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NEWSLETTER

November, 2023 ◗ Price ₹ 20

CHAIRMAN'S COMMUNIQUE

Dear Esteemed Members,
Greetings!

As we usher in the month of November, I am pleased to address you through the pages of our esteemed ICAI newsletter. This month holds significance not only as we approach the end of the year but also as it marks a period of reflection, gratitude, and commitment to our professional journey.

Reflecting on the achievements and challenges of the past months, I am heartened by the resilience and dedication displayed by our members. The global landscape continues to evolve, presenting both opportunities and complexities. It is during such times that the true mettle of our profession is tested, and I am proud to say that the accountancy community has risen to the occasion.

As professionals, we play a crucial role in ensuring financial integrity, transparency, and ethical conduct in the business world. The trust placed in us by stakeholders is a testament to our commitment to upholding the highest standards of our noble profession. Let us continue to strive for excellence and lead by example, setting benchmarks for ethical conduct and professional excellence.

November also serves as a reminder of the importance of gratitude. I extend my heartfelt appreciation to each member of our institute for their unwavering dedication. Our collective efforts have not only contributed to the growth of the profession but have also positively impacted the economic landscape of our nation.

Looking ahead, let us renew our commitment to continuous learning and professional development. The evolving business environment demands that we stay abreast of the latest trends, technologies, and regulatory changes. I encourage each one of you to actively participate in the various professional development programs and initiatives offered by the institute.

In conclusion, let us approach the coming month with enthusiasm, determination, and a spirit of collaboration. Together, we can overcome challenges, seize opportunities, and contribute meaningfully to the progress of our profession and society at large.

Thank you for your continued support and dedication.

Yours truly,
CA Mausam Rathi
Chairman-Indore Branch of ICAI

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Reassessment without notice under section 143(2) when assessee treats original ITR as response to notice under section 148

INTRODUCTION

We professionals see on number of occasions that reassessments are made u/s 143(3) r.w.s without issuing notice u/s 143(2) where the assessee informed A.O. that original ITR be treated as ITR filed in response to notice issued u/s 148.

Now a question arise whether these assessments are valid assessments let us analyse this through the provisions of Income Tax Act and various case laws on this subject.

SECTION 143(2)

Where a return has been furnished under section , or in response to a notice under sub-section (1) of section , the Assessing Officer or the pres-cribed income-tax authority, as the case may be, if, considers it necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not under-paid the tax in any manner, shall serve on the assessee a notice requiring him, on a date to be specified therein, either to attend the office of the Assessing Officer or to produce, or cause to be produced before the Assessing Officer any evidence on which the assessee may rely in support of the return:

Provided that no notice under this sub-section shall be served on the assessee after the expiry of [three] months from the end of the financial year in which the return is furnished.]

SECTION 292BB

Where an assessee has appeared in any proceeding or co-operated in any inquiry relating to an assessment or reassessment, it shall be deemed that any notice under any provision of this Act, which is required to be served upon him, has been duly served upon him in time in accordance with the provisions of this Act and such assessee shall be precluded from taking any objection in any proceeding or inquiry under this Act that the notice was—(a) not served upon him; or(b) not served upon him in time; or(c) served upon him in an improper manner:Provided that nothing contained in this section shall apply where the assessee has raised such objection before the completion of such assessment or reassessment.]

SERVING OF NOTICE FOR SCRUTINY/REGULAR ASSESSMENT UNDER SECTION 143(2)

Where a return has been furnished u/s. 139, or in response to a notice u/s. 142(1), the AO or an income-tax authority not below the rank of an ITO who has been authorized by the CBDT to act as income-tax authority in view of Rule 12E as the case may be, shall serve a notice on the assessee within 3 months from the end of the FY in which the return is furnished if he considers it necessary or expedient to ensure that the assessee-- has

not understated the income in any manner, or- has not computed excessive loss in any manner, or- has not underpaid the tax in any manner.Thus, the only requirement for issuance of the notice u/s. 143(2) for calling upon the assessee to attend office and produce evidence in support of the returns is that the AO should consider it necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not underpaid the tax in any manner.

