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Issuance of notice initiating audit proceedings not sufficient grounds for withholding taxpayer's refund claim

The Delhi High Court has rendered its decision that mere issuance of a notice initiating audit proceedings is not sufficient grounds to withhold taxpayer's refund claim

Background:

- The taxpayer¹ is a company engaged in the business of trading, manufacturing / assembly of telecommunication carrier equipment for sale to independent customers, providing implementation, commissioning and support services related to telecommunication systems.
- The taxpayer had claimed a refund for the Financial Years (FY) 2015-16 to 2017-18, corresponding to Assessment Years (AY) 2016-17 to 2018-19, as per the income-tax return filed. The refund claim arose primarily because of:
 - Delay in issuance of the lower withholding tax certificates by the Assessing Officer (AO); and / or
 - Issuance of withholding tax certificate at a rate higher than requested by the taxpayer.
- The taxpayer's case for the said years was selected for audit and the Assessing Officer (AO) issued a notice under section 143(2) of the Income-tax Act, 1961 (ITA) for initiating detailed audit proceedings.
- The taxpayer followed-up for grant of refund with the tax authorities (including filing of grievance with the Centralized Public Grievance Redress and Monitoring System (CPGRAM)² as well as filing of e-Nivaran³ application in certain years). However, the refund was not granted to the taxpayer and the status was as follows:
 - AY 2016-17: The taxpayer's case was picked up for audit and the refund was to be released after completion of audit proceedings;
 - AY 2017-18: The processing of return was still under progress and taxpayer's grievance submitted remained unresolved;
 - AY 2018-19: The taxpayer had huge refund claims.

¹ Ericsson India P. Ltd. v. ACIT [2020] 117 taxmann.com 381 (Delhi HC)

² CPGRAM is a Government of India portal aimed at providing the citizens with a platform for redress of their grievances. If there is any grievance against any Indian Government organisation then one can lodge grievance on CPGRAM, which goes to the concerned Ministry / Department / State Government for immediate redress.

³ Taxpayers can get tax related and Permanent Account Number related grievances redressed online on the income-tax portal using the 'E-Nivaran' facility.

- Aggrieved by the non-issuance of refund, the taxpayer filed a writ petition before the Delhi High Court (HC).

Provisions, which are relevant in brief:

- Processing of an income-tax return under section 143(1) of the ITA:

An income-tax return is processed, after review of basic points such as arithmetical errors, etc. and consequently, refund due (if any) is paid to the taxpayer. The same needs to be done within one year from the end of the financial year in which the income-tax return is furnished.

- Initiation of detailed audit proceedings under section 143(2) of the ITA:

The AO can initiate detailed audit proceedings of the income-tax return by issuing notice as per section 143(2) of the ITA.

- Exception to processing of return / refund under section 143(1) of the ITA:

- For the period before AY 2017-18 (i.e. until AY 2016-17):

As per section 143(1D) of the ITA if a notice initiating detailed audit proceedings is issued, then the requirement of processing of an income-tax return is not necessary.

- AY 2017-18 onwards:

As per section 241A of the ITA, if an AO is of the opinion that grant of refund is likely to affect the Revenue, then, he may not give the refund until the completion of audit proceedings. The AO, in such a case, needs to record the reasons in writing and obtain prior approval of the Principal Commissioner or Commissioner, as the case may be.

Decision of the Delhi HC:

AY 2016-17:

- The HC noted that for AY 2016-17, section 143(1D) of the ITA (as per which, processing of a return is not necessary if a notice initiating detailed audit proceedings under section 143(2) of the ITA has been issued) was relevant.
- The HC relied on various judicial precedents⁴ (which had examined the position prior to 1 April 2017) and held that, issuance of notice initiating detailed audit proceedings did not prevent the Revenue from processing the returns. Thus, the notice under section 143(2) of the ITA was not a limiting factor for the issue of refund under section 143(1) of the ITA.
- In respect of the judicial precedent relied on by the Revenue⁵, the HC held that the same supported the taxpayer's case, since in the said case it was held that:

