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Direct Tax

Case Study 1:

Whether amounts of excise refund and interest subsidy received by industrial units in pursuance of incentives announced in terms of new industrial policy for accelerated industrial development in State of Jammu and Kashmir for creation of such industrial atmosphere and environment which would provide additional regular sources of employment to unemployed in State, were, in fact, in nature of creation of new assets of industrial atmosphere and environment, having potential of employment generation to achieve a social object and such incentives would be capital receipts in hands of such industrial units.

Solution:

In the case of M/s Shree Balaji Alloys, the Tribunal contended that excise duty refund and grant of interest subsidy received by the assessee in pursuance of the New Industrial Policy introduced in Jammu and Kashmir were revenue receipt and not capital receipt on the grounds that:-

(i) the aforesaid incentives were not given to establish industrial units because the industry was already established.

(ii) the incentives were available only on commencement of commercial production.

(iii) the incentives were recurring in nature.

(iv) the incentives were not given for acquisition of capital assets.

(v) the incentives were given for easy market accessibility and to run the business more profitably.

The High Court observed that the fact that incentives would become available to industrial units entitled thereto from the date of commencement of commercial production and the fact that these were not granted for creation of new assets were not the sole criteria for determining the nature of subsidy. The fact that such incentives were provided to achieve a public purpose should also be considered to determine the nature of subsidy and hence, such subsidy could not be construed as a production or operational incentive for the benefit of the assessee. Hence, the aforesaid incentives are capital receipts not liable to taxation.

Case Study 2:

Gift received by assessee on occasion of his daughter's marriage won't be exempt as the word individual appearing in proviso to sub-clause (vi) of sec. 56(2) relates to marriage of assessee and not of his daughter. Comments

Solution:

This case arose before the High Court and the decision held by the High Court is as follows: Proviso to sec. 56(2) (vi) provides that gift received on the occasion of the marriage of an individual would be exempt from tax. There is no ambiguity in such proviso;

The expression "individual" appearing in proviso (b) to section 56(2)(vi) of the Act, is preceded by the word "marriage" and, therefore, relates to the marriage of the individual concerned, i.e., the assesse and not to the marriage of any other person related to him in whatsoever degree, whether as his daughter or son; The expression "marriage of the individual" is unambiguous in its intent and does not admit of an interpretation, that it would include an amount received on the marriage of a daughter;

If the Legislature had intended that gifts received on the occasion of marriage of the assessee's children would be exempted, nothing would prevent the Legislature from adding the words "or his children", after the words "marriage of the individual"; Thus, taking into consideration the unambiguous legislative intent appearing in the proviso, the addition made to the appellant's income on account of gifts received on the occasion of his daughter's marriage was to be affirmed. Gift received by assessee on occasion of his daughter's marriage won't be exempt as the word individual appearing in proviso to sub-clause (vi) of sec. 56(2) relates to marriage of assesse and not of his daughter and such gifts would be taxable.

Case Study 3:

In case the share capital is raised in a foreign country and repatriated to India on a need basis from time to time for approved uses, can the gain arising on the balance sheet date due to fluctuation in foreign exchange, in respect of that part of share capital which is to be used as working capital, be treated as a revenue receipt?

Solution

In the case of Jagatjit Industries Ltd., 2011, assesse contended that entire gain arising on the balance sheet date due to fluctuation in foreign exchange, in respect of that part of share capital which is to be used as working capital in the foreign country, should be treated as capital receipt since the source of funds was capital in nature.

The Delhi High Court held that the gain due to the fluctuation in the foreign exchange arising on that part of share capital which is used for acquiring fixed assets should be treated as capital receipt and the remaining gain that arises on that part of the share capital that is used as working capital will be treated as a revenue receipt and consequently, would be chargeable to tax. The Delhi Court observed that in this case, the manner of utilization of such fund partly for acquiring fixed assets and partly as working capital was approved by Ministry of Finance. It was further held by High Court that the capital raised, whether in India or outside, can be utilized both for the purpose of acquiring fixed assets and to meet other expenses of the enterprise, that is working capital. For determining nature of receipt due consideration should be given to the source of fund and not to the ultimate use of the funds. Therefore, entire gain has to be capital receipt as the source of fund was capital in nature.

Case Study 4:

In case, there is no possibility of recovery of loans issued by a non-banking financial company (NBFC), which is non-performing assets (NPA) as per RBI guidelines, can the interest on such loan be treated as income of the NBFC, following mercantile system of accounting**?**

Solution:

In the present case, the assessee, a non-banking financial company (NBFC), gave interest bearing loans to group concerns. The NBFC is bound by the NBFC Prudential Norms (RBI) Directions, 1998 which states, inter alia, that the interest/discount or any other charges on non-performing assets (NPA) shall be recognized only when it is actually realized. Accordingly, the assessee did not credit the interest income in the profit and loss account relating to said loan amount which had become NPA as per the said norms.

