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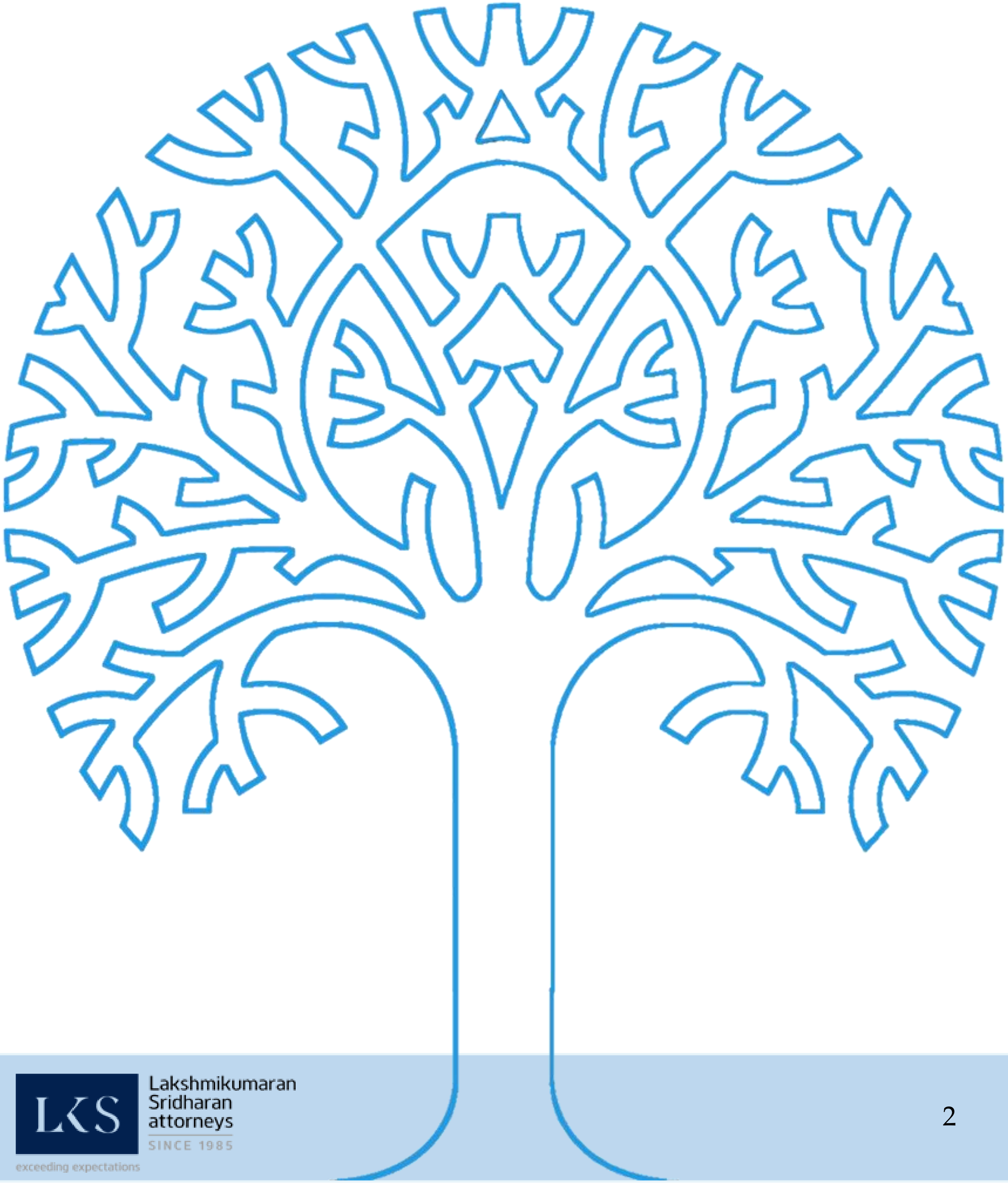

Article

Taxability of sale consideration retained in escrow: A conundrum

By **Tanmay Bhatnagar, Snehal Ranjan Shukla and Avar Lamba**

Ordinarily in the case of a sale, the price mutually agreed upon by the parties which is received by or accrues to a seller should be taken as the *'full value of the consideration'* for calculating capital gains. However, a legal quandary arises in the cases where a portion of the consideration is retained in an escrow account under an agreement between the parties. Taking note of various case law, the article ponders over the questions as to whether such retained amount falls within the purview of 'full value of the consideration' and what would be the year of taxation in such case. Highlighting that the language utilized in the sale agreement becomes critical for determining the taxability of the sums retained in an escrow account, the authors also list various factors the parties should keep in mind in such sales. According to them, the taxpayers should carefully determine their rights and liabilities towards the escrow sums to trace their tax liabilities.

Taxability of sale consideration retained in escrow: A conundrum

By Tanmay Bhatnagar, Snehal Ranjan Shukla and Avar Lamba

Profits or gains arising from transfer of a capital asset are charged to tax under Section 45 of the Income Tax Act, 1961 ('**Act**') as capital gains. Capital gains are computed under Section 48 of the Act by deducting the cost of acquisition of the asset, its cost of improvement or the expenditure incurred in connection with transfer from the '*full value of the consideration*' received or accruing as a result of such transfer.

