

# TAXATION TIMES

March 2022



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## Introduction

In the last few years, India has witnessed a surge in the number of start-ups and as a matter of fact, India is the world's third largest start-up ecosystem. The India Innovation Hub, a project of the India Pavillion at Expo 2020 facilitated & provided startups a global stage to interact with investors, understand the opportunities available as well as engage with innovators & take the next step up on the innovation journey.

Addressing a roundtable meeting in Abu Dhabi on Indian start-ups, Mr. Piyush Goyal said that India aspires to emerge as the world's number one startup destination.

A free trade agreement between UAE & India which was signed recently to facilitate bilateral trade & business-to-business engagements would also help in leveraging the offerings of both countries & enhance the start-up ecosystem in India.

Coming back to this month's Taxation Times, here's what we have to offer :

- An analysis & understanding of the implications of change in shareholding pattern of carry forward of
- losses in line with the Income Tax Act 1961;
- Case laws from various courts;
- Tax news from around the world;
- Tax compliance calendar – April 2022;
- Notifications & Circulars from March 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](mailto:info@uja.in)

Happy Reading!

Best Regards,  
UJA Tax Team



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## To Carry Forward Losses or not to carry forward losses

The Income Tax Act 1961 ('ITA') provides for carry forward & set off of losses incurred in one financial year against the profits of the future years. The ITA also permits the set off of losses incurred under one head of income against the income from another head i.e a taxpayer can avail inter-head adjustment of loss incurred & intra-head adjustment of loss incurred. However, there certain restrictions which need to be kept in mind while making intra-head adjustment of losses.

s. 79 of the ITA prohibits set off & carry forward of losses under certain circumstances. s. 79 of the ITA was introduced as an anti-abuse provision to prevent taxpayers from transferring losses incurred by a loss making entity to a profit making entity & enjoy the benefits of such losses while conducting a profitable business.

As per the provisions of s. 79, a company is not eligible to set off & carry forward losses if the following conditions are satisfied:

1. the taxpayer is a company in which public are substantially not interested;
2. the persons beneficially holding 51% of the voting power on the following two dates are different:
  - a. on the last day of the previous year in which the loss was incurred;
  - b. on the last day of the previous year in which the company wants to set off brought forward losses.

The proviso to s. 79 states that in case of an eligible start-up covered under s. 80-IAC of the ITA, loss incurred in any year prior to the previous year shall be allowed to be carried forward & set off against the income of the previous year on satisfaction of either of following two conditions:

1. continuity of 51% shareholding or
2. 100% of the original shareholders (w.e.f AY 2020 – 2021).

This proviso has been carved out specially to facilitate ease of doing business in case of an eligible start-up.

s. 79 has been introduced as an anti-abuse provision to prevent set off & carry forward of losses in case of companies in which 51% of the shareholding is different as on the last day of the year in which the loss is incurred and last day of the year in which the

loss is proposed to be set off. s. 79 of the ITA specifically lays emphasis on “*persons who **beneficially held shares** of the company carrying not less than fifty-one percent of the voting power*”. Thus, the emphasis here is on **shares carrying voting power** and not **ownership of shares**. There are several controversies around 'shareholding' vis-à-vis 'voting power' & various courts have interpreted these from time to time.

The **Hon'ble Supreme Court** in the case of **Italindia Cotton Co. (P) Ltd<sup>1</sup>** has explained that the object of enacting s. 79 appears to discourage persons claiming a reduction of their tax liability on profits earned in companies which had sustained losses in earlier years. It was not unusual for a group of persons to acquire a company, which had suffered losses in earlier years, in expectation that the company would earn substantial profits after such acquisition, and they would benefit by a reduction of the tax liability on those profits on set off of losses carried forward from earlier years before such acquisition. The acquisition of a company in such a case would be effected by a change in its shareholding and the control over the company could be ensured by securing the beneficial ownership of shares carrying 51 per cent or more of the voting power. If the change in shareholding did not result in holding voting power of 51 per cent or it was established that the shares of the company carrying not less than 51 per cent of the voting power were beneficially held by the same persons, both on the last day of the previous year as well as the last day of the year or years in which the loss was incurred, it could be presumed that there was no change in the control over the company, and the disqualification imposed on the company because of the change in its shareholding would stand removed

