

TAXATION TIMES

April 2022



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Introduction

India & Europe have decided to launch the EU India Trade & technology Council. This strategic co-ordination mechanism will allow both partners to tackle challenges at the nexus of trade, technology & security & thus deepen co-operation. It will be a matter of time to see as to how would this strategic move have an impact on both the countries.

Coming back to this month's Taxation Times, here's what is in store:

1. An article which briefly explains the provisions of s. 37(1) of the Income Tax Act 1961;
2. Case laws from various courts;
3. Tax news from around the world;
4. Tax compliance calendar – May 2022;
5. Notifications & Circulars from April 2022

We hope that you find this month's edition of the Taxation Times useful. In case you have any feedback or need us to include any information to make this issue more informative, please feel free to write to us at info@uja.in

Happy Reading!

Best Regards,
UJA Tax Team



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Article

Explained – section 37(1) of the Income Tax Act 1961

s. 37(1) of the Income Tax Act 1961 ('ITA') is a residual section. The section was introduced with an intent to enable the taxpayers claim expenditure which is not covered under s. 30 to s. 36 of the ITA.

However, there are certain conditions which need to be satisfied in order to claim deduction under s. 37(1) of the ITA :

- The expenditure should not be capital in nature;
- The expenditure should not be personal in nature;
- The expenditure should have been incurred in the previous year;
- The expenditure should be in respect of the business carried on by the assessee;
- The expenditure should have been expended wholly & exclusively for the purpose of business;
- The expenditure should not have been incurred for a purpose which is prohibited by any law.

In this article, we analyse each of the limb of s. 37(1) of the ITA individually to understand the exact circumstances under which deduction can be claimed or cannot be claimed under s. 37(1).

Expenditure should not be covered under s. 30 to 36 of the ITA

The taxpayer cannot claim any expenditure under s. 37(1) of the ITA if the same is allowable under s. 30 to s. 36 of the ITA. However, here it is explicitly pertinent to note that any expenditure which cannot be claimed under s. 30 to 36 cannot be claimed under s. 37 (1) either. For instance, the Hon'ble Supreme Court in the case of ***Southern Technologies Ltd. V/s CIT*** has held that a provision for doubtful debt is expressly excluded from s. 36(1)(vii) & therefore the same cannot be allowed under 37 of the ITA.

Expenditure should not be capital in nature

Expenditure can be classified into two types – revenue & capital. There is no fixed definition by which expenditure can be identified as revenue or capital. It all depends upon the nature of the expenditure which was incurred/expended.

For example - capital expenditure could be for acquiring/improving on a fixed asset whereas revenue expenditure is incurred in normal course of business.

Capital expenditure could be a one-time expenditure; however revenue expenditure could be a recurring expenditure. Capital expenditure can produce benefits which stretch over a period of a few years whereas revenue expenditure the benefit may be limited to the particular year itself.

The Hon'ble Apex Court in ***Brooke Bond India Ltd.*** has stated that share issue expenses are in the nature of capital expenditure. In ***Motor Industries Ltd.*** it was decided that expenditure incurred in relation to right issues were capital in nature.

The Hon'ble Delhi High Court in the case of ***IndianVisit.com (P) Ltd*** has held that for an assessee engaged in travel business the expenditure incurred on development of website was revenue in nature. Although, a website may provide an enduring benefit to an assessee, the intent & purpose is not to create an asset but provide a means for disseminating information about the assessee.

An expenditure was incurred by the assessee to explore the possibility of setting up a paper project which did not materialize. The Punjab & Haryana High Court in ***Vardhman Spinning & General Mills*** treated the expenditure as revenue in nature as no asset of enduring benefit was acquired by the taxpayer & possibly if the plant was set up, the expenditure could be treated as capital expenditure.

Expenditure should not be personal in nature

The expenditure incurred by the assessee should be wholly & exclusively for the purpose of his business & profession. No expenditure incurred which is personal in nature is allowable as a deduction. For instance, the Hon'ble Delhi High Court in the case of ***Mr. Shanti Bhushan V/s CIT*** held that medical expenditure by the assessee has no immediate or direct nexus on his professional field per se. Therefore, such medical expenditure incurred by the assessee is personal in nature & not allowable as a deduction under s. 37(1) of the Income Tax Act 1961.

Expenditure should be incurred in the previous year

To claim deduction under s. 37(1), the expenditure should be incurred in the previous year. In **Kanoria Chemicals & Industries Ltd.** it was held that in order to claim an amount as revenue expenditure, the assessee should establish that either the expenditure was incurred in that particular year or something happened which has created or crystallised a liability of the assessee in that year so that the amount could be claimed as a deduction on accrual basis.

