

Part A

Legal Updates

CLUBBING OF INCOME / ASSETS

Section / Topic Name : WT

290 ITR 0522- COMMISSIONER OF WEALTH-TAX VS. CHIKMAGALUR CLUB (KARNATAKA HIGH COURT)

An association of persons cannot be taxed under section 3 of the Wealth-tax Act, 1957. That is why an amendment was made by the Finance Act, 1981, with effect from April 1, 1981, whereby an association of persons can be subjected to wealth-tax, when the individual shares of the members of the association in the income or assets or both of the association on the date of its formation or any time thereafter are indeterminate or unknown. (21AA)

The assessee, a club registered under the provisions of the Karnataka Societies Registration Act, 1960, had declared nil wealth on the ground that it was not susceptible to the provisions of the Wealth-tax Act, 1957, since it was only an association of persons providing recreation facilities to its members. The Assessing Officer rejecting the claim of the assessee, assessed the wealth of the assessee in the status of an individual and charged wealth-tax.

Held, that the finding was that the assessee was an association of persons, the members were the owners of the assets and the individual shares of the members as the owners of the assets and the individual shares of the members in the income or assets or both of the association on the date of formation or any time thereafter were indeterminate or unknown. Accordingly, the assessee was exigible to wealth-tax as per 21AA.

270 ITR 0379- COMMISSIONER OF WEALTH-TAX VS. S.K. GOLECHA (RAJASTHAN HIGH COURT)

Valuation is an estimate. Where the last year's valuation was not a matter of dispute, enhancement of such value by 10 per cent. to arrive at the current value is neither unreasonable nor excessive as was held in CWT v. S. K. Golecha [2004] 270 ITR 379 (Raj).

280 ITR 0420- T. A. ABDUL KHADER VS. COMMISSIONER OF WEALTH-TAX (KERALA HIGH COURT)

Schedule III to the Wealth-tax Act, 1957, provides that where the property is let, the amount received or receivable or the annual value assessed by the local authority is the gross maintainable rent but the assessing authority has to adopt the rent, whichever is higher. For the building let out, there is no compulsion that the authority should adopt the rent for which it is let out. The authority can assess the rent which is receivable and also the annual rental value assessed by the municipality. In a given case if the assessing authority finds that rent which is claimed by the owner is not the rent receivable, the authority can always assess the rent which is receivable or in a given case can go for the municipal assessment. But the choice is with the assessing authority. The authority has jurisdiction in a given case to assess the rent receivable by the owner as annual rent in case he finds the building let out on lower rent so as to escape from the provisions of the Wealth-tax Act. **For determining such gross maintainable rent the assessing authority has jurisdiction to compare the rent in respect of similar buildings.**

Since Schedule III would require a property to be valued with reference to annual rent, the estimate of such annual rent by comparison of prevailing rent in respect of similar buildings would be in order as was

found in T. A. Abdul Khader v. CWT 280 ITR 420 (Ker).

Where property is jointly held, the law provides for assessment of each co-owner in respect of his share. Where the share is not specific, the co-owners would be presumed to have equal share and each co-owner will be assessable on such share. It was so held for wealth-tax purposes in CWT v. J. K. Srivastava [2006] 280 ITR 470 (All).

282 ITR 0451- OSWAL CHEMICALS AND FERTILISERS LTD. VS. COMMISSIONER OF WEALTH-TAX (DELHI HIGH COURT)

A Rolls Royce car was purchased by the assessee-company from B for an amount of Rs. 131 lakhs and the company made payment to him and also took possession of the car. According to the assessee since the ownership of the car was being disputed and the car had not been registered in the name of the assessee-company under the Motor Vehicles Act, the value of the car was not liable to be included in the net wealth of the assessee. This plea of the assessee was not accepted by the Assessing Officer who added the value of the car in the net wealth of the assessee. Against this order appeal was filed by the assessee. The Tribunal found that there was no dispute whatsoever regarding the sale of the imported car. In pursuance of the sale, delivery had been handed over by the seller to the assessee-company and the car had been got insured by the assessee-company and was being used for its business purposes. The dispute was not regarding the ownership of the car, the dispute was only with regard to the fact whether consideration had been fully paid by the assessee or not. The Tribunal upheld the decision of the Assessing Officer. Held that assessee was assessable to wealth tax for the said car.

282 ITR 0341- SURESH CHAND TALERA VS. UNION OF INDIA (MADHYA PRADESH HIGH COURT)

Section 64(1A) of the Income-tax Act provides for clubbing of minor's income, while agricultural income is clubbed for rate purposes under the Finance Act. It is in this context, that the question posed in Suresh Chand Talera v. Union of India [2006] 282 ITR 341 (MP) was whether agricultural income would also be required to be clubbed for rate purposes in the hands of the parent with the higher income. Since agricultural income is exempt under Chapter III of the Income-tax Act, the question of application of the clubbing provision under the Income-tax Act should not arise in computation of statutory income. The Finance Act, which provides for inclusion of agricultural income for rate purposes, does not provide for such clubbing. The High Court relied upon the definition of income under section 2(24), the charging section 4 and the clubbing provision under section 64(1A) to justify the inclusion of the minor's income for rate purposes.

Agricultural income is not only exempt under section 10(1), but there is also a constitutional limitation for the Central Government to tax the same, so that it could not have been taxable under the Income-tax Act. No doubt, it can be included for rate purposes under the Finance Act, but then, what is not includible under the main Act cannot possibly be included under the Finance Act, which does not provide for clubbing at all. Section 64(1A) would, no doubt, justify inclusion of the income of the minor child, subject to the exceptions under the section itself. But section 64 cannot possibly cover what is exempt under section 10(1). If it is not so covered under the clubbing provision, it could not possibly be taken into account for purposes of computation of tax. At any rate, this is also a possible view, so that the matter is not free from controversy.

**284 ITR 0159- RALLIS INDIA LTD. VS. DEPUTY COMMISSIONER OF INCOME-TAX
(BOMBAY HIGH COURT)**

The Assessing Officer becomes functus officio, once he passes an assessment order. A reference to the valuer as regards the value of the property as on April 1, 1981, for purpose of capital gains serves no purpose after the assessment, since such reference is required to be made only for the purpose of computation of capital gains in the assessment. The assessee's writ petition was, therefore, allowed. It is reasonable to assume, that he should make such reference before the assessment and await the outcome of reference before such assessment. It was so held in Rallis India Ltd. v. Deputy CIT [2006] 284 ITR 159 (Bom). Piecemeal assessment is not permissible under the law.

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Membership Name	Free	DT	IDT
Description	Wealth Tax (excluding valuation rules and questions / answers.)	Direct Taxes for CA final (Includes membership type 3) (also included 130 + Class work problems and solution)	Indirect taxes of CA final. (included +100 Class work problems and solution)
Hours of video access Granted	5 Hrs	100 Hrs	75 Hrs
Membership commence (May 2011 Exam)	16 th May	16 th May	16 th May
Fair Usage of Hours for attending all lectures for given subject once. (approximately in this many hours once all lectures can be attended, some extra time is given considering revision of any chapters that may be required. Particularly for DT if students attend basic topics of IPCC lectures also when we post from time to time then students will have to buy more hours at additional cost.)	5 Hrs	100 Hrs	65 Hrs
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Study notes in softcopy provided for download. (*likely to be provided.)	No	Yes	No*

Membership expiry for May 2011 exam (Respective hours or this date whichever is earlier.)	No	18 th May	18 th May
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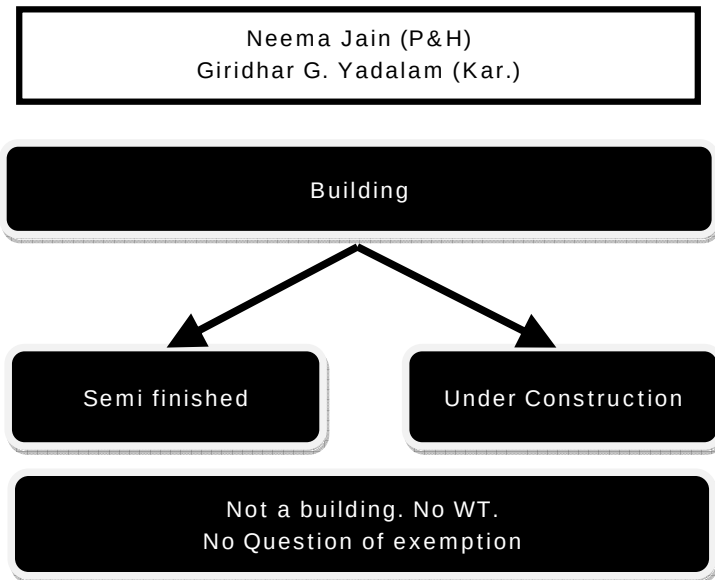
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MEANING OF ASSET

Section / Topic Name : 2 - WT

SEMI FINISHED / INCOMPLETE BUILDINGS

The Punjab and Haryana High Court in CIT v. Smt. Neema Jain [2010] 189 Taxman 308 held that the legislative seeks to bring within the ambit of wealth tax all those buildings, which are complete and ready for use as residential, commercial or guest house, as the case may be, as incomplete structure cannot be put to any such use.



BUILDING UNDER CONSTRUCTION

The Karnataka High Court, in CWT v. Giridhar G. Yadalam [2007] 163 Taxman 372, held that building under construction or one which is not complete would not be eligible for exemption and it would be subject to wealth-tax.

RENTED FACTORY SHED

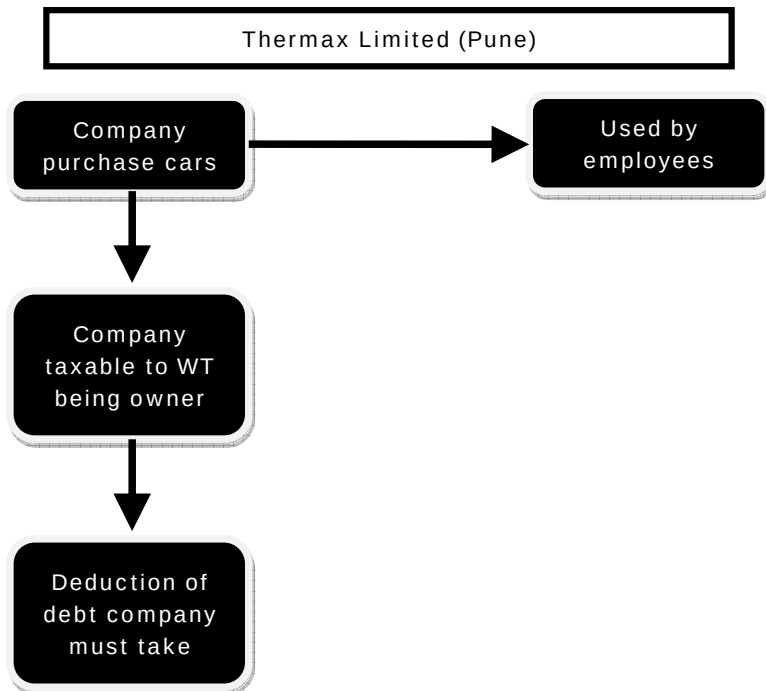
The Bombay High Court in Supreme Nonwovens Ltd. v. Asstt. CWT [2010] 189 Taxman 388, upheld levy of wealth tax on factory shed owned by the assessee when it found that such shed has been let out and not used for any commercial purpose by the assessee. In this case, there was a finding that rental income was assessed under the head 'Income from house property'.

USE OF BUILDING FOR BUSINESS

The Kerala High Court in CIT v. Ponnamma Lakshmi Narayani Asiatic Export Enterprises [2009] 184 Taxman 206 held that the requirement of section 2(ea) for exemption is use of the building for business or profession by the assessee himself. In this case, the assessee, the owner of the factory building, had let out the factory building at market rates of rent to a partnership firm of which the assessee was a partner. The Court held that the business was carried on in the factory by the firm and not by the assessee personally.

SCOPE OF DEBT – CARS PURCHASED FOR EMPLOYEES BENEFIT

Where a company arranges for purchase of vehicles for use of employees by enabling them to own them through vehicle loans, the vehicles may be either owned by the employer or the employees depending upon the terms of the contract and the documentation therefor. Where the employer retains title over the vehicles to secure repayment of the loans, the employer cannot avoid liability for wealth tax, since a motor car is one of the items liable for wealth-tax. However, the debt owed by the employer for acquiring the vehicles on instalment basis would be tied up with the asset, so that it would be deductible against the value of the vehicles. It was so decided by the Tribunal in *Thermax Ltd. v. Deputy CIT [2008] 299 ITR (AT) 141 (Pune)*.



THERMAX LTD (AT) (PUNE)

Motor Car (given to employee for business use)	10
Less Moneys Borrowed for Same	06
Net wealth	04

It is so the case until the car's are not purchased by employees.

If subsequently car's are purchased by employees it is not an asset of company.

262 ITR 0403- CIT VS. SMT. BADHURANI DEEPINDER KAUR (P&H)

In *Nawab Sir Mir Osman Ali Khan (Late) v. CWT [1986] 162 ITR 888*, the Supreme Court stated that the liability to wealth-tax arises because of the belonging of the assessee and not otherwise. Mere possession or joint possession unaccompanied by the right to be in possession or ownership of property would therefore not bring the property within the definition of net wealth for it would not have been an asset

belonging to the assessee. The Supreme Court observed that it had to be borne in mind that unlike the provisions of the Income-tax Act section 2(m) of the Wealth-tax Act, 1957, used the expression “belonging” to and as such indicates something over which a person has dominion and lawful dominion. Held accordingly, that in respect of the Riviera Apartments flat no registered sale deed had been executed in favour of the assessee, that no conveyance had been executed in favour of the assessee and the Okhla plot had not been handed over to him by the DDA, and that for similar reason the hotel site at Chandigarh also did not belong to the assessee. The findings recorded by the Tribunal that the flat in Riviera Apartments, the plot in Okhla estate and the hotel site at Chandigarh did not belong to the assessee were based on correct appreciation of evidence. The value of these properties was not liable to be included in the net wealth of the assessee.

281 ITR (A.T.) 0031- ASSISTANT COMMISSIONER OF WEALTH-TAX VS. HYDERABAD INDUSTRIES LTD. (HYDERABAD BENCH (APPELLATE TRIBUNAL))

Explanation (b) to section 2(ea) of the Wealth-tax Act, 1957, defines “urban land” and excludes from its ambit only such land on which construction of a building is not permissible under any law for the time being in force. The expression “not permissible” denotes a situation where there is a statutory prohibition. Where a specified authority is authorised to permit construction of a building and, in a given case, such authority refuses to grant permission, it can be said to be a case where construction is not permissible. In other words, before making an application to a concerned authority for permission to construct a building, it cannot be concluded that construction would not be permitted on such land.

EXEMPT ASSETS

Section / Topic Name : 5 - WT

247 ITR 0586 GAJ SINGH VS. SETTLEMENT COMMISSION (SC)

Where the assessee, an ex-Ruler of an Indian State, had opted to adopt the one Palace as his house for the purposes of exemption under section 5(1)(iii) of the Wealth-tax Act, 1957, that he could not seek exemption for another house, under clause (vi).

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

The assessee opted to adopt the Umed Bhavan Palace as his house for the purposes of exemption under section 5(1)(iii) of wealth tax, which is specific for the purpose. It was also allowed as exempt by the assessing officer. For the same assessment year assessee also seek exemption for another house, namely, the Sardar Samad Palace under clause 5(1)(vi). You are required to answer whether the Sardar Samad Palace could be regarded as exempt under section 5(1)(vi).

ANSWER

Where the assessee, an ex-Ruler of an Indian State, had opted to adopt the one Palace as his house for the purposes of exemption under section 5(1)(iii) of the Wealth-tax Act, 1957, that he could not seek exemption for another house, under clause (vi). Thus the Sardar Samad Palace cannot be allowed as exempt under clause 5(1)(vi). [2001] 247 ITR 0586 GAJ SINGH VS. SETTLEMENT COMMISSION (SC).

261 ITR 0741- H.H. MAHARAO BRIJRAJ SINGH VS. UNION OF INDIA (RAJ)

For an ex-ruler of Indian state any one building in the occupation of a ruler declared as his official residence qualifies for exemption under section 5 of wealth tax.. Appurtenant land of palace was requisitioned for defence purpose by central government, this is not voluntary act on part of assessee to earn income. Entire palace with its appurtenant land exempt from wealth-tax--wealth-tax act, 1957, s. 5(1)(iii).

249 ITR 0671- COMMISSIONER OF WEALTH-TAX VS. LOKENDRA SINGH (SC)

It was held in case of Commissioner of Income-tax Vs. Lokendra Singh (MP), that In the case of a building in the occupation of an ex-Ruler the expression "any one building" has been used only to indicate that not more than one building can be exempt. Assessee, an ex-Ruler, was entitled to exemption in respect of the entire property, namely, the official residence, although part of it was let out. This judgment is over ruled by supreme court.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

You are required to discuss the treatment for the part of the official residence of the ex-Ruler of Ratlam, that stood let out. The officer is whether justified in law in holding that the assessee is entitled to exemption of the value of the said property in its entirety under section 5(1)(iii).

ANSWER

It was held in case of Commissioner of Income-tax Vs. Lokendra Singh (MP), that In the case of a building in the occupation of an ex-Ruler the expression "any one building" has been used only to indicate that not more than one building can be exempt. Assessee, an ex-Ruler, was entitled to exemption in respect of the entire property, namely, the official residence, although part of it was let out. This judgment is over ruled by supreme court. Thus let out property do not qualify for the purpose of

exemption u/s 5(1)(iii) of the wealth tax act.

250 ITR 0666- GANGABAI CHARITIES VS. COMMISSIONER OF WEALTH-TAX (SC)

Where purpose of charitable trust was not confined to religious or charitable use and property could be used for social, cultural and allied purposes at sole discretion of trustee. The trust will not be entitled to exemption under wealth-tax act u/s. 5(1)(i).

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Purpose of charitable trust was not confined to religious or charitable use and property could be used for social, cultural and allied purposes at sole discretion of trustee. You are required answer whether the property would qualify for the exemption under the wealth tax or not.

ANSWER

Where under a trust deed the purposes for which the trust property could be put to were not confined to religious or charitable use. The property could be used for social, cultural and other allied purposes at the sole discretion of the trustee. The trust is not entitled to exemption under section 5(1)(i) of the Wealth-tax Act. [2001] 250 ITR 0666 GANGABAI CHARITIES VS. COMMISSIONER OF WEALTH-TAX (SC)

257 ITR 0718- M.K. KUPPURAJ (HUF) VS. COMMISSIONER OF WEALTH-TAX (MAD)

Section 7(2) of wealth tax provides for valuation of a house belonging to the assessee and exclusively used by him for residential purposes throughout the period of twelve months immediately preceding the valuation date does not set out a definition of the term “house” nor does it lay down any ceiling regarding the extent of open space which can be regarded as part of the house. Once it is found that the house is in fact a residential house and that the land is being used as the ground attached to the house for the benefit of the residents of the house, it remains a part of the house for the purpose of the section 7(2). It is not for the authorities to decide for the assessee as to what the size of his house should be or the extent of the garden or other area which the assessee should have for the house in which he lives. Such enquiry is outside the scope of the Wealth-tax Act. If a person had acquired a house for being used as a residential house and that house happened to have a large open space around it for use as garden or a play area or other purposes, as long as the house is used solely for residence and the benefit of those grounds is confined to the residents of the house and their visitors, such a house with its grounds would qualify for benefit under section 7(2). Importing individual notions as to what should be the reasonable size of a house or what should be the reasonable extent of the open space around it is not a permissible exercise in making the assessment under the Wealth-tax Act.

The Town Planning Rules do not impose a limit on the maximum open space that can be left around the house. The Assessing Officer cannot take a rule under a different enactment specifying a minimum and convert that into a maximum for the purpose of the Wealth-tax Act and thereafter bring to tax a part of the house which should have been excluded from valuation under section 7(2). When the statute provides an benefit it is not to be whittled down arbitrarily by the Assessing Officers by importing their private notions of reasonableness into the provision which grants exemption.

Question

The assessee owns a house property called “Hawarden” at Coimbatore. The house property consists of large open land. This is the only property belonging to assessee. The assessee claimed the benefit of the section 5(vi) of the Wealth-tax Act. The assessing authority while granting benefit under 5(vi), limited it to an 600 sq. Meters of land after expressing the view that that extent was the reasonable extent which could be regarded as the land appurtenant to the house as per Town Planning Act. Thus officer consider

200 sq. Meters of land as assessable to wealth tax. You are required to answer whether the action of the officer is justified or not.

	As per Town Planning Act	Actual
Construction	300	100
Land kept open	600	800

Answer

A residential house may have appurtenant land with a large open space. Merely because the open space is large, it does not cease to be appurtenant. In the context of exemption for one residential house, the High Court in *M. K. Kuppuraj (HUF) v. CWT* [2002] 257 ITR 718 (Mad) held that there was no justification for the restriction by the Assessing Officer of the exemption by denying exemption for part of the open space appurtenant to it. According to the Assessing Officer, one-third of the appurtenant land required to be open according to the Town Planning Rules alone could be treated as part of the house, and any excess land could not be treated as part of the residential house. The High Court found that the rule does not prescribe maximum as wrongly assumed by the Assessing Officer. A person may like to have open space for garden, way area and other purposes associated with a residence, so that the partial exemption is not consistent with law. Thus the action of the officer is not justified and the entire house with land shall qualify for the purpose of exemption.

262 ITR 0319- CWT VS. VALLABH DAS (RAJ)

In valuing a house property for the purposes of wealth-tax by the rent capitalisation method, it is proper to take ten times the net annual rent of the property for determining its market value. *CIT v. Smt. Vimlaben Bhagwandas Patel* [1979] 118 ITR 134 (Guj) and *Aditya Narain Roy v. CWT* [1990] 183 ITR 175 (Cal) followed.

CLUBBING OF INCOME / ASSETS

Section / Topic Name : 4 - WT

238 ITR 1044 COMMISSIONER OF INCOME-TAX VS. SHRI OM PRAKASH (SC)

Assessee was partner in representative capacity in the partnership firm. The firm paid some remuneration to spouse of the that partner in representative capacity. Held that since he was a partner in representative capacity the clubbing provisions of section 64 were not attracted. That is to say that clubbing provision of section 64 will be attracted only when an assessee's own income is being assessed and not that of a Hindu undivided family. If a karta is brought within the ambit of "individual" in section 64(1), the share income of the spouse of the karta and his minor children will, in effect, be included in the income of the Hindu undivided family which is not what is contemplated by section 64(1)(i) and (ii) which is impermissible.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

A (HUF) is partner in partnership firm M/s ABC. Wife of Mr. A is employed by that firm. She draws the salary of Rs. 35000 per annum which is considered excessive and unreasonable to the tune of Rs. 10000. You are required to explain the tax treatment of the said salary in the hands of Mrs. A.

ANSWER

When the karta of a Hindu undivided family is a partner in a partnership firm, he has a dual capacity; qua the partnership, he functions in his personal capacity and qua third parties, in his representative capacity. When he is assessed in respect of the income derived by him from the partnership firm as a partner, it is in his representative capacity as karta of the Hindu undivided family and not as an individual as such. That is because his capacity vis-a-vis his spouse/minor children who are members of the Hindu undivided family is that of karta and not as individual though vis-a-vis other partners of the partnership firm he functions in his personal capacity. This being the position, the income of a karta's spouse/minor child cannot be included in the computation of his total income for that is the income of the Hindu undivided family and, not his individual income. Section 64 of the Income-tax Act, 1961, will be attracted only when an assessee's own income is being assessed and not that of a Hindu undivided family. If a karta is brought within the ambit of "individual" in section 64(1), the share income of the spouse of the karta and his minor children will, in effect, be included in the income of the Hindu undivided family which is not what is contemplated by section 64(1)(i) and (ii) which is impermissible.

Under section 4, the charging section, the total income of the previous year or years of every person is charged for any assessment year at the rate or rates prescribed by the Finance Act. A plain reading of the definition of "person" in section 2(31) shows that both "an individual" and a "Hindu undivided family" are, inter alia, constituents of the meaning of the term "person". The expression "any individual" is narrower than the terms "person" and "assessee" defined in section 2(7); an individual is a person but every person need not be an individual. So also an individual may be an assessee but every assessee need not be an "individual". Had Parliament intended to give a wider meaning to the word "individual" in section 64(1)(i) and (ii) so as to include the karta of a Hindu undivided family it would have drafted the provision differently. It is thus clear that "individual" in section 64(1) does not take in karta of the Hindu undivided family within its import.

239 ITR 0263 SYED SADIQUE VS. COMMISSIONER OF INCOME-TAX (SC)

A gift had been made by an individual who was a Muslim to his wife. It was not the case of the assessee that the transfer was for adequate consideration. There was no finding to show that the transfer was in connection with an agreement to live apart. Therefore, the provisions of section 64 were clearly attracted in the facts of these cases. In that view of the matter, it was not necessary to go into any further question about the validity of the gift in accordance with the personal law of the donor.

Section 64 of the Income-tax Act, 1961 was inserted to prevent evasion of tax. It must be construed in a way to achieve its object and not to frustrate it.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Mr. A Muslim by religion as per the personal law affecting him made gift of house property to his wife. The property income during the year is Rs. 2 lacs. He is of the opinion that since gift is valid as per the personal law affecting him the amount of income out of the property transferred to his wife is not subject to any clubbing provision under the income tax act. You are required to explain him the correct position of law of income tax.

ANSWER

Provision of section 64(1)(iv) provides that In computing the total income of any individual, there shall be included all such income as arises directly or indirectly, to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart. Thus income out of the asset transferred is subject to the clubbing provision. A gift had been made by an individual who was a Muslim to his wife. It was not the case of the assessee that the transfer was for adequate consideration. There was no finding to show that the transfer was in connection with an agreement to live apart. Therefore, the provisions of section 64 were clearly attracted in the facts of these cases. In that view of the matter, it was not necessary to go into any further question about the validity of the gift in accordance with the personal law of the donor. Section 64 of the Income-tax Act, 1961 was inserted to prevent evasion of tax. It must be construed in a way to achieve its object and not to frustrate it. Thus in the given case the clubbing provisions of section 64 will be attracted and the income out of the property shall be included in hands of Mr. A.

265 ITR 0345- COMMISSIONER OF INCOME-TAX VS. MAJOR B.K. KAUL (ALL)

It was held that a wife, who was a post graduate in economics attending solely to a business in an agency for sale of scooters helping her husband, a war hero, who lost both his hands in war, can certainly be treated as a person professionally qualified, so that the salary paid to her cannot be clubbed with that of her husband under section 64(1) of the Act.

264 ITR 0107- NIZAMUDDIN VS. CIT (RAJ)

A gift of property by a father to minor children by declaration (Hiba) under the Islamic law does not require registration but all the same it is effective. Consequently section 64 is attracted in respect of income from such gifts to minor children. The reasoning of the assessee was that the gift being for ensuring education of minor children. It is for consideration, so that the clubbing provisions could have no application. The High Court in Nizamuddin v. CIT [2003] 264 ITR 107 (Raj) found that in view of the

plain language of section 64 (1A), clubbing cannot be avoided and that non-inclusion would frustrate the intent of the provision. Section 64(1A) provides for automatic aggregation of the minor's income in the hands of the parent with higher income.

270 ITR 0408- DR. K.M. SHAH VS. DEPUTY COMMISSIONER OF INCOME-TAX (GUJARAT HIGH COURT)

Assessee had acquired piece of land which was sub-divided in to 4 sub-plots. Then he put up construction on only sub-plot No. 1, gifted sub-plot No. 3 to the appellant's daughters. Each sub-plot had an access from one or the other of the town planning roads and that each plot was capable of having construction put up on it. That the lands in question being sub-plots Nos. 2 and 4 were separate lands and were not to be considered as land appurtenant to the building on sub-plot No. 1. Hence, Part B of Schedule III to the Act applicable to a building or land appurtenant thereto was not applicable to the said lands.

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HINDU UNDIVIDED FAMILY

Section / Topic Name : HUF

Hindu law recognises partial partition as well as partition of a Hindu undivided family (HUF) by mere ascertainment of shares on severance of status, but the tax law does not recognise partial partition, if made after December 31, 1978. Similarly, a partition, which is not by metes and bounds is also not recognised. But such non-recognition in either case for income tax purposes is limited to Hindu undivided families (HUF) “hitherto assessed”. If they are not so assessed, the income-tax law will follow the Hindu law. There could be a partition between groups of members of the same family, so that Hindu undivided families can be split up into as many groups as had been formed as a result of such partition. The Departmental objection against such partition was found unacceptable, since both the partial partitions took place on March 31, 1975 and October 31, 1976 prior to the amendment. The groupwise partition was also found valid in CIT v. Amrit Lal [2007] 295 ITR 505 (All) following CIT v. Shrawan Kumar Swarup and Sons [1998] 232 ITR 123 (All). This law can be taken to be settled as far as families not “hitherto assessed” are concerned.

252 ITR 0324- BHAGAT RAM VS. TEJA SINGH (SUPREME COURT OF INDIA)

Hindu female is dying intestate without any childrens. Property inherited by such hindu female from father or mother property would devolve on heirs of father. Property inherited by such hindu female from husband or father-in-law would devolve on heirs of husband.

The source from which the Hindu female inherits the property is always important and that would govern the situation. Otherwise, persons who are not even remotely related to the person who originally held the property would acquire rights to inherit the property.

265 ITR 0551- R. KUPPAYEE VS. RAJA GOUNDER (SUPREME COURT OF INDIA)

It was always understood that it was open for the karta of a Hindu joint family to gift movable property on auspicious occasions to a female member, i.e., daughter to the extent commensurate with the wealth of the family even if it is ancestral property. In R. Kuppayee v. Raja Gounder [2004] 265 ITR 551 (SC), this proposition would appear now to have received some extension, when the Supreme Court decided that there is no reason why gift of immovable property also within reasonable limits in favour of his daughter on the occasion of her marriage or even long after her marriage, keeping in view the total extent of the property of the joint family, should not similarly be valid. Such a conclusion was arrived at after review of the case law on the subject. Where the gift is not vitiated by fraud or misrepresentation and was not shown to be unreasonable, the court would not interfere.

263 ITR 0589- MAHENDRA KUMAR SEWTI DEVI VS. CIT (ALL)

Where the Tribunal had found that the mother was allocated no portion of the properties under division nor was she compensated in lieu of the loss of her share in the said properties Held, that the partition of the Hindu undivided family was not valid.

In CIT v. Mrs. Taramati Hariprasad Vasa [1969] 74 ITR 211 (Guj) [FB], where the mother was not given a share, though entitled to it under the law, the High Court found that since no member can identify his or

her interest in the property prior to the partition, there is no disposition to justify the inference of deemed gift by her. The question of validity however was not raised in these cases. They have proceeded on the undisputable assumption that a partition can be valid, even if any one of the members forgoes his right to a share either partially or wholly.

This decision does not appear to have taken note of the Supreme Court ruling in *CGT v. N. S. Getti Chettiar* [1971] 82 ITR 599, where one of the coparceners had not taken any share, so that a gift by him to the other members was presumed. The Supreme Court pointed out that a member of a Hindu joint family has no definite share prior to partition in the family property, so as to presume a gift. In fact, nothing prevents even surrender of one's interest in joint family property.

Question

The mother, Smt. Sewti Devi, was allocated no portion of the properties under division of the family property nor was she compensated in lieu of the loss of her share in the said properties. The officer is of the opinion that it was not a valid partition and thus the family should be continued to be assessed. You are required to answer whether officer is justified in his opinion.

Answer

In *CIT v. Mrs. Taramati Hariprasad Vasa* [1969] 74 ITR 211 (Guj) [FB], where the mother was not given a share, though entitled to it under the law, the High Court found that since no member can identify his or her interest in the property prior to the partition, there is no disposition to justify the inference of deemed gift by her. The question of validity however was not raised in these cases. They have proceeded on the undisputable assumption that a partition can be valid, even if any one of the members forgoes his right to a share either partially or wholly. However it has been held in [2003] 263 ITR 0589 *MAHENDRA KUMAR SEWTI DEVI VS. CIT (ALL)* Where the Tribunal had found that the mother was allocated no portion of the properties under division nor was she compensated in lieu of the loss of her share in the said properties Held, that the partition of the Hindu undivided family was not valid.

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257 ITR 0096- COMMISSIONER OF INCOME-TAX VS. PARSHOTTAMDAS K. PANCHAL (GUJ)

An individual who receives ancestral property at a partition and who subsequently acquires family, but has no male issue, would hold that property only as the property of the family. Under the Hindu law the wife of the coparcener is certainly a member of the family. Whatever be the school of Hindu law by which a person is governed, the basic concept of a Hindu undivided family in the sense of who can be its members is just the same. Thus, in order to constitute a joint family, it is not always necessary that there must be two male members.

Question

The assessee had received a share at a partition of a Hindu undivided family which was included in the hands of his father as he was a minor at that time. After he attained majority, he disclosed the share income in his return in the status of individual. When the assessee got married he filed the return and claimed the status of a smaller Hindu undivided family in respect of the share income obtained at the partition. The authorities below rejected the claim on the ground that in order to constitute a joint family

it is necessary that there should be two male coparceners. You are required to answer whether action of the authorities is justified or not.

Answer

Joint family character of joint family property is not lost when as a result of partition or survivorship such property falls into the hands of an unmarried coparcener. The joint family character revives, once such an individual marries, since such individual and his wife constitute a joint family in respect of such property. It is not necessary that there should be a son, because the joint family can have a single male member. In such case the individual holds the property as a potential joint family property. This is the law which is recognised in CIT v. Parshottamdas K. Panchal [2002] 257 ITR 96 (Guj).

Upon the marriage of the assessee, his wife became a member of his family with a right to claim maintenance charged on the property held by the assessee which he had obtained earlier under the partition. The family of the assessee was a joint family and the property in the hands of the assessee which he got earlier at the partition was to be considered as property held by the assessee in his capacity as the karta of the Hindu undivided family. Therefore, the share income was rightly deleted from the total income of the assessee who was assessed in the status of an individual, since the said income was required to be assessed in the hands of the Hindu undivided family of the assessee. CIT v. Parshottamdas K. Panchal [2002] 257 ITR 96 (Guj)

As against the decision of CIT v. Parshottamdas K. Panchal [2002] 257 ITR 96 (Guj), the Patna High Court had taken a different view holding that the property, which had become that of the individual cannot get converted into joint family property, whether on marriage or even after the birth of a son in CIT v. Shankar Lal Budhia [1987] 165 ITR 380 (Patna) [FB], a decision which was dissented from by the Gujarat High Court. The issue is already before the Supreme Court.

269 ITR 0050- GIRDHARI LAL (DECD.) VS. COMMISSIONER OF INCOME-TAX (ALLAHABAD HIGH COURT)

When a Hindu dies intestate his self-acquired property becomes ancestral property in the hands of his sons. This is because under Hindu law the property which a person inherits from his father, father's father and father's father's father is ancestral property.

280 ITR 0360- COMMISSIONER OF INCOME-TAX VS. SMT. MEERA PREM SUNDAR (HUF) (ALLAHABAD HIGH COURT)

There was no evidence, nor was there any such plea that after the death of the karta, a severance or partition by metes and bounds had taken place in the joint Hindu family properties. On the contrary, the claim was that it was not necessary for the assessee to claim any partition in the Hindu undivided family property under section 171(9). Therefore, there was no partition amongst the surviving members of the Hindu undivided family after the death of the karta and under section 171 there was no severance of status of the Hindu undivided family. Thus, the Tribunal was not right in holding that there was a deemed partition and disruption of the Hindu undivided family as per Explanation 1 to section 6 of the Hindu Succession Act.

MUTUAL CONCERN / ASSOCIATION

Section / Topic Name : Mutual Concern

243 ITR 0089- CHELMSFORD CLUB VS. COMMISSIONER OF INCOME-TAX (SC)

The assessee, a members' club, provided recreational and refreshment facilities exclusively to its members and their guests. Its facilities were not available to non-members. The club was run on "no profit no loss" basis in that the members paid for all their expenses and were not entitled to any share in the profits. Surplus, if any, was used for maintenance and development of the club. The club house was owned by the assessee. The assessee claimed that it was a mutual concern and so the annual letting value of the club house was not assessable. Held, that the assessee's business was governed by the doctrine of mutuality. It was not only the surplus from the activities of the business of the club that was excluded from the levy of income-tax, even the annual value of the club house, as contemplated in section 22 of the Act, would be outside the purview of the levy of income-tax.

The three conditions, the existence of which establishes the doctrine of mutuality are

- 1) The identity of the contributors to the fund and the recipients from the fund,
- 2) The treatment of the company, though incorporated as a mere entity for the convenience of the members, in other words, as an instrument obedient to their mandate, and
- 3) The impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves.

Fundamental Concept:

Under the Income-tax Act, what is taxed is, the "income, profits or gains" earned or "arising", "accruing" to a "person". Where a number of persons combine together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to those persons cannot be regarded in any sense as profit. There must be complete identity between the contributors and the participators. If these requirements are fulfilled, it is immaterial what particular form the association takes. Trading between persons associating together in this way does not give rise to profits which are chargeable to tax. Where the trade or activity is mutual, the fact that, as regards certain activities, certain members only of the association take advantage of the facilities which it offers, does not affect the mutuality of the enterprise. The law recognises the principle of mutuality excluding the levy of income-tax from the income of such business to which the above principle is applicable. A perusal of section 2(24) of the Income-tax Act, 1961, shows that the Act recognises the principle of mutuality and has excluded all businesses involving such principle from the purview of the Act, except those mentioned in clause 2(24)(vii).

267 ITR (A.T.) 0086- WALKESHWAR TRIVENI CO-OPERATIVE HOUSING SOCIETY LTD. VS. INCOME-TAX OFFICER (BOM)

No one can make a profit out of himself. In short, this is the principle of mutuality. The cardinal requirement is that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund. There must be complete identity between the contributors and the participators. If all the participators to the common fund are also contributors and their identity is established, then the test of mutuality is satisfied. A co-operative society can be registered only if it is in accordance with the co-operative principles and is a

voluntary association. The assessee had been granted registration and it could be presumed that the Registrar of Co-operative Societies in Mumbai found this to be a voluntary association. It is mandatory for the promoter to form a society as soon as there is a minimum number of persons required to form a co-operative housing society. The members join the society out of their free choice. There is no compulsion to join the society. There is no compulsion to continue having joined once.

The society could raise funds only for achieving the objects of the society and not for any other purpose. So long as the society was charging the amount of premium, within the framework of law, no profit motive could be attributed to the society. With the common consent, the transferor and the transferee divided equally the premium and paid it to the society. The society issued separate receipts to the transferor and the transferee. The transferor satisfied the test of mutuality. When the premium was paid, he was a member of the society. He received the consideration for alienating his right in favour of the transferee. Legally speaking, the transferee stepped into the shoes of the transferor and became eligible for all the benefits which were till then available to the transferor. But at the time of effecting the transfer, the transferee was not a member. As such, the amount received from the transferee would not satisfy the test of mutuality. The amount received from the transferor was not exigible to tax, whereas the amount received from the transferee was exigible to tax.

A co-operative housing society, once it is conceded to be a mutual association, the premium which is paid by the transferor as a member at the time of payment is exempt and not the premium received from the transferee, who was not the member at the relevant time. It was so decided by the Tribunal in Walkeshwar Triveni Co-operative Housing Society Ltd. v. ITO [2004] 267 ITR (AT) 86 following the principles laid down under co-operative laws and the principle of mutuality. The garb of a co-operative society does not rule out application of the principle of mutuality as was found in CIT v. Apsara Co-operative Housing Society Ltd. [1993] 204 ITR 662 (Cal).

252 ITR 0265- HARYANA STATE CO-OPERATIVE LABOUR AND CONSTRUCTION FEDERATION LTD. VS. CIT (P&H)

The tests of mutuality in a nutshell are : the identity as between contributors and beneficiaries, the objective of mutual benefit and the actual activities resulting in either mutual benefit or return of the contribution to the contributors. A co-operative society, it can be inferred from the decisions, can be exempt as a mutual association, if its constitution is so framed and its activities so carried out to accord with the principle of mutuality. If it is so justified, there would be total immunity by way of exemption for the co-operative society without the assistance of the deductions for various activities under section 80P and relaxation in the rate of tax available for co-operative societies.

The assessee, a co-operative society, received contributions from its members. It claimed that the contributions were not exigible to income-tax by the principle of mutuality. The contributors had no control over the funds received by the assessee from them and they could not direct that the remaining amount after meeting the expenses should be returned to them. The funds could only be used for the specific purposes only. The principle of mutuality could not be invoked.

Question

The assessee is a co-operative society. It provides technical advice to the member-societies in lieu of the subscriptions. The petitioner received contributions from its members during the three years. It claimed that the contributions made by the member-societies were not exigible to the levy of income-tax by the principle of mutuality. Assessing officer has rejected the claim and you are required to answer Whether,

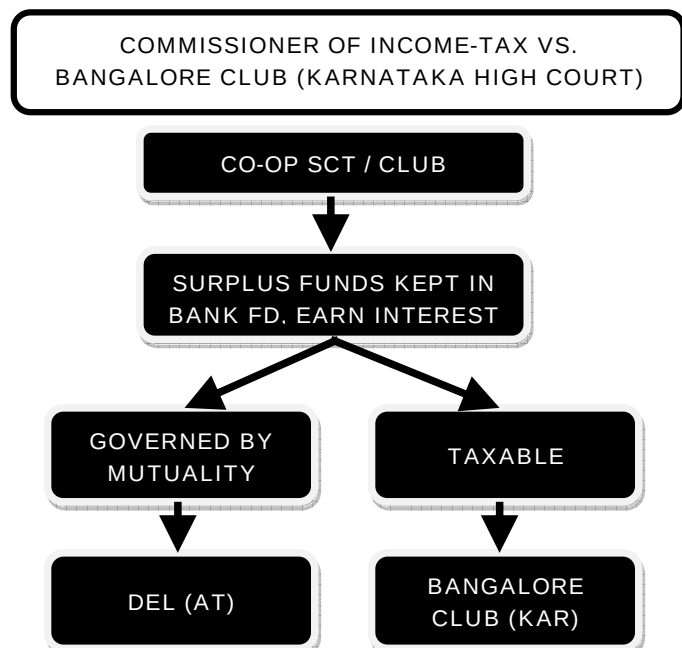
the officer was right in law in holding that the contribution of Rs. 21,205, received by the assessee from its members was not exempt on the principle of mutuality ?

Answer

The tests of mutuality in a nutshell are : the identity as between contributors and beneficiaries, the objective of mutual benefit and the actual activities resulting in either mutual benefit or return of the contribution to the contributors. A co-operative society, it can be inferred from the decisions, can be exempt as a mutual association, if its constitution is so framed and its activities so carried out to accord with the principle of mutuality. Where the contributors had no control over the funds received by the assessee from them and they could not direct that the remaining amount after meeting the expenses should be returned to them. The funds could only be used for the specific purposes only. Following the decision of [2001] 252 ITR 0265- HARYANA STATE CO-OPERATIVE LABOUR AND CONSTRUCTION FEDERATION LTD. VS. COMMISSIONER OF INCOME-TAX (PUNJAB AND HARYANA HIGH COURT) The principle of mutuality could not be invoked.

287 ITR 0263- COMMISSIONER OF INCOME-TAX VS. BANGALORE CLUB (KARNATAKA HIGH COURT)

It is trite law that an association, in order to get the benefit of the principle of mutuality, should confine its activities only as between members. Where such an association banks its surplus funds in fixed deposits, should interest from them be treated as liable to tax as not covered by the mutuality principle, because the banks are not members of such association ? This was the issue posed before the High Court in CIT v. Bangalore Club [2006] 287 ITR 263 (Karn). The High Court concluded that such income from bank interest could not be exempt following its own earlier decision in CIT v. I.T.I. Employees Death and Superannuation Relief Fund [1998] 234 ITR 308 (Karn). It did not agree that the decision of the Supreme Court in Chelmsford Club v. CIT [2000] 243 ITR 89 would support the assessee's case. On the contrary, it felt that the decision of the Gujarat High Court in Sports Club of Gujarat Ltd. v. CIT [1998] 171 ITR 504 would support the view that such income from investments with non-members should be taxable.



BUILDING SOCIETY (DELHI HIGH COURT)

The assessee, a co-operative house building society established with the specific objective of purchasing agricultural land for development as plots to be allotted to its own members, entered into an agreement with the Government of Haryana which stipulated that the society shall keep 30 per cent. of the amount realised by it from the plot holders from time to time in a deposit for being utilised by the society towards meeting the cost of internal development work in the colony, that the society shall not derive any profit out of the sale of the plots to its members and that it shall allot plots only to its members. The Commissioner (Appeals) and the Tribunal concluded that the utilisation of moneys received from time to

time from members and kept in a savings bank account was directly linked with the activity of purchasing agricultural land, developing it and converting it into residential plots after obtaining approval of the Government for allotment to its members and held that the interest on the savings bank account was a capital receipt that went to reduce the cost of the land and was not to be treated as income in the assessee's hands. On appeal Held, dismissing the appeal, that since the question had been settled by the Supreme Court, the question of application of such a decision in a particular set of facts would not constitute a substantial question of law.

BUSINESS INCOME / PROFESSIONAL INCOME

Section / Topic Name : 28

PAYMENT FOR RESTRICTION AGAINST THE USE OF NAME

In *Padmanabha Udupa v. ITO* [2010] 189 Taxman 408 (Ker.), the assessee was carrying on business under the name of M/s. Madhuban Restaurant. In the course of family settlement, the assessee stopped the restaurant business and was paid Rs. 22 lakh for not using the name Madhuban Restaurant in the new business if he started. It was found that the assessee simultaneously started restaurant business.

The assessee's claim for exemption of such payment was turned down by authorities as what resulted in the settlement was only restriction against the use of the name Madhuban Restaurant and not in carrying on restaurant business per se. The Kerala High Court upheld the decision of tax authorities.

VOCATIONAL INCOME FROM VEDANTA TEACHINGS

In *Swami Premananda v. CIT* [2009] 180 Taxman 368 (Mad.), the assessee was running an ashram and reportedly giving Vedanta teachings. During a search operation, he was found to be in possession of several assets and bank accounts which he narrated as acquired out of donations received from his disciples' majorly foreign nationals. From a letter given by one of the donors, the Assessing Officer held that it was given to the assessee in his individual capacity for his Vedanta teachings. In the consequence he held that amounts received by assessee constituted his 'income' and were assessable as profits and gains arising out of his vocation. This decision can lend trouble for several gurus and, swamis that we witness in religious television channels these days who receive devotees in abundance and perhaps large sums as donations too.

P/L 1-4 to 31-3			
Particulars	Amount	Particulars	Amount
		Compensation for not using name of other (No restriction to do business) (Income taxable)	1
		Vedanta Teaching (Income taxable)	2
		Earnest/Advance money for land (stock in trade) (Income taxable)	3

1.	Padmanabha Udupa (Ker)
2.	Swami Premananda (Mad.)
3.	Fair Deal Traders (P & H)

NON-REFUNDABLE EARNEST MONEY IS TRADING RECEIPT

In CIT v. Fair Deal Traders [2009] 184 Taxman 161 (Punj. & Har.), the assessee being engaged in the business of purchase and sale of land received earnest money under an agreement to sell. In this case, the sale deed could not be finalised because of restrictions under the Urban Land (Ceiling and Regulations) Act, 1976. The Assessing Officer sought to treat the said money as revenue receipt of the assessee. The assessee disputed the liability by submitting that the receipt was in advance, since sale had not actually taken place and title had not been passed on to the purchasers.

The Tribunal agreed with such stance of the assessee, but the Punjab and Haryana High Court in turning it down held that earnest money that is non-refundable would find the character of trading receipt. In this case, a bulk of the amount was received by the assessee who had also granted possession to the prospective purchasers. The High Court in particular made reference to the following two cases to hold a view that the earnest money received had got immediate nexus with the 'business' carried on by the assessee :

- (a) Kerala High Court decision in CIT v. Travancore Rubber & Tea Co. Ltd. [1991] 190 ITR 508; and
- (b) Hon'ble Supreme Court ruling in CIT v. Podar Cement (P.) Ltd. AIR 1997 SC 2523. In CIT v. Dhir & Co. Colonisers (P.) Ltd. [2007] 288 ITR 561 (Punj. & Har.), this very Court held that the amounts received as advances or earnest money under agreements to sell plots had to be considered as revenue receipts.

In this case, possession of the plots was transferred and the transferees even made constructions even when in some cases registration could not be effected on account of the restrictions placed by the urban land ceiling laws.

CONTINGENT DEPOSIT OF SALES TAX IS REVENUE RECEIPT

Contingent deposit collected, where sales tax liability is disputed, is ordinarily expected to be either paid to the Government or refunded to the customers on finality being reached. But the courts have found that such deposits are in the nature of trading receipts, so as to be included as part of sale proceeds and allowed as deduction as and when it is paid, if paid. The decision of the Madras High Court in Sundaram Finance Ltd. v. Dy. CIT/Joint CIT [2008] 303 ITR 364 follows this view citing the decision in CIT v. Southern Explosives Co. [2000] 242 ITR 107 (Mad).

WROTE OFF SHAREHOLDING IN SUBSIDIARY COMPANY - ALLOWABLE

Where the subsidiary company had failed and was ordered to be wound up, the assessee wrote off its shareholding and claimed the loss. The assessee had earlier waived the interest receivable from the subsidiary. The Revenue claimed that since the shares were not transferred, the loss could not be treated as having arisen in the year of write off. The High Court in CIT v. H. P. Mineral and Industrial Development Corporation Ltd. [2008] 305 ITR 111 (HP) found that since the subsidiary company was being wound up, the transfer of the shares could not be expected and that the write off was justified. It was further found that the shares were held as stock-in-trade. If it were held as stock-in-trade, it would be a business loss. But it is difficult to understand the finding of the Tribunal that the shares held in a subsidiary company could be stock-in-trade, since a holding company is not ordinarily expected to deal in shares of its subsidiary companies even if it were a dealer in shares. The Explanation to section 73 may come in the way unless it were an investment company. If such shares had been an investment being a capital asset, it would give rise to loss or gain only on distribution under section 46(2). Transfer is a pre-

condition for liability for capital gains or for entitlement of loss under the head “Capital gains”. In *C. A. Natarajan v. CIT* [1973] 92 ITR 347 (Mad), it was pointed out that the mere fact that the asset lost its value does not permit loss under the head “Capital gains”. In this case, the assessee claimed the loss on the strength of a communication from the liquidator intimating the shareholder that there was no prospect of the shareholder getting any amount, since the claim of the secured creditors was larger than the available assets. It was held that capital loss could not be recognised since there was no transfer. It was also the view in *Hall and Anderson (Pvt.) Ltd. v. CIT* [1963] 47 ITR 790 (Cal). The decision in *H. P. Mineral and Industrial Corporation’s* case (supra) would, however, rest on the fact found by the Tribunal, that the shares in the subsidiary were stock-in-trade.

LOAN WRITE-BACK-WORKING CAPITAL LOAN

In *Solid Containers Ltd. v. Dy. CIT* [2009] 178 Taxman 192 (Bom.), the assessee who had taken a loan for trading activity received a waiver and in the consequence credited such waiver to the profit and loss account. He, however, claimed such write back as a capital receipt. The Bombay High Court drawing reference to the Supreme Court ruling in *CIT v. T.V. Sundaram Iyengar & Sons Ltd.* [1996] 6 SCC 294/88 Taxman 429 held that credit balance written back was income of assessee in view of fact that it was directly arising out of business activity of assessee. The Court distinguished its previous decision in *Mahindra & Mahindra Ltd. v. CIT* [2003] 261 ITR 501/128 Taxman 394 (Bom.) only on difference of facts.

In *Hindustan Foods Ltd. v. Dy. CIT* [2009] 178 Taxman 247, the assessee unilaterally transferred unclaimed debenture account balance to the General Reserve Account and further utilized the amount for the purpose of its business. The Bombay High Court also held that the said unclaimed amount should have been treated as income of the assessee by way of trade receipt for the following factual matrix :

- (i) that the unclaimed amount was transferred to the Reserve Fund Account;
- (ii) that such amount was utilized by the assessee-company for its business purpose, treating the same as its own money for its trading activity;
- (iii) that the money was all throughout used by the assessee;
- (iv) that the assessee had not tried to trace out the debenture-holders to pay back the said amount and had not transferred the money to the Investor Education and Protection Fund.

The High Court, however, upheld the order of the Tribunal on the point that in the subsequent assessment years, if some amount is paid to the debenture-holders, the Assessing Officer should deduct such amount in the relevant assessment years.

SUBSIDIARY COMPANY’S LOAN WRITTEN OFF

It is not unusual that a holding company has to come to the assistance of its subsidiaries in getting finance for its operations by giving corporate guarantee and incurring legal expenses in respect of the same. Where the loans are not discharged by the subsidiary company, the amount has to be met by the holding company. The question that arises is whether such loss and expenses could be allowed as a deduction. It may be possible to take the view that it is not in every case that such losses or expenses will be allowed in the hands of the holding company.

In the facts of the assessee’s case, it was found in *CIT v. United Breweries Ltd.* [2007] 292 ITR 188 (Karn), that there was also a direct loan by the company to its subsidiaries, which had to be written off. It was found that in similar circumstances, such loss was allowed as a business loss in *CIT v. Amalgamations P. Ltd.* [1997] 226 ITR 188 (SC), though there was a finding in that case that there was common business interest. Presumably, this was also the finding of the Tribunal, when it allowed the same.

There was, however, another aspect of the case, since the subsidiaries had meanwhile been amalgamated

to the assessee company from a date anterior to the booking of losses on these two counts as well as in the matter of accrued interest from the subsidiaries. The Supreme Court in *Marshall Sons and Co. (India) Ltd. v. ITO* [1997] 223 ITR 809 had decided that effect has to be given from the appointed day being the date specified in the scheme, which has been approved and not the date of the judgment of the High Court approving the amalgamation. The High Court has understood the Supreme Court decision differently. The merger was on March 31, 1994, the appointed day. The judgment does not contain the year in which the claims for write off and expenses are made. If it related to a period on or after April 1, 1994, the debts due from the subsidiary would have got cancelled on the merger. The High Court has observed “a retrospective effect given to the amalgamation would not nullify the decision with regard to writing off of interest on the ground of irrecoverable nature”. The rejection of the argument that the debt did not exist after this date would appear to require some examination. But there is no discussion on this argument. There is, however, an observation that in the event of the Department recovering any amount which is written off, the Department could initiate fresh proceedings in accordance with law “despite this order”. It stands to reason, that such amount would be accountable and assessable, if it had been allowed as deduction and not otherwise. Besides, the question of recovery cannot arise after amalgamation as outstanding debts due from subsidiary would have got cancelled on merger. The decision may need review.

SALES TAX COLLECTION

Where there is dispute about the correctness of levy of sales tax, it is usual for traders to collect it as contingency deposits and ultimately either pay it to the Government or refund it to the parties, subject to the outcome of such dispute. Where the contingency deposits were treated as income, such treatment was upheld in *Ishwardas Sons v. CIT* [2007] 295 ITR 473 (Ker). The Departmental view has been that while such receipts will be included in income, payment out of it, even where separate accounts are kept, could be allowed as deduction in the year of payment, subject to section 43B of the Act. For coming to the conclusion, the nature of sales tax as trading receipt as held in *CIT v. Thirumalaiswamy Naidu and Sons* [1998] 230 ITR 534 (SC) and *Jonnalla Narashimharao and Co. v. CIT* [1993] 200 ITR 588 (SC) were adverted to in this decision. An argument based on the principle of diversion by overriding title would not be applicable for such a case, because the amount on collection becomes taxable as trading receipts, though described as deposits.

P/L 1-4 to 31-3			
Particulars	Amount	Particulars	Amount
Subsidiary company loan w/off (allowable as deduction)	3,4	Sales tax collected (contingency deposit) (Treated as Income)	1,2
Subsidiary company shares w/off (If held as stock in trade, allowable)	8,9	Trading loan w/off (Treated as Income)	5,6
Subsidiary company shares w/off (If held as capital asset then 46(2))	10	Unclaimed debenture account balance. (Treated as Income)	7

1.	Ishwardas Sons (Ker)
2.	Thirumalaiswamy Naidu and Sons (SC)
3.	United Breweries Ltd. (Kar)
4.	Amalgamations P. Ltd. (SC)
5.	Solid Containers Ltd. (Bom.)
6.	Sundaram Iyengar & Sons Ltd. (SC)
7.	Hindustan Foods Ltd. (Bom.)
8.	H. P. Mineral (HP)
9.	Industrial Development Corporation Ltd. (HP)
10.	C.A. Natarajan (Mad)

INTEREST ON TEMPORARY DEPOSITS

In CIT v. Lok Holdings [2010] 189 Taxman 452 (Bom.), the assessee in the course of its business of development of properties received monies in advance from its customers intending to purchase flats in the properties developed by it. Since those monies could not be utilized immediately for the business of the firm, the assessee invested the surplus amount temporarily in the banks and other concerns and earned interest on such deposit and claimed it as business income.

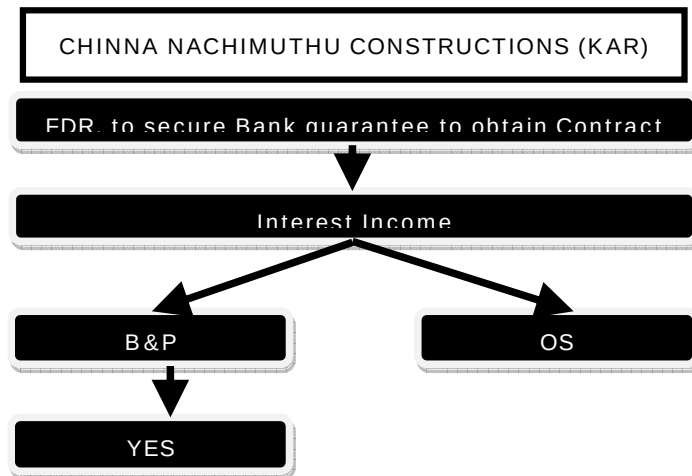
Where a real estate developer receives advances from intending purchasers and derives interest income from the bank on deposit of such advances, such interest income is income from business as held in CIT v. Lok Holdings [2009] 308 ITR 356 (Bom) following CIT v. Paramount Premium P. Ltd. [1991] 190 ITR 259 (Bom), inter alia, distinguishing the case of the Supreme Court in Tuticorin Alkali Chemicals and Fertilisers Ltd. v. CIT [1997] 227 ITR 172 as relating to a business, which had not commenced during the year.

NOTIONAL INTEREST ON RENT DEPOSIT

The Delhi High Court in CIT v. Asian Hotels Ltd. [2008] 168 Taxman 59 held that in the absence of any specific provision similar to one under the Wealth-tax Act, 1957, it is not permissible to consider notional interest as income either under section 23 or as one which is chargeable under section 28(iv). This decision is a reminder to the Government to draft an appropriate law in this respect to resolve the controversy.

DEPOSITS MADE TO AVAIL BANK GUARANTEE

The Karnataka High Court in CIT v. Chinna Nachimuthu Constructions [2008] 170 Taxman 272 held that interest earned on fixed deposit made to secure bank guarantee to be offered to acquire a contract would have to be treated as business income and not as income from other sources.



BROKEN PERIOD INTEREST

In CIT v. Bank of Rajasthan Ltd. [2009] 178 Taxman 304 (Raj.), the assessee-bank purchased certain securities-cum-interest and, thus, the composite purchase consideration also comprised of issue price and accrued interest (broken period interest) uptill the date of purchase. The question in this case was whether the bank was entitled to have deduction of this element of interest from its income. The Tribunal in the first leg quashed the order under section 263 on the premise that if the securities are held as stock-in-trade, the entire consideration including the interest element is allowable as revenue deduction, by way of cost of purchases. It drew reference to the Bombay High Court judgment in American Express International Banking Corporation v. CIT [2002] 258 ITR 601/125 Taxman 488.

The Rajasthan High Court, however, chose to distinguish the Bombay High Court decision and instead followed the ratio of the decision of the Supreme Court in Vijaya Bank Ltd. v. Addl. CIT [1991] 187 ITR 541/57 Taxman 152. It, thus, held that it is not permissible to post-mortem the purchase component of an asset since the scheme of the Income-tax Act does not permit deduction of interest element paid as business expenditure.

Where parties were debited with stipulated interest, but such interest was credited only to a suspense account and not carried to the profit and loss account, is it open to the Assessing Officer to bring to tax such income? This was the issue that was raised in American Express International Banking Corporation v. CIT [2002] 258 ITR 601 (Bom). In coming to the conclusion, the High Court followed the decision in UCO Bank v. CIT [1999] 237 ITR 889 (SC).

Another issue decided in this case related to the treatment of interest from Government securities. The method of accounting followed was to split up the consideration paid and also received as between accrued interest and principal amount, so that the interest receivable for the broken period was set off against interest payable for such period. It was held that the Assessing Officer was not justified in taxing the interest receivable, while disallowing interest payable. In coming to the conclusion, the High Court had to meet the decision of the Supreme Court in Vijaya Bank v. Addl. CIT [1991] 187 ITR 541 as well

as the decision in *United Commercial Bank Ltd. v. CIT* [1957] 32 ITR 688 (SC). But it was found that they were distinguishable in the context of assessment of such income in these cases under the head “Other sources”. Interest on securities for a bank, in view of the requirement of maintenance of Statutory Liquidity Ratio (SLR) in Government securities, would be assessable as business income as was pointed out in *CIT v. Cocanada Radhaswami Bank Ltd.* [1965] 57 ITR 306 (SC). If it is so assessable as income from business, the method of accounting regularly followed cannot be faulted. It was also further pointed out that the assessee’s method of accounting did not result in loss to the Revenue, so that there was no need for interference with the method adopted. This decision on this point should avoid the subsisting controversy based upon the application of *Vijaya Bank’s* case in the case of most banks.

	Interest Income	Head
Lok Holdings (Bom)	Surplus amount deposited in Bank in course of Business	BUSINESS
Asian Hotels (Del)	Rent deposit (Interest Free)	Notional interest not taxable
Bank of Rajasthan (Raj)	Broken period Interest (Asset purchased cum Interest) (10+1 Int = 11 Paid)	Interest no deduction (Asset Cost = 11) (No need to breakup interest)
Vijaya Bank (SC)	Broken period Interest (Asset purchased cum Interest) (10+1 Int = 11 Paid)	Interest no deduction (Asset Cost = 11) (No need to breakup interest)
Chinna Nachimuthu Construction (KAR)	Interest on FD kept to obtain bank guarantee	BUSINESS

COMPENSATION ON CAPITAL ACCOUNT

In *S. Zoraster & Co. v. CIT* [2009] 182 Taxman 52 (Raj.), the assessee received a sum as compensation on account of cancellation of agreement to sell a property due to default of the purchaser. Consequently, he claimed it as a capital receipt. The Rajasthan High Court also declared it to be capital receipt following the Supreme Court ruling in *Travancore Rubber & Tea Co. Ltd. v. CIT* [2000] 243 ITR 158/109 Taxman 250. Under the new direct tax code; however such receipts would be considered as income under residuary head.