**Thus, the Apex Court has explicitly upheld that s. 79 becomes applicable only incase of change of shareholding pattern exceeding 51 percent of the voting power in the year in which the loss was incurred & the year in which the loss was set off, however if the voting power remained with the same management, s. 79 does not become applicable.**

<sup>1</sup>CIT V/s Italindia Cotton Co (P) Ltd (1988) 40 Taxman 126A (SC)

A similar observation was made by the **Hon'ble Karnataka High Court** in the case of **Amco Power Systems Ltd.**<sup>2</sup> wherein it was upheld that an assessee can carry forward & set off unabsorbed losses even if the shareholding changes by more than 49% as long as there is no change in control.

However, a contrary view has been taken by the **Hon'ble Delhi High Court** in the case of **Yum Restaurants India Private Limited**<sup>3</sup>. In this case, the Court observed that the taxpayer cannot carry forward & set-off unabsorbed losses when there is a shareholding of more than 49% even if the transaction is intra-group.

The **Hon'ble Delhi ITAT** in the case of **Select Holiday Resorts Pvt. Ltd**<sup>4</sup> has stated that where a parent company merged with its subsidiary, the amalgamated company is entitled to claim the benefit of brought forward & set off of losses under s. 79 of the ITA. The contention of the Ld. AO that the loss cannot be set off on the ground that there is a change in the shareholding of more than 51% of the share capital of the subsidiary company is not valid since the management of the amalgamated company pre-merger & post-merger is the same.

**Thus, from the above judicial precedents, it is quite evident that even though most of the courts have agreed that mere 'shareholding' is not a criteria but exercise of 'voting power' is of considerable importance while deciding if s. 79 would be applicable or not.**

Apart from beneficial ownership, another aspect which was examined by the courts was if s. 79 also becomes applicable to. The **Hon'ble Mumbai Tribunal** in the case of **Credila Financial Services Private Limited**<sup>5</sup> dealt with the said issue. The Hon'ble ITAT has stated that carry forward & set off of unabsorbed depreciation shall not be permitted since there was a change in shareholding pattern during the year under consideration. Further, 50% shares in the company were held by a listed company, however such shareholding was not held for the entire year & therefore the condition for public becoming substantially interested is not met. The Hon'ble Tribunal also observed that s. 79 applies only to set off & carry forward of losses & not unabsorbed depreciation. Tant case provisions of s. 79

applies only to set off & carry forward of losses & not unabsorbed depreciation. Therefore, in the instant case provisions of s. 79 become applicable & the assessee will not be entitled to carry forward unabsorbed business loss, however unabsorbed depreciation is not impacted in the said case.

Thus, s. 79 has had its fair share of controversies which may continue until clarifications are issued on the aforesaid subject. Keeping in mind that change in shareholding of more than 51% of voting power may be a point of litigation, it is beneficial to completely understand the facts of the case vis-à-vis the provisions of s. 79 & other ancillary sections prior to executing the transaction.

<sup>2</sup>CIT V/s AMCO Power Systems Ltd. [TS-607-HC-2015 (Kar)]

<sup>3</sup>ITA 349/2015 and ITA 388/2015

<sup>4</sup>DCIT V/s Select Holiday Resorts Pvt. Ltd (ITAT Delhi)

<sup>5</sup>DCIT V/s Credila Financial Services Private Limited (ITA No. 1491/Mum/2016)

## Case Law

The taxpayer is entitled to claim deduction under s. 54 of the Income Tax Act 1961 if the possession of the new house has been received within 2 years from the date of the sale of the asset. Further, the source of funds utilized to procure the new asset is of no relevance.

