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House Features

Section 154 - Rectification Of Mistakes Apparent From The Record

Section 154 is one of the of the most frequently invoked provisions of the Income-tax Act. This section deals with rectification of mistakes apparent from the record.

Although this power has been in existence in some avatar or the other for more than hundred years now, it still gives rise to litigation because it is often misused to correct mistakes in a manner inadmissible under the law- as for example, to settle an audit objection accepted by the revenue. It is therefore important for tax administrators, assessees and practitioners alike to be conversant with and appreciate the finer nuances of the scope of this provision. →

Secondment Of Employees: A Tax Conundrum

Integration of the world economy necessitates movement of people from one jurisdiction to another for better coordination, smooth operation and implementation of group policy for multinational enterprises. In such scenario, in case the employment is required to be exercised in another country (host country), the employee generally retains a lien on the formal employment contract with his legal employer in the home country (country of original employment). This arrangement of facilitating the services of employees on a global scale is termed as “secondment”. The entity in the host country becomes the economic employer as it bears the risk for the result produced by the employee rendering the service and the salary cost is also borne by the entity in the host country. The salary may be paid to the employee by the legal employer and the same is claimed by the legal employer as a reimbursement from the entity in the host country. However, such secondment arrangements have created significant tax uncertainty in terms of characterisation of payment by the Indian company to their overseas group company, creation of permanent establishment (PE) of foreign group company as result of secondment in India etc. →

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Statutory provisions

The section stipulates *inter alia* that an income tax authority may rectify any mistake apparent from the record in its order. The power extends to correction of intimations issued in connection with the processing a return of income u/s143(1) or processing of a statement of TDS u/s 200A (1) or of collection of tax u/s 206CB. The error should be patent and obvious and its discovery should not have to be dependent upon an inquiry, arguments or elaboration. The mistake could be one of law or fact. It could be clerical or arithmetical. It may involve overlooking of a statutory provision or arise from a retrospective amendment of law.

Rectification can be carried out only by the authority which passed the order. Such action may be taken *suo motu* or at the behest of the assessee, the tax deductor or tax collector (w.e.f. 1st June, 2015). No rectification is possible if the issue is debatable and more than one view is possible. A mistake found in the order of the CIT(A) can be rectified only by him, either suo motu or at the instance of the assessee or the A.O.

If an order has been the subject matter of an appeal or revision, the A.O. can still amend that the portion which has not been subject to such appeal or revision.

Except as provided u/s 155, rectification cannot be carried out four years after the end of the financial year in which the impugned order was passed. If, however the assessee submits an application within the aforesaid period of four years, the Board has authorized the concerned authorities to dispose of such applications even after the expiry of the time limit. (Circular no 73, dated 7 January 1972). By circular dated 1 June 2001, the Board has directed all income-tax authorities to dispose of all rectification applications within six months of the end of the month in which they are received.

The order of rectification has to be in writing. Where such an order has the effect of reducing the amount of refund or increasing the tax due from the assessee/deductor/ collector, he must be given a reasonable opportunity of being heard. After the order is passed, he must be served a notice of demand, clearly indicating the tax determined afresh. If an amount is due to the assessee, the same should be refunded to him.

These provisions are essentially simple and designed to achieve a practical purpose- namely to enable income-tax authorities to correct obvious mistakes. But in actual fact, they are subject to many finer judge-made nuances.

"Mistake apparent from the record…."

