Division bench)[5]

In addition to relying upon the reasoning given by the Allahabad High Court, the Delhi High Court gave the following reasoning for allowing the writ petitions:

[2] *Palak Khatuja* v. *Union of India & Ors.,* W.P. (T) No. 149 of 2021 dated 23 August 2021.
[3] *Ashok Kumar Agarwal* v. *Union of India*, [TS-926-HC-2021(ALL)].
[4] *Bpip Infra (P.) Ltd.* v. *ITO*, [2021] 133 taxmann.com 48 (Rajasthan).
[5] *Mon Mohan Kohli* v. *Assistant Commissioner of Income-tax*, [2021] 133 taxmann.com 166 (Delhi).

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- Notices issued on or after 1 April 2021 have to comply with the provisions substituted by the Finance Act, 2021 with effect from 1 April 2021.
- TOLA can only change the timelines applicable to issue notice, but they cannot change the applicable statutory provisions.
- Taxman (i.e., Executive) cannot use the administrative power (i.e., issuing notifications) to undermine the expression of Parliamentary supremacy in the form of an Act (i.e., the Finance Act, 2021).
- Section 3(1) of TOLA does not empower the Central Government to postpone the date of applicability of a new law enacted by the legislature.
- Introduction of the new regime regarding re-opening of income-tax assessment is procedural in nature. Accordingly, the benefit of new provisions would be available for past assessment years.
- Non-obstante clause in TOLA cannot override the provision of the IT Act other than the applicable timelines.

In view of the aforesaid reasoning, the Delhi High Court dissented from the view expressed by the Chhattisgarh High Court.

Our comments

The issue of validity of reassessment notices issued under the old law from 1 April 2021 till 30 June 2021 has been in limelight recently. This is especially because of the divergent views laid down by different High Courts.

In humble view of the author, the reasoning and the view given by the Chhattisgarh High Court does not appear to be sound. This is because the notifications issued under the earlier law cannot supersede the newly enacted law. Especially when the notification was issued prior to enactment of the new provisions.

If the intention of the legislature was to save the validity of such notices issued under the old law, an express saving clause must have been introduced in the new legislation. In the absence of the same, such notices cannot be said to be valid.

The view expressed by the Allahabad High Court and the Delhi High Court are legally sound. The act of postponement of the new law by way of delegated legislation is contrary to the well-settled legal principle that subordinate legislation cannot be contrary to the parent statute[6].

Therefore, the rulings of the Allahabad High Court, the Rajasthan High Court, and the Delhi High Court are welcome rulings for all the taxpayers who had received re-assessment notices between 1 April 2021 and 30 June 2021. Accordingly, these rulings should act as *'guiding light'* for numerous writ petitions presently pending before other High Courts.

Nonetheless, with contrary rulings from High Courts, it is expected that the issue will knock the doors of the Supreme Court. Therefore, the taxpayers should remain ready for another round of battle before the Supreme Court.

Also, wherever possible, the Taxman will try to initiate reassessment proceedings under the new legislation. Needless to mention, the time-limit and the requirements as provided in the new provisions for issuance of reassessment notices will have to be abided by the Taxman. In case any notice is issued in non-adherence of the same, the validity of the same can also be challenged by the taxpayers.

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[6] *Indian Express Newspapers* v. *UOI*, AIR 1986 SC 515 and *State of Tamil Nadu* v. *P Krishnamurthy,* (2006) 4 SCC 517.

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Notifications and Circulars

Timelines extended for filing of income-tax returns and various audit reports for AY 2021-22

Vide Circular No. 01/2022, dated 11 January 2022, considering the difficulties faced by taxpayers and stakeholders due to Covid in filing of various reports of audit, the CBDT has provided relaxation in respect of the following compliances:

Particulars		Earlier due date	Extended due date
For assessees required to have their accounts audited and on whom transfer pricing is not applicable	**Furnishing Tax audit report for AY 2021-22**	15 January 2022	15 February 2022
	Furnishing Return of Income for AY 2021-22	15 February 2022	15 March 2022
For assessees on whom transfer pricing is applicable	**Furnishing Tax audit report for AY 2021-22**	31 January, 2022	15 February 2022
	Furnishing Return of Income for AY 2021-22	28 February 2022	15 March 2022
Furnishing form 3CEB for international transactions and specified domestic transactions for FY 2020-21		31 January 2022	15 February 2022
Form 3CEAA for master file		Same as return filing date	

