MOHINDER PURI & CO.
CHARTERED ACCOUNTANTS

Corporate Update

May | 2023

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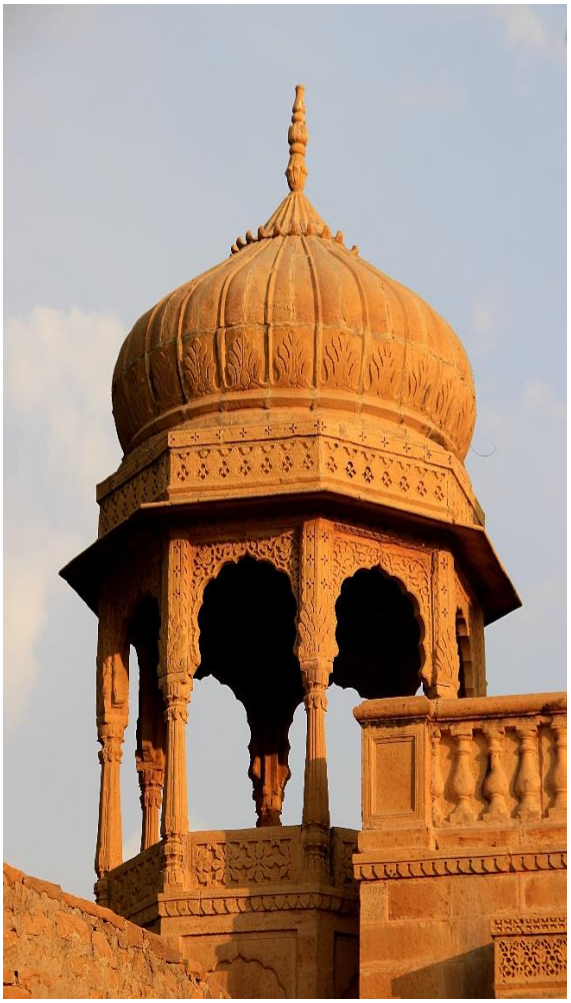

FOREWORD

Dear Reader,

We enclose our Corporate Update covering analysis of certain judgements and important notifications as issued in the last month.

One of the important notifications as covered in this Update refers to issue of Draft Rules of Valuation of unquoted equity shares issued by an Indian company to Non-Residents at a premium.

As you are aware that an amendment was introduced in the Finance Act, 2023 to cover within the ambit of existing provisions of the Indian Income-tax Act, regarding determination of 'Fair Market Value' (FMV) for issue of such shares to Non-Residents. It may be noted that issue of shares at a value higher than the FMV is to be treated as income of the issuer company. The proposed provision will have a bearing on non-resident investments.

It is proposed to provide for five internationally accepted methods for determination of 'FMV', in addition to the DCF and Net Asset Value methods, in respect of issue of such shares to non-residents.

I hope that you will find the current issue of Corporate Update interesting and useful.

C.S. Mathur
Partner

DIRECT TAX

RECENT JUDGEMENTS

Scope of section 148A of the Income-tax Act (`the Act') is limited to ascertainment of information with the tax officer that income of assessee had escaped assessment, without going into merits of the case

In a recent decision on a writ petition in the case of Deepak Kumar Yadav Vs. Principal Commissioner of Income Tax [TS-263-HC-2023 (ALL)], the Allahabad High Court held that the scope of Section 148A of the Act is only confined to existence of information which suggests that income chargeable to tax has escaped assessment. Final determination on the question whether income of assessee has escaped is then to be made by passing an order of assessment or reassessment under section 147, after issue of notice under section 148.

In the instant case, the assessee was an Individual engaged in the business of trading Arecanut (Supari), Chopped Betal Nut and Sweet Betal Nut in the name of his proprietary "S.K.L. Enterprises." The assessee filed his return of income disclosing total income of Rs. 6,81,630. The turnover during the Financial Year 2019-20 from his proprietary concern aggregated to Rs. 5,87,26,116 and aggregate purchases were of Rs. 5,81,61,860.

For the year, the assessee filed its return of income under section 143(1) and no notice u/s 143(2) was issued to the assessee. However, a notice under section 148A(b) of the Act was issued by the tax officer on the basis of information received from DGGI and GST authorities regarding availing and utilization of fraudulent Input Tax Credits by the assessee on the basis of fake invoices without receipt of goods. It was alleged that the assessee had artificially inflated his purchase expense and consequently, reduced his taxable income.

An opportunity under section 148A(b) of the Act was given to the assessee to show cause why a notice under Section 148 of the Act be not issued on the basis of information that suggests that income chargeable to tax has escaped assessment.

