

IN THE INCOME TAX APPELLATE TRIBUNAL
"A" BENCH : BANGALORE

BEFORE SHRI N V VASUDEVAN, JUDICIAL MEMBER
AND SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER

ITA No.809/Bang/2016
Assessment year : 2011-12

Magus Customer Dialog Private Ltd., No.26, Zam Zam Centre, 1 st Floor, Infantry Road, Behind Vijaya Bank, Bengaluru – 560 001. PAN: AABCM 3799C	Vs.	The Principal Commissioner of Income Tax, Bengaluru – 4, Bengaluru.
APPELLANT		RESPONDENT

Appellant by	:	Shri R.B. Krishna, Advocate
Respondent by	:	Shri G.R. Reddy, CIT(DR)-I, ITAT, Bengaluru

Date of hearing	:	23.10.2017
Date of Pronouncement	:	25.10.2017

ORDER

Per N.V. Vasudevan, Judicial Member

This appeal by the assessee is against the order dated 17.03.2016 of the Principal Commissioner of Income-tax-4, Bengaluru [hereinafter referred to as "the Pr. CIT"], Bangalore passed u/s. 263 of the Income-tax Act, 1961 ["the Act"].

2. The assessee is a company engaged in the business of rendering call centre services. For the AY 2011-12, the assessee

filed a return of income declaring at total loss of Rs.63,43,922. An order of assessment u/s. 143(3) of the Act dated 01.11.2013 was passed by the AO accepting the loss returned by the assessee.

3. The Pr. CIT in exercise of his powers u/s. 263 of the Act was of the view that the aforesaid order of AO dated 01.11.2013 accepting the returned loss filed by the assessee was erroneous and prejudicial to the interests of the revenue.

4. The Pr. CIT on perusal of the records noticed that in Note 19 to the financial accounts, there was a reference to the assessee having entered into an agreement with M/s. Easy Access Financial Services, a NBFC for “factoring” of debts and pursuant to the said agreement, some of the receivables of the company were sold at a discount with a further obligation on assessee’s part to collect the proceeds of receivables sold and remit the same to NBFC. The discount portion was termed as ‘factoring charges’ amounting to Rs.21,43,516. The same was debited to the P&L account and claimed as a deduction while computing income of the assessee from business. The Pr.CIT was of the view that the factoring charges was in the nature of interest within the meaning of section 2(28A) of the Act and therefore the assessee ought to have deducted tax at source u/s. 194A of the Act on the factoring charges. Since the assessee failed to deduct tax

at source, the factoring charges which were claimed as deduction while computing income from business, the AO ought to have disallowed the claim for deduction of factoring charges by invoking the provisions of section 40(a)(ia) of the Act.

5. In response to the show cause notice issued by the Pr. CIT u/s. 263 of the Act dated 28.07.2015, the assessee sent replies dated 21.08.2015, 05.11.15 and 04.12.2015 in which the assessee took a stand that “factoring charges” were not in the nature of “interest” within the meaning of section 2(28A) of the Act and in this regard had relied on the decision of the Hon’ble ITAT Kolkata Bench in the case of *ITO v. MKJ Enterprises Ltd. in ITA No.729/Kol/2011 for AY 2007-08, order dated 27.01.2014*, wherein it was held that discounting/factoring charges were not in the nature of interest within the meaning of section 2(28A) of the Act and therefore there was no obligation to deduct tax at source u/s. 194A of the Act.

6. Without prejudice to the aforesaid contention, the assessee submitted that the AO was apprised of this legal position in a letter dated 16.07.2014. This letter, though it was filed after the conclusion of the assessment proceedings, clearly explained the nature of factoring charges and as to how there was no obligation to deduct tax at source on factoring charges u/s. 194A of the Act. The submission

of the assessee was that in the course of assessment proceedings the AO had orally raised queries on this aspect and that was clarified in the letter dated 16.07.2014 filed before the AO. Without prejudice to the aforesaid argument, the assessee also submitted that the 2nd proviso to section 40(a)(ia) of the Act had been introduced by the Finance Act, 2012 w.e.f. 1.4.2013. The effect of the said proviso would be that if the assessee satisfies the AO that the recipient of the payment from the assessee on which no TDS was made, if he furnishes the return of income u/s. 139 of the Act has taken into account the sum received from the assessee in computing his income and paid taxes due on the income, then no disallowance u/s. 40(a)(ia) could be made. The assessee pointed out that though amendment was only w.e.f. 1.4.2013, the same was applicable retrospectively as held by the Hon'ble Delhi High Court in the case of *CIT v. Ansal Landmark Township Pvt. Ltd. (2015) 377 ITR 635 (Del)*.

