

TAX FLASH NEWS

Enhanced profit due to the disallowance of expenditure under Section 40(a)(ia) is eligible for a benefit of Section 10B of the Income-tax Act

Background

Recently, the Pune Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Precision Camshafts Limited¹ (the taxpayer) held that enhanced profits due to disallowance of expenditure under Section 40(a)(ia) of the Income-tax Act, 1961 (the Act) are to be considered as 'eligible profits' while computing the deduction under Section 10B of the Act. The Tribunal observed Section 92C(4) of the Act wherein it is stated that in case any addition is made on account of a transfer pricing adjustment, no deduction under Section 10A/10AA/10B of the Act shall be allowed in respect of such amount of income by which the total income of the taxpayer is enhanced. However, there is no similar provision in respect of the disallowance made under Section 40(a)(ia) of the Act.

Facts of the case

- The taxpayer was a 100 per cent Export Oriented Unit (EOU), engaged in the business of manufacturing of camshafts required by the automobile industry. During the year under consideration, the taxpayer had furnished the return of income claiming a deduction under Section 10B of the Act.
- In the computation of total income filed along with the return of income, the taxpayer had added back a sum of INR13.45 million to the net profit, being the amount disallowed under Section 40(a)(ia) of the Act on account of a non-deduction of tax at source. Subsequently, the deduction under Section 10B of the Act was claimed on the enhanced income.

- The Assessing Officer (AO) was of the view that the said disallowance does not form part of the net profit. On account of such a disallowance, the profits of the business have increased, and the same could not be considered while computing the deduction under Section 10B of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] allowed the claim of the taxpayer vis-à-vis a deduction under Section 10B of the Act on the enhanced income.

Tribunal's ruling

- It has been observed that the issue raised in the present appeal is in relation to the claim of deduction under Section 10B of the Act on enhanced profits, which have been increased due to a disallowance made under Section 40(a)(ia) of the Act.
- The said disallowance was made by the taxpayer *suo motu* in the return of income, for the reason that the tax deductible on the said expenditure was not deposited within the prescribed period and hence, the expenditure was not allowable under Section 40(a)(ia) of the Act. In the said return of income, the taxpayer had claimed a deduction under Section 10B of the Act on the enhanced eligible profits.
- The case of the AO was that such a disallowance, due to which the profits of the business have increased, could not be considered while computing the deduction under Section 10B of the Act. However, the CIT(A) allowed the claim of

¹ Precision Camshafts Limited v. ACIT (ITA No.70/PN/2012, ITA No.72/PN/2012)
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the taxpayer relying on the ratio laid down by the Bombay High Court in the case of Gem Plus Jewellery India Ltd.².

- Further, as referred to by the CIT(A), there is a provision by way of a proviso under Section 92C(4) of the Act that in case any addition is made on account of a transfer pricing adjustment, no deduction under Section 10A/10AA/10B of the Act or Chapter VIA shall be allowed in respect of such amount of income by which the total income of the taxpayer has been enhanced.
- However, there is no similar provision in respect of the disallowance made under Section 40(a)(ia) of the Act. In the absence of a specific provision under the Act, the income enhanced after the statutory disallowance under Section 40(a)(ia) of the Act is to be considered as eligible profits of the undertaking while computing the deduction under Section 10B of the Act.

Our comments

In the instant case, the Pune Tribunal held that enhanced profits due to a disallowance of expenditure under Section 40(a)(ia) of the Act are to be considered as 'eligible profits' while computing deduction under Section 10B the Act since there is no specific provision in the Act to prohibit the same. A disallowance of expenditure due to transfer pricing adjustments are not allowed as 'eligible profits' for deduction under Section 10A/10AA/10B of the Act or under Chapter VIA, as expressly mentioned under Section 92C(4) of the Act. There is no similar provision in respect of the disallowance made under Section 40(a)(ia) of the Act.

In the case of Vertex Infosoft Solution (P.) Ltd.³, the Chandigarh Tribunal held that income enhanced due to disallowance is eligible for deduction under Section 10B of the Act.



² CIT v. Gem Plus Jewellery India Ltd. [2011] 330 ITR 175 (Bom)

³ DCIT v. Vertex Infosoft Solution (P.) Ltd. [2015] 61 taxmann.com 85 (Chd)

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