The assessee filed a detailed objection denying the allegations made in the notice and requested the opportunity of cross examinations of the said suppliers. However, the jurisdictional authority passed an order under section 148(d) of the Act rejecting the assessee's objection to the notice on ground that information exists to suggest that transactions referred to in the notice are fictitious and without actual supply of goods and thus treated the purchases as having escaped assessment for the year. The assessee's request for cross-examination of suppliers was also declined.

Aggrieved, the assessee filed a writ petition before the High Court submitting that the authority concerned has not examined the assessee's reply and the impugned order has been passed in a routine and mechanical manner. Relying upon order passed by the Supreme Court of India in Red Chilli International Sales vs. Income-tax officer [2023] 146 taxmann.com 224 (SC) and order passed by the Bombay High Court in Writ Petition No. 2836 of 2022, the assessee stated that the object of issuing notice under section 148A would stand frustrated, if the authority doesn't examine the reply of the assessee and passes an order without conducting any enquiry.

The revenue submitted that the object of issuing notice under Section 148A of the Act is limited to ascertainment of information which suggests that income has escaped assessment and issues such as sufficiency

or otherwise of material justifying reopening of assessment or adjudication on the correctness of information are ordinarily not warranted at this stage. It was argued that in the present case 'information' exists on record and that the assessee would be at liberty to raise all factual issues/objections at the appropriate stage of the proceedings.

The High Court observed that the scheme of re-assessment of tax under the Act has undergone a change with effect from 01.04.2021 vide Finance Act, 2021. The requirement of 'reasons to believe' for initiating reassessment proceedings hitherto occurring in the Act stands substituted with the availability of information with the Assessing Officer that income of assessee has escaped assessment. The Income Tax Act does not contemplate any detailed adjudication on the merits of information available with the Assessing Officer at the stage of passing order under section 148A(d) of the Act of 1961. Under the scheme of the Act a detailed procedure has been provided under section 148 for issuance of notice whereafter the assessing authority has to determine, in the manner specified, whether income has escaped assessment and the defence of assessee, on all permissible grounds, remains open to be pressed at such stage. The ultimate determination made by the assessing authority under Section 147 for reassessment is otherwise subject to appeal under Section 246A of the Act. Merits of the information referable to section 148A thus remains subject to the reassessment proceedings initiated vide notice under section 148 of the Act. It is for this reason that issues which require determination at the stage of reassessment proceedings and in respect of which departmental remedy is otherwise available are not required to be determined at the stage of decision by the assessing authority under section 148A(d).

Regarding the merits of the case as submitted by the assessee that his books of accounts truly reflect the transactions and goods have been received by way of e-challan, etc the High Court held that such defence on merits of the information is not expected to be authoritatively determined by the assessing authority at the stage of decision under section 148A(d). On the basis of materials referred to in the order under section 148A(d), it cannot be doubted that information did exist with the authorities suggesting that the income chargeable to tax has escaped assessment.

The High Court distinguished the assessee's reliance on the Supreme Court judgement in the case of Red Chilli International Sales supra wherein the Apex Court directed the High Court to consider the reply filed by the petitioner to the notice under section 148A(b) as well as the order under section 148A(d) of the Act as the High Court had refused to examine the issue in view of the availability of alternative remedy. The High court stated that the Supreme Court did not endorse the view that a writ petition itself would not be maintainable against the order passed under section 148A(d) of the Act and consequently directed the High Court to examine the merits of the order. However, the limited scope under Article 226 of the Constitution of India to adjudicate an order passed under Section 148A(d) of the Act, would be confined to existence of the information only.

The scope of enquiry under section 148A of the Act is only to the extent of availability or otherwise of information suggesting that income has escaped assessment. The correctness or otherwise information is an aspect to be gone into later by the assessing authority at the stage of proceedings under section 148 of the Act for reassessment. There is no challenge to information contained in section 148A(b) on the ground that information available with revenue is not

referable to Explanation 1 to the second proviso of section 148 of the Act. Accordingly, the High Court held that no further consideration on merits is required at the stage of decision under section 148A(d) and accordingly dismissed the Writ Petition filed by the assessee.

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Levy of penalty for failure to get books of accounts audited under section 44AB when no books of accounts are maintained

Recently, ITAT Ranchi in the case of **Rakesh Kumar Jha v. ITO [2023] 150 taxmann.com 298 (Ranchi-Trib.)** has held that penalty under section 271B can be levied for failure to get tax audit of books of accounts even when no books of accounts are maintained by the assessee.