CBDT has given the following clarifications with respect to the extensions provided *vide* this circular:

- The extensions provided by this Circular will not apply to the due date referred to in Section 234A of the IT Act, in cases where the amount of tax on the total income as reduced by the amount as specified in clauses (i) to (vi) of Section 234(1) exceeds INR 1 lakh.

  In other words, for computation of interest under Section 234A, the extension of due-dates will be ignored if the tax payable after deducting TDS, advance tax etc. is more than INR 1 lakh.

- However, the notification provides certain relief for computation of interest under Section 234A in case of an individual resident in India who is 60 years old or more during FY 2020-21.

  For the purpose of the above clarification, in case of an individual resident in India who does not have any income chargeable under the head PGBP (profits and gains from business or profession) and is 60 years old or more during FY 2020-21, the self-assessment tax paid by such individual within the due date (without extensions) provided in the IT Act, shall be deemed to be the advance tax. Accordingly, the burden of interest under Section 234A will be reduced.

Faceless Appeal Scheme, 2021 notified

In exercise of the powers granted to it under Sections 250(6B) and 250(6C) of the IT Act, the Central Government has, *vide* Notification No. 139 dated 28 December 2021, notified the Faceless Appeal Scheme, 2021 ('**new Scheme**'), in supersession of the Faceless Appeal Scheme, 2020 ('**earlier scheme**').

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Through the introduction of the new Scheme, the following key changes have been brought about in the faceless appeal process:

- The Regional Faceless Appeal Centres have been removed. Now, the National Faceless Appeal Centre shall directly assign the appeal for disposal to a Commissioner (Appeals) of a Specific Appeal Unit.
- The Commissioner (Appeals) are no longer required to pass a draft order. They are now empowered to directly pass an order under Section 251 of the IT Act.
- In case of a request for personal hearing, the Commissioner (Appeals) is now obligated to grant an opportunity of being heard.
- Section 249(4)(b) of the IT Act provides that no appeal shall be admitted unless at the time of filing the appeal, where no return has been filed by the appellant, the appellant has paid an amount equal to the amount of advance tax which was payable by him. However, in case the appellant files an application in this behalf, the Commissioner (Appeals) may exempt him from the operation of the provisions of that clause. While the earlier Scheme empowered the appeal unit to decide upon such an application, the new Scheme is silent in this regard.
- Recommendation to be sent to the National Faceless Appeal Centre for the initiation of penalty proceedings.
- Penalty proceedings would now be adjudicated upon by the same Commissioner (Appeals) who decided the appeal.
- All orders passed under the new Scheme must be digitally signed by the Commissioner (Appeals).
- Under the earlier Scheme, the delivery of electronic record to the appellant through any mode was to be followed by a real time alert. However, under the new Scheme, the requirement of a real time alert is only applicable if the electronic record is delivered by uploading an authenticated copy on the Mobile App of the appellant.

E-Verification Scheme, 2021 notified

Section 135A of the IT Act empowers the Central Government to make a scheme for faceless collection of information to impart greater efficiency, transparency and accountability. Exercising the afore-mentioned power, the Central Government has, *vide* Notification No. 137 dated 13 December 2021, notified the e-Verification Scheme, 2021 ('**e-verification Scheme**'). The scope of this scheme is with respect to:

- calling for information under Section 133 of the IT Act; or
- collecting certain information under Section 133B of the IT Act; or
- calling for information by prescribed income-tax authority under Section 133C of the IT Act; or
- exercise of power to inspect register of companies under Section 134 of the IT Act; or
- exercise of power of Assessing Officer under Section 135 of the IT Act.

The e-Verification Scheme provides for the processing or utilisation of the information that is either in possession of or made available to the Principal Director General of Income-tax (Systems) or Director General of Income-tax (Systems) by any authority or person (such as Director General of Income-tax (Intelligence and Criminal Investigation), CIT in charge of the CPC).

