B K KHARE & Co
CHARTERED ACCOUNTANTS

Monthly Newsletter

Direct Tax

Friday, 27th Aug 2021

Volume 7, Issue 7

From The Courts - Analysis Of Recent Decisions

We have in this edition covered the interesting and salient decisions of the Courts, pertinent to our readers and hope will make an interesting read.

Madras HC: Upheld The Disallowance Of Deduction Under Section 10-B In Respect Of Super Profit

Madras HC in the case of Tweezerman (India) Private Limited held that super profit earned by an entity enjoying tax holiday benefit is not entitled for deduction under section 10-B of the IT Act specially when the taxpayer itself submitted the workings of super profit in accordance with method selected by it in its transfer pricing study. The taxpayers are advised to take note of the ruling and focus on robust documentation to prove that the super profit, if any, is not due to special business arrangement with closely connected entities with a view to claim higher deduction. →

Del HC: Extended Time Lines As Per CBDT Circular Applied To Quash Final Assessment Order Passed In Violation Of Provisions Of Law

Having regard to the pandemic, assessment order passed without giving the assessee a reasonable opportunity of being heard, aside for fresh assessment. Due to the lock down assessee's objections to the DRP against the draft assessment order were delayed beyond the prescribed period. The High Court set aside the final assessment order passed without being founded on the directions of the DRP. →

Del HC: ITAT Directed To Expedite System For Uploading Daily Order-Sheets, Revised Cause-list On

The HC directed the ITAT to put in a system of uploading the order sheets and revised cause list to avoid inconvenience that is caused to litigants due to communication gap or otherwise. This shall bring in more transparency in the judicial system. →

Connect with Us

LinkedIn

Madras High Court Upheld The Disallowance Of Deduction Under Section 10-B In Respect Of Super Profit

Facts and Issue

The assessee, Tweezerman (India) Private Limited, was a manufacturer of beauty products such as tweezers, cuticle pushers, etc. The assessee was 100% Export Oriented Unit (EOU) entitled to claim tax holiday benefits under 10-B of the IT Act. The assessee had an associated enterprise (AE) in USA, viz, Tweezerman Corporation. The AE relationship between the assessee and Tweezerman Corporation was on account of a common shareholding in these two companies to the extent of 26% or more by an Individual resident in USA. During the AY 2004-05, the assessee sold its goods to its AE. The assessee applied Comparable Uncontrolled Price (CUP) method to justify the arm's length price (ALP) of the goods sold to AE. The assessee's profit margin from the sale of goods to AE was approximately 83%. During the assessment proceedings, the AO referred the issue of computation of ALP to the TPO who confirmed that the international transactions of the assessee were at arm's length. However, the TPO further remarked that the profit margin of the assessee (83%) was much higher than the arm's length margin (48.7%). The TPO had worked out the arm's length profit margin based on Transactional Net Margin Method (TNMM) and reported that the assessee had earned excess profit by INR 5.18 Crores. The AO invoking provisions of section 10B (7) read with section 80IA (10) held that the assessee had earned profit more than ordinary profit. The AO, however, enhanced the taxable income of the assessee only by INR 3.54 Crores by restricting the deduction claimed under section 10-B of the IT Act to INR 8.97

Crores as against INR 12.51 Crores claimed by the assessee in its return of income. In order to determine more than ordinary profit earned by the assessee, the AO had relied on the CUP data furnished by the assessee to the TPO. The assessee, however, furnished some revised CUP data before the AO which was not accepted by the AO.

Aggrieved by the order of the AO, the assessee filed an appeal before the CIT(A) which upheld the addition of the AO although partial relie was granted to the assessee by holding that addition should be made only to the extent of 83% of 3.54 Crores, being the profit element embedded in INR 3.54 Crores.

Aggrieved by the order of the CIT(A), the assessee filed an appeal before the ITAT. The revenue also filed an appeal before the ITAT on partial relief granted to the assessee. The ITAT deleted the addition made by the AO in toto primarily on the ground that mere excess profit earned by the 10-B unit could not be a criterion to reduce the deduction claimed by the assessee. The ITAT also observed that in order to invoke section 10B(7) read with 80IA(8), the AO had to prove that owing to the connection between the assessee carrying on the eligible business with another person the business between them was so arranged in a manner that resulted in excess profit so as to claim the excess deduction. Aggrieved by the order of the ITAT, the revenue filed an appeal before the Madras HC.