BUSINESS MUST BE CARRIED ON TO MERIT DEDUCTION OF EXPENDITURE

The assessee in the business as auto consultants giving technical advice was found to have entered into agreements with various manufacturers through its managing director during his stay in India, when he visited a number of potential customers. An office was hired and rent was incurred, the company also participating in auto fair. It was held that the business should be treated as having commenced, by the Tribunal in *Styler India P. Ltd. v. Joint CIT* [2008] 302 ITR (AT) 1 (Pune) and that the current repairs could, therefore, be allowed as expenditure during the year. The law as settled is that in a manufacturing industry, the assessee should have set up its manufacturing apparatus ready for operation. In the case of a dealer, mere purchase is enough to infer business. In the case of consultants, lawyers, auditors etc. the mere fact that they are in a position to give advice by setting up an office or a name board should be sufficient and it is not necessary that there should be customers or service during the year.

CONTINGENCY DEPOSIT

In *CIT v. Nazir Basheer and Co.* [2008] 169 Taxman 237/[2006] 285 ITR 558 (Mad.), the assessee had collected contingency deposits from parties towards probable sales tax liability. The Assessing Officer added the contingency deposits collected by the assessee treating those as its income. The Madras High Court held that if a receipt is a trading receipt the fact that it is not so shown in the account books of the assessee would not prevent the assessing authority from treating it as a trading receipt. It is the true nature and quality of the receipt and not the head under which it is entered in the account books which is decisive in the matter.

EXPLOITATION OF PROPERTY BY BUSINESS ARRANGEMENT

In *CIT v. Faith Real Estate (P) Ltd.* [2008] 173 Taxman 405 (Delhi) the assessee had given on rent its premises to a retail chain store. Under the agreement the assessee was to receive 2 per cent commission on sales for use of such premises. The assessee offered such income under the head 'business income' whereas the department assessed it as income from house property instead. On examination of facts it was found as under:

- (a) that the assessee was involved in day-to-day functioning of the store;
- (b) that the assessee was required to perform the upkeep of the building;
- (c) that the assessee was to participate in the management by giving suggestions on the display of items and pricing of goods.

The Delhi High Court on perusal of such facts held that the amount received by the assessee had to be assessed under the head 'business income'. Very interestingly the Court made the following relevant observations:

“ It appears that the arrangement arrived at between the assessee and M/s. Ebony Retail Holdings Ltd. was only to exploit the property in this manner due to a recession in the market.”

In the current day scenario property owners must insist on a similar arrangement to optimise their taxes.

GUARANTEES ISSUED

In CIT v. Mehta (P) Ltd. [2008] 174 Taxman 104 (Bom.) the assessee carrying on financing business had issued a guarantee to 'SCCIL' in respect of loan advanced by the latter to another associate entity. The assessee-company was of the view that with the help of said loan, the associate entity would overcome its financial difficulties and would be able to start earning profits and to gradually pay off its creditors including the assessee-company which had to recover Rs. 15 lakhs from the associate entity. As the associate entity had failed to repay the aforesaid loan and interest thereon to 'SCCIL', 'SCCIL' called upon the assessee to make good the payment of loan with interest thereon in terms of the guarantee executed by the assessee. The Assessing Officer, after noticing that some of the directors of 'SCCIL', the assessee-company, and its associate entity were common, took the view that all companies were under the same management and a device was adopted to get maximum benefit out of the said transactions which smacked of collusion. Accordingly, the Assessing Officer declined to allow the loss.

P/L 1-4 to 31-3			
Particulars	Amount	Particulars	Amount
Guarantee Loss (Related Party) (allowable deduction) (Mehta (P) Ltd. (Bom))	12.5		

The Bombay High Court held that the revenue had failed to produce any material in support of its case that the guarantee given by the assessee was not genuine. It held a view that only because some directors were common, one could not reach to a serious conclusion that the entire transaction was collusive and a colourable device only to book losses.

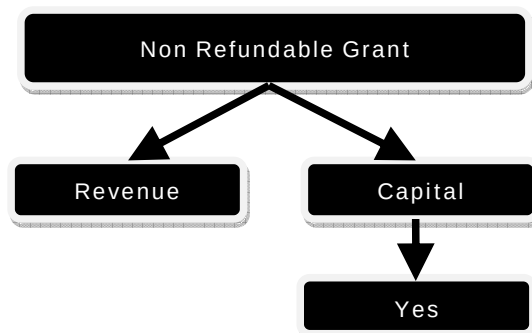
ONLY REAL INCOME ACCRUAL IS LIABLE TO TAX

Before the High Court of Bombay in FGP Ltd. v. CIT [2009] 177 Taxman 147 the assessee contended that no royalty income had been received by it till date pursuant to the royalty agreement as there was dispute between the parties and arbitration proceedings were being proceeded with. In this case, the parties had been referred to arbitration pursuant to a suit filed by the other party seeking relief that no amount was due and payable by them to the assessee.

Following the decision in Godhra Electricity Co. Ltd. v. CIT [1997] 225 ITR 746/91 Taxman 351 (SC), the Bombay High Court held that what could therefore, be assessed was real income, as income-tax is a tax on income. The test therefore, before income can be taxed is whether there is real accrual of income. It thus, held that there was no real accrual of income to assessee and it was only on arbitral proceedings coming to an end and award being passed, that income received by assessee would be liable to be assessed.

NON RETURNABLE GRANT FROM PARENT COMPANY

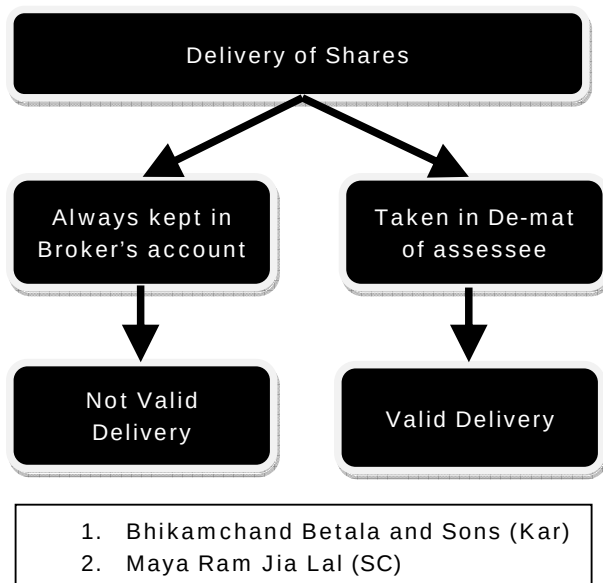
The assessee received a sum of Rs. 13 crores from its parent-company L, which was credited to the profit and loss account by way of a capital grant. The Assessing Officer held that the amount was assessable but the Commissioner (Appeals) held that it was a capital receipt. On appeal to the Tribunal Held, that no business connection had been



brought out between the assessee and the holding company as only the names of the associated concerns had been mentioned. Further, it was not shown that transactions with these associated concerns were not at arm's length leading to the loss to the assessee-company in the past. It was also not shown that such a loss was wholly or partly reimbursed by the holding company. The Revenue had not been able to establish that the receipt was in the nature of income, the burden to prove which lay on it. The receipt was of a capital nature and was not assessable.

SPECULATIVE TRANSACTION – SHARES IN BROKERS ACCOUNT

Physical delivery of shares is a condition for avoiding the inference of speculation. Where a transaction is put through a broker and had become the subject matter of transactions through the stock exchange, delivery is bound to have taken place, except in badla transaction, where permitted. But where the transaction is between a client and the broker on principal to principal basis, physical delivery cannot be presumed as for stock exchange transactions. It is such a transaction on principal to principal basis, settled by payment of difference, without physical delivery, that was characterised as a speculative transaction within the meaning of section 43(5) of the Act. In coming to the conclusion, the High Court in



Bhikamchand Betala and Sons v. ITO [2007] 294 ITR 10 (Gauhati) followed the decision in CIT v. Maya Ram Jia Lal [1986] 162 ITR 520 (P&H).

During the course of assessment proceedings for the assessment year 1995-96, the assessee, an Hindu undivided family, claimed the loss in share business amounting to Rs. 3,99,860. The Assessing Officer disallowed the claim on the ground that the transaction in shares could not be treated as genuine and added the amount to the income of the assessee. The Commissioner (Appeals) held that the disallowance of the loss in share business was based on a wrong perception of the facts and directed the Assessing Officer to allow the loss as claimed by the assessee. The Tribunal observed that

the assessee had purchased the shares on principal to principal basis and resold the shares without taking physical delivery of the shares and also paid only the difference amount of purchase and sale value. The Tribunal took the view that the loss of Rs. 3,99,860 was speculation loss and modified the appellate order. On appeal : Held, dismissing the appeal, that on facts the contention that the assessee had no initial intention to settle the contract by payment of the difference but was only forced by subsequent circumstances to do so and hence the transaction was not speculative in nature could not be accepted. The loss in share business was speculation loss and not deductible. CIT v. Maya Ram Jia Lal [1986] 162 ITR 520 (P & H) followed.

SCOPE OF HEADS OF INCOME – INTEREST INCOME

Where the main business of the assessee is income from civil contracts with money-lending only as subsidiary activity, the question that arose in Ferro Concrete Construction (India) P. Ltd. v. CIT [2007] 290 ITR 713 (MP) was whether interest income on bank deposits should be assessed as income from business or other sources. It was decided that bank interest including that from in short term deposits is assessable under other sources following the decision in Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT [1997] 227 ITR 172 (SC), though the facts were admittedly “slightly different”. The decision in Tuticorin Alkali Chemicals’ case had not been followed in CIT v. Bokaro Steel Ltd. [1999] 236 ITR 315

(SC), CIT v. Karnal Co-operative Sugar Mills Ltd. [2000] 243 ITR 2 (SC) and CIT v. Karnataka Power Corporation [2001] 247 ITR 268 (SC) and finally be treated as overruled in Bongaigaon Refinery and Petrochemicals Ltd. v. CIT [2001] 251 ITR 329 (SC). Again a significant distinction is that Tuticorin Alkali Chemicals' case dealt with the receipt of interest before the commencement of business, so that it could have had no application to the case before the High Court. Strangely, even income from sale of empty bags, containers and drums acquired and used in the assessee's contract business was sought to be treated as income from other sources by the Tribunal. But the High Court mercifully found on this point that these were part of the assessee's day to day business, so that it could be treated as income from business. "Other Sources" is a residuary head of income, so that what will fall to be assessed under "Other Sources" is only income which cannot fall under any other head.

In CIT v. Motlay Finance P. Ltd. [2007] 290 ITR 719 (MP), the issue was whether the income of the assessee from dealing in investments, shares, securities and debentures consistent with the objects of the company offered by the assessee as business income was correct. It appears that the Revenue wanted to make a distinction between transactions in quoted securities in the stock exchange and those which were unquoted. It was found that this could make no difference. The High Court, therefore, decided that there was no substantial question of law, so as to justify interference with Tribunal's decision.

Where the assessee makes an investment by way of fixed deposit with a bank as a condition for getting bank guarantee for purposes of his contract business, such interest income can only be considered as business income. It was so decided in CIT v. Chinna Nachimuthu Constructions [2008] 297 ITR 70 (Karn). In coming to the conclusion, the High Court followed the decision in another contractor's case in CIT v. Govinda Choudhury and Sons [1993] 203 ITR 881 (SC). It is often overlooked that section 56 providing for income from other sources is a residuary one. It is only where an income does not fall under any of the other regular sources of income, there should be need for invoking section 56. Where a person has only one source of income and that is business, there could hardly be any other inference. In Snam Progetti S. P. A. v. Addl. CIT [1981] 132 ITR 70, the Delhi High Court took a broad view and considered interest income as incidental to and, therefore, business income, because it cannot be presumed that the assessee had come all the way from Italy to make bank deposits in India, when it was clear that the company was established for carrying on business. In CIT v. Tamil Nadu Dairy Development Corporation Ltd. [1995] 216 ITR 535, the Madras High Court has held following the decision of the Supreme Court in CIT v. Calcutta National Bank Ltd. [1959] 37 ITR 171, that "business" is a word of very wide connotation with the result, that it should ordinarily be treated as business income. Except where the investments are independent of business made out of surplus funds in long term deposits, there is no possibility of assessing such income under "other sources".

290 ITR 0295- COMMISSIONER OF INCOME-TAX VS. IDEAL SHEET METAL STAMPINGS AND PRESSING P. LTD. (GUJARAT HIGH COURT)

Where disputed excise duty is collected from customers and kept in a separate account, it cannot be claimed that it is not to be included and that at any rate, it could be allowed as a deduction, merely because it is kept in a separate account. The contention was found unacceptable, since the collection being a trading receipt was liable to be included as income and that the tax amount, not having been paid, is bound to be disallowed. It was so decided in CIT v. Ideal Sheet Metal Stampings and Pressing P. Ltd. [2007] 290 ITR 295 (Guj).

251 ITR 0360 COMMISSIONER OF INCOME-TAX VS. AVINASH PASRICHA (DEL)

The definition of "income" in section 2(24) was inclusive, the purpose of the definition was not to limit the meaning of "income" but to widen its net, and the several clauses therein were not exhaustive of the meaning of income. Even if a receipt did not fall within the ambit of any of those clauses, it might still be income if it partook of the nature of income.

The assessee an individual derived income from his profession as a photographer. In an all-India photography contest the assessee won the first prize and received a cash award of Rs. 30,000. He claimed that the said receipt did not bear the character of income and was, therefore, not taxable. Held, that the award of Rs. 30,000 was taxable as income.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

The assessee an individual derived income from his profession as a photographer. In an all-India photography contest the assessee won the first prize and received a cash award of Rs. 30,000. He claimed that the said receipt did not bear the character of income and was, therefore, not taxable. You are required to answer whether assessee is justified or not.

ANSWER

Where a professional photographer wins a prize in a photographic con-test, should it be taxable? If it is so taxable, will it be assessable as his professional income or winnings from lotteries and gains? In CIT v. Avinash Pasricha [2001] 251 ITR 360 (Delhi), where the Assessing Officer had left out the winnings in the assessment, the Commissioner of Income-tax acting under section 263 directed that it should be so included as he considered them to be taxable. Held, that the award was taxable as professional income.

Following ratios emerge from the decided cases

- 1) A view was taken in an English case in *Haves v. Hadniz* [1942] 24 PC 153, where it was held that a solicitor's clerk getting income from articles on his experience relating to his employment was not treated as casual income so as to be exempt.
- 2) In *Parelkar, Gore and Parpia v. CIT* [1958] 34 ITR 312 (Bom), a practising architect won a prize for a plan for a building for the All India Medical Institute. The assessee claimed exemption as casual and non-recurring receipt. It was held to be in the course of exercise of his profession and that it was professional income.
- 3) Even State awards for films or best literary work may become taxable in the hands of those persons who are getting such awards because of their professional work or because they are related to their business.

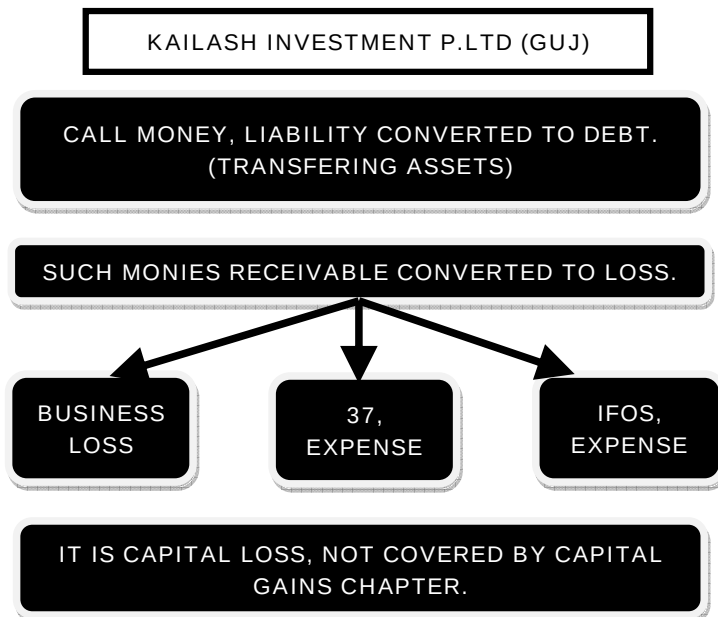
281 ITR 0092- KAILASH INVESTMENTS P. LTD. VS. COMMISSIONER OF INCOME-TAX

(GUJARAT HIGH COURT)

Assessee company has call money liability to pay. The company making the call had also some liability to be paid to assessee company. By effecting triparty agreement the call money liability was converted in to a debt.

The issuance of share capital and receipt of call money against the same account had no relevance to the holding of investments under the head “Income from other sources”. Therefore, the Tribunal was justified in holding that the assessee was not entitled to any deduction under section 28 and/or under section 37. Section 57(iii) requires incurring of an expenditure which is laid out or spent wholly and exclusively for the purpose of making or earning income from other sources. The entire debt was relatable to issuance of share capital and was thus, on capital account. No expenditure had in fact been incurred for the purposes of earning or making income.

Accordingly, the finding of the Tribunal that the assessee was not entitled to deduction under section 57(iii) of the Act did not require any interference.



In other words, where the assessee incurred a loss in conversion of call money liability into a debt, such loss cannot be treated as a business expenditure under section 37 or a loss covered either by section 28 or under the head “capital gains” in section 45 or loss or expenditure under “other sources” in section 57. It was so decided in Kailash Investments P. Ltd. v. CIT[2006] 281 ITR 92 (Guj).

283 ITR 0338- COMMISSIONER OF INCOME-TAX VS. REWASHANKER A. KOTHARI (GUJARAT HIGH COURT)

In order to determine whether profits arising on sale is business income, the following tests can be applied :

- (a) the first test is whether the initial acquisition of the subject matter of transaction was with the intention of dealing in the item, or with a view to finding an investment. If the transaction, since the inception, appears to be impressed with the character of a commercial transaction entered into with a view to earn profit, it would furnish a valuable guideline ;
- (b) the second test is why and how and for what purpose the sale was effected subsequently ;
- (c) the third test is as to how the assessee dealt with the subject matter of transaction during the time the asset was with the assessee, whether it has been treated as stock-in-trade, or been shown in the books of account and balance sheet as an investment. This inquiry, though relevant, is not conclusive ;
- (d) the fourth test is how the assessee himself has returned the income from such activities and how the Department has dealt with the same in the course of preceding and succeeding assessments. This factor, though not conclusive, can afford good and cogent evidence to judge the nature of transaction and would

be a relevant circumstance to be considered in the absence of any satisfactory explanation ;

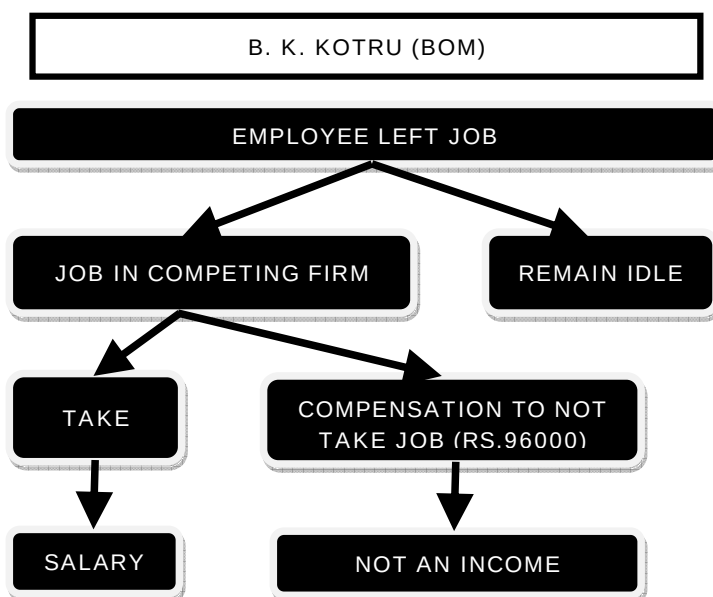
(e) the fifth test, normally applied in cases of firms and companies, is whether the deed of partnership or the memorandum of association, as the case may be, authorises such an activity ; (f) the most important test is as to the volume, frequency, continuity and regularity of transactions of purchase and sale of the goods concerned. In a case where there is repetition and continuity, coupled with the magnitude of the transaction, bearing reasonable proportion to the strength of holding, an inference can readily be drawn that the activity is in the nature of business.

VALUE OF BENEFIT / PERQUISITE OUT OF CARRYING ON OF BUSINESS

Section / Topic Name : 28

282 ITR 0001- B. K. KOTRU VS. COMMISSIONER OF INCOME-TAX (BOMBAY HIGH COURT)

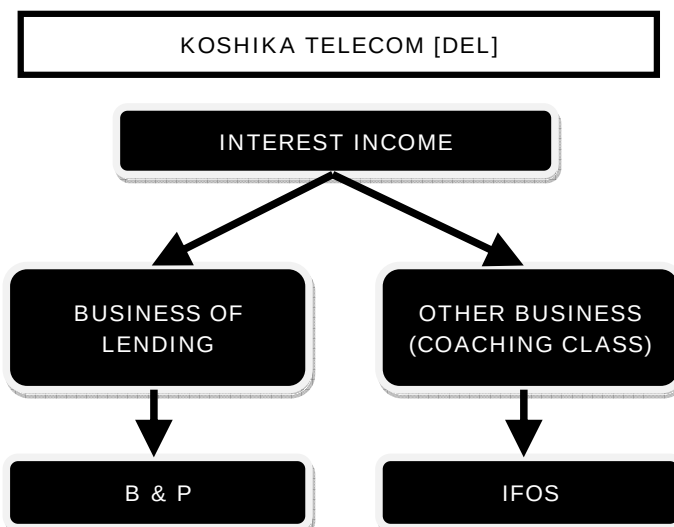
The assessee was in service with S as an industrial officer. He expressed his desire to leave the service and sought waiver of six months' notice period by accepting his resignation with effect from May 25. Resignation became effective from that date. The assessee was offered employment by competitors of S like W. In order to prevent the assessee from accepting such offer, S offered an additional amount of Rs. 96,000 to the assessee on his agreeing not to accept similar job in any other competing organisation for a minimum period of two years



The receipt of Rs. 96,000 could not be linked with salary, perquisites or profit in lieu of salary. The receipt of this amount was after cessation of the employer and employee relationship. This receipt could only be a capital receipt.

287 ITR 0479- COMMISSIONER OF INCOME-TAX VS. KOSHIKA TELECOM LTD. (DELHI HIGH COURT)

Interest income ordinarily falls under the head "Other sources". But where it is linked by nexus with business, such income may well be liable to tax only as business income. It was so held in CIT v. Koshika Telecom Ltd. [2006] 287 ITR 479 (Delhi), where an assessee operating cellular mobile telephone services had deposited margin money to obtain licence with such deposit earning interest, such interest being linked to business is assessable as business income. The authorities relied upon the decision in Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT [1997] 227 ITR 172 (SC) overlooking the fact that it has no application where such deposits are inextricably



linked to business, such income may well be liable to tax only as business income. It was so held in CIT v. Koshika Telecom Ltd. [2006] 287 ITR 479 (Delhi), where an assessee operating cellular mobile telephone services had deposited margin money to obtain licence with such deposit earning interest, such interest being linked to business is assessable as business income. The authorities relied upon the decision in Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT [1997] 227 ITR 172 (SC) overlooking the fact that it has no application where such deposits are inextricably

linked to the requirement of furnishing bank guarantee and not mere investment of surplus funds, so that the later decisions in CIT v. Bokaro Steel Ltd. [1999] 236 ITR 315 (SC) and CIT v. Karnal Co-operative Sugar Mills Ltd. [2000] 243 ITR 2 (SC) were to be followed. The decision to this effect by the Tribunal cannot raise a question of law and much less a substantial question of law.

The deposit of the margin money by the assessee with the banks was inextricably linked to the furnishing of the bank guarantees by the assessee to the Department of Telecommunications for obtaining a licence. Hence, the interest was assessable as business income.

287 ITR (A.T.) 0124- DEPUTY COMMISSIONER OF INCOME-TAX VS. SARAF CHEMICALS LTD. (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

Anti-compete fee for non-competition for a specified number of years has been treated as capital receipt in the hands of the recipient, till it was made taxable under section 28(va) from April 1, 2003. The issue whether it would be deductible as revenue expenditure in the hands of the payer had come up before the Tribunal in Deputy CIT v. Saraf Chemicals Ltd. [2006] 287 ITR (AT) 124 (Mum). It was held that the payment is for elimination of competition, which would mean acquisition of monopoly rights. Such payment would be capital expenditure as was found in Assam Bengal Cement Co. Ltd. [1955] 27 ITR 34 (SC). Such advantage obtained by the payment is not in the revenue field, so as to require application of the decision in Empire Jute Co. Ltd. v. CIT [1980] 124 ITR 1 (SC). This decision of the Tribunal reviewed the case law on the subject, when it came to the conclusion, that it is capital expenditure in the facts of the case.

287 ITR 0148- COMMISSIONER OF INCOME-TAX VS. NIJRANG SPECIFIC FAMILY TRUST (GUJARAT HIGH COURT)

An amount received as compensation for goodwill of a business, which was carried on by the assessee trust as a proprietor and later in partnership, on retirement from partnership, was sought to be treated as the assessee's income from business. Since there is no business after retirement, such compensation cannot partake of the character of business but only as income from "Other sources" as held by the High Court in CIT v. Nijrang Specific Family Trust [2006] 287 ITR 148 (Guj) after an elaborate discussion of the case law on the subject more specifically following the Supreme Court decision in Universal Plast Ltd. v. CIT [1999] 237 ITR 454, which has set out the following guidelines (page 151) :

“(1) no precise test can be laid down to ascertain whether income (referred to by whatever nomenclature, lease, amount, rents, licence fee) received by an assessee from leasing or letting out of assets would fall under the head ‘Profits and gains of business or profession’ ;

(2) it is a mixed question of law and fact and has to be determined from the point of view of a businessman in that business on the facts and in the circumstances of each case, including true interpretation of the agreement under which the assets are let out ;

(3) where all the assets of the business are let out, the period for which the assets are let out is a relevant factor to find out whether the intention of the assessee is to go out of business altogether or to come back and restart the same ;

(4) if only a few of the business assets are let out temporarily, while the assessee is carrying out his other business activities, then it is a case of exploiting the business assets otherwise than employing them for his own use for making profit for that business ; but if the business never started or has started but ceased with no intention to be resumed, the assets also will cease to be business assets and the transaction will only be exploitation of property by an owner thereof, but not exploitation of business assets”.

SPECULATIVE BUSINESS INCOME

Section / Topic Name : 43 (5)

255 ITR 0329- COMMISSIONER OF INCOME-TAX VS. MANGAL CHAND (RAJ)

The actual delivery of share certificates along with the blank transfer form, but without the same having been registered in the name of the assessee would not bring it within the purview of section 43(5).

Question

You are required to answer whether the actual delivery of share certificate along with the blank transfer form, but without the same having been registered in the name of the assessee would bring the case within the purview of section 43(5) for holding it to be speculative transaction or not.

Answer

The actual delivery of share certificates along with the blank transfer form, but without the same having been registered in the name of the assessee would not bring it within the purview of section 43(5).

REPAIRS OF PROPERTY / ASSETS

Section / Topic Name : 30 and 31

MACHINE REPLACEMENT- TEXTILE INDUSTRY

The Supreme Court in CIT v. Sri Mangayarkarasi Mills (P.) Ltd. [2009] 182 Taxman 141 held that integrated process of manufacture of yarn in textile mill or for that matter inter-connection among the various machines does not take away the independent identity and distinct function of each machine. It held that each machine in a textile mill should be treated independently as such and not as mere part of an entire composite machinery of the spinning mill. The Apex Court ruled out deduction either as current repairs or under the residuary head as it termed it as a capital expenditure.

In a passing reference, the Court made the following important observation :

“ . . . Though accounting practices may not be the best guide in determining the nature of expenditure, yet in the instant case they were indicative of what the assessee itself thought of the expenditure it made on replacement of machinery; and that the claim for deduction under the Act was made merely to diminish the tax burden, and not under the belief that it was actually revenue expenditure.”

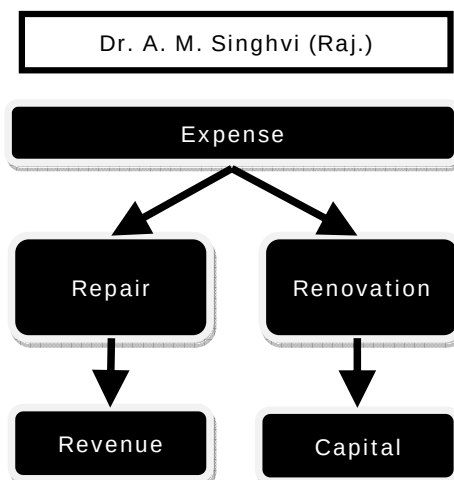
The assessee's must, thus, refrain from different treatment for tax and accounting purpose after this Apex Court observation.

Even where the assessee had capitalised the cost of replacement of machinery, it was found by the Tribunal to be deductible under the law and its view was endorsed by the High Court in CIT v. Coimbatore Alcohol and Chemicals Ltd. [2008] 296 ITR 356 (Mad) following CIT v. Janakiram Mills Ltd. [2005] 275 ITR 403 (Mad). There has been further development in law, wherein the decision in Janakiram Mills' case (supra) was disapproved by the Supreme Court, since one of the grounds on the basis of which deduction was allowed was that the textile industry is a continuous process industry. This view was not acceptable to the Supreme Court in CIT v. Saravana Spinning Mills P. Ltd. [2007] 293 ITR 201 (SC). However, in appeal from the other cases decided in Janakiram Mills' case, the Supreme Court remitted the matter to the Commissioner (Appeals) for consideration whether deduction would be admissible under section 37, if not under section 30 as current repairs. If it was disallowed on the ground that it was capital expenditure under section 30, it could not be treated as revenue expenditure under section 37, which bars deduction of capital expenditure. There are no precedents to the effect that replacement of machinery can be allowed only in a case of continuous process industry. Where it had been allowed in a number of earlier precedents, the test primarily was whether the item of machinery is capable of independent operation. Even so, the decision of the Madras High Court following Janakiram Mills' case should stand justified for more than one reason. The industry in this case is a chemical industry, where continuous process is an ordinary incident. Apart from the same, the inference whether the replacement was revenue or capital expenditure is best drawn with reference to productive capacity even as pointed out in CIT v. Steel Complex Ltd. [1999] 238 ITR 1054 (Ker) following the guidelines of the Supreme Court in Alembic Chemical Works Co. Ltd. v. CIT [1989] 177 ITR 377 (SC). If this test, which has far greater relevance than the other tests, is followed, there would be much less scope for controversy.

REPAIR TO PREMISES ON LEASE

The Delhi High Court in CIT v. HI Line Pens (P.) Ltd. [2008] 175 Taxman 132 held that the expenses, that were incurred by the assessee, towards repairing of the premises taken on lease so as to make it more conducive to its business activity, would admit of deduction under section 30(a)(i). The High Court stressed on the reasoning that the Legislature has made a distinction between expenses incurred by a tenant for repairs of the premises and expenses incurred by a person who is not a tenant towards current repairs to the premises and in its view this distinction has to be given meaning. Perhaps, the logic behind the distinction is that a tenant would, by the very nature of his status as a tenant, not undertake expenditures as would endure beyond his likely period of tenancy or create a new asset, whereas an owner may undertake expenditures so as to even bring about new assets of capital nature. It was, therefore, necessary to qualify the expenditure on repairs. The deduction was, therefore, limited to expenditure on ‘current repairs’ only.

Repairs and renovation of lease hold premises in order to have reasonable facilities for running an office can be allowed as revenue expenditure. It was so held in CIT v. Dr. A. M. Singhvi [2008] 302 ITR 26 (Raj). In such cases, the nature of the expenditure would be important. The fact that it is incurred in respect of rented premises lends further support to the claim for deduction.



STRUCTURAL ALTERATIONS

In Bigjo's India Ltd. v. CIT [2007] 161 Taxman 135 (Delhi), new counters and lift were erected in the showroom and huge expenditure was incurred on purchase of timber and plywood. Further, the assessee had altogether built a new shaft and shifted old shaft to a new site and had spent huge amount on the construction of it. The Delhi High Court held that the expenditures incurred by the assessee were for fixed capital assets and, therefore, the expenditure was in the nature of capital and not just amounting to renovation of existing old assets.

P/L 1-4 to 31-3			
Particulars	Amount	Particulars	Amount
Structural alteration (Capital expense)	1		
Repairs to premises on lease (Not owner) (allowable)	2		
Replacement of machinery inter connected (not allowable)	3,4,5		

1.	Bigjo's India Ltd. (Delhi)
2.	HI Line Pens (P.) Ltd. (Delhi)
3.	Sri Mangayarkarasi Mills (P.) Ltd. (SC)
4.	Janakiram Mills Ltd. (Mad.)
5.	Saravana Spinning Mill P. Ltd. (SC)

CURRENT REPAIRS

The Supreme Court, in CIT v. Saravana Spg. & Mills (P.) Ltd. [2007] 163 Taxman 201, held that the basic test to judge whether a repair is current repair or not is whether expenditure has been incurred to preserve and maintain an already existing asset and secondly, the object of such expenditure is not to bring a new asset or fresh or new advantage. It held that the tests laid down for capital or revenue classification do not hold any relevance for allowance of deduction under this section. Thus, expenditure may be revenue, yet it may not be in the nature of current repair. However, it would not hold true on the contrary where expenditure is capital in nature. The Explanation in the section provides a stop at that point. Again there could be a thin line in classifying between capital and revenue. It is truly endless in the absence of any definition in the Act as of date. Hope the new tax code at least does not make such mess and define them in the Act itself.

An elaborate judgment of the Madras High Court in the case of CIT v. Janakiram Mills Ltd. [2005] 275 ITR 403 discussed and followed the earlier precedents in favour of taxpayers on the subject. This decision in a common judgment included that of Saravana Mills' case, which was taken up first and reversed in CIT v. Saravana Spinning Mills P. Ltd. [2007] 293 ITR 201 (SC). The decision mainly went against the assessee because the main or practically the sole basis for deduction considered by the Supreme Court was whether the assumption that spinning mills will be treated as a single process industry, so as to merit deduction of replacement as current repairs. Notwithstanding a certificate from South India Textile Research Association (SITRA), the Supreme Court found that as a matter of fact, textile industry could not be characterised as a single process industry. It is because of this finding that it was found that replacement could not be automatically allowed in every case as revenue expenditure. It found that items like ring frames could not, therefore, be treated as a part of a larger machinery, since they are capable of operation by themselves. It is in the light of this finding that the other cases relied upon by the assessee were distinguished.

It would appear that in order that replacement should be available as revenue expenditure, the parts replaced should be decrepit and old. If the assessee's argument was based upon this factual aspect, the adverse decision could have probably been avoided. At any rate, in almost all cases, reliefs were given on facts and not on the basis of the blanket rule that all replacements should be allowed as revenue deduction on the assumption of single process industry. The decision in Janakiram Mills Ltd.'s case [2005] 275 ITR 403 (Mad), notwithstanding its acceptance of the inference that the textile industry is a single process industry as one of the grounds for its conclusion, rests on other solid foundations. Almost all the decided cases in favour of the taxpayer earlier and in this group of cases would show that the inference was not based upon SITRA's certificate, but on the facts of the case. The fact that ring frames and carding machines or the various other items are independent machinery and could be operated independently may not be correct on the facts. But they have to be operated in conjunction with other pieces of machinery, though the system as pointed out by the Supreme Court may not be a single process industry, so as to assume that even a blow room would only be part of an integral process with other sections in the textile mill.

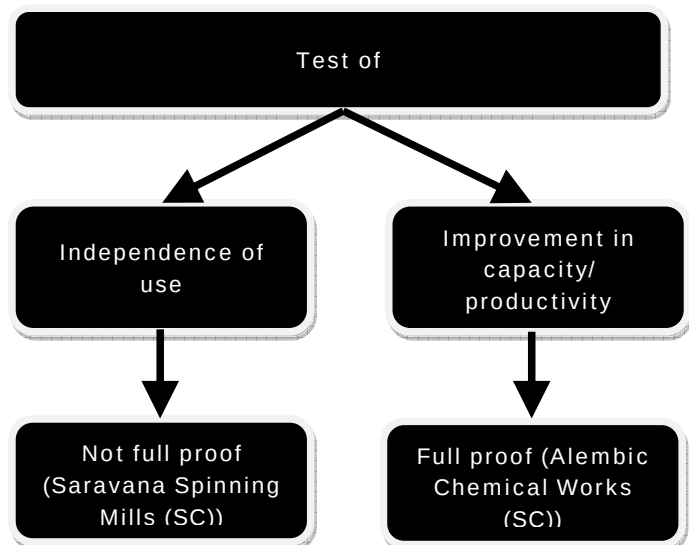
The Supreme Court in Saravana Mills' case [2007] 293 ITR 201 (SC) confined its conclusion with reference to the issue whether the claim would be covered by current repairs. It observed that the contentions of the assessee were not on the facts covered by other decisions favourable to the taxpayer as in the cases in New Shorrock Spinning and Manufacturing Co. v. CIT [1956] 30 ITR 338 (Bom) or CIT v. Mahalakshmi Textile Mills Ltd. [1967] 66 ITR 710 (SC). The Supreme Court further found that in Saravana Mills' case, the finding of all the authorities below was that it constituted current repairs without information as in the precedents cited. None of the precedents went on the basis that the entire textile mill is one single asset. The decision in Saravana Mills' case can only be treated as reversed in that part of the judgment holding that the textile industry could be taken as a single process industry.

The Supreme Court has also observed that the expenditure which does not fall under section 36 can be admissible, if it is not capital expenditure and satisfies the other conditions for such allowance. Deduction under section 37, it was observed, will depend upon the facts of each case. The Supreme Court, therefore, held "we do not wish to express any opinion

on the applicability of section 37(1) in the present case". The Supreme Court in M/s. Ramaraju Surgical Cotton Mills, Rajapalayam in C. A. No. 7594 of 2005 dated August 21, 2007 dealing with the same issue has decided in a bunch of cases that "in the absence of the requisite details regarding the production capacity remaining constant even after replacement, the matter needs to be remitted to the Commissioner (Appeals). There is one more reason why we are inclined to remit the matter. As stated above, the impugned judgment of the Madras High Court in the case of Janakiram Mills Ltd. [2005] 275 ITR 403

has been set aside by this court as there was confusion between the tests to be applied in respect of section 31 vis-a-vis the test to be applied in case of section 37 of the Income-tax Act. Without expressing any opinion on the merits of the case we remit the matter to Commissioner (Appeals) who will decide the question in accordance with law".

It would have probably been more advisable to have remanded even Saravana Mills' case for considering in the light of all the facts of the case, its right to deduction under section 31 or 37. The burden of disallowance of mere renovation in most cases is belated rather than premature. The real test is whether there has been increase in capacity. Any other view would be neither fair nor correct. It may even spell disaster for some mills running on dilapidated machinery embarking on renovation programmes replacing some machinery long overdue for repairs having become decrepit and old.



RENOVATION AND MODERNIZATION EXPENDITURE

In CIT v. Triveni Engg. & Industries Ltd. [2009] 181 Taxman 5 (Delhi), even though the assessee capitalised the renovation/modernisation expenditure in the books of account it offered an explanation that

- (a) the expenditure had been incurred to improve the profitability of
- (b) the company inasmuch as after incurring such expenditure,
- (c) the assessee would be in a position to crush more sugarcane in its two units. The Assessing Officer allowed depreciation on such expenditure.

Following its previous decision in CIT v. Relaxo Footwears Ltd. [2007] 293 ITR 231/162 Taxman 238 the Delhi High Court upheld the allowance as revenue deduction solely since there was continuity of business or existing business. Such expenditure is in the nature of deferred revenue expenditure and needs to be included in the asset category 'Deferred Revenue Expenditure' under the 15th Schedule of the new Direct Tax Code alongside VRS, merger expenses, non-compete fee, etc., to end litigation on this subject.

REPLACEMENT OF PARTS OF MACHINERY/MACHINERY

In CIT v. Renu Sagar Power Co. Ltd. [2008] 169 Taxman 175/298 ITR 94 (All.), the assessee running a captive power plant (CPP) had two thermal power plants. It claimed expenditure of Rs. 1,05,44,904 towards the cost of the turbine rotor, an essential part of turbo generator set. The Tribunal held that such part was not an independent machinery or plant and that the turbine rotor on its own independent functioning could not generate electricity. The Allahabad High Court on this ruling held that the expenditure by the assessee on the replacement of one turbine rotor was on account of current repairs and, as such, it was revenue expenditure.

Also in CIT v. Fenner (India) Ltd. [2008] 169 Taxman 62/[2007] 292 ITR 605 (Mad.), the Assessing Officer disallowed the claim of the assessee in respect of replacement expenditure of auto coner and moulds as revenue expenditure and treated the same as capital expenditure for the reason that the assessee had only replaced the auto coner and moulds without discontinuing their production activities and that there was no acquisition of any new asset, much less capital of any enduring advantage. The Madras High Court held such expenditure as revenue in nature.

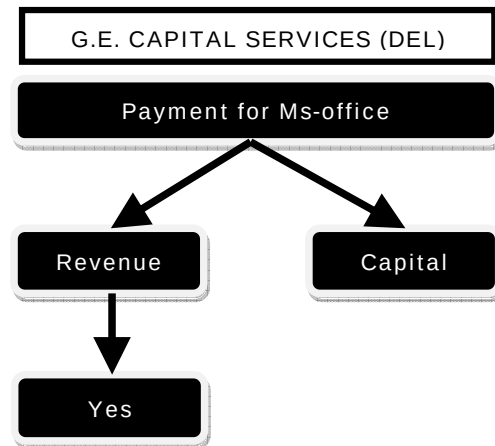
PARTS REPLACEMENT

The Madras High Court in CIT v. Metal Powder Co. Ltd. [2008] 174 Taxman 398 held that where entire plant and machinery was one common unit, cost towards replacement of parts of machinery would be revenue expenditure. In this case the assessee had only replaced certain machinery without discontinuing its production activities so that the Court held that that there was no acquisition of any new asset, much less capital of an enduring advantage. The Court also held that the issue whether the expenditure on replacement of machinery is capital or revenue is not determined by the treatment given in the books of account or in the balance-sheet or by the accounting practice of the assessee. The Court held that instead the claim has to be determined only by the provisions of the Act.

MACHINERY REPLACEMENT & COMPUTER UPGRADATION

In CIT v. Southern Roadways Ltd. [2007] 158 Taxman 1 the assessee made replacement of machineries namely oil tanker, driver cabins & vibrator motors. Also the AO disallowed software upgradation expenditure. Allowing deduction of each of such expenditure the Madras High Court held that the replaced machinery is not an independent item hence it would constitute revenue expenditure and also as regard upgradation of computers the Court relying on Supreme Court decision in Alembic Chemical Works Co. Ltd. v. CIT [1989] 177 ITR 377/43 Taxman 312 held that upgradation of computers by changing certain parts thereby enhancing the configuration of the computers for improving their efficiency, but without making any structural alterations is not of an enduring nature.

Cost of upgradation of software was held to be revenue expenditure in CIT v. G.E. Capital Services Ltd. [2008] 300 ITR 420 (Delhi). The reasoning of the Tribunal was that technological changes and the need to upgrade software on the regular basis cannot be treated as an enduring advantage. The High Court made a difference between customised software and others. A customised software does not require frequent upgradation, but the software in the matter before the High Court was not custom-built software. It is for this reason that the view of the Tribunal was upheld.



284 ITR 0100- COMMISSIONER OF INCOME-TAX VS. L. S. MILLS LTD. (MADRAS HIGH COURT)

The replaced machinery did not bring about any asset or any distinct advantage to the assessee and no structural change was also brought in. The expenditure on replacement of machinery was revenue expenditure. CIT v. Janakiram Mills Ltd. [2005] 275 ITR 403 (Mad) followed.

253 ITR 0405- COMMISSIONER OF INCOME-TAX VS. VOLGA RESTAURANT (DEL)

The law allows current repairs specifically under section 31 of the Income-tax Act. Current repairs do not rule out accumulated repairs undertaken during the year. Where a restaurant is renovated involving large outlay in replacement of airconditioning plants and parts of electric motors, etc., to renovate the same after a fire, the entire amount is allowable.

255 ITR 0243- COMMISSIONER OF INCOME-TAX VS. MADRAS CEMENTS LTD. (MAD)

“Repair” implies the existence of a thing which has malfunctioned and can be set right by effecting repairs which may involve replacement of some parts, thereby making the thing as efficient as it was before or as close to it as possible. After repair the thing to which the repair was carried out continues to be available for use. Replacement is different from repair. Replacement implies the removal or discarding of the thing that was in use, by a different or new thing capable of performing the same function with the same or greater efficiency. The replacement of a section in a series of machines which are interconnected, in a segment of the production process which together form an integrated whole may in some circumstances, be regarded as amounting to repair when without such replacement that unit in that segment will not function. That logic cannot be extended to the entire manufacturing facility from the stage of raw material to the delivery of the final finished product.

In order to constitute “current repairs” the expenditure must have been incurred to “preserve and maintain” an already existing asset, and the object of the expenditure must not be to bring a new asset into existence or for obtaining a new advantage. It is difficult to accept that for the purpose of determining the allowability of expenditure under the head “Repairs” the entire productive apparatus of a manufacturing company be treated as one single asset and wholesale replacement of complete identifiable and distinct parts be regarded as a “repair” effected to the production facility as a whole. While judging a claim for deduction under the Income-tax Act the scope of the term “repair” cannot be stretched beyond all recognition.

Question

The assessee, a cement company invested a sum of Rs. 5,31,55,000 in installing a new cement mill known as “Combidan Cement Mill” during the year 1985, which mill was technologically superior to the four cement mills which it had installed in the years 1961 and 1963 and which four old mills were subsequently sold. The assessee claimed that the sum invested was deductible as current repairs under section 31 of the Income-tax Act, 1961.

Answer

Mill which the assessee had installed and which replaced four old cement mills, was a new cement mill, installed at a different location, was technologically superior, was far more efficient than the four mills together and was capable of delivering a recognizably superior product. The acquisition and installation of that mill, could not by any stretch of imagination be regarded as “repair” to the four cement mills which were discarded and subsequently sold. The expenditure of Rs. 5,31,55,000 incurred by the assessee during the accounting year in installing and commissioning a new cement mill in pursuance of a modernization programme was not allowable under section 31.

Ratio of earlier decided cases

- 1) The issue in CIT v. Madras Cements Ltd. [2002] 255 ITR 243 (Mad) relates to replacement of plant and machinery, which is ordinarily allowable if it had become decrepit and old, but in the facts of the case, it was installing a new cement mill known as, which was technology-wise superior to the four cement mills, which it had replaced, after sale of such mills. The claim of the assessee to treat the cost of replacement as revenue was considered far-fetched and in-admissible.
- 2) The decision of the Supreme Court in Ballimal Naval Kishore v. CIT [1997] 224 ITR 414 dealing with a case of total renovation of a theatre would be seen as a set back for a more liberal view that even such expenditure can be treated as accumulated current repairs so as to qualify for deduction as revenue expenditure. The Supreme Court felt that in the case of such total renovation including some structural alterations involving expensive repairs to the floors, walls, doors and windows with closure of the theatre for a long period to enable completion of the repairs, treatment of such outlay as current repairs would not be justified.
- 3) New Shorrock Spinning and Manufacturing Co. Ltd. v. CIT [1956] 30 ITR 338 (Bom), which had clearly held that replacement of an existing asset would constitute revenue expenditure, but found that the rationale of this decision would have no application, where there is total renovation as was found in Ballimal Naval Kishore's decision in the case of a theatre.
- 4) CIT v. Mahalakshmi Textile Mills Ltd. [1967] 66 ITR 710 (SC), which allowed large scale replacement of ring frames and other parts converting the system of manufacture to a new one following New Shorrock Spinning and Manufacturing Co. Ltd.'s case.
- 5) As long as plant and machinery replaced, though capable of being independently operated, are part of a system as in the case of a continuous process industry or part of a block as in the case of ring frames, generators, motor boilers, tools or other items in the context of a modernisation programme

even where there is significant increase in productivity, the expenditure will have to be allowed as a revenue expenditure.

275 ITR 0403- COMMISSIONER OF INCOME-TAX VS. JANAKIRAM MILLS LTD.
(MADRAS HIGH COURT)

In relation to Textile Mills, entire mill to be treated as one single plant and machines are only a part of it. Replacement of cards/blow room machinery/combing machinery creates no new assets in process of replacement of worn out machines and thus revenue expenditure. Such replacement of worn out machinery expenditure can be considered either under “current repairs” or under “expenditure laid out wholly and exclusively for business”.

DEPRECIATION ON ASSET USED FOR BUSINESS PURPOSES

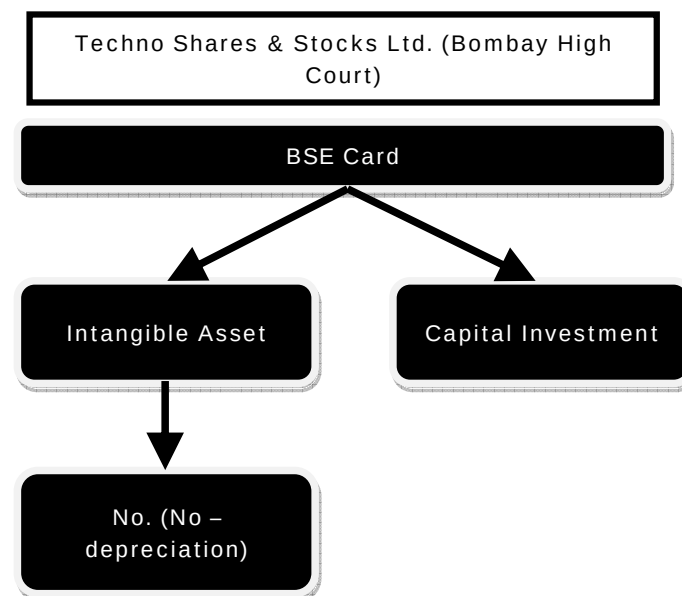
Section / Topic Name : 32, 43A

ADDITIONAL DEPRECIATION- INVESTMENT IN UTILITIES

In CIT v. VTM Ltd. [2010] 187 Taxman 319 (Mad.) the Assessing Officer disallowed the claim of additional depreciation on the wind mill on the ground that the assessee was engaged only in the manufacture of textile goods and the setting-up of a wind mill had absolutely no connection with the manufacture of textile goods. Dismissing such a ground of the revenue the Madras High Court held that clause (iia) of section 32(1) does not state that the setting-up of a new machinery or plant, which was acquired and installed after 31-3-2002 should have any operational connectivity to the article or thing that was already being manufactured by the assessee.

INTANGIBLE ASSETS

The Bombay High Court in CIT v. Techno Shares & Stocks Ltd. [2009] 184 Taxman 103 held that



‘licences’ is used in section 32(1)(ii) to apply to licences relatable to intellectual properties only and not to all licences. Similarly ‘any other business or commercial rights of similar nature’

used in section 32(1)(ii) would exclude business or commercial rights which are not similar to the categories specified in section 32(1)(ii) and, hence, the same would not be entitled to depreciation. The Court held that BSE card is not a business or commercial right relating to intellectual property rights; and hence, depreciation cannot be allowed on the BSE card.

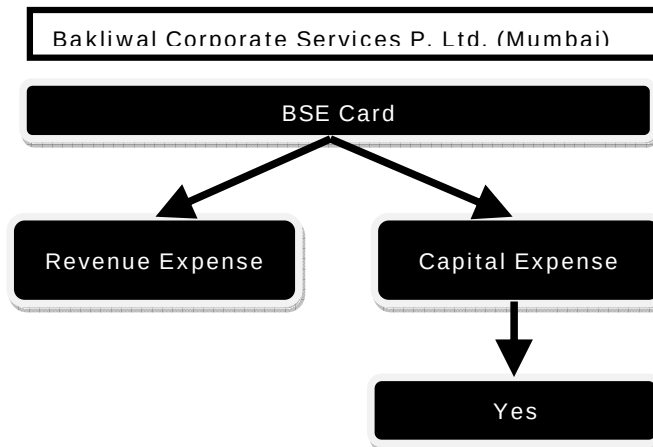
On the contrary, the new Direct Taxes Code provides for allowance of depreciation on BSE

card inasmuch as the definition of ‘intangible assets’ includes any right by way of license or franchise to operate a business besides other intellectual property assets such as patents, trademarks, know-how, etc.

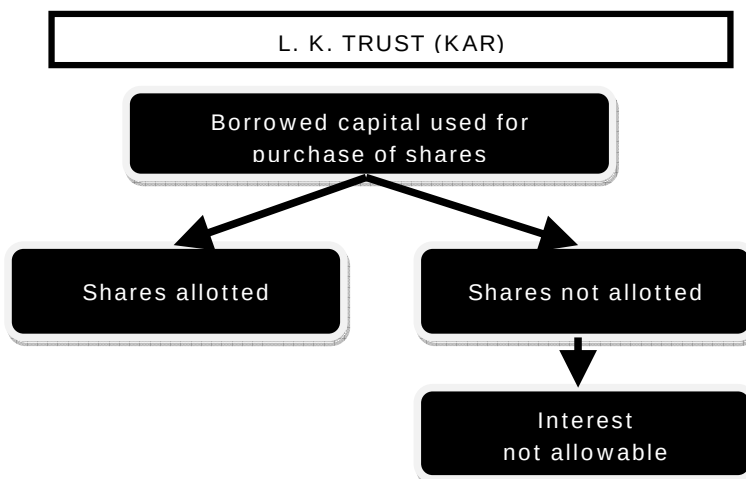
MEMBERSHIP CARD OF STOCK EXCHANGE:

The membership card of a stock exchange is an asset, so that any payment, therefor cannot be allowed as a revenue expenditure. The issue whether it is entitled to depreciation is a matter which has to be considered in the light of the inferences as to whether the asset is of diminishing value and whether it is owned by the assessee and whether it is used for business. The Tribunal could have itself held that with reference to the first test as to whether the asset will diminish in value, depreciation could not have been allowed, so as to require amortisation of the membership card, which is akin to a licence for business.

But the issue was remitted back to the Assessing Officer to be decided in the light of these tests : Bakliwal Corporate Services P. Ltd. v. ITO [2008] 302 ITR (AT) 110 (Mumbai).

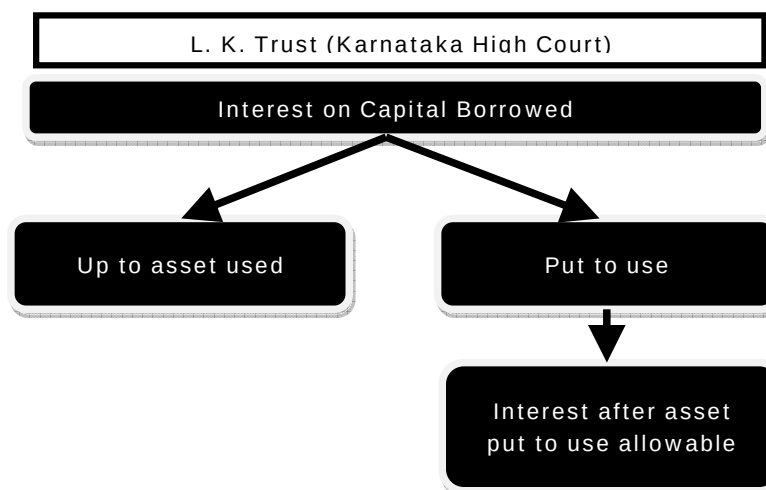


PUT TO USE CONDITION



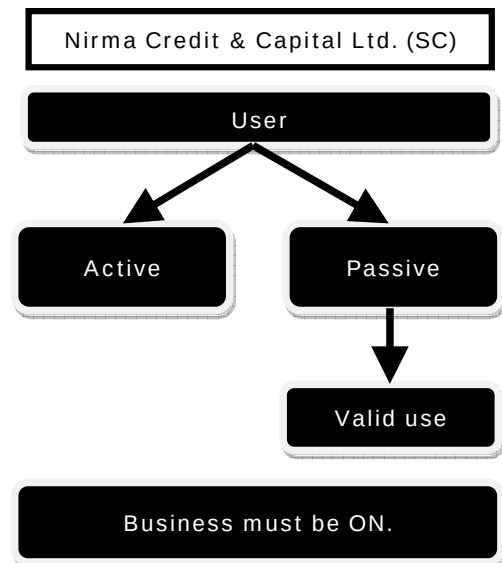
In CIT v. L.K. Trust [2008] 169 Taxman 152/297 ITR 53, the Karnataka High Court held that the amount of interest paid on the borrowed amount for acquisition of assets shall not be allowed for deduction till such asset is put to use. In this case, the assessee, a private family trust, inter alia, carrying on film business borrowed an amount for subscription to equity shares to be issued in future so that the purchase of shares did not materialise during the previous year resulting into a disallowance. Even though this case

pertained to assessment year 1989-90, yet the High Court chose to apply the new proviso in section 36(1)(iii) having come into effect from assessment year 2004-05, giving a clue that such proviso has retrospective application.



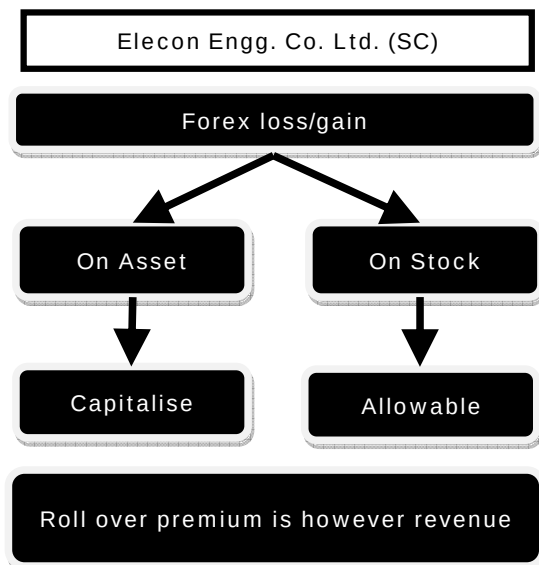
PASSIVE USER

A perusal of section 32(1) of the Income-tax Act, 1961 read with rule 5 of the Income-tax Rules, 1962 clearly shows that an assessee must satisfy two conditions, viz., (i) that it is the owner of the assets and (ii) such assets are used for the purpose of the business or profession. These two conditions are sine qua non for claiming depreciation under section 32. In this regard, there is the reference of the judgment of the Supreme Court in the case of Liquidators of Pursor Ltd. v. CIT [1954] 25 ITR 265. The Third Member bench of the Pune ITAT in Dy. CIT v. Sheth & Sura Engg. (P.) Ltd. [2008] 110 ITD 39 further held that liberal construction cannot imply viz-à-viz the twin conditions of section 32, which are not to be given a go-bye. The decision of the Apex Court in Liquidators of Pursor's case (supra) has been severally explained, followed and distinguished on active-passive score and, thus, there have been varying decisions on the admissibility of claim on passive use of an asset. While Calcutta, Karnataka and Bombay jurisdictions hold passive use or ready for use ineligible, the Delhi, Punjab & Haryana, Kerala, Gauhati, Madras and Allahabad hold passive user as qualifying for depreciation. The Supreme Court in Nirma Credit & Capital Ltd. v. Asstt. CIT [2008] 177 Taxman 416 directed the High Court to pass a fresh judgment once the assessee in this case claimed depreciation allowance despite suspension of business operations during the relevant previous year on the ground of passive use of plant and machinery.



FORWARD CONTRACT-ROLL OVER PREMIUM

In Asstt. CIT v. Elecon Engg. Co. Ltd. [2010] 189 Taxman 83 (SC), the assessee booked forward contracts with a bank for delivery of required foreign currency on stipulated dates for repayment of foreign currency loan taken for purchase of plant and machinery. The contract was entered into for entire outstanding amount and the delivery of the foreign currency was obtained under the contract for instalments due from time-to-time. The value of forward contract after deducting amount withdrawn towards repayment, was rolled over for a further period up to date of next instalment upon payment of roll over premium which was claimed as business expenditure/ interest expenditure. In his order, the Assessing Officer held that the premium was not admissible for deduction under section 36(1)(iii) or under section 37.



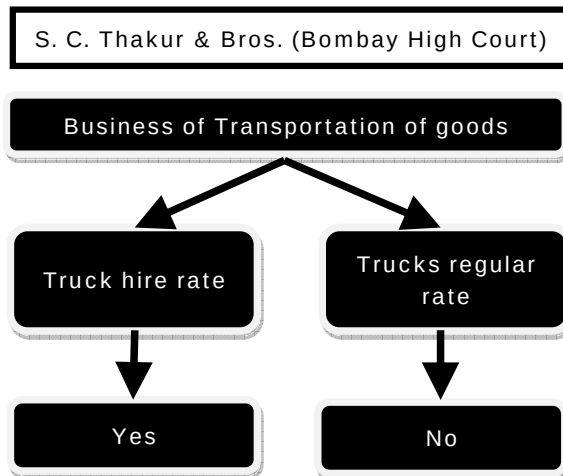
by the assessee were in the nature of interest or committal charge(s) and, hence, the said charges were allowable under section 36(1)(iii). In setting aside the judgment of the High Court, the Supreme Court held that the roll over charges represent the difference arising on account of change in the foreign exchange rates. Finding application of section 43A, it held that roll over charges paid/received in the

instant case are in respect of liabilities relating to the acquisition of fixed assets so that the same should be debited/credited to the asset in respect of which liability was incurred. The Apex Court at the same time held that roll over charges not relating to the fixed assets should be charged to the profit and loss account.

HIGHER DEPRECIATION ON TRUCKS/DUMPERS/MOTOR LORRIES -

BOON FOR CIVIL CONTRACTORS

The Bombay High Court in CIT v. S.C. Thakur & Bros. [2009] 180 Taxman 348 held that higher rate of depreciation is also admissible when the trucks/tempo/motor lorry is used by the assessee in his own business of transportation of goods on hire. In this case the assessee, a civil contractor, was required to transport the mud from one place to another for filling and the earth so transported did not belong to the assessee so that the assessee's business receipt comprised of price of the charges received for transporting the goods from one place to another.