In the instant case, the assessee submitted that it earned income from imparting tuition classes. In quantum proceedings which went up to ITAT, his income was estimated at Rs.7,61,261/- being 8% of gross receipts u/s 145(3) of the Act on account of non-maintenance of books of accounts. The AO subsequently levied penalty u/s 271B of the Act for failure to get accounts audited which was also confirmed by the CIT(A). When the matter came before ITAT, the assessee took the plea that section 271B cannot apply where no accounts have been maintained, relying on the Allahabad High Court's judgement in the case of CIT v. Bisauli Tractors (2007) 165 taxman 1.

The ITAT, on perusal of its order passed in the assessee's quantum appeal, observed that the assessee has not presented the true and correct facts and his case is not that of non-maintenance of books of accounts but rejection of books of accounts and hence, assessee's case is not covered by the Allahabad HC judgement. The ITAT held that even otherwise the provisions of section 44AA and section 44AB are separate and distinct provisions. Reference was also made by ITAT to the case of Hon'ble Madhya Pradesh High Court in the case of Bharat Construction Co. v. ITO reported in [1999] 106 Taxman 460 (MP) wherein it was held that that AO can issue proceedings under section 271B in addition to proceedings under section 271A when books are not maintained. The ITAT held that accepting the argument of the assessee would lead to a situation where a person making default in respect of maintenance of books of accounts as well as failure to get them audited would be in a better position as compared to a person who make default only in respect of getting his books of accounts audited, since penalty for failure to get books of accounts audited is higher than the penalty for default in maintenance of books of accounts. The ITAT thus rejected the appeal of the assessee.

However, it may be of interest to note that the above ITAT decision is not in accord with the decisions of certain High Courts, such as High Court of Allahabad, High Court of Gauhati and High Court of Madhya Pradesh. Therefore, it will be of interest to know whether the above ITAT decision becomes final.

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INCOME-TAX NOTIFICATIONS

Increase in the Tax Exemption limit for Leave Encashment for Non-Government Salaried Employees

In the Budget, Speech Hon'ble Finance Minister has proposed to increase the tax exemption limit for Leave Encashment for non-government salaried employees, considering the growth in salary pay out to the government employees, to provide relief to the non-government employees at the time of their retirement, either on superannuation or otherwise.

Pursuant to the above, the Central Govt. has raised the exemption limit for leave encashment received by non-government employees from the existing limit of Rs. 3 Lacs to Rs. 25 Lac under section 10(10AA)(ii) of the Income -tax Act, as per Notification No. 31/2023 dated May 02, 2023.

The aggregate amount of exemption shall not exceed Rs.25 lacs where such payments are received by a non-government employee from more than one employer in the same previous year.

The new exemption limit will be effective from April 01, 2023.

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Draft proposals regarding share valuation rules provided under Rule 11UA for the purpose of Section 56(2)(vii b)

Section 56(2)(vii b) of the Act provides for the taxation of share premium received by a closely held company from any investor (resident or non-resident) in excess of its Fair Market Value ('FMV').

Prior to its amendment by the Finance Act, 2023, this section was applicable only to consideration for issue of shares to Resident investors. However, with effect from April 01, 2023, non-resident investors have also been brought under the purview of this section. Accordingly, contributions to share capital by non-residents, foreign companies would be examined as to whether the same is as per FMV or not.

Rule 11UA of the Income tax Rules provide for the methods of determining FMV for the purpose of this section. However, inclusion of Non-Resident investors under this section posed certain difficulties due to variations in the valuation rules for determining FMV under Rule 11UA vis.-a-vis. FEMA regulations.

In order to consider the concerns of genuine non-resident investors, CBDT has issued draft rules of valuation on May 26, 2023. The key features of the valuation rule are summarized hereunder:

1) In addition to the two already prescribed methods (applicable for both resident and non-resident investors) i.e., 'Net Asset Value method' [clause (a) of Rule 11UA (2)] and 'Discounted Free Cash Flow method' [clause (b) of Rule 11UA (2)], the following additional methods of valuation for non-resident investors have been proposed under the draft rules in clause (d) of Rule 11UA(2):

a) Comparable Company Multiple Method;
b) Probability Weighted Expected Return Method;
c) Option Pricing Method;
d) Milestone Analysis Method; and
e) Replacement Cost Methods

It is optional to choose any of the above methods however a valuation report is to be obtained from a Merchant banker for determining FMV under the additional methods as specified.

2) The draft rules have provided that merchant banker report issued up to ninety days prior to the date of issue of shares will be acceptable and the date of report can be taken as the valuation date.

3) In order to account for various factors such as exchange fluctuations, bidding process etc. a safe harbour of 10% variation in the value, computed as per the above 'seven' methods, has also been provided in the draft rules.

