

No reassessment could be made solely on basis of audit objections

Summary – The High Court of Karnataka in a recent case of Loyalty Solutions & Research (P.) Ltd., (the Assessee) held that where assessee was managing consumer loyalty programs for its partner whose customers would be entitled to loyalty points on purchase of certain goods or services and audit objection was raised in respect of allowability of provision towards unredeemed loyalty points, same being addressed by Assessing Officer, there would remain no basis for initiating reassessment

Facts

- The petitioner-assessee managed consumer loyalty programs for its partner organizations, whereby the customers of its partners would become entitled to loyalty points on purchase of certain goods or services, which could be redeemed towards future purchases. The loyalty program was managed by the petitioner at an agreed price with its partners. The gross amount received from the partners towards the redemption of the loyalty points was accounted upfront as income and was offered to tax and the cost of redemption of points was claimed as a deduction in computing the said income. Insofar as the unredeemed loyalty of points are concerned, the petitioner had created a provision for its liability towards the same based on past experience and a scientific methodology, and the petitioner claimed the same also as a deduction in computing its business income.
- Initially, during the course of the petitioner's assessment, specific inquiries regarding the aforesaid provision were raised by the Assessing Officer and being satisfied that no disallowance was called for, the assessment was said to have been completed allowing the deduction claimed by the petitioner.
- An audit objection was raised by the Audit Officer on the basis that the deduction in respect of the aforesaid provision ought not have been allowed. The petitioner was said to have explained in detail on the accounting as well as tax treatment, on account of which, no disallowance was made. The first respondent initiated re-assessment proceedings under section 147 on the ground that the provision towards unredeemed loyalty points ought not to have been allowed as a deduction, by virtue of which, there was income which had escaped assessment.

Held

- The petitioner's case was that the Assessing Officer has replied to the audit objection as per letter explaining the business model of the petitioner and how the revenue recognition and cost booking by the company are done. The Assessing Officer has also narrated the essential features of accrual basis of accounting during the assessment proceedings and has concluded that the provision for the expenses for the unredeemed points was made since the liability thereof was certain, only its quantification was based on calculation based on past experience of such nature of transactions. And the liability of provisions for the unredeemed points was reversed as and when the life cycle of the unredeemed points expired. Further, as the transactions were entered into by the petitioner

company with the relevant concerns, in the year ended 31-3-2009, the liability arose in that accounting year since a time limit of 3 years is fixed by those concerns for redeeming the points allotted to each user, the provision made by the assessee was therefore, fair and reasonable. This letter was claimed to be overlooked.

- Having regard to the audit objection having been addressed by the Assessing Officer, there would remain no basis for reassessment four years after the assessment order, when the audit objection has been met by the Assessing Officer as per the letter.
- Having regard to the explanation that is forthcoming from the Assessing Officer as regards the audit objection raised, there is substance in the contention of the petitioner.
- Incidentally, it is pointed out that one other contention by the respondents is that the assessment order does not indicate that the Assessing Officer had dealt with the issue at length and hence it cannot be said that it was present to the mind of the Assessing Officer. The petitioner would point out that it is the settled law that if the assessee has brought the issue to the attention of the Assessing Officer and even though there may be no consideration in the course of the assessment order on the issue which is highlighted by the assessee, it is deemed to have been considered by the Assessing Officer.
- Accordingly, the petitions are allowed.