Contention of the Revenue

Revenue's primary contention was that there was a close connection between the assessee and Tweezerman USA and the excess profit to the assessee was established based on the working submitted by the assessee itself.

Contention of the assessee

The assessee's contention was that once the TPO had already approved the ALP of the transactions, the AO did not have jurisdiction to recompute the 'ordinary profit'. The assessee also argued that TPO had exceeded his jurisdiction in respect of remarks regarding excess profit earned by the assessee. The assessee also contended that its profit margin in the prior AYs were also similar to the AY in question and the excess profit in those were not disallowed for deduction.

High Court Ruling

HC observed that the TPO and the AO had determined the excess profit relying on the CUP data furnished by the assessee. HC rejected ITAT's observation that AO failed to prove how it had computed the 'ordinary profits' in terms of provisions of Sec.10B(7) and blindly adopted a calculation submitted by the assessee before the TPO which was contested by the assessee before the AO as 'erroneous'. HC stated that it was not true that the TPO/AO did not do any spade work to arrive at the ALP. The HC also supported the view of the AO that the taxability or otherwise of the other closely connected person in India was immaterial since by such an arrangement between the assessee and the other closely connected person, the assessee was fetching super profit. The US shareholder had 32.5% stake in the assessee. Therefore, the business arrangement was arranged both for a personal benefit to the Indian shareholder and the foreign shareholder. Based on these, the HC held that the order of the ITAT was perverse on account of shifting of onus of proving the excess profit on the revenue, underplaying the important aspect of close association between the AE and the assessee and the conclusion by the ITAT that there was no independent analysis of the AO for arriving at

the excess profit. Accordingly, HC upheld CIT(A)'s order which confirmed in toto the AO's order as regards the ALP and the resultant excess profit of Rs 3.54 crores to be disallowed for computing deduction under section 10B of the IT Act.

Citation

CIT Vs Tweezerman (India) Private Limited, 1253 & 1254 of 2010

Our Comments

AO's jurisdiction for computation of profit eligible for tax holiday benefit after the TPO approves that the inter-unit or intra-group transaction is at arm's length is highly litigative. One school of thought is that when the TPO approves the transactions entered into by the tax holiday unit or the company enjoying tax holiday benefits as at arm's length price then the computation of deduction under the relevant sections should follow the profit deduced following the ALP so determined by the TPO. Another school of thought is that AO can independently exercise its power and determine the ordinary profit of the tax holiday unit/company for evaluating the extent of deduction allowable under the relevant section. The jurisprudence on this matter suggests that excess profit in the tax holiday unit/entity by itself is not sufficient to curb the deduction. Rather it has to be demonstrated that owing to the close connections business is arranged in a manner which gives more than ordinary profit in the unit eligible for tax holiday benefit for denying the deduction for excess profit. Therefore it is advisable for the taxpayers who are facing litigation on the issue or likely to face litigation to document the reasons for excess profit in comparison with comparable companies.

Del HC: Extended Time Lines As Per CBDT Circular Applied To Quash Final Assessment Order Passed In Violation Of Provisions Of Law

Facts and Issue

The assessee filed a writ petition challenging the final assessment order dated 30th June, 2021 passed under Section 143(3) read with Sections 144C(3) and 144B of the Income Tax Act, 1961 ['the Act'] and the demand notice issued under Section 156 of the Act for the Assessment Year 2017-18. It sought directions to the Respondents not to take any action or initiate further proceedings in furtherance of the impugned assessment order and demand notice.

Contention of the assessee

The contention of the assessee was that the draft assessment issued under Section 144C(1) of the Act was dated 05th May, 2021 and, under section 144C(2), the Petitioner had thirty days to file objections there against to the Dispute Resolution Panel [DRP]. It was submitted that since the office of assessee was closed due to lockdown in Delhi objections against the draft order could not be filed within thirty days of receipt of the draft order, i.e. by 04 June 2021 but could be filed only on 21 June 2021.

