

Significant legal decisions – Income-tax

1. **Can the expenditure incurred by the assessee on techno-economic feasibility report for the manufacture of a new product be eligible for deduction under section 35D?**

CIT v. Tamil Nadu Road Development Co. Ltd. (2009) 316 ITR 380 (Mad.)

The assessee-company engaged in the business of implementation of the industrial policy and creation of infrastructure facilities in the State of Tamil Nadu on a commercial framework claimed the deduction in respect of the expenditure incurred on account of techno-economic feasibility report for the manufacture of new products. The Assessing Officer disallowed the deduction treating it as capital expenditure. The Commissioner (Appeals) allowed the assessee's claim on the finding that the expenses incurred were covered under section 35D of the Income-tax Act, 1961, as the expenses were incurred to find out new ideas by conducting test studies and pilot studies for improving the existing business and, therefore, could not be treated as capital expenditure. This was confirmed by the Tribunal and the High Court.

2. **Is the expenditure incurred by the assessee towards commitment charges for issuing debentures deductible as business expenditure, where the borrowing was for the purposes of meeting the working capital needs of the existing business?**

CIT v. Mihir Textiles Ltd. (2009) 316 ITR 403 (Guj.)

On this issue, the High Court observed that money borrowed by issue of debentures is in the nature of a loan and cannot assume the characteristic of investment. Therefore, the expenditure in the nature of commitment charges at the time of issuing such debentures would be on revenue account only. Hence, the commitment charges were allowable as deduction under section 36(1).

Note - In this case, the Gujarat High Court has followed the decision of the Supreme Court in *Deputy CIT v. Core Health Care Ltd. [2008] 298 ITR 194*.

3. **Can an AOP be constituted by inheritance under will?**

CIT v. Laxmi Pd. and Sons (2009) 316 ITR 330 (All.)

An association of persons is a voluntary association of two or more persons who join together for a particular purpose which may not necessarily be with the object of deriving of income or profits or gains. The association should be voluntary on the part of the persons forming the same irrespective of the object of associating. Forced association of persons on account of inheriting joint property under a will or such other circumstances not being voluntary would not constitute such joint legatees as "association of persons" for the purpose of section 2(31).

4. **Is it necessary that there be a written agreement between persons to prove the status of association of persons, in a case where the accounts seized from the persons prove joint investments and sharing of profits in business?**

CIT v. T. George and M. Syed Alavi (2009) 316 ITR 333 (Ker.)

During the search conducted at the residential premises of two assesseees it was found that the two persons were engaged in contract work for slaughter tapping and sale of rubber trees. The assessments were based on entries in the seized records and available evidence

including statements recorded from the assessees. When a notice under section 147 was issued for taxing income escaping assessments in the hands of the association of persons constituting both the assessees, both of them filed individual returns denying the existence of an association of persons. The Tribunal held that there was nothing to indicate the intention of the members of the association of persons to carry on business together and no written agreement for slaughter tapping for one estate was recovered by the Department.

The High Court observed that the accounts seized from both members of association of persons were mutually complementary and proved joint investments in slaughter tapping and receipt on sale of rubber latex and timber. The assessees had admitted that slaughter tapping of one estate was undertaken by them together as association of persons. Failure on the part of the Department to recover a written agreement in respect of the other estate would not affect the validity of the assessment because the accounts were seized from both the assessees and complementary to each other conclusively establishing that slaughter tapping was done by the assessees together in this estate. The accounts seized from the assessees proved that both undertook business together and shared the profit.

The High Court held that the status of association of persons need not be proved through an agreement. The business carried on by the members together was proved through accounts recovered on search, which justifies the assessment of the assessees in that status.

5. Can the Duty Entitlement Passbook Scheme (DEPB) benefits and Duty Drawback be treated as profit derived from the business of the industrial undertaking to be eligible for deduction under section 80-IB?

Liberty India v. CIT (2009) 317 ITR 218 (SC)

On this issue, the Supreme Court observed that DEPB / Duty drawback are incentives which flow from the schemes framed by the Central Government or from section 75 of the Customs Act, 1962. Section 80-IB provides for the allowing of deduction in respect of profits and gains derived from eligible business. However, incentive profits are not profits derived from eligible business under section 80-IB. They belong to the category of ancillary profits of such undertaking. Profits derived by way of incentives such as DEPB/Duty drawback cannot be credited against the cost of manufacture of goods debited in the profit and loss account and they do not fall within the expression "profits derived from industrial undertaking" under section 80-IB. Hence, Duty drawback receipts and DEPB benefits do not form part of the profits derived from the eligible business for the purpose of the deduction under section 80-IB.