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The scheme also lays down the manner of electronic collection and verification of information, manner of allocation of information, issue and services of notices, response to notices etc.

Timeline extended for verification of electronically filled ITRs

Upon being brought to its notice that a large number of income-tax returns for AY 2020-21 are pending for electronic verification, the CBDT has *vide* Circular No. 21 of 2021 dated 28 December 2021 provided relaxation to taxpayers by extending the last date to 28 February 2022. However, this relaxation shall not apply in those cases, where the department has already taken recourse to any other measure specified in the IT Act for ensuring the filing of the income-tax return after declaring the return as *non-est*.

Additionally, the CBDT has also relaxed the time frame for issuing intimation under the second proviso to Section 142(1) of the IT Act and directing that such returns shall be processed by 30 June 2022. It has also been provided, that in cases of refunds, while determining the interest, provisions of Section 244A(2) of the IT Act would apply.

Insertion of Rule 21AK – Conditions for purpose of Section 10(4E)

Section 10(4E) was inserted into the IT Act by the Finance Act, 2021 to exclude the income of non-residents from transfer of non-deliverable forward contracts entered into with an offshore banking unit of an International Financial Services Centre, subject to the fulfilment of such conditions as may be prescribed.

Now *vide* Notification No. 136 dated 10 December 2021, the CBDT has prescribed the following conditions for the purpose of Section 10(4E) by inserting Rule 21AK in the IT Rules:

- the non-deliverable forward contract is entered into by the non-resident with an offshore banking unit of an International Financial Services Centre which holds a valid certificate of registration granted under International Financial Services Centres Authority (Banking) Regulations, 2020 by the International Financial Services Centres Authority; and
- such contract is not entered into by the non-resident through or on behalf of its permanent establishment in India.

  The definitions of the terms ‘permanent establishment’, ‘a non-deliverable forward contract’ and ‘offshore banking unit’ have also been defined in the Explanation to the said rule.

Computation of capital gains of resultant fund for the purposes of Section 10(23FF)

Section 10(23FF) of the IT Act operates to exempt any income from capital gains, arising or received by a non-resident or a specified fund, on account of transfer of shares of a company resident in India, where:

- The transfer of such shares has been done by a resultant fund (fund established or incorporated in India) or a specified fund to the extent attributable to units held by non-resident (not being a PE in India); and
- Such shares were transferred from the original fund, or from its wholly owned SPV, to the resultant fund in relocation; and
- Capital gains on such shares were not chargeable to tax in the hands of the original fund had that relocation not taken place.

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'Relocation' has been defined to mean transfer of assets of the original fund or of its wholly owned SPV, to a resultant fund on or before the 31 March 2023, where either the shareholder or unit holder or interest holder of the original fund or to the original fund receives shares or units or interest in the resulting fund as consideration for such transfer.

Now *vide* Notification No. 138 of 2021 dated 27 December 2021, the CBDT has inserted rule 2DD in the IT Rules whereby the mode of computation of exempt income mentioned in Section 10(23FF) of the IT Act has been specified along with the compliances in relation thereto.

SEZ units – Form of particulars to be furnished along with return of income for claiming deduction under Section 10A(1B)(b)

Section 10A(1A) of the IT Act provides for certain deductions to undertakings set up in special economic zones for manufacturing or producing articles or things or computer software. Section 10A(1B) lays down the conditions that must be fulfilled for claiming such deduction under Section 10A(1A)(ii) for three consecutive assessment years, following the initial five assessment years in which the deduction is available.

Vide Notification No. 140 dated 29 December 2021, the CBDT has prescribed Form No. 56FF for furnishing the particulars required under Section 10A(1B)(b) of the IT Act.

Ratio Decidendi

Surcharge on sales tax and turnover tax is not 'fee' or 'charge', hence, falls outside the scope of Section 40(a)(iib) of IT Act

In this case, assessee was a state-owned undertaking engaged in the wholesale and retail trade of beverages. The issue involved was whether following expenses were required to be disallowed under Section 40(a)(iib) of the IT Act: (a) turnover tax and surcharge on sales tax; and (b) gallonage fee, license fee and shop rental with respect to FL-9 and FL-1 licenses.