Therefore, s. 143(2) would come into play only when a return is furnished u/s. 139 or a return is furnished in response to a notice u/s. 142(1).

Such notice shall require the assessee, on a date to be specified therein, either to attend his office or to produce any evidence on which the assessee may rely in support of the return.

Issuance of notice is mandatory u/s. 143(2) and Service of notice u/s. 143(2) within the period prescribed is mandatory in nature and not an empty formality. In the absence of notice being served within the time stipulated, assessment proceedings will come to an end.

Thus, it is not discretionary rather mandatory for an assessing officer to issue notice u/s 143(2) once the return of income is filed by assessee. The only relaxation in the case of re assessment is that notice u/s 143(2) can be issued at any time before the expiry of time limit for completing assessment/ re assessment and the same will be deemed as valid notice.

Once notice u/s 148 of the Act, issued to the assessee required it to file a return within 30 days from the date of service of such notice. There is no provision in the Act, which would allow an AO to treat the return which was already subject to a processing u/s 143(1) of the IT Act, as a return filed pursuant to a notice subsequently issued u/s 148 of the Act. However, once an assessee itself declare before the AO that his earlier return can be treated as filed pursuant to notice u/s 148 of the IT Act, three results can follow. Assessing Officer can either say no, this will not be accepted, you have to file a fresh return or he can say that 30 days time period being over I will not take cognizance of your request or he has to accept the request of the assessee and treat the earlier returns as one filed pursuant to the notice u/s 148 of the IT Act. In the former two scenarios, AO has to follow the procedure set out for a best of judgment assessment and cannot make an assessment under section 143(3). On the other hand, if the AO chose to accept assessee's request, he can indeed make an assessment under section 143(3).

If the AO accepts the request of the assessee, this in turn makes it obligatory to issue notice u/s 143(2) after the request by the assessee to treat his earlier return as filed in pursuance to notices u/s 148 of the IT Act

Case laws on this subject

Asstt. CIT v. Hotel Blue Moon the Hon'ble Apex court held that where the A.O. for any reason, repudiates return filed by assessee in response to notice u/s 158BC (a), he must necessarily issue a notice under section 143(2) within time prescribed in proviso to section 143(2).

Pr. CIT v. Shri Jai Shiv Shankar Traders (P.) Ltd.

In this case the Assessee filed the return of income on 16/09/2008 and the Assessing Officer processed the return of income. Subsequently the Assessing Officer picked up the above return for scrutiny assessment and issued on the assessee a notice under section 148.

Thereupon the assessee appeared before the AO and informed him that the return originally filed should be treated as the return filed pursuant to the notice under section 148.

Thereafter the AO passed reassessment order on the assessee and made a certain addition to its income.

On appeal, the assessee contended that in the absence of a notice under section 143(2), the order of reassessment was invalid but the Commissioner (Appeals) held that no specific notice was required to be issued under section 143(2). Non issue of notice under section 143(2) did not render the reassessment invalid.

On second appeal, the Tribunal held that for completing the assessment under section 148 compliance with the procedure under section 143(2) was mandatory. If notice was not issued to the assessee before completion of the reassessment, then such reassessment was not sustainable in law.

On appeal to High Court, the revenue relying on the provisions of section 292BB urged that the assessee having not raised any objection about non service of the notice under section 143(2) either at any time before the Assessing Officer or prior to or during the reassessment proceedings, the assessee was precluded from raising such an objection in the subsequent stages of the proceedings.

The Hon'ble High Court held that

In the instant case, no notice under section 143(2) was issued to the assessee after the date on which the assessee informed the Assessing Officer that the return originally filed should be treated as the return filed pursuant to the notice under section 148.