Barring the legal fictions created to deal with certain specific transfers, the phrase '*full value of the consideration*' has not been defined under the Act. In the context of a sale, the Hon'ble Supreme Court[1] has defined the said phrase to mean the price bargained for by the parties to the sale. Therefore, ordinarily in the case of a sale, the price mutually agreed upon by the parties which is received by or accrues to a seller should be taken as the '*full value of the consideration*' for calculating capital gains.

Having stated the above, a legal quandary arises in the case of those sales where a portion of the consideration has been retained in an escrow account under an agreement between the parties. In this context two issues arise:

- Would such retained amount fall within the purview of '*full value of the consideration*'?
- If such retained amount is to be taxed, what would be the year of taxation, namely, the year in which the transfer takes place or the year in which the retained amount is released to the seller?

One can imagine that where the consideration otherwise accrued in the escrow is sought to be applied towards agreed purposes, the gross consideration accrues to the transferor and should be taxed in the year of transfer. However, practically, such retentions may be far more complex. There are cases where the consideration is parked in escrow and the accrual of consideration is dependent on contingencies to be satisfied in future. These contingencies could be in the form of disposal of litigations, meeting agreed performance parameters or expiry of certain statutory periods. In all such cases, one could argue that the sums in escrow would accrue upon completion of the

[1] *CIT* v. *Gillanders Arbuthnot & Co.*, [1973] 87 ITR 407 (SC)

contingency recognized by the contracting parties. Thus, the inclusion and timing of sums in escrow to sale consideration becomes litigious. In this context, depending on the facts of each case, judicial forums have elucidated on taxation of sums in escrow which have been discussed in the subsequent paragraphs.

(a) ***Caborandum Universal* v. *ACIT*[2], Madras High Court**

In the case of *Caborandum Universal Ltd.*[3] the seller sold its plant by way of a business sale agreement ('**BSA**'), whereunder an amount of INR 31.14 crore was the *'Full and Final Consideration'* for the transfer. The BSA also provided that, out of the aforesaid sum, a sum of INR 3.25 crore was to be set aside and kept in an escrow account which was operable with the consent of both the parties. The BSA further stated that the sum kept in the escrow account was to be used to indemnify the purchaser for any post-sale contingent liabilities and the interest accruing on the said sum belonged to the seller.

The seller excluded the sums in the escrow account to compute capital gains and paid tax on such gains in the year of transfer. Further, since no contingent liabilities materialized during the agreed period, no withdrawals were made by the purchaser from the escrow account and the entire sum therein was received by the seller. The seller offered the sum lying in the escrow account to tax as capital gains in the year of the receipt. The Income-tax Department ('**Department**'), however, contended that the entire sum lying in the escrow account should have also been offered to tax in the year in which the transfer took place.

Disagreeing with the position by taken by the seller in this case, the High Court of Madras held that the entire sale consideration would be taxable in the year of transfer since:

- Setting aside of a portion of the sale consideration in an escrow account, after mutually agreeing upon a *'Full and Final Consideration'*, would represent application of income as the consideration received from the transfer would thereafter be utilized for the purpose of meeting contingent liabilities. Such conduct of the parties to the transaction would not exclude the said amount from the purview of consideration being received by/accruing to the seller for computing capital gains under section 48 of the Act.

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[2] [2021] 130 taxmann.com 133 (Madras)

[3] *Ibid.*

- As the interest on the sum retained in the escrow account accrued in favour of the seller, and the escrow account was operable only with the consent of both the parties, the seller had a clear right over the retained sum. Thus, even if a portion of the retained consideration were to be utilised to indemnify the purchaser, it would not alter the full consideration received by/accruing to the seller pursuant to the BSA.

It is pertinent to note that the aforementioned judgement has been challenged by the seller before the Supreme Court and the said appeal has been admitted.[4]

(b) *Dinesh Vazirani* v. *PCIT*[5], Bombay High Court

In its subsequent decision in *Dinesh Vazirani*[6], the High Court of Bombay has upheld re-computation of capital gains to give effect to the downward adjustment of escrow sums. In this case, a total sale consideration of INR 155 crore agreed upon under the share purchase agreement (‘**SPA**’) for the transfer of the shares of a company. Out of the said total sale consideration, an amount of INR 30 crore was retained in an escrow account for 2 years to indemnify the purchaser for any liability that might arise post the transfer of shares. The seller computed the capital gains from such transfer by considering the total sale consideration of INR 155 crore as the ‘*full value of the consideration*’ and offered the same to tax in the year of transfer.

Subsequently, certain liabilities arose in the company for the period prior to the share sale, on account of which an amount of approximately INR 9 crore was withdrawn from the escrow account. Thus, at the end of the 2-year period stipulated in the SPA, the remaining sum of approximately INR 21 crore was released to the seller. Considering the same, the seller filed an application before PCIT for recomputing the capital gains, that had already been offered to tax, after reducing the amount that had been withdrawn from the escrow account from the ‘*full value of the consideration*’ as the said amount never accrued to the seller.

