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RECENT DEVELOPMENTS IN DIRECT TAX

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DIRECT TAX - RECENT CASE LAWS

Delhi High Court[1] holds that a final assessment order passed without passing of draft assessment order is null and void

FACTS OF THE CASE

- A batch of writ petitions were filed challenging the action of the Assessing Officer **("AO")**, who passed a final assessment order without passing a draft assessment order, thereby violating the procedure prescribed under Section 144C of the Income Tax Act, 1961 **("IT Act")**.
- The principal issues for consideration were as under:
  - Whether AO was justified in framing final assessment order without passing a draft assessment order in accordance with requirement of Section 144C(1) of the IT Act?
  - Whether the court can remand the matter to AO for continuing the assessment from the stage of infraction even after the time limit for passing of order under Section 153 of the IT Act had expired?
- Though various judicial precedents have held that passing final order without passing draft order would be bad in law, the department requested for review of the judicial position by placing reliance on the judgement of Delhi HC in case of **Sarabjit Singh v. Commissioner of Income-tax**[2] wherein it was held that failure to refer the matter to the Deputy Commissioner under the erstwhile Section 144B of the IT Act was a mere procedural irregularity and would not render the proceedings bad in law.
- As per the department, provisions of Section 144B (reference to Deputy Commissioner in certain cases) of the IT Act were para materia to Section 144C of the IT Act and hence, the principles enunciated in the decision of Sarabjit Singh (supra) should guide the interpretation of Section 144C of the IT Act.

RULING OF THE HIGH COURT

- Delhi HC held that contention of AO that Section 144B was para materia to Section 144C was fundamentally misconceived due to the following reasons:
  - The power of the Deputy Commissioner under Section 144B of the IT Act was neither co-terminus nor intended to be co-equal to that of the AO. On the other hand, the powers of the DRP under Section 144C of the IT Act are not only corrective but extend to a power to enhance or reduce the proposed variation subject to the rider that it is not empowered to set aside a proposed variation.
  - Section 144C is a special mechanism of assessment in respect of an 'eligible assessee'. It essentially entails two separate components (i.e., decisions taken by Transfer Pricing Officer and AO) coming to be merged to form a composite assessment. The assessment made under Section 144C of the IT Act is a fusion of two views, comprising of decisions taken by two separate authorities and is a composite blend and merger, it clearly stands on a pedestal distinct and distinguishable from Section 144B of the IT Act.
  - A failure to frame a draft order of assessment not only curtails the right of the assessee to adopt corrective measures, but it also deprives it of a salutary right to challenge the draft in terms of the statutory mechanism laid in place.
- Further, on the issue of whether courts could enlarge / expand the period of limitation by remitting the matter to AO even after the expiry of period of limitation, the Hon'ble Delhi HC held that where legally permissible, courts may consider condonation of delay, however, they were not entitled to expand or enlarge period of limitation as statutorily prescribed.
- Therefore, if the period for completion of the assessment exercise in terms of subsections (3) and (4) of Section

[1] Principal Commissioner of Income Tax v Sumitomo Corporation India (P.) Ltd. [IT Appeal 52 OF 2023 & CM Appl. 3673 OF 2023]
[2] Sarabjit Singh v Commissioner of Income Tax [1998] 234 ITR 641 (Delhi)

153 had expired, it would be wholly impermissible for courts to expand or enlarge the period prescribed for completion of assessment and thus quashed the impugned final assessment orders.

ELP Comments

Delhi HC ruling reiterates the legal position that procedure prescribed under Section 144C has to be strictly followed. Further, the tax department cannot be given a second opportunity by the courts by going beyond the statutory period of limitation.