7. The Pr. CIT, however, was of the view that the AO while completing the assessment did not examine the question whether the provisions of section 194A of the Act are applicable to factoring charges. In this regard, the Pr. CIT also held that the note filed by the assessee dated 16.07.2014 was after the conclusion of the assessment and will be of no effect. The CIT also held that the

definition of "interest" u/s. 2(28A) of the Act was brought into statute to take within its fold even factoring charges. The relevant observations of the Pr. CIT are extracted hereunder:-

4.1.1 The issue in dispute is whether the expenditure incurred on factoring charges can be covered under the provisions of Section 2(28A) of the Income Tax Act. "Factoring" involves the assignment of a debt to a Financier by the client of the debt, the giving of such assignment to the debtor and collection of the debt by the Financier (Factor). The client transfers its trade receivables/invoices to a Factor in order to obtain cash on an immediate basis. The Factor is essentially a funding source that agrees to pay to a client the value of the invoice less its commission and fees. The legal title to these receivables may or may not be transferred to the Factor. In factoring arrangements, the client may transfer its invoices to a Factor with an understanding that the client may buy back any uncollected invoices. Alternatively, the Factor assumes responsibility for all bad debts. The fees paid by the client to the Factor may bear different names such as factoring charges, discounting charges, commercial finance etc. By whatever name called, the character of "interest" payment to the Factor will not change. The Assessing Officer has not examined the arrangement between the assessee company, the client, and the Factor, namely, M/s. Easy Access Financial Services. The terms of the Agreement/Arrangement needed to be called for and examined by the Assessing Officer to arrive at a finding whether or not the financing provided by the Factor was in the nature of loan on which it charged interest under the head "factoring charges" as envisaged under Section 2(28A) of the Income Tax Act.

4.1.2. It is clear from a plain reading of Section 2(28A) that money paid in respect of amount borrowed or debt incurred, is interest payable in any manner. It includes in the terms, the money borrowed or incurred, deposits, claims, including a deposit, claim or other similar right or obligation and includes any service fee or other

charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised. Thus, interest includes any expenditure, by whatever name called, incurred in connection with servicing of loans as long as there exists a lender and a borrower of loans. Thus, the statutory definition given under Section 2(28A) regards amounts which may not otherwise be treated as interest. In the present case, factoring charges have been paid in respect of an obligation incurred in relation to the money borrowed through invoices. The mere fact that the assessee did not treat the same as coming within the ambit of "interest" will not alter the nature of this charge.

4.1.3. Section 194A of the Act prescribes that any person who is responsible for paying to a resident any income by way of interest other than interest on securities, shall deduct tax at source at the rates in force at the time of making such payments, either by way of cash, cheque, draft or crediting the payee's account, including any suspense account. Sub-section (3) there under exempts the payer from TDS provisions, *ibid*, if the interest payments are made to certain categories of payees, which include, *inter alia*, banking companies to which the Banking Regulation Act, 1949 applies. Non Banking Financial Companies (NBFCs) which are registered separately with the Reserve Bank of India and not regulated by the provisions of the Banking Regulation Act are, however, required to deduct tax at source at the time of making interest payment and failure to do so attracts disallowance u/s 40(a)(ia) of the Act. It is not in dispute that M/s. Easy Access Financial Services is a Non Banking Financial Company (NBFC) and not a Banking Company governed by the Banking Regulation Act and hence not exempt from the application of the said section.”

8. The Pr. CIT after making the above observations held that since the AO has not examined this claim while concluding the assessment, his order was erroneous and prejudicial to the interests

of the revenue. On the question of the argument regarding insertion of 2nd proviso to section 40(a)(ia) of the Act w.e.f. 01.04.2013 being retrospective, the Pr. CIT referred to two decisions; one of the Hon'ble Kerala High Court and the other of the Hon'ble Punjab & Haryana High Court taking a view that second proviso to section 40(a)(ia) of the Act was only prospective; held that the argument of the assessee in this regard cannot be accepted. The relevant observations of the Pr. CIT are contained in para 4.2.2 of his order which reads as follows:-

“4.2.2 The Delhi High Court decision relied upon by the assessee in *Ansal Landmark Township Pvt. Ltd.* case is in favour of the assessee. However, the Kerala High Court in the case of ***Thomas George Muthoot vs. CIT in ITA No. 278 of 2014*** has taken a contradictory view wherein it has been held that *"unless it is expressly stated that a provision is retrospective, it is always prospective in operation. Reading of the second proviso to Section 40(a) (ia) does not show that it is meant or intended to be curative or remedial in nature."* **It further held that "by this proviso, instead, an additional benefit is given to the assessee."** The Hon'ble High Court of Punjab and Haryana in the case of ***Ind Swift Laboratories Ltd in ITA No. 188 of 2014*** also decided this issue in favour of Revenue. Respectfully following the judgments of the Kerala High Court and Punjab and Haryana High Court, I hold that the new proviso to Section 40(a)(ia) inserted with effect from 1.04.2013 is prospective in operation and will therefore not help the case of the assessee.”