Aforesaid Section provides for disallowance of certain amounts which are levied exclusively on, or which is appropriated (directly or indirectly) from any State government undertaking by the State Government. Such amounts include royalty, license fee, service fees, privilege fees, service charge or any other fee or charge, by whatever name called.

The conclusions and the reasoning given by the Supreme Court in the present case are as follows:

- *Turnover tax and surcharge on sales tax*: The Supreme Court accepted the contention of the assessee and held that turnover tax and surcharge on sales tax are outside the purview of Section 40(a)(iib) of IT Act. This is based on the reasoning that turnover tax and

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surcharge on sales tax is not a fee or charge coming within the scope of said Section. The court observed that a clear distinction between 'fee' and 'tax' is carefully maintained throughout the scheme under Section 40(a) of the Act itself. Wherever the Parliament intended to cover tax, it specifically mentioned it as a tax. Hence, said amounts cannot be disallowed.

- *Fees in nature of gallonage fees, license fee and the shop rental*: These levies are payable for the licenses issued under FL-1 (held by assessee and one other entity) and FL-9 (held by only assessee and no other entity). Supreme Court decided the issue against the assessee and held that fees payable with respect to both licenses should be disallowed under Section 40(a)(iib).

  The High Court had held that levies relating to FL-9 licenses are covered by said Section as it is levied exclusively on assessee. However, the High Court held that the levies relating to FL-1 are not covered under said Section as this license is not exclusively issued to assessee but also issued to one other entity.

  The Supreme Court rejected the aforesaid interpretation of High Court and held that the aspect of 'exclusivity' under Section 40(a)(iib) must be viewed from the nature of undertaking on which levy is imposed and not on the number of undertakings on which the levy is imposed. In the present case, levies related to both licenses were levied on state government undertakings, therefore, levy was an exclusive levy on said undertakings.

[*Kerala State Beverages Manufacturing and Marketing Corp Ltd.* v. *Assistant Commissioner of Income-tax* – Order dated 3 January 2022 in Civil Appeal No. 11/12/13/14 of 2022, Supreme Court]

Dividend distribution tax not payable where assessee exempted under Section 50 of SIDBI Act – Section 50 of SIDBI Act overrides Section 115-O of IT Act

The assessee was a financial institution established under the SIDBI Act[7]. The issue involved in this writ petition was whether dividend as per Section 115-O of IT Act is payable in case the assessse is exempted under Section 50 of SIDBI Act. Section 115-O of IT Act imposes a tax on the company on the amount of dividend declared, distributed or paid notwithstanding anything contained in any other provisions of IT Act.

In this case, the assessee paid tax as per Section 115-O under protest on dividend distributed by it and claimed refund of the same. The assessee contended that Section 50 of the SIDBI Act exempted the assessee from payment of any income tax or any other tax regarding any income, profits or gains derived or any amount received by assessee. Hence, in assessee's view, tax on payment of dividend as per Section 115-O of IT Act is exempted by virtue of Section 50 of SIDBI Act.

The Department, on the other hand, contended that any amount distributed or paid by the company by way of dividend is not covered by Section 50 of SIDBI Act and therefore, the assessee was liable to pay additional tax on the amount distributed by way of dividend.

The High Court held that Section 50 of SIDBI Act will override Section 115-O of IT Act. The Court observed that Section 50 of SIDBI Act contains non-obstante clause giving overriding effect over provisions of Income-tax Act in respect of any income, profits, gains derived, or any amount received by the company. For interpreting non-

[7] Small Industries Development Bank of India Act.

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obstante clause, the statute in which it appears must be borne in mind. The object of SIDBI Act is to establish SIDBI Bank as the principal financial institution for promotion, financing and development of industry in small-scale sector. The grant of exemption from payment of income tax was to provide an impetus to achieve aforesaid objectives in the formative years.