Bangalore ITAT[3] holds that deemed dividend under Section 2(22)(e) of the IT Act is not attracted in case of indirect benefit and in absence of actual payment

FACTS OF THE CASE

- Mukka Sea Food Industries Pvt. Ltd. **("Mukka"),** a company in which Assessee held 41% shares, made an investment of USD 3,00,000 in Sopromers S.A.R.L. **("SARL")** in Assessment Year **("AY")** 2016-17.
- Further, Mohammed Maou Elainine (one of the director of SARL who was instrumental in investment by Mukka Sea Foods) made an investment in United Fish Meal FZC Dubai ("**UFM**") (sister concern of Mukka).
- The amount invested by Mukka Sea Food Industries Pvt. Ltd. went bad and could not be recovered. Hence, the shares held by Mr. Mohamed Maou Elainine in UFM was transferred to the assessee (in capacity of Managing Director of Mukka) as a compensation and without consideration in AY 2018-19.
- The AO considered the transfer of shares of UFM to Assessee as diversion of funds of Mukka to UFM (an entity in which the Assessee had substantial interest) and consequently, invoked Section 2(22)(e) of the IT Act.

RULING OF THE ITAT

- ITAT held that Section 2(22)(e) of the IT Act is a charging section and should be strictly interpreted. The deeming fiction created for a specific purpose cannot be infused for another application unless and until it is specifically provided in the Act.
- ITAT also highlighted the fact that there was no direct payment made by Mukka to the assessee or any entity in which the Assessee has substantial interest.
- Even if it was assumed without admitting that investment by Mukka indirectly benefitted the Assessee, it would not attract provisions of Section 2(22)(e) of the IT Act since it covers only direct benefit received by the shareholder from any payment made by the company and deems it as deemed dividend.
- ITAT observed that in the present case, no direct payment was made by Mukka to the Assessee and neither there was any movement of accumulated profits to the Assessee and thus, Section 2(22)(e) of the IT Act could not be invoked.

ELP Comments

This ruling of ITAT provides that double deeming is not permitted in law and hence only transactions which strictly fall under the four corners of the deeming provisions are to be taxed.

[3] Sri Haris Kalandan Mohammed [TS-633-ITAT-2024(Bang)]

Delhi ITAT[4] holds that transfer of self-generated trademark is taxable as capital gain

FACTS OF THE CASE

- Assessee transferred and assigned the brand name 'Rath' for INR 11 Crore to ITC Agro Tech Ltd **("ITC")** under an agreement which contained a non-compete clause which prohibited Assessee from dealing in Hydro Generated Vegetable Oil ('Vanaspati') for a period of 60 months and using the brand name "Rath" for any product category.
- The Assessee had registered the trade name 'Rath' in 1984, and it was used by the assessee as intellectual property for selling the Vanaspati in the market till the same was transferred to ITC in May 2000.
- Further, assessee had already claimed the cost of registration of trademark and other relevant costs during the course of business and admitted that the trademark was a capital asset under Section 2(14) of the IT Act during assessment proceedings.
- The Assessee argued that the trademark was a self-generated trademark without incurring any cost and consideration received for transfer of trademark was a capital receipt not liable to tax placing reliance on the judgement of B.C. Srinivasa Shetty[5] while the AO linked the income to non-compete clause and taxed the same as business receipt.

RULING OF THE ITAT

- ITAT held that when the cost of getting the trade name registered was claimed as revenue expenditure and was not capitalized, the Assessee claimed 100% of cost as expenditure which was nothing but claim of 100% depreciation. The trade name was asset of the company without being capitalised in the balance sheet.
- Further, ITAT observed that it was an admitted fact that trademark was a capital asset and hence transfer of capital asset would come under the head 'Capital Gains'. Since cost of registration was already claimed as an expense, the trademark would be a short term capital asset chargeable to tax as short term capital gains.
- As regard the head of income, the ITAT held that the relevant fact was transfer of intellectual property (i.e. trademark) and not the consequential non-compete clause stated in the agreement. Hence, the transfer would be chargeable under the head Capital Gains and not under 'Profits and Gains of Business or Profession'.

ELP Comments

This ruling may adversely affect the cases where assessees have claimed income to be capital receipt by taking shelter of 'failure of computation mechanism' where nominal expenses have been incurred such as expenses for registration of intangible property.

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at insights@elp-in.com or write to our authors:

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[4] Mawana Sugar Ltd [TS-641-ITAT-2024(DEL)]
[5] B C Srinivasa Shetty [128 ITR 294 (SC)]

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