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TAX FLASH NEWS

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The provisions of mandatory filing of tax return before the due date to claim benefit under Section 10B of the Income-tax Act are constitutionally valid

Background

Recently, the Delhi High Court (High Court) in the case of Nath Brothers Exim International Ltd[1] (the taxpayer) upheld the constitutional validity of relevant provisions[2] of the Income-tax Act, 1961 (the Act) mandating timely filing of return of income to claim profit-linked tax holiday benefit for exports and other qualifying activities. The High Court observed that the provisions did not curtail any vested rights of the taxpayer but it only imposed an obligation to claim deductions in a timely manner and in the return of income so filed. The objective behind insertion of the two provisions was to defeat multiple claims of deductions and to ensure better tax compliance. It is open to legislate and prescribe different conditions in respect of those who claim benefits, just as the substantive provisions stipulate certain conditions[3].

Facts of the case

- The taxpayer is an unlisted, deemed, family-owned public limited company engaged in the business of manufacture and export of readymade garments, garment made-ups and silk fabric. During the Assessment Year (AY) 2002-03, the taxpayer set up Export Oriented Unit (EOU) as an independent unit. The profits derived therefrom were eligible for deduction under Section 10B of the Act. The taxpayer has not claimed deduction up to AY 2007-08.

- During the relevant AY[4], the EOU earned profits, which were eligible for tax exemption. However, the taxpayer failed to claim deduction in the belated income tax returns filed by it on 31 December 2008, (which was due on 30 September 2008) and only made claim for deduction under Section 10B of the Act in the subsequent revised return filed by him on 26 March 2010.

- The taxpayer claimed that it was precluded from filing his return of income within the time prescribed under Section 139(1) of the Act because: (a) there were some disputes among family members of the directors of the taxpayer; and (b) due date of filing return by the taxpayer was for the first time reduced by Finance Act, 2009 from 31 October, following the close of the previous year to 30 September. Accordingly, for AY 2008-09, the return was due on 30 September 2009 instead of the earlier due date of 31 October 2009, a fact the taxpayer claims it was unaware of.

- The Assessing Officer (AO) considered the taxpayer's claim of deduction under Section 10B of the Act and denied the deduction. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO. Against, the CIT(A) ruling, the appeal is pending before the Tribunal.

[1] Nath Brothers Exim International Ltd v. Union of India & Anr. (W.P.(C) 12073/2015) – Taxsutra.com
[2] Section 10B(1) read with Section 80A(5) of the Act
[3] Type of accounts to be maintained, eligibility criteria, etc.
[4] AY 2008-09

- Bound by the plain language of Section 80A(5) and fourth proviso to Section 10B(1) of the Act, the taxpayer preferred a writ petition before the Delhi High Court.

High Court's decision

- Section 80A(5) of the Act was added to prevent multiplicity of claims of deductions with respect to the same transactions under the Act. The insertion of said provisions does not curtail any vested rights that the taxpayer had, but only imposes upon them a duty, an obligation to claim deductions in a timely manner and in the return so filed.

- The right to claim such deductions still vests in the taxpayers who are eligible for it. The impugned provisions are interwoven into the mechanism which Parliament found appropriate to create for the purpose of claiming deductions. In such cases, (unlike in cases where no such benefits are sought) the taxpayer has to necessarily claim the benefit while filing a return within the time under Section 139(1) of the Act.

- These provisions are rather like limitation periods, which are statutes of repose that define the status or relationship of the party concerned. Challenges to such provisions, which merely enable the channeling of benefits *per se* arbitrary or discriminatory can seldom succeed. In fiscal and economic matters, more than any other field, Parliament has to constantly innovate and experiment, having regard to experience gained in the administration of the law by executive agencies.

- Such innovation would lead it to refining legislation to achieve particular ends, the effects of which may be seemingly painful or even discriminatory. Commenting on the Courts' approach to challenges posed by such legislation, especially in the context of a challenge to Article 14, the High Court referred the decision of the Supreme Court in the case of Ajoy Kumar Banerjee & Ors.[5]

- The Court is also unconvinced by the taxpayer's contention that the impugned provisions fail to pass muster under the classification test, as to be valid under Article 14 of the Constitution of India. This argument overlooks the fact that those claiming benefits of deduction and those who are not, although no doubt both taxpayers, are clearly apart. Thus, it is open to legislate and prescribe different conditions in respect of those who claim benefits, just as the substantive provisions which stipulate the conditions. Therefore, provision of special limitation in such cases is justified and has a rational nexus with the object which Parliament wished to achieve.