6. Can the reimbursement of expenses towards customs duty be included for computing profits under section 44BB?

Director of Income Tax (International Taxation) v. Schlumberger Asia Services Ltd. (2009) 317 ITR 156 (Uttarakhand)

In this case, the Assessing Officer noticed that the assessee, a non-resident company, had not offered for tax under section 44BB, the reimbursement of expenses, which include customs duty also. The Assessing Officer brought to tax these sums. The Commissioner (Appeals) partly allowed the appeal holding that the customs duty paid in importing the equipment for rendering services does not form part of the amount taxable under section

44BB. It was observed that for import of machinery or equipment, liability to pay the customs duty was on ONGC, who had hired the services of the assessee-company in contract and there could not be any element of profit in reimbursement of the customs duty, paid by the assessee.

The High Court held that reimbursement of expenses towards the customs duty paid by the assessee, being statutory in nature, could not form part of amount for the purposes of deemed profits, unlike the other amounts received towards reimbursement. Therefore, same would not form part of the amount taxable under section 44BB.

7. Can extension of the maximum period of retention of 15 days of books of accounts and documents impounded be granted indefinitely?

Subha and Prabha Builders P Ltd. vs. ITO (2009) 318 ITR 29 (Karn).

On this issue, the High Court observed that section 131 confers on the income-tax authorities the power to impound and retain books of account or other documents for a maximum period of 15 days, after recording of reason for doing so. Extension can be granted with the prior approval of the higher authority for a reasonable period and not for an indefinite period.

The High Court held that the extension can only be a one time exercise and supplementing the outer limit of 15 days for few more days depending on the circumstances. Since the outer limit is specified in days, the period can be extended only in days and not in months or years.

8. Would the provisions of deemed dividend under section 2(22)(e) be attracted in respect of financial transactions entered into in the normal course of business?

CIT v. Ambassador Travels (P) Ltd. (2009) 318 ITR 376 (Del.)

Under section 2(22)(e), loans and advances made out of accumulated profits of a company in which public are not substantially interested to a beneficial owner of shares holding not less than 10% of the voting power or to a concern in which such shareholder has substantial interest is deemed as dividend. However, this provision would not apply in the case of advance made in the course of the assessee's business as a trading transaction.

The assessee, a travel agency, has regular business dealings with the two concerns dealing with holiday resorts and tourism industry. The High Court observed that the assessee was involved in booking of resorts for the customers of these companies and entered into normal business transactions as a part of its day-to-day business activities. The High Court held that financial transactions cannot under any circumstances be treated as loans or advances received by the assessee from these concerns for the purpose of application of section 2(22)(e).

9. Are interest income earned by the assessee on fixed deposits with a bank and other interest income eligible for deduction under section 80-IA?

CIT v. Jagdishprasad M. Joshi (2009) 318 ITR 420 (Bom.)

Relevant Section: 80-IA

On this issue, the High Court concurred with the decision of the Tribunal holding that the interest income earned by the assessee on fixed deposits with the bank and other interest

income were in the nature of business income and should be considered as part of business profit for the purpose of granting deduction under section 80-IA.

10. Would the payments made by the assessee to MTNL / other companies for the services provided through interconnect / port / access / toll attract TDS under section 194J?

CIT v. Bharti Cellular Ltd. (2009) 319 ITR 139 (Del.)

The assessee-companies engaged in providing cellular telephone facilities to their subscribers, had been granted licences by the Department of Telecommunication for operating in specified circles. The licences stipulated that the Department of Telecommunication/MTNL/BSNL would continue to operate in the service areas in respect of which licences were issued. Where calls were to be made by subscribers of one network to another network, such calls were to be routed through MTNL/BSNL through interconnection points known as ports. For providing interconnection, the assessees entered into agreements with MTNL/BSNL, which were regulated by the Telecom Regulatory Authority of India. Under the agreement the assessees had to pay interconnection, access charges and port charges to the interconnection providers. The Department was of the view that interconnect/port access charges were liable for tax deduction at source in view of the provisions of section 194J on the understanding that these charges were in the nature of fee for technical services.