Expenditure should be incurred wholly & exclusively for business purpose

Under s. 37(1) of the Income Tax Act 1961, the assessee should be able to establish the connection between expenditure incurred & his business.

The Hon'ble Supreme Court in **Jamna Auto Industries & Sassoon J. David** has held that an assessee can claim an expenditure even if there is no compelling necessity to incur the same.

The expenditure should not have been incurred for a purpose which is prohibited by any law (Explanation to s. 37(1))

Explanation 1 to s. 37(1) was inserted by Finance Act 1998 retrospectively from 1st April 1962. The intent behind the insertion of the explanation was to disallow claim made by taxpayers in respect of extortion money, bribes, hftas etc. as business expenditure.

Any amounts paid for infraction of law or contravention of law is not allowable under s. 37(1) of the ITA. However, when expenses are compensatory in nature, these can be allowed.

In **CIT V/s Neelavathi**, the Karnataka High Court held that money paid to local police & local gundas towards maintenance of theatre run by the assessee being an illegal payment is not allowable as a business expenditure.

Infraction of law is not a normal incident of business & therefore, no expense which is paid by way of penalty for breach of law can be said to be an amount wholly & exclusively for business purpose [**Haji Aziz & Abdul Shakoor Bros V/s CIT**].

In the case of **Aluminium Co. Ltd V/s CIT (SC)** stated that payment made under a statutory obligation because the assessee was in default could not constitute expenditure for the assessee's business.

However, there are certain decisions wherein it has been held that any expenses which are compensatory in nature are allowed as a deduction under s. 37(1) of the Income Tax Act 1961. In the case of **CIT V/s Kaypee Mechanical India (P) Ltd.**, the delayed payments of service tax made by the assessee was incurred wholly & exclusively for the assessee's business & therefore such payment cannot be construed as payment for the violation of law.

The Supreme Court in **CIT V/s Luxmi Devi Sugar Mills P. Ltd & Mahalaxmi Sugar Mills Company V/s CIT** clearly provided that payment of interest is compensatory in nature & cannot be characterised as penalty

s. 37(1) is a residuary section & there is no clear demarcation which can be identified to interpret whether an expenditure can fall into its ambit or not. The nature & purpose of the expenditure incurred in line with the business of the assessee needs to be closely understood in order to determine whether deduction can be claimed in line with s. 37(1) or not.

Case Laws

When investment has been made by a taxpayer into the equity of another company out of borrowings, the interest so paid on such borrowings is an admissible deduction in terms of s. 36(1)(iii). It can be held that funds are diverted for non – business purposes only incase of interest free advance given and not incase of investment in the equity shares of another company.

Summary: The taxpayer¹ is a company engaged in the business of toll collection and repairs & maintenance of the roads. During the course of the assessment proceedings, the Ld. Assessing Officer ('Ld. AO') observed that the taxpayer has had huge borrowings out of which investment was made in M/s Baramati Tollways Pvt. Ltd. The Ld. AO stated that since there was no business activity in the taxpayers company, it cannot be said that there is any commercial expediency/ business purpose for investing in M/s Baramati Tollways Pvt. Ltd. In response to the show cause notice issued by the Ld. AO as to why interest on the borrowing not be disallowed as the funds have been diverted for non-business use, the Authorized Representative ('AR') relied on the decision of the Hon'ble Punjab & Haryana High Court in the case of *Rockman Cycle Industries (P.) Ltd*² wherein it was upheld that merely because borrowing cost of investment in the share to sister company yielding dividend less than the interest paid on the borrowings such interest cannot be disallowed.

However, the Ld. AO did not accept the contention of the taxpayer and made a disallowance of INR 4,47,93,169/- under s. 36(1)(iii) of the Income Tax Act, 1961 ('ITA') being the total interest payment made by the taxpayer.

Aggrieved by the decision of the Ld. AO, the taxpayer carried the matter before the Hon'ble Commissioner of Income Tax (Appeals) [Hon'ble CIT(A)]. The Hon'ble CIT(A) deleted the disallowance upheld by the Ld. AO stating that the subsidiary is in the business of tollways. When, both the holding company & subsidiary company are engaged in the business of toll collection,

the holding company gains control over subsidiary with investment in shares of the subsidiary. Thus, immediate advantage derived may not be in money terms; however control of Board of Directors on the subsidiary is an advantage in itself for furtherance of business interest of the holding company considering that the holding & subsidiary are in the same line of business.

The Hon'ble CIT(A) invited attention to the decision of the Hon'ble Supreme Court in the case of *CIT v. Malayalam Plantations Ltd*³. and *CIT v. Birla Cotton Spinning and Weaving Mills Ltd*⁴. wherein it was decided that even if there is no profit/revenue emanating from investment, such investment is dictated by commercial expediency & no businessman can be compelled to maximize profits.