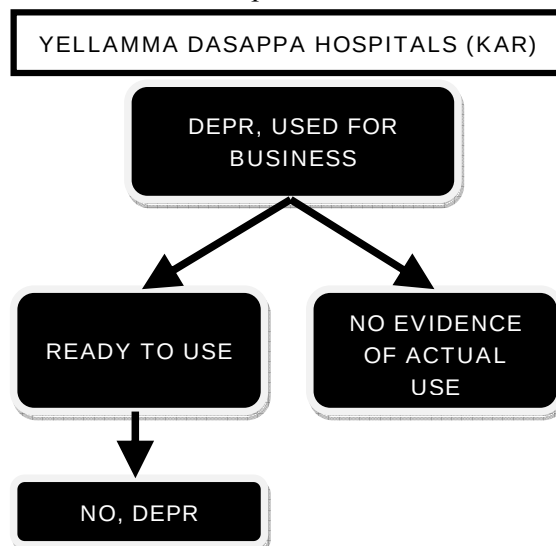


290 ITR 0377- PIAGGIO VEHICLES P. LTD. VS. DEPUTY COMMISSIONER OF INCOME-TAX (BOMBAY HIGH COURT)

Reassessment beyond the four year time limit is possible only when there is a failure to disclose material facts. In Piaggio Vehicles P. Ltd. v. Deputy CIT [2007] 290 ITR 377 (Bom), the assessment was made after enquiry allowing depreciation on goodwill in respect of a business purchased by the assessee as a going concern. There was hardly any doubt, that the deduction by way of depreciation on goodwill, was not admissible even as found by the High Court. The reasoning of the Assessing Officer for issue of notice was on the ground that there was a contradiction between the return of income regarding the date of acquisition of goodwill and the information available from the tax audit report. It was on the basis of this contradiction, that suppression of material facts was inferred. The specified transfer date was March 31, 1998, but subject to the condition precedent that if the conditions are not satisfied, it would be shifted to April 30, 1998. There was no suppression on the part of the assessee, since the tax audit report signed by the auditor was also furnished. The difference in dates was also explained as was evident from the information recorded during the original assessment. It was, therefore, held that the notice for invoking reassessment jurisdiction beyond the four-year time limit was not consistent with the law, which prescribes rigid requirements for reopening the assessment, which is completed after scrutiny as in this case. The Assessing Officer even called for details regarding the goodwill acquired by the assessee and these were furnished before he allowed depreciation by treating it as a commercial right of intangible nature eligible for deduction from April 1, 1998.

[2007] 290 ITR 0353- DEPUTY COMMISSIONER OF INCOME-TAX VS. YELLAMMA DASAPPA HOSPITAL (KARNATAKA HIGH COURT)

Depreciation on an asset is available only subject to the conditions of ownership as well as use. No doubt, the asset should have been actually used. But then, the law is well-established, that the use for the purposes of depreciation is not physical use in every case. A stand-by plant for example may not be actually used, but all the same, it is ready for use. Spare engines have the same character. It was in this context, it has been held in a number of cases, that passive use is sufficient, and that, active use is not necessary in every case. There may also be occasion, when the assessee may not be able to use the machinery due to lock-out in the factory. The courts have, therefore, understood the word “used” to cover “available for use” and “ready for use”. Such an inference is reasonable, since assets depreciate in value even when they are idle. This is the preponderant view taken in CIT v. Viswanath Bhaskar Sathe [1937] 5 ITR 621 (Bom) ; CIT v. Dalmia Cement Ltd. [1945] 13 ITR 415 (Patna) Forest Industries Travancore Ltd. v. CIT [1964] 51 ITR 329 (Ker) ; Whittle Anderson v. CIT [1971] 79 ITR 613 (Bom) ; Capital Bus Service Pvt. Ltd. v. CIT [1980] 123 ITR 404 (Delhi) ; CIT v. Vayithri Plantations Ltd. (1981) 128 ITR 675 (Mad) ; CIT v. O. P. Khanna and Sons [1983] 140 ITR 558 (P&H) ; CIT v. Kanoria General Dealers (P) Ltd. [1986] 159 ITR 524 (Cal) ; CIT v. Refrigeration and Allied Industries Ltd. [2001] 247 ITR 12 (Delhi) ; Asst. CIT v. Ashima Syntex Ltd. [2001] 251 ITR 133 (Guj) and CIT v. Vindiyachal Distilleries Pvt. Ltd. [2005] 272 ITR 583 (MP).



However, a different view was taken in Dineshkumar Gulabchand Agrawal v. CIT [2004] 267 ITR 768 (Bom), where it was found that section 32 as presently worded has used the word “used” in the past tense, so that the earlier decisions would have no application and that it should have been actually used. It is rather odd that notwithstanding the preponderant view taken by the other High Courts, the special leave petition against this decision was dismissed by the Supreme Court in [2004] 266 ITR (St.) 106.

The issue, now is revived by the decision of the Karnataka High Court in Deputy CIT v. Yellamma Dasappa Hospital [2007] 290 ITR 353, where the High Court has chosen to follow the odd decision in Dineshkumar Gulabchand Agrawal’s case (supra) for its conclusion that the asset should have been physically used earlier. But the Karnataka High Court in this case also presumed that the Calcutta and Madhya Pradesh Courts have also taken the same view. The Calcutta High Court’s decision in CIT v. Oriental Coal Co. Ltd. [1994] 206 ITR 682, related to a case of a company, which remained under a lock-out for two years. It did not dissent from the other cases, but distinguished them. Reference to the Madhya Pradesh High Court’s decision is, however, not available. After the concept of block of assets has come into vogue, what is relevant is that, it enters the block on being brought to use. Since it is not possible to go by use of item-wise machinery, the inclusion in the block leads to the inference that it is brought to use. As otherwise, the stand-by generator or an asset which is ready for use would lose the benefit of depreciation, which is a charge on the profits. The controversy would require to be settled by the Supreme Court or by a Board Circular confirming the reasonable inference to avoid litigation.

265 ITR 0537- CIT -TAX VS. AIR TRAVEL ENTERPRISES INDIA LTD. (KER)

Depreciation is admissible under section 32 for an asset owned by the assessee from the date, it is brought to use. It is in the light of this requirement that it was decided in CIT v. Air Travel Enterprises India Ltd. [2004] 265 ITR 537 (Ker) that depreciation can be allowed only with effect from the date from which the requirement for plying it was obtained. Any prior use cannot be legal, so that such use cannot be

recognised for purposes of depreciation. Where the permit is obtained only in the next succeeding year, the assessee cannot be eligible for depreciation, though the asset was apparently used without such permit during the year.

275 ITR 0563- COMMISSIONER OF INCOME-TAX VS. MOTHER HOSPITAL PVT. LTD. (KERALA HIGH COURT)

It is true that the ownership for purposes of income-tax law is beneficial ownership as decided in CIT v. Podar Cement Pvt. Ltd. [1997] 226 ITR 625 (SC) and even for depreciation purposes as decided in Mysore Minerals Ltd. v. CIT [1999] 239 ITR 775 (SC). But where the assessee acquired the right to use a property in pursuance of an agreement by which it financed the cost of construction with the agreement not conferring any right of ownership, assessee cannot be treated as owner for purposes of depreciation.—CIT v. Mother Hospital Pvt. Ltd. [2005] 275 ITR 563 (Ker). There should be some enforceable right as regards the title over the building as a pre-condition for depreciation to be admissible.

Company reimbursed expenditure on construction of building owned by firm and company was using it for its business. There was no provision in agreement for transfer of title to company however company is the user of the property. Held in this case that assessee company is not owner of building and thus not entitled to depreciation in respect of it.

276 ITR 0625- ANIL BULK CARRIERS P. LTD. VS. COMMISSIONER OF INCOME-TAX (ALLAHABAD HIGH COURT)

The two requirements to claim depreciation under section 32 of the Income-tax Act, 1961, (i) the asset should be owned by the assessee, and (ii) it should be used for the purposes of business or profession. The expression “used” has to be given a wide meaning. The expression includes passive as well as active user.

Where an assessee purchased a new truck on 17th February, 1997, built up a body thereon and claimed to have brought it to use before 31st March, 1997, the Assessing Officer did not believe the claim. But luckily for the assessee, it was fined by the Transport Department for having used the truck before registration on 31st March, so that such finding became evidence of use. The fact it was used before registration could not have come in the way of the claim for depreciation. A judicial order passed by the criminal court, having been filed, cannot be lightly disregarded as proof of use, as was held in Anil Bulk Carriers P. Ltd. v. CIT [2005] 276 ITR 625 (All). Since it was used it must qualify for the purpose of depreciation.

276 ITR 0607- COMMISSIONER OF INCOME-TAX VS. MADURAI SOFT DRINKS PVT. LTD. (MADRAS HIGH COURT)

Crates and bottles were entitled for depreciation at the rate of 100 per cent. First Leasing Co. of India Ltd. v. CIT (No. 2) [2000] 244 ITR 238 (Mad) and CIT v. Aqueous Victuals P. Ltd. [2004] 266 ITR 573 (All) followed. The security deposit collected by the assessee from the agents and retailers did not form part of the sale transaction. The Tribunal was, therefore, right in holding that the security deposits received from the agents and the retailers were not taxable in the hands of the assessee.

267 ITR 0768- DINESHKUMAR GULABCHAND AGRAWAL VS. COMMISSIONER OF INCOME-TAX (BOM)

It has always been understood, that an asset which is ready for use as in the case of spare engines or standby equipments like a generator, where the occasion for such use may or may not arise, depreciation cannot be denied on the ground that it has not been used. A number of decisions has held so in the familiar citation, Whittle Anderson Ltd. v. CIT [1971] 79 ITR 613 (Bom), besides a number of other cases as in CIT v. Viswanath Bhaskar Sathe [1937] 5 ITR 621 (Bom) ; CIT v. Dalmia Cement Ltd. [1945] 13 ITR 415 (Patna) ; Forest Industries Travancore Ltd. v. CIT [1964] 51 ITR 329 (Ker) ; Capital Bus Service Ltd. v. CIT [1980] 123 ITR 404 (Delhi) ; CIT v. O. P. Khanna and Sons [1983] 140 ITR 558 (P & H) and CIT v. Geo Tech Construction Corporation [2000] 244 ITR 452 (Ker). Even on mere trial run, depreciation was found admissible in the case of a running business in V. Ramakrishna and Sons (Pvt.) Ltd. v. CIT [1984] 149 ITR 554 (Mad). The law to this effect was understood as settled. "Use" was always understood as including potential use, so that readiness for use was treated as material for eligibility.

In a short judgement in Dineshkumar Gulabchand Agrawal v. CIT [2004] 267 ITR 768 (Bom), the High Court found that subsequent to its judgement there was an amendment to section 32 of the Act using the word "used" in past tense, so that the earlier decision would no more have application. It is seen that the word "used" was in the statute from its inception. At any rate, the precedents have understood the word "used" as "brought to use", when it is available for use. The fact, that the assessee claimed deduction on the basis of the earlier precedents, indicates that it was ready for use and could not be used only for the reason that there was no demand for such use during the year. Assets depreciate even when they are idle as recognised for purposes of accounting as well as depreciation under company law. The decision is, therefore, hard on the assessees, but may well be taken as subject to review. But then a special leave was dismissed by the Supreme Court to the taxpayer in this case ([2004] 266 ITR (St.) 106). Unless the Revenue takes a reasonable view and explains the meaning of the word "used" in a reasonable manner, there is going to be another spate of litigation.

263 ITR 0206- RAJSHREE ROADWAYS (RAJ)

The assessee firm carried on the business of transportation of cement. It entered into a lease agreement with K for taking on lease 15 trucks. The assessee claimed the lease rent as revenue expenditure. The Income-tax Officer, after considering the contents of the agreement with K, was of the view that the trucks were not taken on lease but it was a sale and that therefore, the lease amount which had been paid could not be allowed as revenue expenditure. Held, that under the agreement there was a clause that after completion of lease period, if one per cent. of the total consideration of the trucks was paid, the lessee would be the owner of those trucks. However, the agreement dealt with the ownership of the trucks under the agreement. There was a clear provision that the said machinery shall at all times remain sole and exclusive property of the lessor and the lessee shall have no right, title or interest thereon. It further provided the irrevocable undertaking of the lessee that at no time during the currency of the lease agreement, which shall be non-cancellable, would the lessee attempt to capitalise the leased assets in its balance-sheet. As per clause 8, it had been agreed that the ownership of the said assets during the tenure of the lease and inclusive of any renewal options that the lessor may concur indisputably rested with the lessor. So in clear terms, the agreement provided that during the lease period, only the lessor shall be treated as the owner of the trucks and not the lessee. Moreover, the lessor had been allowed depreciation on the trucks. Therefore, considering the terms and conditions of the lease agreement and the fact that

depreciation on these trucks had been allowed to the lessor, the lease rent was deductible as revenue expenditure.

Question

The assessee-firm carried on the business of transportation of cement. It entered into a lease agreement with K for taking on lease 15 trucks. The assessee claimed the lease rent as revenue expenditure. The Income-tax Officer, after considering the contents of the agreement with K, was of the view that the trucks were not taken on lease but it was a sale and that therefore, the lease amount which had been paid could not be allowed as revenue expenditure. You are required to answer whether such lease rent paid is of revenue in nature or not.

Answer

Depreciation is available to the owner of an asset. In respect of assets leased out in the course of leasing business, it is the lessor, who is the owner though the asset is used by the lessee. Where the agreement for lease clearly spells out the ownership of the lessor indicating that the sale of the truck would be made to the lessee only after the expiry of the lease, it follows that the lessor would be entitled to depreciation as owner, while the lessee would be entitled to the deduction of the lease rent paid by him. This position of law was reiterated in *Rajshree Roadways v. Union of India* [2003] 263 ITR 206 (Raj). The Assessing Officer had understood the lease agreement as one of sale. The High Court took the view that the terms of the agreement cannot be discarded. Mere option to purchase the same at the termination of the lease does not mean that there is any present right for the lessee over the leased assets, except the right to use the asset. Thus amount of the lease rent paid is a revenue expenditure and owner shall qualify for the purpose of depreciation.

228 ITR 0253 SAHNEY STEEL AND PRESS WORKS LTD. VS. CIT; (SC)

Assessee received subsidy from Government. Payments from public funds to assessee in order to assist assessee in carrying on trade or business are revenue receipts and thus chargeable to tax under the provision of section 41. Subsidy was granted to assessee after they started production, Refund of sales tax, subsidies on power consumed and exemption from payment of water charges, etc. Amounts received were production incentives and operational subsidies and thus is not a capital subsidies.

Where Government subsidy is intended as an incentive to encourage entrepreneurs to move to backward areas and establish industries, the specified percentage of the fixed capital cost, which is the basis for determining the subsidy, being only a measure adopted under the scheme to quantify the financial aid, is not a payment, directly or indirectly, to meet any portion of the "actual cost". The expression "actual cost" in section 43(1) of the Income-tax Act, 1961, needs to be interpreted liberally. Such a subsidy does not partake of the incidents which attract the conditions for its deductibility from "actual cost". The amount of subsidy is not to be deducted from the "actual cost" under section 43(1) for the purpose of calculation of depreciation, etc. *Commissioner of Income-tax Vs. P.J. Chemicals Ltd.*

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee started a unit in notified backward area and as result was granted the subsidy by the state government. Said subsidy was for the commencement of unit in backward area and did not relate to any investment made in that area. Assessee while filing its return of income showed it as capital receipt and thus not chargeable to tax. Is the stand taken by the assessee justified.

ANSWER

New Explanation 10 to section 43(1) defining the actual cost provides that where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or State Government or any authority established under any law or by any other person, in the form of subsidy or grant or reimbursement, then in a case where the subsidy is directly relatable to the asset, such subsidy shall not be included in the actual cost of the asset. In a case where such subsidy or grant or reimbursement is of such a nature that it cannot be directly relatable to any particular asset, so much of the amount so received as bears the same proportion that such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received shall not be included in the actual cost of the asset.

Where Government subsidy is intended as an incentive to encourage entrepreneurs to move to backward areas and establish industries, the specified percentage of the fixed capital cost, which is the basis for determining the subsidy, being only a measure adopted under the scheme to quantify the financial aid, is not a payment, directly or indirectly, to meet any portion of the "actual cost". The expression "actual cost" in section 43(1) of the Income-tax Act, 1961, needs to be interpreted liberally. Such a subsidy does not partake of the incidents which attract the conditions for its deductibility from "actual cost". The amount of subsidy is not to be deducted from the "actual cost" under section 43(1) for the purpose of calculation of depreciation, etc. P.J. Chemicals v/s CIT (SC) [1994] --- If payments in the nature of subsidy from public funds are made to the assessee to assist him in carrying on his trade or business, they are trade receipts. The character of the subsidy in the hands of the recipient_whether revenue or capital_will have to be determined, having regard to the purpose for which the subsidy is given. The source of the fund is quite immaterial. However, if the purpose is to help the assessee to set up its business or complete a project the monies must be treated as having been received for capital purposes. But if monies are given to the assessee for assisting him in carrying out the business operations and the money is given only after and conditional upon commencement of production, such subsidies must be treated as assistance for the purpose of the trade. Sahney steel and press works v/s CIT (SC) [1997] --- conclusion --- since in the given case it is an subsidy for the commencement of unit in the back ward area Rupees 3 Lakhs shall be treated as revenue receipt and is taxable as business income and cost of the asset shall not be reduced.

231 ITR 0285 CIT VS. TATA IRON AND STEEL CO. LTD; (SC)

Actual cost of the fixed asset depends on the amount paid by assessee to acquire asset. Loan was obtained to acquire asset. Manner or mode of repayment of loan or non-repayment of loan will not alter cost of asset. Fluctuations in rate of foreign exchange resulting in gain or loss while repaying instalments of foreign loan will not alter cost incurred for purchase of asset for computing depreciation. Now as on today provision of section 43A will be operative that says the exchange loss should form part of actual cost.

The manner of repayment of a loan cannot affect the cost of the assets acquired by the assessee. What is the actual cost depends on the amount paid by the assessee to acquire the asset. The amount may have been borrowed by the assessee. But even if the assessee did not repay the loan it will not alter the cost of the asset. If the borrower defaults in repayment of a part of the loan, the cost of the asset will not change. What has to be borne in mind is that the cost of an asset and the cost of raising money for purchase of the asset are two different and independent transactions. Even if an asset is purchased with non-repayable subsidy received from the Government, the cost of the asset will be the price paid by the assessee for acquiring the asset.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Mr. X acquired a motor car used for the purposes of the business. Car was acquired out of the borrowed money of Rs. 2 Lakhs and balance 1.5 Lakhs was managed out of his own funds. The borrowed money was not paid to the extent of Rs. 50,000. Assessing officer is of the opinion that actual cost of the asset should be reduced by Rs. 50,000, indirectly denying the benefit of depreciation to that extent. Is the opinion of the officer justified.

ANSWER

Actual cost is the cost incurred. The law takes care to ensure that where part of the cost is met by a third party, such cost could not be treated as part of the actual cost, as it would exclude any part of the cost as has been made directly or indirectly paid by any other person or authority. Where the asset is purchased with the assistance of a loan which later does not become repayable, it cannot obviously be treated as abridging the actual cost, because it is an event subsequent to the acquisition of the asset. This was the proposition upheld by the Supreme Court in CIT v. Tata Iron and Steel Co. Ltd. [1998] 231 ITR 285, a view which can be taken as self-evident. Thus the assessing officer not justified in reducing the actual cost of the asset and dis-allow the depreciation. (The manner or mode of repayment of the loan had nothing to do with the cost of an asset acquired by the assessee for the purpose of his business.) However liability to repay this loan is in nature of capital liability and thus amount not paid do not amount to trading receipt or revenue receipt.

231 ITR 0741 CIT VS. HINDUSTAN TIMES LTD.; (SC)

Assessee purchased existing residential building for use for commercial purposes. Commercialisation Charges were paid for conversion of building from residential purpose to commercial purposes. Such commercialisation charges paid to local authority do not qualify for the purpose of deduction. However Additional commercialisation charges for putting up multi-storeyed structure over the original structure should be treated as actual cost of the building and is entitled to depreciation.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Company acquired a building for 50 Lakhs. It wanted to use it as office building and thus paid commercialisation charges to the Municipal corporation and company was given the permission to pull down the old structure and build new multi-storeyed building. Cost of new construction amounted to 150 Lakhs and charges paid to Municipal corporation was 25 Lakhs. Assessee is of the opinion that 25 Lakhs paid to Municipal corporation also qualifies for the depreciation. Kindly advice to the company.

ANSWER

Assessee purchased existing residential building for use for commercial purposes. Commercialisation Charges were paid for conversion of building from residential purpose to commercial purposes. Such commercialisation charges paid to local authority do not qualify for the purpose of deduction.

235 ITR 0131 [SC] STATE OF BIHAR V. STEEL CITY BEVERAGES LTD.

Judgement is actually in relation to SSI unit but the concept is laid down.

In respect of an industry, manufacturing soft drinks and beverages, it can be said that plant would mean that apparatus which is used for manufacturing soft drinks or beverages and not articles like crates and bottles used for storing the manufactured product.

In calculating the value of plant and machinery, the cost of storage tanks which store raw materials/finished products only and which are not linked with the manufacturing process shall be

excluded. The Government of India again issued a circular, after having received representations from the industry seeking clarification whether bottles and crates are to be taken into account for determining the SSI status of the units engaged in the manufacture of soft drinks/concentrates, clarifying that investment in bottles and crates in such units is in the nature of storage of finished products and, therefore, such investment has to be excluded while computing the value of plant and machinery.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee a Company in the line of manufacturing of soft-drink has invested Rs. 3.5 lacs in bottles and crates. It proposes to claim it as deduction under section 37(1) because the life of the bottles was short in the opinion of the assessee. Officer is of the opinion that it must qualify for depreciation but it is neither Building, Plant or Furniture. You are required to examine the correct tax treatment of 3.5 lacs expenditure incurred by assessee.

ANSWER

In respect of an industry, manufacturing soft drinks and beverages, it can be said that plant would mean that apparatus which is used for manufacturing soft drinks or beverages and not articles like crates and bottles used for storing the manufactured product. [1999] 235 ITR 0131 [SC] STATE OF BIHAR V. STEEL CITY BEVERAGES LTD. However assessee may be allowed deduction in respect of cost incurred under section 37(1) since the degree of durability is less in case of plant.

239 ITR 0775 MYSORE MINERALS LTD. V.COMMISSIONER OF INCOME-TAX (SC)

Anyone in possession of property in his own title exercising such dominion over the property as would enable others being excluded there from and having the right to use and occupy the property and/or to enjoy its usufruct in his own right would be the owner of the building though a formal deed of title may not have been executed and registered as contemplated by the Transfer of Property Act, the Registration Act, etc. “Building owned by the assessee”, the expression as occurring in section 32(1) of the Income-tax Act, means the person who having acquired possession over the building in his own right uses the same for the purposes of the business or profession though a legal title has not been conveyed to him consistently with the requirements of laws such as the Transfer of Property Act and the Registration Act, etc.

- 1) Section 32 of the Act allows certain deductions, one of them being depreciation of buildings, etc., owned by the assessee and used for the purposes of the business or profession. The terms “own”, “ownership” and “owned” are generic and relative terms. They have a wide and also a narrow connotation.
- 2) Generally speaking depreciation is an allowance for the diminution in the value due to wear and tear of a capital asset employed by an assessee in his business.
- 3) The very concept of depreciation suggests that the tax benefit on account of depreciation legitimately belongs to one who has invested in the capital asset and is utilising the capital asset and thereby losing gradually the investment caused by wear and tear, and would need to replace the same by having lost its value fully over a period of time.
- 4) It is well-settled that there cannot be two owners of the property simultaneously and in the same sense of the term. The intention of the Legislature in enacting section 32 of the Act would be best fulfilled by allowing deduction in respect of depreciation to the person in whom for the time-being vests the dominion over the building and who is entitled to use it in his own right and is using the same for the purposes of his business or profession. Assigning any different meaning would not subserve the legislative intent.

Conclusion

Wide meaning must be given to the word owner under section 32. If assessee is in possession of building on part payment of price and building is not registered in name of assessee. Assessee is to be regarded as owner of building for purposes of section 32 and is entitled to depreciation on it.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee purchased some of the quarters for stay of his employees by paying Rs. 15 lacs. However the quarters are not actually registered in the name of the assessee. You are required to advise assessee on the point whether he can claim depreciation under section 32 or not on the amount paid.

ANSWER

The Supreme Court has held in *Mysore Minerals Ltd. v. CIT* [1999] 239 ITR 775 that owner for purposes of depreciation under section 32 need not be a titular owner. In this case, the assessee had acquired a building for the purpose of business and had taken possession on part-payment. The Supreme Court followed its own earlier decisions in *R. B. Jodha Mal Kuthiala v. CIT* [1971] 82 ITR 570 and *CIT v. Podar Cement Pvt.Ltd.* [1997] 226 ITR 625, where it was held that the tax laws should be concerned with beneficial ownership for the purpose of assessing the income. This principle is now followed for the purpose of allowing claims for depreciation by recognizing limited ownership even under section 53A of the Transfer of Property Act as one for being treated as owner for the purpose of depreciation. Thus assessee shall be allowed the depreciation on the property in the question.

256 ITR 0357 - CIT VS. MOHD. BUX SHOKAT ALI (NO.2) (RAJ)

The consideration for the purchase of vehicles had been met by the firm consisting of eight partners and debited to the books of account of the firm only. It was also a finding of fact arrived at by the Tribunal that the vehicles had been exclusively used for the purpose of the business of the firm. Merely because, the vehicles had been registered under the Motor Vehicles Act in the name of one of the partners only, it would not deprive the firm of the ownership of the vehicle which is not distinct from its partners.

Mysore Minerals Ltd. v. CIT [1999] 239 ITR 775 (SC) wherein the court was considering the case of building which was in possession of the assessee company, the possession having been acquired on payment of price but actually deed of conveyance was not executed by the Housing Board in favour of the company, thus there was no vesture of legal title of the company in terms of the Transfer of Property Act required for transfer of ownership. Yet considering the meaning of the word “owned” as used in section 32, the court answered the question. The court posed a question for itself “It is the word ‘owned’ as occurring in section 32 which is the core of controversy. Is it only an absolute owner or an owner of the asset as understood in its legal sense who can claim depreciation ? Or, a vesting of title short of full-fledged or legal ownership can also entitle an assessee to claim depreciation under section 32 ?” Then the court after considering the various aspects of the term “ownership” concluded that “In our opinion, the term ‘owned’ as occurring in section 32(1) of the Income-tax Act, 1961, must be assigned a wider meaning. Anyone in possession of property in his own title exercising such dominion over the property as would enable others being excluded therefrom and having the right to use and occupy the property and/or to enjoy its usufruct in his own right would be the owner of the buildings though a formal deed of title may not have been executed and registered as contemplated by the Transfer of Property Act, Registration Act, etc. . . .” It is well settled that there cannot be two owners of the property simultaneously and in the same sense of the term. The intention of the Legislature in enacting section 32 would be best fulfilled by allowing deduction in respect of depreciation to the person in whom for the time being vests the dominion over the building and who is entitled to use it in his own right and is using the same for the

purposes of his business or profession. Assigning any different meaning would not subserve the legislative intent.

Question

A partnership firm M/s SOLO has purchased a Motor Car by paying Rs. 856,000 to Shakthi Ford, however the car is registered in the name of one its partners Mr. Vishwanath Patel in order to save RTO taxes upon the registration. Assessing officer under the income tax has denied the depreciation to the partnership firm. However officer does not have doubt regarding the its usage for the purpose of business and profession. You are required to answer whether depreciation on so called motorcar is permissible or not.

Answer

It is not unusual for a firm to have the property registered in the name of its partners. Partnership law does not place a bar on this. In the case of movable property there should even be less scope for any reservation. Where the vehicle is purchased by the firm on behalf of the firm but it is registered in the name of the partners, there should be no scope for disallowance of depreciation. The High Court in CIT v. Mohd. Bux Shokat Ali (No. 2) [2002] 256 ITR 357 (Raj) found that the Supreme Court in Mysore Minerals Ltd. v. CIT [1999] 239 ITR 775 has recognised the right of the beneficial owner to depreciation, so that this decision should squarely apply to the assessee's claim for depreciation on the vehicle. Thus the depreciation on said motor car shall be allowed to the assessee firm.

247 ITR 0803- INDORE MUNICIPAL CORPORATION VS. CIT (SC)

Question before the court was, Whether, the expenditure incurred by the assessee towards construction of the metal roads on trenching grounds was an item of revenue deduction ? and Whether, the assessee was entitled to depreciation on the amount of the cost of construction of metal roads on the trenching grounds ?

Learned counsel for the assessee has invited attention to the decision of this SC in CIT v. Gwalior Rayon Silk Manufacturing Co. Ltd. Where the roads were constructed to approach about 500 trenches for dumping waste and night soil in the trenches and transporting the processed manure. The High Court while answering the said question has said that the roads could not be treated as "building". In CIT v. Gwalior Rayon Silk Manufacturing Co. Ltd. (SC), while construing the expression "building" in section 32, has observed that the roads and roadways are adjuncts of the building lying within the factory area linking them together and are being used for carrying on its business by the assessee. And thus qualifies for the purpose of depreciation.

However Held in this case that the expenditure incurred by the assessee towards construction of the metal roads on trenching grounds was not revenue expenditure. That the roads were not buildings. As there was no other construction except the roads, the roads by themselves could not constitute buildings, and the assessee was not entitled to depreciation on the cost of construction of the roads.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

You are required to answer whether expenditure incurred by the assessee towards construction of the roads was an item of revenue deduction and whether, the assessee is entitled to depreciation on the amount of the cost of construction of roads.

ANSWER

In case of [2001] 247 ITR 0803- INDORE MUNICIPAL CORPORATION VS. CIT (SC) it has been held that the expenditure incurred by the assessee towards construction of the metal roads on trenching grounds was not revenue expenditure. That the roads were not buildings. As there was no other

construction except the roads, the roads by themselves could not constitute buildings, and the assessee was not entitled to depreciation on the cost of construction of the roads.

254 ITR 0267 - CIT VS. INDUSTRIAL CABLES (INDIA) LTD. (P&H)

The assessee, which had set up an industrial unit in a backward area, constructed temporary quarters for the workers. It also provided a kacha (temporary) road linking the workers' quarters with the factory. Held, (i) that the temporary road was not an asset of an enduring nature and expenditure thereon was revenue expenditure under section 37 (ii) alternatively, that, even if the expenditure was capital expenditure, since the road was a temporary structure the assessee was entitled to claim 100 per cent. depreciation.

Expenses or outlay on temporary roads linking workers' quarters with factory is revenue expenditure as was decided in CIT v. Industrial Cables (India) Ltd. [2002] 254 ITR 267 (P&H). The reasoning was that temporary structure does not spell out an enduring advantage. Alternatively even otherwise it should have been eligible for 100% depreciation, even if it were in the nature of capital expenditure by treating such temporary roads as capital assets.

253 ITR 0303 CIT VS. PEPSU ROAD TRANSPORT CORPORATION (P&H)

The assessee was a transport corporation. It had a large fleet of buses. These can normally be seen standing by the road side. Thus, it had to keep spare engines in store. The engines are meant to be used in case of need. There is a normal depreciation of value even when a machine or equipment is merely kept in a store. Secondly, keeping in view the nature of the assessee's business, it had to necessarily keep certain spare engines in store to meet an emergent situation. There was nothing on record to indicate that an engine, which was purchased a year or two earlier, would fetch the same price in the open market. The Tribunal was right in law in allowing depreciation on the spare engines lying in the stock of the assessee.

Question

The Assessing Officer finalised the assessment of transport corporation under section 143(3). The deduction claimed on account of depreciation on spare engines held as stock were disallowed by the officer but was allowed by ITAT. You are required to answer whether, the Income tax Appellate Tribunal was right in law in allowing depreciation on spare engines lying in the stock of the assessee?

Answer

Admittedly, the assessee is a transport corporation. It has a large fleet of buses. These can normally be seen standing by the road side. Thus, it has to keep spare engines in store. The engines are meant to be used in case of need. Thus, it cannot be said that the spare engines purchased by the assessee and kept in store are not meant for use.

Every thing ages with the passage of time, including engines which gather dust in the store room. There is a normal depreciation of value even when a machine or equipment is merely kept in a store. Secondly, keeping in view the nature of the assessee's business, it has to necessarily keep certain spare engines in store to meet an emergent situation. There is nothing on record to indicate that an engine, which was purchased a year or two earlier, will fetch the same price in the open market even today. In this situation, it is clear that the authorities have taken a possible view. Nothing has been pointed out to show that the opinion is perverse or untenable. Thus depreciation shall be allowed to the assessee.

255 ITR 0091 - CIT VS. DELHI AIRPORT SERVICE (DEL)

The assessee, a partnership firm, was carrying on the business of transport bus service. Assessee claimed that the air-conditioner was an integral part of the bus and it was entitled to depreciation at 30 per cent. The Assessing Officer valued the air-conditioning machinery separately and allowed depreciation. Held, that the air-conditioner fixed in the bus was an integral part of the bus. Therefore, the depreciation on air-conditioning plant should be allowed at the rate applicable to the bus not at the rate applicable to the air-conditioning plant.

Question

You are required to answer whether depreciation on airconditioner fixed in a bus was allowable at the rate applicable to the bus, instead of the rate applicable to air-conditioner when separate rates of depreciation have been provided for motor vehicles and air-conditioning plant ?

Answer

Where an air conditioner is fitted in a bus, should the rate of depreciation be that applicable to a bus or an air conditioner ? Such an issue arises in many similar cases, where two different assets are fused into one. The principle on the basis of which the air conditioner was allowed the same rate as for bus by the Delhi High Court in CIT v. Delhi Airport Service [2002] 255 ITR 91 (Delhi) is that the air conditioner fixed in the bus became an integral part of the bus. Where an air conditioner is sold along with the bus or it is built into it, it would appear that it loses its independent character.

255 ITR 0068- CIT VS. INDIAN EXPRESS (MADURAI) PVT. LTD. (MAD)

Is it necessary that the assessee should use the plant and machinery on which depreciation is claimed exclusively by it ? In CIT v. Indian Express (Madurai) Pvt. Ltd. [2002] 255 ITR 68 (Mad), it was held that the fact that the product of the machinery is used by a sister concern should not stand in the way of the claim being allowed.

Sections 30, 31 and 32 uniformly use the expression “used for the purposes of the business or profession”. The emphasis here is on the user for business or profession and it excludes user for purposes other than the business or profession. To the extent of such user for non-business or non-professional purposes, the benefit allowed under sections 30, 31 and 32 is required to be reduced proportionately. If payment or expenditure is incurred for the purpose of the trade of the assessee it does not matter that the payment may benefit a third party. The fact that a benefit is obtained by a third party by reason of an expenditure incurred by an assessee does not ipso facto result in the assessee not being regarded as having incurred the expenditure solely and exclusively for its business. What is important is the intention of the assessee and the user by the assessee of the machinery in relation to his business. If the investment is made by the assessee and ownership vests in the assessee, expense is incurred by the assessee, the machine is used for the business of the assessee, and the machine has not been used by the assessee for any non-business or non-professional use, the expenditure incurred on the machinery is commercially expedient from the point of view of the business of the assessee, and if the business of the assessee is benefited from the user of the machine, then the identical sharing of the benefits obtained from the user of the machine with an associate would not render the user of the machine non-exclusive for the purpose of section 38(2).

261 ITR 0463- CIT VS. GIRNAR CONSTRUCTION CO. (RAJ)

Assessee submits that the new bodies on trucks were built up of the dumpers, and no evidence has been shown except a receipt on the letter head. Assessee submits that receipt of the body builder has been submitted though on the letter head but thereafter Vishwa Karma Truck Body Repairs who did this job was examined and he accepted that he has done the work of body building of the dumpers and trucks and received the amount against them. Whether the new body was built by Vishwa Karma Truck Body Repairs or not that is basically a question of fact and on finding of facts and the material on record, it cannot be said that the finding of fact is perverse. That the Tribunal had found that new bodies had been built for trucks. The Tribunal was correct in holding that the assessee was entitled to depreciation on them. The Tribunal had found that the expenditure was fully supported by vouchers. Another issue decided in this case is that no disallowance can be made, merely because it is not supported by vouchers, unless such payments are found to be not genuine.

280 ITR 0006- S.B.I. HOME FINANCE LTD. VS. COMMISSIONER OF INCOME-TAX (CALCUTTA HIGH COURT)

Depreciation is available on the items mentioned in section 32, on satisfaction of the conditions that the plant was owned wholly or partly by the assessee and such plant was used for the purpose of his business. The term “owned” occurring in section 32(1) must be assigned a wider meaning. Anyone in possession of a property in his own title exercising such dominion over the property as would enable others being excluded therefrom and having the right to use and occupy the property and/or to enjoy its usufruct in his own right would be the owner though he may not have formal documents recognized as documents of title under the provisions of the respective law governing the subject. A lease does not extinguish the right of ownership of the lessor ; nor does the lessee acquire any right of ownership thereon. In case of lease (operating lease) of property lessor will qualify for the purpose of depreciation.

268 ITR 0432- CIT VS. JODHAN REAL ESTATE DEVELOPMENT CO. P. LTD. (RAJ)

Sanitary pipeline fittings in a cinema theatre fall in the category of plant and are entitled to depreciation at the rate of of plant.

CIRCULAR NUMBER: 002 [2001] 247 ITR (STAT) 0053A

In all leasing transactions, the owner of the asset is entitled to the depreciation if the same is used in the business. The ownership of the asset is determined by the terms of contract between the lessor and the lessee. In cases where assets are factually non-existent, having been created by hawala transaction, the question of allowance of depreciation does not arise. In cases of sale and lease-back of assets without any alteration in the situation of assets and its working, the denial of depreciation claimed has to be considered keeping in view the principles.

New Accounting Standard on “leases” issued by the Institute of Chartered Accountants of India require capitalisation of the asset by the lessees in financial lease transaction. By itself, the accounting standard will have no implication on the allowance of depreciation on assets under the provisions of the Income-tax Act.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

X limited finance company as per Accounting Standard on “leases” issued by the Institute of Chartered Accountants of India capitalised asset by means of book entry. On this capitalised assets it has proposed

to take the allowance of depreciation provisions of section 32. You are required to state whether any depreciation on these assets are permissible or not.

ANSWER

In all leasing transactions, the owner of the asset is entitled to the depreciation if the same is used in the business. The ownership of the asset is determined by the terms of contract between the lessor and the lessee. In cases where assets are factually non-existent, having been created by hawala transaction, the question of allowance of depreciation does not arise. In cases of sale and lease-back of assets without any alteration in the situation of assets and its working, the denial of depreciation claimed has to be considered keeping in view the principles.

New Accounting Standard on “leases” issued by the Institute of Chartered Accountants of India require capitalisation of the asset by the lessees in financial lease transaction. By itself, the accounting standard will have no implication on the allowance of depreciation on assets under the provisions of the Income-tax Act.

244 ITR 0764 CIT VS. UNITED PROVINCES ELECTRIC SUPPLY COMPANY (SC)

In a case of acquisition of the assessee’s undertaking by the Government, determination of compensation and its payment by the authority would certainly mean that moneys payable “became due” within the meaning of section 41(2) and the Explanation thereto. In a case of dispute or difference in the determination of the market value, pendency of proceedings for additional moneys payable would not be relevant so far as taxability of the compensation amount received is concerned. If any additional amount is received in a subsequent year it would be business income in that year.

The likelihood of the income being reduced in the subsequent assessment year as a result of the litigation may give rise to resort to other remedies available in the Act for rectification and refund of the tax, but on that ground also it cannot be held that no income had accrued to the assessee for the relevant assessment year.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

An undertaking of X limited an company in the business of Generation and Distribution of electricity was compulsory acquired in May 2001 by the state government. The consideration for acquisition was determined and paid Rs. 35 Lakhs. However assessee has accepted the payment subject to dispute of valuation. You are required answer whether weather this amount received will accrue in this year or in the year in which the dispute is settled.

ANSWER

In a case of acquisition of the assessee’s undertaking by the Government, determination of compensation and its payment by the authority would certainly mean that moneys payable “became due” within the meaning of section 41(2) and the Explanation thereto. In a case of dispute or difference in the determination of the market value, pendency of proceedings for additional moneys payable would not be relevant so far as taxability of the compensation amount received is concerned. If any additional amount is received in a subsequent year it would be business income in that year.

255 ITR 0026- ASHWIN VANASPATI INDUSTRIES VS. CIT (GUJ)

Section 43(1) authorises the Assessing Officer to adopt actual cost for purposes of depreciation differently from what is shown as the cost by the assessee by various Explanations. Explanation 3 confers

authority to the Assessing Officer to estimate the value of any used asset, if the Assessing Officer is satisfied that the main purpose of transfer of such asset directly or indirectly to the assessee is prompted by the object of claiming larger depreciation on enhanced base. Such estimate can be made only with the previous approval of the Joint Commissioner meant as a protection to the taxpayer.

Assessing officer is empowered to determine actual cost only if transfer of assets was for claiming depreciation on enhanced cost as per explanation 3 to section 43(1). Where assessee is taking over assets of other person on its dissolution and depreciation is claimed on enhanced value of only three items there is no evidence that transfer was made with a view to claiming depreciation on enhanced cost. Where a business as such is taken over on dissolution and the value adopted for the asset is on the basis of a report by a registered valuer, there is no justification for resort to estimate the value under Explanation 3 to section 43(1). In such case assessee is entitled to depreciation on such enhanced cost.

Question

Certain members of the Thakkar family entered into a partnership to carry on business in the name of Ashwin Vanaspati Industries. Later on the firm was dissolved and was incorporated with all the shareholders being erstwhile partners, viz., belonging to the Thakkar group. Upon the transfer the assets were taken over at price higher than the value of the assets and company claimed the depreciation at enhanced cost. You are required to answer whether company is justified in so doing or not.

	Assets	Value in rupees	W. D. V.
1.	Plant and machinery	33,68,000	6,77,055
2.	Factory building	3,50,000	82,523
3.	Residential building	1,50,000	35,367

Answer

Section 43(1) authorises the Assessing Officer to adopt actual cost for purposes of depreciation differently from what is shown as the cost by the assessee by various Explanations. Explanation 3 confers authority to the Assessing Officer to estimate the value of any used asset, if the Assessing Officer is satisfied that the main purpose of transfer of such asset directly or indirectly to the assessee is prompted by the object of claiming larger depreciation on enhanced base. Assessing officer is empowered to determine actual cost only if transfer of assets was for claiming depreciation on enhanced cost as per explanation 3 to section 43(1). Where assessee is taking over assets of other person on its dissolution and depreciation is claimed on enhanced value of only three items there is no evidence that transfer was made with a view to claiming depreciation on enhanced cost. Where a business as such is taken over on dissolution and the value adopted for the asset is on the basis of a report by a registered valuer, there is no justification for resort to estimate the value under Explanation 3 to section 43(1). In such case assessee is entitled to depreciation on such enhanced cost.

However Explanation 1 to section 43(6)(c) provide that When in a case of succession in business or profession, an assessment is made on the successor company as per section 170(2), the written down value of any asset or any block of assets of the company shall be the amount which would have been taken as its written down value if the assessment had been made directly on the person succeeded to i.e. firm.

261 ITR 0501- MAHINDRA AND MAHINDRA LTD. VS. CIT (BOM)

Actual cost is the cost incurred. The law takes care to ensure that where part of the cost is met by a third party, such cost could not be treated as part of the actual cost, as it would exclude any part of the cost as

has been made directly or indirectly paid by any other person or authority. Where the asset is purchased with the assistance of a loan which later does not become repayable, it cannot obviously be treated as abridging the actual cost, because it is an event subsequent to the acquisition of the asset. This was the proposition upheld by the Supreme Court in CIT v. Tata Iron and Steel Co. Ltd. [1998] 231 ITR 285, a view which can be taken as self-evident.

The manner of repayment of a loan cannot affect the cost of the assets acquired by the assessee. What is the actual cost depends on the amount paid by the assessee to acquire the asset. The amount may have been borrowed by the assessee. But even if the assessee did not repay the loan it will not alter the cost of the asset. If the borrower defaults in repayment of a part of the loan, the cost of the asset will not change. What has to be borne in mind is that the cost of an asset and the cost of raising money for purchase of the asset are two different and independent transactions. Also such amount of un paid loan cannot be treated as benefit or perquisite arising out of the carrying on of the business or profession.

Question

The assessee manufactured jeeps. In June 1993, it entered into an agreement with an American company which agreed to sell to the assessee dies, welding equipment and die models toolings for production of special types of jeeps by the assessee in India. The price of the toolings was agreed at \$ 6,50,000. Since the assessee could not secure foreign exchange, the American company agreed to provide a loan of an amount of \$ 6,50,000 repayable after ten years in instalments with interest at 6 per cent. However deduction on account of interest was not allowed to assessee. Accordingly, the toolings were supplied by the American company. During previous year the American company was taken over and as a term thereof it had been agreed to waive the principal amount of loan advanced to the assessee. The assessee filed its return in which an amount of Rs. 57,74,064 was reflected as cessation of its liability towards the American company. The Income-tax Officer came to the conclusion that with the waiver of the loan the credits represented income and not a liability. The assessing officer is also of the opinion that such waiver shall be taxed as benefit or perquisite arising out of the carrying on of the business or profession. You are required to discuss the correct tax treatment.

Answer

There were two important facts which had been overlooked by the Assessing Officer. Firstly, the assessee continued to pay interest at 6 per cent. for a period of ten years on the loan amount. The agreement for purchase of toolings was entered into much prior to the approval of the loan arrangement given by the Reserve Bank of India. Therefore, the loan agreement, in its entirety, was not obliterated by such waiver. Secondly, the purchase consideration related to capital assets. The toolings were in the nature of dies. The assessee was a manufacturer of heavy vehicles and jeeps. It required these dies for expansion. Therefore, the import was that of plant and machinery. The consideration paid was for such import. In the circumstances, section 28(iv) was not attracted. Lastly, the principal amount of loan had been forgone as a part of takeover arrangement to which the assessee was not a party. The waiver of the principal amount was unexpected. In the circumstances, such waiver would not constitute business income. [2003] 261 ITR 0501- Mahindra and Mahindra Ltd. vs. Commissioner of Income-tax (Bombay High Court)

That in order to apply section 41(1), an assessee should have obtained a deduction in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee. The assessee had not obtained such allowance or deduction in respect of expenditure or trading liability. The assessee had paid interest at 6 per cent. over a period of ten years on Rs. 57,74,064. In respect of that interest, the assessee never got deduction under section 36(1)(iii) or section 37. In the circumstances, section 41(1) of the Act was not applicable. Secondly, even assuming that the assessee had got deduction on allowance section 41(1) was not applicable because such deduction was not in respect of loss, expenditure or trading

liability. Lastly the toolings constituted capital assets and not stock-in-trade. Therefore, taking into account all the above facts, section 41(1) of the Act was not applicable. [2003] 261 ITR 0501- Mahindra and Mahindra Ltd. vs. Commissioner of Income-tax (Bombay High Court)

270 ITR 0398- COMMISSIONER OF INCOME-TAX VS. FAZILKA DABWALI TPT. CO. PVT. LTD. (PUNJAB AND HARYANA HIGH COURT)

In CIT v. Podar Cement Pvt. Ltd. [1997] 226 ITR 625, the Supreme Court held that though under the common law “owner” means a person who has got valid title legally conveyed to him after complying with the requirements of law such as the Transfer of Property Act, the Registration Act, etc., in the context of the Income-tax Act, 1961, having regard to the ground realities and further having regard to the object of this Act, namely, to tax the income, “owner” is a person who is entitled to receive income from the property in his own right. i.e. owner includes beneficial owner.

Buses were initially purchased by the directors of the assessee-company and the finance was raised by them from bankers in their individual names. However, the buses were taken over by the assessee. The income of the said buses was shown and assessed in the hands of the assessee-company and the expenses relating to these buses on account of interest paid to the bank, insurance, hire purchase charges and salaries to the drivers were also being claimed as a deduction by the assessee-company. The costs of the buses were reflected in the balance-sheet of the company and the liability towards the bank against these buses on account of “term loan” was also reflected under the head “Secured loans”. The Assessing Officer refused to allow depreciation on the buses in the hands of the company. The Tribunal concluded that there was ample evidence on record to show that the assessee had taken over the buses from the directors and the mere fact that they were not got registered in the names of the assessee could not be a ground for disallowing the claim of depreciation. Held that the assessee was entitled to depreciation on the buses which were standing in the names of the directors.

279 ITR (A.T.) 0041- BHARATBHAI J. VYAS VS. INCOME-TAX OFFICER (AHMEDABAD BENCH)

Upon the retirement of partner of firm amount was paid as goodwill. The firm sought to claim depreciation on such sum. In light of that goodwill cannot be treated on par with other intangible assets like know-how, patents, copy right, trade mark or any business or commercial rights of similar nature. It was so held by the Tribunal in Bharatbhai J. Vyas v. ITO [2005] 279 ITR (AT) 41 (Ahmedabad).

The inference followed the finding that the firm from which the assessee acquired goodwill on dissolution did not have any know-how, patent, copy right or trade marks. The inference was therefore an easy one. Goodwill being a compendious term for various advantages, there can be circumstances, where it has an inclusive character covering know-how, trade name etc. Right to depreciation cannot possibly be ruled out merely because of adoption of nomenclature - goodwill. But then separate valuation of each such intangible asset, distinct from what is generally understood in a broader sense as goodwill, could avoid such controversies.

279 ITR (A.T.) 0001- MAHINDRA SINTERED PRODUCTS LTD. VS. DEPUTY COMMISSIONER OF INCOME-TAX (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

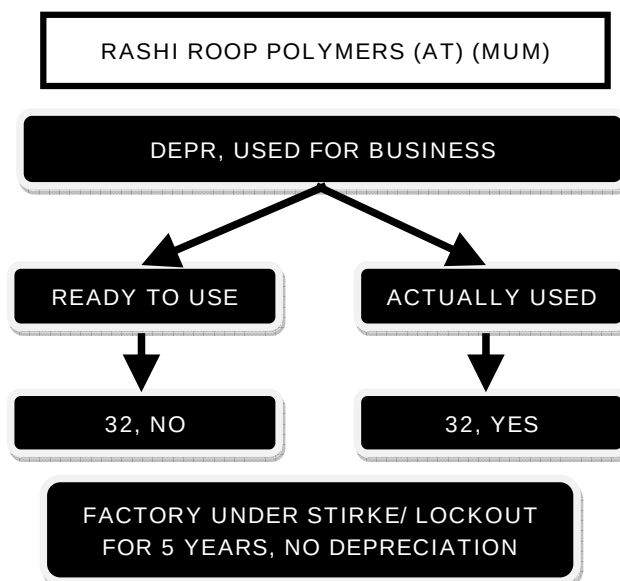
Assessee had two industrial units. For the both the units the block of asset maintained was one. It had sold one of the unit at Ahmednagar. The case of the assessee was that the entire Ahmednagar unit was sold as a whole along with licences, etc., as a going concern and therefore it was a slump sale. The valuation of the assets was done by the vendee through registered valuers and it was not an attempt on the part of the assessee. That the revenue authorities had gone wrong in not setting off the sale consideration from the entire block of assets of the company. Nowhere is it mentioned in section 50 that the sale consideration is to be deducted from the written down value of that particular asset. The block of assets referred to in section 50 should be construed as part of the business as a whole so that the total taxable income arising from various units of an assessee can be computed. The two units of the assessee were part of the total business of the assessee and they were not segregated for the purpose of taxation and therefore should not be segregated while computing short-term capital gains. The entire group of assets in respect of which the same percentage of depreciation was prescribed fell under one block of the assessee. In terms of section 50(2), surplus arising on transfer of capital assets is taxable as short-term capital gains, when the written down value of a block of assets is reduced to nil even though all the assets falling within that block are not transferred.

In other words the block of assets need not be separated in respect to each of the business.

286 ITR (A.T.) 0054- ASSISTANT COMMISSIONER OF INCOME-TAX VS. RISHIROOP POLYMERS P. LTD. (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

The word “used” in section 32 of the Income-tax Act, 1961, denotes that the asset has been actually used and not that it is merely ready for use. There should be actual use of the asset for it to be eligible for depreciation. Therefore, depreciation on an asset ready for use but not actually used, cannot be allowed. Merely including an item in the block of assets will not make it eligible for depreciation if other conditions for allowability of the claim are not satisfied.

During the relevant previous year there was lock out/strike in the assessee’s factory which resulted in temporary closure of manufacturing activity but the company was not closed down, as the assessee had intention to continue with the business and to resume manufacturing as soon as the dispute was settled with the labour. The assessee explained that the machines in question formed part of block of assets and were already put to use in the past and also in the subsequent years but the Assessing Officer disallowed the claim of depreciation on the ground that these machines were not put to use during the previous year. The Commissioner (Appeals) cancelled the disallowance on the ground that the temporary lull in business did not amount to closure of business once and for all. On the Department’s appeal Held, allowing the appeal, that there was lock out and strike for five years and the plant and machinery was not put to use as there was



was lock out and strike for five years and the plant and machinery was not put to use as there was

admittedly no manufacturing activity. The depreciation could not be allowed on such non-use. Therefore, the assessee was not entitled to depreciation on the passive use or on the plant and machinery ready for use.

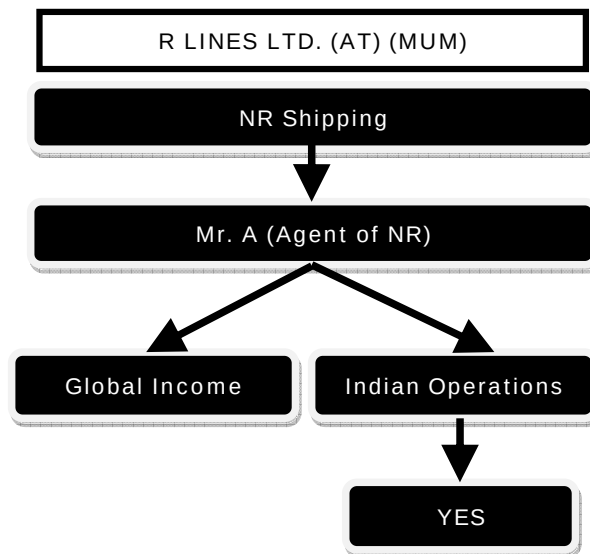
NON RESIDENT SHIPPING BUSINESS

Section / Topic Name : 172

CIRCULAR NUMBER: 09 [2001] 250 ITR (STAT) 0081-

Under the provisions of section 172(7), the non-resident owner or charterer is allowed an option to be assessed on his total income of the previous year in accordance with other provisions of the Act. When such option is exercised and an assessment is made accurately, the tax already paid under the provisions of section 172(4) by the non-resident owner or charterer would be treated as tax paid in advance for that assessment year before determining the amount of tax finally due. Board earlier clarified that the assessee, who exercises his option under section 172(7) to get his total income assessed in accordance with the other provisions of the Act, is neither liable to pay interest under sections 234B and 234C, nor entitled to receive interest under section 244A of the Income-tax Act, 1961.

This issue has subsequently been discussed and decided by the Supreme Court in the case of A. S. Glittre. It has been held that the payment of tax under section 172(3) / (4) is at par with advance tax instalments. Hence, in case of a regular assessment under section 172(7) the assessee is entitled to refund, as well as interest on such refund. The Circular No. 730 earlier issued by CBDT, under the circumstances, no longer legally tenable and is, therefore, withdrawn. It is clarified that in case of a regular assessment under section 172(7), the non-resident assessee is liable to pay interest under sections 234B and 234C and also entitled to receive interest under section 244A as the case may be.



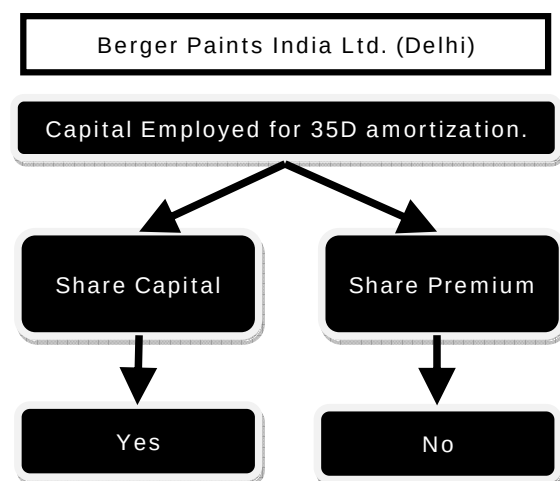
SCIENTIFIC RESEARCH EXPENSE

Section / Topic Name : 35, 35D, 35DD, 35DDA, 35E

R & D EXPENDITURE

The Himachal Pradesh High Court in CIT v. Engineering Innovation Ltd. [2009] 178 Taxman 237 held that any methodical or systematic investigation based on science into the study of any materials and sources is a scientific research and, thus, in this case the dismantling of the imported coffee machine with a view to decipher how the said machine functions and also with a view to develop a new model of machine suitable for Indian conditions was held as R&D activity entitling the assessee to 100 per cent deduction of expenditure on import of coffee machine.

But in this case one would wonder how this activity would have had a relationship to the business of the assessee of manufacture and sale of precision sheet metal components. There was no reference in this regard in the decision and, thus, the revenue might like to get insight into this for appropriate further action.



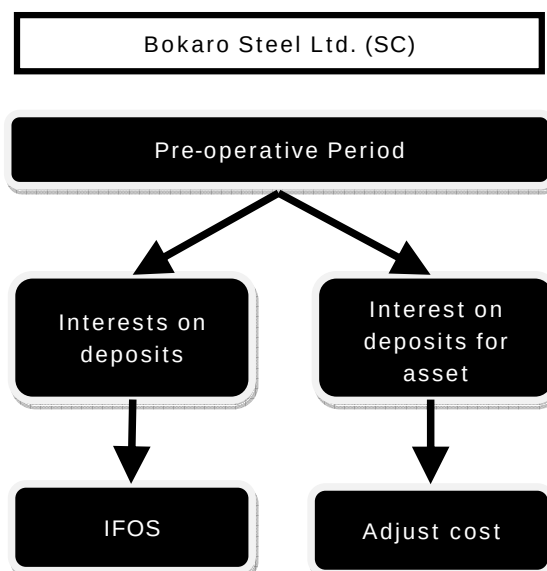
AMORTISATION OF EXPENSE

Section 35D(3) places a ceiling on account of expenditure, which would be deductible on staggered basis under section 35D with reference to capital employed. In Berger Paints India Ltd. v. CIT [2007] 292 ITR 658 (Delhi), it was held that premium on issue of shares is different from shares themselves, so that they could not be treated as capital employed in the business of the company. It cannot also be treated as long-term borrowings either in fact or a fiction of law. It is under these circumstances, the restriction sought by the Revenue by not treating such premium as capital

employed was found to be justified and the assessee's appeal was dismissed.

INTEREST ON SHARE APPLICATION IN PRE-COMMENCEMENT

Where interest is received on share application money pending commencement of business, the question that arose for consideration was whether such interest will be assessable as income from business or income from other sources or treated as abatement of capital expenditure to be set off against the preliminary expenses to be amortised under section 35D. The Revenue had relied upon the decision in Tuticorin Alkali Chemi-cals and Fertilizers Ltd. v. CIT [1997] 227 ITR 172 (SC) to tax such receipts as income from other sources. In CIT v. Neha Proteins Limited [2008] 306 ITR 102 (Raj), the High Court found that interest was from part of the funds available from share capital pending use for construction of a factory prior to



commencement of business. It pointed out that the decision of the Supreme Court in CIT v. Bokaro Steel Ltd. [1999] 236 ITR 315 should have application distinguishing Tuticorin Alkali Chemicals and Fertilizers Ltd.'s case (supra), where the amount was put in short term deposit with a view to earn income treating such deposits as a source of income. It was not so in the case before the High Court. It was treated as an amount to be set off against expenses requiring the balance to be amortised under section 35D.

276 ITR 0045- COMMISSIONER OF INCOME-TAX VS. U.P. ELECTRONIC CORPORATION LTD. (ALLAHABAD HIGH COURT)

The assessee was a Government of U. P. undertaking and was set up with the basic object of promoting and developing electronic industries in the State of U. P. It set up factories to manufacture black and white television sets. With effect from April 1, 1987, the State Government created certain separate corporations. The factories owned by the assessee were transferred to different corporations set up by the State Government. These corporations were wholly owned subsidiaries of the assessee. After the transfer of the factories the assessee was engaged mainly in the work of research and development. The results of such research and development were used by the factories which were wholly owned subsidiaries. Apart from the research work, the Corporation was also engaged in providing consultancy services for which during the year under consideration it had received a sum of Rs. 6,72,992 as fee. It had also received Rs. 3,03,000 from the State Government for preparing feasibility reports. Apart from this, it had also received a sum of Rs. 6,46,300 from the promotion and development of electronic industry in the State. It claimed deduction of Rs. 19,23,250 under section 35 of the Act which related to the expenditure on scientific research.

Section 35 allows expenditure including capital expenditure on scientific research. Depreciation on machinery used for scientific research however is allowed under section 32, so that such plant and machinery should have been used for the business of the assessee. In fact, the cost of the machinery could have been allowed under section 35 but the dispute arose because the scientific expenditure related to consultancy business in CIT v. U. P. Electronic Corporation Ltd. [2005] 276 ITR 45 (All). The High Court in this case upheld the finding of the Tribunal, that though the assessee was not directly engaged in business, it was engaged in consultancy and preparation of feasibility reports for electronic industry, so that this itself could be treated as expenditure relating to its business. Scientific research does not ordinarily relate to the immediate activity of the assessee, but for potential expansion. It is for this reason that a separate section 35 to allow scientific expenditure apart from section 37 was considered necessary with the Legislature intending to give even greater weight for such expenditure by allowing capital expenditure as well. Hence, any expenditure relating to scientific research against any business should ordinarily be deductible without any further requirement of establishing the right to deduction with reference to his operations during the year. The High Court, however, in this case found that there is a requirement that even scientific expenditure is laid out or expended or is related to the business, that is carried on by the assessee, but all the same, found that business has to be understood in a wider sense to include business owned by the subsidiaries. There should have been no scope for any doubt as to the deductibility of such expenses.

INTEREST ON CAPITAL BORROWED FOR BUSINESS

Section / Topic Name : 36 (Interest on capital borrowed)

TRANSACTIONS BETWEEN SISTER CONCERNS - TEST OF BUSINESS EXPEDIENCY

The Punjab and Haryana High Court in CIT v. Rockman Cycle Industries (P.) Ltd. [2010] 187 Taxman 242 held that commercial expediency is the judging factor in transactions between sister concerns. In this case the Assessing Officer held that there was no justification to borrow funds at the rate of 18 per cent interest for making investment in shares, which would give a dividend of 4 per cent only so that he found it an imprudent transaction and disallowed interest, whereas the Tribunal allowed the assessee's claim holding that it could not be prevented from making investment only because return from shares was low and that it was in wisdom of the assessee to have entered into transactions even if such transactions were not prudent. The High Court showing dissatisfaction to such a decision of the Tribunal referred the matter to the Larger Bench keeping in view the test of business expediency.