The Court also relied on Section 115R of IT Act which contains a non-obstante clause giving effect over Section 32 of Unit Trust of India Act (Section similar to Section 50 of SIDBI Act). It noted that similar provision in Section 115-O with respect of Section 50 of SIDBI Act was not present. The Court observed that this indicated that whenever legislature wants to give overriding effect over exemption from payment of tax under any Act, specific provision is inserted in IT Act, giving overriding effect over said Act which provides for an exemption from payment of Income-tax.

Further, the Court held that the sub-Section (2) of Section 115-O of IT Act has limited operation and is not applicable in the present case. This is because said sub-section applies if a total income of a company is computed in accordance with the provisions of IT Act. In the present case, no income is computed at all under IT Act, in view of the overall overriding effect of Section 50 of SIDBI Act. [*Small Industries Development Bank of India* v. *CBDT and Ors.* – Order dated 2 December 2021 in W.P. No. 1994 of 2003, Bombay High Court]

Initiation of re-assessment proceedings subsequent to approval of Resolution Plan is not valid

The issue involved in this writ petition was whether the Income-tax Department can issue notice under Section 148 of IT Act to a corporate debtor calling upon it to submit Income-tax return for the assessment year falling prior to the date of approval of Resolution Plan under Insolvency and Bankruptcy Code, 2016 (‘**IBC**’).

In this case, Corporate Insolvency Resolution Process was initiated against the petitioner. Thereafter, the Resolution Professional made a public announcement calling upon the creditors to submit a proof of their claim. Thereafter, the resolution plan was approved by NCLT. Subsequent to the approval of resolution plan, a notice under Section 148 of IT Act was issued against the petitioner.

The petitioner challenged the notice under Section 148 of IT Act mainly on the ground that it is contrary to Supreme Court’s decision in the case of *Ganashyam Mishra and Sons Private Limited* v. *Edelweiss Asset Reconstruction Company Limited* [2021(9) SCC 657]. The petitioner contended that Income Tax Department could not have issued the impugned notice subsequent to the approval of the Resolution Plan by the Adjudicating Authority i.e. NCLT. The petitioner contended that claims which were not a part of the Resolution Plan are not maintainable against the corporate debtor, nor can any claim be initiated thereafter and hence, the respondents are not entitled to initiate any proceedings of recovery of any dues from the petitioner.

The Department, on the other hand, contended that impugned notice could not be a part of the resolution plan in as much as the claim had not crystallised at that time. Therefore, according to the Department, such statutory claim is maintainable even after the approval of the Resolution Plan.

The High court rejected the contentions of the Department and held that after approval of

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Resolution Plan by the Adjudicating Authority, a creditor including the Central Government, State Government or any local authority is not entitled to initiate any proceedings of recovery of any of the dues from the corporate debtor, which are not part of the approved Resolution Plan. The claims which were not a part of the Resolution Plan including recoverable statutory dues shall stand extinguished upon approval of the resolution plan. In this regard, the High Court relied on the Supreme Court ruling in *Ganashyam Mishra and Sons Private Limited* (Supra).

Further, the High Court observed that there could be a case where statutory authority was precluded from raising the claim in the CIRP proceedings because of the fault attributable to the corporate debtor such as escapement of income because of suppression of facts by the assessee and the suppressed fact has been noticed by the assessing officer subsequent to the approval of the Resolution Plan. In the present case, the High Court observed that the impugned notice is silent on the point and reasons could not be gathered for not raising the claim earlier before Resolution Professional or NCLT. [*Murli Industries Limited* v. *ACIT* – Order dated 23 December 2021 in Writ Petition 2948 of 2021, Bombay High Court]

Faceless Assessment Scheme does not mean no personal hearing – Word 'may in Section 144B(7)(viii) should be read as 'must' or 'shall'

The Delhi High Court has opined that a faceless assessment scheme does not mean no personal hearing. The Court in this regard was of the view that where an action entails civil consequences, observance of natural justice would be warranted and unless the law specifically excludes the application of natural justice, it should be taken as implanted into the scheme. It noted that in fact, the opportunity to provide hearing before making any decision is considered to be a basic requirement in Court proceedings.