The Hon'ble Supreme Court in *Hero Cycles (P.) Ltd. v. CIT (Central)*⁵ has held that when the assessee has significant interest in the business of the subsidiary and utilizes even borrowed money for furthering its business no disallowance can be made under section 36(1) (iii). Here it was further observed that it was for the AO to establish nexus between the borrowing and advancing to prove that expenditure was for non-business purpose which Assessing Officer failed to do. The Hon'ble Supreme Court has also cited from the judgment of the Delhi High Court in *CIT v. Dalmia Cement Ltd*⁶. and agreed with the view that once it is established there is nexus between expenditure and purpose of business (which need not necessarily be business of assessee itself) the test of commercial expediency is satisfied.

Against the order of the Hon'ble CIT(A), the taxpayer has preferred an appeal before the Hon'ble ITAT.

¹ACIT V/s Rideema Toll (P) Ltd [2022] 137 taxmann.com 252 (Mumbai – Trib)

²CIT v. Rockman Cycle Industries (P.) Ltd.

[2011] 15 taxmann.com 306/203 Taxman 302/331 ITR 401 (Pun. & Har.)

³CIT v. Malayalam Plantations Ltd. [53 IT 140]

⁴CIT v. Birla Cotton Spinning and Weaving Mills Ltd. [82 IT 166].

⁵*Hero Cycles (P.) Ltd. v. CIT (Central)* in Civil Appeal No 514/2008

⁶*CIT v. Dalmia Cement Ltd.* [254 ITR 377](#)

Decision: The investments have been made by the taxpayer in the ordinary course of its business. Further, the investments have been made in the equity shares of a company in materially similar line of activity. As long as the funds borrowed by the taxpayer are used for business purposes, interest is admissible under s. 36(1)(iii) of the ITA. An investment in equity of another company is materially different from an interest free advance/loan to another company. The Hon'ble ITAT observed that the diversion of funds for non – business purpose would come into play in case of an interest free advance & not for investment for another company. Therefore, the disallowance made by the Ld. AO is not justified as the very basis/ premises of such disallowance is that investment in share capital of another company would amount to diversion of funds for non – business purposes. If such investment yields returns in the year of investment is immaterial.

It is pertinent to note that in the investment in share capital of another company amounts to diverting the borrowed funds for the business of another company but then as we noted earlier an equity investment as inherently and materially different *vis-a-vis* an interest free loan and advance. Since, the distinction has been set aside in the present case, the disallowance deleted by the Hon'ble CIT(A) is upheld.

Where, the taxpayer being engaged in the business of plying trucks had accepted & repaid loans in cash from family members to meet business exigencies such as payment to drivers & other business associates, keeping in mind the nature of the taxpayers business the explanation is acceptable & therefore the penalty imposed under s. 271D & 271E ought to be set aside.

Summary: The taxpayer⁷ is an individual. He is engaged in the business of plying trucks & filed its return of income on the basis of estimations with reference to gross receipts derived. A survey under s. 133A was conducted in the premises of the taxpayer on 19th November 2007. Certain documents & registers – lorry receipts, expenses & other entries were impounded from the business premises of the taxpayer.

During the course of the assessment proceedings, the assessee could not produce any books of accounts & claimed that he did not maintain any regular books of accounts. The Authorized Representative ('AR') of the taxpayer agreed that to the receipt of the hand loans & payment thereof. It was also pointed out that such loans were taken from family members for business need for payment to drivers & other business associates to enable the taxpayer ply trucks.

These loans were repaid within a few days on receipt from the transportation. Further, the taxpayer being uneducated, no books of accounts were maintained. The AR for the taxpayer pleaded that having regards to the facts of the case, it is not feasible for an uneducated/ undereducated taxpayer to make effective use of banking channels & a benign view should be taken consistent with the ground realities & the penalties imposed should be cancelled.

The assessment under s. 143(3) was concluded on the basis of the registers impounded & other incidental information. The registers contained entries of cash receipts & cash payments in excess of INR 20,000/- from various persons which are admitted as cash loan receipts and cash loan payments. Provisions of s. 271D & 271E were invoked for alleged infringement of s. 269SS and 269T & penalty of INR 21,82,000/- & INR 16,70,500/-. The Hon'ble Commissioner of Income Tax (Appeals) [CIT(A)] upheld the penalty imposed. Aggrieved, the appeal was preferred before the Hon'ble ITAT.

Aggrieved, the appeal was preferred before the Hon'ble ITAT.