The mistake to be corrected should be patent on the face of the record and should not be the subject matter of debate, or comprise an error on which more than one opinion is possible. The mistake should also not be one on which detailed investigation is required to arrive at the truth [no rectification is possible on debatable point of law see specifically *Balaram v. Volkart Bros. (82 ITR 50 (SC);* mistake should be patent- *CIT v. P.K. Bhardwaj (279 ITR 326) (P and H), CIT v. Gujarat State Export Corporation Ltd. 279 ITR 477 (Gujarat)*. In other words, the mistake has to be obvious and glaring [*Venkatachalam V. Bombay Dyeing 34 ITR 143, 150 (SC)*]. Examples could be failure to grant depreciation where the assessee is clearly eligible for the same u/s 56(2)(iii)[*CIT v. Kanta 40 ITR 187*], grant of extra shift allowance when the assessee is not entitled to claim the same [*CIT v.Sundaram Textiles Ltd. 149 ITR 525 (Madras)*], failure to follow a binding decision of the Supreme Court, High Court or the Special Bench of the Tribunal[*Akbar Travels of India Pvt Ltd. v. CIT ITSC 332 ITR 572 (Bom)*], failure to give credit for advance tax paid or TDS to the assessee to whom the income clearly belongs [*CIT v. Permanent Bank 149 ITR 788 (Madras)*], valuing the opening stock at a figure different from the closing stock of the earlier year[*Mahendra Mills Ltd v. P.B. Desai 99 ITR 135* (SC)], overlooking by the A.O. of a mandatory provision of the law which gives no discretion to him e.g. charging interest or surcharge on the tax determined on the total income [V*enkatachalam V. Bombay Dyeing 34 ITR 143, 150 (SC), Velu v. CIT 33 ITR 463 (Madras)],* miscalculation of interest [*CIT v. Younus Kundu 402 ITR 95 (Kerala)*]. Where however the statute gives discretion to the A.O. to act or not to act in a particular manner, for example, whether to levy or not levy interest, an order of rectification levying interest which was earlier ignored through oversight cannot be passed [S.A.L. *Narayan Row v. Ishwarlal Bhagwandas 57 ITR 149(SC)*].

Conflict of judicial opinion on an issue

When a matter is debatable, the A.O. cannot overrule his earlier decision through an order u/s 154. Accordingly, when there are conflicting judgments on the same issue by different benches of the same high court or among different high courts, that would clearly indicate that the matter is debatable; as such the A.O. would be debarred from carrying out a rectification in respect thereof [*CIT v. Cello Writing Instruments and Containers P. Ltd 319 ITR 63*]. Similarly, when the question whether the assessee is entitled to a deduction or not is pending adjudication by a high court, that in itself would be indicative of the fact that two views are indeed possible and rectification cannot be carried out. A rectification order passed when the matter was debatable would not be supported by a subsequent Supreme Court order settling the issue [*Jiyajeerao v. ITO 130 ITR 710 (Cal)*]. However, where the Supreme Court's decision was based on an earlier Supreme Court decision, the matter, it was held, was never debatable at all and the rectification order based on the basis of an earlier Supreme Court decision would be valid in law [*Shahbad Cooperative Sugar Mills Ltd. V. DCIT 336 ITR 222*].

Examples of a debatable issue

Whether deduction u/s 80- IA is admissible after setting off losses of earlier years is a debatable issue and cannot be the subject matter of a rectification [*Dinosaur Steels Ltd. V. JCIT 349 ITR 360 (SC)]*. Likewise, whether interest u/ss 234 A, B and C is leviable or not is also a debatable issue [H*arish Kumar Gupta v. CCIT 404 ITR 590 (Uttarakhand*)]. The quantum of profits eligible for deduction u/s 80HHC cannot be redetermined [(CIT *v. Seshasayee Paper and Boards Ltd. 238 ITR 200(Madras)*]. Even the residential status of an assessee cannot be rectified, unless the facts are absolutely clear and no interpretation is involved [*Vijay Mallya v. ACIT 263 ITR 41 (Cal)*].

The assessee was allowed investment allowance in a particular year which it carried forward and set off in a subsequent year. The assessment of the subsequent year was sought to be rectified on the basis of a subsequent decision of the Supreme Court in which it was held that the assessee was not entitled to this allowance. Held that the rectification was bad in law because the assessment of the subsequent year could not be rectified unless the original assessment in which this allowance was allowed was first amended. Since this had not been done, withdrawal of the allowance in the subsequent year was also bad in law. [P*refab Gratings Ltd. v. ACIT 366 ITR 550(A.P. and T)*].