Commenting on the use of the word 'may' in Section 144B (7)(viii) of the Income-tax Act, 1961, the Court was also of the view that where a discretion is conferred upon a quasi-judicial authority whose decision has civil consequences, the word 'may' which denotes discretion should be construed to mean a command. It held that that the word 'may' in Section 144B(7)(viii) should be read as 'must' or 'shall' and that the requirement of giving an assessee a reasonable opportunity of personal hearing is mandatory.

The Division Bench also failed to understand as to how grant of personal hearing would either frustrate the concept or defeat the very purpose of Faceless Assessment Scheme. It stated that the identity of the assessing officer can be hidden/protected while granting personal hearing by either creating a blank screen or by decreasing the pixel/density/resolution. [*Bharat Aluminium Company Ltd.* v. *Union of India* – Judgement dated 14 January 2021 in W.P.(C) 14528/2021, Delhi High Court]

Royalty arising in India to a resident of Germany will be taxable on receipt basis under India-Germany DTAA

In this case, assessee, a company incorporated in Germany, entered into royalty agreement with an Indian company for grant of use of trade mark of assessee. The assessee was following cash basis of accounting for offering its Indian source income to tax in India. The assessee waived off a particular amount of the royalty for assessment year in question as the Indian entity was facing liquidity crisis and was not able to make royalty payments to the assessee.

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The issue involved in this case was whether royalty arising to the assessee is to be taxed on receipt basis or accrual basis.

The ITAT decided the issue in favour of the assessee by holding that royalty is to be taxed on receipt basis in the hands of the assessee. The ITAT relied on Article 12 of India-German DTAA. The clause 1 of said article provides that royalty arising in a contracting state and **paid** to a resident of other contracting state may be taxed in the other state. Clause 3 of said Article provides that royalty is a payment of any kind received as a consideration. The ITAT observed that a conjoint reading of clause 1 and clause 3 of Article 12 of India-Germany DTAA shows that royalty has to be **paid** to a resident and royalty has to be **received** as a consideration. In the present case, neither the Indian entity paid the royalty nor the assessee received the same as consideration. In this regard, the ITAT relied on the case of *Pizza Hut international,* 22 taxmann.com 111 and *CSC Tech Singapore Pre,* 19 taxman.com 123.

The ITAT also distinguished the Supreme Court judgment in the case of *Standard Triumph Motors.* In said judgment, the SC had held that royalty arising to a non-resident will be taxable only on accrual basis under IT act irrespective of the fact that the non-resident is maintaining its accounts on cash basis.

According to the ITAT, the Apex Court did not have the chance to interpret the treaty as none maybe existed at that time. Therefore, in terms of Section 90 of IT Act, treaty was applied as the interpretation under treaty was more favourable to the assessee. [*Faber Castell* v. *ACIT* – Order dated 9 December 2021 in ITA No. 7619/Del/2017, ITAT Delhi]

Remittance of employee's contribution to PF and ESI – Explanation 2 to Section 36(1)(va) is not clarificatory and will apply prospectively from AY 2021-22 onwards

In this case, disallowance under Section 36(1)(va) of IT Act was made on account of late remittance of employee's contribution to PF and ESI beyond the due dates under respective acts but before date of filing return u/s 139(1) of IT Act. The relevant assessment year was AY 2019-20. Section 36(1)(va) of IT Act provides that a deduction will be allowed to the assessee of any sum received by the assessee from any of his employees if such sum is credited by the assessee to the employee's account in the relevant fund or funds on or before the due date. Explanation 1 of Section 36(1)(va) provides that 'due date' means the date by which the assessee is required as an employer to credit an employee's contribution to the employee's account in the relevant fund as per the provisions of the relevant Act.

The assessee contended it has paid the employee's contribution to PF and ESI prior to the due date of filing return under Section 139(1) of IT Act having regard to first proviso of Section 43B. Therefore, it was submitted by the assessee that it is entitled to deduction of the employee's contribution of PF and ESI. The assessee relied on the case of *Essae Teraoka Pvt. Ltd.* v. *DCIT* [366 ITR 408].