The High Court held that the services rendered relating to interconnection, port access did not involve any human interface and, therefore, the services could not be regarded as "technical services" as contemplated under section 194J. The interconnect/port access facility was only a facility to use the gateway and the network of MTNL/other companies. MTNL or other companies did not provide any assistance to the assessees in managing, operating, setting up their infrastructure and networks. Even though the facility of interconnection and port access provided by MTNL/other companies was "technical" in the sense that it involved sophisticated technology, the expression "technical service" is not to be construed in the abstract and general sense but in the narrower sense as circumscribed by the expressions "managerial service" and "consultancy service" under Explanation 2 to section 9(1)(vii). The expression "technical service" would have reference to only technical service rendered by a human. It would not include any service provided by machines or robots. The interconnect charges/port access charges could not, therefore, be regarded as fees for technical services, and hence TDS provisions under section 194J are not attracted.

11. Can an assessee manufacturing textile goods claim additional depreciation under section 32(1)(ia) on setting up of a windmill?

CIT v. VTM Limited (2009) 319 ITR 336 (Mad.)

The assessee is a company engaged in the business of manufacture of textile goods. It had claimed additional depreciation on the setting up of wind mills for generation of power. The Revenue contended that the setting up of a windmill for generation of power had absolutely no connection with the business of the company i.e. for the manufacture of textile goods, and, therefore, the company was not entitled to claim the additional depreciation under section 32(1)(ia).

The High Court held that in order to claim the benefit of section 32(1)(ia), what is required to be satisfied is that the new machinery or plant should have been acquired and installed after

March 31, 2002 (*March, 31, 2005, as per the amended provisions*), by an assessee, who was already engaged in the business of manufacture or production of any article or thing. The provision does not state that the setting up of a new machinery or plant should have any operational connectivity to the article or thing that is already being manufactured by the assessee. Hence, the assessee is entitled to additional depreciation on setting up of a wind mill.

- 12. Where the hotel industry was established based on subsidy announced by the State Government, can such subsidy received be treated as a revenue receipt solely due to the reason that the same is received by the assessee after completion of the hotel projects and commencement of the business?**

CIT v. Udipi Builders P. Ltd. (2009) 319 ITR 440 (Kar.)

The assessee-company treated the amount of subsidy received from the State Government, as a capital investment. The subsidy was granted by the State Government to encourage the hotel industry. The Assessing Officer opined that the same was a revenue receipt. The Commissioner (Appeals) held that the subsidy had been granted to the assessee by the State Government as per the package of incentives and concessions and that it was towards investment and not a revenue receipt. The Tribunal confirmed the order passed by the Commissioner (Appeals).

The Revenue filed an appeal to the High Court contending that since the subsidy is received by the assessee after completion of the hotel project and commencing of the business, such receipt has to be taken as a revenue receipt and not a capital investment.

The High Court held that the hotel industry was established based on the subsidy announced by the State Government to encourage tourism and the State Government was in the habit of releasing the subsidy amount depending upon the budgetary allocation in each year. In several cases, the State Government had released the subsidy amount even after ten years of the commencement of the project. Therefore, the subsidy received has to be treated as a capital receipt and would not be liable to tax.

- 13. Can the interest under sections 234B and 234C, be levied on the basis of interest calculation given in the computation sheet annexed to the assessment order, though the direction to charge such interest is not mentioned in the assessment order?**

CIT v. Assam Mineral Development Corporation Ltd. (2010) 320 ITR 149 (Gau.)

The Assessing Officer determined the total income of the assessee for the year in question and issued an order. No specific order levying interest was recorded by the Assessing officer. However, in the computation sheet annexed to the assessment order, interest under 234B and 234C was computed while determining the total sum payable by the assessee. On appeal the Commissioner of Income-tax (Appeals) deleted the interest charged under sections 234B and 234C.

The High Court held that, as per the judgment of the Supreme Court in case of *CIT v. Anjum M. H. Ghaswala (2001) 252 ITR 1*, the interest leviable under sections 234B and 234C is mandatory in nature. The computation sheet in the form prescribed signed or initialed by the Assessing Officer is an order in writing determining the tax payable within the meaning of section 143(3). It is an integral part of the assessment order. Hence, the levy of interest and

the basis for arriving at the quantum thereof have been explicitly indicated in the computation sheet and therefore, such interest has to be paid.

- 14. Is an employee liable to pay interest under sections 234A, 234B and 234C, where the employer has failed to deduct tax at source, but has later paid such tax with interest under section 201(1A)?**

CIT v. Emilio Ruiz Berdejo (2010) 320 ITR 190 (Bom.)