Not akin to the power of revision

The power to rectify is distinct from, and does not include the power to revise or review. Thus, although a mistake such as the failure to mention the correct name of the A.O. as the respondent to an appeal can be corrected [*CIT v. Yodhraj Bhalla 23 ITR 371 (Punjab)*], this power does not extend to reconsideration of a conclusion drawn on the facts and circumstances of the case [Mrs. *Khorshed Shapoor Chenai v. CED 122ITR 21 (SC),*], enhance the income assessed [*Manickavasagam v. ITO 33 ITR 482*], or sit in judgment over the order of rectification of a predecessor in office [*CIT v. Chemical Limes 149 ITR 325 (Raj)*]. The section does however cover a case where an assessee agrees to the adoption of a final figure of income as finally determined instead of a tentative one initially determined [*Manickavasagam v. ITO 33 ITR 482*].

If all the facts necessary for claiming a deduction are available on record and yet it is not granted out of sheer inadvertence or failure on the part of the assessee to make a claim, it can be granted through a rectification order [*Anchor Pressings v. CIT 161 ITR 159(SC); Chokshi* Metal Refinery *v. CIT 107 ITR 63(Guj); CIT v. K.N. Oil 142 ITR 13(M.P.)*].

Law passed with retrospective effect

Ordinarily, an order of rectification must look at the law as it existed at the time when the original order was passed. The question to be asked is: does the original order run contrary to or misapply that law? Rectification will be possible, if the answer is in the affirmative. But when the law itself changes retrospectively creating an error in the original order, the latter can certainly be rectified to give effect to the amended law, on the principle that the statutory fiction should be given full effect and taken through to its logical conclusion [M.K. *Venkatachalam v. Bombay Dyeing 34 ITR 143(*SC), J.K. *Bhatia v. I.M. Shah 156 ITR 474(SC)*]. Thus, an error-free order may be rendered erroneous because a deduction may be deemed as having been incorrectly granted as a consequence of a retrospective amendment in the law. The A.O. would be competent to carry out a rectification of such an order denying the benefit of the deduction to the assessee.

"…From the record"

The word "record" includes not merely the order of assessment or the original order sought to be rectified but all the records of the proceedings and the materials on which such order is based [*Maharana Mills Pvt. Ltd v. ITO 36 ITR 350 (SC)].* An earlier year's rectification order is also part of the record and can be relied upon to make a rectification for a subsequent year [*CIT v. Lakshmi Vilas Bank 329 ITR 591(Mad)*]. A reference to outside material is not admissible [*CIT v. Keshri Metal Pvt Ltd.237 ITR 165 (SC)*]. Thus, when a long-term capital gain is claimed as a short-term capital gain and the mistake is easily identifiable, the mistake can be rectified [*Vijay Gupta v.CIT 386 ITR 643(Del*)]. This is not the case when the assessee has to establish the mistake with the help of outside material [*Satbir Nijjer v. CIT (Appeals) 383 ITR 71(P and H*)].

Opportunity of being heard

When the assessee's liability is enhanced whether by way of tax or interest or reduction of refund, he must be given an opportunity of being heard; otherwise, the order would be invalid. *[M.Chockalingam v.CIT 48ITR 34(SC*)]. Conversely, when such liability is reduced, it is not necessary to grant such an opportunity to him [*Vedantham Raghaviah vs Third Additional* Income-Tax *Officer 49 ITR 314(Mad*].

A formal notice is not required if the assessee is aware of the rectification proceeding; the matter has been discussed with him; and he has been given an adequate opportunity of being heard [*Maharana Mills Pvt. Ltd v. ITO 36 ITR 350 (SC)*].

Limitation

A rectification order must be passed within four years of the end of the financial year in which the order sought to be rectified was passed. Where the assessm*ent* order has merged with the appellate order, the limitation would start from the date of the appellate order [*CIT v. Tony Electronics Ltd. 320 ITR 378(Del)]*. The word "order" u/s 154(7) observed the Supreme Court, has not been qualified and would thus mean any order- including the amended or the rectified order and not necessarily the original order [*Hind Wire Industries Ltd. V. CIT 212 ITR 369(SC)*].