**Facts:** The taxpayer<sup>1</sup> along with his wife booked a residential flat in an under construction (hereinafter referred to as 'new residential house') in May 2011. Majority of the payments were discharged to the builder by availing a bank loan. Thereafter, in May 2014, the taxpayer and his wife being co-owners holding 50% share sold a residential flat (hereinafter referred to as 'original asset') and utilized the sale proceeds for repayment of the existing bank loan. In the Income Tax Return for AY 2015 – 2016 during which the sale took place, the taxpayer claimed deduction under s. 54 of the Income Tax Act 1961 ('ITA') and offered to tax 'NIL' long term capital gains.

The Ld. Assessing Officer ('AO') during the assessment proceedings denied the benefit of s. 54 of the ITA on the ground that the taxpayer has not purchased a new residential house within the period specified under s. 54 of the ITA i.e one year before or two years after the sale of the original asset. According to the Ld. AO the new residential house was purchased on 15<sup>th</sup> Feb 2012 i.e on the date on which the agreement to sale dtd. 7<sup>th</sup> Feb 2012 was registered. Since this was 2 years & 3 months prior to the date of transfer/sale of the original asset (i.e 21<sup>st</sup> May 2014), the taxpayer could not be granted the benefit of s. 54 of the ITA. Further, the Ld. AO was also of the view that the taxpayer had utilized his regular income to repay the loan installments & not the consideration received from the sale of the original property.

The Ld. CIT(A) held that the date of registration of the agreement for sale (7<sup>th</sup> Feb 2012) is to be considered as the date of purchase of the new residential house & decided the appeal against the taxpayer since the purchase of property was beyond the specified period of two years. The Ld. CIT(A) also rejected the alternative argument of the taxpayer that since the property was being purchased was under construction, the benefit of s. 54 of the ITA can be extended under 'construction' and not 'purchase.'

Aggrieved the taxpayer carried the matter before the Income Tax Appellate Tribunal ('ITAT').

**Issue:** Is the taxpayer eligible to claim the deduction under s. 54 of the ITA if the possession of the new house is taken within 2 years from the agreement of sale of the new asset?

**Held:** The Hon'ble ITAT observed that the date of registration of the agreement to sale has been taken by the Ld. AO & the CIT(A) as the date of purchase & therefore, the terms & conditions of this agreement are to be examined. The said agreement is not a sale/conveyance deed but only an agreement entered into between the developer & the taxpayer & the obligation of the taxpayer to make the payment was linked to construction.

As per the clauses contained in the Agreement to Sale, the purchases/taxpayer is put in possession only as a licensee and to that extent the purchaser/taxpayer acquires interest in the premise on receiving the possession. In the instant case, since by the date, the taxpayer has already paid the majority consideration for purchase, it can be held that on the date of taking such possession the property has been purchased for purpose of s. 54 of the ITA as has been held in *CIT V/s Smt. Beena K Jain*<sup>2</sup>. While examining the issue in respect of Section 54F of the Act the Hon'ble High Court held that for the purpose of determining the date of purchase of new residential house the relevant date is the date when the petitioner paid the full consideration amount on the flat becoming ready for occupation and obtained possession of the flat.

The Hon'ble ITAT also relied upon the decision of *Bastimal K Jain v. ITO*<sup>3</sup> which followed the decision of the High Court above and held that the date of handing over the possession should be considered as the appropriate date of handing over possession for considering the provisions of s. 54. Further, the Hon'ble Counsel for the taxpayer relied on the decision of *V.M Dujodwala* wherein it was held that the date of taking possession

<sup>1</sup>Reji Easow V/s ITO [2022] 136 taxmann.com 111 (Mumbai – Trib)

<sup>2</sup>*CIT v. Smt. Beena K. Jain* : 217 ITR 363

<sup>3</sup>*Bastimal K Jain v. ITO* : [2016] 76 Taxmann.com 368 (Mumbai)



shall be the relevant date for claiming benefit of exemption under s. 54 of the ITA.

Therefore, keeping in mind the aforesaid judgements & facts of the case, it is hereby held that the date on which the taxpayer has received possession of the new residential house shall be the date of purchase. The only requirement of s. 54 is that the taxpayer should purchase a residential house within the stipulated period & the source of funds is quite irrelevant. Further, it is nowhere mentioned that the funds from the original asset should be utilised for purchase of the new residential house. Accordingly, the taxpayer is entitled to the benefit under s. 54 of the ITA.