The High Court held that the person who fails to deduct tax is liable to pay interest under section 201(1A). Sections 234A, 234B and 234C cast liability on the assessee to pay interest for the default committed by him in the circumstances mentioned in the sections. Interest charged under sections 234A, 234B and 234C are compensatory and not in the nature of penalty.

Therefore, where the deductor had already discharged tax liability with interest payable under section 201(1A), no further interest could be claimed by the Revenue from the deductee-employee either under section 234A or section 234B or section 234C.

- 15. Would the doctrine of merger apply for calculating the period of limitation under section 154(7)?**

CIT v. Tony Electronics Limited (2010) 320 ITR 378 (Del.)

The issue under consideration is whether the time limit of 4 years as per section 154(7) would apply from the date of original assessment order or the order of the Appellate Authority.

The High Court held that once an appeal against the order passed by an authority is preferred and is decided by the appellate authority, the order of the Assessing Officer merges with the order of the appellate authority. After merger, the order of the original authority ceases to exist and the order of the appellate authority prevails. Thus, the period of limitation of 4 years for the purpose of section 154(7) has to be counted from the date of the order of the Appellate Authority.

Note - In this case, the Delhi High Court has followed the decision of the Supreme Court in case of Hind Wire Industries v. CIT (1995) 212 ITR 639.

- 16. Can long-term capital gain exempted by virtue of erstwhile section 54E be included in the book profit computed under erstwhile section 115J?**

N. J. Jose and Co. (P.) Ltd. v. ACIT (2010) 321 ITR 0132 (Ker.)

The assessee claimed exemption under section 54E on the income from long-term capital gains by depositing amounts in specified assets in terms of the said provision. In the computation of book profit under section 115J, the assessee claimed exclusion of capital gains because of exemption available on it by virtue of section 54E. The Assessing Officer reckoned the book profits including long-term capital gains for the purpose of assessment under section 115J.

The High Court held that once the Assessing Officer found that total income as computed under the provisions of the Act was less than 30 per cent of the book profit, he had to make the assessment under section 115J which does not provide for any deduction in terms of section 54E. As long as long-term capital gains are part of the profits included in the profit

and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956, capital gains cannot be excluded unless provided under the Explanation to section 115J(1A).

Note – It may be noted that the rationale of this decision would apply even where minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18% of book profits. If an assessee has claimed exemption under section 54EC by investing in bonds of NHAI/ RECL, within the prescribed time, the long term capital gains so exempt would be taken into account for computing book profits under section 115JB for levy of minimum alternate tax (MAT), since Explanation 1 to section 115JB does not provide for such deduction. Further, it may be noted that even the long term capital gain exempt under section 10(38) is included for computation of book profit under section 115JB.

- 17. In a case where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, would the assessee-firm be entitled to deduction in respect of remuneration paid to partners?**

CIT v. Anil Hardware Store (2010) 323 ITR 0368 (HP)

Relevant section: 40(b)(v)

The partnership deed of the assessee firm provided that in case the book profits of the firm are up to Rs. 75,000, then the partners would be entitled to remuneration up to Rs. 50,000 or 90 per cent of the book profits, whichever is more. In respect of the next Rs. 75,000, it is 60 per cent and for the balance book profits, it is 40 per cent. Thereafter, it is further clarified that the book profits shall be computed as defined in section 40(b) of the Income-tax Act, 1961, or any other provision of law as may be applicable for the assessment of the partnership firm. It has also been clarified that in case there is any loss in a particular year, the partners shall not be entitled to any remuneration. Clause 7 of the partnership deed laid down that the remuneration payable to the partners should be credited to the respective accounts at the time of closing the accounting year and clause 5 stated that the partners shall be entitled to equal remuneration.

The High Court held that the manner of fixing the remuneration of the partners has been specified in the partnership deed. In a given year, the partners may decide to invest certain amounts of the profits into other venture and receive less remuneration than that which is permissible under the partnership deed, but there is nothing which debars them from claiming the maximum amount of remuneration payable in terms of the partnership deed. The method of remuneration having been laid down, the assessee-firm is entitled to deduct the remuneration paid to the partners under section 40(b)(v) of the Income-tax Act.