9. The final directions of the Pr. CIT in the impugned order are as follows:-

“5. In view of the elaborate discussion made above, I hold that the Assessment Order passed by the Assessing Officer is erroneous and prejudicial to the interests of the revenue. Hence, in exercise of powers conferred on me under clause (a) of Explanation (2) of Section 263, I set aside the order of Assessing Officer to examine the claim of factoring charges and frame the Assessment in accordance with the law.”

10. Aggrieved by the aforesaid order of the Pr. CIT, the assessee is in appeal before the Tribunal.

11. We have heard the rival submissions. It is an admitted position that the AO before completing the assessment did not make any enquiries questioning whether provisions of section 194A of the Act were applicable to factoring charges and consequently factoring charges cannot be allowed as a deduction in computing income from business in view of the provisions of section 40(a)(ia) of the Act for non-deduction of tax at source. The law with regard to exercise of jurisdiction u/s.263 of the Act on the ground that the AO failed to make enquiries which he ought to have made in the given circumstances of a case is well settled. The Commissioner can regard the order as erroneous on the ground that in the

circumstances of the case the Income-tax Officer should have made further inquiries before accepting the statements made by the assessee in his return. The Income-tax Officer is not only an adjudicator but also an investigator. He cannot remain passive in the face of a return which is apparently in order but calls for further inquiry. It is his duty to ascertain the truth of the facts stated in the return when the circumstances of the case are such as to provoke an inquiry. It is because it is incumbent on the Income-tax Officer to further investigate the facts stated in the return when circumstances would make such an inquiry prudent that the word "erroneous" in section 263 includes the failure to make such an enquiry. The order becomes erroneous because such an inquiry has not been made and not because there is anything wrong with the order if all the facts stated therein are assumed to be correct. We derive support for the proposition as stated above from the decision of the Hon'ble Delhi High Court in the case of *Gee Vee Enterprises 99 ITR 375 (Del)*. In the light of the law on the issue and in the light of the admitted fact that the AO did not make any enquiries which were required to be made on the issue in question, the order of the AO became both erroneous and prejudicial to the interest of the revenue calling for exercise of revisional jurisdiction u/s.263 of the Act. We therefore

uphold the exercise of jurisdiction u/s.263 of the Act by the CIT by the impugned order.

12. However, we make it clear that the question whether factoring charges with the meaning of section 2(28A) will be in the nature of interest or not should be left open and the observations of the Pr. CIT in the impugned order in para 4.1.1 and para 4.1.3 should not have any bearing or consideration in the assessment proceedings or the appellate proceedings, pursuant to the impugned order. This is because the Pr. CIT has not considered the decision of the ITAT Kolkata Bench directly on the issue in the case of *MKJ Enterprises Ltd. (supra)*. We also make it clear that the observations of the Pr. CIT with regard to the retrospective operation of second proviso to section 40(a)(ia) of the Act should not influence the AO or the appellate authorities in the proceedings pursuant to the impugned order. This is because the Pr. CIT in the impugned order has not considered the question as to whether in the absence of the decision of jurisdictional High Court, whether the view favourable to the assessee rendered by the non-jurisdictional High Court or the view against the assessee by the non-jurisdictional High Court should be taken into consideration. In any event, we are of the view that when the assessment is set aside on the ground that the AO did not make

proper and adequate enquiries before concluding the assessment, the Pr. CIT ought not to have expressed any view on the other issues that might arise for consideration in the assessment proceedings, pursuant to the order u/s. 263 of the Act. With the aforesaid modifications, we confirm the order of the Pr. CIT.

13. In the result, the appeal of the assessee is treated as partly allowed.

Pronounced in the open court on this 25th day of October, 2017.

Sd/-

(INTURI RAMA RAO)
Accountant Member

Sd/-

(N.V. VASUDEVAN)
Judicial Member

Bangalore,
Dated, the 25th October, 2017.

/ Desai Smurthy /

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Senior Private Secretary
ITAT, Bangalore.