The legal position regarding section 292BB has already been made explicit by the Allahabad High Court in the cases of CIT v. Rajeev Sharma [2010] 192 Taxman 197/[2011] 336 ITR 678 and CIT v. Salarpur Cold Storage (P.) Ltd. [2014] 50 taxmann.com 105/[2015] 228 Taxman 48 (All.)(Mag.). That provision would apply insofar as failure of service of notice was concerned and not with regard to failure to issue notice. In other words, the failure of the Assessing Officer in reassessment proceedings to issue notice under section 143(2) prior to finalising the reassessment order cannot be condoned by referring to section 292BB.

The resultant position is that the failure by the Assessing Officer to issue a notice to the assessee under section 143(2) is fatal to the order of reassessment.

Therefore, the order of the Tribunal deserved to be upheld.

Pr. CIT v. Kamla Devi Sharma [IT Appeal No. 197 of 2018, dated 10-7-2018]

In this case, the assessee is an individual. The assessee had purchased the land on 30.4.2008 for a consideration of Rs.1,01,20,000/- and paid in cash. Notice u/s 148 of the Income Tax Act, 1961 was issued on 31.5.2013. Notice was served on 6.6.2013 through notice server. Return of income was filed on 22.4.2014. Notice u/s 142(1) of the Act was issued along with questionnaire on 30.4.2014. The assessment was made on 5.3.2015 at Rs.1,01,20,000/-, that is the amount paid for purchase of the agricultural land, treated as unexplained investment. The CIT(A) has confirmed the action of the Assessing Officer.

While considering the matter, the Hon'ble ITAT has observed as under: -

A written submission was also made by the LD AR of the assessee on the issue of nonissue of notice U/s 143(2) of the Act prior to finalization of the assessment U/s 143(3) of the Act. In these grounds of appeal, assessee has challenged the action of Ld. C1T(A) in confirming the action of ld. AO in completing assessment without issuing notice u/s 143(2), which is sine qua non once assessee furnished return of income.

The Hon'ble Rajasthan High Court held that the facts of the assessee's case are similar to the facts of the case involved in the decision of the Hon'ble Delhi High Court wherein it has been categorically held that the issue of notice U/s 143(2) in reassessment proceedings, prior to finalizing re-assessment order, cannot be condoned by referring to Section 292BB and is fatal to the order of reassessment. Respectfully following the same, we hereby set aside the order of the authorities below and allow the grounds No. 1 to 4 of the assessee's appeal.

In our considered opinion, the tribunal is bound by the decision of Delhi High Court in the case of Shri Jai Shiv Shankar Traders (P.) Ltd. (supra) and has rightly followed the same, which is not challenged.

In that view of the matter, we are in complete agreement with the view taken by the tribunal. Hence, no substantial question of law arises.

The appeal stands dismissed.

DIT v. Society for World Wide Inter Bank Financial Telecommunications the Hon'ble Delhi High Court invalidated an reassessment proceedings after noticing that the notice u/s 143(2) the Act was not issued to the Assessee pursuant to the filing of the return. In other words, it was held mandatory to serve the notice u/s 143(2) of the Act only after the return filed by the Assessee is actually scrutinised by the A.O.

In view of above judicial pronouncements, it can be concluded that so far as assessee furnishes return of income u/s 148, Ld.AO is duty bound to issue notice u/s 143(2) of the Act and the non-issuance of notice u/s 143(2) is not a procedural error which can be corrected in the wake of deeming provisions of sec 292BB of the Act.

It has no where been provided in the Act that A.O. shall be absolved with the requirement of issuing notice u/s 143(2) in the event of late filing of return of income. In fact, proviso to section 148 provides that notice u/s 143(2) can be issued at any time before completion of assessment.

Conclusion

It is very much evident after going through the provisions of Income Tax and various case laws that notice u/s 143(2) is mandatory after submission of return of income by the assessee pursuant to notice u/s 148. Moreover failure of AO to issue notice u/s 143(2) prior to finalizing the reassessment cannot be condoned by referring to section 292BB.