However, the said revision application was rejected by the PCIT *inter-alia* on the ground that while computing capital gains under Section 48 of the Act only the cost of acquisition, cost of improvement or expenditure incurred exclusively in connection with the transfer could be reduced from the total sale consideration under the SPA. The indemnification clause

[4] C.A. No. 8054/2024 arising out of SLP(c) No. 17978/2022

[5] [2022] 140 taxmann.com 581 (Bombay).

[6] *Ibid.*

in the SPA, for meeting contingent liabilities which may arise subsequent to the transfer, cannot be reduced from consideration received for computing capital gains.

The Bombay High Court, however, quashed the PCIT's order and observed as follows:

- As per the SPA between the parties, the purchase price defined therein was not an absolute amount and was subject to certain liabilities contemplated therein that might arise due to certain subsequent events.
- The portion of the retained consideration that had been withdrawn by the purchaser had neither been received by the seller nor did it accrue to the seller, as the said amount was transferred directly to and thereafter withdrawn from the escrow account.
- Tax can be levied only on the real income of the seller, which in this case would be the total sale consideration as reduced by the amount withdrawn from the escrow account. This was because the liability for which the amount was withdrawn was contemplated in the SPA and had to be taken into account while determining the *'full value of the consideration'*. Irrespective of the fact that the actualisation of the contingent liabilities is a subsequent event, the same ought to be taken into consideration for determining capital gains.

(c) *Modi Rubber Ltd.* v. *DCIT*[7], ITAT Delhi

Analysing the aforesaid decisions, the ITAT Delhi in *Modi Rubber Ltd.*[8] emphasised that the question of taxability of the consideration retained in an escrow account has to be decided as per the facts of the case and a principle for universal application cannot be laid down.

In this case, the seller sold the shares of a company for a total consideration of approximately INR 117 crore out of which an amount of approximately INR 25 crore was kept aside in an escrow account for indemnifying the purchaser against some liabilities. The operation of the escrow account was under joint instructions of the seller and the purchaser, and the amount kept in escrow was to be released at pre-determined points of time along with the accrued interest after adjustment of claims of indemnification. The seller excluded the sum retained in the escrow account from the *'full value of the consideration'* for computing capital gains. Subsequently, in another year, some portion of the retained money was received

[7] I.T.A. No. 6866/DEL/2018.

[8] *Ibid*.

by the seller and offered to tax as capital gains in that year. Furthermore, during the period of retention, substantial claims of more than approximately INR 78 crore had been identified and raised against the retention amount remaining in the escrow account.

The ITAT Delhi, while ascertaining the tax treatment of the part of consideration retained in an escrow account, differentiated the judgement in *Caborandum Universal*[9] by holding that, unlike the facts of the present case, therein the entire amount placed in the escrow account was returned to the seller without any deductions and accordingly, the question of amendment of the '*full value of the consideration*' for computing capital gains did not arise. Accordingly, in that case the entire sale consideration, including the amount lying in the escrow account, was held to be taxable under the head capital gains.

The ITAT instead placed reliance on the decision in *Dinesh Vazirani*[10] by holding that it was factually identical to the case before it. Basis the same, the ITAT held that even though the sum retained in the escrow account forms a part of the mutually agreed consideration, such an amount would not necessarily form part of the '*full value of the consideration received or accruing*' as result of transfer of a capital asset in a case where there is a likelihood that the retained sum may never come into the hands of the seller. It also held that the retained sum shall not be taxed in the year in which the transfer of the asset took place.

Analysis

As may be seen from the above, different views have been taken by various judicial forums regarding the inclusion of the amounts set aside in an escrow account in the '*full value of the consideration*' and also the year in which the said amounts are to be taxed:

- ***Caborandum Universal***[11] - The amounts set aside in an escrow account must be taken into consideration for determining the '*full value of the consideration*' for computing capital gains. Thus, the amounts retained in the escrow account are to be taxed in the year in which the transfer has taken place.
- ***Dinesh Vazirani***[12] - The subsequent adjustment to amounts set aside in an escrow account must be reduced from the total sale consideration agreed by the parties for determining the '*full value of the consideration*'

[9] Supra at 2.
[10] Supra at 4.
[11] Supra at 2.
[12] Supra at 4.

for computing capital gains. However, the question regarding the year in which the retained amounts are to be taxed never arose before the High Court.

- ***Modi Rubber Ltd.***[13] - The ITAT Delhi has followed the position laid down in *Dinesh Vazirani*[14] regarding the reduction of the amounts set aside in an escrow account while determining the *'full value of the consideration'* for computing capital gains. Further, it has held that the said amounts must be taxed in the year in which they are received by the seller.

In light of the above discussion, it may appear that the position taken by the ITAT Delhi represents a successful middle path for taxpayers as: (a) it gives the benefit of reduction of the retention amount lying in the escrow account for computing capital gains and; (b) also the benefit of the retention money only being chargeable to tax in the year in which it is received.

However, the latter position regarding the timing of taxation of the sums retained in the escrow account may face challenge from the Department as it may be argued that Section 45(1) of the Act provides that the capital gains arising from a transfer shall be the income of the year in which the transfer takes place. The Department may also argue that upon a perusal of Section 45 of the Act, it becomes apparent that the situations wherein the Legislature's intent was to take a particular transfer out of the purview of Section 45(1) and defer the taxation of capital gains, specific provisions have been enacted with a non-obstante clause to Section 45(1). To illustrate the same, reference is being made to some of the said provisions:

- Section 45(1A) provides that where any person receives an insurance payout on account of damage to, or destruction of, any capital asset then the capital gains arising from the receipt of such money shall be chargeable to tax in the year in which such money was received and not in the year in which the asset is damaged/destroyed.
- Section 45(5) *inter-alia* provides that where the capital gain arises from the transfer of a capital asset as a result of its compulsory acquisition under any law and the compensation for such transfer is enhanced or further

[13] Supra at 9.