- In order to avail benefit of Section 10B of the Act, the taxpayer relied on the rule of 'substantial compliance' with respect to furnishing the audit report of the chartered accountant. Relying on Supreme Court's decisions[6] it has been observed that a proviso is meant to limit the scope of the general enactment and thus, proviso that cannot be held to be invalid as long as the objective of the general provision is not frustrated.

- Accordingly, the fourth proviso to Section 10B(1) of the Act is a qualifying proviso and it only seeks to limit the general provision in Section 10B(1) of the Act with a further stipulation or condition.

- As held in Nallamilli Ramli Reddi[7], Article 14 of the Constitution of India permits reasonable classification on fulfillment of two factors: (a) that the classification must be found on intelligible differentia which distinguishes persons grouped together from others who are left out of the group, and (b) that differentia must have a reasonable connection with the object sought to be achieved.

- The objective behind insertion of the impugned provisions was to defeat multiple claims of deductions and to ensure better tax compliance. Thus, the impugned provisions[8] so inserted acknowledge the existence of persons owning 100 per cent EOUs and seek to limit their time to claim deductions under the Act.

- In various decisions[9] the courts have held that the legislature can devise classes for the purposes of taxing or not taxing, exempting or not exempting, granting incentives or prescribing rates of tax, benefits or

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[5] Ajoy Kumar Banerjee & Ors. etc v. Union Of India & Ors (AIR 1984 SC 1130)

[6] Kedarnath Jute Manufacturing Co. Ltd. v. CTO, AIR 1966 SC 12
Union of India v. Sanjay Kumar Jain (Appeal (Civil) 5178 of 2004, dated 11 August 2014

[7] State of A.P. v. Nallamilli Ramli Reddi, (2001) 7 SCC 708

[8] Fourth proviso to Section 10B(1) and Section 80A(5) of the Act

[9] State of U.P. v. Kamla Palace, (AIR 2000 SC 617)
Southern Petrochemical Industries Co. Ltd. v. Electricity Inspector & ETIO, (AIR 2007 SC 1984)

concessions. Thus, the court would uphold the wide discretion, which is enjoyed by the legislature in matters of making policy for taxation.

- In the case of Sham Bhar Khandige[10] it was observed that where there are more than one methods of assessing a tax and the Legislature selects one among so many, the Court will not be justified to invalidate the law on the ground that the Legislature should have adopted another method, which in the opinion of the Court, is more reasonable or appropriate, the exception being where the court is convinced that the method adopted is capricious and fanciful.

- Thus, with the addition of the fourth proviso to Section 10B(1) of the Act, the manner of claiming deduction is now time barred under the provisions of the Section 139(1) of the Act and relief cannot be granted after expiry of the time mentioned in Section 139(1) of the Act. Thus, Parliament acted within its power to differentiate between a return of income filed under Section 139(1) of the Act and a belated return filed under Section 139(4) for the purposes of deductions claimed Section 10B(1) of the Act.

- Accordingly, the CIT(A)'s order has been upheld and the challenge to the provisions has to fail. Resultantly, the writ petition is dismissed.

Our comments

In the present case, the High Court upheld the constitutional validity of Section 80A(5) as well as fourth proviso to Section 10B(1) of the Act. The High Court observed that it is open to legislate and prescribe different conditions in respect of those who claim benefits, just as the substantive provisions which stipulate the conditions. Therefore, provision of special limitation in such cases is justified and has a rational nexus with the object which Parliament wished to achieve.

The present decision states that the taxpayer has to fulfill the additional conditions in order to claim deduction under Section 10B of the Act. In case the taxpayer fails to file return of income before the due date, it needs to approach CBDT citing valid reasons for non-compliance.

The CBDT for avoiding genuine hardship[11], by general or special order, relax any requirement where taxpayer failed to comply with such requirement specified for claiming deduction, provided the default in complying with such requirement was due to circumstances beyond the control of the taxpayer and the taxpayer has complied with such requirement before the completion of assessment in relation to the previous year in which such deduction is claimed.

[10] Sham Bhar Khandige v. Agricultural I.T.O. (AIR 1963 SC 591)

[11] Under Section 119(2)(c) of the Act

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Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri
Vadodara 390 007
Tel: +91 0265 235 1085/232 2607/232 2672

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