However, once the order of rectification is held to be valid, the subsequent order of refund or demand that follows could be issued even beyond the period of limitation [*Velu v. CIT 33 ITR 463(Mad)*].

Conclusion

With the advent of CPC and Faceless assessment and appellate proceedings, rectification of intimations u/s 143(1) and other orders enters into a new zone of controversy unless such rectification proceedings are assigned to and done by the jurisdictional AO.

Secondment Of Employees: A Tax Conundrum

Integration of the world economy necessitates movement of people from one jurisdiction to another for better coordination, smooth operation and implementation of group policy for multinational enterprises. In such scenario, in case the employment is required to be exercised in another country (host country), the employee generally retains a lien on the formal employment contract with his legal employer in the home country (country of original employment). This arrangement of facilitating the services of employees on a global scale is termed as “secondment”. The entity in the host country becomes the economic employer as it bears the risk for the result produced by the employee rendering the service and the salary cost is also borne by the entity in the host country. The salary may be paid to the employee by the legal employer and the same is claimed by the legal employer as a reimbursement from the entity in the host country. However, such secondment arrangements have created significant tax uncertainty in terms of characterisation of payment by the Indian company to their overseas group company, creation of permanent establishment (PE) of foreign group company as result of secondment in India etc.

The Issue

In secondment arrangement where the employee of the foreign entity is seconded to Indian group entity, the Indian entity and the foreign company take the position that payment made by the Indian entity to the foreign company is not taxable in the hands of the foreign entity as the amount paid is merely reimbursement of salary expenses on actual basis without any mark-up. Therefore, it does not constitute income in the hands of the foreign company. However, the revenue authorities contend that foreign entity, which has seconded the employee to the Indian entity, is the employer in real sense and payment of salary remitted by the Indian entity to the foreign entity for secondment is in the nature of ‘Fees for technical services’ (‘FTS’) and therefore, the foreign company has to pay tax on the same and the Indian entity has to deduct tax on such payment u/s 195 of the IT Act. Further, the revenue authorities also contend that furnishing of services by the employees in India creates a service PE or even a fixed place PE in cases where the extent of stay of employees in India is prolonged, provided of course, the conditions of ‘carrying on business through fixed place’ and ‘disposal test’ in respect of such fixed place are satisfied. There has been long drawn litigation on the issue of taxability of re-imbursement of salary for the seconded employees. Conflicting rulings of the tribunals and courts on the matter have further compounded the issue for both the taxpayers and tax administrators.

Jurisprudence In India

Tribunals and Courts in the past have adopted ‘substance over form’ principle in many cases and held that, if the secondment arrangement is such that the secondee works under the supervision and control of the Indian entity; secondee works for the Indian entity; salary cost is borne by the Indian entity; foreign legal employer is not responsible for the work done by the secondee then the Indian entity should be considered as economic employer of the secondee. In such a scenario, foreign legal employer may not be considered to have rendered any services to Indian entity. This view has been upheld in many ITAT decisions, viz, Bangalore ITAT in:

- *IDS Software Solutions India Private Limited Vs ITO (International Taxation),*
- *Abbey Business Services Indian Private Limited Vs DCIT, which was also affirmed by the Karnataka High Court on further appeal by the revenue,*
- *ITO Vs AON Specialists Services Private Limited*;
- *ITO Vs Ariba Technologies India Private Limited,*

Mumbai Tribunal *in Deputy Director of Income Tax (International Taxations) Vs Tekmark Global Solutions LLC* has also affirmed the above principle and ruled in favour of the taxpayer.

