NEWSLETTER

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DAMANIA & VARAIYA

Chartered Accountants

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Welcome Circular on "Admissible of claim of Bad Debts under Section 36 of The IT Act."

It is frequently experienced that when a Company writes off certain amounts as "Bad Debts" towards not recoverable debtors, the Assessing Officers would object such write offs and asks the Company to justify whether the debtors have in fact become non recoverable. Many cases are pending before various Tribunals and Courts on this issue of allowability of bad debts.

This circular no. 12 cited the Supreme Court decision in the case of TRF Ltd. that "After 1.4.1989, for allowing deduction for the amount of any bad debt or part thereof under section 36(1)(vii) of the Act, it is not necessary for assessee to establish that the debt, in fact has become irrecoverable; it is enough if bad debt is written off as irrecoverable in the books of accounts of assessee."

The circular thereafter states that claim for any debt in any previous year, shall be allowed under section 36(1)(vii) of the Act, if the same is written off as irrecoverable in the books of accounts of the assessee for that previous year and fulfills conditions laid down under section 36(2) of The Act.

Accordingly no appeal may henceforth be filed on this ground and appeals if any filed on this issue may be withdrawn or not pressed up on.

The legislative intention behind this circular is to eliminate litigation on this issue of allowability of bad debts by doing away with the requirement for the assessee to establish that the debt has in fact become irrecoverable.

Inflation Index Cost

Cost Inflation Index declared for the Financial Year 2016 – 17: **1125**

Modification in Rule 8D read with Section 14A

The CBDT has modified the calculation that determines the amount of expenditure in relation to the income not chargeable to tax.

The expenditure that will be considered related to the exempt income shall be aggregate of the following:

i. The amount of expenditure directly related to such exempt income; and
ii. 1% of annual average of monthly average of the opening and closing balances of the value of investment, income from which does not or shall not form part of the total income:

Provided that the amount so calculated in clause (i) and (ii) does not exceed the total expenditure claimed by the assessee.

Re: Cooper Corporation – Pune Tribunal

Sub: Foreign exchange fluctuation loss on outstanding foreign currency loan to acquire domestic capital assets – Whether allowable expenditure?

The Company had earlier taken loan from domestic banks for the purpose of acquiring certain fixed assets in India. In order to save on the interest cost, these term loans were converted into foreign exchange loans where the rate of interest was much lower. The Company claimed as revenue expense the foreign exchange fluctuation loss on outstanding foreign exchange loans due to devaluation of rupee.

The AO disallowed such claim stating that it was merely a notional loss and not an actual loss incurred by the assessee. The AO further stated that this loss, if at all, is capital in nature since the same is obtained for acquiring capital assets.

The Tribunal observed as follows:

- The assessee converted domestic loans into foreign exchange loans to gain advantage of savings in interest cost;
- The Capital assets for which the foreign loans were obtained, were already been "put to use".
- The loss occasioned from foreign currency loans is a post facto event subsequent to capital assets were put to use;
- Provisions of Section 43A would not apply since the assets were not acquired from out of India.

The Tribunal therefore held that the conversion in foreign currency loans which led to impugned loss, were driven by revenue consideration towards savings in interest cost and therefore the loss being on revenue account was an allowable expenditure under section 37 of The IT Act.

INCOME TAX *(cont.)*

Re: Mridu Hari Dalmia Parivar Trust – Delhi Tribunal

Sub: Transfer of shares in off market transaction

The Tribunal held that the assessee transferring shares in an off market transaction to enjoy claim of set off and carry forward of such loss is a glaring example of tax planning rather than tax avoidance. Accordingly it was held that the loss suffered on such off market deal is a genuine loss which cannot be disallowed just because it does not fall within the ambit of Section 10(38) because of non-payment of STT.

Re: Savvis Communication Corporation – Mumbai Tribunal

Sub: Section 9 of The Act and Article 12 of India-USA Treaty – Payment for providing web hosting services – Whether taxable?

The American Company was engaged in the business of providing information technology services including providing web hosting services.

According to AO, the Company provided space on server for use by Indian Companies. The web hosting program is for limited period and the server is not owned by these Companies. The AO concluded that the payment for granting right to use scientific equipment and therefore it was "Royalty" in terms of Section 9(1)(vi) of The Act.

The Mumbai Tribunal observed and held as follows:

- If a taxpayer receives income by allowing customer to use scientific equipment, it is taxable as royalty. However, use of scientific equipment by the Taxpayer, in the course of giving a service to the customer, is distinct from allowing the customer to use scientific equipment.

- The true test is: whether the consideration is for rendition of services though involving scientific equipment, or whether the consideration is for the use of scientific equipment simplicitor by the taxpayer. If it is former, consideration is not taxable and if it is latter, the consideration is taxable as royalty for use of equipment.

- If the person making payment does not have independent right to use the equipment or have physical access to it, the payment cannot be said to be consideration for use of scientific equipment.

Accordingly, the receipt was not "consideration for the use or right to use of, scientific equipment" as envisaged in Section 9(1)(vi) of the IT Act and hence not taxable.

Compiled by: Tax Team, D & V