4) Where any consideration is received by a company for issue of shares from any entity notified under clause (ii) of the first proviso to the clause (vii b) of sub-section 2 of Section 56, the price of equity shares corresponding to such consideration may be taken as the FMV of the equity shares for resident and non-resident investors subject to the following:

i. To the extent the consideration does not exceed the aggregate consideration that is received from any notified entity; and
ii. The consideration has been received by the company from the notified entity within a period of ninety days of the date of issue of shares which are the subject matter of valuation.

On similar lines, price matching for Resident and Non-resident investors would be available with reference to investment by Venture Capital Funds or Specified Funds.

5) A separate notification No. S02274(e) dated May 24, 2023 has been issued by CBDT, to notify certain class of investors the consideration received from whom in respect of issue of shares shall be out of the purview of this this clause. Such class or class of persons include Government, Government related investors or banks or entities involved in insurance business governed by applicable regulations in home country or specified entities, being resident of specified countries / territories [See Annexure].

Annexure:

Any of the following entities, which is a resident of any country or specified territory having applicable regulatory framework: -

a. Entities registered with Securities and Exchange Board of India as Category-I Foreign Portfolio Investors.
b. Endowment Funds associated with a university, hospitals or charities,
c. Pension Funds created or established under the law of the foreign country or specified territory,
d. Broad Based Pooled Investment Vehicle or Fund where the number of investors in such vehicle or fund is more than 50 and such fund is not a hedge fund or a fund which employs diverse or complex trading strategies.

The notified countries/specified territories are - Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Iceland, Israel, Italy, Japan,

Korea, New Zealand, Norway, Russia, Spain, Sweden, United Kingdom and United States.

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NOTIFICATION OF DTAA

India notifies DTAA with Chile, effective in India from Financial Year 2023-24 and in Chile from January 01, 2023

Notification No. 24/2023/ F. No.500/62/2017-FT&TR-V (Pt-III) dated May 03, 2023

The Ministry of Finance has notified India's Double Taxation Avoidance Agreement (DTAA) with Republic of Chile along with a Protocol. The DTAA was signed on March 09, 2020 and entered into force on October 19, 2022. The provisions of the DTAA shall have effect in India from FY 2023-24 and in Chile from January 01, 2023.

The DTAA incorporates minimum standards and other recommendations of OECD Base Erosion Profit Shifting (BEPS) Project. It includes, inter-alia, Preamble text, Principal Purpose Test, Limitation of Benefits Clause to curb tax planning strategies which exploit gaps and mismatches in tax rules.

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REGULATORY

FEMA

Amendment to Foreign Exchange Management (Current Account Transactions) Rules, 2000: Inclusion of International Credit Cards under the Liberalized Remittance Scheme

The Ministry of Finance ("Ministry") vide its notification dated May 16, 2023 ("Notification") has omitted Rule 7 of Foreign Exchange Management (Current Account Transactions) Rules, 2000 ["FEM (CAT) Rules"]. The existing Rule 7 exempted the use of international credit cards from the Liberalized Remittance Scheme ("LRS") for payments by a person towards meeting expenses while such a person is on a visit outside India. Accordingly, the said exemption is no longer available and such expenses would be included within the existing LRS Limit of USD 2,50,000.

The above has come into force with effect from the date of Notification i.e. May 16, 2023.

The Ministry vide its Press Release dated May 19, 2023 has released the Frequently Asked Questions (FAQs) regarding the inclusion of International Credit Cards under the LRS.

Citing the need for Notification, it has been mentioned in the FAQ that while on a visit abroad, a person could use international debit cards or other methods or international credit cards for undertaking current account transactions. Payments by debit cards etc. have been treated as LRS even earlier. Due to the exemption under erstwhile Rule 7, expenditures through credit cards were not accounted for under the specified LRS limit, which has led to some individuals exceeding the LRS limits. The differential treatment between debit cards and credit cards needed to be removed in the interest of uniformity and equity in the treatment of modes of drawal of foreign exchange and for capturing total expenditures under LRS for prudent foreign exchange management and to prevent by- passing of LRS limits.

As per the FAQ, the Notification does not affect any changes in the use of international credit cards by residents while in India and accordingly, such expenses shall remain included within the existing LRS Limit of USD 2,50,000.

Further, as per the FAQ, LRS does not cover business visits of employees. When an employee is being deputed by an entity for any of the above, and the expenses are borne by the latter, such expenses shall be treated as residual current account transactions outside LRS and may be permitted by the AD without any limit, subject to verifying the bona fide of the transaction

(Source: Notification No G.S.R. 369(E) dated May 16, 2023 issued by Ministry of Finance read with Press Release dated May 19, 2023 released by Ministry of Finance)

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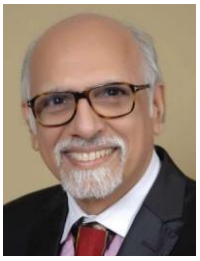

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