DEPRECIATION U/S 32 AND SOME KEY ISSUES INVOLVED

Introduction

Depreciation is a deduction allowed for the reduction in the real value of a tangible or intangible asset used by a taxpayer.

Let's understand the concept and purpose of Depreciation.

The concept of depreciation is used for the purpose of allocating the cost of an asset over its useful life so that financial statements reflect true and fair position of the state of affairs of the entity.

Depreciation is a mandatory deduction in the profit and loss statements in respect of tangible assets and intangible assets, not being goodwill of a business or profession, owned WHOLLY or PARTLY by the assessee and used for the purpose of the business or profession. It is allowed on the Written Down Value (WDV) of the block of assets at the prescribed percentage. However, in case the undertaking is engaged in power generation or its generation and distribution, there is an option to choose the straight-line method.

Curious about 'Block of Assets'? Let's take a straightforward look at it.

Block of assets is a group of assets falling within a class of assets comprising of: Tangible assets, being building, machinery, plant or furniture, Intangible assets, being know how, patents, copyrights, trade-marks, licenses, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession.Further, the depreciation percentage within the class of assets must be considered for asset classification. Each such class of asset with the same rate of depreciation will be identified as a block of the asset.

Individual assets lose their identity under Income Tax Act as depreciation is calculated on the block of assets rather than on individual assets.

Primarily, Income Tax has categorized the assets into 4 distinct blocks :Block of Assets Depreciation Rate Buildings10%Plant & Machinery 15% Furniture 10% Intangible Assets25% Can 2 assets falling under different classification be grouped together for calculating the WDV of the block? Let us understand the same through an example.

The opening WDV as on 01-04-2023 of the block of assets of Animal Private Limited is as follows :Block of Assets Rate of Depreciation WDV as on 01.04.2023 (in Rs.) Buildings10%100Furniture10% 500Now, if the company disposes the building for Rs. 200 then what will be the closing WDV of the block of assets and will any capital gain arise in the hands of the company?

The block of assets would be calculated in the following manner:Building Furniture Opening WDV100 Opening WDV500Additions0 Additions0Less: Transfer during the year200 Less: Depreciation (10%)50Short Term Capital Gain (100) Closing WDV 450 As per the opinion of BOMBAY CHARTERED ACCOUNTANTS' SOCIETY (BCAS) in its 2nd Edition of Depreciation & Losses published in August 1998, if 2 assets fall under different classification, they cannot be grouped together even though the depreciation rate prescribed in respect of those assets may be the same. So, accordingly Furniture and Building cannot be grouped together for calculating WDV of the block as they are considered as 2 different blocks under the Income Tax Act, 1961 even though they have same rates of depreciation.

Further, in the above example, the whole block of the building is transferred. Hence, STCG of Rs. 100 will arise in the hands of the company. So, is there no concept similar to Companies Act, 2013 of allowing depreciation on the basis of number of days the asset was used in business or profession? Well, there is no such concept. However, as per Second Proviso to Sec. 32(1) of Income Tax Act, 1961 where any asset falling within the block of assets is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days in that previous year, the deduction of depreciation in respect of such asset shall be restricted to fifty per cent (50%) of the depreciation allowable.

So, there is a concept of 180 days under Income Tax

rather than allowing depreciation on the basis of number of days the asset was used.

