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An e-newsletter from
Lakshmikumaran & Sridharan, India

October 2019 / Issue–61

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Deduction for additional employment - Simple yet ambiguous

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In the wake of rising reports on unemployment, the Central Government has taken various steps to fulfil its commitment of job creation. As part of these efforts, the provisions of Income-tax Act, 1961 ('IT Act') were amended[1] to substitute the provisions of Section 80JJAA of the IT Act[2] with seemingly less restrictive and simpler provisions to encourage job creation. The amended provisions expanded the benefit to all employers including service sector and removed the threshold of 10% increase for claiming deduction. Thus, deduction was available for every additional employee employed.

The importance of the amended provision can be gathered from the fact that upon reduction of corporate tax rates vide the Tax Ordinance[3], the corporates opting for lower tax rates have been restricted from availing all major deductions other than the deduction provided in Section 80JJAA of the IT Act. In this backdrop, let us examine some of the hurdles likely to be encountered by the taxpayers while claiming this deduction.

The intent behind amendment to Section 80JJA of the IT Act is simple. Employers receive tax deduction[4] for every additional employee whose salary is below twenty-five thousand per month provided there is a degree of permanency in the employment (the employee was required to be employed for a period of at least 240 days). Further, the legislature provided some inherent checks to prevent abuse. The provisions cast a burden on the employer to prove that the employment of the additional employees during the year has led to an increase in the total number of the employees employed by the employer when compared to the last day of the preceding year. Thus, the employer cannot avail deduction on account of replacement of the old employees by new ones.

The provisions of Section 80JJAA of the IT Act require the taxpayer to furnish, along with its return of income, its claim of deduction in Form 10DA[5]. A perusal of the Annexure of the Form 10DA demonstrates the following:

1. **The increase in employment is measured on last day of previous year**: Form 10DA postulates that in order to compute the additional employees employed by the employer during the previous year, a comparison should be made between the number of employees as on the **last day of previous year** to the number of employees as on the last day of the year prior to the previous year. Thus, as per Form 10DA, if the taxpayer was claiming deduction for A.Y. 2019-20, the comparison for computing additional employees should be made between the number of employees as on 31st March 2019 and 31st March 2018. If the

[1] Amendment vide Finance Act, 2016 with effect from A.Y. 2017-18

[2] Section 80JJAA of the IT Act provides deduction to an employer employing additional employees

[3] The Taxation Laws (Amendment) Ordinance, 2019

[4] 30% of the additional salaries paid for a period of three years starting from the year in which additional salary is paid

[5] Form 10DA is notified by Central Government vide Rule 19AB

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number of employees as on 31st March 2019 are more than number of employees as on 31st March 2018, the employer is eligible for deduction.

2. **The deduction is restricted to only the increase in number of employees as on last day of previous year**: Once the differential of the employees between the last day of previous year and year prior to that has been computed, the form requires the taxpayer to provide the number of employees which satisfy the conditions stated in Section 80JJAA of the IT Act. However, the form provides that the number of additional employees entitled for deduction cannot exceed the differential computed between the two aforesaid dates.

Let us say an employer, ABC Ltd., had 100 employees as on 31st March 2018. Now, say ABC employed 50 employees in the month of April 2018 and these employees continued to be employed throughout the year but 30 of these employees left in March 2019. Thus, the number of employees as on 31st March 2019 is 120. In such a case, deduction, as per Form 10DA, cannot be claimed for salaries paid to more than 20 employees even though, the employer had 50 employees throughout the year which satisfied the conditions stated in Section 80JJAA of the IT Act.

The aforesaid example very well demonstrates the position of a taxpayer which though has incurred cost of additional employment and satisfied all other conditions provided in Section 80JJAA of the IT Act but does not stand to gain tax benefit from such cost. The legislature, in its wisdom, can without a doubt curtail the benefit it seeks to grant to the taxpayer. However, in case of Section 80JJAA of the IT Act, the legislature has not done so. The interpretation derived from the Annexure of Form 10DA, as will be discussed in the following paragraphs, is seemingly not in line with either the literal reading of provisions of Section 80JJAA or its legislative intent.

The provisions of Section 80JJAA cast a burden on the taxpayer to demonstrate that there has been an *'increase in the number of employees from the total number of employees employed as on the last day of the preceding year'*. It is clearly evident that the provision benchmarks the total number of employees on the last day of preceding year to examine the increase in number of employees in previous year.

However, the provisions do not provide any specific day of the current year on which the increase in the number of employees has to be examined. Thus, the provisions are widely worded to grant deduction in respect of all additional employees provided there has been an overall increase in the number of employees. Such an increase can be at any time during the previous year.