However, the Delhi High Court in Centrica India Offshore Private Limited Vs CIT rejected the above principle and observed that mere nomenclature of payment as ‘re-imbursement’ does not define the nature of payment. Hon’ble Delhi High Court held that the re-imbursement of salary to the Canadian and UK entity for the secondees in India was nothing but fee for technical services (FTS) from UK and Canadian entity. Delhi HC ruling in Centrica India Offshore Private Limited deserves a separate mention as the SLP filed by the taxpayer before the SC has been dismissed and the judgement has attained finality on the facts and circumstances of the case. Brief facts of case were as below:

Centrica India Offshore Pvt. Ltd. (‘CIOP’) was a wholly owned subsidiary of Centrica Plc, UK. British Gas Trading Ltd. (“BSTL UK”) and Director Energy Marketing Limited, Canada (“DEML”) were also subsidiaries of Centrica Plc and were engaged in the business of supplying gas and electricity to consumers across UK and Canada. BSTL UK and DEML (together referred to as ‘overseas group entities’) outsourced their back-office support functions to third party vendors in India. CIOP entered entered into a service agreement with overseas group entities to provide interface with Indian vendors and overview the work of Indian vendors. In terms of the agreement, CIOP was compensated compensated on full costs plus mark-up of 15%. CIOP entered into a secondment agreement with the overseas group entities under which the employees seconded were to work under CIOP’s direct direct control and supervision and CIOP would bear all the risks and rewards associated with the work performed by such employees. In respect of their compensation, the employees continued to to remain on the payroll of the overseas entities who used to pay the salaries to the seconded employees. CIOP reimbursed such salary costs to the overseas employer purely on cost basis. CIOP

CIOP withheld taxes u/s 192 of the IT Act. CIOP sought an advance ruling on whether the payment made to the overseas entities was “income accruing” to the overseas group entities and whether tax tax was liable to be deducted at source u/s 195 of IT Act. The AAR ruled that the services rendered by the employees were in fact managerial services rendered by overseas group entities. However, in However, in terms of Article 12 and Article 13 of the India-Canada and India-UK tax treaty respectively, the managerial services so rendered were not in the nature of ‘Fee for Technical Services’ defined in the tax treaty, The AAR also held that the overseas entities had service PE under under the relevant DTAA on account of employees deputed by overseas entities to CIOP under the the terms of Secondment Agreement; and tax was liable to be deducted at source u/s 195 of the IT IT Act. Aggrieved by the order of the AAR, CIOP preferred an appeal before Delhi High Court. The High Court observed that:

- The seconded employees retained their entitlement to participate in the overseas group entity’s retirement and social security plans and other benefits, and their salaries were payable by the overseas entity, which was recharged from the Indian entity;

- Whilst the agreement between the Indian company and the overseas group entity granted the Indian company the right to terminate the secondment, the Indian company had no right to terminate the original underlying employment relationship between the secondee and the overseas entity;

- there was no entitlement / obligation clearly spelt out whereby CIOP had to bear the salary cost of these employees and CIOP could not be sued for default in payment of their salary;

- the payment was not in the nature of reimbursement, but payment for services rendered.; and

- the money paid by the Indian company accrued to the overseas group entity, which may or may not have used the money to fund the payments to the secondees,

Based on the above and relying on the Hon’ble SC ruling in the case *of DIT (International Taxation) Vs Morgan Stanley & Co Inc*, Hon’ble Delhi HC decided that the payment made by the Indian entity to overseas group entity towards the salary cost of the seconded employee was in the nature of ‘FTS’ and these also satisfied the ‘make available’ conditions mentioned in tax treaty between India-Canada. The HC also held that the presence of the seconded employees in India created ‘services PE’ of the overseas group entities in India. It is interesting to note that Article 5(2)(l) and Article 5(2)(k) of India-Canada and India-UK tax treaty respectively, dealing with service PE, precludes creation of services PE if the payment for services availed is characterised as ‘FTS’ in nature in terms of Article 12 and Article 13 of India -Canada and India-UK tax treaty. This point seems to have missed the attention of arguing counsel and. accordingly, the Hon’ble HC also did not ponder over the matter.

The Bombay High Court in the case of Marks & Spencer Reliance India Pvt. Ltd. (ITA No. 893 of 2014) had held that merely supplying employees or assisting the Indian entity in the business did not constitute making available technical or consultancy services. Further, once the Indian entity has withheld tax on the salaries of seconded employees, that same salary income could not be subject to withholding tax a second time when the income is remitted by the Indian entity to the foreign entity. However, neither the aspect of direction and control of the seconded employees nor the aspects covered by the Delhi High Court’s judgement in Centrica was discussed in the Marks & Spencer Reliance India (supra) case.