**When the taxpayers claim of making genuine purchases from the vendors is not proved, however, the sales made by the taxpayer are accepted, it is safely concluded that the purchases have been made by the taxpayer from the open/grey market. Therefore, disallowances of purchases claimed from the said parties to be restricted to 12.50% of the impugned value of purchases.**

**When the Assessing Officer disallowed under s. 40A(2)(a) of the Income Tax Act 1961, taxpayers claim for salary paid to directors daughter, however, no reliance or justification was given on what basis was such expenditure unreasonable or excessive, disallowance under s. 40A(2)(a) was not justified.**

#### **Facts :**

The taxpayer<sup>4</sup> is a company engaged in the business of trading FMCG products, moulded plastic caps, cosmetic items etc. The return of the income filed by the taxpayer was processed under s. 143(1) of the ITA. Subsequently, case of the taxpayer was selected for scrutiny assessment under s. 143(2) of the ITA. The assessment was concluded by the Ld. Assessing officer ('AO') making the following disallowances

Particulars	INR
Disallowance of Purchases	19,08,688
Disallowance of Salary under s. 40A(2)(b)	6,00,000

The CIT(A) upheld the disallowance made by the Ld. AO. Aggrieved, the taxpayer has preferred an appeal before the Hon'ble ITAT.

#### **Held:**

The issues before the Hon'ble ITAT were twofold –

Issues	Particulars	INR
Issues I	Disallowance of Purchases	19,08,688
Issues II	Disallowance of Salary under s. 40A(2)(b)	6,00,000

#### **Issue I :**

The Hon'ble ITAT observed that during the course of the assessment proceedings in order to verify the genuineness of the purchases made, the taxpayer was requested to furnish details of purchases made from parties in excess of INR 1 lac during the AY under consideration. After perusing the details filed by the taxpayer, notice under s. 133(6) were issued to (i) M/s Nidhi Printer & (ii) M/s Cupid Ltd. The notice was returned unserved by the postal authorities incase of M/s Nidhi Printer. M/s Cupid Ltd. filed it's confirmation whereby there was a discrepancy of INR 1,32,962/- as regards purchases claimed by the taxpayer in comparison to those shown by the said party in it's books of accounts. Since, no confirmation was received by M/s Nidhi Printer, the Ld. AO disallowed purchases of INR 17,75,726/- that were claimed by the taxpayer. Also, since a sum of INR 1,32,962/- remained unreconciled in regards M/s Cupid Ltd. disallowance of purchases to the extent of INR 19,08,688/- were made.

Before the Hon'ble ITAT, the Authorized Representatives for the taxpayer placed on record the confirmation of M/s Cupid Ltd. which therein reveals that the closing balance tallies with that reflected by the taxpayer in it's books of accounts. Additionally, the purchases claimed by the taxpayer from the said party tallies with that reflected by the said party in it's confirmation of account. Therefore, the disallowance of INR 1,32,962/- made by the Ld. AO in connection with M/s Cupid Ltd. be deleted.

<sup>4</sup> Kimaya Impex (P) Ltd V/s ITO.

Insofar as M/s Nidhi Printer is concerned, the taxpayer had placed a confirmation from the said party along with copies of purchases. However, the invoices placed on record nowhere mentioned the L.R number, date, vehicle number etc. On perusal of the said documents, the Hon'ble ITAT concluded that the taxpayer has not made genuine purchases from M/s Nidhi Printer. At the same time, the ITAT also observed that the sales by the taxpayer were accepted by the Ld. AO & therefore accordingly, the taxpayer has purchased goods from M/s Nidhi Printers but at a discounted price from the open market. Therefore, in all fairness, purchases made from the said party are restricted to 12.50% of the aggregate value of the purchases in question.