Even the recovery of principal amount of the said loan was doubtful. The department did not dispute that the recovery of the said loan was doubtful but contended that since the assessee is following mercantile system of accounting, it is required to declare interest income on the above loan on accrual basis in the relevant assessment year, irrespective of the date of actual receipt of interest and hence the interest income should be treated as income of the assessee as per the provisions of section 5 and taxed accordingly. On the said issue, the Delhi High Court held that it was prudent decision on the part of the assessee, which the interest income on the non-performing asset, whose recovery was doubtful, was not accounted for in the books of account. Also, the assessee was bound by the RBI guidelines, which required the said treatment of the interest income. Therefore, in this case, the High Court held that there was no real accrual of interest income in the hands of assessee and, hence, it would not be chargeable to tax under section 5.

Case Study 5:

Smifs Securities Ltd. acquired the business of Y Ltd. under the scheme of amalgamation. Transferee paid an excess consideration over the net assets acquired from transferor as goodwill on which transferee claimed depreciation. The assessee's claim for depreciation on goodwill was rejected by the Assessing Officer on ground that goodwill was not an asset falling under Explanation 3 to section 32(1). Is the assessee entitled to depreciation on the value of goodwill considering it as an asset within the meaning of explanation 3(b) to section 32(1)?

Solution:

In this case, the assessee has paid an excess consideration over the value of net assets of the amalgamating company acquired by it, which is treated as goodwill, since the extra consideration was paid towards the reputation which the amalgamating company was enjoying in order to retain its existing clientele. The assessee had claimed depreciation on the said goodwill. However, the Assessing Officer contended that the goodwill is not an asset falling under Explanation 3 to section 32(1) and therefore, is not eligible for depreciation. On this issue, the Supreme Court observed that Explanation 3 to section 32(1) states that the expression 'asset' shall mean an intangible asset, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature.

A reading of the words 'any other business or commercial rights of similar nature' in Explanation 3(b) indicates that goodwill would fall under the said expression. In the process of amalgamation, the amalgamated company had acquired a capital right in the form of goodwill because of which the market worth of the amalgamated company stood increased. Therefore, it was held that 'Goodwill' is an asset under Explanation 3(b) to section 32(1) and depreciation thereon is allowable under the said section.

Case Study 6:

Where the provision for bad and doubtful debts under section 36(1)(viia) relates to rural advances, can deduction for actual write off under section 36(1)(vii) in respect of urban advances be restricted to the amount in excess of the credit balance in the provision for bad and doubtful debts made under section 36(1)(viia)?

Solution:

As per the provisions of section 36(1) (viia), a scheduled bank can claim deduction in respect of provision for bad and doubtful debts in respect of its rural advances. Further, as per proviso to section 36(1)(vii), deduction under section 36(1)(vii) in respect of bad and doubtful debts written off shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts created under section 36(1)(viia). The issue under consideration is whether the claim for bad debts under section

36(1)(vii) in respect of urban advances can be restricted to the amount in excess of the credit balance in the provision for bad and doubtful debts made under section 36(1)(viia) in respect of rural advances. In the case of Catholic Syrian Bank Ltd., the Supreme Court observed that the deduction on account of provision for bad and doubtful debts under section 36(1)(viia) relating to rural advances of a scheduled bank is distinct and independent of the provisions of section 36(1)(vii), where such bad debts are in respect of urban advances. In effect, where the provision under section 36(1)(viia) is in respect of rural advances and the bad debts write off under section 36(1)(vii) is in respect of urban advances, the restriction contained in the proviso to section 36(1)(vii) would not apply. The Supreme Court held that in such a case, the benefit of deduction under section 36(1) (vii) in respect of urban advances would be available to the bank, subject to provisions of section 36(2).

Case Study 7:

Can a company engaged in the business of owning, running and managing hotels claim interest on borrowed funds, used by it for investing in the equity share capital of a wholly owned subsidiary company, as deduction where the subsidiary company was formed for exercising effective control of new hotels acquired by the parent company under its management?

Solution:

In the case of Tulip Star Hotels Ltd., the assessee-company, that is, Tulip Star Hotels Ltd. was engaged in the business of owning, running and managing hotels. The assessee had borrowed certain funds which it had utilized to subscribe to the equity capital of the subsidiary company.

The investment in the wholly owned subsidiary was for effective control of the hotels acquired by the assessee-company under its management and the subsidiary company also used the funds for the said purpose. The assessee paid interest on the borrowed money. This interest liability incurred by the assessee was claimed by it as deduction under section 36(1) (iii) on the ground that it was business expenditure. The Assessing Officer refused to allow the expenditure. However, the Commissioner (Appeals) reversed the decision of the Assessing Officer and this opinion was confirmed by the Tribunal. The High Court held that the assessee was in the business of owning, running and managing hotels. For the effective control of new hotels acquired by the assessee under its management it had invested in a wholly owned subsidiary company. The expenditure incurred was for business purposes and was thus allowable under section 36(1) (iii).

Note - Under section 36(1) (iii), the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession is allowable as deduction. In this case, it has been held that interest paid on capital borrowed for investment in a subsidiary company is allowable as deduction since the subsidiary company was formed to carry on the business of the parent company in a more effective manner.

