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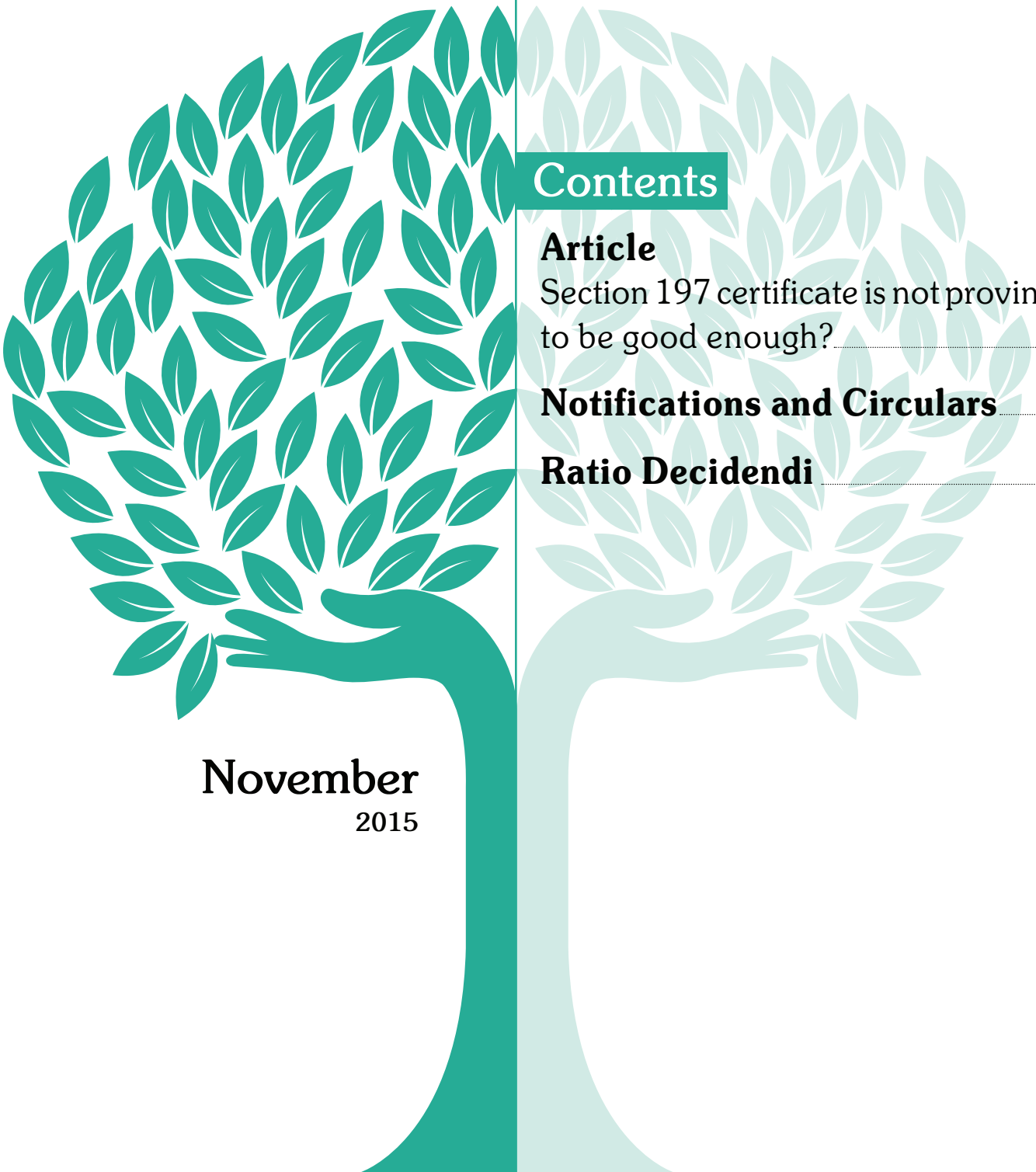

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Section 197 certificate is not proving to be good enough?