Note –

- (1) Payment of remuneration to working partners is allowed as deduction if it is authorized by the partnership deed and is subject to the overall ceiling limits specified in section 40(b)(v). The limits for partners' remuneration under section 40(b)(v) has revised upwards and the differential limits for partners' remuneration paid by professional firms and non-professional firms have been removed. On the first Rs.3 lakh of book profit or in***

case of loss, the limit would be the higher of Rs.1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

- (2) The CBDT had, vide Circular No. 739 dated 25-3-1996, clarified that no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.

In this case, since the partnership deed lays down the manner of quantifying such remuneration, the same would be allowed as deduction subject to the limits specified in section 40(b)(v).

18. Does the Central Board of Direct Taxes (CBDT) have the power under section 119(2)(b) to condone the delay in filing return of income?

Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441 (Del.)

The assessee filed his return of income which contains a claim for carry forward of losses a day after the due date. The delay of one day in filing the return of income was due to the fact that the assessee had not reached the Central Revenue Building on time because he was sent from one room to the other and by the time he reached the room where his return was to be accepted, it was already 6.00 p.m. and he was told that the return would not be accepted because the counter had been closed. These circumstances were recorded in the letter along with the return of income delivered to the office of the Deputy Commissioner of Income-tax on the very next day. Later on, the CBDT, by a non-speaking order, rejected the request of the assessee for condonation of delay in filing the return of income under section 119.

The issue under consideration is whether the CBDT has the power under section 119(2)(b) to condone the delay in filing return of income.

The High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown sufficient reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the petitioner. Therefore, the Court held that the delay of one day in filing of the return was to be condoned.

*Note – Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or **any other relief under the Act** after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of a loss return is relatable to a claim arising under the category of any other relief available under the Act. Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.*

19. Can the notional interest on interest free deposit received by the assessee in respect of a shop let out on rent be brought to tax as “Business income” or “Income from house property”?

CIT v. Asian Hotels Ltd. (2010) 323 ITR 0490 (Del.)

The assessee had received interest free deposit in respect of shops given on rent. The Assessing Officer added to the assessee's income notional interest on the interest free deposit at the rate of 18 per cent simple interest per annum on the ground that by accepting the interest free deposit, a benefit had accrued to the assessee which was chargeable to tax under section 28(iv).

The High Court held that Section 28(iv) is concerned with business income and brings to tax the value of any benefit on perquisite, whether convertible into money or not arising from the business or exercise of the profession. Section 28(iv) can be invoked only where the benefit or amenity or perquisite is other than cash. In the instant case, the Assessing Officer has determined the monetary value of the benefit stated to have accrued to the assessee by adding a sum that constituted 18 per cent simple interest on the deposit. Hence, section 28(iv) is not applicable.

Section 23(1)(a) deals with the determination of the annual letting value of such property for computing the income from house property. It provides that the annual letting value is deemed to be the sum for which the property might reasonably be expected to be let from year to year. This contemplates the possible rent that the property might fetch and not certainly the interest in fixed deposit that may be placed by the tenant with the landlord in connection with the letting out of such property.

Thus, the notional interest is not assessable as business income or as income from house property.

- 20. Can the valuation done by any authority of the State Government for the purpose of payment of stamp duty in respect of land or building be taken as actual sale consideration received by the purchaser?**

CIT v. Chandni Buchar (2010) 323 ITR 0510 (Pun. & Har.)

The Assessing Officer added the difference between purchase price disclosed in the sale deed and purchase price of the property adopted for the purpose of paying the stamp duty to the total income of the assessee as income from unexplained sources. The Commissioner of Income-tax (Appeals) deleted this addition by holding that section 50C is a deeming provision for the purpose of bringing to tax the difference as capital gain. Further, he also held that in the absence of any legally acceptable evidence, valuation done for the purpose of section 50C would not represent actual consideration passed on to the seller. The Tribunal also held that valuation done by any State agency for the purpose of stamp duty would not *ipso facto* substitute the actual sale consideration as being passed on to the seller by the purchaser in the absence of any admissible evidence. The Assessing Officer is obliged to bring on record positive evidence indicating the fact that the assessee has paid anything more than the sum disclosed in the purchase deed. In this case, the assessee has discharged the burden of proving the sale consideration as projected in the sale deed by producing original bank statement.

The High Court, therefore, held that the view taken by the Tribunal while accepting the order of the Commissioner of Income-tax (Appeals) does not suffer from any legal infirmity.

- 21. Does the Appellate Tribunal have the power to recall its own order under section 254(2)?**

CIT v. Earnest Exports Ltd. (2010) 323 ITR 577 (Bom.)