Alright we have covered normal rates, now let's have a look at the assets eligible for higher rate of depreciation. Assets Rate of Depreciation Buildings- Purely Temporary erections such as wooden structures40%Moulds used in rubber and plastic goods factories30%Aeroplanes- Aeroengines 40% Motor buses, motor lorries and motor taxis used in a business of running them on hire30%Air Pollution, Water Pollution and Solid Waste Control Equipment40%Plant & Machinery used in semi-conductor industry30%Lifesaving medical equipment such as ventilators40%Containers made of glass or plastic used as re-fills40%Computers including computer software40%Gas cylinders including valves and regulators40%Glass manufacturing concerns - Direct fire glass melting furnaces40%Renewal Energy Devices- (a) Biogas plant and biogas engines40%(b) Electrically operated vehicles including battery powered or fuel-cell powered vehicles40%(c) Agricultural and municipal waste conversion devices producing energy40%(d) Solar power generating systems40%(e) Solar-photovoltaic modules and panels for water pumping and other applications40%Books owned by assessees carrying on a profession40%Books owned by assessees carrying on business in running lending libraries40%Ocean-going ships, vessels20%So, the maximum rate of depreciation has been capped at 40% as evident in most of the cases in the above table.

Reasons for allowing higher rate of depreciation: To encourage the use of renewable energy devices like windmills, solar power generating systems, electrically operated vehicles etc. To alleviate operational constraints, particularly for rubber and plastic factories heavily reliant on moulds with a limited useful life.Now, let's have a detail understanding of how and when higher depreciation would be allowed to the assessee by analyzing a couple of cases from the above table. 1. Higher Depreciation rate in case of Moulds used in rubber and plastic goods factories: Moulds used in rubber and plastic factories for manufacturing of rubber and plastic components are eligible for higher rates of depreciation i.e., @ 30%. However, there is ambiguity in the Act as to which factories mentioned above would be eligible for higher rate of depreciation and under what conditions. Yet, in various case laws, High Courts and Tribunals have interpreted it in the following manner: Assessee should be owning or possessing a separate unit wherein manufacturing of plastic and rubber components takes place. The eligibility for a higher depreciation rate is not contingent on the plastic or rubber components/ products being the end products that the assessee deals with. Even if these components are used in the manufacturing process of end products, the assessee is still entitled to the higher depreciation rate. Further, there is no necessity that the end product should also be of plastic or rubber. Regardless of the nature or material (be it metal, plastic, rubber, etc.) of the end product, the assessee would be eligible for higher depreciation. Reliance is placed on the following pronouncements: CIT v. Amco Batteries Ltd. Pr. CIT v. L.K. India (P.) Ltd.Example:

XYZ Limited is engaged in the manufacturing of batteries. It has got a separate division in its factory wherein moulds are used for manufacturing of rubber containers which were further required for manufacturing of batteries. Now, is the company eligible to claim depreciation at higher rates i.e., 30% instead of 15%?

The company is fulfilling the basic criteria of manufacturing rubber components (rubber containers) and that too in a separate division in its factory. Also, these containers are used in the manufacturing of the end product i.e., batteries. Hence, as per the decision of Hon'ble High Court of Karnataka in the case of Amco Batteries Ltd. (supra), the said company is eligible to claim depreciation on moulds used in manufacturing of rubber components @ 30%.

2. Higher Depreciation rate in case of purely temporary erections such as wooden structures

Depreciation is available at higher rates in case of a building which is a purely temporary erection. However, what is the meaning of purely temporary erections is nowhere defined in the Rules or Act and hence a litigative matter.

Yet, in various case laws, High Courts and Tribunals have interpreted it in the following manner: In the

case of contractors, certain structures are put up at project site on land given temporarily by the contractee. These structures are meant for the use by the contractor as his project office and also for housing labour as well as employees of the contractor. The land is neither owned by the contractor; nor is it held by the contractor as leasehold. Therefore, the structures put up on such land, of whatever nature, are purely temporary structures. It is not necessary that the structures be built of wooden material due to use of the words "such as wooden material". They might be of cement, concrete or other such material and have longer life.Reliance is placed on the following pronouncements:

Shalivahana Constructions Ltd. v. Dy. CIT

Jt. CIT v. Lanco Industries Ltd. [IT Appeal No. 487 (Hyd.) of 2000, dated 31-1-2005]

Example:

ABC Pvt. Ltd. claimed depreciation on workshop building, constructed on leased land, at the rate of 40% on premise that the structure was temporary in nature. Is the contention of the assessee tenable under the law?