The ITAT held that the assessee would be entitled to deduction of employee's contribution to PF and ESI since the payments were made prior to the due date of filing of the return of income under Section 139(1) of IT Act in accordance with Section 43B of IT Act. The ITAT applied Section 43B in the present case and observed that the word 'contribution' used in clause (b) of Section 43B means contribution of the employer and employee, that being so, if the contribution is made on or before the due date for

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furnishing the return of income under Section 139(1), the employer is entitled to deduction. In this regard, the ITAT relied on jurisdictional HC case in *Essae Teraoka Pvt. Ltd.* (Supra)

ITAT gave a specific finding on the applicability of Explanation 2 to Section 36(1)(va) inserted by Finance Act 2021 (w.e.f. 1 April 2021). The Explanation 2 to Section 36(1)(va) provides that '*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'.*

The ITAT held that said amendment is not clarificatory as the same has been mentioned to be effective from 1 April 2021, and will apply from AY 2021-22 onwards. Further, the ITAT relied on the Supreme Court case of *Aqua Technologies Limited* v. *CIT* [(2021) 436 ITR 582] to hold that, the term 'removal of doubts' cannot be presumed to be making the amendment retrospective if it alters or changes the law as it earlier stood. In the present case, in view of judgment of the jurisdictional High Court in the case of *Essae Teraoka*, the assessee would have been entitled to deduction of employee's contribution to ESI, if the payment was made prior to due date of filing of the return of income. Therefore, the ITAT held that since the said amendment brought about by the Finance Act, 2021 alters the position of law adversely to the assessee, it will be applicable prospectively. [*Eskay Heat Transfers Private Limited* v. *ACIT* – Order dated 8 December 2021 in ITA No. 534/Bang/2021, ITAT Bangalore]

No TDS under Section 194H of IT Act on payment of bank guarantee fee

The assessee was a company engaged in the business of manufacturing of energy meters and meter parts. It had paid bank guarantee fee to bank. The Assessing Officer held that the assessee was obligated to deduct tax at source under Section 194H of IT Act. Having failed to do so, assessee's claim for deduction of bank guarantee fee was disallowed under Section 40(a)(ia) of IT Act.

Section 194H provides for deduction of tax on payment of commission or brokerage. The term 'commission or brokerage' is defined as including any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to any asset, valuable article or thing, not being securities.

The ITAT held that the assessee was not required to deduct tax at source under Section 194H of IT Act. This is because Section 194H does not cover bank guarantee fee that is charged by the bank for rendering banking services in the normal course of its business.

The ITAT relied on case of *CIT* v. *JDS Appraisal Pvt. Ltd.* [(2015) 370 ITR 454 (Delhi HC)] wherein it was held that fee charged by the bank for rendering banking services could not be treated as a commission or brokerage paid in course of use of any services by a person acting on behalf of another for buying or selling of goods. Therefore, no obligation was cast upon the assessee to deduct tax at source under Section 194H.

The ITAT observed that when a bank issues bank guarantee on behalf of the assessee, there is no principal-agent relationship between the bank and the assessee which is a mandatory condition for invoking the provisions under Section 194H of IT act. Reliance was placed on the ITAT Delhi judgement in case of *Navnirman Highway Project Pvt. Ltd.* v. *DCIT* [ITA No. 117/Del/2017].

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Further, the ITAT also observed that the scope of the expression 'commission' was to be confined to an allowance, recompense or reward made to agents and brokers for affecting sales and carrying out business transactions and shall not extend to the payments such as 'bank guarantee commission'. The same is in the nature of fees for services rendered or product offered by the recipient of such payments on principal to principal basis. Therefore, fees charged by the bank as bank guarantee commission, which though is termed as 'guarantee commission', is not in nature of 'commission' as envisaged in Section 194H of IT Act. In this regard, reliance was placed on the judgment of ITAT Mumbai in *Kotak Securities Ltd.* v. *DCIT* [14 ITR 495]. [*Elymer International Pvt. Ltd.* v. *ACIT* – Order dated 10 December 2021 in ITA No. 5076/Del/2018, ITAT Delhi]

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