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 assessees 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 (Uttrakhand)

   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)(iia) 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)(iia).

The High Court held that in order to claim the benefit of section 32(1)(iia), 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. Udupi 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 15% of book profits (for A.Y. 2010-11). 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.