⁴ Tata Teleservices Ltd. v. CBDT [2016] 69 taxmann.com 226 (Delhi HC); Group M. Media India (P.) Ltd. v. UOI [2017] 77 taxmann.com 106 (Bom HC)

⁵ Vodafone Mobile Services Ltd. v. ACIT [2018] 100 taxmann.com 310 (Delhi HC)

- Where the one-year period (for the taxpayer claiming refund) was over, the Revenue could not be inactive and the AO had to apply his mind whether as per the facts and circumstances of the case refund should be granted to the taxpayer.
- In view of the above and due to the following reasons, the HC directed the AO to process the income-tax return of the taxpayer and pass consequential order:
 - The AO should have processed the return after the expiry of the one-year period. The Revenue chose to decline the refund solely based on the issuance of a notice under section 143(2) of ITA (i.e. notice initiating detailed audit proceedings);
 - It was an unjust and arbitrary approach to withhold refunds, in anticipation of additions / disallowances that would have been made after completion of audit proceedings. This was particularly in the facts of the taxpayer’s case, since there was no history of high tax demand;
 - The AO should have exercised his discretion objectively in good faith, by considering all the relevant material to arrive at a decision in a logical manner;
 - The Revenue was not able to demonstrate any cogent reason for withholding the refunds, except that regular audit proceedings were pending.

AY 2017-18 and AY 2018-19

- The HC noted that for AY 2017-18 and AY 2018-19:
 - The refund mechanism was governed by section 241A of ITA (as per which an AO can withhold refund, if the same would affect the Revenue adversely). The AO needs to record the reasons and also seek prior approval of the Principal Commissioner or Commissioner, for the same;
 - The Revenue had denied the refunds solely on the grounds that an order under section 241A of the ITA was passed after obtaining prior approval of the Principal Commissioner;
 - There were no reasons mentioned in the proposal sent to the Principal Commissioner for approval, except for reproduction of phraseology of section 241A of the ITA.
- The HC noted that in its earlier decision⁶, it was held that section 241A of the ITA directed the AO to process the determined refunds and the discretion vested was to be exercised judiciously.
- Accordingly, in view of the above and in the absence of any cogent reasons justifying the withholding of refund due to the taxpayer for the said AYs, the HC held that:
 - The proposal, as well as the approval granted by the Principal Commissioner, lacked consideration of relevant and germane conditions;
 - The order under section 241A of the ITA was to be set aside and the Revenue had to undertake the said exercise afresh.
- The HC granted six weeks’ time to the Revenue to determine whether the amount of refund (or any part thereof) was liable to be withheld under section 241A of the ITA. While doing the said exercise, the

⁶ Maple Logistics (P.) Ltd. v. PCCIT [2019] 112 taxmann.com 199 (Delhi HC)

HC directed that the following aspects should be examined to ascertain whether the payment of refund (or any part thereof) would affect the Revenue adversely:

- AO should, firstly, make a prima facie estimation of the probability that additions would be made in the audit proceedings;
- Secondly, the AO should estimate the quantum of disallowance / addition and the likely tax effect thereof;
- Thirdly, the AO should consider the financials and financial standing of the taxpayer with respect to the ability to meet and service any tax demand arising from the audit proceedings;
- The AO should also consider other factors such as past demands, outstanding litigations and past conduct of the taxpayer.

Comments:

- This ruling affirms the following principles:
 - Prior to AY 2017-18 (i.e. until AY 2016-17)

Issuance of notice under section 143(2) of the ITA initiating detailed audit proceedings does not prevent the Revenue from processing the returns and the consequential issuance of refund. The AO should exercise his discretion objectively in good faith, by considering all the relevant material to arrive at a decision in a logical manner.
 - AY 2017-18 onwards

The AO needs to process the refund where the same are determined and the discretion to withhold refund under section 241A of the ITA, needs to be exercised judiciously and the reasons thereof need to be recorded in writing.
- This ruling also lays down the key aspects required to be examined by the Revenue (under section 241A of the ITA) while determining whether grant of refund would adversely affect the Revenue. These may be taken note of by the taxpayers.



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