LOAN TO AN ASSOCIATE-NEXUS BETWEEN LENDING AND BORROWING

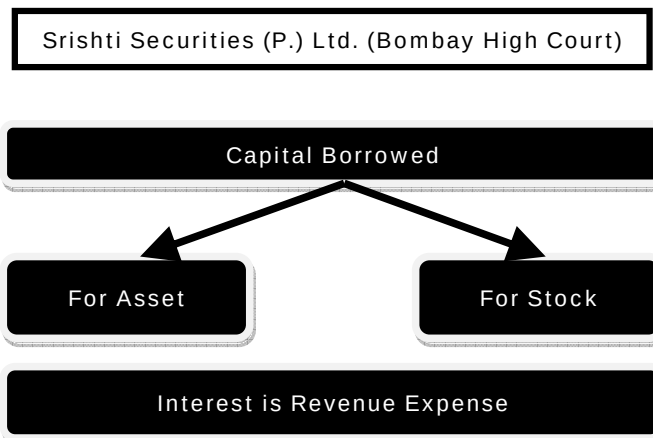
In CIT v. H.B. Stock Holdings Ltd. [2009] 184 Taxman 352 (Delhi), the assessee claimed deduction of interest paid in respect of amount borrowed from a bank. The Assessing Officer rejected the claim on the ground that the assessee had given interest-free advances to its sister concern. As the Tribunal found that the loan which was given to the sister company was before the loan which was taken by the assessee from bank, the High Court deleted the addition stating that the revenue was incorrect in contending that there was a nexus between the loan given by the assessee to its sister concern and the loan which it availed of from the bank. The Court went on to point out that as the own funds of the assessee being share capital and reserves and surplus in the form of share premium money much exceeded the amount of loan made to the sister concern, deduction for interest was allowable to the assessee under section 36(1)(iii).

PRE-OPERATIVE PERIOD INTEREST - EXPANSION OF BUSINESS

The Supreme Court in L.K. Trust v. CIT [2009] 183 Taxman 80 held that the proviso to sub-clause (iii) in section 36(1) is mandatory and not clarificatory in nature so that the proviso would operate prospectively only.

OBJECT OF LOAN IRRELEVANT - ACQUIRING CONTROLLING INTEREST

In CIT v. Srishti Securities (P.) Ltd. [2009] 183 Taxman 159, the Bombay High Court upheld the ITAT's view that if the funds are borrowed by an investment company for making investment in shares which may be held as investment or as stock-in-trade or for the purpose of controlling interest in other companies, interest paid on such borrowed funds will be deductible under section 36(1)(iii). The High Court drew its conclusions based on decision of the Apex Court in India Cements Ltd. v. CIT [1966] 60 ITR 52 (SC) to the effect that the object of the loan is an irrelevant consideration. The Assessing Officer in Srishti's case (supra) disallowed entire amount of interest paid on the ground that the object of acquiring shares was not to earn dividend but to acquire a controlling interest in the company.



ROLL OVER CHARGES- FORWARD EXCHANGE CONTRACT

The Gujarat High Court in Elecon Engg. Co. Ltd. v. Asstt. CIT [2008] 173 Taxman 107 held that the roll-over charges/premium paid by the assessee to bank were nothing, but the interest or committal charges and the same were allowable under section 36(1)(iii).

P/L 1-4 to 31-3			
Particulars	Amount	Particulars	Amount
Interest paid (Money Borrowed for acquiring shares/controlling interest) (allowable as deduction)	1		
Forward exchange contract (Roll over charges) (allowable as deduction)	2		

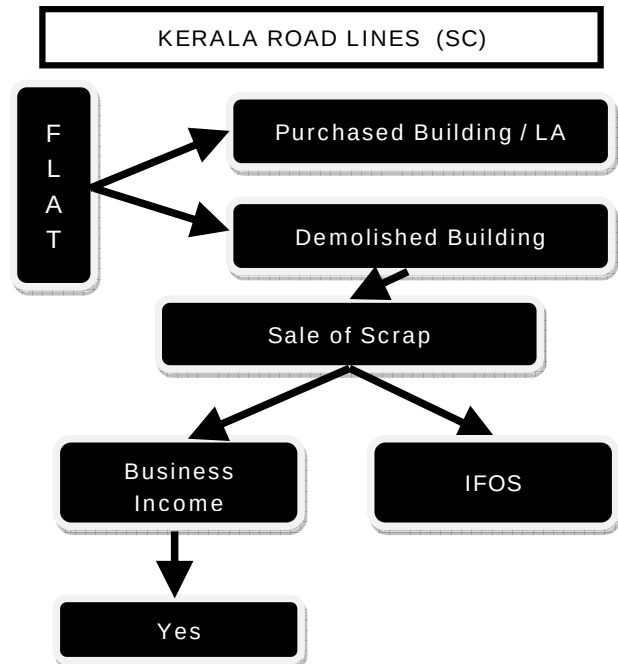
1.	India Cements Ltd. (SC)
2.	Elecon Engg. Co. Ltd. (Gujarat High Court)

CORRELATION BETWEEN AMOUNT BORROWED AND MONEYS

ADVANCED

In CIT v. South India Corporation (Agencies) Ltd. [2008] 166 Taxman 78/[2007] 293 ITR 237, the Madras High Court upheld the finding of the Tribunal which deleted the notional/estimated addition for the sole reason that no fresh loan was given by the assessee to its sister concern during the relevant assessment year and more so for the reason that similar claim of allowance of interest paid on borrowings as interest referable to the advances given to its subsidiary company is held allowable during the earlier assessment years, and the same remained unchallenged all through.

The High Court found favour with its previous decision in the assessee's own case, viz., judgment dated August 31, 2006 in CIT v. South India Corpn. (Agencies) Ltd. [2007] 290 ITR 217/164 Taxman 249 (Mad.), made in T.C. (A) Nos. 262 to 267 of 2006 and 1231 to 1237 of 2006, in favour of the assessee. In the said decision, the Court found that the assessee has a lot of business action with the subsidiaries and carrying on various activities through the subsidiaries and further for the fact that the assessee had its own free reserves and funds used mainly for running expenses and also for the reason that there was no correlation made by the revenue that the money borrowed was actually given to its subsidiaries, deleted the addition towards interest.



INTEREST ON CAPITAL PURCHASE

In Kerala Road Lines v. CIT [2008] 168 Taxman 208 (SC), the assessee who was running buses and lorries for hire entered into an agreement for purchase of land with building thereon. It paid the consideration in instalments along with interest pursuant to a provision in the agreement that if the instalments were not paid in time, the assessee would be liable for interest thereon. Pursuant to this agreement, the assessee took possession of the property and sold to others the building thereon for its scrap value. The assessee claimed that it had to pay a sum of Rs. 4 lakhs as interest to the vendor pursuant to the agreement for sale, and this payment of Rs. 4 lakhs was liable to be deducted as business expenditure. The Assessing Officer rejected the claim; the Tribunal allowed it but the High Court restored order of the Assessing Officer.

Reversing the order of the High Court, the Supreme Court held that once the department has subjected to tax the scrap value realised from the building as business income it is obliged to also allow deduction of interest paid on unpaid consideration of such investment in land with building thereon.

245 ITR 002 CIT VS. GOPAL BANSILAL INANI (SC)

It was not a case of complete partition by metes and bounds recognised under section 171. Monies distributed by HUF to coparceners were lent by coparceners to HUF on which the interest was paid. Held that Payment of interest by the Hindu undivided family to coparceners cannot be allowed as a deduction.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

X(HUF) has made interest payments to Mr. X a coparceners of that HUF on amount lent by Mr. X to X(HUF). X(HUF) has claimed it as deduction while computing business income u/s 36(1). You are required to answer with reasons whether the claim of the HUF is justified or not. State the assumptions if any.

ANSWER

It is assumed that, it was not a case of complete partition by metes and bounds recognised under section 171. Monies distributed by HUF to coparceners were lent by coparceners to HUF on which the interest was paid. Held that Payment of interest by the Hindu undivided family to coparceners cannot be allowed as a deduction. [2000] 245 ITR 002 COMMISSIONER OF INCOME-TAX VS. GOPAL BANSILAL INANI (SC).

249ITR235 CIT VS. SARASWATI CHEMICALS AND ALLIED INDUSTRIES (P.) LTD. (DEL)

The expression "capital borrowed" used in section 36(1)(iii) means money and not any other asset. Interest paid need not, however, bear the character of a revenue outgoing. To be admissible as an allowance under the concerned provision, interest must be paid in respect of the capital borrowed. Interest payable on capital borrowed means interest, which actually becomes payable on an amount of money and not on any other asset. An amount due under a statute cannot be regarded as borrowed capital for the expression "capital" predicates the relationship of a borrower and a lender, which relationship has to be found as a matter of fact. Interest can be described as a consideration paid either for use of money or for forbearance in demanding it after it has fallen due.

The interest paid by the assessee to the directors on undisbursed salaries did not constitute interest on capital borrowed for the purpose of the business within the meaning of section 36(1)(iii).

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

You are required to discuss whether assessing officer was right in holding that the amounts of salaries due to the directors of the company, but not paid to them and utilised by the company for the purposes of its business, constituted capital borrowed for the purposes of its business within the meaning of section 36(1)(iii) and Whether, the officer was right in holding that the interest paid by the assessee to the directors on such undisbursed salaries constituted interest on capital borrowed for the purposes of the business within the meaning of section 36(1)(iii) of the Act.

ANSWER

Interest on borrowed capital is deductible as business expenditure under section 36(1)(iii) of the Income-tax Act. But where directors have not drawn their salaries and interest was credited to their accounts, the interest, it was held, cannot be allowed as interest on borrowed capital in the case of CIT v. Saraswati Chemicals and Allied Industries (P.) Ltd. [2001] 249 ITR 235 (Delhi). But the argument that in such cases, though it is not deductible under section 36(1)(iii), it is allowable under section 37 was not obviously raised in this case. But if it had been raised, it would have been found allowable.

251 ITR 0061- DCIT VS. CORE HEALTHCARE LTD. (GUJ)

It is the settled legal position that interest paid/payable has to be in respect of capital borrowed for the purposes of business the section nowhere stipulates that such borrowing has to be only on revenue account. The only requirement is that the interest must have been incurred for the purpose of capital borrowings made for the purpose of business. Therefore, whether the interest is paid for a borrowing which is utilised for acquisition of a capital asset or which is utilised for a revenue purpose loses its distinction. The view that interest which is capitalized in the books of accounts, after the commencement of the business but before an asset is first put to use cannot be allowed as a revenue deduction under section 36(1)(iii) of the Act is against the plain language of the provisions of the Act.

READ EXPLANATION 8 TO 43(1) TOGETHER 36(1)(III)

Explanation 8 to 43(1) only lays down that where an amount is paid/payable as interest in connection with the acquisition of an asset, so much of such amount as is relatable to any period after such asset is first put to use, shall not be included in the actual cost of such asset. The scope and ambit of this Explanation on a plain reading is restricted to a situation where after the asset is first put to use the interest which is paid/payable would never form a part of the actual cost. The Explanation nowhere provides that interest pertaining to a period prior to an asset being first put to use will not be allowed as a deduction under section 36(1)(iii).

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

You are required to answer whether the officer is right in allowing as deduction for, interest on borrowing made for acquisition as capital assets, though pertaining to period prior to the asset being put to use, under section 36(1)(iii).

ANSWER

It is the settled legal position that interest paid/payable has to be in respect of capital borrowed for the purposes of business the section nowhere stipulates that such borrowing has to be only on revenue account. The only requirement is that the interest must have been incurred for the purpose of capital borrowings made for the purpose of business. Therefore, whether the interest is paid for a borrowing which is utilised for acquisition of a capital asset or which is utilised for a revenue purpose loses its distinction. The view that interest which is capitalized in the books of accounts, after the commencement of the business but before an asset is first put to use cannot be allowed as a revenue deduction under section 36(1)(iii) of the Act is against the plain language of the provisions of the Act. The officer is justified in allowing as deduction under section 36(1)(iii), interest on borrowing made for acquisition of the capital assets, though pertaining to the period prior to the commencement of production.

260 ITR 0341- KEJRIWAL ENTERPRISES VS. COMMISSIONER OF INCOME-TAX (CAL)

In a matter relating to deduction of interest on borrowing for investment in a joint venture company, the Tribunal felt that such interest is not admissible under section 36(1)(iii) of the Income-tax Act on the ground, that the amount advanced by the joint venture company was lying in the company without interest as contribution towards shares without being allotted such shares. The High Court in *Kejriwal Enterprises v. CIT* [2003] 260 ITR 341 (Cal) found that the amount was borrowed and invested in a company formed as a joint venture with a Russian company, but the company could not take off, because of the political developments in Russia. The company was doing business and even making profits, while the amount contributed as application money was refunded.

The High Court found that the issue as to whether it was lying as mere application money or investment in shares or whether interest was payable or it was interest free would not be relevant in the facts and circumstances of the case, as long as it was a borrowing for business purposes and it was so applied for such purposes. Thus the interest was allowable as deduction.

Question

The assessee firm entered into a joint venture collaboration agreement with a company of the USSR at the time just before the disintegration of the United Soviet Russia. The agreement was in writing and the basic terms of the agreement were, that a company would be floated by the two parties, and capital would be contributed by the assessee to the extent of 60 per cent. and by the Russian party to the extent of 40 per cent. The Russian collaborator was unable to contribute to the share capital of the joint venture company to the extent agreed. Till then application monies were kept blocked in the joint venture company. You are required to answer for the assessee's tax returns, as to whether since the funds which the assessee had borrowed for the purpose of advancing to the joint venture, were attracting interest, the assessee was entitled to claim a deduction for interest paid by it, on such borrowings, as deductions of a revenue nature or not

Answer

The assessee being compelled to keep its application money blocked, because its associate was being so compelled to keep its money blocked without conversion into share capital because of the State's internal problems. The borrowings kept as application money in the joint venture company was for use of the money for the assessee's business and thus the only conclusion of law would be that the interest thereon was deductible as revenue expenses by the assessee. *Kejriwal Enterprises v. CIT* [2003] 260 ITR 341 (Cal).

260 ITR 0579- CIT VS. LOKHANDWALA CONSTRUCTION INDS. LTD. (BOM)

Interest is ordinarily an expenditure of revenue nature. There are, however, circumstances when doubts may arise as to the eligibility for deduction as revenue expenditure. In CIT v. Lokhandwala Construction Inds. Ltd. [2003] 260 ITR 579 (Bom), it was sought to be disallowed on the ground that the borrowing was for purposes of obtaining development right in respect of land, so that it was treated as requiring capitalisation of the cost of land and not deductible. The High Court found that the borrowing was for the purpose of business and in fact for a developer, the land is stock-in-trade. In fact, even if it were for acquiring a capital asset, it would have been deductible as held by the Supreme Court in India Cements Ltd. v. CIT [1966] 60 ITR 52.

In yet another decision in CIT v. Tin Box Co. [2003] 260 ITR 637 (Delhi), the Assessing Officer disallowed part of the interest on borrowed capital stating that the assessee had given interest free loans. The High Court endorsed the finding of the Tribunal that there were sufficient capital and interest free funds with the assessee to cover interest free loans to sister concerns and that, at any rate, the Department had not brought any evidence to indicate that interest bearing borrowings were diverted to sister concerns. It was under these circumstances, it was found that no part of the claim could have been disallowed.

Question

The assessee-company was engaged in the business of construction of buildings. The assessee had secured development rights from Bombay Gaw Rakshak Mandal under an agreement in respect of a plot of land. The assessee had taken loans amounting to Rs. 1.15 crores for securing development right (Kandivali project). The assessee claimed deduction of Rs. 14,09,942 paid as interest on the moneys borrowed under section 36(1)(iii). The deduction was allowed but the Commissioner exercising his authority under section 263 of the Income-tax Act came to the conclusion that the loan of Rs. 1.15 crores was utilised by the assessee for acquiring a capital asset and, therefore, the claim for deduction under section 36(1)(iii) could not have been allowed because it was not a revenue expenditure. You are required to answer whether the claim of the commission is justified or not.

Answer

In fact for a developer, the land is stock-in-trade. Since the assessee had received loan for obtaining stock-in-trade (Kandivali project), the assessee was entitled to deduction under section 36(1)(iii). CIT v. Lokhandwala Construction Inds. Ltd. [2003] 260 ITR 579 (Bom).

260 ITR 0637- COMMISSIONER OF INCOME-TAX VS. TIN BOX CO. (DELHI HIGH COURT)

The Assessing Officer disallowed part of the interest on borrowed capital stating that the assessee had given interest free loans. The High Court endorsed the finding of the Tribunal that there were sufficient capital and interest free funds with the assessee to cover interest free loans to sister concerns and that, at any rate, the Department had not brought any evidence to indicate that interest bearing borrowings were diverted to sister concerns. It was under these circumstances, it was found that no part of the claim (on account of interest payment) could have been disallowed.

Question

The assessee, a registered firm, engaged in the business of manufacture and sale of tin containers and printers, had been advancing interest free loans to its sister concern, namely, “Wholesale Limited” since 2 years. At the same time it had been availing of overdraft loan facilities from the State Bank of India against hypothecation of stocks, etc., and was paying interest to the bank. The Assessing Officer

disallowed a sum of Rs. 3 lakhs (considered reasonable) out of the total interest paid by the assessee to the State Bank of India in its overdraft account. You are required to answer whether officer is justified in so doing or not.

Answer

Assessee in case of [2003] 260 ITR 0637- COMMISSIONER OF INCOME-TAX VS. TIN BOX CO. (DELHI HIGH COURT) submitted that the interest free advances to the sister concern were out of interest-free funds available with the assessee, being based on facts and figures, extracted in the impugned orders also, the orders do not give rise to any substantial question of law. In support of the proposition that it is not for the Revenue to direct the assessee to run its business in a particular manner, learned counsel has also placed reliance on a decision of this court in CIT v. Dalmia Cement (B.) Ltd. [2002] 254 ITR 377. It is asserted that the assessee having established that the amounts borrowed from the State Bank of India had been used for the purpose of the business, no disallowance for the interest paid could be made. While noticing that the Department had not been able to controvert or disprove the fact that the assessee had substantial capital and interest-free funds available with it, not only in the preceding years but also in the years under consideration, which far exceeded the interest-free advances to the sister concern. Departmental Representative could not point out any specific interest bearing borrowed funds, which had been diverted by the assessee to its sister concern thus the disallowance of interest is not justified..

265 ITR 0250- INDIAN SHAVINGS PRODUCTS LTD. VS. CIT (RAJ)

The tribunal found that the assessee company is running in huge losses and when the assessee had paid huge interest on the loan from financial institutions, there is no justification to advance interest-free loan of Rs. 2,40,74,820 to its subsidiaries for purchase of shares.

On the aforesaid findings, whether interest should be allowed or not, whether interest-free loan advanced to the four subsidiaries is for purpose of business, is basically a question of fact. No substantial question of law does arise for consideration. Otherwise also, the finding of fact of the Tribunal that interest-free loan to its four subsidiaries was not for the purpose of business is not perverse, nor there was any justification to pay huge amount of interest on the borrowings and advance the loan to its subsidiaries at free of interest.

In other words for interest on borrowed capital to be deductible, it should be for purposes of business. Where dealing in shares is not the business of the assessee, interest on money borrowed for acquiring shares cannot be allowed as a business deduction under section 36(1)(iii) of the Act as was found in Indian Shavings Products Ltd. v. CIT [2004] 265 ITR 250 (Raj). A similar view was taken in Caldern Pharmaceuticals Ltd. v. CIT [2004] 265 ITR 244 (Cal), where the borrowing was utilised for lending the amount to a sister concern without interest, such lending being not part of the assessee's business, following the earlier decision on similar facts in CIT v. Bombay Samachar Ltd. [1969] 74 ITR 723 (Bom).

276 ITR 0115- JCT LTD. VS. DEPUTY COMMISSIONER OF INCOME-TAX (CALCUTTA HIGH COURT)

Explanation 8 to 43(1) is clear and unambiguous. It crystallizes the principle and removes the doubt, which had already been dispelled by various decisions. Explanation 8 does not make any distinction between acquisition of an asset before the assessee commences his business or the project commences its production and acquisition of an asset for the purpose of expansion after the assessee has commenced his business or an industrial undertaking has commenced production. It is the actual cost of the asset that has

to be ascertained on the cut off date as to when such asset is first put to use. The interest paid in connection with acquisition of an asset with borrowed capital under a deferred payment scheme, until the asset is first put to use is to be treated differently from the interest paid after the asset is first put to use. Explanation 8 makes it clear that such interest paid after the asset is first put to use shall not be added to the actual cost of such asset. Therefore, this interest paid on borrowed capital under the deferred payment scheme after the machinery is first put to use would be revenue expenditure, since it cannot be treated to be the actual cost of such asset for being capitalised for the purpose of claiming depreciation or development rebate. But so long as the machinery is not first put to use, Explanation 8 would operate conversely. The interest paid before the asset was first put to use would be included in the actual cost and then it is to be treated as capital expenditure eligible for being capitalized on which depreciation and development rebate would be admissible.

The issue as to whether interest element should be identified in the instalment paid under a deferred payment scheme, so as to disallow the same, till the asset is brought to use was the issue decided in JCT Ltd. v. Deputy CIT [2005] 276 ITR 115 (Cal). The decision went against the assessee on the ground that the payment should be treated as made for acquiring the asset, so that it would be part of the actual cost of the asset. The issue involved application of Explanation 8 to section 43(1), which would not treat any amount paid or payable as interest in connection with acquisition of asset as actual cost after it is brought to use.

DEDUCTION ON ACCOUNT OF BAD DEBTS

Section / Topic Name : 36 (bad debts)

NPA PROVISIONING

The Supreme Court in Southern Technologies Ltd.v. Jt. CIT [2010] 187 Taxman 346 held that a provision for NPA debited to Profit and Loss Account under the 1998 directions is only a notional expense and, therefore, the same would be added back to that extent in the computation of total income under the Income-tax Act. The Apex Court further pointed out that under section 36(1)(vii), read with the Explanation, a 'write off' is a condition for allowance. Brushing aside the real income theory brought out by the assessee the Apex Court held that if 'real profit' is to be computed one needs to take into account the concept of 'write off' in contradistinction to the 'provision for doubtful debt'.

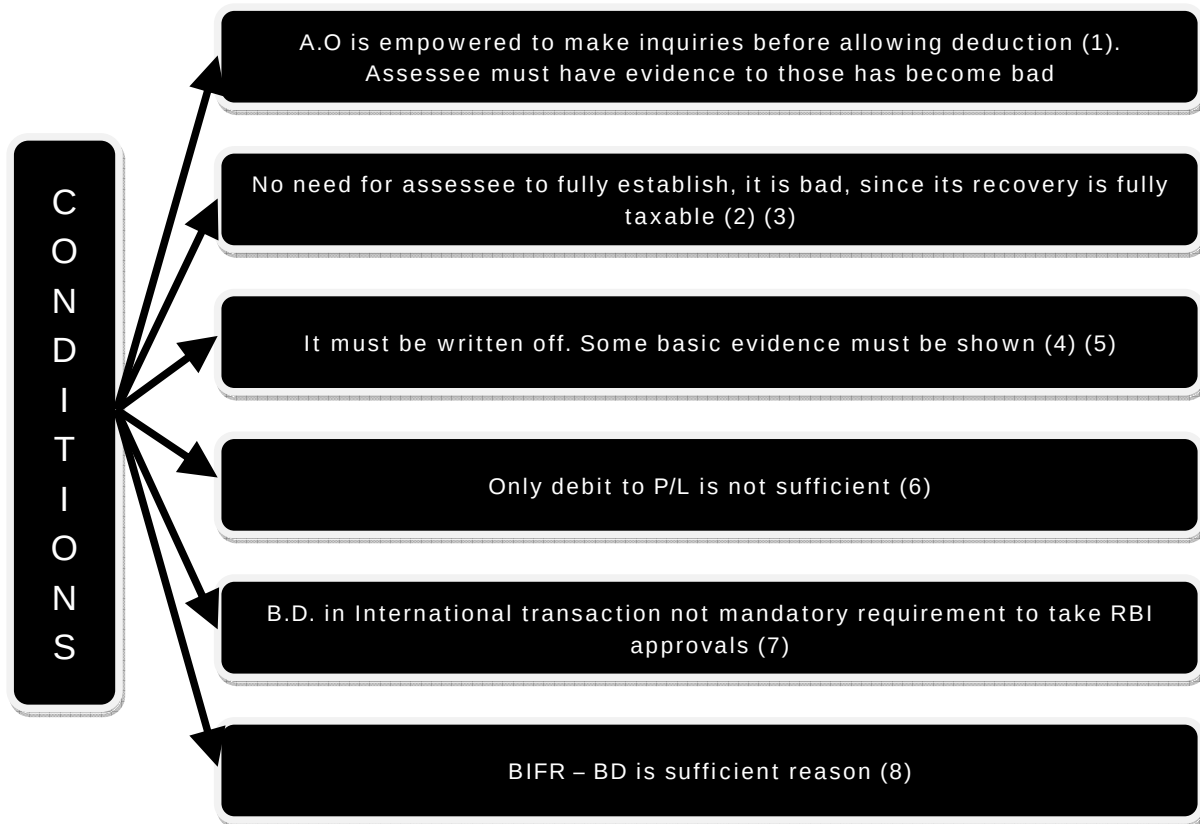
BAD DEBT CLAIM - ASSESSING OFFICER TO PROBE

The Allahabad High Court in CIT v. Kohli Bros. Color Lab (P.) Ltd. [2010] 186 Taxman 62 held that the Assessing Officer, before allowing/refusing deduction, is fully empowered to make an enquiry to ascertain whether entry of writing off bad debt or part thereof is a genuine entry and not an imaginary or fanciful entry. Even though the Court made a point that wisdom of an assessee cannot be questioned and for that matter, no demonstrative or infallible proof of debt having become bad would be required so to say yet seldom these pointers would matter as far as the Assessing Officer is concerned who in all situations would take a view against the assessee and may in the least even to hold that such claims premature in all cases.

In other words, now it would be required of the assessee to substantiate by evidence that he had made all efforts to recover/realize this amount of debt/loan and having failed in his effort, had written off the same as bad debt. This, therefore, means opening of old Pandora Box. No doubt that the question of bad debt is a matter of fact but one cannot outweigh this argument over the intent of the amendment in 1989 which by design provides the assessee option to use his wisdom and write off a debt.

In my opinion, the inquiry, if any, must be made only in the case of the debtor to ascertain if he has in the consequence included corresponding sum in his income. In fact, one must accept that a corresponding amendment is required to be made in section 41 to include amounts of such nature as income on deemed basis in the hands of debtor.

Before the Patna High Court in Lawlys Enterprises (P.) Ltd. v. CIT [2009] 314 ITR 297, the revenue claimed that there was no evidence on record to show that the assessee took any steps to realise the account and as such it could not be said to be a bad debt. Showing its dissent, the Court proceeded to hold that the assessee was only to write off debts as irrecoverable in its account and not required to prove that they had become bad after 1989 amendment. The Delhi High Court in CIT v. Global Capital Ltd. [2008] 306 ITR 332 also held that under the provisions of section 36(1)(vii) of the Income-tax Act, 1961, as amended with effect from April 1, 1989, an assessee is not required to establish that the concerned debt has actually become bad in the relevant year for the purpose of claiming deduction under the section and the only requirement for claiming this deduction is that the assessee has to write off the relevant debt in its books of account treating it as bad. The Bombay High Court also held likewise in DIT (International Taxation) v. Oman International Bank SAOG [2009] 313 ITR 128/184 Taxman 314.



1.	Kohli Bros. Lab (P.) Ltd. (Allahabad Court)
2.	Suresh Gaggal (Himachal Pradesh High Court)
3.	Oman International Bank SAOG (Bombay High Court)
4.	Nilofer I. Singh (Delhi High Court)
5.	Realest Builders & Services Ltd. (Delhi)
6.	Dhall Enterprises & Engineers (P.) Ltd. (Gujarat High Court)
7.	Sawhney Exports (Delhi)
8.	Goyal M.G. Gases (Delhi High Court)

BAD DEBT CLAIM - NO QUESTION ASKED

The Himachal Pradesh High Court in Suresh Gaggal v. CIT [2009] 180 Taxman 90 held that once the debt has been written off as a bad debt, it is not the requirement of law that the assessee should establish that the debt has, in fact, become bad. The Court went on to hold that the reason behind this is that after amendment to section 36(2), if the assessee recovers any part of the debt, the same would be assessable as his income in the year in which the debt is recovered. The following observation by the Court will clear the mist on the subject :

“Para 11. As per the amended provisions of the Income-tax Act, 1961 once the debt has been written off as a bad debt, it is not the requirement of law that the assessee should establish that the debt has in fact become bad. The reason behind this is that after amendment to section 36(2), in case the assessee recovers any part of the debt the same is assessable as his income in the year when the debt is recovered.”

BAD DEBT CLAIM

In DIT (International Taxation) v. Oman International Bank SAOG [2009] 184 Taxman 314, the Bombay High Court upon comparison between the provisions of section 36(1)(vii), as it stood before and after its amendment with effect from 1-4-1989 held that subsequent to the amendment to the language of the section, it would be sufficient if the bad debt or part thereof is written off as irrecoverable in the accounts of the assessee based on commercial expediency. In other words, it is no longer required to seek an explanation from the assessee to prove that the debt is bad debt.

On the contrary, the Allahabad High Court in CIT v. Kohli Brothers Color Lab (P.) Ltd. ITA NO. 02/2007, dated 5-11-2009 held that notwithstanding the amendment made in 1989 it is permissible for the Assessing Officer to initiate inquiries and not to allow deduction blindly. Interestingly in the Direct Taxes Code, a ceiling of 1 per cent of aggregate average advances is provided for write off claims in case of permitted financial institutions including NBFC. Also the Code in specific allows deduction of write off claims in case of a trade debt being defined as one taken to profit and loss account in any financial year or money lent in the ordinary course of business of money lending or banking. Also, it allows deduction for loss of inventory or money on account of theft, robbery, embezzlement or fraud occurring in the course of business, subject however to actual write off of such loss in the books.

WRITE OFF CONDITION

The Delhi High Court in CIT v. Smt. Nilofer I. Singh [2009] 176 Taxman 252 held that for claiming deduction under section 36(1)(vii), all that assessee is required to do is to write off debt as irrecoverable in its accounts of relevant previous year and the fact that permission of the Reserve Bank of India to write off debt is communicated to assessee after end of relevant previous year is not relevant for that purpose. Further, the Kerala High Court in South India Bank Ltd. v. CIT [2009] 176 Taxman 277 held that the Explanation introduced to section 36(1)(vii) by the Finance Act, 2001 with effect from 1-4-1989 is only clarificatory in nature and, thus, provision for bad debt in the return/accounts is held as prima facie inadmissible in an order under section 143(1)(a) passed prior to its introduction.

LOAN WRITE-OFF

In CIT v. Realest Builders & Services Ltd. [2009] 178 Taxman 163 (Delhi), the interest accrued on an advance was assessed to tax as business income in the preceding years of the assessee and, thus, when he wrote off such advance in books it left no doubt that the assessee was engaged in the business of money lending. Hence, the claim was found admissible. Further, the Delhi High Court held that it is a settled position of law that an assessee does not have to establish the bad debt and he has merely to indicate that the bad debt was written off in his books in the year in question.

B I F R -- DEBTORS

The Delhi High Court, in CIT v. Goyal M.G. Gases (P.) Ltd. [2007] 163 Taxman 541, held that the fact that the debtor is declared a sick company under the BIFR regulations is a good reason to hold that the debt is irrecoverable and its write off can yield deduction from the net profits. In the same manner where the cheques received from the parties have been dishonoured there is every reason to hold that the write off of such amounts as bad debts is for bona fide reasons.

233 ITR 0203 TRAVANCORE TEA ESTATES CO. LTD. VS. CIT (SC)

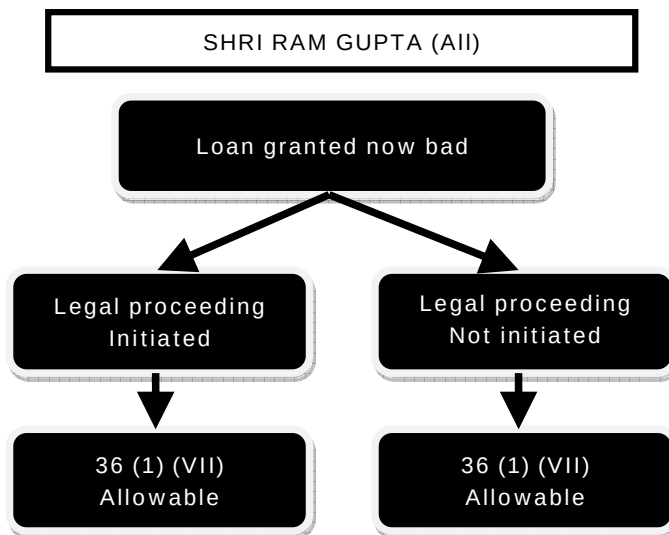
Whether debt became bad or point of time when it became bad are pure questions of fact Amount was due for commodity supplied by assessee and dispute arose regarding amount. Matter was referred to arbitration meanwhile Sale of business was effected during pendency of arbitration proceedings. Amount written off as bad debts is not allowable as bad debt. The Supreme Court dismissed the appeal holding that it was well settled that whether a debt had become bad or the point of time when it became bad were pure questions of fact and no question of law was involved therein. Decision of the Kerala High Court was affirmed.

285 ITR (A.T.) 0105- CONCEPTA CABLES LTD. VS. ADDITIONAL COMMISSIONER OF INCOME-TAX (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

The Explanation to section 36(1)(vii) would rule out deduction of any provision for bad and doubtful debts. But where a provision for non-performing assets is made according to the requirement of the Reserve Bank of India, it may be allowable subject to certain limits and conditions for scheduled banks under section 36(1)(vii)(a). This concession is not available for non-banking financial institutions, though they are also subject to similar regulations of the Reserve Bank of India. However, the Tribunal had recognised such deduction for the non-banking financial institutions in Overseas Sanmar Financial Ltd. v. Joint CIT [2003] 86 ITD 602 (Chennai). This was distinguished by the Tribunal in Concepta Cables Ltd. v. Addl. CIT [2006] 285 ITR (AT) 105 (Mumbai) on the ground that the decision was rendered on February 5, 2001, while the Explanation to section 36(1)(vii) was inserted by the Finance Act, 2001 with retrospective effect from April 1, 1989. The Tribunal also dismissed the alternative argument that if it is not allowable as a bad debt, it should be allowable as a business loss. This argument was not found acceptable in view of the clear bar against deduction in the Explanation to section 36(1)(vii). The argument of the assessee that money being stock-in-trade of a finance company, the loss should be allowed, was also found to be unacceptable for the same reason. Whether the assessee is in money-lending business and money is his stock-in-trade, a mere provision, which is contingent, is not deductible for non-banking finance companies.

286 ITR (A.T.) 0008- DEPUTY COMMISSIONER OF INCOME-TAX VS. OMAN INTERNATIONAL BANK SAOG (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

The adjective “bad” is prefixed to the word “debt” only to focus in a broad manner the nature of the deduction admissible under section 36(1)(vii). A debt which is not bad is not allowed as a deduction at all. Any debt or part thereof which was not bad, could not be claimed as a deduction even if written off as irrecoverable. Therefore, it became necessary for the Legislature to qualify the debt which would be entitled for deduction in computing the taxable income. It was for that purpose of identifying or qualifying the debt that the adjective “bad” had been prefixed to the word “debt” in section 36(1)(vii). The presence of the expression “bad” does not lay down any rule of evidence or onus of proof. The expression “bad debt” always goes along with the second limb of the provision that is “written off as irrecoverable”. Therefore, the presence of the expression “bad” has to be read in the normal sense without attributing any unintended implication and, therefore, it is to be held that the expression “bad debt” does not mean that the assessee should establish that the debt has become bad. On the other hand, it only qualifies that debt which is entitled to be deducted if written off as irrecoverable. The act of writing off a debt as irrecoverable in the accounts of the assessee is deemed to be discharging the onus of the assessee in holding a debt as bad. When the statute has provided the mode of discharging the onus of proof by writing off the debt as bad debt it is not incumbent on the Revenue to call for further evidence. The rule regarding the deductibility of bad debt provided in section 36(1)(vii) after the amendment is a statutory rule by itself and, therefore, there is no need for insisting any other proof. The statutory rule itself declares the rule of deduction of bad debt. If it were again necessary to prove by demonstrative proof that the debt has become bad, then there would be no necessity to insert a statutory rule.



Where the assessee had written off a debt as bad, such amount is deductible under section 36(1)(vii). The write-off of an amount subjected to audit and adopted at a general meeting could not be questioned, as long as such write off is bona fide. No further proof is required for the deduction. The amendment to law has dispensed with the need for such proof. It was so decided by a Special Bench of the Tribunal in Deputy CIT v. Oman International Bank SAOG [2006] 286 ITR (AT) 8 (Mum).

CERTAIN DIS-ALLOWANCES AND DEEMED INCOME

Section / Topic Name : 37(2B) to 43B

245 ITR 0116- ESKAYEF VS. COMMISSIONER OF INCOME-TAX (SC)

Section 40 opens with a non obstante clause "notwithstanding anything to the contrary in sections 30 to 39", which means that even if any amount is entitled to deduction under any of the provisions contained in sections 30 to 39, it will be disallowed if it falls, inter alia, within section 40. Section 40(a)(ii) states that any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of any such profits or gains, will not be deductible. 40(a)(ii) do not contain any words indicating that the profits and gains spoken of by them should be determined in accordance with the provisions of the Income-tax Act. All they say is that it must be a rate or tax levied on the profits and gains of business or profession.

Held that the liability to pay surtax is not an admissible deduction in computing the total income.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee a Company was liable to pay no taxes since the income as per the income tax act was nil. However it had to bare the income tax liability of Rs. 3 Lacs because it has profits as per the company law. On this tax liability of 3 Lacs it had also to pay the surcharge of Rs. 45,000. Company claims that the amount of surcharge is deductible while computing the income. You are required to answer whether the claim of the company is justified or not. OR

Companies (Profits) Surtax Act, 1964, says that it is "an Act to impose a surtax on the profits of certain companies". i.e., on the profits above the prescribed limit. The assessee company was liable to pay Rs. 45,000 on account of surtax and claimed it as deduction under the income tax act. Assessing officer disallowed the claim of the company on the grounds that Section 40(a)(ii) states that any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of any such profits or gains, will not be deductible. You are required to state whether the reasons of the officer is justified or not.

ANSWER

Section 40 opens with a non obstante clause "notwithstanding anything to the contrary in sections 30 to 39", which means that even if any amount is entitled to deduction under any of the provisions contained in sections 30 to 39, it will be disallowed if it falls, inter alia, within section 40. Section 40(a)(ii) states that any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of any such profits or gains, will not be deductible. 40(a)(ii) do not contain any words indicating that the profits and gains spoken of by them should be determined in accordance with the provisions of the Income-tax Act. All they say is that it must be a rate or tax levied on the profits and gains of business or profession. Held in case of [2000] 245 ITR 0116- ESKAYEF VS. COMMISSIONER OF INCOME-TAX (SC) that the liability to pay surtax is not an admissible deduction in computing the total income.

280 ITR (A.T.) 0074- INCOME-TAX OFFICER VS. SAMIRAN MAJUMDAR (CALCUTTA BENCH)

The term “computer” has not been defined under the Act, yet Explanation (a) to clause (xi) of section 36(1) of the Income-tax Act, 1961, defined the term “computer system”. Further, the Institute of Chartered Accountants of India in its study material defined the term “computer” as an electronic data processing device capable of receiving input, storing sets of instructions for solving problems and generating output with high speed and accuracy. A fair reading of the report of the Inspector showed that the printer and scanner could not be used without the computer, that is, they were part of the computer system. Thus, the printer and scanner were an integral part of the computer system and they were to be treated as computer for the purpose of allowing higher rate of depreciation.

282 ITR 0379- COMMISSIONER OF INCOME-TAX VS. SOUTHERN ROADWAYS LTD. (MADRAS HIGH COURT)

Upgradation of computers by changing certain parts thereby enhancing the configuration of the computers for improving their efficiency, but, without making any structural alterations is not of an enduring nature. Further the assessee had not acquired any computer software. The expenditure incurred by the assessee had therefore to be treated as revenue expenditure.

In other words all computers require upgradation from time to time in view of changes in technology to achieve greater efficiency in the fast-changing scientific scenario. There is no enduring advantage to justify the disallowances in such cases as decided in CIT v. Southern Roadways Ltd. [2006] 282 ITR 379 (Mad) following the rationale of the decision of the Supreme Court in Alembic Chemical Works Co. Ltd. v. CIT [1989] 177 ITR 377.

CIRCULAR NUMBER: 786 [2000] 241 ITR (STAT) 0132-

The Comptroller and Auditor-General (C and AG) raised an objection that the Assessing Officer in computing the profits and gains of business or profession, in a case in Mumbai charge, had wrongly allowed a deduction in respect of a payment to a non-resident where tax had not been deducted at source. The nature of the payment in this case was export commission and charges payable for services rendered outside India. In the view of C and AG the expenditure should have been disallowed in accordance with the provisions of section 40(a)(i) of the Income-tax Act, 1961. It has come to the notice of the Board that a similar view, on the same set of facts has been taken by some Assessing Officers in other charges.

The following clarification is issued.

1. The deduction of tax at source under section 195 would arise if the payment of commission to the non-resident agent is chargeable to tax in India.
2. It had been clarified then that where the non-resident agent operates outside the country, no part of his income arises in India.
3. Further, since the payment is usually remitted directly abroad it cannot be held to have been received by or on behalf of the agent in India. Such payments were therefore held to be not taxable in India.
4. No tax is therefore deductible under section 195 and consequently, the expenditure on export commission and other related charges payable to a non-resident for services rendered outside India becomes allowable expenditure.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Company X claimed a deduction in respect of a payment to a non-resident on account of export commission where tax had not been deducted at source. Export commission and charges payable for services rendered outside India. In the view of assessing officer the expenditure should have been disallowed in accordance with the provisions of section 40(a)(i). You are required to answer whether the opinion of the assessing officer is justified or not.

ANSWER

The nature of the payment in this case was export commission and charges payable for services rendered outside India. It has come to the notice of the Board that a similar view, on the same set of facts has been taken by some Assessing Officers in other charges. (Circular No. 786)

The following clarification is issued.

1. The deduction of tax at source under section 195 would arise if the payment of commission to the non-resident agent is chargeable to tax in India.
2. It had been clarified then that where the non-resident agent operates outside the country, no part of his income arises in India.
3. Further, since the payment is usually remitted directly abroad it cannot be held to have been received by or on behalf of the agent in India. Such payments were therefore held to be not taxable in India.
4. No tax is therefore deductible under section 195 and consequently, the expenditure on export commission and other related charges payable to a non-resident for services rendered outside India becomes allowable expenditure.

269 ITR 0535- S.A. BUILDERS LTD. VS. COMMISSIONER OF INCOME-TAX (PUNJAB AND HARYANA HIGH COURT)

Interest on borrowed money is allowed as a deduction from business, only if it satisfies the condition that it is for the purpose of business or profession. Where the money borrowed was diverted for giving interest free loans to sister concerns, the proportionate interest attributable to such loans could be legitimately disallowed by the Assessing Officer. It was so held in S. A. Builders Ltd. v. CIT [2004] 269 ITR 535 (P & H).

ACTUAL V. DEEMED PAYMENT- BOTTLING FEE

The Supreme Court in CIT v. McDowell & Co. Ltd. [2009] 180 Taxman 514 held that the requirement of section 43B is the actual payment and not deemed payment for making the claim for deduction in respect of any of the expenditure incurred by the assessee during the relevant previous year. The section, thus, requires that money must flow from the assessee to the public exchequer.

In this case, the Assessing Officer disallowed bottling fees chargeable from the assessee under the Excise Law by applying provisions of section 43B. The Tribunal, however, allowed the assessee's claim by holding that unpaid amount of bottling fee had, on furnishing of bank guarantee to be treated as actual payment within the meaning of section 43B. The High Court however, held that in the first bottling fees in question was not covered within ambit of section 43B. It further disagreed with the view of the Tribunal that the guarantee amounted to actual payment for the purpose of section 43B. The Supreme Court in confirming the High Court's view held that the bottling fees for acquiring a right of bottling of IMFL, which is determined under the Excise Act and rule 69 of the Rules was payable by the assessee as a consideration for acquiring the exclusive privilege. It was neither fee nor tax, but the consideration for grant of approval by the Government as per terms of contract in exercise of its rights to enter into a contract in respect of the exclusive right to deal in bottling of liquor in all its manifestations. Yet again the Apex Court in CIT v. Udaipur Distillery Co. Ltd. [2009] 180 Taxman 530 held that bottling fees payable for acquiring a right of bottling of IMFL, which was determined under Excise Act and Rules, was neither fee nor tax, but was consideration for grant of approval by Government in respect of exclusive right to deal in bottling of liquor in all its manifestations.

EMPLOYEE'S CONTRIBUTION TO PROVIDENT FUND

In Consulting Engg. Services (India) (P.) Ltd. v. CIT [2009] 183 Taxman 280 (Delhi) the Assessing Officer disallowed the deduction in respect of, staff provident fund dues on the ground that those dues were payable on 31-3-1998 and as per the provisions of the relevant statute, the last date for payment of dues pertaining to the month of March, 1998 was 15-4-1998 whereas the assessee had admittedly made payments on 1-5-1998, 18-5-1998 and 5-6-1998. Since the payments had been made after 15-4-1998, those could not be allowed as per the provisions of section 36(1)(va). The Delhi High Court while holding in favour of the assessee, observed as under :

“In our view, the aforesaid issue is squarely covered by our judgment in the case of CIT v. P.M. Electronics Ltd. [2009] 177 Taxman 1 (Delhi) as corrected by our order dated 5-12-2008 passed in CM 17067/2008 in P.M. Electronics Ltd.'s case (supra). In the said judgment we have noted that a Division Bench of the Madras High Court in CIT v. Nexus Computer (P.) Ltd. [2009] 177 Taxman 202 has taken a view contrary to that of its own Division Bench, in the case of Synergy Financial Exchange Ltd. (supra) by holding that the decision of the Supreme Court in the case of CIT v. Vinay Cement Ltd. [2007] 166 Taxman 62 being the law declared under article 141 of the Constitution of India was binding on it, as also, the fact that in Vinay Cement Ltd.'s case (supra) the Supreme Court had dealt with the case which related to a period prior to the amendment of section 43B of the Act.”

CONTRIBUTION TO PROVIDENT FUND

The Supreme Court in CIT v. Alom Extrusions Ltd. [2009] 185 Taxman 416 held that deletion of second proviso to section 43B by the Finance Act, 2003 is retrospective and it would operate with effect from 1-4-1988. However, dispute often arises in terms of payment of the employees' share of contribution where the revenue in the recently completed assessments held a view that such payments must be made by the due date mentioned in the relevant CPFC regulations, goes through perhaps since the issue is pending with the Apex Court.

If one closely goes through clause (va) of section 36(1) there is reference to the words 'as an employer' and 'employee share' whereas under second clause to section 43B there is no specific reference to either employer or employee's contribution. It is, thus, harsh to disown application of section 43B vis-a-vis employees' contribution, especially when a clause (va) in section 36 provides for a deduction of employees-contribution.

There is a clear case of differentiation in the matter of allowance of deduction for employer's share and employee's share and such differentiation is not rational, having due regard to the objects sought to be achieved as per 1983 speech of the then FM and subsequent uniform treatment advocated in 1988. Such differentiation is totally discriminatory and challenges the principle of equality. It, therefore, violates article 14 of the Constitution. By setting different due dates for payment of employer's and employee's contribution the provisions in the Act have set unreasonable parameters worth challenging in the writ proceedings.

P/L 1-4 to 31-3			
Particulars	Amount	Particulars	Amount
Payment of cess/duty/tax (43B actual payment is must) (Guarantee is not payment)	1,4,5		
CTR to PF, (late payment) (employees share) (36(1)(va) – Not allowable)	2		
CTR to PF (employee share) (43B – allow on payment basis)	3		
Rent to government (not covered by 43B)	6		
Advance payment of VAT (Not deductible)	7		

1.	McDowell & Co. Ltd. (SC)
2.	Consulting Engg. Services (India) (P.) Ltd. (Del)
3.	Alom Extrusions Ltd. (SC)
4.	Mugal Dyeing and Printing Mills (Guj.)
5.	Dunlop India Ltd. (SC)
6.	Satish Chandra Hegde Family Trust (Karnatak High Court)
7.	Kerala Solvent Extractions Ltd. (Kerala High Court)

CURATIVE AMENDMENT THEORY DID NOT WORK

The MP High Court in *B. S. Patel v. Dy. CIT* [2008] 171 Taxman 304 held that omission of the second proviso to section 43B by the Finance Act, 2003 w.e.f. 1-4-2004 is prospective in operation and, thus, any sum payable to provident fund, etc., would need to be deposited within the time prescribed under the relevant Act.

The Madras High Court in *CIT v. Synergy Financial Exchange Ltd.* [2007] 288 ITR 366/165 Taxman 67 also held that the second proviso to section 43B of the Income-tax Act, 1961, as it stood prior to its omission by the Finance Act, 2003, with effect from April 1, 2004, imposed a condition that no deduction shall, in respect of any sum referred to in clause (b) of the section be allowed, unless such sum has actually been paid in cash or by issue of a cheque or draft or by any other mode on or before the due date as defined in the Explanation below clause (va) of sub-section (1) of section 36, and where such payment has been made otherwise than in cash, the sum has been realised within fifteen days from the due date. With the omission of the proviso, the assessee is entitled to the deduction of payment made towards provident fund, etc., when such payment is actually made by the assessee on or before the due date applicable for filing the return, irrespective of whether such payment is made on or before the due date by which the assessee is required to credit the contribution to the employee's account in the relevant fund under the relevant Act. It held that it is not permissible in law to take a liberal view or lenient approach to give retrospective effect to the deletion of the second proviso to section 43B of the Act so as to apply it to earlier assessment years, particularly when there is no indication in the Finance Act, 2003, from the language used and from the object indicated that the Legislature intended expressly or by implication that the second proviso to section 43B was deleted to cure an acknowledged evil for the benefit of the community as a whole or to remove any such hardship, or any express provision in the statute that such deletion of the second proviso to section 43B of the Act would have any retrospective effect.

DISCHARGE OF SUBSEQUENT YEAR'S LIABILITY

The Kerala High Court in *CIT v. Kerala Solvent Extractions Ltd.* [2008] 173 Taxman 155 held that section 43B, in itself, is not a provision providing for deduction of any item of expenditure which is otherwise not allowable under any of provisions of the Act so much so that the additional payment of a sum towards sales-tax payable for April, 1994 in the assessment year 1994-95 assessment would be held inadmissible under the law. As per the Court if the assessee remits any amount in the financial year towards tax payable for any month of the next financial year, the said amount does not constitute tax liability of the assessee for that previous year. On the other hand, it would be carried as an amount of tax paid in advance for the next year and if the assessee carries on business and incurs liability in the next year, the amount would be adjusted towards tax liability for that year.

PF CONTRIBUTIONS AFTER DUE DATE-BOTH ON ACCOUNT OF EMPLOYER'S AND EMPLOYEES' SHARE

The Delhi High Court in *CIT v. P.M. Electronics Ltd.* [2009] 177 Taxman 1 held that the subject issue is no longer res integra in view of the decision of the Supreme Court in the case of *CIT v. Vinay Cement Ltd.* [S.L. A. No. 1934 of 2007, dated 7-3-2007] which has been followed by a Division Bench of this Court in the case of *CIT v. Dharmendra Sharma* [2008] 297 ITR 320 (Delhi) and, therefore, provident fund payments which were made after the due date prescribed under the Employees' Provident Fund Act and the Rules made thereunder but before the due date for furnishing the return of income under sub-section (1) of section 139 are admissible under section 36(1)(va) read with section 2(24)(x) and section 43B to the assessee in respect of both employer/employees contributions.

Yet again the Madras High Court in CIT v. Nexus Computer (P.) Ltd. [2009] 177 Taxman 202 held that payment of provident fund and ESI contributions after close of accounting period but prior to filing of return would be eligible for deduction under section 43B.

KIST/RENTAL TO GOVERNMENT

The Karnataka High Court in CIT v. Satish Chandra Hegde Family Trust [2007] 158 Taxman 35 held that section 43B as such has application only to a statutory liability hence liability for payment of kist/rental to the State Government which is not statutory is outside the ambit of section 43B provisions.

BANK GUARANTEE – NOT PAYMENT

Section 43B would bar deduction, where the listed items covered by the section have not been actually paid during the year. Notwithstanding the fact that the assessee may be maintaining accounts under the mercantile system of accounting, payment for this purpose cannot include furnishing a bank guarantee. Bank guarantee is not equivalent to payment till it is invoked by the party entitled to it. For coming to the decision, the High Court in Mugat Dyeing and Printing Mills v. Asst. CIT [2007] 290 ITR 282 (Guj) accepted Board Circular No. 372, dated December 8, 1983, [1984] 146 ITR (St.) 9 and applied the decision of the Supreme Court in Somaiya Organics (India) Ltd. v. State of U. P. [2001] 251 ITR 20, which was decided in the context of arrears of tax covered by bank guarantee. Reference was also made to Assistant Collector of Central Excise v. Dunlop India Ltd. [1985] 154 ITR 172 (SC), where it was pointed out that Governments do not run on mere bank guarantees and that it is nothing more than security for payment, so that it cannot be treated as payment itself.

ADVANCE PAYMENT OF SALES TAX

Section 43B bars deduction of any tax, unless it is paid. It follows that the deduction for tax, which was due and otherwise allowable, gets postponed till the year of payment. But it does not substitute the cash system for the mercantile system in toto, so as to allow a deduction which had not become due either in the same year or in an earlier year, so that sales tax paid in advance would not be deductible as held in CIT v. Kerala Solvent Extractions Ltd. [2008] 306 ITR 54 (Ker).

INTEREST ACCRUED BUT NOT DUE

In Triveni Engg. & Industries Ltd. v. CIT [2009] 184 Taxman 179 (Delhi), the contention that where the amount was not due for payment before the end of the relevant previous year, such amount, though having accrued, could not be disallowed under section 43B(d), was rejected by the Supreme Court which held that any such interpretation would negate the intention of existence of section 43B(d) and would render otiose the expression ‘actually paid’ occurring in the provision. Besides this issue, the assessee had come up in appeal before the Apex Court on two more points, viz., allowance of contingent liability and change in basis of valuation of stocks. The assessee having changed the method of valuation once again switched back to the old method of valuation of closing stock just one year after the relevant assessment year. Also the assessee made a claim for deduction of a liability that it had contested in special leave petition. All the three issues had been held against the assessee concurrently by all the three authorities below, namely, the Assessing Officer, CIT (Appeals) and the Income-tax Appellate Tribunal. Showing their displeasure, the Delhi High Court also imposed a cost of Rs. 25,000 in this case for needless litigation.

TRADE DISCOUNT TO SISTER CONCERN

The Delhi High Court in United Exports v. CIT [2009] 185 Taxman 374 held that it is not unknown in the trade circles to give bulk discounts for bulk sales. The Court held a view that the very fact that out of the

total domestic sales of Rs. 13.20 crores, the sale to the sister concern was Rs. 11.11 crores that clearly justified giving a trade discount at 11 per cent to the sister concern as compared to 3 per cent to others. It further held that section 40A(2) does not apply to trade discount inasmuch as trade discount is not an expenditure which is incurred or with respect to which a payment is made.

Related party transaction		
Trade Discount to related party 11% as compared to 3% otherwise	Reasonable	1
Service charges/remuneration, twice for the same service	Not reasonable	2

1.	United Exports (Delhi High Court)
2.	Paarel Imports & Exports (P.) Ltd. (Kerala High Court)

SERVICE CHARGES

In CIT v. Paarel Imports & Exports (P.) Ltd. [2008] 171 Taxman 209 the assessee paid remuneration to its managing director and other directors and in addition it also paid service charges to a firm for various management services. Interestingly, the firm had the managing director and other directors as its partners. The Kerala High Court held that the two payments constituted payment for the same service and, thus, the transaction between the assessee and the firm was a device to avoid tax.

FUNDING OF INTEREST INTO LOAN

The Madhya Pradesh High Court in Eicher Motors Ltd. v. CIT [2006] 157 Taxman 501 upheld the order of the Tribunal in stating that by funding of interest the outstanding interest was not actually paid in terms of section 43B. In fact an Explanation 3C is enacted to section 43B so as to inform this fact as well as having retrospective application from 1.4.1989.

OLD OUTSTANDING

In CIT v. Smt. Sita Devi Juneja [2010] 187 Taxman 96 (Punj. & Har.) the Assessing Officer made an addition of Rs. 1.47 crores on account of outstanding sundry credit balances as on 31-3-2004, while holding that liability in respect of these creditors had ceased to exist and, as such, it had become liable to be treated as deemed income under the Explanation I to section 41(1). In this case such liability remained outstanding for the relevant last six years. The Punjab and Haryana High Court held that in the absence of any bilateral act of the assessee and the creditors, which indicated that the said liability had ceased to exist no addition was warranted under section 41(1).

In this case it was also not proved that any benefit was obtained by the assessee concerning such a trading liability by way of remission or cessation thereof in the earlier year. The Court held that the fact that the liability was old would not make any ground for addition.

The Delhi High Court in CIT v. Jaipur Jewellers (Exports) [2010] 187 Taxman 169 upheld the finding that so long as there was no cessation of liability by writing back same, no addition could be made under section 41(1). In this case the amounts payable to creditors had been acknowledged by the assessee in its books and liability pertained to amount payable by the erstwhile firm being at the relevant time taken over by the assessee. Moreover, various creditors were being paid off by the assessee.

CESSATION OF LIABILITY IS A PRE-CONDITION

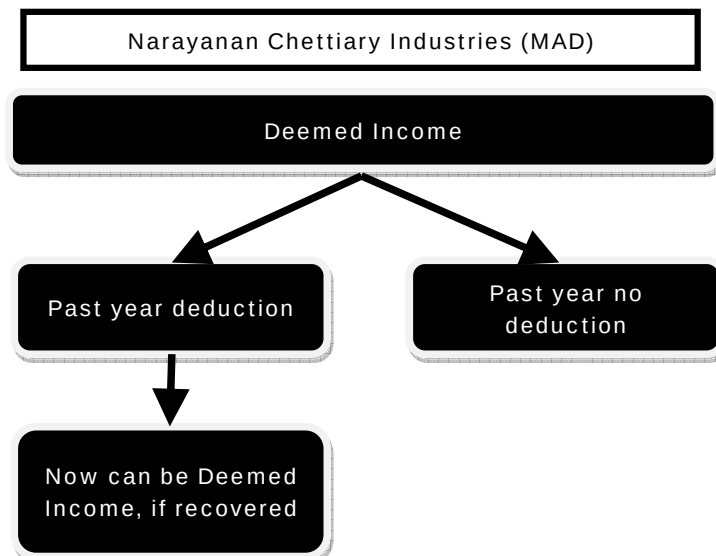
The Madras High Court in CIT v. Tamilnadu Warehousing Corpn. [2008] 170 Taxman 123 held that unless and until there is a cessation of liability, section 41 would not be pressed into service. In this case, even though the assessee had shown gratuity liability in the balance sheet, yet the Commissioner in exercise of powers required it to be taxed under section 41 on the allegation that the assessee had surrendered under Group Gratuity Scheme to LIC and received certain amount. The High Court refused to give its ears to such a plea on the apparent fact that the assessee had continued to show said sum as a liability in balance sheet.

LOAN WAIVER

The Delhi High Court in CIT v. Tosha International Ltd. [2009] 176 Taxman 187 held that remission of principal amount of loan obtained from bank and financial institutions was a capital receipt as the assessee had not claimed any such sum as an expenditure or trading liability in any of earlier previous year. In this case, the assessee ran into huge losses and it ultimately became a sick company and registered with the BIFR. Under the one time settlement scheme, the financial institutions and banks required the assessee to pay 60 per cent of the amount due towards principal.

NO DEDUCTION IN EARLIER YEARS

In Narayanan Chettiary Industries v. ITO [2007] 158 Taxman 15/277 ITR 426 the Madras High Court held that no addition under section 41(1) be made unless an allowance or deduction in previous year in respect of loss, expenditure or trading liability had been made out. In this case there was no finding to this fact hence the issue came under challenge before the High Court no matter that it was not so specifically taken up before the Tribunal.



286 ITR (A.T.) 0210- S. K. ENGINEERING VS. JOINT COMMISSIONER OF INCOME-TAX (ASSTT.) (INCOME-TAX APPELLATE TRIBUNAL--BANGALORE)

Section 40A(2), puts a curb on expenditure in respect of which payment has been made to close associates having substantial interest in the company for goods, services and facilities. Under this section, the Assessing Officer can disallow only that portion of the total expenditure, which, in his opinion, is excessive or unreasonable. He cannot disallow the total expenditure by invoking the provisions of section 40A(2). Section 40A(2) and section 37 cannot go together because section 40A(2) is of overriding nature which would come into operation if the payment is otherwise found to be allowable under section 37(1).

The authorities had gone by the principle that since in the earlier year the commission amount paid was 0.94 per cent., amount in excess of 0.94% becomes unreasonable. This approach was not correct. There might be several reasons why the assessee paid lower commission in the initial years. Looking to the background of the person concerned and the nature of services rendered by him, the payment of

commission at two and half per cent. could not be considered excessive or unreasonable. The services were rendered by a person who was an influential person, who retired from M as senior vice president and was able to influence the company which was one of the top most customers of the assessee. Therefore, no part of the commission could be disallowed invoking the provisions of section 40A(2).

275 ITR 0001- COMMISSIONER OF INCOME-TAX VS. NESTLE INDIA LTD. (DELHI HIGH COURT)

The scope of section 40, spells out what amounts are not deductible from the income charged to tax under the profits and gains of business or profession. In the case of any interest or royalty which is payable outside or in India to non-residents on which tax is deductible at source under Chapter XVII-B of the Act if such tax is not deducted or after deduction has not been paid during the previous year or in the subsequent year before the expiry of the time prescribed under sub-section (1) of section 200, the interest or royalty shall not be deducted. The section has three ingredients (a) royalty which is payable outside India or in India to a non-resident ; (b) the tax is deductible at source under Chapter XVII-B and has not been deducted ; or (c) after deduction has not been paid during the period specified. The Legislature has made it mandatory by using the expression “and” at one place and “or” at the other. They cannot be interchanged and both the ingredients must co-exist simultaneously during the period permissible in law. The most significant aspect of this provision is its payment within the time specified in law. Held, dismissing the appeal, that there was no dispute that the assessee had deducted the tax at source within the same financial year but deposited the same subsequently in the next financial year but within the limitation of time specified under Chapter XVII-B of the Act read with section 200 (1). The assessee had complied with the requirements of section 40(a)(i). Thus amount in question was not to be disallowed under section 40.

282 ITR 0117- COMMISSIONER OF INCOME-TAX VS. KOTHARI SANITATION AND TILES P. LTD. (MADRAS HIGH COURT)

Section 40A(3) would require disallowance of 20 per cent. for payments in cash for expenses including purchases, unless the payment is excepted under rule 6DD. The limit under section 40A(3) applies for a single payment irrespective of the fact that it may be part payment in respect of a single sale or purchase or service, though the aggregate of such payments made on different occasions may exceed Rs. 20,000. It was so held in CIT v. Kothari Sanitation and Tiles P. Ltd. [2006] 282 ITR 117 (Mad). This decision was rendered by the High Court ex parte after hearing counsel for the Revenue, distinguishing the decision in Addl. CIT v. Shree Shanmuga Gunny Stores [1984] 146 ITR 600 (Mad) on the ground that the payment in that case was in respect of a single payment, though covering different items in the bill. The claim in that case was for bill-wise splitting, which was unacceptable, since what is relevant is the size of the payment. The attempt on the part of the Revenue to draw mileage from this decision to suggest that the payments on different dates against a single bill could be clubbed was obviously mistaken. The High Court followed the decision in CIT v. Triveniprasad Pannalal [1997] 228 ITR 680 (MP). There are other decisions to the same effect. The decision in CIT v. Aloo Supply Co. [1980] 121 ITR 680 (Orissa) ruled that the statutory limit applies to a payment each time and not even aggregate payments during the course of the day as recorded in the books. The special leave petition against this decision was dismissed in [1983] 143 ITR (St.) 67. It was this decision, which was followed in CIT v. Triveniprasad Pannalal [1997] 228 ITR 680 (MP).