[14] Supra at 4.

enhanced by any authority, the capital gain shall be chargeable to tax in the following manner:

- The capital gains computed with reference to the initial compensation awarded shall be chargeable to tax in the year in which such compensation is received; and
- The amount by which the compensation is enhanced shall be chargeable to tax in the year in which such an amount is received.

Furthermore, considering the fact that the '*full value of the consideration*' may vary depending on the contingent liabilities that may be met out of the sums retained in the escrow account, it may be that the Department may take a position that since the consideration accruing to the seller as a result of the sale is unascertainable, the provisions of Section 50D of the Act may be invoked and the fair market value of the said asset on the date of transfer shall be deemed to be the '*full value of the consideration*'.

Accordingly, as is apparent from the above discussion, the position in the case of a taxpayer would completely depend on the facts and circumstances in their case. Thus, the language utilized in the sale agreement becomes critical for determining the taxability of the sums retained in an escrow account and therefore the parties to such sale should keep in mind factors such as:

i. What does the sale agreement provide regarding the right of the seller to receive the sums retained in the escrow account?

ii. Whether the retention has been made by way of the same sale agreement which facilitates the transfer of the capital asset?

iii. What are the rights or control, if any, that the seller has over the sums retained in the escrow account?

iv. What will be the right of the seller over the interest, if any, that may accumulate in the escrow account?

v. What is the nature of the liabilities for which the purchaser is being provided an indemnity through the sums lying retained in the escrow account?

vi. What is the likelihood of materialisation of the liabilities for which the purchaser is being provided an indemnity through the sums lying retained in the escrow account?

vii. Whether the sums retained in the escrow account have actually been utilized to meet some claims/indemnify the purchaser?

Therefore, till the time the position regarding the sums retained in an escrow account is not settled by way of the decision of the Supreme Court, any position taken by a taxpayer in relation thereto is likely to be litigative. The specifics of each agreement will play a critical role in determining the liability of the taxpayer. Thus, till the time some final word is spoken on the subject by the Supreme Court, the taxpayers should carefully determine their rights and liabilities towards the escrow sums to trace their tax liabilities in relation to these sums.

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Notifications & Circulars

- Direct Tax Vivad se Vishwas Scheme, 2024 – Guidance Note issued
- Due date for furnishing return of income for Assessment Year 2024-25 extended for certain assessees
- Cooperative societies claiming deduction under Section 80P – Condonation of delay under Section 119(2)(b) for delayed returns of income for AY 2023-24
- Monetary limits of income-tax authorities for entertaining applications under Section 220(2A) for reduction or waiver of interest payable under Section 220(2)
- Income-tax Rules, 1962 amended – Changes made in Rules 26B, 31AA, and 37-I
- No TCS on payments received from Reserve Bank of India
- Valuation – Transaction price to be deemed to be Arm's Length Price in certain cases

Direct Tax Vivad se Vishwas Scheme, 2024 – Guidance Note issued

The Direct Tax Vivad se Vishwas Scheme, 2024 ('**DTVSV Scheme, 2024**') was enacted *vide* the Finance (No.2) Act, 2024 to provide for dispute resolution in respect of pending income tax litigation. After enactment of the scheme, several queries were raised by the assessees seeking guidance in respect of the provisions of the scheme.

To answer the queries, the Central Board of Direct Taxes ('**CBDT**') has, under Section 97 of the DTVSV Scheme, 2024, issued a Guidance Note in the form of answers to the frequently asked questions to help create better understanding with respect to the provisions of the scheme. The Guidance Note issued by CBDT Circular No. 12/2024, dated 15 October 2024 provides clarification with respect to appeals/cases covered in the scope of the Scheme, the amount payable under the Scheme, the Forms and timelines specified under the Scheme, clarification regarding search cases, refund and TDS/TCS issues etc.

Due date for furnishing return of income for Assessment Year 2024-25 extended for certain assessees

The due date of filing of return of income under Section 139(1) of the Income Tax Act, 1961 ('**Act**') has been extended from 31 October 2024 to 15 November 2024 for the following persons. CBDT Circular No. 13/2024, dated 26 October 2024 has been issued for this purpose.

- Companies,
- Persons (other than companies) who are subject to audit under either the Act or any other law; and
- Partners of those firms that are subject to audit under either the Act or any other law.

Cooperative societies claiming deduction under Section 80P – Condonation of delay under Section 119(2)(b) for delayed returns of income for AY 2023-24

In order to mitigate the difficulties being faced by cooperative societies, claiming deduction under Section 80P of the Act, in filing their returns of income ('**ITRs**') on account of delays in getting books of accounts audited under respective State laws for AYs 2018-19 to 2022-23, the CBDT had issued Circular No. 13/2023 dated 26 July 2023. Under the said Circular, Chief Commissioners of Income-tax / Directors General of Income-tax were authorised to deal with the applications for condonation of delay in furnishing returns of income filed by such cooperative societies. By way of Circular No. 14/2023, dated 30 October 2024 the CBDT has now extended the applicability of Circular 13/2023 to AY 2023-24 as well.