Case Study 8:

Assessee was engaged in business of manufacturing of textiles - It had four manufacturing units out of which one unit located in Delhi had to be closed down as according to master plan in Delhi, it as located in non-confirming area - It claimed deduction of expenses pertaining to closed unit on account of retrenchment compensation paid to employees and interest on monies borrowed for payment of retrenchment compensation, provident fund and legal expenses - Assessing Officer disallowed assessee's claim on ground that closure of unit would amount to closure of business. Is the expenditure incurred on payment of retrenchment compensation and interest on money borrowed for payment of retrenchment compensation on closure of one of the textile manufacturing units of the assessee-company revenue in nature?

Solution:

In the case of DCM Ltd., The assessee-company had four textile units, out of which one unit had to be closed down as it was located in a non-conforming area, while the other three units continued to carry on business. The company claimed deduction of retrenchment compensation paid to employees of the unit which had been closed down and interest on money borrowed for payment of retrenchment compensation. The Revenue contended that the textile unit was a separate business maintaining separate books of account and engaging separate workers, and hence, with the closure of the unit, the assessee should not be allowed deduction of the aforementioned expenses. The issue under consideration was whether closure of one textile mill unit would amount to closure of the business as contended by the Revenue.

The Tribunal observed that there was no closure of business since the textile mill unit was only a part of the textile manufacturing operations, which continued even after closure of the textile mill unit, as the assessee-company continued in the business of manufacturing of textiles in the remaining three units. The assessee prepared a consolidated profit and loss account and balance sheet of all its manufacturing units taken together; the control and management of the assessee was centralized in the head office and also all important policy decisions were taken at the head office. Also, the head office provided funds required for various units and there were common marketing facilities for all the textile units.

The Tribunal applied the tests laid down by the Apex Court in CIT v. Prithvi Insurance Co. (1967) 63 ITR 632 and arrived at the conclusion that there was interconnection, interlacing and unity of control and management, common decision making mechanism and use of common funds in respect of all the four units. The High Court concurred with these findings of the Tribunal and accordingly, held that deduction was allowable in respect of expenditure on payment of retrenchment compensation and interest on money borrowed for payment of retrenchment compensation.

Note - In this case, the payment of compensation to workers on closure of a textile mill unit is treated as revenue expenditure since after closure of the unit, the remaining business continued and there was inter-connection in the functioning of the different units. Therefore, it follows that if compensation is paid to workers on closure of the entire business, the same would be a capital expenditure.

Case Study 9:

Would non-resident match referees and umpires in the games played in India fall within the meaning of sportsmen to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer?

Solution:

In the case of Indcom, the Calcutta High Court observed that, in order to attract the provisions of the section 194E, the person should be a non-resident sportsperson or non-resident sports association or institution whose income is taxable as per the provisions of section 115BBA.

The umpires and the match referees can be described as professionals or technical persons who render professional or technical services, but they cannot be said to be either non-resident sportsmen (including an athlete) or non-resident sports association or institution so as to attract the provisions of section 115BBA and consequently, the provisions of tax deduction at source under section 194E are also not attracted in this case.

Though for the purpose of section 194J, match referees and umpires are considered as professionals, the tax deduction provisions thereunder are attracted only in case where the deductee is a resident individual, which is not so in the present case. Therefore, although the payments made to non-resident umpires and the match referees are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the assessee is not liable to deduct tax under section 194E.

Note - It may be noted that since income has accrued and arisen in India to the non- resident umpires and match referees, the TDS provisions under section 195 would be attracted and tax would be deductible at the rates in force.

Case Study 10:

Assessee society received `2 lakhs from WAFM for holding a national convention for farmers - According to assessee, it was an advance for holding convention which could not be held in that year but was held in subsequent year and amount was utilized therefore. Assessing Officer denied benefit of accumulation as he was of view that objects for which accumulation was sought were not particularized in as much as they covered entire range of objects of trust. Whether the Tribunal was right in negating the assessee's claim for accumulation of unspent income?

Solution:

In the case of Bharat Krishak Samaj, The assessee had received an amount of Rs.2,00,000 from WAFM for the purposes of holding a national convention of farmers. According to the assessee, the amount was received by way of advance for holding the convention but the convention could not be held in that year and was only held in the subsequent year. The assessee claimed that this amount constituted a capital receipt in its hands. The Assessing Officer rejected the claim. The Tribunal held that the amount was assessable under section 2(24)(iia).

The High Court held that there was nothing in the record of the case to suggest that the amount was actually received by the assessee as an advance as contended. The amount received was for holding a national convention. It is also not clear from the record whether the national convention of farmers was to be held for and on behalf of the donor or was to be utilised for holding a national convention of the assessee. Under the circumstances, in view of the failure of the assessee to explain the receipt of Rs.2,00,000 the provisions of section2(24)(iia) of the Act would be attracted and the amount must be treated as income of the assessee and not as a capital receipt.