[2005] 277 ITR (A.T.) 0035- Architectural Associates vs. Assistant Commissioner of Income-tax (Hyderabad Bench (Appellate Tribunal))

Section 40(b) now provides for deduction of interest and salary paid to partners to the extent stipulated in the partnership deed, but not exceeding the parameters laid down under section 40(b). The manner in which such interest is reckoned became the subject matter in *Architectural Associates v. Asst. CIT* [2005] 277 ITR (AT) 35 (Hyderabad). In the case before the Tribunal, the assessee had withdrawals during the year, so that the issue was whether the interest has to be reckoned on the opening credit balance or the closing balance. If one were to reckon the calculation of interest on day to day basis, the calculation no doubt would be more accurate, but such a method is hardly ever followed, because of the difficulty in calculation of interest on daily basis. The Tribunal in this case, while conceding that it is difficult to arrive at a profit or loss on each day of transaction, held that it cannot accept that the withdrawals are from share of profits of the partners, which had accrued. It remanded the matter back to the Assessing Officer suggesting that the method followed by the bank could be adopted, not a satisfactory solution, unnecessarily cumbersome, while it would not take into consideration accretion by way of profits of the year, 50 per cent. of which is usually added to opening balance on the assumption of uniform accrual. Thus matter remanded back to officer to calculate eligible interest.

246 ITR 463 CIT VS. GUJARAT POLYCRETE PVT. LTD. (SC)

Section 43B provides inter alia, that a deduction in respect of any sum payable by the assessee by way of tax or duty under any law for the time being in force shall be allowed from the income of the previous year in which such sum is actually paid irrespective of the previous year in which the liability to pay such sum was incurred.

Sales tax concessions, whether by way of subsidy or by loan waived on satisfaction of the prescribed conditions have been subject matter of dispute, since the amount of concession often becomes final only at the end of the specified period, while the assessee charges sales tax and shows it as having been paid as per requirements of the conditions severally described as Sales Tax Deferral Scheme or Loan Scheme. The issue as to whether such amounts could be treated as payment in the respective years had arisen in a number of cases with the Board insisting that it can be shown as paid only if the relevant State law requires it to be treated as paid.

The question that arises is, whether deferred sales tax payments should be excluded from the purview of section 43B as the operation of this provision has the effect of diluting the incentive offered by the deferral schemes. If the State Governments make an amendment in the Sales Tax Act or issues appropriate notification to the effect that the sales tax deferred under the scheme shall be treated as actually paid, such a deeming provision will meet the requirements of section 43B.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee made claim of unpaid sales tax based on the Governments deferred payment scheme. As per the scheme sales tax payable was converted into interest-free loan. Assessee has passed the appropriate book entry showing the sales tax as paid and the same amount to be treated as loan from the sales tax department. You are required to answer whether assessee is justified in making the claim or not in view of 43B of income tax act.

ANSWER

Sales tax concessions, whether by way of subsidy or by loan waived on satisfaction of the prescribed conditions have been subject matter of dispute, since the amount of concession often becomes final only at the end of the specified period, while the assessee charges sales tax and shows it as having been paid as per requirements of the conditions severally described as Sales Tax Deferral Scheme or Loan Scheme. The issue as to whether such amounts could be treated as payment in the respective years had arisen in a

number of cases with the Board insisting that it can be shown as paid only if the relevant State law requires it to be treated as paid. Presuming that the relevant state law treats it as paid it shall be allowed as deduction under section 43B of the income tax act.

247 ITR 0798 CIT VS. D. SHANKARAIAH (SC)

It was found in case of Chowringhee Sales Bureau P. Ltd. (SC) that the sales was effected by the assessee and realised monies on account of sales tax. This amount was credited separately in its account books under the head "Sales tax collection account". The appellant did not pay the amount of sales tax to the actual owner of the goods. Nor did it deposit the amount realised by it as sales tax in the State Exchequer, because it took the position that the statutory provision creating that liability upon it was not valid, or refund it to the persons from whom it had been collected. Held, that the sum realised as sales tax by the appellant in its character as an auctioneer formed part of its trading or business receipts and the fact that the appellant credited the amount received as sales tax under the head "sales tax collection account" did not make any material difference. It is the true nature and quality of the receipt and not the head under which it is entered in the account books as would prove decisive. If a receipt is a trading receipt, the fact that it is not so shown in the account books of the assessee would not prevent the assessing authority from treating it as trading receipt.

Where a commission agent collects sales-tax and passes it on to the Sales-tax Department. Where such sales-tax is not found payable, the amount is refunded to him. Such refund was sought to be taxed by Revenue in the view that it is trading receipt following Chowringhee Sales Bureau P.Ltd. (SC). The Supreme Court in CIT v. D. Shankaraiah (SC) found that this decision will not apply to a commission agent.

In other words Sales tax collected from purchasers and paid to the sales tax department, by the assessee, who was a commission agent, as well as the amount of refund of sales tax collected by the assessee from the department when it was found that sales tax was not payable, were not income taxable in the hands of the assessee.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

You are required to answer whether the sales tax collected by the assessee, who was a commission agent from the purchasers and paid to the Sales Tax Department as well as the amount of refund of sales tax collected by the said assessee from the Department when it was found that sales tax was not payable, could be treated as income in the hands of the assessee and whether the same is liable for payment of income-tax or not.

ANSWER

Where a commission agent collects sales-tax and passes it on to the Sales-tax Department. Where such sales-tax is not found payable, the amount is refunded to him. Such refund was sought to be taxed by Revenue in the view that it is trading receipt following Chowringhee Sales Bureau P.Ltd. (SC). The Supreme Court in CIT v. D. Shankaraiah (SC) found that this decision will not apply to a commission agent. Thus assessee a commission agent is not liable to pay income tax on this account.

248 ITR 0003- GORELAL DUBEY VS. COMMISSIONER OF INCOME-TAX (SC)

Royalty is a tax. Royalty payable to the Government is also a tax like cess and, therefore, leviable only by the Central Government. Therefore, it is a tax for all purposes including section 43B of the Income-tax Act, and the unpaid liability for royalty for extraction of limestone cannot be deducted.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee in the business of extraction of limestone was under obligation to pay royalty to state government which was unpaid during the previous year. Further assessee was of the opinion that provisions of section 43B of the Income-tax Act, were not applicable to the unpaid liability towards royalty payment of Rs. 77,000 since royalty was neither tax nor duty ? you are required to evaluate the facts in the view of section 43B.

ANSWER

Royalty payable to the Government may well be in the nature of a tax so as to be covered by section 43B and be allowed only on actual payment. The Supreme Court in Gorelal Dubey v. CIT [2001] 248 ITR 3 followed its own decision in the context of interpretation of the Mines and Minerals Regulation and Development Act, where it was held, that royalty payable to the Government is also a tax like cess and, therefore, leviable only by the Central Government.

260 ITR 0218- MEWAR MOTORS VS. CIT (RAJ)

The object of section 43B is to curb the activities of those taxpayers who do not discharge their statutory liability of payment of sales tax or excise duty for long periods but claim deduction in that regard from the income on the ground that the liability to pay this amount had been incurred by them in the relevant previous year. Interest paid is part of the sales tax. Interest payable to the Sales Tax Department is also “tax” and the provisions of section 43B of the Act are applicable thereto.

260 ITR 0097- CIT VS. NATIONAL STANDARD DUNCAN LTD. (CAL)

Where sales tax payable is exempted, adjusted or set off in accordance with sales tax rules, such sales tax should be treated as actually paid and allowed as a deduction under section 43B of the Income-tax Act as held in CIT v. National Standard Duncan Ltd. [2003] 260 ITR 97 (Cal). Section 43B of the Income-tax Act allows deduction on tax payable by the assessee. When the assessee purchases raw materials, it is liable to pay purchase tax. An equivalent of this amount is adjusted towards the liability on the sale of the product produced out of the raw materials purchased. This adjustment, by legal fiction, is deemed to be an actual payment of the tax liability. Admittedly, this amount is a tax payable. If it is a tax liability, on being set off or adjusted as deemed actual payment by legal fiction, it is deductible under section 43B.

260 ITR 0193- CHEMICALS AND PLASTICS INDIA LTD. VS. CIT (MAD)

Section 43B is an independent provision authorising deduction of specified amounts on actual payment. Hence, the fact that the assessee had not debited such amount in the accounts is not a bar for the deduction.

Question

The assessee is engaged in the manufacture of rigid PVC pipes and fittings and other items. The assessee had, in the previous year, imported materials required for the manufacture of the assessee's products. The assessee had paid import duty of Rs. 35,09,826. According to the assessee, the cost of the imported

materials inclusive of duty was taken to the profit and loss account only on consumption basis. The balance of import duty of Rs. 11,58,833 paid on the raw materials held as closing stock, was taken into the balance-sheet and shown as part of current assets. The assessee's claim under section 43B of the Act for deducting the actual customs duty and excise duty paid on the stock of raw material and finished goods was negated by the Assessing Officer. You are required to answer whether the action of the officer is justified or not.

Answer

The assessee is entitled to the deduction of the amount of duty paid in the year in which the payment was made. The fact that part of the customs duty was paid in respect of raw materials which remained with the assessee at the end of the year would not deprive the assessee of the benefit of claiming the deduction in the year in which duty had been actually paid. So also the right of the assessee to claim deduction for the amount of excise duty paid in the year in which it was paid was unaffected by the fact that part of the duty paid was in relation to the finished goods which remained with the assessee at the end of the year. The fact that the duty paid was not charged to the profit and loss account would not disentitle the assessee from claiming the deduction under section 43B. It was open to the assessee to file an adjustment statement before the Assessing Officer. [2003] 260 ITR 0193- CHEMICALS AND PLASTICS INDIA LTD. VS. COMMISSIONER OF INCOME-TAX (MADRAS HIGH COURT) Thus the action of the officer is not justified and assessee must qualify for the purpose of deduction under section 43B.

266 ITR 0099- BERGER PAINTS INDIA LTD. VS. CIT (SC)

The entire amount of excise duty/customs duty paid by the assessee in a particular accounting year is allowable under section 43B of the Income-tax Act, 1961, as a deduction in respect of that year, irrespective of the amount of excise duty/customs duty included in the valuation of the assessee's closing stock at the end of the accounting year as relating thereto.

264 ITR 0701- CIT VS. DEVENDRA UDHYOG (RAJ)

The assessee had shown the sales tax incentive under the heading "Reserve fund and surpluses". During the course of proceedings, the Assessing Officer found that the amounts were related to the Sales Tax Deferment Scheme for Industries 1987 of the Government of Rajasthan. Under the scheme, the assessee had collected the sales tax but not paid it to the State Government within the accounting period or before filing of the return of income. The Assessing Officer invoked the provisions of section 43B and added the amount. Held, that for the purpose of the benefit of the Central Board of Direct Taxes Circular No. 496 unless the Government made amendment in the Sales Tax Act to the effect that the sales tax collected under the sales tax deferment scheme shall be treated as actually paid for the purpose of section 43B, the addition under section 43B should be made. Admittedly, no such amendment had been made in the Sales Tax Act by the State Government. The amount of sales tax collected had not been converted into loan as required under the Circular therefore, the addition made by the officer was justified.

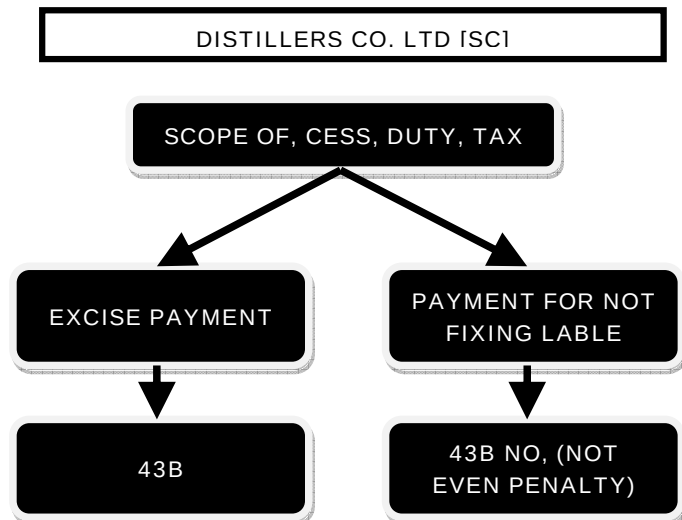
284 ITR 0250- COMMISSIONER OF INCOME-TAX VS. MOHINDER KUMAR AND PARTY (RAJASTHAN HIGH COURT)

Whatever is paid to the Excise Department does not necessarily become excise, so as to be covered under section 43B to require payment before deduction could be allowed. It was so found in CIT v. Mohinder Kumar [2006] 284 ITR 250 (Raj). Liability to pay what was described as issue price for the licence, though payable in instalments, was neither a duty nor a tax, so that the amount payable was found to be

allowable following its own earlier decision in CIT v. Udaipur Distillery Co. Ltd. (No. 1) [2004] 268 ITR 305 (Raj). It was further found that merely because the assessee disputed the liability, it does not become a suspended or contingent liability. It has to be provided by any prudent businessman. Even for this reason, the amount could not have been disallowed.

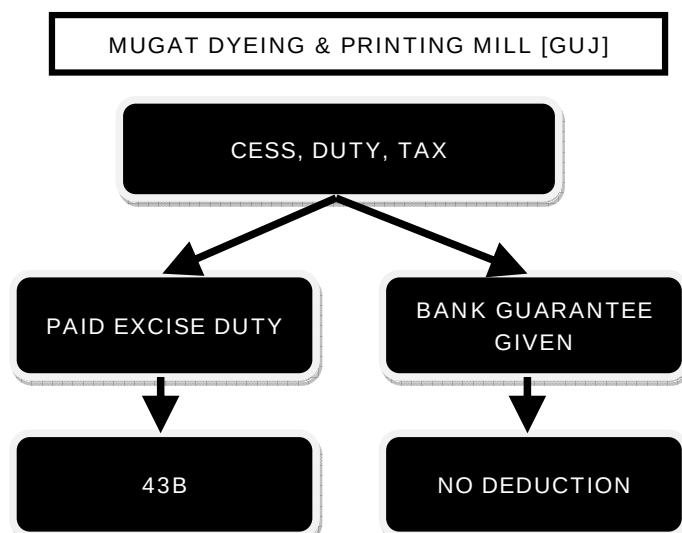
290 ITR 0419- COMMISSIONER OF INCOME-TAX VS. DISTILLERS CO. LTD. (SUPREME COURT OF INDIA)

The additional amount paid as fee for permission for bottling arrack without having such arrack matured in wooden vats for at least fifteen days and the amount paid for not affixing labels on bottles are not payments in connection with manufacture of excisable articles. It is also not an amount payable under the statute. It is fixed only by the Commissioner of Excise. In the context of the fact that there is no time-limit fixed for blending and the regulations issued by the Commissioner of Excise are not a matter decided with concern for public health, there is no element of penalty on these amounts, which are paid in pursuance of trade regulations. They cannot be characterised either as penalty or additional excise duty, so as to require payment before deduction under section 43B. It was so decided by the Supreme Court in CIT v. Distillers Co. Ltd. [2007] 290 ITR 419 following the decision in Commissioner of Central Excise v. Indian Aluminium Co. Ltd. [2006] 10 Scale 34 ; [2006] 7 RC 517. The reasoning of the Supreme Court for understanding tax, additional tax and penalty should serve as a precedent for decision on similar issues.



290 ITR 0282- MUGAT DYEING AND PRINTING MILLS VS. ASSISTANT COMMISSIONER OF INCOME-TAX (GUJARAT HIGH COURT)

Section 43B would bar deduction, where the listed items covered by the section have not been actually paid during the year. Notwithstanding the fact that the assessee may be maintaining accounts under the mercantile system of accounting, payment for this purpose cannot include furnishing a bank guarantee. Bank guarantee is not equivalent to payment till it is invoked by the party entitled to it. For coming to the decision, the High Court in Mugat Dyeing and Printing Mills v. Asst. CIT [2007] 290 ITR 282 (Guj) accepted Board Circular No. 372, dated December 8, 1983, [1984] 146 ITR (St.) 9 and applied the decision of the Supreme Court in Somaiya Organics (India) Ltd. v. State of U. P. [2001] 251 ITR 20, which was



decided in the context of arrears of tax covered by bank guarantee. Reference was also made to Assistant Collector of Central Excise v. Dunlop India Ltd. [1985] 154 ITR 172 (SC), where it was pointed out that Governments do not run on mere bank guarantees and that it is nothing more than security for payment, so that it cannot be treated as payment itself.

TAX AUDIT / MAINTAIN BOOKS OF ACCOUNTS

Section / Topic Name : 44AA and 44AB

OTHER INCOMES TO BE IGNORED

The Bombay High Court in Ghai Constructions v. State of Maharashtra [2009] 184 Taxman 52 held that the requirement of compulsory audit is only in respect of the business carried on by the person and not in respect of his income from other sources. The High Court has thus put on record that in the case of an individual carrying on business as a sole proprietor it is necessary to comply with the provisions of section 44AB only in respect of his business income. It would not be necessary to comply with the provisions of section 44AB in respect of his other income. The same would apply in the case of a professional whose income is over Rs. 10,00,000 per annum. It is his professional income and not his income from other sources, which would be covered by the provisions of section 44AB. 'Total turnover' has been defined in the Direct Taxes Code as gross sum received including taxes and duties.

Where the assessee has got more than one source of income, the question that arises is whether the limit for the tax audit report should be considered taking into consideration the income or the turnovers of all the sources or only the income or receipts from business. The expression "total turnover" and "gross receipts" requires the entire turnover of the trading business, but should not include, as for example, proceeds of transfer of movable or immovable property in the nature of investments. In other words, it has to be a trading turnover. The argument that the job work receipts cannot be included in turnover for purposes of limit for tax audit was found to be unacceptable. But this defect could be rectified by filing a fresh audit report before assessment, though beyond the due date. If no opportunity is given to rectify the defect, no penalty can be levied. Bona fide belief that audit was not necessary could also avoid penalty. It was so held in Bajrang Oil Mills v. ITO [2007] 295 ITR 314 (Raj), where penalty was found to be not exigible.

GROSS TURNOVER

The Rajasthan High Court, in Bajrang Oil Mills v. ITO [2007] 163 Taxman 154, held that gross receipts in business for surpassing turnover requirement limit would mean receipts from all sources including job work that is assessable under the head 'Business'. The Court further held that, however, such receipts must bear an integral relation to the business and do not include capital receipts and certainly not the receipts which are not relatable to business and may fall under the expression 'income' to be subjected to tax as income from sources other than business 'heading'.

<u>Business Income</u>	
Sales T.O. (1)	43
Job-work Income (2)	6
<u>IFOS</u>	
Interest Income	2
GTI	51
44AB T.O.	49

1.	Ghai Constructions (Bombay High Court)
2.	Bajrang Oil mills (Rajasthan High Court)

237 ITR 0315 VENKATA RAO (T.D.) VS. UNION OF INDIA (SC)

Section 44AB of the Income-tax Act, 1961, requires every person carrying on business, if his total sales, turnover or gross receipts exceeded Rs. 40 lakhs, and every person carrying on a profession, if his gross receipts exceeded Rs. 10 lakhs, in any previous year “to get his accounts of such previous year audited by an accountant before the specified date . . .”. The Explanation to the section defines “accountant” for its purpose to have the same meaning as in the Explanation below section 288(2) who is a chartered accountant.

United Cardamom Auctioneers (Ker)	
Sales	100
Sales Tax/VAT (Income of assessee)	10
Income	110
43 B (if paid)	10
Total Income	100

Chartered accountants, by reason of their training have special aptitude in the matter of audits. It is reasonable that they, who form a class by themselves, should be required to audit the accounts of businesses whose income exceeds Rs. 40 lakhs and professionals whose income exceeds Rs. 10 lakhs in any given year. An income-tax practitioner does not have the same expertise as a chartered accountant in the matter of accounts. Hence, excluding them for purposes of auditing accounts does not violate articles 14 and 19 of the Constitution of India. Section 44AB is valid.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Chartered accountant is eligible to conduct the tax audit under section 44AB of the Income tax act. However Income tax practitioner is not entitled to conduct the the Tax audit. One of the Income tax practitioner is of the opinion that this provision of section 44AB is not constitutionally valid because article 14 of the constitution of India is violated on the grounds of equality. Please elucidate.

ANSWER

The validity of section 44AB has been challenged on the ground that income-tax practitioners have been discriminated against in not being authorised to do tax audit under section 44AB. The constitutionality was upheld by the Supreme Court in T. D. Venkata Rao v. Union of India [1999] 237 ITR 315 in a short judgment bringing finality to an issue on which a number of the High Courts had earlier decided in favour of the validity of the provision.

**283 ITR 0092- STAYWELL HOTELS P. LTD. VS. COMMISSIONER OF INCOME-TAX
(MADHYA PRADESH HIGH COURT)**

Where there was a delay only of two months in filing the audit certificate under section 44AB, it was found that penalty being discretionary could not have been levied, since the delay was short and an explanation was also furnished for the delay. In the context of the facts, there could have been no deliberate intention on the part of the assessee as held in Staywell Hotels P. Ltd. v. CIT [2006] 283 ITR 92 (MP).

PRESUMPTIVE TAXATION / MISC PROVISIONS

Section / Topic Name : 44AD / 44AE

NET PROFIT RATE

In *Shri Ram Jhanwar Lal v. ITO* [2009] 177 Taxman 135 (Raj.) the assessee's gross receipts exceeded Rs. 40 lakhs so that the case did not fall within the parameters laid down under section 44AD yet the Assessing Officer adopted the net profit rate criteria. The Rajasthan High Court in reversing such technique held that so far as the permissibility of adopting principle underlying section 44AD is concerned, no legal authority has been shown to support the proposition that in this manner the principle underlying therein can be adopted. It further remarked as under :

“May be, that the learned Tribunal claims to be adopting this practice, but then, in our view, in taxing statutes, such adopting the principle underlying other sections, cannot be said to be permissible, and sooner the practice is stopped, the better. Thus, question No. 3 is answered in favour of the revenue, and against the assessee, and it is held, that the Tribunal was not justified in adopting the principle underlying section 44AD, when it was not applicable, as such. Rather all the Tribunals are directed to stop this practice forthwith, if they are still continuing.”

BOOKS MAINTAINED AND PRESUMPTIVE RATE

Where the assessee keeps accounts, which disclose a larger income than that prescribed under

SHIVANI BUILDERS (AT) (AHMEDABAD)

1	44 AD (30 Lakh * 8%)	2.4
2	Profits as per books (After tax Adjustment)	3.2
	Profit Taxed (44AD Not Applicable)	3.2

section 44AD, the Tribunal in *Shivani Builders v. ITO* [2007] 295 ITR (AT) 281 (Ahmedabad) held that in such cases, section 44AD itself would not be applicable. The better inference is that section 44AD itself provides that a person covered by section 44AD is liable to tax either on the income at the prescribed rate applicable to gross receipts or the sum as declared by the assessee in his return of income. An assessee is bound to declare the income earned by him under section 139(1), so that the income on estimate basis could be computed only where the assessee's real income is lower. No doubt, where it is lower, the assessee can prove it with tax audit report.

Shivani Builders (Ahmedabad)

44AD: 30 Lakh * 8%	2,40,000
Actuarial profits as per books	2,60,000
Assessment will be at	2,60,000

260 ITR 0087- MANOHAR RAM CHANDRA PATIL VS. UNION OF INDIA (ORI)

The argument that section 44AD of the Act does not apply to sub-contracts and applies only to a contract cannot be accepted. The mere fact that in the matter of deduction at source, a distinction is made in section 194C between a contractor and a sub-contractor, does not enable the assessee to contend that section 44AD cannot apply to the case of a sub-contractor. The section speaks of any assessee engaged in the business of civil construction or supply of labour for civil construction and provides for a presumptive profit from such business. The wording of section 44AD of the Act, makes it clear that a sub-contractor would also come squarely within the purview of that provision.

SMT. SANTOSH JAIN (P&H)

Estimated Income (by rejecting books) 43 Lake T.O. * 12%	5.16
Add : Expense in cash 40A (3)	NA
Total Income	5.16

288 ITR 0517- COMMISSIONER OF INCOME-TAX VS. THIRUMALAI FERTILISER AND CO. (MADRAS HIGH COURT)

Section 44AE provides for an estimate of presumptive income for transporters. Where the application of the provision to the facts of the assessee's case is a debatable one, rectification provisions could have no application as held in CIT v. Thirumalai Fertiliser and Co. [2007] 288 ITR 517 (Mad). The fact that the assessee acquiesced in such application in a previous year due to the smallness of the tax involved, would make no difference to this conclusion.

The assessment was made under section 143(3) of the Act and the Assessing Officer accepted the return of loss filed by the assessee. Further he estimated the income by way of addition of Rs. 48,000 from the lorries under section 44AE of the Act. From the records it was seen that the assessee maintained books of account and filed a profit and loss account, which was considered by the Assessing Officer in determining the income. Once the books of account were accepted, it was wrong on the part of the Assessing Officer to estimate income under section 44AE of the Act. Even though the Assessing Officer was wrong in estimating the lorry income, the assessee did not prefer an appeal against the assessment

due to the smallness of the amount involved and also to purchase peace with the Department. The assessment under section 44AE by invoking the rectification proceeding under section 154 of the Act, was not justified.

262 ITR 0504- CIT VS. BANK OF AMERICA NT AND SA (BOM)

Section 44C places a cap on head office expenses of a non-resident carrying on business in India in computation of such business income. In CIT v. Bank of America NT and SA [2003] 262 ITR 504 (Bom), the issue whether the average or actual expenditure has to be considered for this purpose came up for consideration. The Assessing Officer limited the deduction to actual expenditure but the average expenditure was allowed on the concurrent finding of the first appellate authority and the Tribunal by the High Court.

276 ITR 0585- COMMISSIONER OF INCOME-TAX VS. ONGC (UTTARANCHAL HIGH COURT)

The concept of multiple stage grossing up of income is not applicable to the deemed profits derived by a non-resident under section 44BB of the Income-tax Act, 1961, because firstly, section 44BB which deals with computation of deemed profits, is a complete code by itself and it is a charging section as far as the income of the non-resident from oil exploration is concerned. Secondly, section 195A comes under Chapter XVII which deals with collection and recovery of tax whereas section 44BB comes under Chapter IV which deals with computation of business income. Section 195A is not a charging section and it provides for tax deduction at source. Therefore, the concept of multiple stage grossing up of income cannot be applied by the Revenue to compute income falling under section 44BB of the Act. Held, accordingly, that the Tribunal had rightly held that there was no scope of grossing up and that the income determined on notional basis in accordance with section 44BB was not liable to be grossed up under section 195A.

CIT v. ONGC [2003] 264 ITR 340 (Uttaranchal) followed.

277 ITR (A.T.) 0209- ARB INC VS. JOINT COMMISSIONER OF INCOME-TAX (DELHI BENCH)

The work done by the non-resident for providing facility by way of drilling etc. for laying down pipelines for Gas Authority of India Ltd. (GAIL) cannot be treated as prospecting for extraction or production of mineral oil within the meaning of section 44BB. It was so held by the Tribunal in ARB Inc. v. Joint CIT [2005] 277 ITR (AT) 209 (Delhi). It was incidentally pointed out that GAIL itself does not have an oil well, so that the assessee, which facilitates its activity could not be engaged in extraction or production of mineral oil within the meaning of section 44BB. GAIL itself was not producing natural gas, but only producing liquefied petroleum and other products, which are commercially different from natural gas.

GAIL did not have any gas well. It simply purchased natural gas. Natural gas purchased by GAIL continued to be natural gas as a result of the process carried on by it, though in a compressed form and resultantly no new item emerged as a result of such process. Therefore, liquefied petroleum gas and natural gas are entirely different commercial items. Liquefied petroleum gas is a by-product of natural gas. Therefore, Gas Authority of India Limited could be said to be a manufacturer of liquefied petroleum gas and consequently could not be said to be a manufacturer/producer of natural gas. What was produced by GAIL was not natural gas but a different item that is liquefied petroleum gas. Hence, the

facility/service provided by the assessee to GAIL could not be said in connection with prospecting for, extraction or production of mineral oil as contemplated under section 44BB.

264 ITR 0340- COMMISSIONER OF INCOME-TAX VS. O.N.G.C. (UTTARANCHAL HIGH COURT)

Where presumptive income is the mandate of law, the computation of income under the head business in the normal course is not possible. It was so held in CIT v. O. N. G. C. [2003] 264 ITR 340 (Uttaranchal), where the High Court, in the context of income from prospecting, extraction or production of mineral oil of a non-resident, held that the income is bound to be assessed under section 44BB on a presumptive basis and that it was not open to the Assessing Officer to resort to the provision for adding the tax borne by the contractee as a perquisite under section 28(iv). The argument of the Revenue was that section 44BB has to be read in conjunction with section 28(iv). Such an argument was found by the High Court to be unacceptable, since the plain reading of section 44BB would not admit of such interpretation, since section 44BB is a complete code by itself. Section 194A on which reliance was placed providing for addition of the tax borne by the firm for purposes of tax deduction at source is not a provision for computation of income, so that it can have no application where the computation of presumptive income does not provide for such addition to the income. The illustration given by the High Court indicates that the dispute was not that the tax borne by the payer ONGC in this case should not be included as part of receipt. The real issue was the departmental contention, that tax on tax should also be taken into consideration. Hence, the judgment is not an authority for overlooking section 28(iv), where tax is borne by the payer, but the departmental contention that section 28(iv) should be understood as including tax on tax is not correct, because reading of section 28(iv) itself indicates that only the tax has to be treated as perquisite and not tax on tax. Such cases are best understood on appreciation of the difference between tax free income and income net of tax. In the assessee's case, it was the latter income, so that if it were tax free income the Income-tax Department would have been right.

Similar view was taken on the same issue in CIT v. Schlumberger Sea Co. Inc. [2003] 264 ITR 331 (Cal), where the High Court held that the addition on account of tax borne by the payer of an amount taxable under section 44BB could only be confined to 10 per cent. of the tax and not tax on tax. Rectification to alter the tax to make the further addition of tax on tax was without jurisdiction, since at best the issue was debatable.

Question

ONGC, filed a return under section 160 read with section 163(1) as agent of a non-resident. The contract between ONGC and the non-resident was a "net of tax" contract. Since the contract was for oil exploration section 44BB was applicable. Under that section 10 per cent. of the gross receipts is deemed to be the income of the non-resident. Since ONGC had taken over the tax liability of the non-resident, the Assessing Officer came to the conclusion that to the extent ONGC undertook to discharge the tax liability of the non-resident it would amount to benefit under section 28(iv) of the Act. Accordingly, he added that tax component to the income of the assessee on the basis of multiple grossing. You are required to answer whether the action of the officer is justified or not.

Answer

Section 44BB of the Income-tax Act, 1961, is a special provision for computing profits and gains in connection with the business of oil exploration. It applies to non-resident companies engaged in such business. It begins with a non obstante clause. It provides for charging tax on 10 per cent. of the aggregate of receipts referred to in section 44BB(2). Even if the non-resident makes a loss in a given year it is liable to pay tax. Section 44BB provides both for chargeability of tax and computation. It is a complete code by itself. Section 44BB imposes tax on notional income and that notional income has to be

computed in accordance with section 44BB. There is no need to refer to section 28(iv). Section 195A comes under Chapter XVII of the Income-tax Act which deals with collection and recovery of tax whereas section 44BB comes under Chapter IV which deals with computation of business income. Therefore, section 195A cannot be invoked to apply the concept of multiple stage grossing up of income to the profits derived by the non-resident from oil exploration falling under section 44BB. Thus the action of the officer is not justified.

PRESUMPTIVE INCOMES

Section / Topic Name : 44B / BB / BBA etc.

ACTUAL COST REIMBURSEMENTS ARE ALSO CHARGEABLE

In CIT v. Halliburton Offshore Services Inc. [2008] 169 Taxman 138, the Uttarakhand High Court held that even actual cost reimbursements against expenditure would form part of the aggregate amount specified under section 44BB. The Court held that section 44BB is a complete code in itself so that one need not get into a debate for an amount received whether having character of income or not since what is specified in the section is the total amount paid or received by the assessee.

	44BB
NR providing services/facilities in connection with oil exploration	
(a) Mobilisation/De-mobilisation charges (1)	10
(b) Re-imbursed Catering/Fuel Expense (2)	5
(c) Re-imbursed of transportation of drilling unit (3)	7
(d) Re-imburement against expenses (4)	3
(e) Freight/transportation & Handling charges (5)	5
Total	30
44BB presumptive income 10 %	3

1.	R & B Falcon Drilling Co. (Uttarakhand High Court)
2.	RBF Rig Corporation (Uttarakhand High Court)
3.	Sedco Forex International Income (Uttarakhand)
4.	Halliburton Offshore Services Income (Uttarakhand High Court)
5.	B.J. Services Co. (Uttarakhand)

FREIGHT, TRANSPORTATION AND HANDLING CHARGES

Section 44BB provides for a presumptive income at 10 per cent. of the turnover from exploration of mineral oil. Where the assessee sought to exclude from the purview of turnover, the amount received on account of supply of spare parts. The Tribunal found such exclusion acceptable, but the High Court reversed the decision of the Tribunal on the ground that the mere fact that the assessee received only reimbursement of cost could not justify the exclusion of such amount from the turnover. It also found that though the assessee has characterised receipt as reimbursement, it did charge 5 per cent. on cost as handling charges, so that it was held that the assessee's claim for exclusion of such amount was not justified in CIT v. B. J. Services Co. [2008] 300 ITR 392 (Uttarakhand).

In a similar case, where the assessee receives reimbursement by way of freight and transportation charges

in respect of business of prospecting and extracting or production of mineral oil covered by section 44BB, such reimbursement would have to be included in the base for estimate, so as to constitute its turnover or business, for which the section is applicable. It was so decided in CIT v. Halliburton Offshore Services Inc. [2008] 300 ITR 265 (Uttarakhand).

Scope of 44 BB

	Mr. n (exploration of mineral oil u/s 44 BB)	
1	Mobilization Charges (Sedco Forex International Inc. (utt))	20
2	Supply of spare Parts (B.J. Services Co. (utt))	30
3	Re-imbursement of freight & transportation (Halliburton offshore Services Inc (utt))	10
	Total	60
	Income as per 44 BB (10%)	06

GENERAL DEDUCTION OF SECTION 37(1)

Section / Topic Name : 37(1)

EXPENSE ON MERGER OF PROFESSIONAL ACTIVITIES – NOT ALLOWED

The assessee running a diagnostic centre entered into an agreement with three doctors making them eligible for a specific percentage of collections for the next 25 years on their undertaking not to compete with the assessee's business. Such amount was treated as professional charges paid to them and claimed as a deduction under section 37 or in the alternative as a liability created by an overriding charge. Since there was no service provided for such payment, it could not be allowed under section 37. It could not be said that the very source of the income was diverted by overriding title, so that the principle of diversion by overriding title would also have no application as held by the Tribunal in I. D. O. R. I. Pvt. Ltd. v. Deputy CIT [2008] 301 ITR (AT) 374 (Pune). The latter inference that there is no diversion at source may need revision, since the genuineness of the agreement has not been questioned.

NOTIONAL LOSS ON FOREX FLUCTUATIONS

The Supreme Court in Oil & Natural Gas Corpn. Ltd. v. CIT [2010] 189 Taxman 292 held that loss incurred by an assessee on account of fluctuation in rate of foreign exchange as on date of balance-sheet is allowable as an expenditure under section 37(1) on accrual basis keeping into account the mercantile system of accounting followed by the assessee.

ADVISORY PAYMENTS IN RELATION TO BUYBACK OF SHARES

In CIT v. Selan Exploration Technology Ltd. [2010] 188 Taxman 1 (Delhi), the Assessing Officer termed payment for advisory services for regulatory compliance in relation to buyback of shares as 'capital' in nature. The Delhi High Court held the Tribunal as right in holding that the assessee had not acquired the benefit or addition of enduring nature because after the buyback, benefit or addition of enduring nature would not arise as capital employed had, in fact, gone down.

REGULARIZATION FEE/COMPOUNDING FEE

The Karnataka High Court in Millennia Developers (P.) Ltd. v. Dy. CIT [2010] 188 Taxman 388 held that compounding/regularisation fee paid for having violated sanctioned plan in terms of Building bye-laws approved by municipal authorities would be payment in the nature of penalty and, therefore, it would not qualify for deduction under section 37.

SERVICE CHARGES TO STATE GOVERNMENT - GOVERNMENT COMPANY'S CASE

In CIT v. Travancore Titanium Products Ltd. [2010] 187 Taxman 81 (Ker.) the assessee was a Government company. It was owned by the State Government with 80 per cent stake. Being a Government company, it was under the control of the Government and its board of directors was also constituted with the Government nominees, including the Government Secretaries. The company had put up its plant in an extensive land leased to it by the State Government on a paltry lease rent. Besides that, the Government was rendering a lot of services and giving incentives to the company by way of reduction of sales tax on its products, whenever there was slump in the market. In consideration of the services rendered by the Government, the State Government issued a Government order directing the company to pay service charges on per tonne of manufacture of Titanium Dioxide which has come under challenge.

The Kerala High Court held that the payment of service charges was essentially its business expenditure allowable under section 37(1). In deciding such matter the Court considered the following factors :

- (a) the service charges were mainly for the sacrifices and incentives provided by the State to the company;
- (b) all policy decisions of the company were taken by the Government;
- (c) The Government appointed a special officer for ensuring raw materials supply to the Government company from another company at moderate costs.
- (d) The board of directors of the assessee-company was constituted with Secretaries to the Government and the Government servants;
- (e) The board members were not entitled to additional remuneration, which was a saving for the company;
- (f) Concessional lease of land to company;
- (g) Sacrifices of its revenue by way of reduction or exemption for sales tax.

This appears to be a case of application of profits, as the payment is visualised only because of profits earned by the company due to successful management provided by the State Government. The State Government issued a Government Order in this case which is kind of forced payment. Had there been no profits perhaps there would have been no payment of like nature as one would like to introspect. Further, the High Court left a note for the CBDT to take up the matter with the State Government on the fixing of the basis of service charges to make it more rational, so that the revenue has one more opportunity to make up for the lost case.

Particulars (below items assumed to be debited to P/L)	Judgment	Rs.
Profit as per P/L		108
Pooja expense	1	-
Expense on merger of professional activities	2	(+) 4
Advisory payment on buyback shares	3	(+) 4
Compounding/Regularisation fee by developer	4	(+) 4
Service charges to government by government company	5	(+) 4
Subsidiary company loan w/off	6	-
Corporate club membership	7	-
Advertisement for film products	8	-
Warranty provisions (Not a contingent liability)	9	-

1.	Mohan Meakin Ltd. (Delhi High Court)
2.	I. D. O. R. I. Pvt. Ltd. (Pune)
3.	Selan Explorations Technology Ltd. (Delhi)
4.	Milennia Developers (P.) Ltd. (Karnataka High Court)
5.	Travancore Titanium Products Ltd. (Ker.)
6.	Salem Magnesite (P.) Ltd. (Bom.)
7.	Samtel Color Ltd. (Delhi High Court)
8.	Geoffrey Manners & Co. Ltd. (Bombay High Court)
9.	Rotork Controls India (P.) Ltd. (SC)

LOAN TO SUBSIDIARY - WRITE-OFF CLAIM

In Salem Magnesite (P.) Ltd. v. CIT [2009] 180 Taxman 545 (Bom.), the assessee as well as its subsidiary were in the business of mining. The assessee lent an amount of Rs. 5 lakhs to its subsidiary company for the purpose of constructing a jetty. In the following years, the subsidiary company suffered heavy losses and as a result it was not in a position to repay the loan taken from the assessee holding company. The assessee accepted a sum of Rs. 41,500 in full and final settlement of the loan of Rs. 5 lakhs and wrote off the balance of Rs. 4,58,500 as a loss incidental to its business.

In this case there was a clear finding that the assessee was not in the business of lending money so that the loss was held as one that did not spring directly from the business of the assessee or being in the nature of loss incidental to its business. There had been a further finding of fact that the money was lent to its subsidiary company to enable the subsidiary company to construct a jetty which was a capital asset of the subsidiary company, thus, that the loss would bear the character of a capital loss.

On the contrary in CIT v. Gillanders Arbuthnot & Co. Ltd. [1982] 138 ITR 763 (Cal.) the assessee successfully claimed deduction of loan write-off as a business loss for the following findings of the Tribunal :

- (i) The subsidiaries were all controlled and managed by the assessee-company;
- (ii) The employees of the assessee-company were on the board of directors of the subsidiary company;
- (iii) The loan were advanced to the subsidiary as an integral part of business activity of the assessee-company. More so the Tribunal in this case held that the interests of the subsidiaries were vitally connected with the assessee's business interests;
- (iv) That the memorandum of association permitted the assessee-company to advance the loans to its subsidiaries

CORPORATE CLUB MEMBERSHIP

The Delhi High Court in CIT v. Samtel Color Ltd. [2009] 180 Taxman 82 held that corporate membership only facilitated smooth and efficient running of the business enterprise and did not add to profit earning apparatus of the business enterprise; even if the assessee acquired enduring benefit, it was not on capital account. The High Court even held that the law is settled that an expenditure which gives enduring benefit (including lump sum payment) is, by itself, not conclusive as regards the nature of the expenditure.

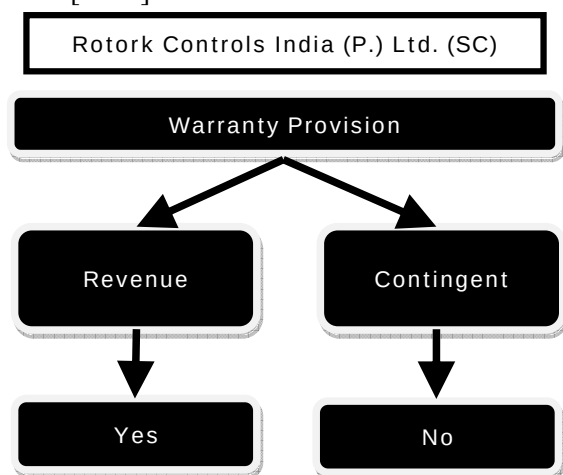
AD FILM PRODUCTION

The Bombay High Court in CIT v. Geoffrey Manners & Co. Ltd. [2009] 180 Taxman 87 held that the expenditure incurred by assessee on film production by way of advertisement for marketing of products manufactured by it was allowable as revenue expenditure, inasmuch as it was in respect of promoting ongoing products of assessee and not the one that is yet to be marketed. In this case the ad film was in respect of promoting ongoing products of assessee.

WARRANTY PROVISION

The Supreme Court in Rotork Controls India (P.) Ltd. v. CIT [2009] 180 Taxman 422 held that if the historical trend indicates that a large number of sophisticated goods were being manufactured in the past and if the facts established show that defects existed in some of the items manufactured and sold, then the provision made for warranty in respect of the army of such sophisticated goods would be entitled to deduction from the gross receipts under section 37. The Apex Court further narrated the following four important aspects in any provisioning :—

- (a) That it relates to present obligation;
- (b) That it arises out of obligating events;
- (c) That it involves outflow of resources; and
- (d) That it involves reliable estimation of an obligation.



The objection taken by the Revenue that warranty charges are in the nature of contingent liability has not been accepted by the Tribunal and the courts, where the liability has been reasonably established with reference to past claims or such other basis. This established law, that the fact, that a liability may get quantified in a later year, is no bar for deduction has been repeatedly laid down by the Supreme Court in Calcutta Co. Ltd. v. CIT [1959] 37 ITR 1 and Bharat Earth Movers v. CIT [2000] 245 ITR 428 (SC). Following these decisions, the Punjab and Haryana High Court in CIT v. Majestic Auto Ltd. [2008] 296 ITR 309 had upheld the deduction for warranty provision pointing out that this has been the decision of the Privy Council in Commissioner of Inland Revenue v. Mitsubishi Motors New Zealand Ltd. [1996] 222 ITR 697 and that of the Delhi High Court in CIT v. Vintec Corporation P. Ltd. [2005] 278 ITR 337. There are decisions of other High Courts to the same effect in that of the Kerala High Court in CIT v. Indian Transformers Ltd. [2004] 270 ITR 259 and the Madras High Court in CIT v. Bheema Mfrs. (P) Ltd. [2003] 130 Taxman 400.

WARRANTY PROVISION

The Delhi High Court yet again in CIT v. Hewlett Packard India (P) Ltd. [2008] 171 Taxman 13 held that estimation of warranty liability on past historical cost, failure rate experienced in the past, length of warranty and after considering the increase in volumes would assume scientific basis and, thus, the same would represent an accrued liability only.

The Delhi High Court in CIT v. Hewlett Packard India (P.) Ltd. [2008] 173 Taxman 162 held that where the warranty clause is a part of the sale document and it imposes a liability on the assessee to discharge its obligation for the period of warranty, the liability could be capable of being construed in definite terms and, therefore, could be deducted while working out the profits and gains of business. In this case the assessee-company had followed a scientific method of making the estimate, which was based on the past historical cost; failure rate experienced in the past; the length of warrantee; increase in volumes, etc. On that basis, it was held that the estimation made by the assessee was not at all an arbitrary one and, therefore, it was entitled to succeed in the appeal.

POOJA EXPENSES

The Delhi High Court in CIT v. Mohan Meakin Ltd. [2010] 189 Taxman 377 held that expenditure incurred by an assessee-company on Puja, Hawanand Kirtan, as a welfare measure for its employees and staff members is an allowable business expenditure.

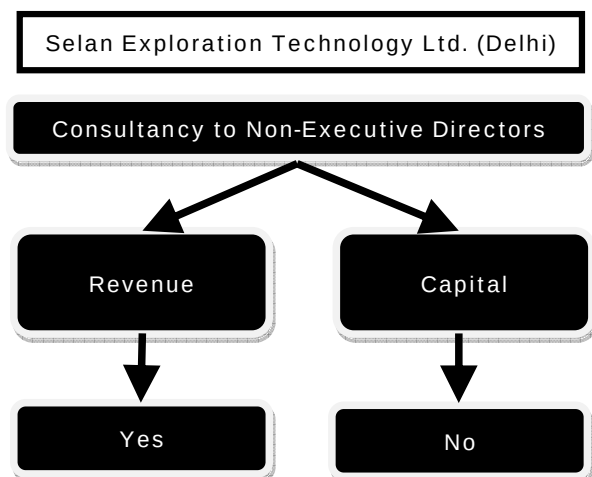
CONSULTANCY PAYMENT TO NON EXECUTIVE DIRECTORS (NEDS)

In CIT v. Selan Exploration Technology Ltd. [2010] 188 Taxman 1 (Delhi), the Assessing Officer doubted payment to NED as for non business in the absence of any documentary evidence suggesting any work carried out by the consultant non-ED except for an invoice and a board resolution. The Tribunal upon examination found that the non-ED had, in fact, rendered services and such payment was made for obtaining consultancy services in field of review of annual accounts, audit review and review of internal controls, etc. The ITAT recorded the following finding in the instant case :

“We feel that for services rendered as an advisor regarding legal compliance, there may not be some documentary evidence as noted by Ld. CIT(A) but since the need of advisory services is shown by pointing out that new SEBI guidelines are made applicable in this year and it is also shown that Mr. Mirza was capable of rendering such services, the claim of the assessee deserves to be allowed in the facts and circumstances of this case.”

The Delhi High Court went by what Tribunal reckoned as finding of fact based on cogent material and upheld such finding in the instant case.

The best course in such type of case is to straightaway invoke the provisions of section 40A(2)(b) as the general principle of reasonableness also undermines payments to NEDs. More so in such a case, the burden is upon the assessee to establish that the price paid by it is not excessive or unreasonable and it, therefore, is the duty of the assessee to prove and discharge its burden by leading proper evidence subject to cross-examination by the Department. In this manner, the Assessing Officer would be able to judge the propriety of the transaction too.

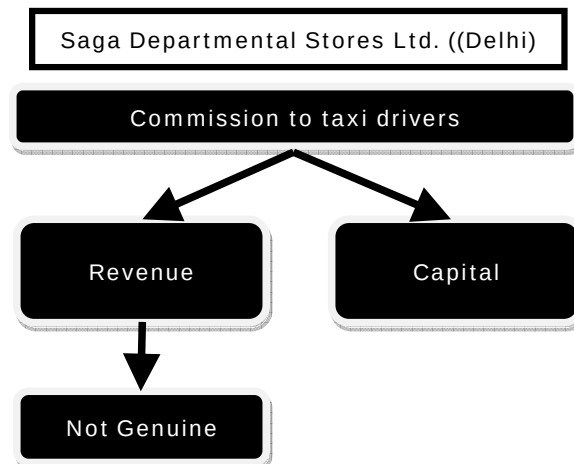


COMMISSION TO TAXI DRIVERS, GUIDES AND COMMISSION AGENTS- DEPARTMENT STORES CASE

In *Saga Departmental Stores Ltd. v. CIT* [2010] 188 Taxman 27 (Delhi), the assessee-company carried on business of departmental stores where handicraft items were sold to tourists. It claimed deduction of expenditure towards commission paid by it to taxi drivers, guides and commission agents which ranged between 18-20 per cent of the total turnover. The Assessing Officer held it as unreasonably inflated and restricted allowance to barely 2 per cent. The CIT(A) allowed it at a level of 14 per cent. Later the ITAT allowed it at 16 per cent. Before the Delhi High Court, in further appeal, it was strenuously urged that either the entire commission should have been allowed or the books of account should have been rejected. To this, the Court held as below :

“We do not think this contention is correct in the facts of the present case inasmuch as the authorities below have clearly noted the deficiency in the proofs and that various transactions were found to be questionable.

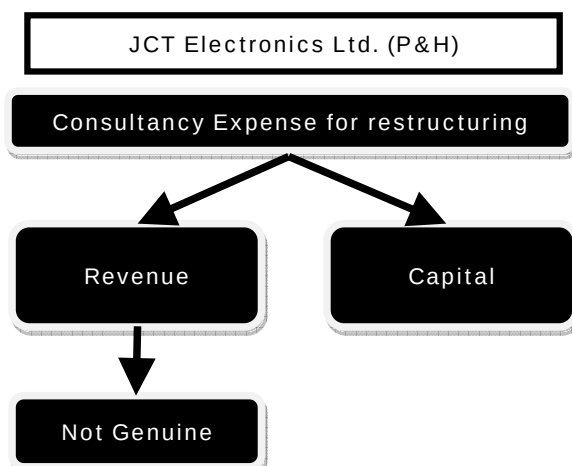
In various cases, where transactions run into huge numbers i.e., of hundreds or thousands, it is not unusual to take a sample basis to arrive at a decision. Having done so, in the facts of the case, and taking such facts in that totality, these findings of facts have been arrived at by the ITAT to allow expenditure towards commission at 16 per cent.”



CONSULTANCY EXPENDITURE- RESTRUCTURING AND VIABILITY STUDY

In *CIT v. JCT Electronics Ltd.* [2010] 188 Taxman 191 (Punj. & Har.), the assessee-company had become a sick unit and in that regard, a reference was made to the BIFR for its rehabilitation which passed an order giving it substantial relief. The services of chartered accountants were engaged which resulted in preparation of final restructuring scheme. On account of assistance rendered by the chartered accountants, major concession and substantial reliefs were given to the assessee. Payment made to the chartered accountants was claimed by the assessee as revenue expenditure. The Assessing Officer held that such expenditure incurred by the assessee for the purpose of restructuring would be an advantage of an enduring nature.

Rubbing such stance, the Punjab and Haryana High Court held that the word ‘capital’ connotes permanency and the capital expenditure is, therefore, closely akin to the concept of securing something, tangible or intangible property, corporeal or incorporeal right so that it could be of a lasting or an enduring benefit to the enterprise in issue. The revenue nature of expenditure, on the other hand, is operational in its perspective and is solely intended for the furtherance of the enterprise.



The decision was a quick reminder to the Assessing Officer that not all one time payments are capital in nature. As long as such payments are for furtherance of an enterprise and do not bring into existence any tangible or intangible property, these would retain revenue character.

HUGE EXPENDITURE AGAINST MINIMAL INCOME - START UP EXPENSES CLAIM JUSTIFIED

It is a sure shot, settled and bingo law that when a business is established and is ready to commence business, then it can be said of that business that it is set-up vide *Western India Vegetable Products Ltd. v. CIT* [1954] 26 ITR 151 (Bom.). It is at this point of time that the previous year would begin to roll so that one need not wait for actual commencement of business to draw a computation of taxable income and to complete the assessment. These watertight principles hold good not only for the purpose of determination of the income or loss under the provisions of the Income-tax Act, 1961 but also in the context of preparation of profit and loss account and balance sheet in compliance with the provisions of the Companies Act, 1956 and in accordance with the established accounting standards and guidance notes.

In the light of this well laid down law the Delhi High Court in *CIT v. Aspentech India (P.) Ltd.* [2010] 187 Taxman 25 held that salary paid to employees, travelling cost and administration and other operating expenses incurred prior to actual commencement of the project would not be pre-operative expenditure, as it found that such expenses relate to start of the essential business activity of order procurement being incidental to the business of software development. In the result it held that such expenses would be regarded for purpose of business and not for setting-up of the business.

In further conclusion the Court observed that in the succeeding year the assessee had achieved turnover to the tune of Rs. 4 crores with help of seven employees, that clearly indicated that their efforts made in the relevant period had shown fruitful results in succeeding years. In this case the Assessing Officer claimed application of section 35D.

SHUTTERING EXPENSE

The Punjab and Haryana High Court in *CIT v. Random Constructors (P.) Ltd.* [2010] 186 Taxman 303, held that the fact that shuttering material could be used in the subsequent assessment year, is no ground to deny claim for deduction of shuttering expense as revenue expenditure in the first instance.

On the contrary, the Rajasthan High Court in *CIT v. Mohta Construction Co.* [2005] 273 ITR 276 held that shuttering is a plant or machinery so it would qualify for depreciation. The Allahabad High Court too in *Harijan Evam Nirbal Varg Avas Nigam Ltd. v. CIT* [1998] 229 ITR 776/[1996] 85 Taxman 456 held that shuttering material is a plant item and the assessee would be entitled to depreciation on it under section 32 of the Act.

BACKDATING INCENTIVE SCHEME

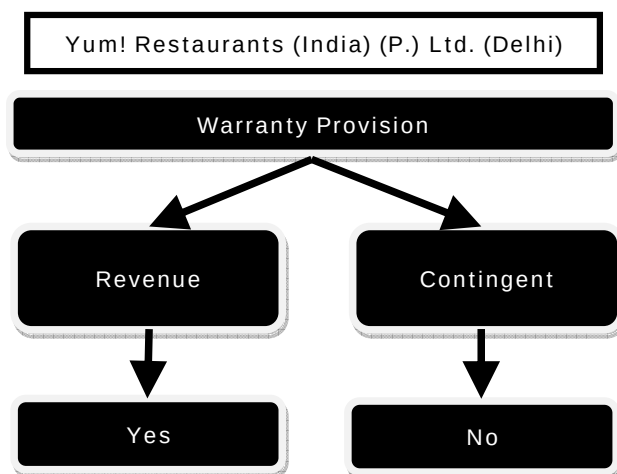
In *Yum! Restaurants (India) (P.) Ltd. v. CIT* [2009] 180 Taxman 8 (Delhi), the assessee-company held licences from Kentucky Fried Chicken International Holdings, Inc. ('KFC') and Pizza Hut International LLC ['PHILLC']. Under such licences, the assessee-company was to develop and manage franchisees for running restaurants for the two brands. The assessee-company received contributions/franchise fee in its wholly owned subsidiary which also undertook 'co-operative advertising' on behalf of its franchisees based on contributions received from the franchisees which were equivalent to 5 per cent of the gross sale made by them under a tripartite agreement executed between the assessee-company, its sub and its franchisees in September, 2000. The assessee-company, in order to incentives development of Pizza Hut brand in India, formulated a scheme in April, 2001, whereby it offered to reimburse contributions made towards advertisement to the extent of 2 per cent of the sales of the franchisees outlets for the period from 1-12-2000 to 30-11-2001, provided they commenced operations/business at or from three additional outlets by 30-11-2001.

The assessee claimed deduction of such incentive provision in the previous year relevant to assessment year 2001-02 which claim was held inadmissible by the Delhi High Court for the fact that the incentive scheme came to the knowledge of the franchisees only in April, 2001 and the assessee-company could not have predicted in the assessment year under consideration the liability on that account when the scheme came to be formulated only in April, 2001. Moreover the Court did not see any commercial expediency in booking such expenses as it found that the

contribution received by the subsidiary from the franchisees exceeded the amount it spent on common advertising and the sub held unspent balance in its books.

In the parallel in the case of *Yum! Restaurants (Marketing) (P.) Ltd. v. CIT* [2009] 180 Taxman 27 the Delhi High Court turned down the plea of the assessee that it was a mutual concern inasmuch as the Court found that it had received contributions from its holding company which is not a franchisee. The Court further pointed out that even the principle of mutuality is applicable to those entities whose activities are not tagged with commercial purpose. More so the exemption was denied as the Court found that the assessee earned a surplus in its account books. The following words drawn from the judgment need a close reading :—

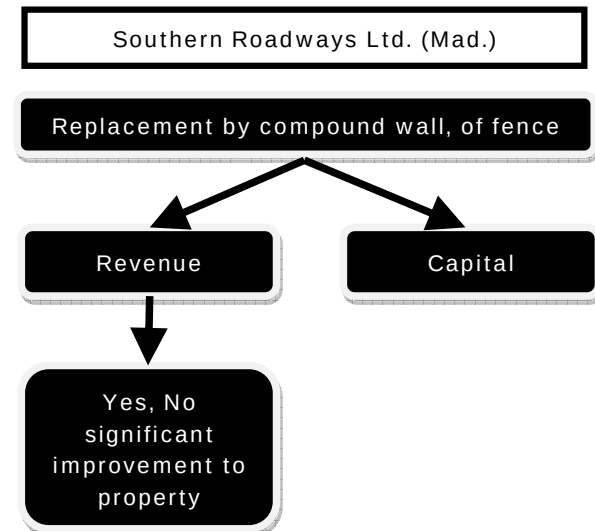
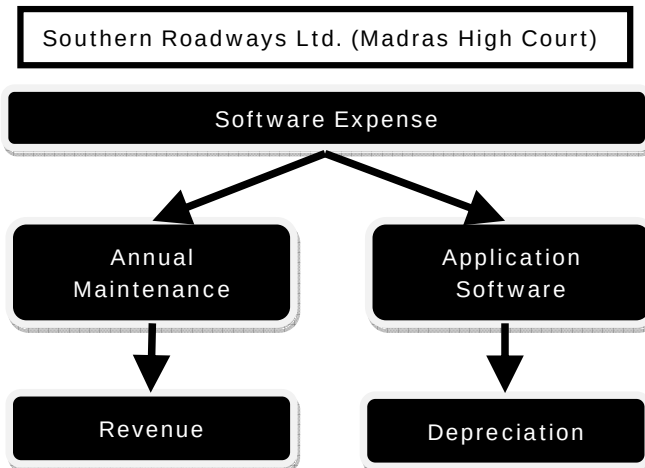
“8. The point to be noted is that what the assessee-company in law could not have claimed directly, that is, by making a provision for advertising expenditure could it then be allowed to claim an amount as an expense merely on account of the fact that it had set up an intermediary in the form of a wholly owned subsidiary. In our opinion as rightly held by the authorities below, it cannot be so. For any expenditure to be permitted as deduction under section 37(1) of the Act the twin conditions which are required to be fulfilled are that the expenditure in issue should not be of a capital nature, and that, it should have been expended wholly for the purposes of business. It is well-settled that the expression 'for the purposes of business' in section 37 of the Act has been held to mean an expenditure which is voluntary in nature and commercially expedient. In the present case the Tribunal has returned a finding of fact that the assessee-company has not been



able to prove that the contributions to the subsidiary were made in the course of business or on account of commercial expediency. . . .”

REPLACEMENT ITEMS, SOFTWARE, COMPOUND WALL IN PLACE OF BARBED WIRE FENCING

The Madras High Court in CIT v. Southern Roadways Ltd. [2009] 183 Taxman 234 held that the proposition that there cannot be any single rigid formula to find out whether a particular expenditure is revenue in nature or capital and the fact that the expenditure was incurred to obtain a benefit of an enduring nature, is not the sole test in every case is a well-settled law. In this background it held that the payment for application software even though having enduring benefit, does not result in acquisition of any capital asset and it merely enhances the productivity or efficiency so that it has to be treated as revenue expenditure. Once again, on the question of compound wall in place of barbed wire fencing, the Court held that the expenditure incurred on the construction of the compound wall in the place of barbed



wire fencing, would be revenue expenditure as it would not result in significant replacement so as to alter the character of the business premises. Finally, the Court also held the expenditure incurred on replacement of UPS and printer as revenue based on up-gradation theory. Interestingly, the Court stated the assessment years involved in each of the three types of expenditure so that one must understand and apply such decision to appropriate years.

Expenditure on replacement of UPS system and printer was found to be allowable in CIT v. Southern Roadways Ltd. [2008] 304 ITR 84 (Mad) after review of the first principles on the subject and finding that the replacement of the parts in the computer amounted

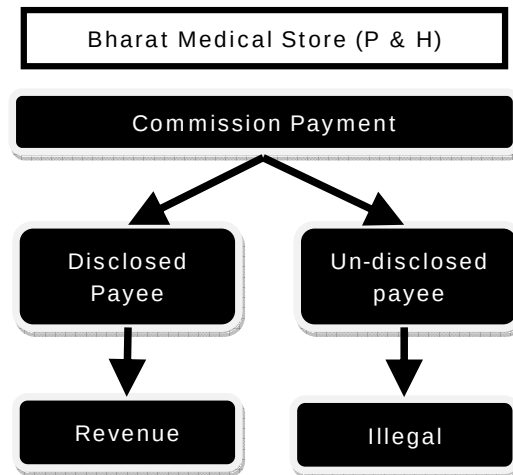
only to upgradation, enhancing the use of the computer by improving its efficiency without any structural alteration.

EXPENDITURE ON REPLACEMENT OF A FENCE BY A COMPOUND WALL

Expenditure on replacement of a fence by a compound wall was allowed by the High Court as revenue expenditure in CIT v. Southern Roadways Ltd. [2008] 304 ITR 84 (Mad) following the decision of the Karnataka High Court in Senapathy Synams Insulations P. Ltd. v. CIT [2001] 248 ITR 656, which followed the settled law as between capital and revenue expenditure.

