DESAI SAKSENA & ASSOCIATES

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Friday Tax Alert

Supreme Court holds temporary lull does not mean cessation of business, allows set-off under section 71 of the Income Tax Act, 1961

Summary:
In a recent judgment, the Hon'ble Supreme Court held that a temporary lull in the business does not mean cessation of business. The taxpayer showed clear intent to carry on business in India, even during a lull period without active contracts. Further, it clarified that a non-resident need not have a permanent establishment in India to be taxed on income deemed to accrue or arise here, overturning the Delhi High Court's restrictive view.

Facts of the case:

1. The taxpayer, a non-resident company incorporated in France is engaged in oil drilling activities.
2. The taxpayer entered into 10 year drilling contract with ONGC, i.e., from 1983 to 1993. There was no active contract between 1993 to 1998. During this period, the taxpayer carried on business correspondences with ONGC from its office at Dubai and headquarters at France and also submitted a bid for oil exploration in 1996. During this period, the taxpayer also undertook various expenditures including administrative charges, audit fees, etc. with the intention of carrying out its business activities.
3. For FYs 1996-97, 1997-98 and 1998-1999, the taxpayer filed a Nil tax return. The only income credited under the head 'Income from Business' was interest received on income tax refunds. The taxpayer having incurred various expenditure like administrative charges, audit fees, etc., such expenses and unabsorbed depreciation were claimed as deductions against the income. The tax officer disallowed deduction of business expenditure as well as the carry-forward of unabsorbed depreciation on the ground that the taxpayer was not carrying on any business during the relevant FYs.
4. Aggrieved, the taxpayer preferred an appeal. The first appellate authority upheld the order of the tax officer while the second appellate authority ruled in favour of the taxpayer. The Hon'ble Delhi High Court, however, reversed the order passed by the second appellate authority.
5. Aggrieved, the taxpayer further preferred an appeal before the Hon'ble Supreme Court of India.

Observations of the Hon'ble Supreme Court:

1. Ample materials have been placed on record to show that during the interim period, the taxpayer had continuous business correspondences with ONGC with regard to hiring of manpower services in respect of expert key personnel for drilling in deep waters. The taxpayer had even unsuccessfully submitted a bid in 1996.
2. It must be construed from the taxpayer's conduct, whether the failure to procure the drilling contract with ONGC was owing to the taxpayer's disinterest to carry on business during the relevant period or not.

3. If such conduct, from the standpoint of a prudent businessman, evinces intention to carry on business, mere failure to obtain a business contract by itself would not be a determining factor to hold the taxpayer had ceased its business activities in India.
4. The second appellate authority rightly noted that a business going through a lean period of transition which could be revived if proper circumstances arose, must be termed as lull in business and not a complete cessation of the business.
5. Continuous correspondence between the taxpayer and ONGC regarding supply of manpower for oil drilling purposes and its unsuccessful bid in 1996 demonstrates various acts aimed at carrying on business in India which unfortunately did not fructify in procuring a contract country to be chargeable to tax on any income accruing in India.
6. The High Court's view that the taxpayer did not carry on business in India since it did not have a permanent establishment in India and corresponded with ONGC from its foreign office is wholly fallacious and contrary to the very scheme of the Act.
7. The Act does not require a non-resident company to have a permanent office within the country to be chargeable to tax on any income accruing in India. A combined reading of the charging provisions under Section 4 and Section 5(2) of the Act read with Section 9(1)(i) of the Act makes it clear that a non- resident person shall be liable to pay tax on income which is deemed to accrue or arise in India.
8. None of these provisions make it mandatory for a non- resident taxpayer to have a PE in India to carry on business or have any business connection in India. The issue of 'PE' may be relevant for the purposes of availing the beneficial provisions of the DTAA between India and France.
9. In an era of globalisation whose life blood is trans-national trade and commerce, the High Court's restrictive interpretation that a non-resident company making business communications with an Indian entity from its foreign office cannot be construed to be carrying on business in India is wholly anachronistic with India's commitment to Sustainable Development Goal relating to 'ease of doing business' across national borders.

Conclusion:

Accordingly, the Supreme Court held that a temporary lull in the business does not mean cessation of business & allowed set off under section 71 of the Act.

[Pride Foramer S.A. v Commissioner of Income Tax & Anr. (Civil Appeal Nos. 4395-4397/2010)]

Mumbai ITAT holds that carry forward of unabsorbed depreciation cannot be denied on the ground of *non-est* return filed beyond due date under section 139(1) of the Income Tax Act, 1961

Summary:

The Mumbai ITAT has recently held that filing returns beyond the due date under Section 139(1) does not bar the carry forward of unabsorbed depreciation under Section 32(2). Unlike business or capital losses, depreciation is deemed to have been claimed by law and therefore cannot be denied merely because the returns were treated as non-est.

Facts of the case:

1. The taxpayer, a company engaged in the business of providing innovative technology leasing and financial asset management solutions to customers in India is a subsidiary of HPFS

Ventures Holdings Ltd. USA and earns income from loan arrangements, hire purchase and finance lease (other than hire purchase).

2. The taxpayer claimed carry forward of unabsorbed depreciation pertaining to FYs 2001-02 to 2007-08. The tax authorities denied the claim on the ground that the tax returns for these years were either not filed or were filed beyond the due date prescribed under section 139 of the IT Act, rendering them as *non-est* (non-existing). The tax officer contended that Section 32(2) of the Act allows the carry forward of unabsorbed depreciation only to the extent determined in assessment and in taxpayer's case where the return is *non-est*, unabsorbed depreciation cannot be allowed to be carried forward. The first appellate authority upheld the order of the tax officer. Aggrieved, the taxpayer preferred an appeal before the Mumbai ITAT.

Observations of the Hon'ble Mumbai ITAT:

1. As per Section 139(3) and section 80 of the Act, the losses under the head "Profits and gains from business of profession" and loss under "Capital Gains" are not allowed to be carried forward if the tax return is not filed within the due date as specified under section 139(1) of the Act.
2. Section 157 of the Act contain provisions relating to intimation of loss by the tax officer in the course of assessment. The said section provides for intimation of various losses under section 72(1), section 73(2), section 74 (1) / 74(3) or section 74A(3) of the Act, but does not talk about the unabsorbed depreciation under section 32(2) of the Act.
3. The taxpayer's contention that the requirement to file the tax return within the due date under section 139(1) of the IT Act is not a condition precedent to carry forward the unabsorbed depreciation is valid.
4. Reliance is placed on Hon'ble Andhra Pradesh High Court's decision in case of *CIT vs Sri Vijayalakshmi Minerals & Trading Co ([1998] 101 taxman 283 (Andhra Pradesh))* wherein it was held that unabsorbed depreciation for a preceding year, even where the return was treated as *non-est* under section 139(10), could still be carried forward and set off in the subsequent year.
5. Therefore, unabsorbed depreciation for FY 2001-02 to FY 2007-08 cannot be denied being carried forward on the ground that the tax return for the said FYs are *non-est*.

Conclusion:

Explanation 5 to section 32 of the Act provides that provisions of section 32(1) of the Act shall apply whether or not the taxpayer has claimed the deduction in respect of depreciation in computing his total income. Therefore, even if the taxpayer has not claimed the depreciation allowance in the tax return, the law deems it to have been claimed. In the tax returns filed beyond the due dates under section 139(1) of the IT Act, the taxpayer has claimed depreciation. The tax officer cannot deny the unabsorbed depreciation as not having been claimed since the return of income is non est.

[Hewlett Packard Financial Services (India) Pvt. Ltd v ACIT (I.T.A. No. 915/Mum/2017)]

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