Monetary limits of income-tax authorities for entertaining applications under Section 220(2A) for reduction or waiver of interest payable under Section 220(2)

Section 220(2) of the Income Tax Act provides for levy of simple interest in case an assessee fails to pay the tax demand as specified in the notice of demand issued under Section 156 of the Act. Further Section 220(2A) empowers the following income-tax authorities to reduce / waive off such interest payable by such an assessee upon the satisfaction of the conditions laid down therein:

- Principal Chief Commissioner of Income-tax ('**Pr. CCIT**')
- Chief Commissioner of Income-tax ('**CCIT**')
- Principal Commissioner of Income-tax ('**Pr. CIT**')
- Commissioner of Income-tax ('**CIT**')

Pursuant to the above, the CBDT has now by Circular No. 15/2024, dated 4 November 2024 specified the following monetary limits for determination of jurisdiction of the income tax authorities for reduction / waiver of interest:

S. No.	Income Tax Authority	Monetary limit for reduction / waiver of interest
1.	Pr. CIT / CIT	Up to INR 50 lakh
2.	CCIT / DGIT	Above INR 50 lakh to INR 1.5 crore
3.	Pr. CCIT	Above INR 1.5 crore

Income-tax Rules, 1962 amended – Changes made in Rules 26B, 31AA, and 37-I

In exercise of the powers granted under Section 295 read with Section 192, the CBDT has amended the following provisions of the Rules:

a. ***Rule 26B of the Rules***, which provides for the statement furnished to the person deducting tax under Section 192(1) of the Act, has been substituted with effect from 15 October 2024. In addition to what was provided therein earlier, the amended provision brings within its ambit details of tax deducted at source or tax collected at source under the provisions of Part B or Part BB of Chapter XVII in the statement to be furnished in form 12BAA to the person responsible for making payment under Section 192(1) of the Act.

b. ***Rule 31AA of the Rules*** provides for the statement of collection of tax to be furnished by a person under the proviso to Section 206C(3). A new clause (viii) has been inserted in Rule 31AA(4) of the Rules which requires the person collecting tax to furnish particulars of any amount received or debited on which tax was not collected or tax was collected at a lower rate in view of any notification issued under Section 206C(12) of the Act. The said amendment shall take effect from 16 October 2024.

c. ***Rule 37-I of the Rules*** lays down the mechanism for the credit of tax collected at source. A new sub-rule (1A) has been inserted in Rule 37-I of the Rules to provide that where the income of a collectee is assessable in the hands of another person, such other person shall be given the credit of tax collected at source on the filing of a declaration with the collector. The said amendment shall take effect from 16 October 2024.

CBDT Notifications No. 112/2024 dated 15 October 2024 and No. 114/2024 dated 16 October 2024 have been issued for this purpose.

No TCS on payments received from Reserve Bank of India

The CBDT, *vide* exercise of powers under section 206C(12) of the Act, has specified that no tax shall be collected at source under section 206C(1F) of the Act on any payment received from the Reserve Bank of India. CBDT Notification No. 115/2024, dated 16 October 2024 has been issued for this purpose.

Valuation – Transaction price to be deemed to be Arm's Length Price in certain cases

The third proviso to Section 92C(2) of the Income Tax Act lays down that if application of the most appropriate method, referred to in Section 92C(1), results in more than one price being determined, then the arm's length price ('**ALP**') shall be computed in the manner provided in Rule 10CA of the Rules.

Exercising the powers, the third proviso to Section 92C(2) read with the proviso to Rule 10CA(7), the CBDT has notified that in case of any variation between the ALP determined under Section 92C and the price at which an international transaction or specified domestic transaction ('**Transaction**') has actually been undertaken does not exceed:

a. one percent of the price at which the Transaction has taken place in respect of wholesale trading; and

b. three percent of the price at which the Transaction has taken place in all other cases.

then the price at which the Transaction has actually been undertaken shall be deemed to be the ALP for the AY 2024-25.

For the purposes of the Notification No. 116/2024, dated 18 October 2024, the term 'wholesale trading' has been defined to mean a Transaction of trading in goods, which fulfils the following conditions:

a. Purchase cost of finished goods is 80% or more of the total cost pertaining to such trading activities; and

b. Average monthly closing inventory of such goods is 10% or less of sales pertaining to such trading activities.