COMMISSION PAYMENTS

In CIT v. Bharat Medical Store [2009] 185 Taxman 54 the Punjab and Haryana High Court allowed deduction of commission paid after the finding by the Tribunal that the payment of commission was for advancing the purpose of the assessee's business and the services of the agents procured by the assessee-firm, in fact, helped it in persuading the institutions to place orders with the IDPL and arrange acceptance of supplies made by IDPL as well as were instrumental in getting all the terms of the contract between IDPL and the assessee-firm complied with. Further, it found such appointment of agents as commercial expediency because the assessee-firm was not in a position to cover all the 13 districts of Punjab and Chandigarh by itself.



ROYALTY

The Delhi High Court in Climate Systems India Ltd. v. CIT [2009] 185 Taxman 139 upheld deduction of royalty as it was not fixed but fluctuating with the quantum of sales and it would decrease or increase every year depending upon the decrease or increase in the sales. In this case the lump sum amount, admittedly, was treated as capital expenditure.

SET-UP OF BUSINESS

In the context of an assessee incorporated on 27-7-1995 as a financial enterprise, with its main objects according to the Memorandum of association, to carry on the business of financing of all kinds of goods including consumer goods and consumer durables, etc., to purchase or finance all kinds of financial instruments, to finance private industrial enterprise in India by way of loans or advances and so on in CIT v. Whirlpool of India Ltd. [2009] 185 Taxman 387 (Delhi) the Assessing Officer took the view that the business in its case would be said to have been

“set-up” only on 1-2-1996 when the bank account was opened in the assessee's name and, therefore, only the expenditure incurred thereafter could be allowed as a deduction. The assessee claimed that during months of September and October, 1995, it had purchased computers and appointed various key employees such as branch managers, regional managers, consumer finance managers, company secretary, finance manager and accounts manager, etc., and that it had set-up its business from 1-11-1995. The High Court admitted the ground of the assessee and allowed relief of expenses incurred from 1-11-1995.

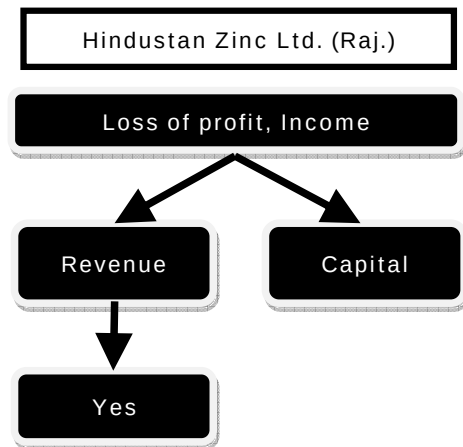
FAILURE TO PRESS FOR CLAIM DURING ASSESSMENT STAGE

In Jayashree Tea & Industries Ltd. v. CIT [2008] 169 Taxman 6/[2007] 288 ITR 386 (Cal.), the assessee did not claim any deduction on account of leave encashment for the relevant assessment year which it might have to pay to its employees under the scheme. Later on, after the assessment was completed, the Supreme Court in an identical case delivered judgment in Bharat Earth Movers Ltd. v. CIT [2000] 245 ITR 428/112 Taxman 61, holding that such a liability on account of leave encashment was a liability in praesenti, although it might be discharged at a later date and the assessee would be entitled to claim appropriate deduction by debiting its profit and loss account and by making a corresponding credit entry in the liability account.

Soon after the judgment was delivered by the Supreme Court, the assessee applied for revision before the Commissioner within the statutory period of limitation. The Calcutta High Court held that the assessee was not entitled to the benefit because the assessment had been completed prior to delivery of the judgment in the case of Bharat Earth Movers Ltd. (supra). This case is a clear reminder to all the assesseees to prefer all possible claims at assessment stage itself to protect its interest.

DEPRIVATION CHARGES OR LOSS OF PROFITS

In CIT v. Hindustan Zinc Ltd. [2008] 171 Taxman 159 (Raj.), the assessee took over an undertaking under a Government ordinance. Before actual acquisition, the assessee was called upon to administer and manage the operations of the acquired undertaking to the exclusion of previous owner. Under an agreement, the assessee was required to pay a separate deprivation charge for deprivation of management and possession of the undertaking, over and above the price for acquisition of the undertaking. Both the ITAT and the Rajasthan High Court held such payment as revenue in nature being similar to payment of loss of profits.

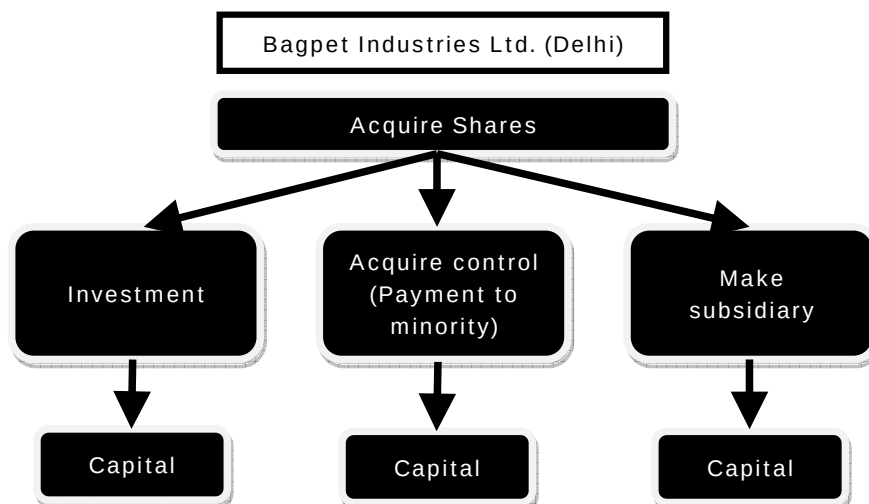


The Madras High Court in the reverse in the case of CIT v. M.Ct.M. Corpn. (P.) Ltd. [1995] 211 ITR 95/80 Taxman 536 held that amount forfeited as compensation for loss of income or

profits would be a revenue receipt liable to tax.

PAYMENT FOR SHARES FOR ACQUIRING CONTROL - CAPITAL EXPENSE

Where an assessee took over shares from minority shareholders, he had split up the consideration paid as one for purchase of shares and the other as compensation for removing obstacles raised by the minority shareholders in the smooth functioning of the company. The amount so inferred as such compensation was debited to the assessee's profit and loss account and claimed as revenue expenditure. The Tribunal found that it was clear that the assessee paid the amount as consideration for purchase of shares and the claim



that expenditure was incurred for removing obstacles in the working of the company could not be factually correct in the assessee's case, because the minority held only 3 per cent. of the shares, so that the argument for buying them out by paying compensation was not convincing. The manner in which the extra payment was worked out was with reference to the face value of the shares, so that the face value by itself could not have been taken as the real value. It was also found that the amounts given by the minority shareholders were treated as loans on which no interest was paid. Only such interest due as per the direction of the Company Law Board, it was found, could be allowed as a deduction and not the alleged compensation as held in Bagpet Industries Ltd. v. Deputy CIT [2008] 304 ITR (AT) 114 (Delhi). It is settled law that even payment for getting controlling interest cannot ordinarily be dissected as a

separate consideration from the payment for purchase of the shares. Therefore, the payment made by the assessee towards the purchase of shares was a capital expenditure and could not be allowed as a deduction while computing the profit of the company.

COMMISSION

The Delhi High Court in *Schneider Electric India Ltd. v. CIT* [2008] 171 Taxman 177 declined to allow deduction of commission payment for want of any direct evidence to show that the recipient had procured any sale orders for assessee and made it very clear that mere production of bills or payments having been made by account payee cheques would be no remedy in this regard. In another case of *CIT v. Gautam Creations (P.) Ltd.* [2008] 171 Taxman 271, the Tribunal found that there was an agreement (written or otherwise) between parties and the work was done in accordance with such agreement and, thus, payment of commission was held justified by the Delhi High Court.

Deferred revenue expenditure

The Delhi High Court in *CIT v. Jai Parabolic Springs Ltd.* [2008] 172 Taxman 258 held that the revenue expenditure, which is incurred wholly and exclusively for the purpose of business, must be allowed in its entirety in the year in which it is incurred. It cannot be spread over to a number of years even if the assessee has written it off in his books over a period of a number of years.

COMMISSION PAYMENTS - ALLOWANCE IN PAST AND FUTURE ASSESSMENTS

In the case of *CIT v. Tusker Dye Chem.* [2008] 173 Taxman 104 (Delhi) commission payments were held as admissible for previous and subsequent year's assessments. In this case the assessee had furnished substantial material in the relevant year in the form of copies of bills on the basis of which commission was paid; confirmation letters issued by the agents, their names, addresses, income-tax details, etc.

The Tribunal had also noted that in respect of at least 9 of such 12 agents, the assessee had a continuing relationship and commission paid to them for similar services was accepted by the revenue in the assessments completed under section 143(3) for the assessment year 2003-04. In respect of some of the agents, commission paid by the assessee in respect of the earlier assessment year 1998-99 was also accepted by the revenue. On such overwhelming set of facts the Delhi High Court upheld the order of the Tribunal.

CONSISTENCY PRINCIPLE

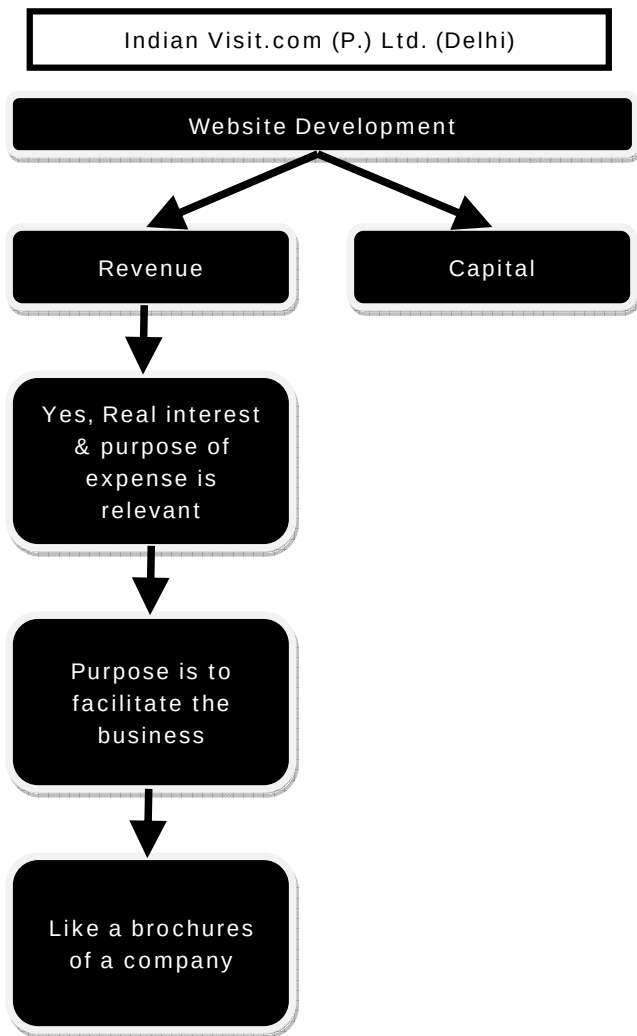
In *CIT v. Harig Crank Shafts Ltd.* [2008] 173 Taxman 152 (Delhi) the assessee-company was not financially sound and was a loss-making concern and, therefore, instead of claiming the entire deduction for product development expenses of Rs. 6.9 crores as revenue expenditure in one year, it claimed the deduction on a deferred revenue basis. The claim was held as allowable in the first year but in the subsequent years it was held as inadmissible. The Delhi High Court held that having allowed such deduction at 1/10th in the first year the Assessing Officer should have given similar deduction in the subsequent years on a consistent basis. The High Court held that it amounted to change of opinion/mind which was impermissible under the law in view of decisions of instant Court in *CIT v. Kelvinator of India Ltd.* [2002] 256 ITR 1 / 123 Taxman 433 (Delhi) (FB) and *CIT v. Eicher Ltd.* [2007] 294 ITR 310.

USE OF TECHNOLOGY FOR BUSINESS - WEBSITE DEVELOPMENT

In *CIT v. Indian Visit.com (P.) Ltd.* [2009] 176 Taxman 164 (Delhi) the assessee in travel business spent an amount of Rs. 20,23,317 on development of its website and the question arose whether it was capital or revenue. Allowing it as revenue, the Delhi High Court drawing support from the Apex Court decision in

Alembic Chemical Works Co. Ltd. v. CIT [1989] 177 ITR 377/ 43 Taxman 312 made the following worthy observations/findings:

“7. Considered in the light of these principles enunciated by the Supreme Court, it is clear that just because a particular expenditure may result in an enduring benefit would not make such an expenditure of a capital nature. What is to be seen is what is the real intent and purpose of the expenditure and as to whether there is any accretion to the fixed capital of the assessee. In the case of expenditure on a website, there is no change in the fixed capital of the assessee. Although the website may provide an enduring benefit to an assessee, the intent and purpose behind the purpose for a website is not to create an asset but only to provide a means for disseminating the information about the assessee. The same could very well have been achieved and, indeed, in the past, it was achieved by printing travel brochures and other published materials and pamphlets. The advance of technology and the wide-spread use of the internet has provided a very powerful medium to companies to publicize their activities to a larger spectrum of people at a much lower cost. Websites enable companies to do what the printed brochures did but, in a much more efficient manner as well as in a much shorter period of time and covering a much larger set of people worldwide.” (P. 166)



COMMISSION PAYMENTS

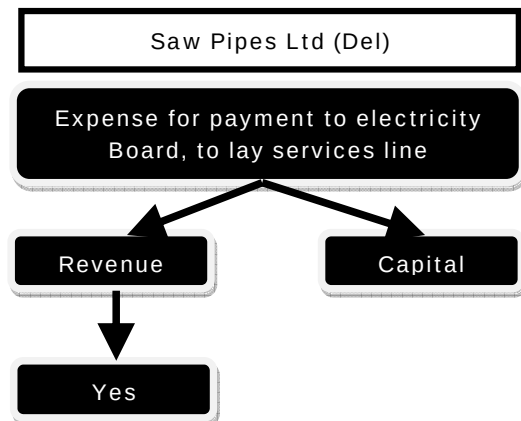
In CIT v. Ravinder Nath Goel [2009] 177 Taxman 64 (Delhi) the Tribunal rejected revenue's contention holding that it could not be expected of consignment agent to maintain growth rate of sale at same level year after year and, thus, it distanced with the plea of excess payment of commission on application of section 40A(2)(b) provisions, especially for the argument that the increase in sales in the earlier year(s) when compared to the immediately preceding year was more than two folds, whereas in the year under consideration, increase in sale was less than 15 per cent when compared to the immediately preceding year.

WAGE REVISION

In Central Government Employees Consumer Co-operative Society Ltd. v. CIT [2009] 178 Taxman 5 (Delhi), the assessee made a provision in its books of a wage revision pursuant to a board resolution of a date subsequent to the year closing date. In the resolution, the board of directors decided to give effect to pay revision effective from a date falling in the relevant previous year. The Tribunal held that there was

no liability to pay extra amount by way of revised pay as at year end it found a parallel resolution indicating that there would be no pay revision before a certain date falling in the succeeding previous year.

Interestingly, the Tribunal on the application of Accounting Standard 4 pointed out that the events occurring after the balance sheet should be indicative of a liability existing at the balance sheet date, but noticed subsequently, or at least the same should be relating to conditions existing on the balance sheet date.



COMMERCIAL PRUDENCE

The assessee had established a new unit in its existing business, which required service lines for the construction of which the assessee had to make payments to the Electricity Board. Since a service line belonged to the Electricity Board, the assessee's expenditure is revenue expenditure, since it is of commercial nature for normal business advantage as decided in CIT v. Saw Pipes Ltd. [2008] 300 ITR 35 (Delhi)

PAYMENTS TO GOVERNMENT DOCTORS

The Allahabad High Court in CIT v. Pt. Vishwanath Sharma [2009] 182 Taxman 63 held that the amount paid to the Government doctor by the assessee for prescribing medicines to the patients is an inadmissible deduction on the premise that a Government servant is not entitled to receive any amount in consideration of discharge of his official duty, unless provided/permitted by the rules and regulations applicable to his conditions of service.

On the contrary the Bombay High Court in Brihan Maharashtra Sugar Syndicate Ltd. v. Dy. CIT [2009] 182 Taxman 236 held that supply of the Indian Made Foreign Liquor (IMFL) samples manufactured by the assessee-company at various military functions were not against the public policy as it was commercially expedient that the defence personnel could develop a taste for it and the assessee could secure bigger orders from the CSD (Canteen Stores Department).

BRIBES PAID - CONSTRUCTION INDUSTRY

In Pranam Foundations v. Asstt. CIT [2009] 185 Taxman 6 (Mad.) during search assessments the assessee-developer was found to have made certain illegal payments such as bribes, etc., in order to complete the construction process including the provision for amenities such as electricity, water connection, sewerage, etc., and debited the same as construction expenses in the books of account. Noting that the subject payments were against the statutory provision with reference to the Explanation to section 37(1) of the Income-tax Act the Madras High Court declined allowance for deduction of such expenditure.

TECHNICAL AND FINANCIAL FEASIBILITY EXPENSES-NEW PROJECT SHELVED

In CIT v. Priya Village Roadshows Ltd. [2009] 185 Taxman 44 (Delhi) the assessee running cinemas was pursuing the following two new projects :

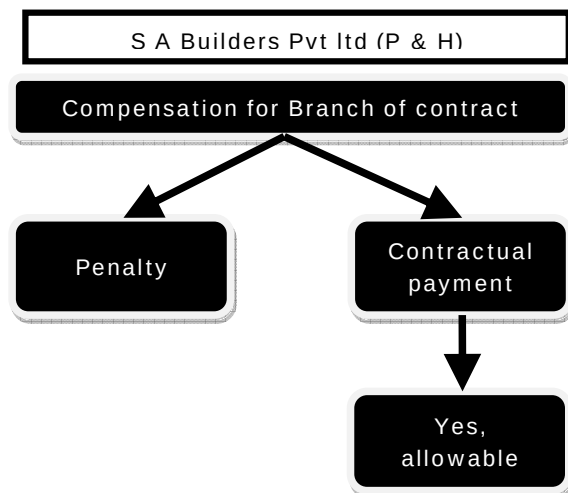
- (a) taking over an existing cinema for conversion into a multiplex;
- (b) taking over one single screen cinema for the purpose of conversion into a four-screen cinema complex.

However, both the projects were not found to be financially and technically viable and, thus, were shelved. The assessee, however, incurred expenses for payments to architects, engineers, etc., for feasibility studies which were claimed as revenue in nature.

Allowing such deductions the Delhi High Court held that the impugned expenditures were incurred in respect of same business, which was already carried on by the assessee so that the expenditure incurred on the two projects would constitute revenue expenditure. Further, for the fact that the study was abandoned, without creating any new asset it justified such a claim of the assessee.

COMPENSATION FOR BREACH OF CONTRACT – NOT PENALTY

An assessee in business may be liable for compensation either for breach of law or breach of contract. If it were for breach of law, it is not allowable as a deduction especially after amendment to section 37(1), which specifically bars such deduction. But where the assessee is obliged to pay compensation in the



course of business, because of breach of contract on its part, such payment will not partake of the character of penalty, even if it were so described, so that it cannot be disallowed. The law on this point is well-settled as decided in CIT v. Amalgamated Development Ltd. [1967] 65 ITR 395 (SC). Even where there is such breach merely to take advantage of the ruling market conditions, the compensation may have to be allowed as decided in South India Viscose Ltd. v. CIT [1982] 135 ITR 206 (Mad). The Supreme Court itself in Prakash Cotton Mills P. Ltd. v. CIT [1993] 201 ITR 684 (SC) had held that even where penalty is levied, it may not always be a punitive one, so that where it is

compensatory, it may well have to be allowed. The Punjab and Haryana High Court, therefore, allowed a claim for compensation for breach of contractual obligation in CIT v. S. A. Builders P. Ltd. [2008] 299 ITR 88 after review of the case law on the subject and following its own decisions in CIT v. Murari Lal Ahuja and Sons [1989] 177 ITR 228 (P&H) and CIT v. Indo Asian Switch-Gears P. Ltd. [1996] 222 ITR 772 (P&H).

Similar view was also taken by a Full Bench of the Punjab and Haryana High Court in Jamna Auto Industries v. CIT [2008] 299 ITR 92, in respect of damages paid for breach of contract, because the assessee was unable to obtain an import licence for import of goods agreed to be purchased. The Full Bench after discussion of the case law on the subject pointed out the difference between compensation for breach of contract and penalty for infringement of law. The difference is so fundamental, that such decision of the Tribunal allowing the relief should not have come up to the High Court as it did in these two decisions before the High Court.

NON-COMPETE FEE

The Delhi High Court in CIT v. Eicher Ltd. [2008] 173 Taxman 251 held that payment of non-compete fee which had only eliminated competition in the two-wheeler business for a while and had not resulting in any permanent or ephemeral benefit to the assessee would be revenue in nature. In this case the assessee had entered into a non-compete agreement with 'V', who was an employee of the assessee, and 'VCPL', a company promoted by 'V', whereby the assessee had paid a sum of Rs. 4 crores to 'VCPL' so that 'VCPL' and 'V' would not carry out any business activity with regard to two-wheelers after retirement of 'V' from the assessee-company.

On the revenue side the Delhi High Court in Rohitasava Chand v. CIT [2008] 171 Taxman 147 held that non-compete fee received by an individual, who was a shareholder, director and software engineer would be a capital receipt if the agreement contained a restrictive covenant so as not to take up any business activity relating to software development for a period of 18 months in all the companies where he was either a major shareholder, director or a member.

Particulars (below items assumed to be debited to P/L)	Judgment	Rs.
Profit as per P/L		108
Payment to Government doctors (not legal)	1	(+) 4
Expense on supply of Indian made foreign liquor to military	2	-
Illegal payments as bribes	3	(+) 4
Payment for breach of contract (it is not for breach of law)	4	-
Non-Compete fees (eliminate competition is business advantage, thus revenue)	5	-
License fee on Y-Y basis	6	-
Debentures Issue Expenses (Including commitment charges)	7	-
Feasibility/exploration expense (if materialised can be 35D)	8	-
Settlement with landlord for early exit from premises	9	-

1.	Vishwanath Sharma (Allahabad High Court)
2.	Brihan Maharashtra Sugar Syndicate Ltd. (Bombay High Court)
3.	Pranam Foundations (Mad.)
4.	Amalgamated Development Ltd. (SC)
5.	Eicher Ltd. (Delhi High Court)
6.	Lumax Industries Ltd. (Delhi High Court)
7.	Secure Meters Ltd. (Rajasthan High Court)
8.	Vardhman Spinning & General Mills (P & H)
9.	Microsoft Corporation of India Pvt. Ltd. (Delhi High Court)

LICENSE FEE

The Delhi High Court in CIT v. Lumax Industries Ltd. [2008] 173 Taxman 390 held that payment of license fee on year-to-year basis or recurring basis to acquire technical information to increase efficiency and productivity would constitute revenue expenditure in the whole and not just 75% of it. The Court found sufficient support from the Board's Circular No. 21, dated 9-7-1969. In this case the AO made the disallowance for the first time in a period of ten years so that the Court had to hold that there was no reason as to why after a gap of 10 years the AO had suddenly changed his mind.

DEBENTURE ISSUE EXPENSES/COMMITMENT CHARGES

The Rajasthan High Court in CIT v. Secure Meters Ltd. [2008] 175 Taxman 567 held that debenture issued is a loan and, thus, expenditure incurred in issuing any debentures and raising loan as debentures is admissible, irrespective of fact whether it is convertible or non-convertible.

The Gujarat High Court in CIT v. Mihir Textiles Ltd. [2009] 176 Taxman 428 held that commitment charges payable in connection with the issue of debentures for working capital are allowable as a deduction under section 37 or even under section 36(1).

FEASIBILITY/EXPLORATION EXPENSES

In CIT v. Vardhman Spinning & General Mills [2009] 176 Taxman 157 (Punj. & Har.), the assessee spent certain amount to explore the possibility of setting up of a paper project which did not materialise. The Punjab & Haryana High Court in allowing such expense held that no asset of permanent nature with enduring benefit was acquired by the assessee and also for the reason that such expenditure could possibly have been capitalized if the plant was set up.

SETTLEMENT WITH LANDLORD

In CIT v. Microsoft Corporation of India Pvt. Ltd. [2009] 176 Taxman 395, the Delhi High Court held settlement expenses for an early exit from its premises as allowable. In this case, the following facts were understood as meeting the tests of 'commercial expediency':

- (i) the assessee could avoid the payment of Rs. 3,70,53,924 as user charges for the unexpired period between August, 1999 to July, 2000;

- (ii) it would get immediate return of its interest free security deposit lying with 'P' in the sum of Rs. 6,15,81,997, after netting off the settlement expenses on which it could earn a return in the form of interest or otherwise;
- (iii) it would avoid the payment of discount charges of Rs. 1,26,35,881 as demanded by 'P' for immediate payment of interest free security deposit;
- (iv) it would save money towards payment of rent not only for two premises, but would also save an amount of not less than Rs. 10 lakhs per month by shifting to the new premises; and
- (v) it would avoid not only expenditure in the form of litigation costs, but would also avoid the attendant expenses in the form of productive time spent by its officers/executives looking after the litigation.

RENOVATION EXPENSE

In CIT v. Dr. A.M. Singhvi [2008] 168 Taxman 136 (Raj.), the assessee-advocate carried out extensive repairs and renovation in the leasehold office premises. The Rajasthan High Court held such expenditure as revenue in nature having been incurred for smooth working of the business and to see that profession is carried out more efficiently and more profitably leaving the fixed capital untouched. Also in Roger Enterprises (P.) Ltd. v. CIT [2008] 169 Taxman 41, the Delhi High Court held that renovation expenditure involving change of flooring in leased premises would be revenue in nature.

TECHNICAL KNOW-HOW LICENSE

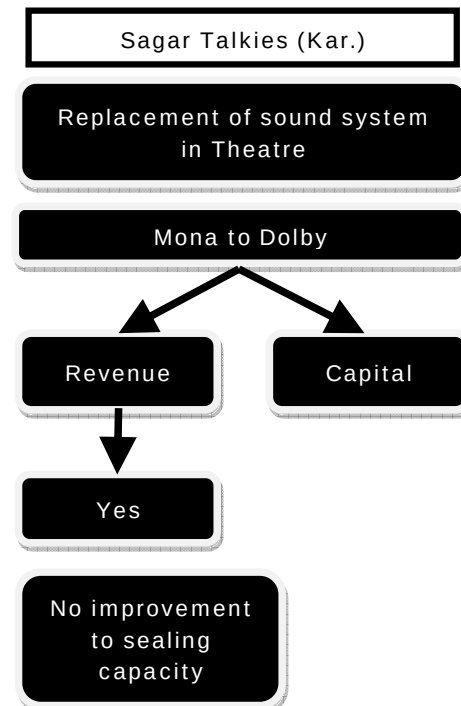
The Delhi High Court in Shriram Pistons & Rings Ltd. v. CIT [2008] 171 Taxman 81 held that technical know-how payments would be revenue in nature, unless there is absolute transfer of any right therein so that:

- (a) the licensee has a unhindered/free hand to sub-license with no prior permission of the licensor;
- (b) the licensee is not obliged to treat the same as confidential;
- (c) the agreement does not provide for any exit clause .

To say so in many words, the Court held that in case the assessee's rights were hedged in with all sorts of conditions, then that would clearly make it a case of right to use the technology and not sale of the technical know-how, no matter the kind of nomenclature used in the agreement.

THEATRE BUSINESS - REPLACEMENT/CHANGE OF SOUND SYSTEM

In CIT v. Sagar Talkies [2008] 173 Taxman 12 (Kar.) the old sound system was in existence for several years and due to use of that very sound system for several years, the old system had worn out. So the assessee replaced the old mono-sound system of its theatre with a new dolby stereo system and treated it as a revenue expenditure. The fact that it had not benefited the assessee in any way with regard to its total income, since there was no change in the seating capacity of its theatre or increase in the tariff rate of the ticket the Court held such expenditure on replacement of sound system as revenue in nature.



IMPORTED CAPITAL SPARES

Once more the revenue has battled for capital expenditure and alleged in the case of CIT v. Composite Tools Co. (India) Ltd. [2008] 173 Taxman 363 (Jharkhand) that the expenditure debited under the head 'Repairs and maintenance' is capital in nature for the reason that such expenditure equalled to as much as 20% of the capital cost in the books (actually found to be the written down value). In this case it was the Commissioner who in the exercise of powers under section 263 levelled such a charge. However, on examination by the Tribunal it was found that most of it related to imported consumable spares and only some of the items related to repairs so that the Jharkhand High Court upheld the claim of the assessee.

ACCESS TO TECHNICAL INFORMATION/KNOW HOW

The Delhi High Court in CIT v. J. K. Synthetics Ltd. [2009] 176 Taxman 355 held a payment as revenue in nature when it signified the following features:—

- (i) that the agreement envisaged only 'access' to technical information, that is, know-how related to process of manufacture, which was not related to any secret process or patent rights or even right to use a trademark or trade name under agreement;
- (ii) that there was no transfer of ownership with respect to process and know-how in favour of assessee; and
- (iii) that under the agreement the vendor was obliged to give advice only for a period of 7 years.

CSR (CORPORATE SOCIAL RESPONSIBILITY) EXPENDITURE

In CIT v. Madras Refineries Ltd. [2009] 177 Taxman 8 the Supreme Court returned the question on the allowance of deduction under section 37(1) for aid given by the assessee to residents living in vicinity of its factory for examination of the Tribunal. In the previous instance the Madras High Court in CIT v. Madras Refineries Ltd. [2004] 266 ITR 170/138 Taxman 261 held that the amount spent for bringing drinking water as also for establishing or improving the school meant for the residents of the locality in which the business was situated could not be regarded as being wholly outside the ambit of the business purpose of the assessee, especially where the undertaking owned by the assessee was one which was to

some extent a polluting industry. As there was no finding on the issue of aid per se in the judgment of the High Court the Apex Court drove it back to the Tribunal.

The fact that the Apex Court did not disagree on the other expenditure on drinking water/school project, impliedly holds that social costs or more particularly CSR (Corporate Social Responsibility) expenditure, whether capital or revenue are admissible business deductions.

AIRCRAFT HIRE

In CIT v. United Hotels Ltd. [2009] 177 Taxman 417 (Delhi), the assessee running hotel business paid an amount of Rs. 1.19 crores to an associate towards annual entitlement fee in terms of an agreement for the purpose of availing certain fixed flying hours annually at discounted rates on charter hire basis of a Jet Aircraft for use by the assessee's directors, executives, hotel guests and employees. Under the agreement, the assessee was entitled to avail of a maximum of 35 flying hours in a year for an annual fixed charge of Rs. 1.19 crores plus variable costs at the rate of Rs. 65,000 per flying hour as against the market rate of Rs. 1.25 lakhs per hour. The assessee was committed to the payment of fixed charges irrespective of the fact as to whether the assessee utilized any of the flying hours or not. In the present case, the assessee was not able to utilize the flying hours, however, the said sum of Rs. 1.19 crores became payable on account of annual fixed charges. The Assessing Officer did not allow this amount as a deduction on the plea that there was no utilization of the flying hours whereas the Tribunal held that there was commercial expediency for entering into such an agreement and that the assessee had negotiated the flying rates at a concessional price. The Delhi High Court chose not to interfere with such finding of the Tribunal.

Particulars (below items assumed to be debited to P/L)	Judgment	Rs.
Profit as per P/L		108
Access to Technical Information (No transfer of ownership of process	1	-
Aid given to residents living in vicinity of factory, school, water, drinking facility (SR-Expense)	2	-
Aircrafts hire (Use of directors employees for Business purposes) (Hours contracted 100, but used 60) (Full-100 hrs expense allowed on commercial expediency)	3	(+) 4
Wage Settlement	4	-
Wage Revisions (events occurring after B/S date	5	-
Long Service Award (provision) (Not a contingent liability, based on actuarial valuations)	6	-
Retrenchment compensation (For close of unit) (If it is for close of business it cannot be allowed)	7	-

1.	J. K. Synthetics Ltd. (Delhi High Court)
2.	Madras Refineries Ltd. (SC)
3.	United Hotels Ltd. (Delhi)
4.	Kerala State Financial Enterprises Ltd. (Kerala High Court)
5.	Employees Consumer Co-operative Society Ltd. (Delhi)
6.	Insilco Ltd. (Delhi High Court)
7.	DCM Ltd. (Delhi High Court)

WAGE SETTLEMENT

The Kerala High Court in CIT v. Kerala State Financial Enterprises Ltd. [2009] 178 Taxman 449 held that in a wage settlement the assessee following mercantile basis of accounting would be entitled to claim deduction of wage increase attributable up to the end of the previous year, no matter receipt of approval by the Government in the subsequent year.

LONG SERVICE AWARDS

The Delhi High Court in CIT v. Insilco Ltd. [2009] 179 Taxman 55 held that provision for 'long service award' estimated on actuarial calculations under a scheme would be a deductible as business expenditure like gratuity. In this case the assessee engaged an actuary to carry out an actuarial calculation as regards the provision which it would be required to make in respect of the liability on account of 'long service award' as envisaged in the scheme evolved by it.

This decision would benefit all companies that have a scheme for payment of long service award on completion of required service or even those who do not have such scheme can now frame such a scheme which would benefit the company as well as the employees. Such companies can now make a provision on actuarial basis in their books.



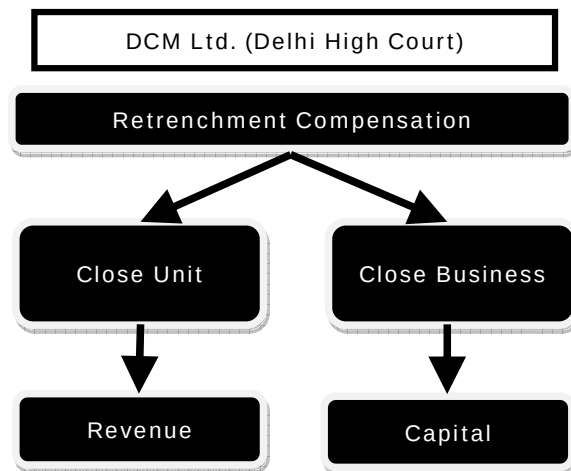
CLOSURE OF UNIT

In CIT v. DCM Ltd. [2009] 179 Taxman 296 the assessee incurred certain obligation pertaining to closed unit on account of retrenchment compensation to employees; interest on monies borrowed for payment of retrenchment compensation; provident fund and legal expenses. The Tribunal in this case held that there was no closure of business, as such, since DCM Mill unit was only a part of the textile manufacturing operations, which continued even after the closure of the DCM Mill Unit as the assessee continued in the business of manufacture of textiles in the three remaining units. The Tribunal further noted that the assessee had 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, that all important policy decisions were taken at the Head Office. The Tribunal also noted the fact that the Head Office provided funds required for various units; and that there were common marketing

facilities for all textile units. It, thus, held that there was inter-connection; inter-lacing and unity of control and management; common decision making mechanism and use of common funds in respect of all four units so that it allowed claim for deduction of expenses pertaining to units closure. Affirming the order of the Tribunal the Delhi High Court held that there was no closure of the business, as such, so that the expenditure pertaining to unit under closure was held as admissible.

The Delhi High Court in CIT v. Modi Spg. & Wvg. Mills Co. Ltd. [2007] 292 ITR 479 upheld allowance of deduction of closure compensation

and notice fee paid on account of the closure of its unit in Haryana due to the prohibition policy. Even the judges have dismissed the Department's special leave petition, CIT v. Williamson Financial Services [2008] 297 ITR 17 (SC).



PRE-PAYMENT PREMIUM FOR DEBT RESTRUCTURING

The Delhi High Court in CIT v. Gujarat Guardian Ltd. [2009] 177 Taxman 434 held that that pre-payment premium paid to the IDBI was nothing, but interest. Further since it was paid to a public financial institution, i.e., IDBI, in terms of section 43B(d), the assessee's claim for deduction could only have been allowed in the year in which the payment had actually been made and there was no scope for spreading over the liability over a period of 10 years, as was sought to be done by the Assessing Officer and the Commissioner (Appeals).

DEVELOPMENT CHARGES TO BECOME MEMBER OF STOCK EXCHANGE

In Rajendra Kumar Bachhawat v. CIT [2007] 158 Taxman 54/276 ITR 567 (Cal.) the assessee paid a sum of Rs. 25 lakhs for development purposes for the purpose of becoming a member of the Calcutta Stock Exchange and claimed that the sum was revenue expenditure. It made a claim for deduction thereof in ten equal parts, in ten successive assessment years. The Kolkata High Court held that since an enduring benefit accrued to the assessee, the expenditure in question was of capital nature. Further it held that that there was no provision in the Act entitling the assessee to carry forward revenue expenditure after dividing it, according to the assessee's own wish, to subsequent years.

REDEMPTION FINE

In CIT v. Jayaram Metal Industries [2007] 158 Taxman 169 (Kar.) the assessee paid a sum of Rs. 2 lakhs as redemption fine to the Central Excise Authorities to redeem the finished goods confiscated for suppression of production. The Karnataka High Court held the Tribunal committed a legal error in allowing deduction of such sum.

RE-LOCATION OR RE-ADJUSTMENT OF MACHINERY

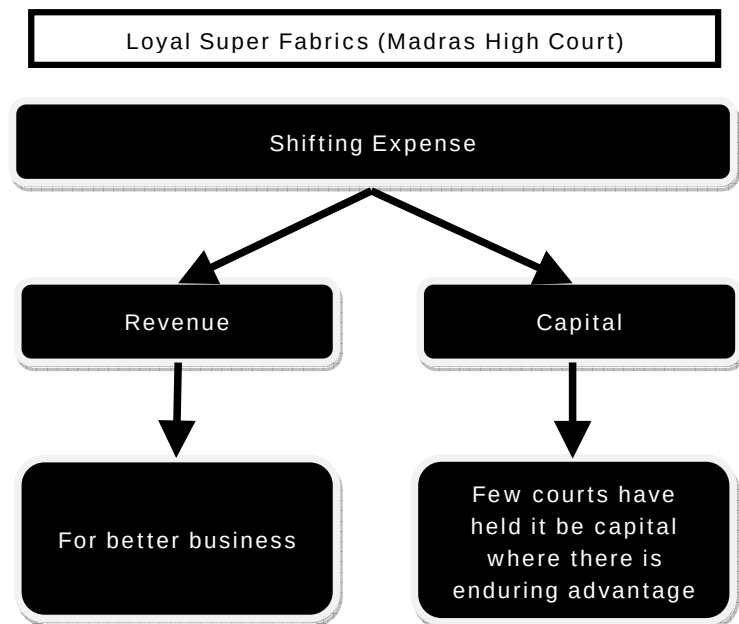
In CIT v. Brakes India Ltd. [2007] 161 Taxman 47 (Mad.), the assessee had to move its plant within the factory from one location to the other for better output, hence, the expenditure incurred during such transfer was held to be revenue in nature. Similarly, the expenditure for moving of land and sand from one area to another that would help the assessee as it had helped for storing water would be only revenue

in nature. Interestingly, to hold such a view, the Madras High Court did not take help of any previous Court decision.

FACTORY/OFFICE/SHOP

SHIFTING

The Madras High Court, in CIT v. Loyal Super Fabrics [2007] 163 Taxman 136, held that expenditure incurred in factory shifting to secure its survival or for compelling reasons is to revenue account. On the contrary if such shifting is to benefit certain trading or business advantage it could be revenue. In this case, shifting was due to objection of the public. This timely decision would benefit all those who have set shops elsewhere due to recent ceiling initiatives in the State capital.



EXPANSION EXPENDITURE

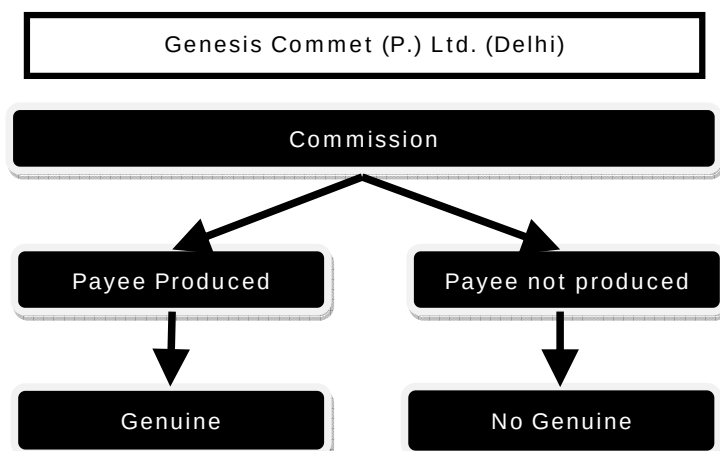
In CIT v. Usha Iron & Ferro Metal Corpn. Ltd. [2007] 163 Taxman 256 (Delhi), the assessee succeeded in getting deduction of substantial expenditure incurred in the setting-up of raw material plant for the existing business no matter it had capitalized such revenue expenditure in its books.

INCOME REVERSAL

In CIT v. Punjab State Industrial Development Corpn. Ltd. [2007] 163 Taxman 457 (Punj. & Har.), the assessee was to refund interest earlier charged on loans on the basis of instruction received from the IFCI and for the fact that the books of account of the assessee were open on such date it was allowed a deduction of such reversal on the grounds of commercial expediency.

FAILURE TO PRODUCE PARTIES

In CIT v. Genesis Commet (P.) Ltd. [2007] 163 Taxman 482 (Delhi), the Assessing Officer disallowed commission sums on the failure of the assessee to produce the parties. In reversing such decision, the Delhi High Court held that the Assessing Officer in the alternate could have summoned such parties or would have made independent enquiries by himself from the customers and since he had failed in this regard the assessee had



succeeded.

ORAL ADVICE

In CIT v. Mico Ltd. [2007] 163 Taxman 510 (Kar.), the assessee having made an annual payment of Rs. 5,50,000 for obtaining certain advice and guidance for marketing its products made a claim for deduction when the Assessing Officer decided to hold on to such allowance for want of any written advice. The Court held that advice need not be in writing so that such claim was held admissible on the basis of agreement between the parties.

ROYALTY TO FOREIGN COLLABORATOR

The MP High Court, in CIT v. Eicher Motors Ltd. [2007] 163 Taxman 556, held that periodic royalty payments are outlay for earning profits in the normal course of business than an expenditure with the object of acquiring an advantage or assets of enduring nature for the benefit of trade.

REHABILITATION EXPENSES

In International Airports Authority of India v. CIT [2007] 163 Taxman 620 (Delhi), the assessee made certain payments to the Delhi Development Authority for development of an alternative site for rehabilitation of villagers who were evicted from their land to make way for airport extension. The Delhi High Court held it to be capital in nature.

ISSUE OF PARTLY CONVERTIBLE DEBENTURE

In regard to the expenses incurred on partly convertible debenture in CIT v. South India (Corpn.) Agencies Ltd. [2007] 164 Taxman 249, the Madras High Court allowing such deduction under section 37(1), held that issue of shares is a future event which may or may not happen. The Court emphasized that at present, the expenditure incurred was on the issue of debentures only and, hence, the expense incurred on obtaining a loan was a revenue expenditure.

MS OFFICE SOFTWARE

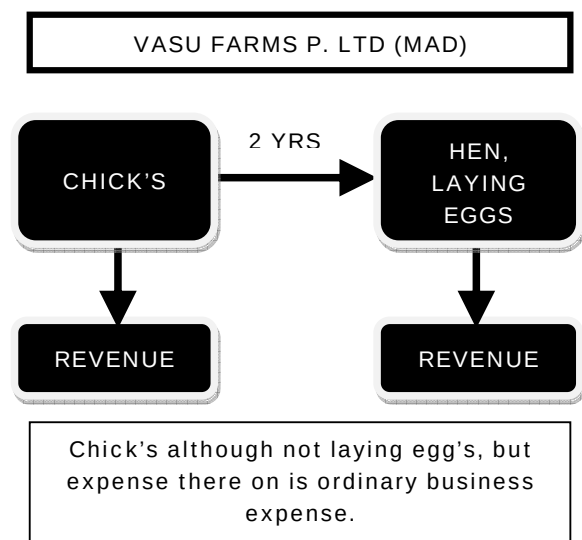
The Delhi High Court in CIT v. G E Capital Services Ltd. [2007] 164 Taxman 46, held that expenditure incurred on MS office software which is not customized software and which software requires frequent upgradation is an allowable business expenditure whereas according to it only customized software can have an enduring value.

LOOSE TOOLS WRITE OFFS

In South India Corporation (Agencies) Ltd.'s case (supra), the Assessing Officer, while permitting the write off in principle held that 20 per cent of the value of the tools so written off would be realisable as scrap value so that it disallowed the claim to that extent. The Madras High Court, however, upheld the finding of the Tribunal which held that if and when such tools are sold, the same would be brought into the profit and loss account so that the assessee stands entitled to full write off benefit.

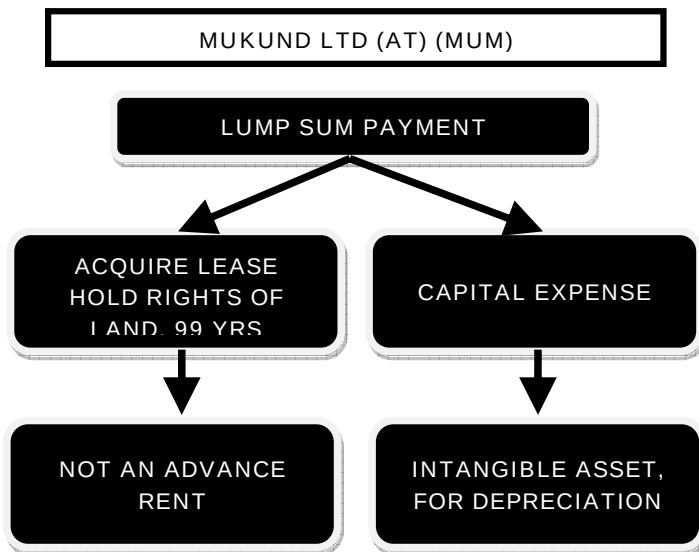
287 ITR 0038- COMMISSIONER OF INCOME-TAX VS. VASU FARMS P. LTD. (MADRAS HIGH COURT)

In a poultry farm, chicks which lay eggs may be understood as capital assets, so that the Assessing Officer took the view that any expenditure on them till the date on which such chicks start laying eggs, would be capital expenditure. According to the Assessing Officer, they can only add to the cost of chicks to be allowed on sale of chicks or on their death. The Tribunal, however, found that chicks are also livestock and that laying of eggs by them was due to biological and physical changes in them. It was also not possible to predicate that all chicks would lay eggs at any particular point of time. All that matters is that, poultry farming is the assessee's business and that all such expenditure even during pre-layer stage would be business expenditure. The High Court endorsed the view in CIT v. Vasu Farms P. Ltd. [2006] 287 ITR 38 (Mad). It was found that such expenditure is of revenue nature, so that it cannot be disallowed.



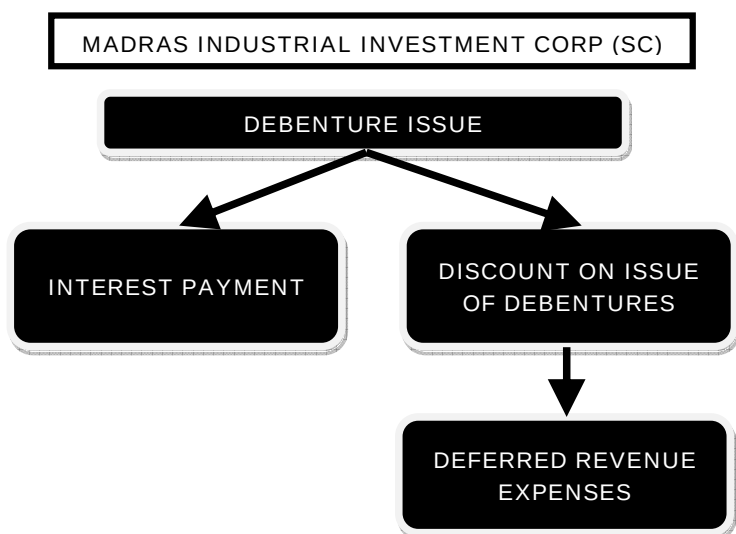
**291 ITR (A.T.) 0249- JOINT COMMISSIONER OF INCOME-TAX VS. MUKUND LTD.
(INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)**

All the essential ingredients for treating the amount of Rs. 2.04 crores paid by the assessee for acquisition of leasehold rights for 99 years in the land as capital in nature were present. The lease was for a period of 99 years, which was as good as a perpetual lease in favour of the assessee. The benefit conferred on the assessee of lease rights for 99 years against the lump sum payment of Rs. 2.04 crores was of enduring nature.



There was no material on record to suggest that the amount of Rs. 2.04 crores was an advance payment of rent to the MIDC for the period of lease paid in lump sum by the assessee-company. The terms of the agreement entered into between the assessee and the MIDC clearly mentioned that a sum of Rs. 2.04 crores was the amount of deposit to be adjusted towards “premium” payable by the licensee for the allotment of 50 acres of land in the industrial area. The agreement provided that in the case of termination of lease, the “premium” was non-refundable and in case the licensee failed to complete the said factory building within the time and in

accordance with the stipulations provided therein, the MIDC without making any compensation or allowance or refund or repayment of the premium could resume the land in question. If the assessee terminated the lease agreement and handed over vacant possession of the land to MIDC prior to the expiry of the lease period of 99 years, it was not entitled to any refund out of the amount of Rs. 2.04 crore. Thus, the “premium” could not be considered advance payment of rent. There was also no material on record to show that the assessee had made the advance payment of rent for future years to secure any reduction in the rent payable for the future years or for any other business consideration. Considering the totality of the facts and circumstances of the case and the terms of the agreement as a whole, the consideration of Rs. 2.04 crores paid by the assessee-company for obtaining the leasehold rights from MIDC for a period of 99 years was capital in nature and therefore, not allowable as deduction to the assessee.



Expenses consequent on discounted issue of commercial papers is allowable as business expenditure as held in Joint CIT v. Mukund Ltd. [2007] 291 ITR (AT) 249 (Mum) (SB). In fact, it should have made no difference even if it were incurred for long-term debentures following the decisions of the Supreme Court in India Cements Ltd. v. CIT [1966] 60 ITR 52 and Madras Industrial Investment Corporation Ltd. v. CIT [1997] 225 ITR 802.

291 ITR 0001- COMMISSIONER OF INCOME-TAX VS. GLEN VIEW RUBBER CO. P. LTD. (KERALA HIGH COURT)

When a water treatment plant is installed permanently in compliance with the statutory requirement the same would attain the character of capital expenditure. A water treatment plant of permanent nature had come into existence with enduring advantage to the assessee. A water treatment plant is a chargeable asset installed to prevent pollution. The question as to whether by installation of this plant, production of centrifuged latex had been increased or not was immaterial. Failure to comply with the statutory requirements of installation of water treatment plant would lead to closure of the factory and hence there was no question of any increase in the manufacture or production in the plant. The water treatment plant installed by the assessee consisted of various chambers namely equalisation tank, primary settling tank, mixing channel, aeration tank, secondary settling tank and drying bed. The plant installed was a permanent tangible asset of enduring advantage to the assessee, of a pollution free atmosphere and environment. The benefit/advantage derived by the assessee was not only for the year under consideration but for all succeeding assessment years. Expenditure spent for its operating and maintenance costs may be revenue, but the expenditure spent for installation of the plant was capital expenditure.

CIT v. Steel Complex Ltd. [1999] 238 ITR 1054 (Ker) commented upon and held confined to facts of the case.

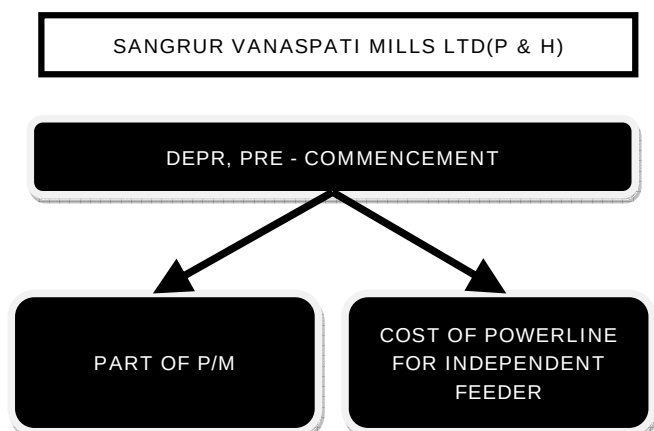
291 ITR 0107- DEPUTY COMMISSIONER OF INCOME-TAX VS. MCDOWELL AND CO. LTD. (KARNATAKA HIGH COURT)

Payment of non-compete fee to the extent of Rs. 1 crore to a company, while acquiring its distillery was found deductible in Deputy CIT v. McDowell and Co. Ltd. [2007] 291 ITR 107 (Karn). In coming to the conclusion, the decision of the Madras High Court in CIT v. G. D. Naidu [1987] 165 ITR 63 was followed.

288 ITR 0222- SANGRUR VANASPATI MILLS LTD. VS. COMMISSIONER OF INCOME-TAX (PUNJAB AND HARYANA HIGH COURT)

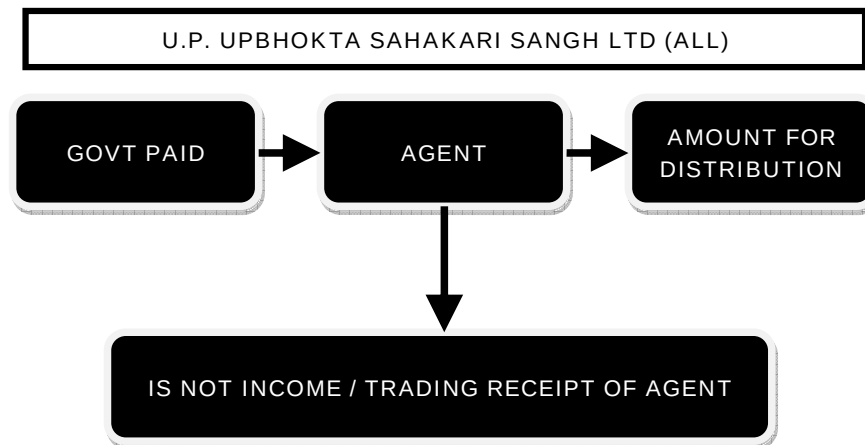
The expenditure incurred by the assessee on the cost of powerline for independent feeder, incurred prior to commencement of production, had to be treated as part of plant and machinery being necessary for commencement of production and had to be capitalized.

Expenditure incurred prior to the commencement of business would be on capital account. To the extent such expenditure has nexus with the assets, it would stand capitalised so that the value of such asset along with capitalised expenditure relating thereto, would be entitled to depreciation from the year the assets are put to use. This is the principle decided by the High Court in Sangrur Vanaspati Mills Ltd. v. CIT [2007] 288 ITR 222 (P&H). In this case, the claim related to the cost of temporary electric connection, power line and inspection fee relating thereto, treated as part and parcel of the plant and machinery, a treatment which was accepted by the High Court.



288 ITR 0106- COMMISSIONER OF INCOME-TAX VS. U. P. UPBHOKTA SAHKARI SANGH LTD. (ALLAHABAD HIGH COURT)

Whatever is received by an assessee need not necessarily belong to it. Where a co-operative society

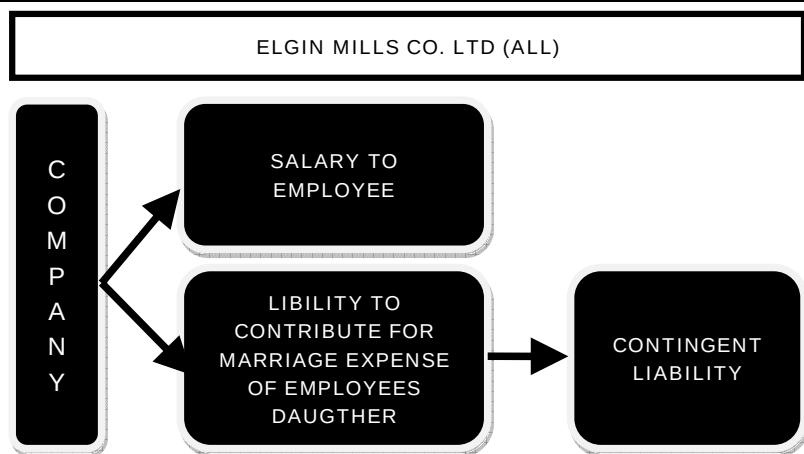


received a certain sum from the Government of Uttar Pradesh for disbursement to its bhandars (distribution centres) to meet expenses of salary of certain employees, through the society under an order of the U. P. Government, such amount cannot be treated as income of such co-operative society. Though the principle of diversion by overriding title

was not referred to, it was found that the amount did not have the character of income in the hands of the assessee. The order of the Tribunal to this effect was upheld by the High Court in CIT v. U. P. Upbhokta Sahkari Sangh Ltd. [2007] 288 ITR 106 (All).

288 ITR 0085- ELGIN MILLS CO. LTD. VS. COMMISSIONER OF INCOME-TAX (ALLAHABAD HIGH COURT)

Liability to contribute to expenditure of marriage of daughters of employees is a liability contingent in nature. Actual contribution in year alone deductible.



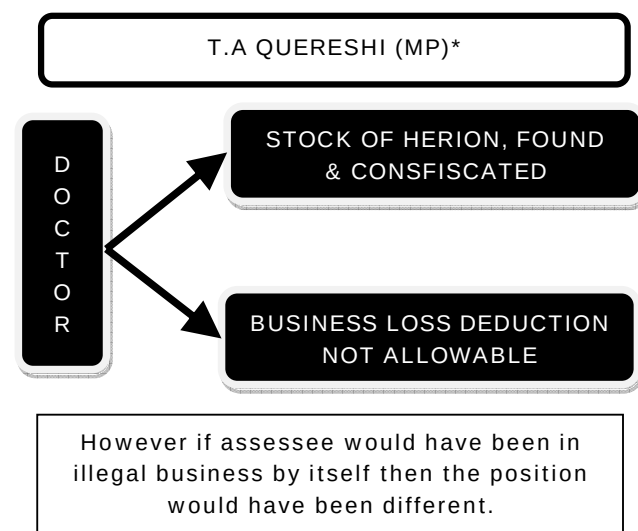
[2007] 288 ITR 0015- COMMISSIONER OF INCOME-TAX VS. SOUTHERN ROADWAYS LTD. (MADRAS HIGH COURT)

Computer is a capital asset, so that its cost is not admissible as a revenue expenditure. The assessee is only entitled to depreciation, but that does not mean that the cost of upgrading should be capital expenditure. The High Court in CIT v. Southern Roadways Ltd. [2007] 288 ITR 15 (Mad) made an apt reference to the observation in Alembic Chemical Works Co. Ltd. v. CIT [1989] 177 ITR 377 (SC) in the following words (page 17) :

“What is capital expenditure and what is revenue are not eternal verities but must needs be flexible so as to respond to the changing economic realities of business. The expression ‘asset or advantage of an enduring nature’ was evolved to emphasise the element of a sufficient degree of durability appropriate to the context.”

Upgradation is not an enduring benefit. The High Court, therefore, allowed the deduction following the rationale of its own earlier decision in CIT v. Janakiram Mills Ltd. [2005] 275 ITR 403 (Mad).

Another way of saying that upgradation of computers by changing certain parts thereby enhancing the configuration of the computers for improving their efficiency, but without making any structural alterations is not change of an enduring nature. The expenditure incurred by the assessee had therefore to be treated as revenue expenditure. Alembic Chemical Works Co. Ltd. v. CIT [1989] 177 ITR 377 (SC) applied.



287 ITR 0547- DR. T. A. QUERESHI VS. COMMISSIONER OF INCOME-TAX (SUPREME COURT OF INDIA)

The assessee, a medical practitioner, claimed deduction of the value of heroin seized from his gross income. The Department denied the deduction. On appeal the Appellate Tribunal held as a fact that heroin was a part of his stock-in-trade and allowed deduction of the estimated value of the heroin seized from the gross income as a business loss. On appeal the High Court held that the rigour of the Explanation to section 37 of the Income-tax Act, 1961, was fully satisfied, that

possession of heroin was an offence, that it was disgraceful for a doctor to indulge in activities against

humanity, and that hence the question of claiming deduction of the value of the seized article did not arise. On appeal to the Supreme Court Held, reversing the decision of the High Court, (i) that the Explanation to section 37 had no relevance as this was not a case of business expenditure but was one of business loss. Business loss was allowable on ordinary commercial principles in computing the profits. Once it was found that the heroin seized formed part of the stock-in-trade of the assessee, it followed that the seizure and confiscation of such stock-in-trade had to be allowed as a business loss.

This decision of the Supreme Court in Quereshi's case (supra) is a watershed in development of income-tax law in distinguishing business loss from business expenditure to which alone the restrictive Explanation to section 37 would be applicable.

286 ITR 0232- COMMISSIONER OF INCOME-TAX VS. GENERAL INSURANCE CORPORATION (SUPREME COURT OF INDIA)

Issuance of bonus shares by a company does not result in any inflow of fresh funds or increase in the capital employed, the capital employed remains the same. Issuance of bonus shares by capitalization of reserves is merely a reallocation of the company's funds. Thus it cannot be held that the company has acquired a benefit or advantage of an enduring nature. The total funds available with the company will remain the same and the issue of bonus shares will not result in any change in the capital structure of the company. Issue of bonus shares does not result in the expansion of the capital base of the company. Expenditure incurred by the company on account of stamp duty and registration fees for the issue of bonus shares is allowable expenditure.

286 ITR 0211- MAHANAGAR TELEPHONE NIGAM LTD., IN RE VS. (AUTHORITY FOR ADVANCE RULING)

The assessee, a State undertaking, was entitled to liquidated damages for delayed delivery of equipment and it also received such amount. But where it was refunded to its supplier on its request and the direction of Telecom Commissioner, the question arose, whether such refund could be allowed as a deduction in computation of business income in Mahanagar Telephone Nigam Ltd. In re [2006] 286 ITR 211 (AAR). It was found that the amount was not deductible since the amount was in relation to a transaction on capital account. If what is received is a capital receipt, what is repaid out of the same would not have a different character. It cannot, therefore, fall under section 37 or 57, as was decided in this case.