By **Sumeet Khurana**

Purpose of Section 197

Provisions relating to deduction of tax at source ('TDS') do offer the government a good tool of efficient tax recovery but unless counterbalanced with a measure like Section 197, can become a weapon of oppression. Thus, to ensure that taxpayers who don't have enough tax liability, should not suffer from a cash-flow problem, provisos and sub-sections were introduced in Section 18 of the Income Tax Act, 1922 (now are embodied in section 197 of the current Act), so as to make the tax collection mechanism just and fair.

Problems faced

This judicious and fair approach gets diluted if the issuance of the certificate is either delayed or it is issued in the name of specified persons, based on anticipation of the taxpayer seeking the certificate, and during the year dynamics of business warrant further certificate in the name of other payers of income.

Fairness has been the cornerstone

Till 1959 the TDS regime was confined to salaries. In early 1950s it was contemplated to expand the ambit of TDS to various incomes e.g. rent, commission, interest etc. Income tax Investigation Commission (constituted under an Act of 1947) as well as Taxation Enquiry committee, 1953-54 in its report expressed reluctance to the idea of expanding TDS regime chiefly because of its harsh effect on taxpayers. Both the bodies felt that there would be a large number of cases where the tax deducted at the source will be more than the total tax payable by recipients of income who will then have to apply for refund and be put to considerable inconvenience.

Judiciary has also stressed on necessity of fairness in TDS as a tax collection mechanism by highlighting its subordination to the ultimate tax liability. The purpose of Section 197 being to obviate the hardship of taxpayers is also well evident from the CBDT Circular no. 636 dated 31 August 1992.

Inability or laxity of statutory authority should not prejudice assessee

It is a trite law that taxpayer should not be made to suffer on account of delay in the conduct of statutory authorities. Even statutory provisions have been read down to ensure that the time consumed in statutory process does not act harshly against the interest of assessee. To illustrate the third proviso to Section 254(2A) has been read down to the effect that if the delay in disposal of appeal before Tribunal is not attributable to the assessee then the stay does not stand vacated even after the statutorily prescribed period of 365 days [see *Pepsi Foods* 119 DTR 373 (Del)] and proviso to Section 80IB(10) has been read down to the effect that date of issuance of completion certificate by Municipal Corporation shall be understood to be the date

when the taxpayer filed an application for obtaining said certificate [*Hindustan Samuh Awas* 377 ITR 150 (Bom)]

CBDT being conscious of this aspect had on several instances advised the officers to issue certificate expeditiously and reiterated this recently in Instruction 1 of 2014 dated 15 January 2014.

So, how to handle things practically?

Effort needs to be made to translate in practice, the fiscal philosophy discussed above. With a view to achieve that, taxpayers should consider and deliberate on following:

1. Filing application well in advance:

   CBDT Circular mentions that assessee should be allowed to file a fresh application even before the expiry of the existing certificate for the succeeding period. One can contend that the tax officer need not wait till 1 April of next year to start working on such application.

2. Insist on generic certificate as against specific certificate in the name of payer of income:

   Taxpayers should file a special request highlighting the fact that it is not possible to predict all payers of income / clients in advance hence a generic certificate should be issued. This should be possible especially in the case of lower withholding order since rules have been relaxed with effect from 24 September 2014.

3. Approach writ court in deserving cases:

   Many taxpayers have been able to get suitable directions from the High courts by filing writ petitions in relation to obtaining the certificates. Writ court option should therefore be explored in deserving cases for instance if:

   a. The officer refuses to give a generic certificate (especially in case of lower withholding order case)

   b. The officer takes long time (say more than two months) to dispose-off the application

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Notifications and Circulars

Protocol amending the DTAA between India and Turkmenistan

Press release dated 5-11-2015 made by the Government of India that the Union Cabinet has given its approval for amending the Double Taxation Avoidance Convention (DTAC) signed between India and Turkmenistan in 1997. The press release states that the protocol contains internationally accepted standards for effective exchange of information on tax matters including bank information and would also contain 'Limitation of Benefits' Article. The text of the Protocol was not yet made available in public domain.