The Delhi ITAT, in its 2018 decision in the case of AT & T Communication Services (India) P. Ltd., distinguished the jurisdictional High Court decision in Centrica and held that such reimbursements were not FTS as the seconded employees were working under the control and supervision of the Indian entity and were not furthering the business of the overseas entity.

More recently in June 2022, The Karnataka High Court in the case of Flipkart Internet Private Limited Vs DCIT has held that payment of salary to its associated enterprise, Walmart Inc, in USA for the reimbursement of salary of seconded employees was not taxable as fee for included services as the services rendered did not satisfy the make available conditions prescribed in in India-USA tax treaty. Interestingly, the Karnataka HC observed that US entity's authority to decide on the employees' continuation with US entity post secondment period is not relevant. It was the Indian entity who had the right to terminate the services of the seconded employee during the period of secondment. It is worth pointing out here that the fact of authority to terminate the secondment was also with Indian entity in Centrica India (supra) case but this fact did not find favour in the Delhi HC rulings. The Hon'ble Karnataka HC in Flipkart Internet (supra) also pointed out that Flipkart India was not a back-office support services provider of Walmart Inc in which case the seconded employees could have been considered as the employee of Walmart Inc. The Karnataka HC distinguished on facts the Delhi High Court ruling in the Centrica India Offshore (supra), relied upon by the revenue.

Inter-Play Of PE, FTS And TP

Another interesting aspect of secondment arrangement emerges from the inter-play of Permanent Establishment, Fees for Technical Services and Transfer Pricing. In cases where seconded employees create services PE (assuming there is no specific exclusion of the creation of services PE if the payment for secondment is characterised as FTS, e.g., India-UK, India-Canada etc) or even fixed place PE, then payment/re-imbursement of salary of seconded employees to overseas group entity, even if characterised as FTS, will be considered effectively connected with such PE (service PE or fixed place PE, as the case may be) and net basis of taxation as per Article 7 of the treaty will take precedence over gross basis taxation dealing with FTS taxation. It is important to note here that in the Centrica India (supra) ruling Hon'ble Delhi HC had no occasion to discuss this aspect as the same was never raised before the HC. In case the payment of salary is without any mark-up, there will not be any income left in the hands of the PE of the overseas group entity for taxation in India. However, the revenue authority may raise the issue of arm's length pricing under transfer pricing for the PE in India. Indian tax payers can argue that any expectation of mark-up or profit for the PE will lead to increase in payment by the Indian entity to overseas group entity which will lead to additional deduction for the Indian company.

Conclusion And Way Forward

Payment/re-imbursement of salary and incidental cost in relation to seconded employees by the Indian entity to the overseas group entity has always been mired in tax controversies. There is plethora of conflicting rulings on the matter. While drafting the secondment agreement between the Indian entity, overseas entity and seconded employees, it would be important to take into account the objective of the secondment, day to day business of the formal employer, integration of the seconded employees with the day to day business of the formal/legal employer till the secondment, supervision and control of the seconded employee, right of termination of services of seconded employees, assumption of risk related to work performed by the seconded employee etc. In case the Indian entity is a captive contract service provider for the overseas group entity and lien of employment of the seconded employee continues to remain with legal employer then it would be difficult to take a position that services rendered by the seconded employee is not FTS unless the relevant tax treaty puts a restrictive condition of “make -available” or services are only “managerial” in nature and the relevant tax treaty does not encompass “managerial” services as FTS. In case the presence of seconded employees creates service PE or fixed place PE then the taxpayer can still take an argument that there is no tax liability for the PE as result of net basis taxation under Article 7 of the tax treaty. However, in case on non-captive scenarios, one can still make an argument that payment to overseas group entity is a mere ‘reimbursement’ provided all other aspects discussed above are factored in before entering into secondment arrangement.