#### **Issue II :**

The taxpayer has incurred INR 20,30,220/- towards salary & bonus which included salary of INR 12,00,000/- to Ms. Anita Poddar, the daughter of the director. Ms. Anita Poddar was a qualified MBA & was handling the marketing work in the organization & the salary paid to her was on this account. Therefore, the salary paid to her was justified. Copy of her return of income was also placed on record. However, the Ld. AO observed that the turnover of the company has reduced substantially in comparison to the immediately previous year. Backed by this conviction, the Ld. AO triggering the provisions of s. 40A(2)(b) disallowed 50% of the salary that was paid to Ms. Anita Poddar.

The Hon'ble ITAT opined that where the taxpayer incurs any expenditure in respect of which payment has been made to a related party as contemplated in s. 40A(2)(b), then, if the AO is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by him therefrom, that the expenditure which is considered by him to be excessive or unreasonable shall not allowed as a deduction.

In the instant case, the Ld. AO has scaled down the taxpayers claim of salary paid to Ms. Anita Poddar merely for a reason that the turnover of the taxpayer was reduced to one half during the year under consideration. The Hon'ble ITAT has held that the very basis for taking recourse to the provisions of s. 40A(2)(a) is misconceived & therefore the claim cannot be justified in the eyes of law. Accordingly, the disallowance passed by the CIT(A) deserves to be set-aside.



## Tax News from around the world

**Countries respond to Ukraine war with tax proposals.**

<https://www.internationaltaxreview.com/article/b1x9zvdwkyx0g5/this-week-in-tax-countries-respond-to-ukraine-war-with-tax-proposals>

**As the Russia-Ukraine war continues, the US considers tougher economic sanctions against Russia and some politicians are wondering if this is the time to reconsider the US-Russia tax treaty.**

<https://www.internationaltaxreview.com/article/b1x3tpjrdr5y77/this-week-in-tax-russian-tax-treaties-in-doubt>

**OECD releases IT-format to support exchange of tax information on digital platform sellers**

<https://www.oecd.org/tax/exchange-of-tax-information/oecd-releases-it-format-to-support-exchange-of-tax-information-on-digital-platform-sellers.htm>

**Spain's National Court challenges the deductibility of intragroup services in the absence of a written contract**

<https://mnetax.com/spains-national-court-challenges-the-deductibility-of-intragroup-services-in-the-absence-of-a-written-contract-46933>

**OECD Releases Commentary on Globe Model Rules**

<https://www.ibfd.org/news/oecd-releases-commentary-globe-model-rules>

## Circulars, Notifications & Press Release

### A. Circulars:

a. CBDT provides circular containing rates of deduction of Income-tax from the payment of income chargeable under the head "Salaries" during the financial year 2021-22 and explains certain related provisions of the Act and Income-tax Rules, 1962.

<https://incometaxindia.gov.in/communications/circular/circular-04-2022.pdf>

b. CBDT provides relaxation from the requirement of electronic filing of application in Form No. 3CF for seeking approval under section 35(1)(ii)/(iia)/(iii) of the Income-tax Act, 1961.

<https://incometaxindia.gov.in/communications/circular/circular-no-5-2022.pdf>

c. CBDT condone delay under section 119(2)(b) of the Income-tax Act, 1961 in filing of Form 10-IC for Assessment Year 2020-21 to 30<sup>th</sup> June, 2022.

<https://incometaxindia.gov.in/communications/circular/circular-no-6-2022.pdf>

### B. Notifications:

a. The CBDT makes Scheme called as 'Faceless Jurisdiction of Income Tax Authorities Scheme, 2022', which will come into force on the date of publication in the Official Gazette.

<https://incometaxindia.gov.in/communications/notification/notification-15-2022.pdf>

## Tax Compliances for April 2022

14 April 2022

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

30 April 2022

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

Due date for uploading declarations received from recipients in Form. 15G/15H during the quarter ending March, 2022

Due date for deposit of Tax deducted by an assessee other than an office of the Government for the month of March, 2022

Due date for deposit of TDS for the period January 2022 to March 2022 when Assessing Officer has permitted quarterly deposit of TDS under section 192, 194A, 194D or 194H

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