New Mechanism to address grievances caused on account of high-pitched assessments

The Central Board of Direct Taxes ('CBDT') has formulated guidelines to set-up local committees of high-ranking officials for each Pr. CCIT region which will examine grievances caused, and ascertain whether *prima-facie* the grievance is caused on account of high-pitched assessment, non-observance of principles of natural justice, non-application of mind, gross negligence or lack of involvement of assessing officer. The committee will report to Pr. CCIT on unreasonable and high-pitched additions have been made by the assessing officer. Instruction No.17/2015 dated 9-11-2015 has been issued in this regard.

CBDT decides to withdraw appeals on issue of disallowance of expenses for earning interest income from non-statutory liquid ratio securities

Revenue authorities have treated the interest income earned by banks and co-operative societies from non-SLR securities as 'income from other sources' under Section 56 and disallowed expenses incurred for realizing such under Section 57(i). However, the Hon'ble Supreme Court in the case of *Nawanshahar Central Cooperative Bank Ltd* [2007] 160 Taxman 48 (SC) had held that investments made by a banking concern are part of the business of banking and interest income arising to such banking concerns is assessable under Section 28. Adopting the above ruling of Hon'ble Supreme Court, the CBDT has decided to withdraw appeals on issue of disallowance of expenses for earning interest income from non-statutory liquid ratio securities, as per Circular No.18/2015 dated 2-11-2015.

Transfer Pricing tolerance range remains unchanged

As per Notification No. 86 /2015dated 29th October, 2015, the Transfer Pricing tolerance range under section 92C for FY 2014-15 remains unchanged vis-à-vis FY 2013-14. Hence the range will be 1% for wholesale traders and 3% for all other taxpayers.

Ratio decidendi

Reimbursement of salaries of high level managerial employees falls within the definition of FTS: The taxpayer, pursuant to a secondment agreement with its Hong Kong parent company had deputed 5 high level managerial employees and reimbursed the salaries paid by its parent without deducting tax at source. The revenue authorities insisted on deduction of tax at source. The ITAT held that payment made by the taxpayer to the parent company is taxable as fees for technical services ('FTS') under Section 9(1)(vii) and rejected taxpayer's stand that payment was in the nature of reimbursement of salary. However, the ITAT remanded back the matter to examine the case afresh in light of absence of tax treaty between India and Hong Kong and whether there will be any further attribution required in view of Supreme Court ruling in *Morgan Stanely*. [*Food World Supermarkets Ltd* v. *DDIT*, ITA 1356 & 1357 of 2013, ITAT, Bangalore, decision dated 28-10-2015]

'Marked to market' loss when not speculative : The tax payer had entered into forward contracts to hedge loss on account of fluctuation in foreign exchange. It determined the 'marked to market loss' based on difference in exchange rates on date of balance sheet. The revenue authorities contended that marked to market loss is a notional loss and the tax payer cannot deduct the same. Agreeing with the tax payers' contention, the ITAT held that the loss from the transactions is not speculative since loss was determinable with certainty though settlement was made later. The ITAT also observed that the transactions were undertaken through registered stock exchange and contract for derivatives in foreign currency are commodity as per Section 43(5) of the Income Tax Act, 1961, the underlying asset being foreign currency and hence non-speculative. [*Inventurus Knowledge Services Pvt. Ltd.* v. *ITO*, ITA 5922/Mum-2013, ITAT, Mumbai order dated 21-10-2015]

Franchisee fee to conduct matches – Not capital expenditure: The dispute revolved around the franchise fee for ten years which was paid by the tax payer to the BCCI. The tax payer revised its return claiming that it was revenue expenditure. Reasoning that no perpetual rights had been granted to the tax payer and that only on payment for each year it could get the rights to organise the cricket matches, the ITAT held that the expenditure was not towards acquiring any capital asset and was revenue in nature. [*DCIT* v. *Deccan Chargers,* I.T.A. No. 1043/HYD/2013, ITAT, Hyderabad, order dated 28-10-2015]