Ratio Decidendi

- Transfer Pricing – Transactional Net Margin Method cannot be rejected without any reasoning and 'other method' applied, without also ruling out applicability of other five methods – *Delhi High Court*
- Transfer Pricing – Extended limitation period under Section 153(4) for passing assessment order is not available once a TPO reference is quashed as being without jurisdiction – *ITAT Mumbai*
- Findings in proceedings under Income tax Act have no binding force in proceedings under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 – *ITAT Mumbai*
- Failure to provide 'consent waiver form' to facilitate information exchange under the India-Switzerland DTAA is valid ground for upholding assessment under Section 153A – *ITAT New Delhi*
- Broken period interest to be allowed as revenue expenditure to banks for securities being held as stock-in-trade – *Supreme Court*
- Jurisdictional Assessing Officer is not denuded of jurisdiction by virtue of Faceless Assessment Scheme – *Delhi High Court*

Transfer Pricing – Transactional Net Margin Method cannot be rejected without any reasoning and 'other method' applied, without also ruling out applicability of other five methods

In the present case, the Assessee-company was providing marketing support services to its group entities outside India and benchmarking the said international transactions by consistently applying Transactional Net Margin Method ('**TNMM**'). During the AY under consideration as well the Assessee-company used TNMM for benchmarking the international transactions with its associated enterprises ('**AEs**'). The Transfer Pricing Officer ('**TPO**'), however, rejected the same and applied the 'Berry ratio' as the 'other method' as per Section 92C of the Income-tax Act, 1961 ('**Act**') read with Rule 10AB of the Income Tax Rules,1962 ('**Rules**') to make an upward adjustment to the Assessee-company's income.

The said rejection was upheld by the Dispute Resolution Panel ('**DRP**') but was later overturned by the ITAT on the grounds that the TPO had rejected the TNMM without providing any reasons for the same despite the fact that TNMM had been consistently applied by the Assessee-company for previous AYs. The ITAT also held that, contrary to the provisions of Rule 10AB(1)(f), the TPO had failed to provide reasons for discarding the other five methods before adopting the 'other method'. The ITAT also cited ICAI Guidelines in support of its conclusions. Further, the ITAT also agreed with the Assessee-company's objections regarding the comparables selected by the TPO.

Dismissing the Revenue's appeal against the aforesaid ITAT order, the High Court upheld the above-mentioned findings given by the ITAT. Referring to the 'principle of consistency', the High Court noted that the TPO must follow the method consistently used in prior years to determine the ALP unless there are compelling reasons to change it. Elaborating on the reliance placed by the ITAT on the ICAI Guidelines, the High Court clarified that the 'other method' was for complex transactions wherein comparable data did not exist.

The High Court also held that the TPO had chosen transactions that did not align with Assessee-company's transactions and that this mismatch in comparables weakened the TPO's case and bolstered the Assessee-company's argument that the TPO's selections were unsuitable for determining the arm's length price.

[*Pr. Commissioner of Income Tax* v. *Sabic India Pvt Ltd.* – Judgment dated 14 October 2024 in ITA 514/2024, Delhi High Court]

Transfer Pricing – Extended limitation period under Section 153(4) for passing assessment order is not available once a TPO reference is quashed as being without jurisdiction

In the given case, the Assessing Officer ('**AO**') was of the view that during the previous year relevant to AY 2014-15 the Assessee had undertaken specified domestic transactions with its AEs and therefore, reference was made to the TPO under Section 92CA of the Act on 29 December 2016. Aggrieved by the same, the Assessee challenged the reference made to TPO by preferring a writ petition before the Bombay High Court. *Vide* its order dated 20 December 2018, the High Court quashed the reference made to the TPO. The AO, thereafter, passed the assessment order on 15 February 2019.

In first appeal, the Assessee contended that the assessment order was barred by limitation since it had been passed beyond the period of limitation specified in Section 153(1) of the Act and also that the extended period of limitation available under Section 153(4) in those cases where a reference is made to TPO will not be available to AO. Agreeing with the Assessee, the CIT(A) allowed the said appeal.

Aggrieved by the CIT(A)'s order, the Revenue preferred an appeal before the ITAT and argued that on account of the assessment proceedings being stayed by the High Court, by virtue of clause (ii) of Explanation 1 to Section 153 of the Act, the period of such stay was to be excluded while computing the period of limitation under the said provision. Accordingly, it was contended that the assessment order had been passed within the period of limitation available as per Explanation 1 to Section 153 read with Section 153(4).

Disagreeing with the aforesaid contentions of the Revenue, the ITAT observed that there was distinction between a 'challenge to jurisdiction' and a 'challenge to the incorrect exercise of jurisdiction'. Once the Assessee had succeeded in its challenge against the very jurisdiction of the TPO, the reference made by the AO under Section 92CA was a *void ab initio*. Thus, when the TPO had no jurisdiction, the extended time period under Section 153(4) was not available to the Revenue and that if the benefit of the extended time period was provided to the Revenue it would constitute a violation of the High Court's binding order.

Furthermore, the ITAT also dismissed the contention of the Revenue that it was eligible to get the benefit of Explanation 1 to section 153 by observing that the period of limitation expired on

31 December 2016 whereas the High Court had stayed the assessment proceedings *vide* its interim order only on 26 July 2017. Accordingly, the ITAT upheld the CIT(A)'s order.

[*DCIT v. HDFC Bank Ltd*. – Order dated 30 September 2024 in ITA No. 3373/Mum/2023, ITAT Mumbai]

Findings in proceedings under Income tax Act have no binding force in proceedings under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

In the present case, the Assessee was a resident individual who had beneficial interest in an offshore entity and was also the beneficiary and sole authorized signatory of the said entity's bank account in Singapore. In this context, the Income-tax Department made additions to the Assessee's income under Sections 68 and 69 of the Income Tax Act, 1961 ('**Act**'), which were later overturned by the ITAT in appeal. Subsequently, assessment proceedings were also initiated against the Assessee under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ('**BMA**') and the entire value of the assets lying in the said bank account were treated as his income. Against the said order passed under the BMA, the Assessee eventually preferred an appeal before the ITAT.