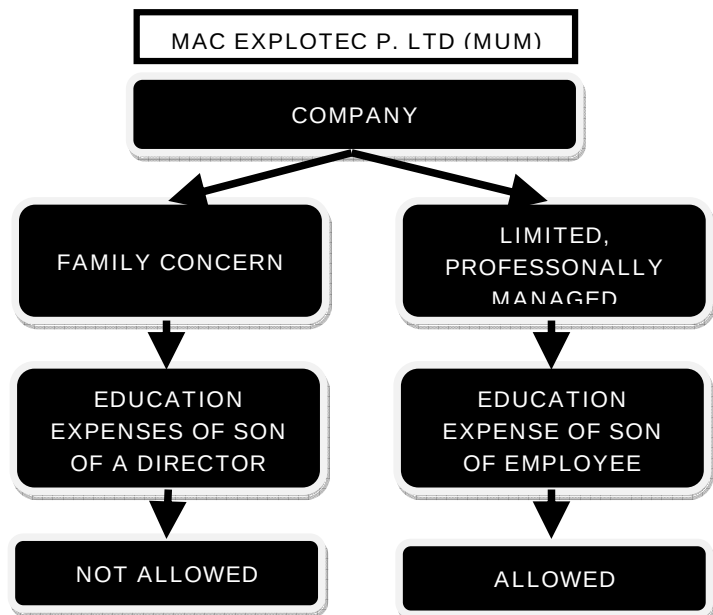
286 ITR 0403- COMMISSIONER OF INCOME TAX VS. JAYARAM METAL INDUSTRIES (KARNATAKA HIGH COURT)

Where the assessee paid an amount of about Rs. 2 lakhs as redemption fine to redeem confiscated goods from the Central Excise Department and it debited the sum to the purchase account, such payment being in the nature of penalty for infraction of law, could not be allowed as a deduction. Where it had been earlier allowed, it could be withdrawn by way of re-assessment within longer time, because the assessee had debited the expenditure to the purchase account and thereby failed to disclose the information. The High Court in CIT v. Jayaram Metal Industries [2006] 286 ITR 403 (Karn) referred to a number of precedents including the one in Prakash Cotton Mills P. Ltd. v. CIT [1993] 201 ITR 684 (SC) on the merits, while distinguishing on the facts the decision of the Madras High Court in CIT v. N. M. Parthasarathy [1995] 212 ITR 105, where it was observed that the rule relating to an amount payable for infraction of law was held to be not an inflexible rule. It was found that if such amount is allowed as a

deduction, it would be a premium for violators for the purpose of tax benefit. Actually, the issue of deductibility of redemption fine is covered by the decision of the Supreme Court against the taxpayer in Haji Aziz and Abdul Shakoor Bros. v. CIT [1961] 41 ITR 350.

286 ITR 0378- MAC EXPLOTEC P. LTD. VS. COMMISSIONER OF INCOME-TAX (KARNATAKA HIGH COURT)

The cost of meeting educational expenses of one's child is on the parent. Such expenditure is not ordinarily deductible from business income of such parent. Where a family company meets the cost of education of the son of the directors, who were both husband and wife, for meeting the cost of normal education and not any specialised training necessary for running the business, the amount is not deductible. It was so held in MAC Explootec P. Ltd. v. CIT [2006] 286 ITR 378 (Karn). The decision would, therefore, be an authority even for deduction, where the educational expenses are given to an employee for further specialised education suitable for the company, even if he were related to the directors. It is to be established, that the expense was incurred in the interest of the company, which can be done only with reference to the facts of the case.



285 ITR 0330- N. K. LEASING AND CONSTRUCTION P. LTD. VS. COMMISSIONER OF INCOME-TAX (ANDHRA PRADESH HIGH COURT)

Where the assessee claimed to have transferred shares in two companies acquired in 1986 as a part of settlement for acquiring shares and retaining control in a third company with the assessee undertaking not to interfere with the control and management of these two companies, the argument of the assessee was that there was only a settlement, so that the amount receivable and adjusted would be a capital receipt without giving rise to capital gains tax. On the other hand, the Revenue's contention was that it was a sale simpliciter and that the assessee had acquired the shares with a view to resell the same at a profit and that it is not a mere investment, so that the surplus would be in the nature of business income. The Tribunal held in favour of the Revenue on both counts. It found that the transaction could not be treated as an investment independent of the trading activity of the company. It also found that, what was received by the assessee as shares was consideration for the shares sold. What counted was the substance of the transaction and not the manner in which it is put through. It was so held in N. K. Leasing and Construction P. Ltd. v. CIT [2006] 285 ITR 330 (AP).

285 ITR 0310- COMMISSIONER OF INCOME-TAX VS. INDUSTRIAL CREDIT AND DEVELOPMENT SYNDICATE LTD. (KARNATAKA HIGH COURT)

Where the assessee repurchased debentures issued by it before the date of redemption by acquiring such debentures at a price below the face value, the issue was whether the surplus would have revenue

character or could be a capital receipt. The Karnataka High Court in CIT v. Industrial Credit and Development Syndicate Ltd. [2006] 285 ITR 310 accepted the assessee's contention that the surplus amount credited to the reserves in the balance sheet did not constitute a revenue receipt on the ground that the amount saved by the assessee by being able to discharge its liability at a lower amount could not be income of revenue nature. It was felt that, when the substance of the transaction is taken into consideration, it cannot have revenue character.

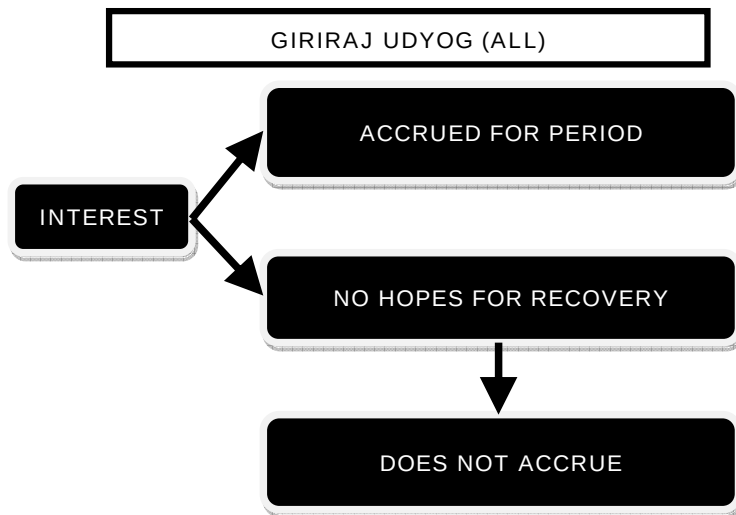
However, the decision of the Supreme Court in Madras Industrial Investment Corporation Ltd. v. CIT [1997] 225 ITR 802 was not cited before the High Court. In this case, it was held that the discount on issue of debentures is part of borrowing cost allowable on spread over basis during the life of the debenture. The question of deductibility itself was not in doubt. But the claim of the assessee to have it allowed in the same year was not considered justified, so that only the proportionate amount relating to the year was found deductible. In this case, after quoting Spicer and Pegler's Book Keeping and Accounts and Batliboi's Principles and Practice of Auditing, the Supreme Court found that the discount of debentures is to be treated as interest. It also referred to its own decision in India Cements Ltd. v. CIT [1966] 60 ITR 52 (SC), where the cost of raising debentures even for financing capital assets would still be a revenue deduction. It is an upfront payment, which could be spread over, as was decided, following this decision in CIT v. Taparia Tools Ltd. [2003] 260 ITR 102 (Bom) on the same reasoning. Bonus on redemption of debentures was allowed as a deduction in National Engineering Industries Ltd. v. CIT [1999] 236 ITR 577 (Cal). If the assessee suffers a loss on redemption of shares, such loss is a business deduction treated as cost of borrowing. A company may discharge its liability either by redeeming it on maturity or purchasing the same before such maturity. If loss is allowed by way of discount or bonus as cost of borrowing, the surplus, if any, should be taxable. Such an argument is possible. But the decision of the Karnataka High Court may still be justified, if one can make a difference between redemption on maturity and discharge by purchase of debentures. But then, such a distinction may count against the assessee, where even by repurchase of debentures, there is a net out-go, which will not be deductible on the reasoning of the Karnataka decision in Industrial Credit and Development Syndicate Ltd.'s case (supra), an inference which will be hard on the taxpayer and probably not justified in the light of the decision of the Supreme Court in Madras Industrial Investment Corporation's case (supra).

274 ITR 0011- CIT VS. SRIKRISHNA BOTTLERS P. LTD. (AP)

The assessee imported Coca Cola concentrate from a foreign country and soft drinks were manufactured therefrom. For this purpose the assessee had to procure bottles which bore the trade mark embossed on them. During the accounting year the Government prohibited use of concentrates prepared by the Coca Cola Corporation. Since the bottles were embossed with the trade mark, they could not be utilised for bottling of any other soft drinks. Thus all the bottles of the assessee became useless. The Coca Cola Corporation made an ex gratia offer of compensation to assist the bottlers through the difficult period. As the bottles had no commercial value in India and in order to prohibit their misuse, it was proposed that after counting the bottles in the factory, the bottles should be destroyed under the supervision of the Coca Cola Corporation. For the destruction of bottles the compensation was paid which is held to be revenue in nature.

273 ITR 0495- COMMISSIONER OF INCOME-TAX VS. GIRIRAJ UDYOG (P.) LTD. (ALL)

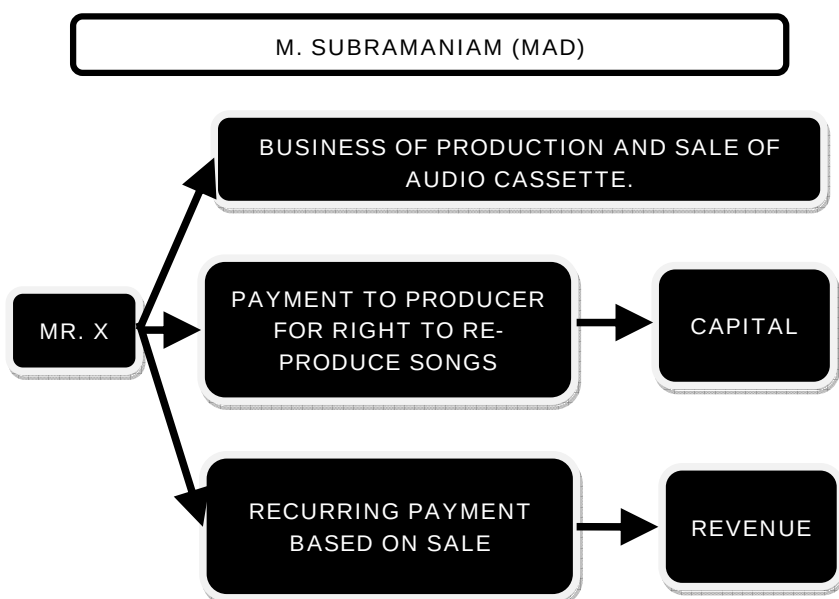
The mercantile system does not create income. It only recognises income that has accrued. Where there is no chance of recovery of the principal amounts and the assessee chooses not to charge interest on the same, the Assessing Officer is not justified in bringing to tax such interest not charged as accrued income. Such estimated income is not real income. There has been a number of decisions on the subject, which were reviewed by the High Court in CIT v. Giriraj Udyog (P) Ltd. [2005] 273 ITR 495 (All). The Tribunal had understood that it was a waiver of accrued interest prompted by business expediency, so that it was not assessable. It was this finding, which was endorsed by the High Court, while the more persuasive inference is that the income had not accrued at all as there was no prospect of recovery.

**272 ITR 0525- CIT VS. M. SUBRAMANIAM (MAD)**

The assessee was an individual engaged in the production of audio cassettes with popular film songs. He carried on the business of manufacturing pre-recorded cassettes and selling them. In order to obtain such popular songs, the assessee entered into agreements with the producers of the films for obtaining the right to reproduce the film songs. The assessee claimed that the monies paid under those agreements were in the nature of royalty and should, therefore, be allowed as revenue expenditure in computing the assessee's income.

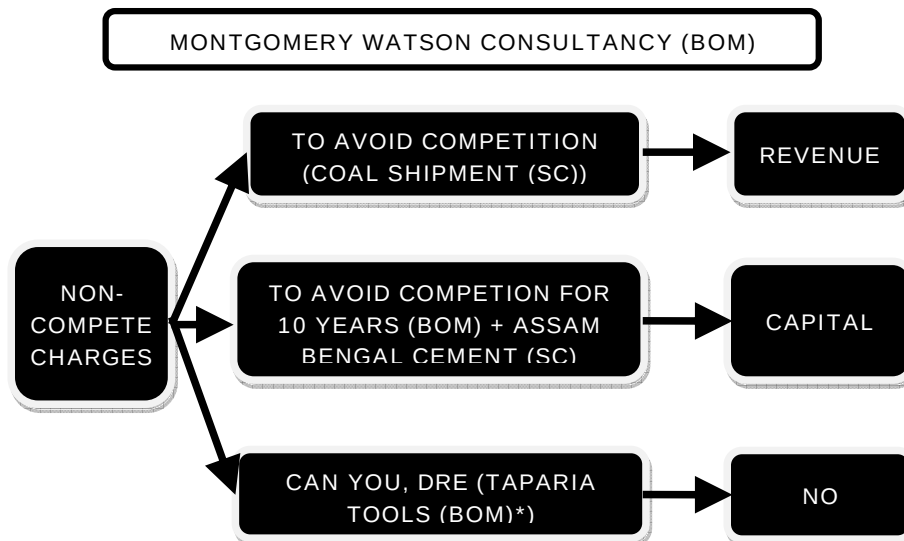
A right may be acquired either on payment of a lump sum as premium or periodically by way of rent or royalty. There could be both premium as well as rent in respect of the same transaction. Where copyright over film songs was acquired by an assessee by

payment of Rs. 500 at the time of making the agreement and was also in receipt of variable amounts depending on sales, the former, it was held would be capital expenditure and not the latter in CIT v. M. Subramaniam [2005] 272 ITR 525 (Mad). Probably in such cases, even the former payment could have been allowed as revenue expenditure.



272 ITR (A.T.) 0153- MONTGOMERY WATSON CONSULTANTS INDIA P. LTD. VS. ACIT (BOMBAY BENCH)

The assessee-company had paid the sum of Rs. 6.5 lakhs to restrain the erstwhile management for a

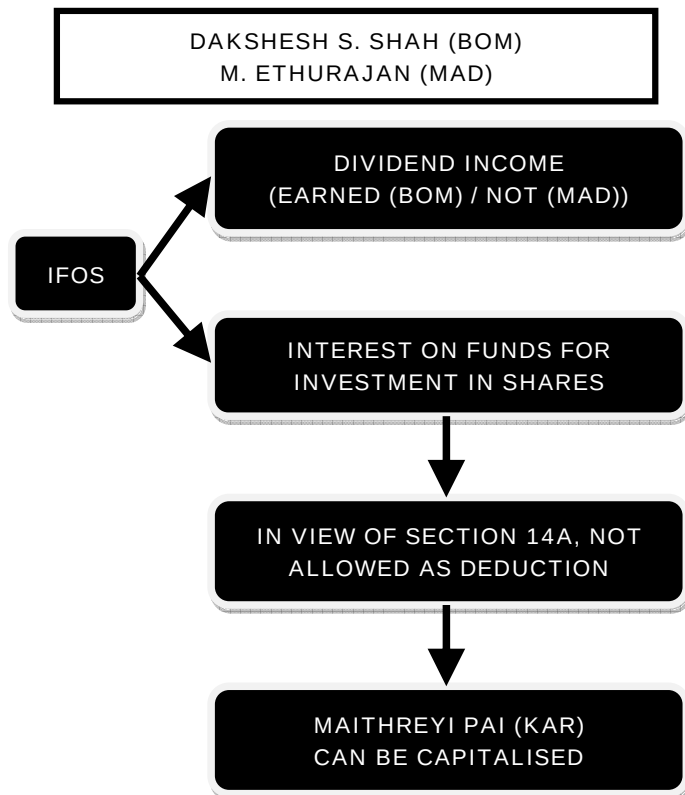


period of ten years from engaging in the same business and also to engage in several other activities as stipulated under clause of the agreement. The erstwhile management had no unilateral right to alter any of the conditions of the agreement. The payment was treated as capital expenditure by the officer. Held, (i) that the assessee-company had derived

benefit of enduring nature by entering into the agreement to ward off business competition for a sufficiently long period of ten years. Clause of the agreement was only an enabling provision to make the various conditions of the agreement valid and effective if on account of certain unforeseen circumstances such conditions became invalid. Clause could not dilute the legally binding nature of the non-competition agreement. Thus, the payment of Rs. 6.5 lakhs was in the nature of capital expenditure. CIT v. Coal Shipments P. Ltd. [1971] 82 ITR 902 (SC) and Tamilnadu Dairy Development Corporation Ltd. v. CIT [1999] 239 ITR 142 (Mad) followed. That since the expenditure was in the nature of capital expenditure it could not be allowed as deferred expenditure over a period of ten years. Taparia Tools Ltd. v. Joint CIT [2003] 260 ITR 102 (Bom) distinguished.

272 ITR (A.T.) 0131- ACIT VS. DAKSHESH S. SHAH (BOMBAY BENCH)

In order to claim deduction of expenditure under section 57(iii) of the Income-tax Act, 1961, the assessee has to show that the dividend income is assessable under section 56. The assessee had made investment in shares by obtaining loans. The Assessing Officer disallowed the interest of Rs. 4,97,090 payable to an investment company on the ground that the dividend income had been excluded from the computation of taxable income by virtue of its being exempt from tax under the provisions of section 10(33) read with section 115-O of the Income-tax Act, 1961. Since the dividend income was not chargeable under the head “Income from other sources” the Assessing Officer disallowed the interest expenditure referable to the investment under section 57 of the Act. Held that such interest was not allowable as deduction since the dividend income was exempt. Section 14A expressly prohibits allowance of such claims.



Since section 14A would specifically bar any expenditure incurred by the assessee in relation to an income “which does not form part of the total income under this Act”, one may have to be satisfied with the alternative of treating such expenditure as the cost of retaining the assets by capitalising it and getting it allowed only as the cost of improvement of the asset at the time when it is sold. There are authorities for the alternative claim as in CIT v. Mithlesh Kumari [1973] 92 ITR 9 (Delhi) ; Addl. CIT v. K. S. Gupta [1979] 119 ITR 372 (AP) and CIT v. Maithreyi Pai [1985] 152 ITR 247 (Kar).

272 ITR (A.T.) 0017- AMAR RAJA BATTERIES LTD. VS. ACIT (HYDERABAD BENCH (APPELLATE TRIBUNAL))

Expenditure on launching a new product in an existing business is fully deductible, even if the assessee had treated it as deferred revenue expenditure in its books. It was so held in Amar Raja Batteries Ltd. v. Asst. CIT [2005] 272 ITR (AT) 17. The Revenue had relied upon the decision in Madras Industrial Investment Corporation Ltd. v. CIT [1997] 225 ITR 802 (SC) for the proposition that deferred revenue expenditure can be allowed on staggered basis. It was pointed out by the Tribunal that this is distinguishable, because upfront lump sum discount was a benefit referable to a specified period of life of the bond measurable on year to year basis for use of the fund borrowed, so that there was scope for application of matching concept. But in the case of advertising outlay, it is a once-for-all payment relating to business of the assessee without any scope for inference of any definite benefit relatable to any specified number of years. Only when the benefit can reasonably be estimated year-wise, is it possible to spread over the deduction. It is also established law that accounting treatment is not conclusive of the treatment that is required under the law.

227 ITR 0465 CIT VS. SIVAKAMI MILLS LTD.; (SC)

Assessee purchased a machinery on deferred payment basis and paid interest there on. Held that interest on deferred payment basis is revenue expenditure and fully allowable as deduction under section 37 and expenditure on the account of payment of guarantee commission is fully revenue in nature and thus in its entirety is an allowable deduction under section 37. More over guarantee commission is expenditure in connection to obtain finance and thus is fully allowable deduction.

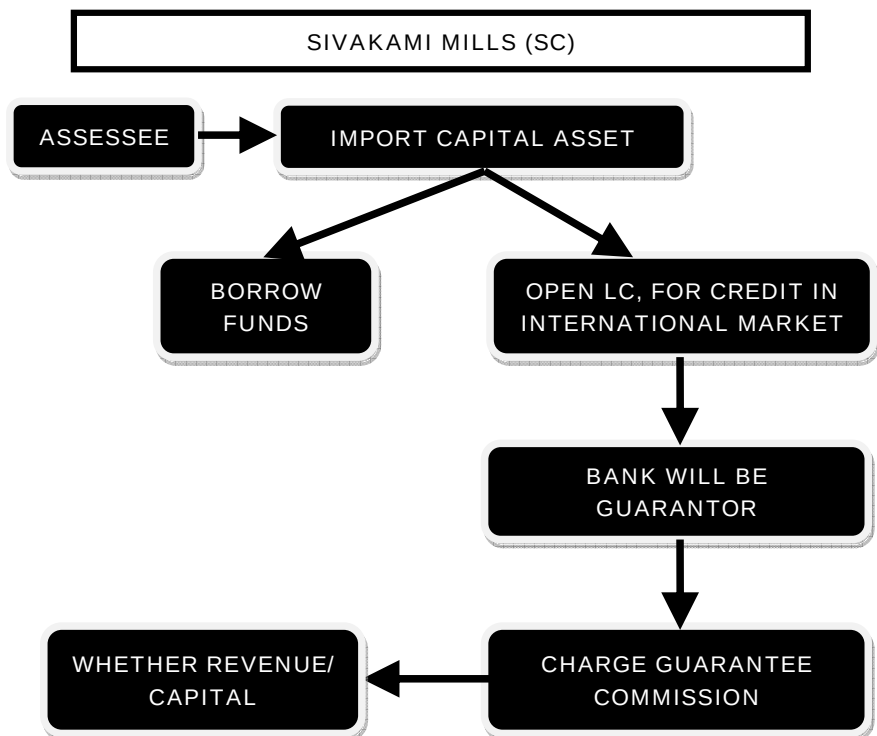
QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee company purchased a plant and machinery out of the borrowed funds in the international market and in order to obtain the finance it had to give the bank guarantee and in order to obtain the bank guarantee it had to pay commission @ 10 % of the guarantee given which was Rs. 10 Lakhs. Company is of the opinion that it must be added to the actual cost of the plant and machinery and officer is of the opinion that it is not the cost of the machinery nor it is the revenue expenditure and thus no deduction there of must be allowed. You are required to answer that whether any benefit in regards is available to assessee for the guarantee commission paid.

ANSWER

High court in case of sivakami mills case has held that such payment is so closely related to the business that it could be viewed as an integral part of the conduct of the business and would be a revenue expenditure, that it did not bring into existence any asset of an enduring nature nor did it bring in any other advantage of an enduring benefit, that the acquisition of the machinery on instalment terms was only a business exigency and that the very nature of the expenditure and the time at which it had been incurred would justify the claim of the expenditure as revenue expenditure. On appeal to the Supreme Court :

Held, affirming the decision of the High Court, that the guarantee commission paid to the bank was revenue expenditure and hence was an allowable deduction in computing the total income of the assessee. Decision of the Madras High Court in Sivakami Mills Ltd. v. CIT [1979] 120 ITR 211 affirmed by the supreme court



Such commission is financing chare, thus like expense connected with borrowal.
Thus allowed as deduction.

227 ITR 0557 VELLORE ELECTRIC CORPORATION LTD. VS. CIT; (SC)

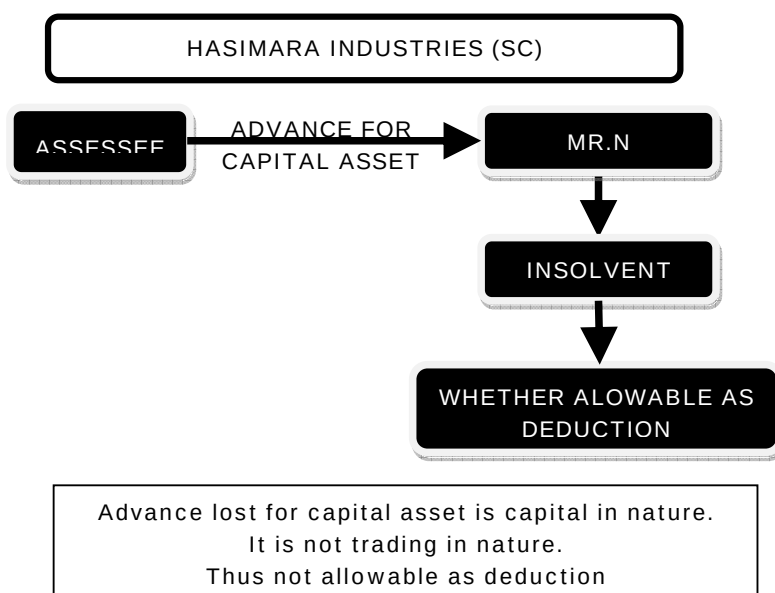
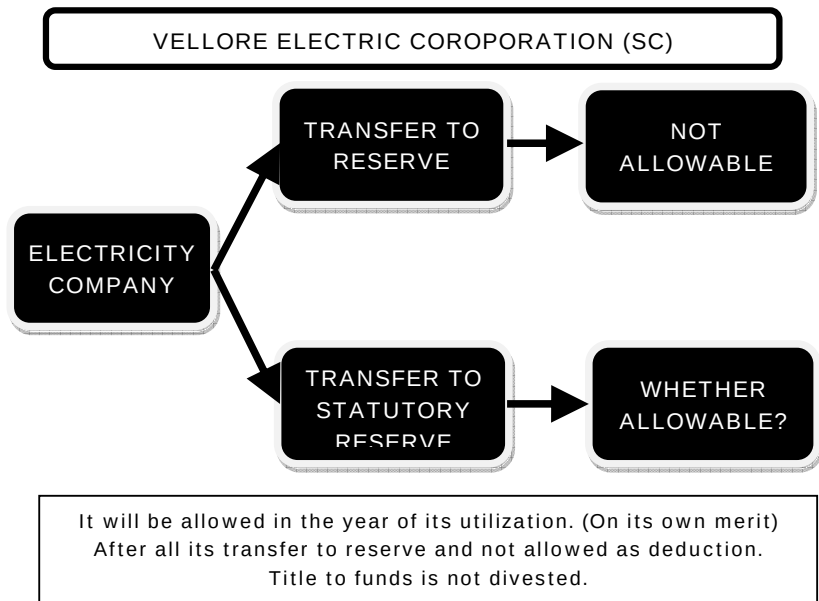
Amounts transferred to contingencies reserves, development reserve and tariff and dividend control reserve by the electricity company since amounts belong to electricity supply company it is not deductible in computing its income.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee company was in to the line of supplying electricity. Under the electricity company act it was required to transfer certain amount to contingency reserve by debiting the profit and loss account. Company claims that since it was a transfer effected statutorily it must be allowed as deduction under section 37(1). Is the claim of the company justified.

ANSWER

[1997] 227 ITR 0557A, Vellore Electric Corporation Ltd. Vs. CIT; (SC). Amount were transferred to contingencies reserves, development reserve and tariff and dividend control reserve by the electricity company. Since amounts belong to electricity supply company it is not deductible in computing its income.

**230 ITR 0927 HASIMARA INDUSTRIES LTD. VS. CIT; (SC)**

Assessee paid deposit under leave and licence agreement to run cotton mills and Deposit was returnable to assessee with interest upon expiry of agreement. Assessee unable to recover deposit and deposit was to acquire profit-making apparatus. Held that loss was not revenue loss and thus not deductible.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee company had paid deposit [Rs. 10 Lakhs] under leave and licence

agreement to run a cotton mill inspite of deposit being recoverable assessee could not recover the sum and thus proposed to claim it as business loss under section 28 Kindly advise the assessee.

232 ITR 0002 P. MARIAPPA GOUNDER VS. CIT (SC)

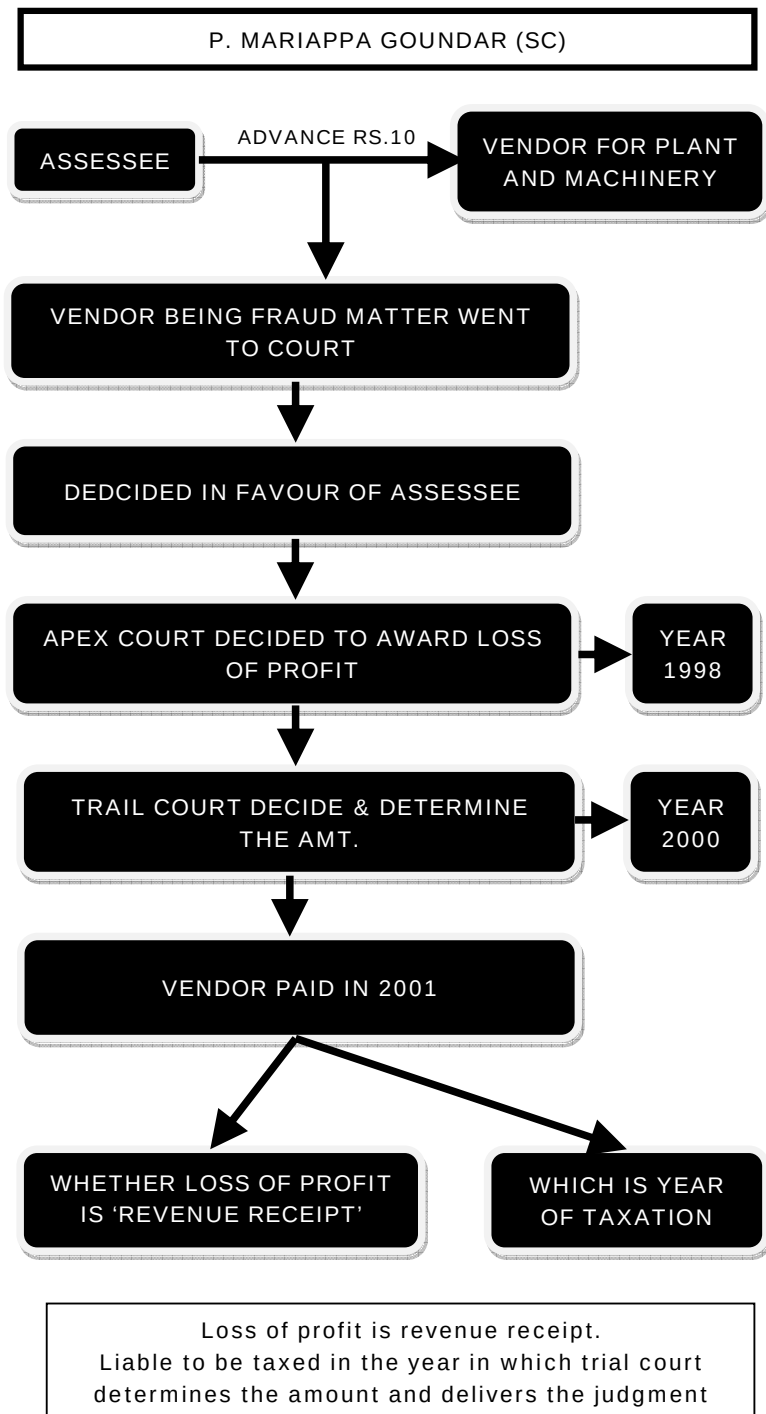
Suit was filed by assessee against vendor for specific performance of agreement to sell property [factory] Decree by Supreme Court was passed on say 22-4-1997. Supreme Court also declared assessee entitled to mesne profits [loss of profit] and directed trial court to determine quantum of such profits. Trial court determined mesne profits by order dated say 22-12-1998. Held by the supreme court that when the Supreme Court on April 22, 1997, decreed the appellant's suit, there was only an inchoate right which arose in his favour. The trial court was directed by the Supreme Court to hold an enquiry and then to determine the amount of mesne profits which was payable. It was only when the trial court determined the amount of mesne profits that the right to receive the same accrued in favour of the appellant. Following the mercantile system of accounting, the mesne profits awarded by order dated December 22, 1998, were rightly to be taxed in the assessment year 1999-2000 and it was wholly irrelevant as to when the amount awarded was in fact realised by the assessee.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Mr. X entered in to an agreement to acquire the factory at the price of Rs. 30 Lakhs. Vendor also agreed to sale at the mentioned price but after taking the advance money he did not effected the actual sale in time. Assessee went to the supreme court which decided the matter in favour of the assessee directed vendor to confirm the sale and court also awarded compensation for loss of profit on 2-4-96. Trial court there after determined the amount of loss of profit 3 Lakhs as on 2-8-98. You are required to mention whether this compensation is chargeable to tax and if yes in which year.

ANSWER

Suit was filed by assessee against vendor for specific performance of agreement to sell property [factory] Decree by Supreme Court was passed. Supreme Court also declared assessee entitled to mesne profits



[loss of profit] and directed trial court to determine quantum of such profits. Trial court determined mesne profits by order dated 02-08-1998. Held by the supreme court that when the Supreme Court, decreed the appellant's suit, there was only an inchoate right which arose in his favour. The trial court was directed by the Supreme Court to hold an enquiry and then to determine the amount of mesne profits which was payable. It was only when the trial court determined the amount of mesne profits that the right to receive the same accrued in favour of the appellant. Following the mercantile system of accounting, the mesne profits awarded by order dated 02-08-1998, were rightly to be taxed in the assessment year 1999-2000 and it was wholly irrelevant as to when the amount awarded was in fact realised by the assessee. However if the method of accounting followed was cash then the amounts would have been chargeable to tax in the year of receipt.

270 ITR 0452- KERALA SMALL INDUSTRIES DEVELOPMENT CORPORATION LTD. VS. COMMISSIONER OF INCOME-TAX (KERALA HIGH COURT)

In order to be eligible for deduction under section 37 of the Income-tax Act, 1961, the expenditure should not be of the nature of capital expenditure. It must be laid out or expended wholly and exclusively for the purpose of the business. It is not the factor or circumstance which causes the loss that is material in determining the true nature and character of the loss, but whether the loss has occurred in the course of carrying on the business or is incidental to it. In determining the question as to whether the loss suffered by the assessee was a trading loss and whether the loss was in respect of a trading asset or a capital asset, the memorandum and articles of association of the company are also very relevant.

Where a State Government company is floated for promoting employment, by financing industrial co-operative societies by participation in share capital, it stands to reason that the loss suffered should be deductible because the shares are not held as investment but as part of its circulating capital. Even so, it is necessary that the amount should have been irretrievably lost, before such loss is charged to the profit and loss account. Mere revaluation of shares and charging the difference on account of downward revaluation to the profit and loss account cannot justify the claim to the loss on such revaluation. It was so held in Kerala Small Industries Development Corporation Ltd. v. CIT [2004] 270 ITR 452 (Ker).

270 ITR 0259- COMMISSIONER OF INCOME-TAX VS. INDIAN TRANSFORMERS LTD. (KERALA HIGH COURT)

The issue as to whether provision for warranty liability is deductible for income-tax purposes, when it is a charge on the profits on accounting principles and accounting standards, has been a long standing controversy because of the departmental perception, that such liability is only a contingent not having accrued during the year. In CIT v. Indian Transformers Ltd. [2004] 270 ITR 259 (Ker), the High Court found that the provision for after sale service of transformers in the facts of the case was a reasonable one in view of the actual expenses, which materialised in a later year, so that it was held allowable following the decision in Bharat Earth Movers v. CIT [2000] 245 ITR 428 (SC), which, however, related to a case of leave encashment. But the rationale of this decision should have application for warranty cases as well. But in the matter of leave encashment, the law has nullified the decision by insertion of 43B(f) with effect from the assessment year 2002-03.

As regards warranty claims, the High Court followed not only this decision on leave encashment by the Supreme Court, but also the decision in Calcutta Co. Ltd. v. CIT [1959] 37 ITR 1 for the principle that a certain liability in future is not a contingent liability even as held by the Privy Council in IRC v.

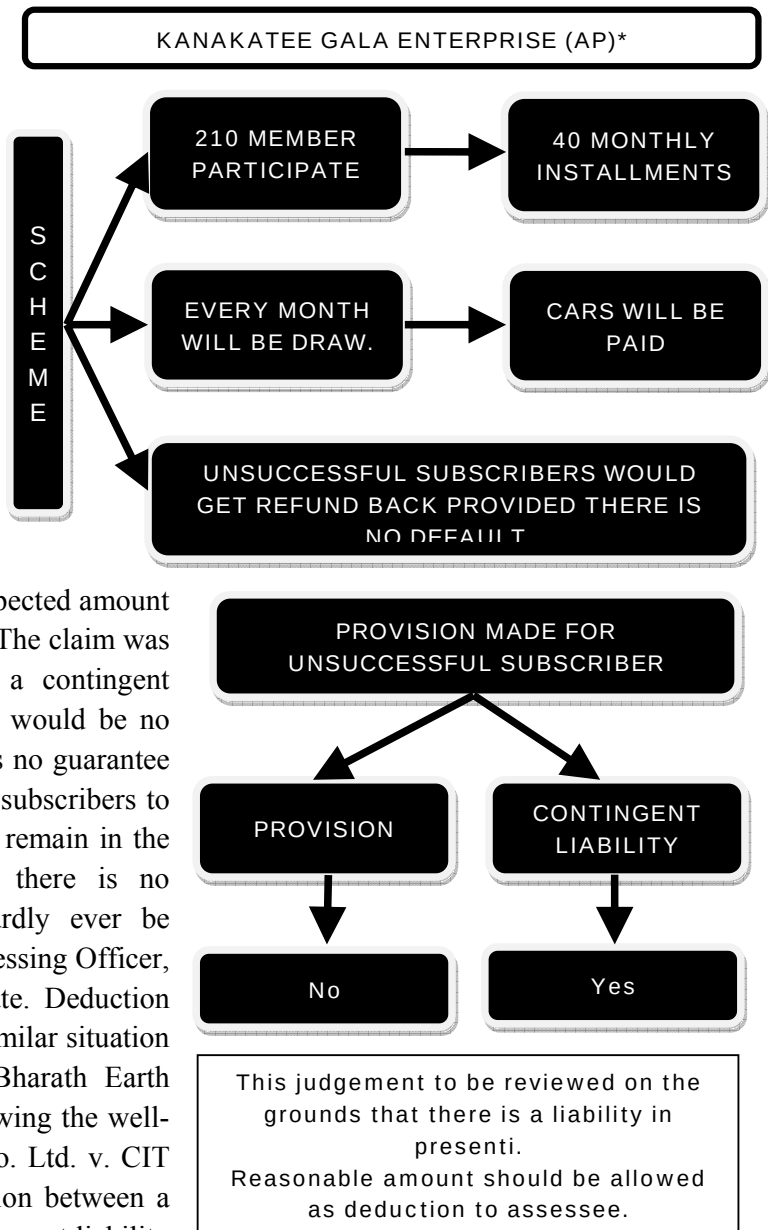
Mitsubishi Motors New Zealand Ltd. [1996] 222 ITR 697 (PC) specifically on the subject of warranty. The decision of the High Court based upon these well established precedents should merit acceptance, subject to such provision being reasonable.

Two instances of defects came to the notice of the assessee of which one was with respect to ten numbers of transformers sold to BHEL and as per the complaint all the transformers failed within one year of such purchase. This gave a clear picture that a major portion of the transformers sold were defective and therefore a reasonable provision had to be made. The assessee had made a provision of Rs. 3,50,000 but the actual expenses incurred for that year was Rs. 7,98,958. These circumstances clearly showed that the provision was made on a reasonable basis. The Tribunal had rightly held that the provision made for the three years was based on an ascertained liability and that it could not be treated as a contingent liability.

**275 ITR 0448- KANAKATEEGALA ENTERPRISES VS. COMMISSIONER OF INCOME-TAX
(ANDHRA PRADESH HIGH COURT)**

Ascertaining the income is difficult for lack of settled guidelines in money circulation schemes and sale coupled with lottery are also instances such as development agreement, chit business, mutual fund activities and time-sharing. In such a business, the assessee as organiser had formed a scheme for each group with 250 members expected to contribute specified monthly subscription on due date. A lottery was drawn for each month, with a single winner in the lot being awarded a vehicle. When the scheme ran out after 40 months, the 210 members who were not lucky to win the lot would get back the subscriptions paid without interest only if they had paid their subscriptions without default. In the computation of income of the year, the assessee while accounting for

subscriptions as income had set off the expected amount of repayment as at the end of the scheme. The claim was disallowed on the ground that it was a contingent liability, since it was assumed that there would be no default. The Tribunal held that “there was no guarantee as to how many members continue to be subscribers to the scheme and how many members will remain in the scheme till the end”. It is true that there is no “guarantee”, but the liability could hardly ever be treated as notional or contingent. The Assessing Officer, can, at best, substitute a realistic estimate. Deduction was allowed by the Supreme Court in a similar situation of provision for leave encashment in *Bharath Earth Movers v. CIT* [2000] 245 ITR 428 following the well-settled principle starting from *Calcutta Co. Ltd. v. CIT* [1959] 37 ITR 1 (SC) making a distinction between a certain liability at a future date and a contingent liability which may or may not arise. If the assessee made a wrong provision on the assumption that there could be liability in respect of all the remaining members, there cannot be an equally wrong assumption, that all the remaining members would be defaulters and will not be entitled to the refund under the scheme. A reasonable estimate would have necessarily to be made on the first principles relating to the mercantile system of accounting. It is in this view that the decision in *Kanakateegala Enterprises v. CIT* [2005] 275 ITR 448 (AP) would need review.



275 ITR 0352- COMMISSIONER OF INCOME-TAX VS. DR. T.A. QURESHI (MADHYA PRADESH HIGH COURT)

The Explanation to section 37 of the Income-tax Act, 1961, was inserted by the Finance (No. 2) Act, 1998, retrospectively with effect from April 1, 1962. A mere reading of the Explanation would clearly indicate that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and that no deduction or allowance shall be made in respect of such expenditure.

The assessee was a doctor. In July, 1985, there was a raid in his residential premises. In this raid a clandestine laboratory to manufacture heroin powder along with several contraband drugs were recovered. All these contraband articles were seized. In his assessment for the assessment year 1986-87 the assessee claimed that since the heroin seized from his possession worked out to Rs. 5,50,000, and since the heroin seized from him formed part of the stock-in-trade its loss on account of seizure was an allowable deduction while computing his profits and gains of business/profession. The Assessing Officer negated the claim but the Tribunal allowed it. On appeal to the High Court Held_ that the assessee in this case was engaged in the profession of doctor. He had nothing to do with the contraband article heroin for carrying on his profession. It was an admitted fact that the possession of heroin was an offence under the Narcotic Drugs and Psychotropic Substances Act, 1985. The loss was therefore not admissible.

Where a stock of heroin was seized from a trader, such loss cannot be allowed as a deduction in view of the restrictive Explanation to section 37. It was so held in CIT v. Dr. T. A. Qureshi [2005] 275 ITR 352 (MP). Heroin is a drug, the possession of which is illegal. All the same, the Tribunal found its way to allow the same, following the decision in CIT v. Piara Singh [1980] 124 ITR 40 (SC), which applied to a case of a professional smuggler, so that his income could only be decided on net basis on considering both illegal receipts and illegal expenses or loss. The High Court pointed out that this decision cannot be applied to a doctor, who was legitimately engaged in medical profession. Holding of contraband goods is not part of such profession. In fact, it is a disgrace to the profession. Though the High Court relied upon the Explanation for the disallowance, it could not have been allowed even in the light of pre-existing law as decided in Haji Aziz and Abdul Shakoor Bros. v. CIT [1961] 41 ITR 350 (SC), which has been followed in a number of cases with Piara Singh's case distinguishing the same, so that the law at present is that loss from an illegal activity cannot be allowed against a legal business. But if the business or profession itself is illegal, such loss can be allowed against such illegal income. The assessee in the case before the High Court could have succeeded, if his primary business was in narcotics and not the medical profession. That was not apparently the case of the assessee.

283 ITR 0445- COMMISSIONER OF INCOME-TAX VS. UNION CO. (MOTORS) LTD. (MADRAS HIGH COURT)

Where a seller has a building demolished before handing over the land in a transaction of sale of land, there can be no element of inference of sale of building. The Assessing Officer had split up the sale consideration as between land and building, so as to subject a part of the consideration as relating to the building to tax as short-term capital gains. The High Court had little difficulty in upholding the order of the Tribunal, that the entire consideration should be treated as relating to the land, so as to subject the surplus to tax solely as long-term capital gains in CIT v. Union Co. (Motors) Ltd. [2006] 283 ITR 445 (Mad).

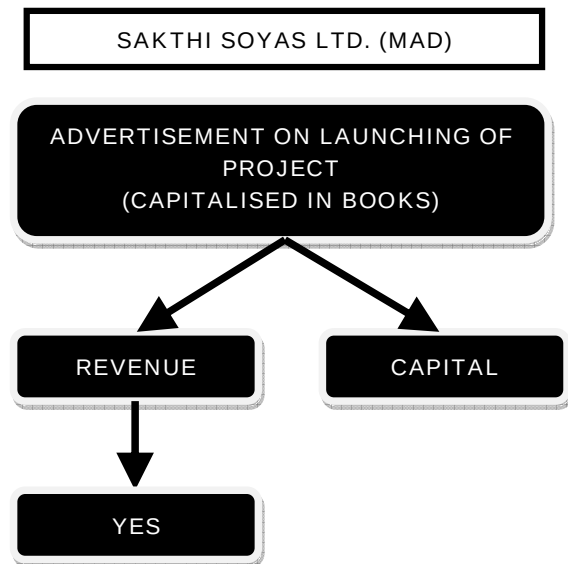
If at all there could have been liability for short-term capital gains in such cases, it would be if the value of the debris on demolition, exceeds the written down value of the building on the date of demolition/sale

of debris. By the same token, if there were no sale on debris or there was a short fall of realisation with reference to the written down value, there would be short-term capital loss, which could be adjusted against long-term capital gains.

It was clear that the sale consideration paid by the purchaser was only for the land, since the building had no value and got demolished. The gains were assessable as long-term capital gains on account of land. Section 50 does not apply.

283 ITR 0194- COMMISSIONER OF INCOME-TAX VS. SAKTHI SOYAS LTD. (MADRAS HIGH COURT)

An expenditure in launching a project for crop development of soya products should ordinarily be revenue expenditure, because launching a project is different from launching a new business. It was for this reason that promotion expenses including advertisement, so as to attract participation of farmers through visual and print media, were treated as revenue expenditure, notwithstanding the fact that the assessee itself treated it as capital expenditure in its books, as held in CIT v. Sakthi Soyas Ltd. [2006] 283 ITR 194 (Mad). The decision does not clearly indicate whether the assessee was already in business. Presumably, it was a new project for an existing business.



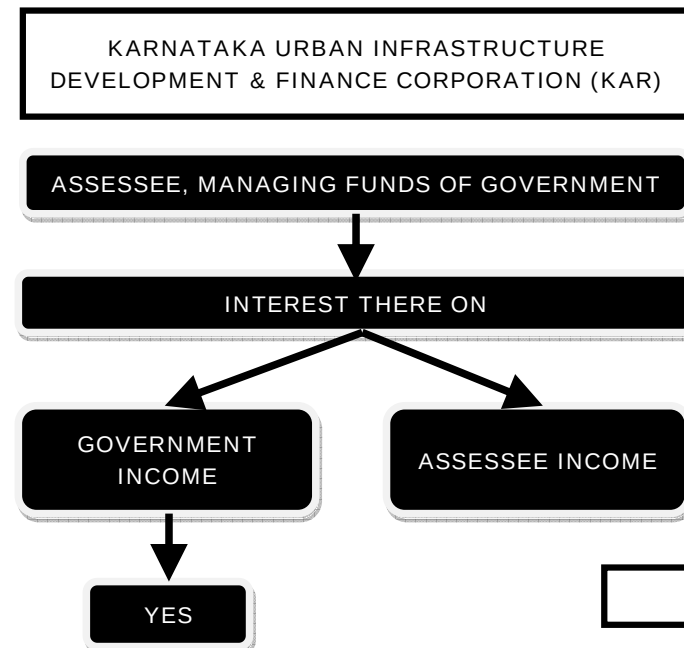
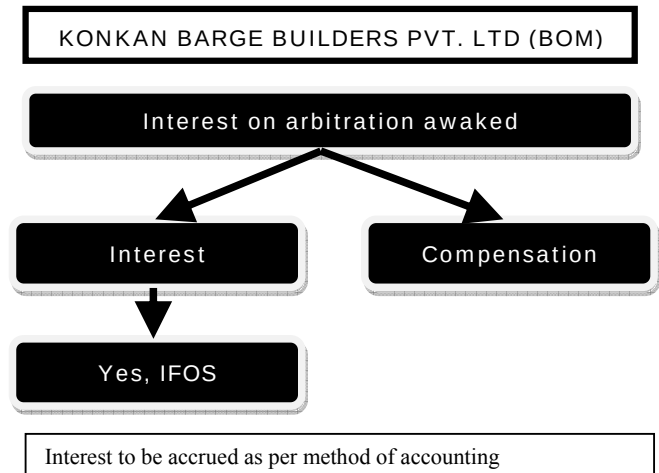
283 ITR (A.T.) 0001- JOINT COMMISSIONER OF INCOME-TAX VS. VIDEO ELECTRONICS LTD. (INCOME-TAX APPELLATE TRIBUNAL--DELHI)

The principle of real income comes into play in exceptional circumstances where subsequently it transpires that there was never any right to receive income or there was no likelihood of enforcement of such right, if any. The real income theory cannot be pressed into service for the reason only that the income could not be subsequently recovered.

The agreements between the parties had been acted upon, inasmuch as the assessee handed over drafts of the agreed amounts to the lessees favouring the suppliers of machinery nominated by the lessees. The lessees also deposited with the assessee upfront payments agreed upon by way of security deposit for the leased assets. Both the lessees did pay lease rent. Therefore, it could not be said that the lease rent amounts did not accrue at all. The assessee could not seek to enforce the right to receive before the court of law and at the same time argue that there was in reality no accrual of income. In the case of the lessee R, the assessee had not filed any suit for recovery and no particular material had been relied upon by the assessee. Even the plea was taken before the Commissioner (Appeals) for the first time that the lessees had purchased no machinery at all but no material was placed on record. The surrender of the withdrawal from the IDBI did not affect the accrual of income to the assessee in relation to its agreements with the lessees. The addition made by the Assessing Officer was restored on the premise that income had accrued to the assessee on account of lease rent.

284 ITR 0582- COMMISSIONER OF INCOME-TAX VS. KARNATAKA URBAN INFRASTRUCTURE DEVELOPMENT AND FINANCE CORPORATION (KARNATAKA HIGH COURT)

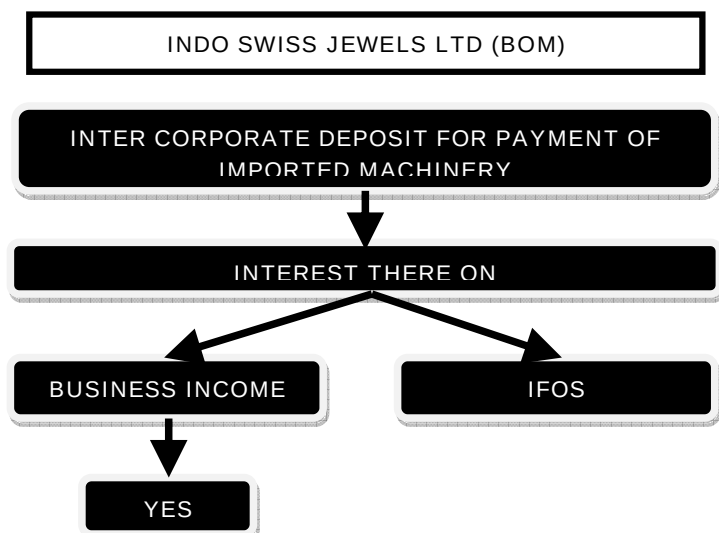
In CIT v. Karnataka Urban Infrastructure Development and Finance Corporation [2006] 284 ITR 582 (Karn), it was found that the assessee, a Government company was undertaking infrastructure development as a nodal agency receiving funds from the Government. Interest from deposits of such fund, which is required to be utilised for the purpose for which they were given, has no income element for the assessee. The assessee is acting as a mere agency managing the funds entrusted to it in the manner expected of it. Interest income could not be treated as its income, because such income is out of moneys advanced by the Government of India for a particular purpose as a tied-up grant or advance. It is for this reason that such income from the funds is not the assessee's income and is not assessable in its hands. This is a



at source by overriding title.

284 ITR 0389- COMMISSIONER OF INCOME-TAX VS. INDO SWISS JEWELS LTD. (BOMBAY HIGH COURT)

Inter-corporate deposits were made by the assessee from the surplus funds that were set apart for payment for imported machinery.

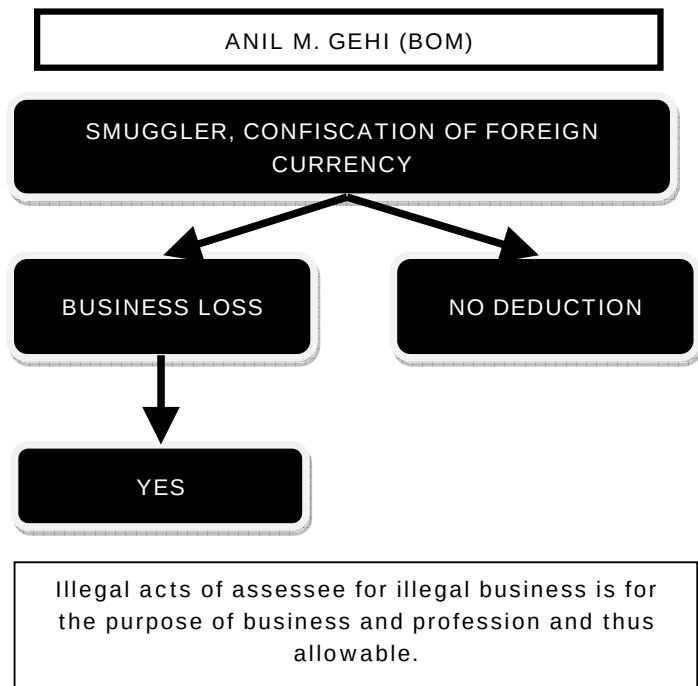


useful decision, because there is often confusion as regards such income from the funds, managed by a trust or a public institution, received as tied-up grants or funds, the income from which is not available to such trust or institution, which is only expected to manage it and be accountable for it. In such cases, it is acting merely as a constructive trustee holding the funds merely in a representative capacity. If the funds belong to the Government, such income from the same could not be taxable even in representative capacity. At any rate, it cannot form part of the income of the assessee. In fact, it gets diverted

The interest earned on the short term deposits of the money kept apart for the purposes of business had to be treated as income earned from business and could not be treated as income from other sources.

284 ITR 0338- COMMISSIONER OF INCOME-TAX VS. ANIL M. GEHI (BOMBAY HIGH COURT)

Loss arising out of action under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act (COFEPOSA) on confiscation of foreign currency, where the assessee was treated as a smuggler and had been detained under that Act, will have to be allowed as business deduction as held in CIT v. Anil M. Gehi [2006] 284 ITR 338 (Bom), since the currency illegally acquired related to an illegal business, following the rationale of the Supreme Court decision in CIT v. Piara Singh [1980] 124 ITR 40. If the assessee had not



MODERN SPINNERS LTD (DEL)

LIABILITY TO PAY INTEREST TO FINANCIAL INSTITUTION SETTLED

SUBJECT TO FULFILLING FURTHER CONDITION

ASCERTAINED LIABILITY

CONTINGENT LIABILITY

YES

been branded as a smuggler, the loss would not have been eligible for the deduction.

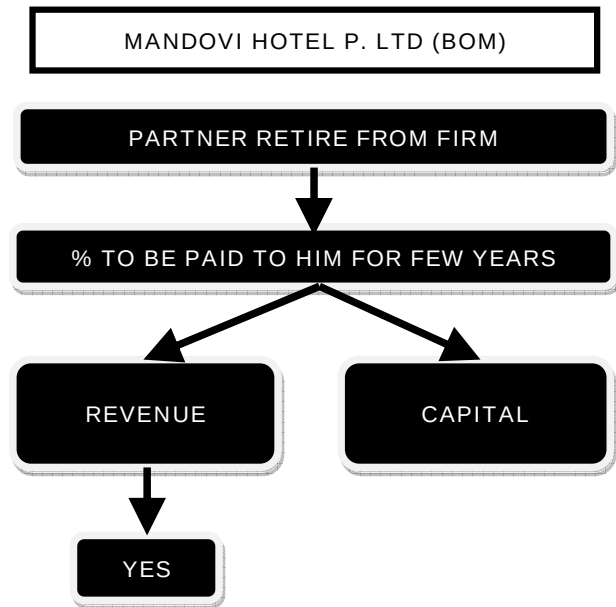
284 ITR 0308- COMMISSIONER OF INCOME-TAX VS. MODERN SPINNERS LTD. (DELHI HIGH COURT)

Where the assessee's liability for payment of interest to a financial institution was settled, subject to the assessee fulfilling further conditions, the amount claimed could not be disallowed merely on the ground that such deduction has to await satisfaction of the conditions. It had become an ascertained liability, so as to be eligible for deduction. The disallowance was, therefore, considered unjustified in CIT v. Modern Spinners Ltd.

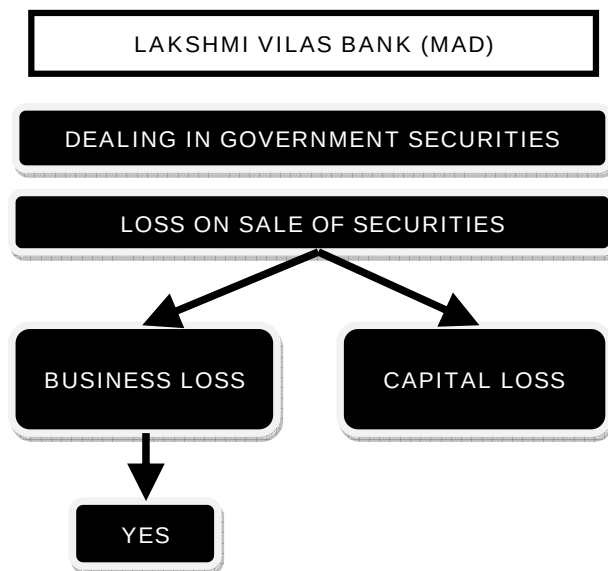
[2006] 284 ITR 308 (Delhi).

284 ITR 0129- COMMISSIONER OF INCOME-TAX VS. MANDОВI HOTEL P. LTD. (BOMBAY HIGH COURT)

The dissolution deed did not specify any capital sum payable to the retiring partners. The payment of 30 per cent. of the annual profits, subject to the minimum of Rs. 60,000 every year for seven years could not be held to be a fixed price for purchase of the capital assets. The payment of 30 per cent. of the net profits payable by the assessee to the retiring partners for a period of seven years subject to the minimum payment of Rs. 60,000 was related to annual profits that flowed from the business activities of the assessee. The amount paid by the assessee to the retiring partners was in the nature of revenue expenditure.



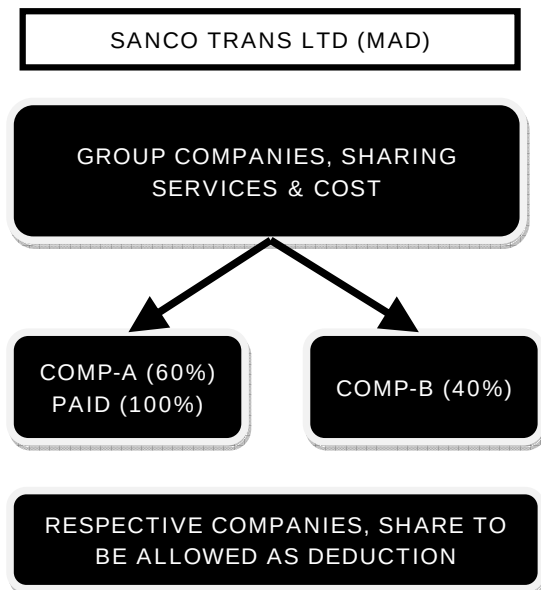
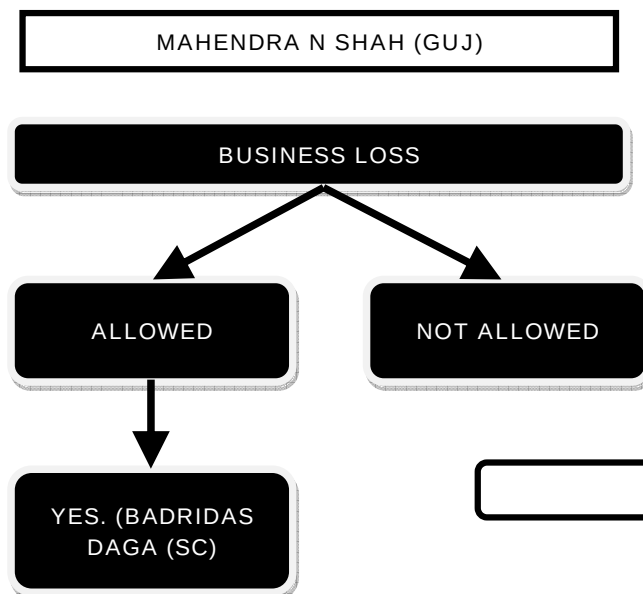
284 ITR 0093- LAKSHMI VILAS BANK LTD. VS. COMMISSIONER OF INCOME-TAX (MADRAS HIGH COURT)



The assessee was dealing in purchase and sale of Government securities. The profit and loss on the sale of Government securities had been assessed as business income/loss under the Income-tax Act. The assessee-bank had always been treating Government securities as stock-in-trade. There was no change of method of accounting of the securities. In the earlier assessment years, the Revenue had accepted the plea of the assessee that the Government securities were stock-in-trade and against the earlier orders, the Revenue did not agitate the matter by filing an appeal and therefore, they reached the finality. The Government securities were stock-in-trade of the assessee. It was entitled to deduct the loss in their value in computing its income.

284 ITR 0051- COMMISSIONER OF INCOME-TAX VS. SANCO TRANS LTD. (MADRAS HIGH COURT)

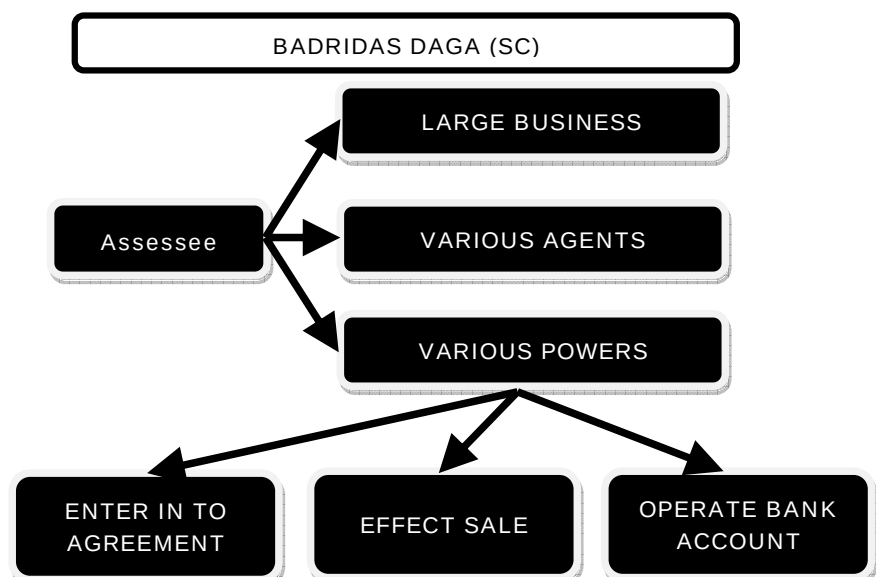
It is not unusual for group companies to share services, which are common as between them. Where the expenditure is allocated on a reasonable basis as between them, the shared expenditure cannot be disallowed merely because it is initially incurred by one of the group concerns. It was in this context, that the repair and renovation work by black topping the ground, levelling the platform, godown, roads etc. for smooth running of the business initially incurred by a subsidiary company in the group and then partly allocated to the assessee was not disallowed, since the liability was reflected in the assessee's account by a debit note. It could not be treated as unrelated to the assessee's business merely because it was initially incurred by the assessee's subsidiary company as held in CIT v. Sanco Trans Ltd. [2006] 284 ITR 51 (Mad).