The assessee relied on CBDT Circular No.12 of 2021 and Notification No.74/2021 dated 25 June, 2021 which provided for relaxation of time limits for certain compliances, which included extension of time limit to file objections to the DRP, where the same

were to be filed by 1 June 2021 or thereafter, upto 31 August, 2021 and the time limit for completion of assessment was extended to 30 September 2021.

It was further submitted that the Objections were thus filed within the extended time and therefore the final assessment order was passed contrary to the prescribed procedure.

Contention of the Revenue

The Department did not have objection to the matter being remitted to the DRP.

Ruling of the HC

The HC observed that the AO had no jurisdiction to pass the impugned assessment order under Section 143(3) read with section 144C (3) since the mandate of Section 144C (13) of the Act was that, on receipt of the directions of DRP under section 144C(5) of the Act, the Assessing Officer was to complete the assessment in conformity with the directions of the DRP, which was not done in the present case.

The High Court, allowing the writ petition, quashed the final assessment order and the resultant notice of demand and remitted the matter to the DRP for re-consideration under Section 144(C) of the Act and thereafter for the Assessing Officer to pass the assessment order in accordance with the procedure stipulated under Section 144B (1) (xxix) to (xxxi) as well as Section 144(C) of the Act.

Citation

SRF LTD v NATIONAL FACELESS ASSESSMENT CENTRE, DELHI

Our Comments

This is one of the several instances where the Courts have had to step in to rectify a lapse on the part of the tax department in the unusual situation created by the pandemic. One only wishes that the officers of the Department were more conscious of the extensions granted by CBDT and Courts in the matter of procedural timelines which would have resulted in saving time and hardship to all. May be, because this assessment order was passed under the Faceless Scheme, the officer actually doing the assessment was not familiar with the situation of the pandemic in New Delhi.

Del HC: ITAT Directed To Expedite System For Uploading Daily Order-Sheets, Revised Cause-list On Website

Facts and Issue

The assessee petitioner filed a writ petition challenging the ITAT order disposing off the miscellaneous application without providing opportunity of being heard and prayed that the ITAT be directed to hear the miscellaneous application afresh.

Contention of the assesse

The AR contended that the miscellaneous application was heard on February 14, 2020 and was adjourned to February 28, 2020. However, on February 28, 2020, the AR did not find that the case was listed in the cause list and upon enquiry with the registry, the AR was informed that the matter was heard on February 21, 2020. Order dismissing the application was passed on February 27, 2020. Thus, the assessee petitioner was not granted adequate and fair opportunity to represent the case.

Contention of the Department

The counsel representing the ITAT filed a letter clarifying as follows:

- That five adjournments were taken before the matter was listed on February 7, 2020, on which date the matter was adjourned to February 21, 2020 at the request of the AR for want of filing an affidavit.
- That the averment of the AR that the case was adjourned to February 14, 2020 and then to February 28, 2020 was not correct.

- That due to clerical error the case was not listed in cause list for February 21, 2020 published on the ITAT portal. However, the matter was included in the revised list displayed on the notice board.
- That the matter was taken up for hearing on February 21, 2020 and since no body appeared on behalf of the assessee petitioner, the case was disposed off on February 27, 2020.

Observation and rulings of the HC

The HC found that the case was adjourned from February 07, 2020 to February 21, 2020. The HC also noted that the petitioner assessee was prevented from having an adequate notice or fair opportunity to represent the case as neither the daily order-sheets nor the revised cause list had been uploaded on the ITAT website. Thus, the order of ITAT disposing off the miscellaneous application was set aside.

The HC also noted that inconvenience is caused to the litigants / counsel for non-publication of daily order sheets / revised cause list on the ITAT website. The HC directed the ITAT to put in a system to upload the daily order sheets and revised cause list on its website.

Citation

Ankit Kapoor [TS-586-HC-2021(DEL)]

Our Comments

This decision is welcomed. The HC directed the ITAT to put in a system of uploading the order sheets and revised cause list to avoid inconvenience that may be caused to litigants due to communication gap or otherwise. A similar system is already in place

for matters before Supreme Court / High Courts. This is indeed a positive step and shall improvise the judicial systems leaving no room for misappreciation or communication gap and thus, bring in more transparency.