The structures built by the company are temporary in nature. Further, as described above it is not relevant that the structure built be a wooden structure. In light of the facts, the assessee is correct in claiming depreciation at higher rate i.e., 40%.

SOME KEY ISSUES INVOLVED: 1. In case of business of leasing out vehicle if lessee is using the vehicle for running them on hire, shall depreciation be available at higher rate?

In the case of "CIT v. Annamalai Finance Ltd.", Hon'ble Madras High Court held that on a plain reading of section 32 and depreciation rates given in the Rules, it is clear that it is the end user of the specified asset, which is relevant for determining the percentage of depreciation. Section requires that the assets should be used for the purpose of the assessee's business and the I.T. Rules refer to the use it should be put to. Once it is accepted that the leasing out of the vehicles is one of the modes of doing business by the assessee and in fact, the income from such leasing is treated as business income of the assessee, it would be clearly contradictory in terms to hold that the vehicles in question were not used wholly for the purpose of the assessee's business. Thus, the assessee who was engaged in the business of leasing out vehicles and if lessee is using the vehicles for running them on hire, was entitled to depreciation at the higher rate. [30% depreciation rate instead of 15%]2. Can an assessee claim depreciation on building or property in his possession, title of which is yet to be transferred?

Hon'ble Supreme Court in the case of "Mysore Minerals Ltd. v. CIT " held that depreciation is allowable to the assessee on the buildings whose possession has been acquired by the assessee and which were used by him for the purposes of his business or profession, even though such buildings were not transferred in the name of the assessee. Registration of name under the Registration Act is not determinative of ownership. What has to be seen is the beneficial ownership. Therefore, if the assessee has taken the possession of a building in pursuance of an agreement to sell, then he is deemed as the owner of the building for claiming depreciation even if the building is not registered in his name.3. Is it necessary that the assessee should be the owner of the building in order to claim depreciation?

It is not necessary that the assessee should be the owner of the building. As per the Explanation 1 to Sec. 32(1), even if he holds a lease or other right of occupancy and incurs capital expenditure in the form of construction of a structure or any other work in relation to renovation, extension or improvement to building, then such structure or work shall be deemed to be a building owned by the assessee and accordingly he is eligible to claim depreciation.CONCLUSION:

The monetary value of an asset decreases over time due to use, wear and tear or obsolescence. Therefore, it is necessary to charge from the assets a value so that assets are reflected at their true and fair value. Depreciation gives you a way to correlate the cost of an asset with its usefulness, or ability to produce revenue, year over year. Distributing an asset's cost over its lifespan, instead of recognizing the entire cost at once, gives you a more accurate view of the asset's value and your business's profit at the end of the year. It can also have tax benefits.

Loan to Director by Private Limited Company

Question: - Is giving loan/guarantee/security to director, a permissible transaction under Companies Act 2013 and Income Tax Act? - If answer to the question is "affirmative", what compliance do we need to take care? - If answer to the question is "Negative", why the restrictions were imposed on such kind of transaction? - Are there any exception to said transaction under the statutes? The answer to this question is very simple as the primary objective of bringing in the provision is to prevent directors from taking undue advantage of their position and to safeguard the interests of shareholders and stakeholders, which in turn ensures transparency and accountability in corporate affairs. The restrictions helps in promoting good governance, preventing potential conflicts of interest, and safeguarding the interests of shareholders and stakeholders.