Remission of bank loan shown in P&L A/c not to be excluded for computing book profits under section 115JB: The taxpayer has credited P&L A/c with the remission of bank loan and this treatment is adopted pursuant to method of accounting prescribed at Schedule VI of the Companies Act. However, for the purpose of computing book profit under section 115JB, the taxpayer excluded the same and filed the tax return. Revenue authorities included the same in book profit computation and passed the order. The ITAT held that once P&L A/c is admittedly prepared as per Schedule VI of the Companies Act, then neither the revenue authority nor the taxpayer has any power to tinker with it, for the purpose of computing book profits under section 115JB. The judgment of the Hon'ble Supreme Court in the case of *Apollo Tyres* and the judgment of Hon'ble Bombay High Court in the case of *HCL Comnet System* were followed. [*B & B Infotech Ltd* v. *ITO,* ITA No. 726 of 2014, order dated 7-10-2015, ITAT, Bangalore]

Foreign tax credit available even though tax payable is under MAT provisions: The foreign tax credit claim of the taxpayer was denied on the ground that the tax is payable under the MAT provisions. However, the ITAT observed that the Mumbai Tribunal in the case of *L&T Ltd* has held that the tax computation mechanism post arriving at taxable income has to be governed by the normal provision of the Act and further held that there was no provision in the Act, debarring granting of credit for tax paid abroad in case income is computed under MAT provisions. Applying the

ratio of above ruling it held that the taxpayer could not be denied the set off of tax relief against the tax liability determined under MAT provisions. [*DCIT* v. *Subex Technology Ltd* ,ITA No. 913 of 2013, order dated 1-10-2015, ITAT, Bangalore]

An itemized transfer on a 'going concern' basis cannot be treated as 'slump sale': The taxpayer sold one of his two tea estates on a piecemeal basis allocating values for the tea estate, standing trees and every movable property. However, the revenue authorities considered the sale as slump sale as the tea estate was sold on a 'going concern' basis and levied capital gains tax. On appeal, the ITAT had observed that in a 'slump sale' the parties intend to transfer the undertaking on a lump sale consideration without values being assigned to the individual assets and liabilities and further pointed out that the expression 'going concern' was a functional qualification which was insufficient to decide the exact legal character of the transaction. It observed that the taxpayer had assumed all the liabilities including the statutory liabilities and retained financial assets. Hence, held that transfer of tea estate took place on itemized basis and non-transfer of liabilities and financial assets demonstrates that the transfer is not a 'slump sale'. [*DCIT* v. *Tongani Tea Co. Ltd.*, TS-647-ITAT-2015(Kol)]

Carry forward of loss can be denied only if there is change in voting power and not change in shareholding pattern: The holding company of a loss making subsidiary had transferred the shares of the said loss making subsidiary to another wholly owned subsidiary. Reasoning that there is a change in shareholding of the company revenue authorities denied the benefit of carry forward and set-off of losses in the hands of loss making subsidiary. However, the taxpayer argued that the exception provided to Section 79 would apply as more than 51% of the voting power on the last day of the previous year were beneficially held by the same persons who beneficially held shares of the Company carrying not less than 51% of the voting power on the last day of the year in which the loss was incurred. The HC held that the expression ''not less than 51% of voting power..." used in Section 79 indicates that only beneficial voting power is relevant and not the shareholding pattern. It observed that despite transfer of shares, the holding company still held effective control over the taxpayer. Therefore, it held that losses could be carried forward and set-off even if there is change in shareholding since effective control over the assessee company was unchanged. [*CIT* v. *AMCO Power Systems Pvt. Ltd* ,ITA No. 1046 of 2008, decision dated 7-10-2015, Karnataka HC]