In this case, the High Court observed that the power under section 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters. Section 254(2) is not a carte blanche for the Tribunal to change its own view by substituting a view which it believes should have been taken in the first instance. Section 254(2) is not a mandate to unsettle decisions taken after due reflection.

In this case, the Tribunal, while dealing with the application under section 245(2), virtually reconsidered the entire matter and came to a different conclusion. This amounted to a reappraisal of the correctness of the earlier decision on merits, which is beyond the scope of the power conferred under section 254(2).

22. Can the Assessing Officer reopen an assessment on the basis of merely a change of opinion?

Aventis Pharma Ltd. v. ACIT (2010) 323 ITR 0570 (Bom.)

The power to reopen an assessment is conditional on the formation of a reason to believe that income chargeable to tax has escaped assessment. The existence of tangible material is essential to safeguard against an arbitrary exercise of this power.

In this case, the High Court observed that there was no tangible material before the Assessing Officer to hold that income had escaped assessment within the meaning of section 147 and the reasons recorded for reopening the assessment constituted a mere change of opinion. Therefore, the reassessment was not valid.

23. Can the penalty under section 271(1)(c) be imposed where the assessment is made by estimating the net profit at a higher percentage applying the provisions of section 145?

CIT v. Vijay Kumar Jain (2010) 325 ITR 0378 (Chhattisgarh)

In this case, the Assessing Officer levied penalty under section 271(1)(c) on the basis of addition made on account of application of higher rate of net profit by applying the provisions of section 145, consequent to rejection of book results by him.

On this issue, the High Court held that the particulars furnished by the assessee regarding receipts in the relevant financial year had not been found inaccurate and it was also not the case of revenue that the assessee concealed any income in his return. Thus, penalty could not be imposed.

The High Court placed reliance on the ruling of the Supreme Court in *CIT v. Reliance Petroproducts P. Ltd. (2010) 322 ITR 158*, while considering the applicability of section 271(1)(c). In that case, the Apex Court had held that in order to impose a penalty under the section, there has to be concealment of particulars of income of the assessee or the assessee must have furnished inaccurate particulars of his income. Where no information given in the return is found to be incorrect or inaccurate, the assessee cannot be held guilty of furnishing inaccurate particulars.

24. In determining the period of holding of a capital asset received by a partner on dissolution of firm, can the period of holding of the firm be taken into account?

P. P. Menon v. CIT (2010) 325 ITR 122 (Ker.)

The assessee was a partner in a firm which owned a hospital building and land. The firm was dissolved and the entire assets including the hospital building and land were taken over by the assessee. The assessee sold the hospital building and the land within three days of dissolution. He, however, claimed that the period of holding should be reckoned by including the period when he was a partner of the firm. He contended that since the total period has more than 36 months, the capital gain was to be treated as a long-term capital gain.

The High Court held that the benefit of taking the cost of acquisition as the cost to the previous owner under section 2(42A) read with section 49(1)(iii)(b) can be availed only if the dissolution of the firm had taken place at any time before April 1, 1987. In this case the firm was dissolved on April 15, 2001 and therefore the benefit of these sections was not available to the assessee. Therefore, the period of holding of the asset by the assessee in this case was only from the date of dissolution of the firm. Since the assessee sold the property within three days of acquiring the same the gains have to be treated as short-term capital gain.

- 25. Can the amount incurred by the assessee for replacing the old mono sound system in its cinema theatre with a new Dolby stereo system be treated as revenue expenditure?**

CIT v. Sagar Talkies (2010) 325 ITR 133 (Karn.)

On this issue, the High Court observed held that the assessee had provided certain amenities to its customers by replacing the old system with a better sound system and by introducing such system, the assessee had not increased its income in any way. The assessee installed dolby stereo system instead of repairing the existing old stereo system. This had not benefited the assessee in any way with regard to the total income since there was no change in the seating capacity of the theatre or increase in the tariff rate of the ticket. In such a case,, the expenditure on such change of sound system could not be considered capital in nature.

- 26. Can the interest payable by the assessee company on loan availed from the directors for the purchase of an asset be added to the cost of acquisition of the asset while computing long term capital gain, where the resolution to pay interest has been passed after the date of sale?**

CIT v. Sri Hariram Hotels P. LTD (2010) 325 ITR 136 (Karn.)