It is, therefore, imperative for companies and directors - to understand the nuances of provision given under Companies Act 2013 and Income Tax Act 1961, - to comply with its provisions, and - to adopt robust governance practices to ensure smooth operations and maintain trust in the corporate ecosystem.Provision to discuss: - Section of Companies Act 2013 - Section of the Act read with Companies (Auditor's Report) Order, 2020- Section of the Income Tax ActA. Companies Act 2013

Loan to director is governed by Section 185 of the Companies Act 2013. This section deals with restrictions on the Companies in providing any loan or giving any guarantee or security. It also provides for the persons to whom such loans, guarantees or security can be extended and penalties in cases of contravention. Let's dive in to understand the provision in steps:-

Prohibited transaction

As per section 185(1), no company shall, directly or indirectly, - advance any loan, including any loan represented by a book debt to, or - give any guarantee or provide any security in connection with any loan taken by,--(a) any director or (b) director of the holding company or (c) any partner or relative* of any such director; or(d) any firm in which any such director or relative is a partner.* For the purpose of this section, relative as per section 2(77) means:FatherBrother Son Daughter Husband /WifeMotherSisterSon's wife Daughter husband's Member of HUFPlease note that Father, mother, son, brother and sister also include the step-counterparts

Conditional waiver for granting of loan

As per the provision of section , a company may provide loan/guarantee/security to any person or entity in whom any of the Directors are interested*, subject to condition:-(a) a special resolution is passed by the company in general meeting-(disclosing full particulars of the loans, or guarantee or security and purpose for which it shall be utilised by the recipient in the explanatory statement to the notice; and(b) the loans are utilised its principal business activities.Eligible Person: the expression "any person in whom any of the director of the company is interested" means--(a) any private company of which any such director is a director or member;(b) any body corporate at a general meeting of which not less than twenty-five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or(c) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.Are there any exemption given under Section 185? i.e. permitted transactions

As per the provision of section 185(3), this section shall not apply to-(a) the giving of any loan to a managing or whole-time director- as a part of the conditions of service extended to all its employees and such scheme is approved by a special resolution; or(b) Loan or guarantee or securities in the ordinary

course of business and where interest is charged at a rate not less than the rate of prevailing yield of one year, three years, five years or ten years Government security closest to the tenor of the loan; or(c) Such transactions made by a holding company to its wholly owned subsidiary company*(d) any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company*

* Condition: the loans are utilised by the subsidiary company for its principal business activities.

Penalty for violating the provision Particulars Penalty Imprisonment Remarks Minimum Maximum Company5 Lakh25 lakh-NA---Directors or other office in default5 Lakh25 lakhsix months--Recipient of the loan5 Lakh25 lakhsix monthsWith bothApplicability of section 185 of the Act Private CompanyNo subject to condition:

- No investment has been done by any body corporate
- Borrowing from banks/ FIs/ body corporate is less than lower of : - Twice of paid up capital Fifty crore rupees- It has no default in repayment of borrowings subsisting at the time of transactionAs summarized above, the private Companies are exempted from the Prohibitions of Section 185 vide MCA notification of 2015 i.e. Pvt. Company can grant loan to its director subject to certain conditions as mentioned above. Further, the intention of the law is to protect the interest of the shareholder or stakeholders, bringing in transparency and ensuring corporate governance at top level.

However there are chances that the same will come under the fiction of dividend i.e. 'Deemed Dividend' u/s of Income Tax Act, 1961 if it fulfills the conditions as given under the said Section.

So let's dive in to understand the concept...whether advance of loan to director will fall into the definition of Deemed Dividend?

Treatment of Loan to directors under the Income-tax Act ParticularsProvisionProvisionSection 2(22)(e) of the Income Tax Act 1961ApplicabilityClosely held companyPayment covered- To the shareholder by way of advance or loan- For the benefit of shareholder to any concern*, in which such shareholder is a member** or a partner and in which he has a substantial interest***- for shareholder's individual benefitQuantumTo the extent, company possesses accumulated profits.Condition- Payment covered payment of any sum to a shareholder who holds a minimum of 10 per cent of the voting rights, and is the beneficial owner of shares. However, it is important that the shares held are not entitled to a dividend rate's fixed rate.- To the extent of accumulated profit.* Concern: for this purpose, concern means HUF Sole Proprietor Firm AOP BOI Company

** Member: Shareholder should be Both Registered & Beneficial Shareholder. However, where the shareholder is a beneficial holder but not the registered holder of shares, even then section 2(22)(e) would not attract to him.