In this background, the question that arose before the ITAT was whether the findings recorded by the ITAT in proceedings under the Income Tax Act would be binding on it in the proceedings under the BMA. To answer the same, the ITAT examined the BMA's preamble and Statement of Objects and Reasons and noted that the intention behind BMA's introduction was to target undisclosed foreign income/assets. Further, analysing the provisions of Section 4(3) of the BMA, the ITAT concluded that as per the said provision any addition for undisclosed foreign income and asset under the BMA could not again be assessed under the Act. However, there was no corresponding provision in the Act which stated that additions made under the Income Tax Act would have no bearing under the BMA.

Furthermore, comparing the scopes of both the legislations, the ITAT noted that the BMA is focused on the taxation of undisclosed assets located outside India and undisclosed foreign income, whereas the Income Tax Act seeks to tax all income unless it is specifically exempted from being included in taxable income.

The ITAT also noted that by way of Section 59 of the BMA, assessees had an opportunity to declare their undisclosed foreign assets, in which case they would not be assessed/reassessed or included in the total income under the Act, but that there were no corresponding provisions under the Act. Basis the same, the ITAT concluded that the Act and the BMA had different scopes and that findings given in the income-tax proceedings may have a guiding force but certainly not a binding force in proceedings under the BMA.

Another question which was addressed by the ITAT was whether the Assessee could be considered obliged to make a disclosure of his foreign assets/income in the absence of any specific column for the same in the Income-tax Returns for the period under consideration. Regarding this, the ITAT held that the Assessee was obliged to make a declaration for the undisclosed foreign asset as per provisions of Section 59 of the BMA within the time stipulated therein.

[*Captain Vilas Waman Katre* v. *Additional Commissioner of Income tax* – Order dated 8 October 2024 in BMA No. 4/Mum/2022, ITAT Mumbai]

Failure to provide 'consent waiver form' to facilitate information exchange under the India-Switzerland DTAA is valid ground for upholding assessment under Section 153A

In this case, a search action was conducted against the Assessee, who was a resident individual. During the course of such search, the Assessee was confronted with certain documents, received from foreign tax authorities under the relevant DTAA, which showed that the Assessee held a bank account in Switzerland. However, the Assessee denied holding any such bank account.

Pursuant to such search action, proceedings under Section 153A of the Income Tax Act were initiated and an assessment order was passed making additions on account of undisclosed foreign asset in the form of foreign bank account and related interest income on deposits therein. In the said assessment order, it was noted that the Revenue had sought verification from the Swiss authorities regarding the said bank account. Consequently, during the first round of litigation, the ITAT had remanded the matter to AO to obtain verification report/evidence from the Swiss authorities to corroborate the allegations towards undisclosed bank account.

In order to enable it to gather the required information from the Swiss authorities as per the aforesaid ITAT order, the Revenue requested the assessee to sign a '*Consent Waiver Form*'. However, the Assessee refused to sign the same. Noting that the Assessee had refused to cooperate because of which no verification report could be obtained, the AO once again made the same additions to the Assessee's total income, which were upheld by the CIT(A) in appeal.

In further appeal before the ITAT, the Assessee *inter-alia* contended that as the Revenue had failed to obtain the verification report as per the ITAT's instructions, the additions had been made on the basis of uncorroborated material. In this regard, the ITAT observed that the verification report could not be obtained by the Revenue due to non-signing of the '*Consent Waiver Form*' by the Assessee.

Having stated the same, the ITAT held that the documents received by the Revenue, basis which the addition was made, had been obtained from other sovereign countries and could not be brushed aside as wholly unreliable evidence. The ITAT held that to lend credence to his claims, the Assessee should have cooperated with the Revenue and his refusal to do so led to the preponderance of probabilities being against him.

Regarding the Assessee's argument that he could not be compelled to sign the '*Consent Waiver Form*' as it might incriminate him, the ITAT held that had the Assessee not held any foreign bank account the verification report would establish the same and thus, the refusal to sign indicated his culpability. The ITAT further held that the Assessee was not an 'accused' in the context of income tax proceedings and accordingly, providing consent waiver would not amount to violation of Article 20(3) of the Constitution. Thus, the Assessee's appeal was dismissed.

[*Parag Dalmia* v. *DCIT* – Order dated 30 August 2024 in ITA No. 1871/Del/2023, ITAT Delhi]

Broken period interest to be allowed as revenue expenditure to banks for securities being held as stock-in-trade

In this case, the issue before the Supreme Court was regarding the allowability of deduction for broken period interest while computing the income of the Assessee, which is a Scheduled Bank.

As per the guidelines issued by the Reserve Bank of India ('**RBI**'), Scheduled Banks are required to purchase certain government securities to maintain the Statutory Liquidity Ratio ('**SLR**'), which are tradeable. Interest is also payable on such securities on predetermined coupon dates. In this scenario, when a bank purchases such a security, along with the sale consideration for such security, it also makes the payment of the interest due to the seller-bank for the period between the last coupon date and the date of sale. The said interest payment is called 'broken period interest'.