The assessee borrowed loans from some of its directors and purchased an immovable property in order to put up a hotel building. However, the project did not materialize on account of various reasons. Ultimately, the assessee sold the property. While filing the return, it claimed the interest paid to the directors on the loan borrowed from them in order to purchase the property as cost of acquisition for computation of the capital gain. The Assessing Officer disallowed the claim made by the assessee, but the Tribunal allowed it.

The main contention of the Revenue was that it was after the sale of property that a resolution was passed by the company to pay the interest to the Directors, and as such, there was no liability for the company to pay the interest as on the date of sale.

The High Court, dismissing the appeal, held that since the property had been purchased out of the loans borrowed from the directors, any interest paid thereon had to be included while calculating the cost of acquisition of the asset.

Note: In this case, it has been established that the date of passing resolution for payment of interest is not relevant since interest generally starts accruing as soon as the loan is taken.

27. **Would there be an obligation to deduct tax at source under section 195 in respect of payments to non-residents if such payments do not give rise to income chargeable under the provisions of the Income-tax Act, 1961?**

GE India technology Centre P. Ltd. v. CIT and Another (2010) 327 ITR 456 (SC)

The Apex Court observed that the expression “chargeable under the provisions of the Act” in section 195(1) shows that the remittance has got to be a trading receipt, the whole or a part of which is liable to tax in India. If the tax is not so assessable, there is no question of tax at source being deducted. A person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax under the Act.

Note – In this case, the Apex Court remitted the case to the High Court to decide whether or not the amount paid by the appellant to the foreign software suppliers constituted “royalty”. Only if the amount is in the nature of royalty which is deemed to accrue or arise in India, then, tax is liable to be deducted at source under section 195.

28. **Does the High Court have an inherent power under the Income-tax Act, 1961 to review an earlier order passed on merits?**

Deepak Kumar Garg v. CIT (2010) 327 ITR 448 (MP)

The power to review is not an inherent power and must be conferred by law specifically by express provision or by necessary implication. The appellate jurisdiction of the High Court carries with it statutory limitations under the statute, unlike the extraordinary powers which are enjoyed by the Court under article 226 of the Constitution of India.

It was observed that, keeping in view the provisions of section 260A(7), the power of re-admission/restoration of the appeal is always enjoyed by the High Court. However, such power to restore the appeal cannot be treated to be a power to review the earlier order passed on merits.

29. **Can freight subsidy arising out of the scheme of Central Government be treated as a “profit derived from the business” for the purposes of section 80-IA?**

CIT v. Kiran Enterprises (2010) 327 ITR 520 (HP)

Section 80-IA provides for deduction in respect of profits and gains derived from eligible business. In this case, the Central Government had framed a scheme whereby freight/transport subsidy was provided to industries set up in remote areas where rail facilities were not available and some percentage of the transport expenses incurred to transport raw material/finished goods to or from the factory was subsidized.

The issue under consideration is whether such freight subsidy arising out of the scheme of Central Government can be treated as a “profit derived from the business” for the purposes of section 80-IA.

On appeal, the High Court held that the transport subsidy received by the assessee was not a profit derived from business since it was not an operational profit. The source was not the business of the assessee but the scheme of Central Government. The words “derived from” are narrower in connotation as compared to the words “attributable to”. Therefore, the freight subsidy cannot be treated as profits derived from the business for the purposes of section 80-IA.

30. Can exemption under section 54B be denied solely on the ground that the new agricultural land purchased is not wholly owned by the assessee, as the assessee's son is a co-owner as per the sale deed?

CIT v. Gurnam Singh (2010) 327 ITR 278 (P&H)

The assessee claimed deduction under section 54B in respect of the land purchased by him along with his son out of the sale proceeds of the agricultural land. However, the same was denied by the Assessing Officer on the ground that the land was registered in the name of the assessee's son.

The Tribunal observed that the agricultural land sold belonged to the assessee and the sale proceeds were also used for purchasing agricultural land. The possession of the said land was also taken by the assessee. It is not the case that the sale proceeds were used for other purposes or beyond the stipulated period. The only objection raised by the Revenue was that the land was registered in the name of his son. Therefore, it cannot be said that the capital gains were in any way misused for any other purpose contrary to the provisions of law.

In this case, the High Court concurred with the Tribunal's view that merely because the assessee's son was shown in the sale deed as co-owner, it did not make any difference. It was not the case of the Revenue that the land in question was exclusively used by the son. Therefore, the assessee was entitled to deduction under section 54B.