[Case law: Rameshwarlal Sanwarmal v. CIT [1980] 122 ITR 1 (SC) further referred in Dy. CIT v. National Travel Services] also see ITO v. Sagar Sahil Investment (P.) Ltd. .

***Substantially interested means beneficially entitled to not less than 20% of the income of such concern.

In a nutshell for application of this section, there should be a payment made by the company which is closely held that is private companies, by way of advancing loan; the director should have 10% or more voting power in the company (i.e. the director in the present case is also a shareholder) or have a substantial beneficial interest in the shares of the company.

If the recipient of the loan is not a shareholder on the date, the loan was advanced, this clause is not applicable to the assessee. [Case law: CIT v. H.K. Mittal].

Now the question arises, where a loan or advance is made to a concern in which shareholder as referred in the section is substantially interested, taxability should arise in the hands of that concern or in the hands of ultimate shareholder having substantial interested in the Company.

Ans.: Taxability should not arise in the hands of that concern but in the hands of the shareholder having beneficial interest in the concern and that too when the money is finally received by that shareholder.

And same was decided on merit in the various cases, referred below.

Exceptions under Section of the Income Tax Act Loan or advance given to a shareholder out of the share premium account of a company. (As specifically exempted under section of Companies Act 1956 tax Act or Section 52 of Companies Act 2013.) When a money lending company offers loans under the natural course of business. Loans given to shareholders that are later adjusted upon declaring dividends and distributed. No tax will be payable by shareholder on such dividend declared. Loans given to shareholders who holds less than 10% of voting rights in the company. Transactions that acts as an inter-corporate deposit (Case law: Bombay Oil Industries Ltd. v. Dy. CIT Amounts given by a company to an assessee against his debenture account (Anil Kumar Agrawal v. ITO The advances which are in the nature of trade advances are outside the ambit of provisions of Sec. 2(22)(e) of the I.T. Act, 1961. [Case law: CIT v. Rajkumar also see Case law: CIT v. Nagindas M. Kapadia]Disclosures in financial statements

Company as well as auditor are under an obligation to make disclosure of aforesaid transactions, which are advance/ loan/ guarantee/ security in nature as follows:

- By Director

A director is bound to inform a company about its interest in any contract or arrangement or its shareholding in any other company. Therefore, having a loan from a company or a loan obtained by any person in whom the director is interested needs to be intimated to the company itself and other companies where he/she holds directorships.

- By Company

The company shall disclose to the members in the financial statement the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security.

- By Auditor

a. Under CARO i.e. Section of the Act read with Companies (Auditor's Report) Order, 2020

The Auditor need to comment or disclose in Audit Report the following details: Whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so, whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-A. the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associatesB. the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associatesParticulars Guarantees Security Loans Advances in nature of loans Aggregate amount during the year

- Subsidiaries*- Joint ventures*- Associates*- Others Balance outstanding as at balance sheet date

- Subsidiaries*- Joint ventures*- Associates*- Others whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest in respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regularb. In case of audit u/s 44AB of Income Tax Act. There is no specific provision in the Audit Report Form No. 3CD prescribed by the I.T. Rules, 1962 for reporting of 'Deemed Dividend' paid by a Company. ` Clause 27 of Form No. 3CD requires the auditor to disclose whether the assessee has complied with the provisions of Chapter XVII-B relating to Deduction of Tax at Source. ` Since, Tax is required to be deducted by the principal officer of an Indian Company u/s 194, the Auditor is obliged to report of Non-deduction of TDS u/s 194 in the Audit Report Form No. 3CD.

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