The Assessee in this case treated the aforesaid government securities as stock-in-trade in its books and the amount realized from their sale was offered to tax as business income. Further, the Assessee offered to tax the broken period interest earned by it after netting off the broken period interest paid by it. The Revenue, however, basis the SC's decision in *Vijaya Bank* v. *ACIT*[15], took the position that the Assessee could not be allowed to claim the deduction of the broken period interest paid by it while computing its income.

In final appeal before it, the SC firstly held that securities that are acquired by banks as a part of their banking business are held as stock-in-trade and not investments. Referring to Circulars dated 21 April 1998 and 21 April 2001 issued by the RBI, the SC noted that banks are required to not capitalise the broken period interest paid to the seller as a cost but must rather treat it as an item of expenditure under the profit and loss account.

The SC also noted that particularly in the case of those securities that are to be held till maturity, the question whether they are held as 'stock-in-trade' or as investments would depend on the facts. Such securities would be held as investments if: (i) they are actually held till maturity and are not transferred before and (ii) are purchased at their cost price/face value.

In the light of the above, the SC concluded that whenever the securities are held as 'stock-in-trade', broken period interest will be allowed as revenue expense. However, where such securities are held as investment the broken period interest would be treated as a capital expenditure.

Further, the SC distinguished the present case from the *Vijaya Bank* v. *ACIT* (*supra*) on the basis that income of the bank therein was assessed under the head 'interest on securities under the erstwhile Sections 18 to 21 of the Act, which had been repealed with effect from 1 April 1989.

[*Bank of Rajasthan* v. *CIT* – Judgement dated 16 October 2024 in C.A. Nos. 3291-3294/2009, Supreme Court]

15 (1991) Supp (2) SC 147

Jurisdictional Assessing Officer is not denuded of jurisdiction by virtue of Faceless Assessment Scheme

The Delhi High Court has dismissed a batch of writ petitions challenging the validity of reassessment proceedings initiated under Section 148 of the Income Tax Act on account of them being non-compliant with the Faceless Scheme of Assessment under Sections 144B and 151A.

The challenge to the reassessment proceedings was on the basis of the decisions of the High Courts of Telangana[16], Bombay[17], Punjab & Haryana[18], and Gauhati[19], wherein, it was held that after the introduction of Sections 144B and 151A read together with the 'E-Assessment of Income Escaping Assessment Scheme, 2022' ('**Faceless Reassessment Scheme**') as notified on 29 March 2022, the JAO would not have jurisdiction to commence proceedings under Section 148 of the Act.

Distinguishing the aforesaid decisions of the other High Courts, the Delhi HC noted that Section 144B is a procedural provision which outlines the procedure for the conduct of faceless proceedings but is not in itself the basis for reassessment. Rather, a reassessment under the Act is a complex process which is driven by factors such as the initial filing of returns, information which is provided to a JAO under the Explanations 1 and 2 to Section 148 of the Act, flagging of audit objections and the materials gathered during search/survey proceedings. Thus, Section 144B cannot be considered to be the solitary basis of commencement of reassessment and is just one component in the broader statutory framework for reassessment of returns.

Further, the Delhi HC referred to the notification dated 13 August 2020, which it stated had not been produced before other High Courts, and noted that therein, it was stipulated that the officer authorized to conduct faceless assessment were 'concurrently' being conferred with powers and functions of the JAOs i.e., a contemporaneous conferment of powers and functions that would not serve to deny the JAOs of their power to conduct reassessments.

Referring to its earlier decision in *Sanjay Gandhi Memorial Trust* v. *CIT (Exemption)*[20], the Delhi HC held that faceless and jurisdictional assessments are not mutually exclusive. Rather, it

[16] *Kankanala Ravindra Reddy* v. *ITO* [W.P. (c) 25903/2023]; *Venkataramana Reddy Patloola* v. *DCIT* [2024 SCC OnLine TS 1792]
[17] *Hexaware Technologies Ltd.* v. *ACIT* [2024 SCC OnLine Bom 1249]; *Kairos Properties Private Limited* v. *ACIT* [2024 SCC OnLine Bom 2571]
[18] *Jatinder Singh Bhangu and Another* v. *UOI* [2024 SCC OnLine P&H 9337]
[19] *Ram Narayan Sah* v. *UOI* [2024 SCC OnLine Gau 1424]
[20] 2023 SCC OnLine Del 3161

held that they are intended to operate in conjunction with each other to ensure fairness and procedural integrity. In this regard, the Delhi HC also agreed with the position taken by the Gujarat High Court in *Talati and Talati LLP* v. *ACIT*[21].

The Delhi HC also held that clause 3 of the Faceless Reassessment Scheme divides the process of reassessment into two stages. The first stage being conducting initial enquiry and formation of opinion to reassess by the JAO followed by actual assessment to be conducted in a faceless manner. Thus, the Delhi HC dismissed the writ petitions filed by the assessees.

[*TKS Builders Pvt. Ltd.* v. *ITO* – Judgment dated 28 October 2024 in W.P.(C) 1968/2023, Delhi High Court]

[21] 2024: GUJHC: 54567-DB

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