'Engaged in business' is different from 'commencement of business': The Karnataka HC while examining the provisions of Section 72A with respect to carry forward of loss of amalgamating company to amalgamated company had observed that the term 'engaged in the business' is different from 'commencement of business'. It held that 'commencement of business' may be from

the date when production starts, but a party is said to engage itself in a particular business 'from the day when it gets involved in setting up of the business'. The activities like obtaining license for setting up power generation business, loans for the same, construction of building, purchase of machinery, etc., have to be considered as activities 'engaged in business'.[*CIT* v. *KBD Sugars & Distilleries Ltd,* TS-630-HC-2015(Kar)]

TP adjustment for underutilization of capacity: The taxpayer in the relevant period had operated at 14.84% of its installed capacity and requested adjustment for underutilization of capacity due to the economic slowdown. TPO and DRP rejected the claim stating that no satisfactory explanation was provided even though, the taxpayer submitted the certificate from a Chartered Engineer for the capacity utilization before the DRP. The ITAT observed that the Mumbai Bench of ITAT in *Petro Araldite* (2012) 148 ITD 182[1] had laid a precedent of granting benefit for underutilization of capacity, however, in the above ruling, the adjustment is computed on the assumption that all comparable companies operate at installed capacity. The ITAT held that the benefit of TP adjustment should be granted to the taxpayer but differed with the assumption made in the above ruling. The ITAT held that manufacturing industries cannot always operate at full installed capacity and therefore TP adjustment should be granted on the assumption that the comparable companies operate at optimum capacity and directed the revenue authorities to compute the TP adjustment on the basis of optimum capacity instead of installed capacity. [*Biesse Manufacturing Co Pvt Ltd* v. *ACIT* [TS-533-ITAT-2015(Bang)-TP]

No TDS if payment is not in money terms: For developing the Bangalore city, the taxpayer, a government body, had acquired lands on voluntarily basis and not on compulsory acquisition. The consideration for the land surrendered was discharged by way of granting certificate of development rights, which was 1.5 times the floor area surrendered. The revenue authorities insisted on deduction of tax at source under Section 194LA, which otherwise applies for cases falling under compulsory acquisition of land. The ITAT held that the provisions of Section 194LA are not applicable since land in the present case was surrendered not compulsory acquired and there is no consideration payable in money terms. The revenue authorities contended that provisions of Section 194LA are applicable even if there is no consideration payable in terms of money. The High Court held that when there is no quantification of the sum payable in terms of money nor any actual payment is made in monetary terms, it would not be fair to burden a person with the obligation of deducting tax at source and exposing him to the consequence of such default. [*CIT* v. *Bruhat Bangalore Mahanagar Palike* , ITA NO. 94, 466 of 2015, Karnataka High Court, 29-9-2015]

Set-up and commencement of business takes place when employees are recruited: The taxpayer recruited employees for the purpose of its business but did not carry on any business during the previous year. The revenue authority disallowed the entire claim of expenses on the ground that the taxpayer has not commenced business as specified at Section 28(1). The ITAT observed that the taxpayer is in the business of merchandising of diamonds, gold, and jewellery and requires expertise who have proficiency in understanding the carats of diamonds and related jewellery, without such recruitment, it would be a futile exercise to commence the business. The ITAT held that recruitment of employees and the fact that expenditure was incurred is indicative of the fact that business was set up. [*Reliance Gems and Jewels Ltd* v. *DCIT*, ITA No. 3855/2013 order dated 28-10-2015, ITAT, Delhi]

No TP adjustment, if taxpayer's income is exempt or the AE is assessed at higher tax rate : The taxpayer company contended that the TP adjustment made by the TPO is not applicable on two grounds - the income was exempt from tax in India under Section 10 A and, the AE was assessed at higher tax rate in the foreign jurisdiction than in India. The ITAT observed that the said issue is covered in favour of taxpayer by the decision of Bombay High Court in the *Vodafone* 361 ITR 531 (Bom.) case and many other subsequent decision and held that TP adjustment cannot be made if the taxpayer's income is exempt under Section 10A or Section 80HHE or if the AE is assessed at a rate of tax higher that tax rate in India, as there is no under reported income in India. [*DCIT* v. *Tata Consultancy Services,* ITA No. 7513/2010 order dated 4-11-2015 ITAT, Mumbai]

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