Thus, demonstration of increase is a factual exercise (wherein taxpayer will be required to prove that the new employees have resulted in fresh employment and is not a case of replacing old employees with new ones). The fiction of increase on last day of previous year, as is contemplated in Form 10DA, makes the entire exercise of examining the fresh employment, a mechanical one and does not get any support from the literal reading of provisions of Section 80JJAA. Thus, the Form notified by the Central Government is not in line with the provisions enacted by the legislature. It is worth mentioning here that the Form 10DA has been notified by the

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executive by virtue of powers delegated upon it *vide* provisions of Section 80JJAA. However, the executive cannot exercise the delegated power to introduce conditions /prohibitions not contemplated by the provisions of the Act[6].

The computation of additional employees in case of seasonal industries is also a challenge. The period of 240 days has been relaxed to 150 days in case of certain seasonal industries. Despite this, there are serious issues regarding, computation of additional employees in seasonal industries. This is because, in seasonal industries the employees tend to leave after the peak season only to be re-appointed during the next peak season. In such a case, there is no clarity as to whether the deduction can ever be availed if the peak season does not coincide with the last day of previous year. The ambiguity holds ground, specially by virtue of Form 10DA wherein the comparison is mechanically made on last day of two years. In such a case, there may be no additional employment between two dates even though new employees could have been employed during the peak season.

Apart from the Form 10DA, the provisions of Section 80JJAA of the IT Act are themselves not unambiguous. An additional employee has been defined to be an employee who has a salary of less than Rs. 25,000/- per month. Practically there can be cases where an employee has employed for a monthly salary of less than the said limit but ends up having a higher annual average annual salary on account of year end bonus etc. In such case, there is no clarity as to whether the salary paid to such an employee will be eligible for deduction.

Then, there is the issue surrounding the period of computation of employment. The provisions of Section 80JJAA of the IT Act require the new employee to be employed during the previous year for a period of at least 240 days to be an 'additional employee' eligible for deduction. There may be cases where the employment of a new employee may be split between two years and the deduction is not available in respect of the salary paid to the new employee merely because the new employee did not complete 240 days in either of those two years.

Conclusion:

It is apt to quote here the Bombay High Court which once held that a superficial and narrow interpretation can only defeat the benevolent purpose behind a provision and the substance of the matter may get shrouded under a technicality which cannot be permitted to supersede the dominant intention of the provision[7]. The provisions of Section 80JJAA of the IT Act were enacted with a social objective of encouraging employment. In light of the ambiguities in the provisions, this objective should be given paramount importance while interpreting the provisions of Section 80JJA. Meanwhile, in light of the Form notified by the Central Government, some clarity in respect of these provisions in the upcoming Budget may go a long way to avoid any litigation between the taxpayer and taxman.

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[6] Kunj Behari Lal Butail vs State of HP: [2000] 3 SCC 40

[7] Gannon Dunkerley & Co. Ltd.: [1986] 159 ITR 162 (Bombay)

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Circular

Clarification on availment of MAT credit and carry forward of brought forward loss on account of additional depreciation

The CBDT has issued Circular No. 29/2019, dated 2-10-2019 to clarify certain issues raised regarding the availment of MAT credit and carry forward of brought forward loss on account of additional depreciation. Companies can opt for the lower corporate tax rates introduced by the Taxation Laws (amendment) Ordinance, 2019 but they would have to forgo certain exemptions and benefits under the Income Tax Act. These companies cannot claim additional depreciation in the computation of income and any loss brought forward on account of the exemptions, deduction availed earlier would not be allowed to be deducted. While it was specifically provided that the provisions of MAT would not be applicable, the Ordinance does not provide for carry forward and set off of MAT paid earlier, but there is also no express bar. It has now been clarified that brought forward balance of additional depreciation would not be allowed to be set off. As regards set off of MAT credit, the Circular states that when MAT provisions (Section 115JB) are not applicable, set off also would not be allowable. Also, since there is no specific timeline by which companies have to opt for lower rates, companies can choose to set off MAT and then opt for the scheme.

Ratio Decidendi

Gift of shares under restructuring scheme when not a taxable transfer

The assessee had transferred certain shares as part of group restructuring exercise to its sister concern. The CIT invoked Section 263 of the Income Tax Act, stating that the issue had not been examined properly by the Assessing Officer and opined that the assessee was liable to pay tax on capital gains and the nil consideration as reported by the assessee could not be accepted. The ITAT held that the CIT could not have exercised jurisdiction under Section 263, since proper enquiry had been made by the Assessing Officer and the view formed was not prejudicial to revenue. It held that a company could gift shares and the transaction would not be regarded as taxable transfer as per Section 47(iii). It further stated that the requirement of love and affection between the parties had been negated by various judgements and there was no requirement of a gift deed so long as the Memorandum of Association permitted the companies to give and receive gifts. [*Direct Media Distribution Ventures P. Ltd.* v. *PR. CIT*, Order dated 4-10-2019 in ITA No. 2211/Mum/2019, ITAT, Mumbai]