⁷Delhi Tribunal in Balwan Singh v. Asstt. CIT [2022] 137 taxmann.com 395

Decision: The Hon'ble ITAT accepted the fact that the taxpayer is engaged as a taxpayer & has not maintained any regular books of accounts. The assessment was concluded on estimation basis which also includes some impugned entries towards cash receipts by way of loan. The taxpayer during the course of the assessment itself accepted that cash has been received by way of temporary loan to meet certain business exigencies considering the nature of business. The Revenue has not disregarded the business exigency of the taxpayer, the defence has been rejected merely because the taxpayer failed to come out with complete facts/ documents regards the transaction. The turnover receipts declared by the taxpayer at INR 39,61,195/- was enhanced to INR 1,33,67,162/- for the purposes of estimation of income based on such impounded records. Therefore, imposition of penalty separately towards such receipts by way loan is not justified.

The impromptu response of taxpayer at the time of survey requires to be seen in its natural perspective. Considering the nature of the business of the taxpayer, the explanation given by the taxpayer appears plausible. Several decisions such as *Dy. CIT v. Rupen Dass*⁸, *CIT v. Balaji Traders*⁹, *Dy. CIT v. Vignesh Flat Housing Promoters*¹⁰ amongst others have reiterates that breach of s. 269SS and 269ST for receipt & payment of cash attributable to business exigencies is merely technical or venial breach.

Accordingly, in view of the facts & circumstances of the case, penalty under s. 271D & 271E of the ought to be set aside.

⁸Dy. CIT v. Rupen Dass [2011] 16 taxmann.com 35 (Kol.)

⁹CIT v. Balaji Traders [2008] 167 Taxman 27/303 ITR 312 (Mad.)

¹⁰Dy. CIT v. Vignesh Flat Housing Promoters [2007] 105 ITD 359 (Chennai)

Tax News from around the world

Characterization as a resident for withholding tax exemption under tax treaties signed by France

<https://mnetax.com/characterization-as-a-resident-for-withholding-tax-exemption-under-tax-treaties-signed-by-france-47230>

India entered into 62 APAs in 2021-2022

<https://mnetax.com/india-entered-into-62-apas-in-2021-2022-47138>

Brazil announces new transfer pricing regime

<https://mnetax.com/brazil-announces-new-transfer-pricing-regime-47218>

Circulars & Notifications

Notifications:

- a. The CBDT amends the Income Tax Rules 1962 called as the Income Tax (6th Amendment), Rules, 2022 and inserts rule 12AAA 'Taxation of income from retirement benefit account maintained in a notified country' effective from the date of their

<https://incometaxindia.gov.in/communications/notification/notification-24-2022.pdf>

- b. The Central Government make e-Dispute Resolution Scheme, 2022 effective from the date of their publication in the Official Gazette

<https://incometaxindia.gov.in/communications/notification/notification-no27-2022.pdf>

- c. The CBDT amends the Income Tax Rules 1962 called as the Income Tax (8th Amendment), Rules, 2022 and inserts sub-clause (3) and (4) of rule 2 'The Infrastructure Debt Fund' effective from the date of their publication in the Official

<https://incometaxindia.gov.in/communications/notification/notification-no28-2022.pdf>

- d. The CBDT amends the Income Tax Rules 1962 called as the Income Tax (9th Amendment), Rules, 2022 and inserts rule 12AB 'Conditions for furnishing return of income by persons referred to in clause (b) of sub-section (1) of section 139' effective

<https://incometaxindia.gov.in/communications/notification/notification-37-2022.pdf>

Tax Compliances for May 2022

7 May 2022

Due date for deposit of Tax deducted/collected for the month of April, 2022.

15 May 2022

Due date for issue of TDS Certificate for tax deducted under section 194-IA, 194-IB and 194M in the month of March, 2022

Quarterly statement of TCS deposited for the quarter ending March 31, 2022

30 May 2022

Submission of a statement (in Form No. 49C) by non-resident having a liaison office in India for the financial year 2021-22

Due date for furnishing of challan-cum-statement in respect of tax deducted under section 194-IA, 194-IB, 194M in the month of April, 2022

Issue of TCS certificates for the 4th Quarter of the Financial Year 2021-22

31 May 2022

Quarterly statement of TDS deposited for the quarter ending March 31, 2022

Application for allotment of PAN in case of non-individual resident person, which enters into a financial transaction of Rs. 2,50,000 or more during FY 2021-22 and hasn't been allotted any PAN

Application for allotment of PAN in case of person being managing director, director, partner, trustee, author, founder, karta, chief executive officer, principal officer or office bearer of the person referred to in Rule 114(3)(v) or any person competent to act on behalf of the person referred to in Rule 114(3)(v) and who hasn't allotted any PAN

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