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Enhancement of income by CIT(A) based on accounts submitted to AO is not a 'new source of income'

The first appellate authority CIT(A) deleted certain additions made by the AO but enhanced the income by including certain labour charges and sundry creditors from the profit and loss account submitted to the AO. The assessee argued that the CIT(A) is not empowered to make additions since it would amount to a new source of income. However, the High Court held that the powers of the CIT(A) are co-terminous with the AO and that in the instant case there was no occasion to interfere with the order of the CIT(A). [*S.D. Traders* v. *CIT*, Judgement dated 3-9-2019 in ITA 159/2016, Allahabad High Court]

Commencement of certain activities out of a set of activities for which the company was incorporated satisfies commencement of business

The assessee was incorporated with the objective of undertaking various activities, *viz.*, designing, manufacturing, distributing, selling, after sales engineering services, research and development of commercial vehicles and related products and components for domestic Indian and overseas market. The assessee commenced/performed activities relating to designing of commercial vehicles and related products, R&D, buying and selling of parts and it was in process of construction of factory building for manufacture of commercial vehicles. The Assessing Officer held that since there was no income from the main activity which had not commenced, the corresponding expenditure is not allowable as a deduction. The CIT(A) observed that the assessee had two limbs of business activity; first relating to setting up of manufacturing facility for commercial and heavy vehicles; and second business relating to import and sale of readymade light and commercial vehicles. It was pointed out that in the case of manufacturing, the assessee was engaged in designing, manufacturing and selling of vehicles for commercial purposes. It was held by the CIT(A) that the assessee had already commenced activities relating to design and also pre-activities essential for commencement of manufacture in the AY 2009-10. The High Court held that merely because manufacturing and sale of vehicle did not take place, it could not be said that business of assessee had not been setup. It noted that the manufacturing activity of assessee was a part of the composite business activities. [*Daimler India Commercial Vehicles (P.) Ltd.* v. *DCIT* – (2019) 107 taxmann.com 243 (Madras)]

Test of beneficial ownership of interest is dominion and control without obligation to pass on the interest

The assessee – an investment company and tax resident of Cyprus claimed that as beneficial owner of the interest earned on certain Compulsorily Convertible Debentures (CCD) in terms of the India-Cyprus DTAA. The revenue authorities objected to the claim stating that the assessee had invested funds received by it from a group company located in Mauritius and that it was a back to back loan transaction such that the assessee was not the beneficial owner of the interest. The assessee submitted proof of its independence stating that the loan received from the group company changed character as a CCD and this decision and the income accruing from the instrument was the property of the assessee alone. The ITAT held that the test of dominion and control was satisfied in case of the assessee who invested some portion of its own funds as well as funds received from the group concern and it was under no obligation to forward the interest to the group concern. Thus, the assessee was held to be eligible for the lower rate of 10% taxation on interest as per the DTAA. [*Golden Bella Holdings Ltd.* v. *DCIT* – (2019) 109 taxmann.com 83 (Mumbai – Trib.)]

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Expenses incurred as part of government's flood relief programme is deductible under Section 37(1)

The assessee engaged in iron-ore extraction incurred certain expenses in terms of an MoU with the government to provide relief by constructing houses for the people affected by flood. The revenue authorities denied deduction of the sum citing it was not incurred wholly and exclusively for the business. The High Court, however, agreed with the reasoning of the assessee that the expenses were incurred as part of its business since the government was an important stakeholder in its business and also the expense benefitted the public rather than being opposed to public policy. The Court was also of the view that the object of incurring the expense is to be kept in mind and even if certain purpose other than the promotion of the business was achieved, the expenditure would not be disqualified from deduction. [*Kanhaiyalal Dudheria* v. *CIT*, Judgement dated 13-7-2019 in ITA 100016/2018, Karnataka High Court]

Benefit test is not one of the prescribed methods and cannot be applied to compute ALP

The Transfer Pricing Officer (TPO) formed a view that the assessee had not derived any tangible benefit from payment of royalty and rejected the TNMM method used by the assessee to substantiate arm's length price (ALP) of the transactions. The TPO opined that CUP method was to be applied by segregating the transaction of royalty which the assessee claimed was interlinked with manufacturing and other business operations. No comparable was put forth by the TPO and instead he proceeded to determine ALP at nil, saying that the assessee could not prove what benefit was derived by paying royalty year after year. The assessee argued successfully that there is no mandate to segregate royalty as a separate transaction when it was interlinked with other transactions and commercial expediency of paying royalty cannot be questioned for the purposes of determining transfer price. Hence the order of the CIT(A) deleting the transfer pricing adjustment was upheld. [*DCIT* v. *SNF (India) Pvt. Ltd.*, Order dated 4-10-2019, ITAT Visakhapatnam]]

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