**280 ITR 0462- COMMISSIONER OF INCOME-TAX VS. MAHENDRA N. SHAH (GUJARAT HIGH COURT)**

Tribunal was right in holding that the assessee was entitled to deduction of a sum of Rs. 3,45,000 as business loss.

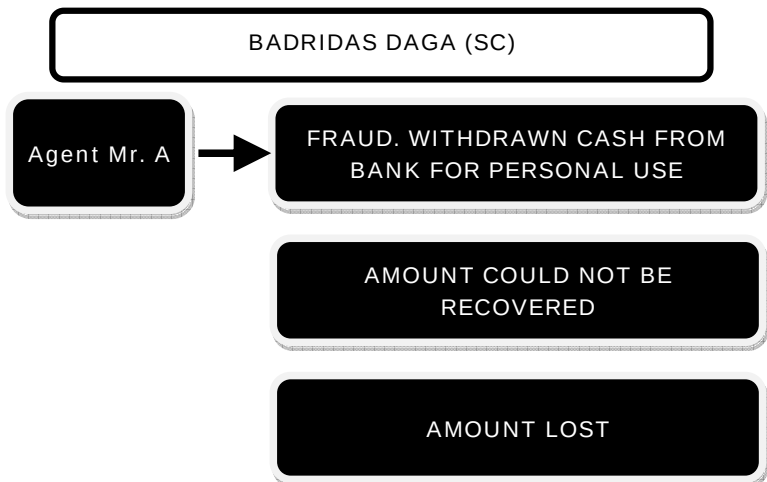
Business loss has necessarily to be deducted though it is not one of the items listed for

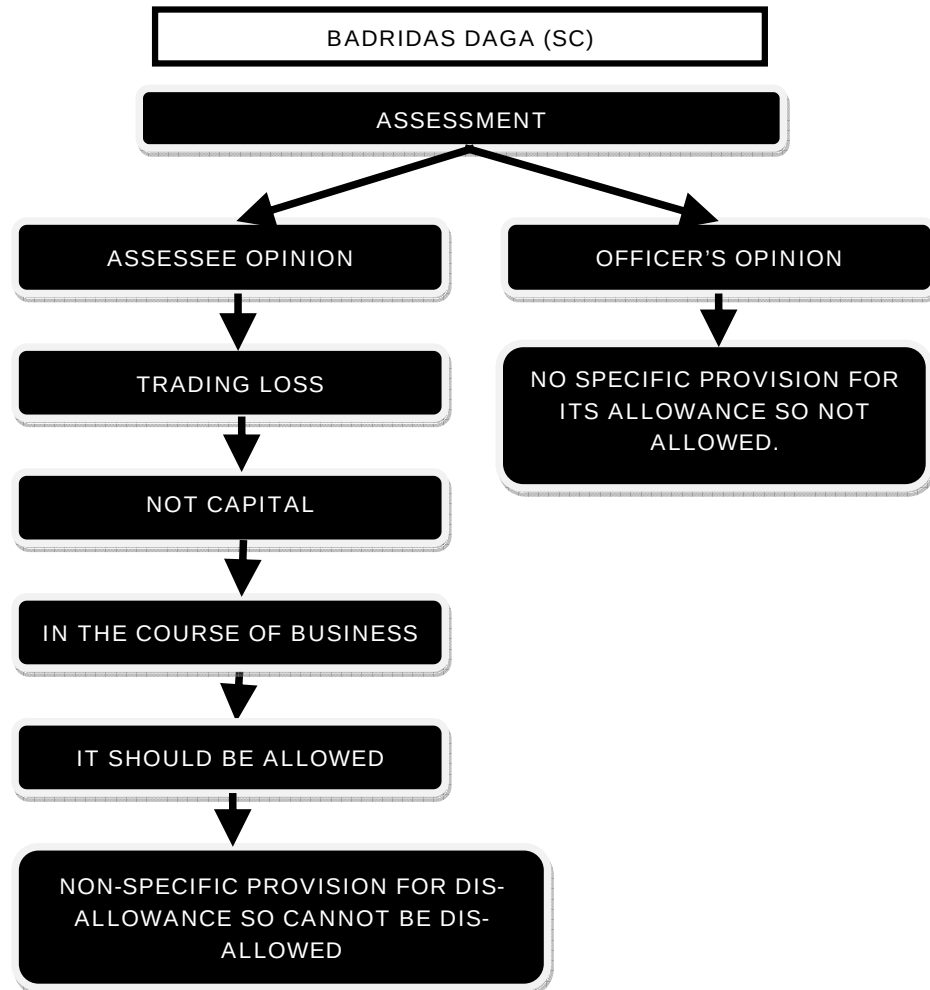
The Tribunal had found that (i) the assessee had in fact suffered a loss to the tune of Rs. 3,45,000 ; (ii) the loss related to the business and came to knowledge in the year under consideration ; (iii) the contention that the transaction was not genuine was not even the case of the Assessing Officer because the Assessing Officer himself had observed in the assessment order that a fraud had been committed by the Dubai party by presenting false shipping documents. The



deductions. It is because it is allowable even under section 28 itself at the threshold. Where the loss was not questioned on the ground of genuineness, such loss being consequent on dishonour of cheques issued by the non-resident, it was held that there was no case for disallowance rejecting the argument that it was not allowable as the assessee's claim against the bank, when a civil suit was pending, in CIT v. Mahendra N. Shah [2006] 280 ITR 462 (Guj). Though no citations were given on the issue, it follows that the only test, whether such loss was incurred in the course of

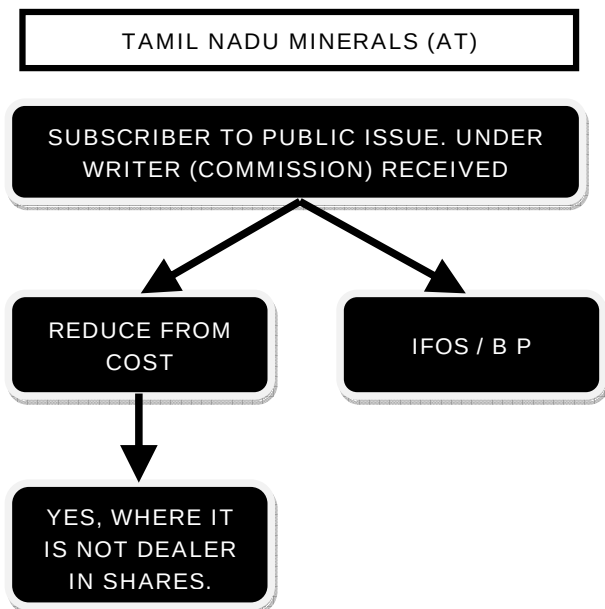
business. There are many items which are not specifically listed for deduction as for example even wages are not listed as a deductible item, but there is a provision for bonus. Income has to be computed under ordinary principles of commercial accounting. This law has been settled. As otherwise, what will be assessable will not be real profits. This has been pointed out in various cases. It is not necessary even to refer to section 37 which is a residuary clause for deduction in such cases as decided for example in Badridas Daga v. CIT [1958] 34 ITR 10 (SC), where loss due to embezzlement was found admissible as a business loss, though there is no provision for deduction. Even losses which were voluntarily undertaken, though not contractual or otherwise obligatory were found admissible in CIT v. Nainital Bank Ltd. [1966] 62 ITR 638 (SC).





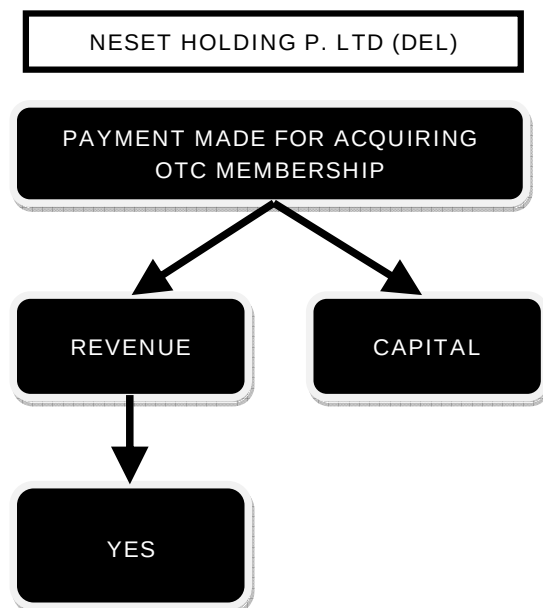
281 ITR (A.T.) 0101- TAMIL NADU MINERALS LTD. VS. JOINT COMMISSIONER OF INCOME-TAX (INCOME-TAX APPELLATE TRIBUNAL--CHENNAI)

Underwriting commission should ordinarily be a revenue receipt. But where the assessee subscribing to a public issue receives commission given to underwriters, such commission may well be an abatement of the cost of shares in circumstances where the assessee is not a dealer in shares. Treatment of the same as capital receipt, reducing cost of the shares, it was found, accords with accounting principles, putting it outside the liability to tax as held in Tamil Nadu Minerals Ltd. v. Joint CIT [2006] 281 ITR (AT) 101 (Chennai).



282 ITR 0601- NESET HOLDINGS P. LTD. VS. COMMISSIONER OF INCOME-TAX (DELHI HIGH COURT)

Where a payment is made for acquiring OTC membership in a stock exchange, the initial payment as security deposit, which is non-refundable and non-transferable, though described as deposit, the issue, whether it is capital or revenue expenditure was decided in Neset Holdings P. Ltd. v. CIT [2006] 282 ITR 601 (Delhi) holding it to be revenue expenditure in that it was not only the initial payment, that was required, but also service charges from year to year. There was no enduring advantage, so as to justify denial of deduction. Such a conclusion was arrived at on first principles with reference to the law laid down by the Supreme Court in Empire Jute Co. Ltd. v. CIT [1980] 124 ITR 1 and the precedents both in England and India.



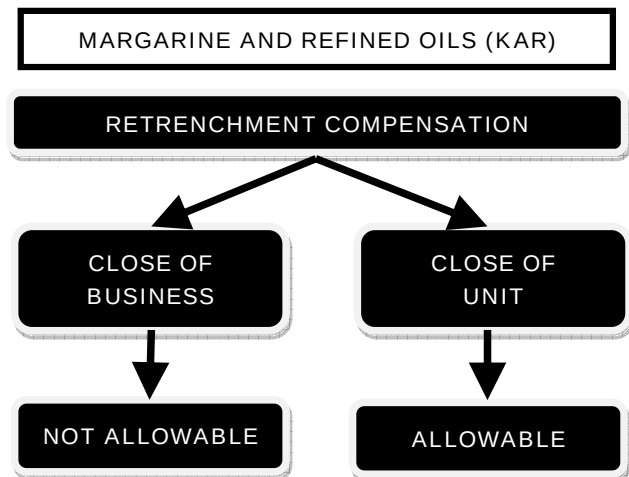
In other words membership and entry of a dealer in the OTC Exchange was upon payment of non-refundable deposits, which were in question here. Access to the facilities were not dependent solely on the payment of such charges. It also presupposed clearance of other dues. The

mere fact that the deposit was not refundable in nature, did not alter this circumstance. The assessee would have been termed as an “inactive” member if payment for those periodic charges/demands was not made. The expenditure incurred in the present case could not be termed as one of an “enduring nature”. It was deductible as revenue expenditure.

282 ITR 0576- COMMISSIONER OF INCOME-TAX VS. MARGARINE AND REFINED OILS CO. LTD. (KARNATAKA HIGH COURT)

Retrenchment compensation was found inadmissible at the time of closure of business in CIT v. Gemini Cashew Sales Corporation [1967] 65 ITR 643 (SC). But where what is proposed is not closure of business, the claim could be allowed as was found in CIT v. Doongaji and Co. Distillery [2005] 276 ITR 402 (MP). Where there is only a lull in the business, the amount should be deductible as was decided in CIT v. Margarine and Refined Oils Co. Ltd. [2006] 282 ITR 576 (Karn) on general principles.

Ever since the decision of CIT v. Gemini Cashew Sales Corporation [1967] 65 ITR 643 (SC), it has been felt that gratuity for retrenched or retired employees on winding up or transfer of business would not be deductible as capital outlay. This decision has now been explained in W.T. Suren & Co. Ltd. v. CIT [1998] 230 ITR 643 (SC) to the relief of many taxpayers. The distinction is based upon the difference as between retrenchment compensation and gratuity. In Gemini Cashew's case [1967] 65 ITR 643 (SC), the claim was for payment of retrenchment compensation, which was not payable under the Industrial Disputes Act, if the employees on closure of business are absorbed by the successor, because in such cases there is no determination of employment so as to make the employees eligible for compensation. Gratuity liability, which stood transferred as part of transfer of business and, therefore, paid to the transferee company had been understood by the revenue as payment of part of the price. But the High Court in CIT v. Sarada Binding Works [1985] 152 ITR 520 (Mad) had taken the view that it should be construed as revenue expenditure. The Supreme Court in approving, inter alia, the decision in Sarada Binding Works' case [1985] 152 ITR 520 and a few other cases, as in CIT v. Salem Magnesite Pvt. Ltd. [1991] 189 ITR 154 (Bom) and CIT v. Standard Furniture Co. Ltd. [1979] 116 ITR 751 (Ker) held that the gratuity compensation is not on par with retrenchment compensation in the sense that it is payable on termination of employment on any account except dismissal. This decision of the Supreme Court in W.T. Suren's case [1998] 230 ITR 643 settles a long standing controversy.



282 ITR 0545- COMMISSIONER OF INCOME-TAX VS. I. G. ELECTRONIC (INDIA) LTD. (DELHI HIGH COURT)

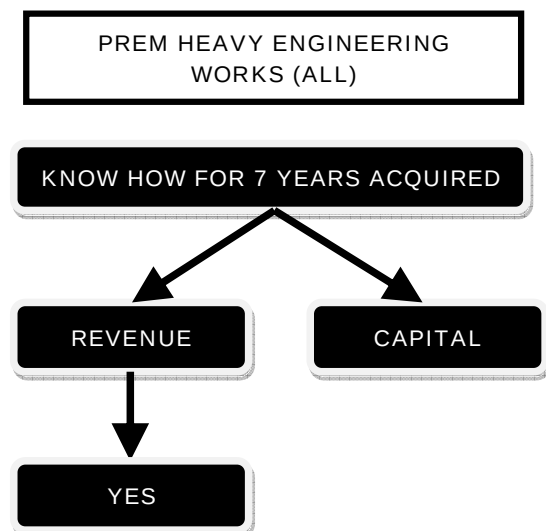
The date of setting up a business and the date of its commencement could be two separate dates. The law has reference to the date of setting up of the business. The Tribunal had noted that the business of the assessee was set up on February 21, and that in view of the definition of the expression “previous year” the previous year shall be the period beginning with the date of setting up the business.

I.G. ELECTRONICS (DEL)

DATE OF SETTING UP	01-02
DATE OF COMMENCEMENT	15-02
PREVIOUS YEAR	1-2 TO 31-3

282 ITR 0011- COMMISSIONER OF INCOME-TAX VS. PREM HEAVY ENGINEERING WORKS P. LTD. (ALLAHABAD HIGH COURT)

The payment for acquiring know-how for manufacture of equipment for a period of seven years does not necessarily mean that it is capital expenditure. Where the non-resident assessee had been carrying on business of manufacture of machinery locally and had parted with workshop drawings and documentation relating to structural components along with special tools for a consideration, the finding of the Tribunal that the payment was not for outright purchase of an intangible capital asset was endorsed by the High Court in CIT v. Prem Heavy Engineering Works P. Ltd. [2006] 282 ITR 11 (All), after elaborate review of the precedents on the subject. The reasoning was that the payment was more in the nature of royalty and that there is no enduring asset acquired by the assessee. It was an allowable payment, as held by the Supreme Court in CIT v. Ciba of India Ltd. [1968] 69 ITR 692.



240 ITR 0139 GENERAL INSURANCE CORPORATION OF INDIA VS. CIT (SC)

“Spending” in the sense of “paying out or away” of money is the primary meaning of “expenditure”. “Expenditure” is what is paid out or away and is something which is gone irretrievably. Rule 2(2)(a) of the General Insurance Business (Nationalisation) Rules, 1973 undoubtedly speaks of the amount set apart for redemption of preference shares being treated as an item of expenditure in the profit and loss account.

Merely because rule 2(2)(a) of the General Insurance Business (Nationalisation) Rules permits the amount set apart for redemption of preference shares to be debited to the profit and loss account, the amount so set apart does not become an amount of expenditure for all intents and purposes, so as to fall within the meaning of the term “expenditure” as employed in Income-tax Act, 1961.

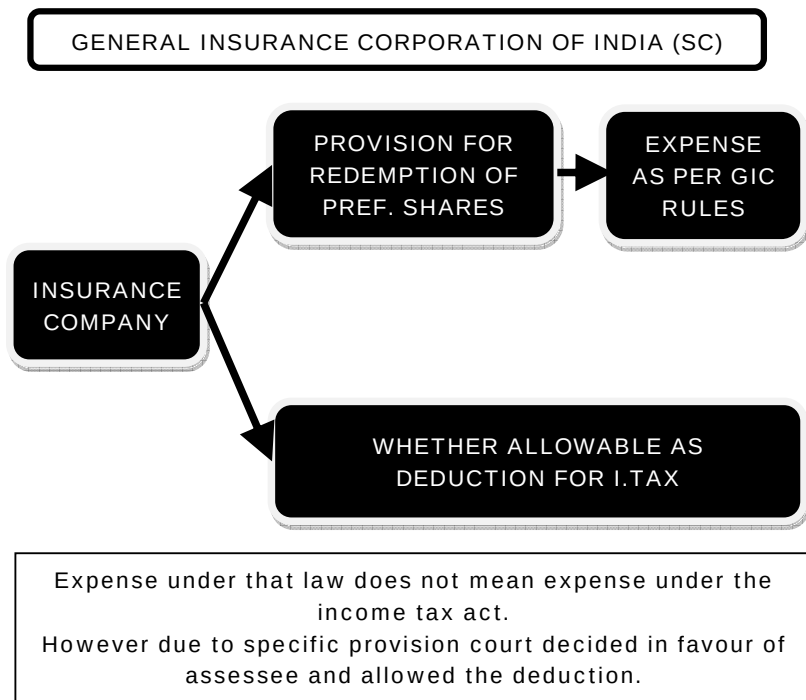
QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

General insurance corporation of India has made provision for the payment to preference shareholders at the time of redemption of preference shares. This amount was provided by

means of showing it as expenditure in the profit and loss account. This was in conformity with the General Insurance Business Rules. For the purpose of the income tax act general insurance corporation has proposed to claim it as deduction and officer has disallowed the same. You are required to answer whether officer is justified or not.

ANSWER

There is another approach to the same issue. Section 44 of the Income-tax Act read with the Rules contained in the First Schedule to the Act lays down an artificial mode of computing the profits and gains of insurance business. For the purpose of income-tax, the figures in the accounts of the assessee drawn up in accordance with the provisions of the First Schedule to the Income-tax Act and satisfying the requirements of the Insurance Act are binding on the Assessing Officer under the Income-tax Act and he has no general power to correct the errors in the accounts of an insurance business and undo the entries made therein. The amount set apart by the General Insurance Corporation for redemption of preference shares and treated as expenditure under rule 2(2)(a) of the General Insurance Business (Nationalisation) Rules is so treated for the purpose of the Insurance Act, 1938. The reserve is not an expenditure in the ordinary commercial sense of the term. It cannot be added back for computing the profits and gains of business by including it in "expenditure not admissible under the provisions of sections 30 to 43A of the Income-tax Act" by reference to rule 5(a) of the First Schedule to the Income-tax Act.



242 ITR 0450 RAJASTHAN STATE WAREHOUSING CORPORATION VS. CIT (SC)

In computing the “profits and gains of business or profession” when an assessee is carrying on business in various ventures and some among them yield taxable income and the others do not, the question of allowability of the expenditure will depend on fulfillment of requirements of that provision of section 37 (1) the general deduction and on the fact whether all the ventures carried on by him constituted one indivisible business or not. If they do, the entire expenditure will be a permissible deduction, but if they do not, the principle of apportionment of the expenditure will apply, because there will be no nexus between the expenditure attributable to the venture not forming an integral part of the business and the expenditure sought to be deducted as the business expenditure of the assessee.

Held that in view of the fact that a perusal of the question itself disclosed that income from various ventures was earned in the course of one indivisible business, the impugned order upholding the apportionment of the expenditure and allowing deduction of only that proportion of it which was referable to the taxable income, was unsustainable.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee's profit and loss statement disclosed that assessee has the taxable income of Rs. 20 lacs (Gross Income 50 less gross expense 30) and non-taxable income as 30 lacs (Gross Income 50 less gross expense 20). The administrative expense were 5 lacs including the depreciation of Rs. 2 lacs on the computer used for the accounting of both the purposes. Assessing officer proposes to disallow the proportionate administrative expense as it relates to the non-taxable income. I.e. exempt income is computed as $20 - 2.5 (50\% \text{ of } 5) = 17.5$ lacs. You are required to answer whether assessing officer is justified in so doing.

ANSWER

Certain incomes are not includible while computing the total income as these are exempt under various provisions of the Act. There have been cases where deductions have been claimed in respect of such exempt income. This in effect means that the tax incentive given by way of exemptions to certain categories of income is being used to reduce also the tax payable on the non-exempt income by debiting the expenses incurred to earn the exempt income against taxable income. This is against the basic principles of taxation whereby only the net income, i.e., gross income minus the expenditure, is taxed. On the same analogy, the exemption is also in respect of the net income. Expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income. Section 14A clarifies the intention of the legislature, that no deduction shall be made in respect of any expenditure incurred by the assessee in relation to income which does not form part of the total income. In view of the same, assessing officer is now given the authority to disallow some reasonable common expenditure thus where assessing officer has disallowed the sum he justified in the same where sum so disallowed is reasonable.

243 ITR 0002 CIT VS. KARNAL CO-OPERATIVE SUGAR MILLS LTD. (SC)

The assessee was running a sugar mill. The assessee's factory had not commenced production. Sugar production had started thereafter. Loss was shown on account of various expenses incurred in connection with the setting up of the factory. The Assessing Officer, during the course of assessment, noticed that assessee was in receipt of interest on certain fixed deposits. The assessee's plea was that the interest income was to be adjusted against the pre commencement expenditure thereafter the balance expenditure shown as loss was to be treated as part of capital expenditure.

Following Facts to be Noted.

- 1) The Commissioner of Income-tax as well as the Tribunal had given a finding of fact that the business of the assessee had not commenced.
- 2) The assessee had raised share capital and also loans, so as to set up the sugar factory. Therefore, these two activities were ancillary to the commencement of business and could not be said to be the main business.
- 3) The money was deposited with the bank with a definite purpose, to execute an agreement for the purpose of acquiring a machine.
- 4) There was no evidence on record to show that the fixed deposit had been made by the assessee out of the borrowings.
- 5) It was the share capital which was deposited. The assessee purchased fixed deposits in the course of an activity directly relatable to the acquisition of an asset. There was thus a direct nexus between the purchase of the machinery and the deposit of money in the bank.
- 6) Such interest income being directly relatable to the terms of the contract for acquiring a business asset.

Held in the supreme court that :

Assessee had deposited money to open a letter of credit for the purchase of the machinery required for setting up its plant in terms of the assessee's agreement with the supplier. It was on the money so deposited that some interest had been earned. This was, therefore, not a case where any surplus share capital money which was lying idle had been deposited in the bank for the purpose of earning interest. The deposit of money in the present case was directly linked with the purchase of plant and machinery. Hence, any income earned on such deposit was incidental to the acquisition of assets for the setting up of the plant and machinery. The interest was a capital receipt, which would go to reduce the cost of asset.

Conclusion:

In case money is borrowed by a newly started company which is in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalised and added to the cost of the fixed assets created as a result of such expenditure. By the same reasoning if the assessee receives any amounts which are inextricably linked with the process of setting up its plant and machinery, such receipts will go to reduce the cost of its assets. These are receipts of a capital nature and cannot be taxed as income.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

The assessee running a sugar mill. A return was filed declaring pre-commencement loss amounting to Rs. 7,29,700 under the head "Business". Loss was shown on account of various expenses incurred in connection with the setting up of the factory. The Assessing Officer, during the course of assessment, noticed that a sum of Rs. 1,60,000 had been received by the assessee-company by way of interest on certain fixed deposits. The assessee is of the opinion that interest income was to be adjusted against the expenditure. Assessing officer is of the opinion that interest income must be taxed under the head "Other Sources" and tax there on must be levied. You are required to comment on the issue.

ANSWER

In case of [2000] 243 ITR 0002 COMMISSIONER OF INCOME-TAX VS. KARNAL CO-OPERATIVE SUGAR MILLS LTD. (SC), assessee had deposited money to open a letter of credit for the purchase of the machinery required for setting up its plant in terms of the assessee's agreement with the supplier. It was on the money so deposited that some interest had been earned. This was, therefore, not a case where any surplus share capital money which was lying idle had been deposited in the bank for the

purpose of earning interest. The deposit of money in the present case was directly linked with the purchase of plant and machinery. Hence, any income earned on such deposit was incidental to the acquisition of assets for the setting up of the plant and machinery. The interest was a capital receipt, which would go to reduce the cost of asset.

However if it was a case where any surplus money which was lying idle had been deposited in the bank for the purpose of earning interest or the deposit of money was not directly linked with the purchase of plant and machinery. Then in such a case interest income would be taxed as income under the head other sources.

243 ITR 0640- NEW INDIA MINING CORPORATION PVT. LTD. VS. CIT (SC)

The word "expenditure" means "disbursement". "Expend" means "to pay out or distribute; to spend". The Supreme Court in the decision in Indian Molasses Co. (P.) Ltd. v. CIT [1959] 37 ITR 66 held that the word "expenditure" means "put out or away; spending something which is gone out irretrievably"

These were mining leases. lease agreement laid down that upon the determination of the lease, the lands should be restored to their original condition. The Tribunal held that the expenditure incurred by the appellant for the purpose of restoring the lease land to the original condition was permissible expense under section 37(1). However, there was a clear finding that during the relevant years the appellant did not incur any expense to restore the lands to their original condition. Held in the supreme court that admittedly no expense has been incurred by the appellant. Any question of any allowable deduction can arise only if any expense is so incurred by the assessee.

Conclusion :

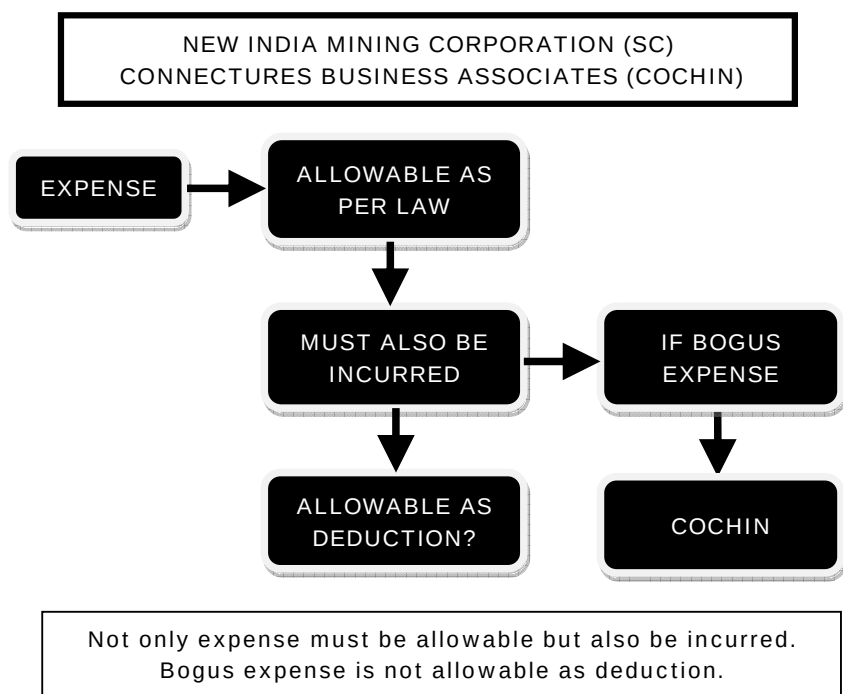
Once it is held that no expense was incurred by the assessee, the question of any allowable expense being deducted in computing the income from the profits and gains of the assessee does not arise.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee took land on the mining leases. Lease agreement laid down that upon the determination of the lease, the lands should be restored to their original condition. The Tribunal in the other case had held that the expenditure incurred by the appellant for the purpose of restoring the lease land to the

original condition was permissible expense under section 37(1). Based on this judgment assessee claimed 10 lakhs as deduction on account of restoring the lease land to the original condition. You are required to answer whether assessee is justified in claiming this deduction or not.

ANSWER



These were mining leases. lease agreement laid down that upon the determination of the lease, the lands should be restored to their original condition. The Tribunal held that the expenditure incurred by the appellant for the purpose of restoring the lease land to the original condition was permissible expense under section 37(1). However, there was a clear finding that during the relevant years the appellant did not incur any expense to restore the lands to their original condition. Held in the supreme court that admittedly no expense has been incurred by the appellant. Any question of any allowable deduction can arise only if any expense is so incurred by the assessee.

245 ITR 0428 - BHARAT EARTH MOVERS VS. CIT (SC)

The question before the court was whether the provision for making the liability for encashment of earned leave by the employee is an admissible deduction? The Karnataka High Court was of the opinion that Leave salary is payable only when a person goes on leave and during the period of leave the salary paid to him is known as leave salary. It cannot be ascertained with any certainty whether, in a particular year, the employee would go on leave. It will depend upon the option of the employee. The liability will only arise when a person goes on leave and it is only for the particular period that he is on leave that the leave salary is payable. Therefore, neither leave salary nor leave encashment benefit payable to the employees can be said to be a present liability but it is only a contingent liability and an assessee (employer) is not entitled to deduction of the provision made to meet such liability.

However Supreme Court reversed the judgment of the Karnataka Court and held that If a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain. The provision made by the assessee-company for meeting the liability incurred by it under the leave encashment scheme proportionate with the entitlement earned by the employees of the company, subject to the ceiling on accumulation as applicable on the relevant date, was entitled to deduction. The liability was not a contingent liability.

NOW 43B provides for deduction for certain amounts payable by the assessee to be allowed in computing the income of that previous year in which the sum is actually paid. It is now provided that the deduction for any sum payable by an employer in lieu of any leave at the credit of his employee shall also be allowed only on actual payment basis. This amendment will take effect from 1st April, 2002, and will, accordingly, apply in relation to the assessment year 2002-2003 and subsequent years. However if in the earlier years the deduction is already allowed on the accrual basis the very same sum shall not again qualify for the purpose of the deduction in the year of payment.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

The assessee-company had two sets of employees, Staff and Officers. The officers were entitled to earned leave calculated at the rate of 2.5 days per month, i.e., 30 days per year. The staff (other than officers) were entitled to vacation leave calculated at the rate of 1.5 days per month, i.e., 18 days in a year. The earned leave could be accumulated up to a maximum of 240 days while the vacation leave could be accumulated up to a maximum of 126 days. The officers could at their option avail of the accumulated leave or in lieu of availing of the leave apply for encashment whereupon they would be paid salary for the period of leave earned but not availed of. So did the scheme extend the facility of encashment to the staff

in respect of vacation leave. The assessee-company had created a fund by making a provision for meeting its liability arising on account of the accumulated earned/vacation leave. An amount of Rs. 62,00,000 was set apart in a separate account as provision for encashment of accrued leave and was claimed as deduction while computing the income of the assessee company. You are required to answer whether such provision is allowable as deduction or not.

ANSWER

NOW 43B provides for deduction for certain amounts payable by the assessee to be allowed in computing the income of that previous year in which the sum is actually paid. It is now provided that the deduction for any sum payable by an employer in lieu of any leave at the credit of his employee shall also be allowed only on actual payment basis. This amendment will take effect from 1st April, 2002, and will, accordingly, apply in relation to the assessment year 2002-2003 and subsequent years. However if in the earlier years the deduction is already allowed on the accrual basis the very same sum shall not again qualify for the purpose of the deduction in the year of payment.

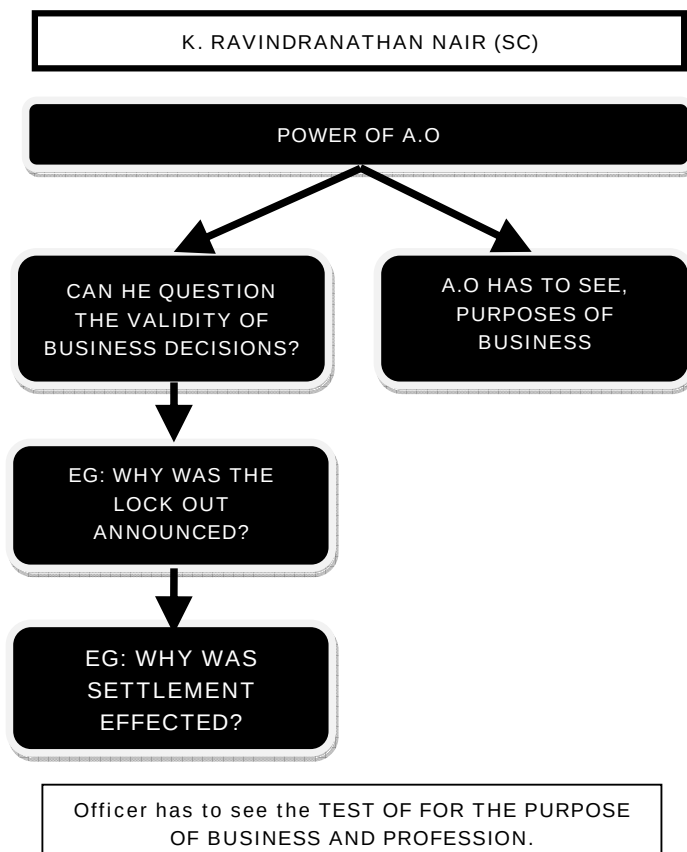
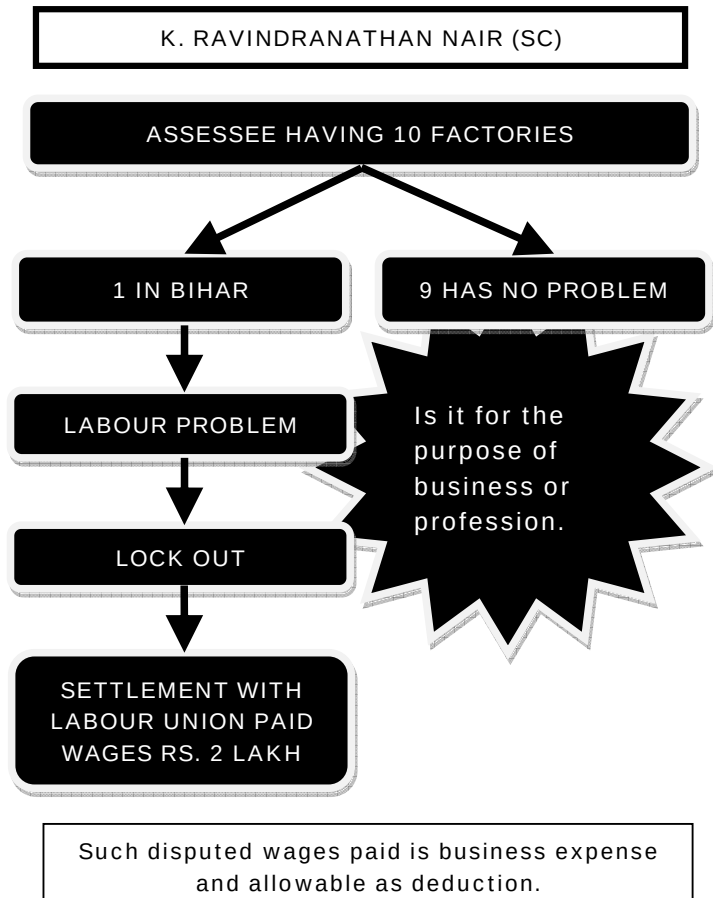
247 ITR 0178- K. RAVINDRANATHAN NAIR VS. CIT (SC)

Business expenditure to be admissible as a deduction should be one incurred in the course of carrying on business. It is for this reason that the Supreme Court earlier held that retrenchment compensation paid in connection with the closure of the business was held inadmissible. But where such retrenchment is made with a view to make the business more viable, the disallowance cannot possibly arise, or in other words, where business is still continuing, the disallowance will not be warranted.

The assessee, carried on the business of processing cashew nuts in ten units. The assessee faced labour problems consequent upon which he ordered a lockout of the four units. Assessee entered into a settlement with the trade unions representing the workmen of the units and agreed to pay them for the periods of their service up to the date of the lock-out wages for each year of service. An aggregate payment of Rs. 4,18,000 was made in this behalf. Assessee made a claim for the deduction of the said sum under section 37(1). The Income-tax Officer disallowed the claim. The Tribunal noted that the ten units run by the assessee constituted a single business.

It was because a part of the business had been affected by labour disputes, that for the industrial health of the business as a whole, it was thought just and necessary that the industrial dispute in that one part of the business be stopped. This was the purpose for which the payment was made and it was, therefore, incurred for the purposes of the business. The Tribunal noted correctly, that it was for the assessee to decide how he would conduct his business. For the purposes of continuing his business, he had to reduce the number of units from ten to six. Any incidental expense in reducing those units was an expenditure incurred in the course of conducting the business and allowable under section 37. The expenditure that was incurred by the assessee was a business expenditure and the assessee was entitled to its deduction under section 37. Held that where the assessee had 10 cashew nut processing units and paid compensation for the employees of 4 units, all forming part of the same business, the disallowance would not be warranted.

QUESTION THAT CAN BE SET IN AN



EXAMINATION CONDITION

The assessee, an individual Mr. X, carried on the business of processing cashewnuts in ten units. Four of these units were situated in Kerala. Of these four units, two were owned by the assessee and two were taken on lease. In October, 1995, the assessee faced labour problems in Kerala, consequent upon which he ordered a lock-out of the four units there. The agreement in this behalf provided that the workmen employed in the two units would have continuity of service. During the previous year the assessee entered into a settlement with the trade unions representing the workmen of the units in Kerala and agreed to pay them for the periods of their service up to the date of the lock-out five days' wages for each year of service. An aggregate payment of Rs. 4,18,000 was made in this behalf. You are required to answer whether, the assessee is entitled to claim deduction of Rs. 4,18,000.

ANSWER

It was because a part of the business had been affected by labour disputes, that for the industrial health of the business as a whole, it was thought just and necessary that the industrial dispute in that one part of the business be stopped. This was the purpose for which the payment was made and it was, therefore, incurred for the purposes of the business. The Tribunal noted correctly, that it was for the assessee to decide how he would conduct his business. For the purposes of continuing his business, he had to reduce the number of units from ten to six. Any incidental expense in reducing those units was an expenditure incurred in the course of conducting the business and allowable under section 37. The expenditure that was incurred by the assessee was a business expenditure and the assessee was entitled to its deduction under section 37. Held that where the assessee had 10 cashew nut processing units and paid compensation for the employees of 4 units, all forming part of the same business, the disallowance would not be warranted.

248 ITR 0110- COMMISSIONER OF INCOME-TAX VS. AUTOKAST LTD. (SC)

Assessee kept the moneys borrowed from the Industrial Development Bank of India for purchase of plant and machinery in short-term deposits in banks and used it in bill discounting until payment for the plant and machinery, the interest earned on the deposits was taxable in the hands of the assessee as income from other sources.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee had derived interest from short term deposits out of moneys borrowed for purchase of plant and machinery. Such deposit was also used for bill discounting. Assessee is of the view that since it has nexus with the business, it would be assessable under the head "Business". You are required to advise him on the matter.

ANSWER

Assessee kept the moneys borrowed from the Industrial Development Bank of India for purchase of plant and machinery in short-term deposits in banks and used it in bill discounting until payment for the plant and machinery, the interest earned on the deposits was taxable in the hands of the assessee as income from other sources. As decided in case of [2001] 248 ITR 0110- COMMISSIONER OF INCOME-TAX VS. AUTOKAST LTD. (SC)

248 ITR 0341- BISON FIELD A ESTATE VS. INSPECTING AC (SC)

If a coffee grower chooses to maintain his accounts on the mercantile system he might have credited the value of the coffee handed over to the coffee pool on the basis of the value given by the pooling agent although consideration finally determined in a subsequent point of time should be treated as relating to the year in which it was pooled for sale was the question before the court.

Held that handing over the coffee by the planter to the Coffee Board amounted to a sale, the related consideration is required to be accounted in the year of such sale under mercantile system of accounting. EXCESS RECEIVED IN SUBSEQUENT YEAR ALSO ACCRUES IN YEAR OF SALE.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee pooled coffee under the arrangement with the Coffee Board, where the payment for the pooled coffee becomes determined and available to the planters in a later year. You are required to answer whether should it be taken as relating to the year of sale or such later year ?

ANSWER

Though the concept of accrual would recognise revenue, where there is a right to receive an income or an obligation to meet an expenditure, instances do arise where it is difficult to find an answer to the treatment of a particular receipt or payment in the peculiar facts of the case. One such case is in respect of consideration that has to be adopted for coffee pooled under the arrangement with the Coffee Board, where the payment for the pooled coffee becomes determined and available to the planters in a later year. Should it be taken as relating to the year of sale or such later year? This was the issue answered by the Supreme Court in *Bison Field A Estate v. IAC* [2001] 248 ITR 341, although price finally determined in a subsequent point of time, should be treated as relating to the year in which it was pooled for sale.

252 ITR 0622- BHARAT STEEL TUBES LTD. VS. CIT (DEL)

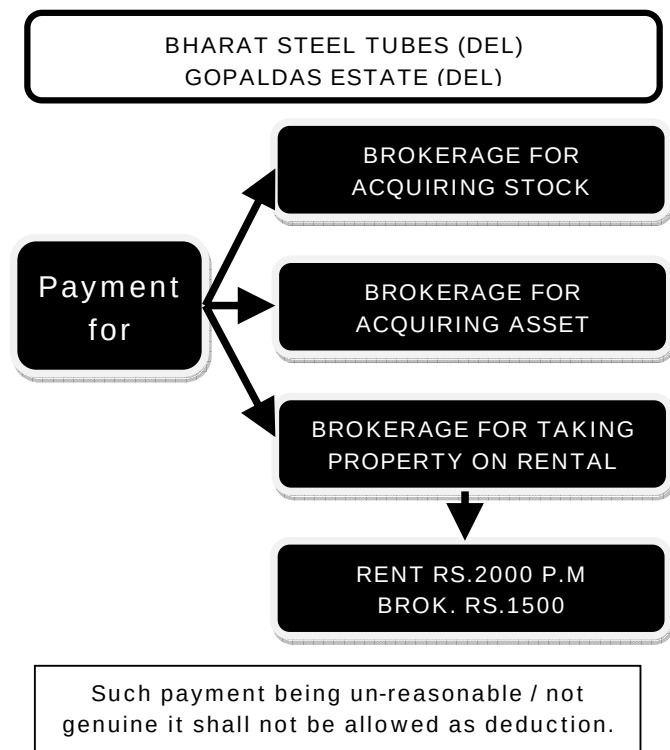
Commission paid for engaging a premises for rent would partake of the character of normal revenue expenditure of the business. But in this case the amount paid was Rs. 21,110, while the annual rent was only Rs.2,625. It is probably in these circumstances, that the amount was treated as salami or premium and was disallowed.

Question

The assessee a public limited company claimed deduction of Rs. 23,735 as commission for renting office premises. Rs. 2,625 was paid for renting office premises at 12-13/F, Connaught Place, New Delhi. The Income-tax Officer disallowed the entire claim on the ground that it was of capital nature. The assessee was of the opinion that acquiring of suitable office premises was certainly in the interest of the assessee-company and expenses incurred for renting the premises were in the nature of revenue expenditure incurred for the purpose of the business and commission were incidental thereto. You are required to answer whether such commission is allowable as deduction or not.

Answer

Commission paid for engaging a premises for rent would partake of the character of normal revenue expenditure of the business. But in this case the amount paid was Rs. 21,110, while the annual rent was only Rs.2,625. It is probably in these circumstances, that the amount was treated as salami or premium and was disallowed. [2001] 252 ITR 0622- BHARAT STEEL TUBES LTD. VS. COMMISSIONER OF INCOME-TAX (DELHI HIGH COURT)



253 ITR 0667- CIT VS. COATS VIYELLA INDIA LTD. (MAD)

Payment made to government for construction of new bridge providing access to assessee's factory for its workmen and movement of goods is a revenue expenditure and allowable as deduction. The fact that such contribution resulted in a capital asset would not make any difference, because the assessee is not the owner of such asset created by the contribution.

Question

Officer was of the opinion that the contribution made by the assessee to the Government for building a new bridge across the river in place of the old one which had become unserviceable, and which bridge was essential to provide access to the assessee's factory as the workmen could not reach the factory unless that bridge was available for their movement is in the nature of capital expenditure, and not revenue. Where assessee do not find it possible to agree. You are required to explain the correct position of law.

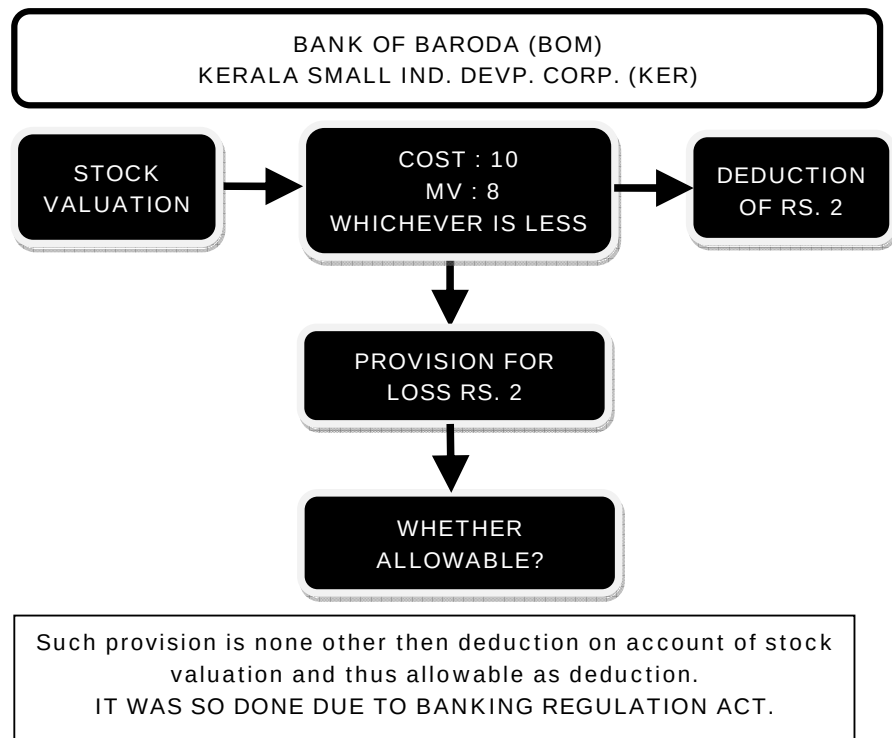
Answer

The Supreme Court in the case of L. H. Sugar Factory and Oil Mills (P.) Ltd. v. CIT [1980] 125 ITR 293, held that when a road is constructed in order to facilitate transport of sugarcane to the sugar factory and the outflow of the manufactured sugar to the market, such construction facilitates the business operation of the assessee and enables the assessee to conduct the business more efficiently and profitably. Though the advantage may be of long duration as the roads would last long, nevertheless, it would not be an advantage in the capital field, as no tangible or intangible asset was acquired by the assessee, nor was there any addition to, or expansion of the profit-making apparatus of the assessee.

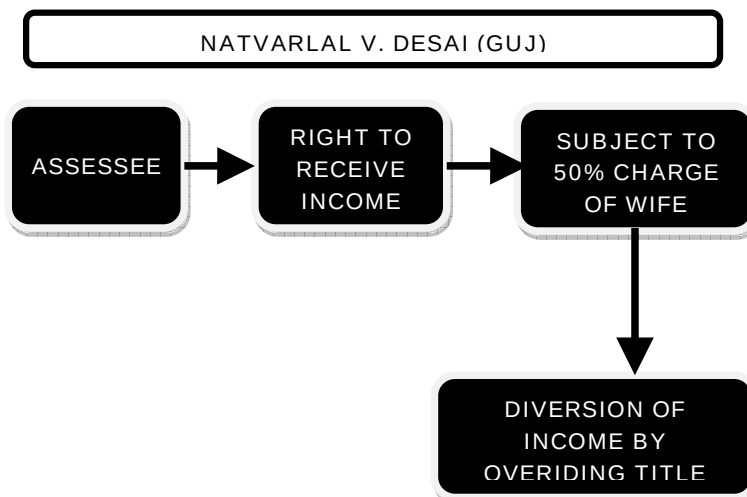
Here, the bridge is one which is built across the river. The bridge is not owned by assessee. It is built by the Government, and the assessee does not acquire any rights of ownership over the bridge in the short-term or in the long run by reason of the contribution that it agreed to pay towards the construction of the bridge. So far as the assessee is concerned, the payment made is an outgo in return for which it receives no addition to the value of any of the assets owned by it. The bridge merely facilitates the movement of the workmen to gain access to the assessee's factory and to return home, and also for the movement of the goods over the bridge. The facts of this case are such as to bring it within the ratio of the decision in the case of L. H. Sugar Factory and Oil Mills (P.) Ltd. v. CIT [1980] 125 ITR 293 (SC). Therefore the amount is to be treated as revenue expenditure. [2002] 253 ITR 0667- COMMISSIONER OF INCOME-TAX VS. COATS VIYELLA INDIA LTD. (MAD)

262 ITR 0334- COMMISSIONER OF INCOME-TAX VS. BANK OF BARODA (BOM)

The assessee was a nationalised bank. The assessee-bank had in its possession, during the relevant assessment year, shares and securities worth several crores of rupees. The method of valuation followed by the assessee was to value investments at cost or market value whichever was lower. During the year of account, depreciation with regard to securities held by the assessee was to the tune of Rs. 11,82,35,007. The assessee-bank claimed deduction. This was disallowed by the Income-tax Officer. The assessee-bank appealed to the Commissioner (Appeals) who took the view that the said investments were rightly valued at the end of the year at cost or market value whichever was lower and the difference arising as a result of this valuation had to be allowed to the assessee as a loss. Held, that the loss of Rs. 11,82,35,007 had been debited to the profit and loss account which was reflected as a provision for liability in the balance-sheet and the shares and securities were valued at cost on the assets side. The assessee was entitled to the deduction.

**262 ITR 0064 CIT VS. NATVARLAL V. DESAI (GUJ)**

Where the assessee's right to receive the fifty per cent. share from the firm was subject to one-half of it being given to his wife and the wife had a prior charge over the share income received from that firm.

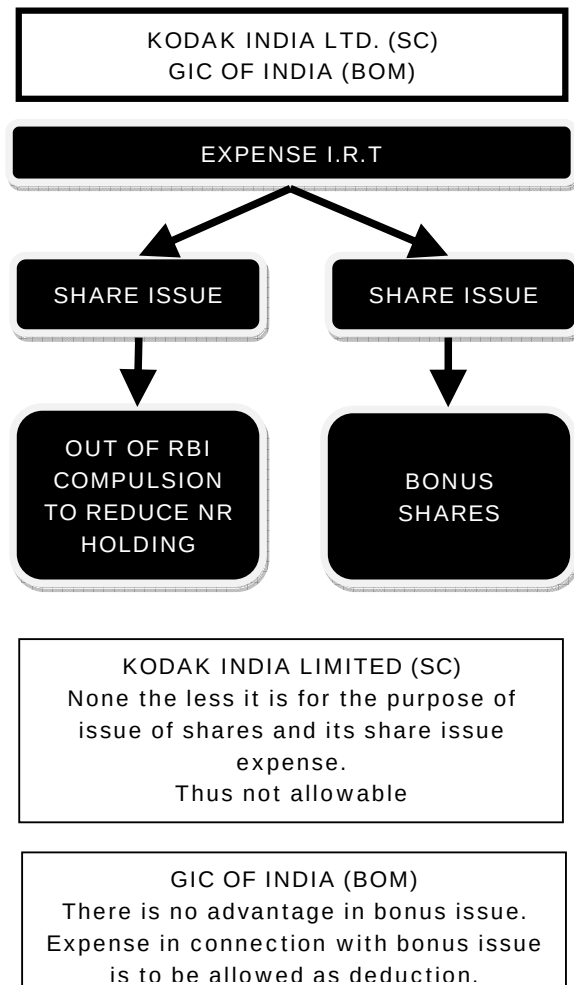


Therefore this was not a case of sharing the profits of a partnership between the assessee and his wife but of subjecting the assessee's share from the firm to a fifty per cent. charge in favour of the wife. It was not as if the assessee and his wife were jointly doing some business and after the profits were received from that business, they were dividing it between themselves. That fifty per cent share was subject to the charge in favour of his wife to the extent of one-half of it. That was merely a division of the profit

and not authority to carry on business on behalf of the wife. Therefore, the requirement of partnership was not satisfied. Therefore, this was a case of diversion of the profit at source and the assessee's wife

had agreed to make a partition and not to any other transaction. The Tribunal had rightly come to the conclusion that no sub-partnership was formed between the assessee and his wife and the share of the assessee's wife could not be included in the income of the assessee. (However now by virtue of section 10 the share of profit from partnership firm is exempt from tax)

253 ITR 0445- CIT VS. KODAK INDIA LTD. (SC)



Where the assessee company incurred expenditure for the public issue of shares to increase its share capital pursuant to a direction of the Reserve Bank to do so to reduce its non-residential holding to 40 per cent. : Held, that the expenditure was capital expenditure.

Question

The registration fee was paid by the assessee company for increasing the authorised capital of the company. After increasing the authorized capital assessee has issued the shares to non residents. This was because it had to reduce its non-residential holding to forty per cent as per the direction of RBI. You are required to answer whether such share issue expense is allowable as deduction or not.

Answer

The assessee had acted to increase its share capital because it had been directed by the Reserve Bank of India so to do. This was because it had to reduce its non-residential holding to forty per cent. It was learned counsel's submission that the only way in which the assessee could do business after the Reserve Bank directive was to issue share capital to comply with it. In his submission, therefore, the decision of this court in the case of Punjab State Industrial Development Corporation Ltd. [1997] 225 ITR 792 was

distinguishable. Whichever way we look at it, the object of the assessee was to increase its share capital ; whether it did so to continue to do business after the Reserve Bank directive or otherwise, the case is covered by the judgment in the case of Punjab State Industrial Development Corporation Ltd. [1997] 225 ITR 792 (SC). And the expenditure is not allowable as deduction. [2002] 253 ITR 0445 COMMISSIONER OF INCOME-TAX VS. KODAK INDIA LTD. (SUPREME COURT OF INDIA)

253 ITR 0062- CIT VS. MADURA COATS LTD. (MAD)

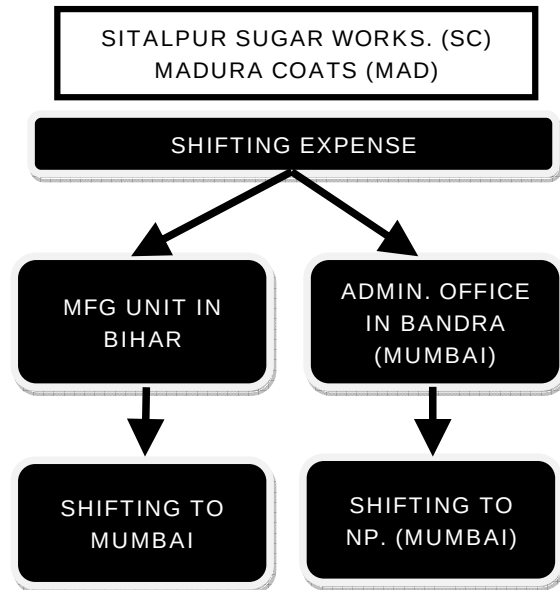
The expenditure incurred by the assessee for shifting its administrative office from M to B as a result of amalgamation of three companies having a number of activities in various centres was allowable as a revenue expenditure in the computation of business income, since such shifting enables mere improvement in convenience and efficiency and not an enduring advantage.

Question

You are required to answer whether the expenditure incurred in shifting the offices after amalgamation from Madurai to Bangalore should be regarded as capital or revenue expenditure.

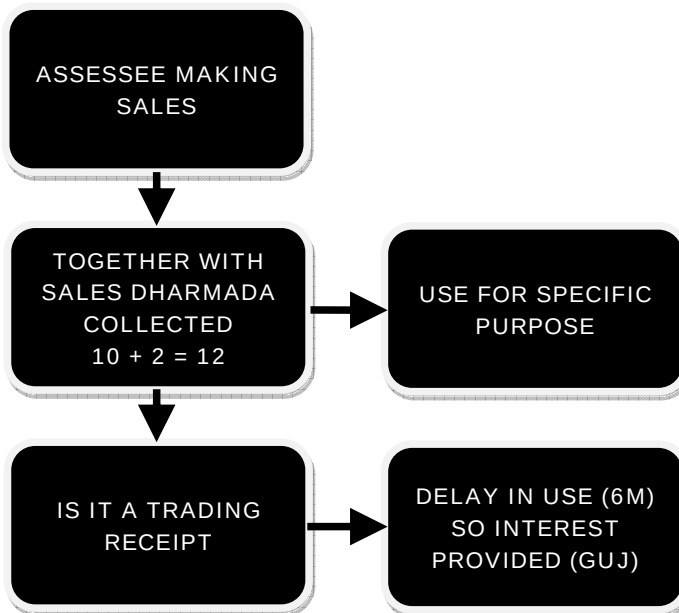
Answer

It is obvious that the expenditure incurred was in relation to the continuing business of the company which was to be henceforth carried on so far as the administrative control is concerned from Bangalore instead of Madurai. The fact that it was done after amalgamation cannot be regarded as rendering it capital expenditure, as no enduring advantage can be said to have been received. Mere improvement in convenience, and increase in efficiency does not mean a



permanent advantage which has to be regarded as falling within the capital field.

BIJLEE COTTON MILLS (SC)
NANALAL MANSUKHRAM (GUJ)



However reasonable interest provided is expenditure for the purpose of business.

253 ITR 0050- CIT VS. NANALAL MANSUKHRAM (GUJ)

The funds received [as Donation] by the assessee-firm were treated as capital receipts in the hands of the assessee-firm by the Income-tax Officer. Once the Department accepts that the monies lying to the credit of various accounts do not belong either to the firm or to its partners' but belong to a third party and if such funds are utilised for the purpose of business and interest is paid, it has to be held that such interest is rightly claimed as a deductible item of expenditure.

Question

The assessee is a private firm and it was maintaining charity accounts known as "Subh Accounts" in its books of account in relation to the amounts of money received from various

persons who were related to the partners. Admittedly, the assessee was not required to return the funds received from such persons and in view of the said fact, the Income-tax Officer treated the said amounts as capital receipts in the hands of the assessee-firm. However, in view of the fact that though these moneys were required to be utilised only for charitable purposes and yet were utilised for the purposes of business of the assessee-firm, the Income-tax Officer disallowed the interest paid on the balances standing in such accounts. You are required to answer whether such interest is rightly disallowed by assessee or not.

Answer

Section 36(1)(iii) of the Act permits allowance of interest paid on any capital borrowed for the purposes of business. In the present case, it is not in dispute that the funds received by the assessee-firm were treated as capital receipts in the hands of the assessee-firm by the Income-tax Officer. The said funds were utilised for the purpose of business by the assessee and it has paid interest on such funds utilised in its business. The Tribunal has found as a matter of fact that the Revenue has not doubted the genuineness of the stand taken by the assessee in respect of various accounts bearing the character of public trust. In view of this factual situation, once the Department accepts that the monies lying to the credit of various accounts do not belong either to the firm or to its partners' but belong to a third party and if such funds are utilised for the purpose of business and interest is paid, it has to be held that such interest is rightly claimed as a deductible item of expenditure.

254 ITR 0203- CIT VS. GENERAL INSURANCE CORPORATION OF INDIA (NO.1) (BOM)

Expenses incurred in connection with issue of bonus shares are deductible as revenue expenditure. Bombay Burmah Trading Corporation Ltd. v. CIT [1984] 145 ITR 793 (Bom) followed. As regards filing fees for enhancement of capital, the Supreme Court has already decided that it would be capital expenditure in Punjab State Industrial Development Corporation Ltd. v. CIT [1997] 225 ITR 792 (SC). At any rate, a case relating to expenditure on the issue of bonus shares should merit a favourable view, since there is no effective increase in capital because the issue is only out of reserves forming part of the net owned fund. However, this is an area, which should merit a more sympathetic treatment at least by way of staggered deduction under section 35D.

Question

You are required to answer whether the registration fee paid by the assessee for increasing the authorised capital of the company is a capital expenditure or revenue expenditure? After increasing the authorized capital assessee has issued the bonus shares and also incurred the expenditure on its issue. Such bonus shares issue expenditure is claimed as deduction by assessee. Whether the claim of assessee is justified or not?

Answer

In a short judgement, the Supreme Court dealt with payment of charges to the Registrar of Companies as filing fees for the enhancement of the capital base of a company already in business. Notwithstanding the fact that the company was only expanding the capital base of a business already in existence and that such expansion would help the business of the company as well as its profits, it still retains the character of capital expenditure as it directly relates to the expansion of the capital base of the company. It was so held in Punjab State Industrial Corporation Ltd. v. CIT [1997] 225 ITR 792 (SC).

However expenses incurred in connection with issue of bonus shares are deductible as revenue expenditure. At any rate, a case relating to expenditure on the issue of bonus shares should merit a favourable view, since there is no effective increase in capital because the issue is only out of reserves

forming part of the net owned fund. [2002] 254 ITR 0203- Commissioner of Income-tax vs. General Insurance Corporation of India (No.1) (Bom)

254 ITR 0799- LACHMANDAS MATHURADAS VS. CIT (SC)

Should interest on sales tax arrears be treated differently from interest under income-tax law since sales tax unlike income-tax is an allowable deduction, it can be disallowed only if it is for violation of law as decided by the Supreme Court in Prakash Cotton Mills Pvt. Ltd. v. CIT [1993] 201 ITR 684. In Lachmandas Mathuradas v. CIT [2002] 254 ITR 799 (SC), interest on arrears of sales tax was found to be compensatory in character and therefore deductible.

254 ITR 0201- CIT VS. GEMINI ARTS P. LTD. (MAD)

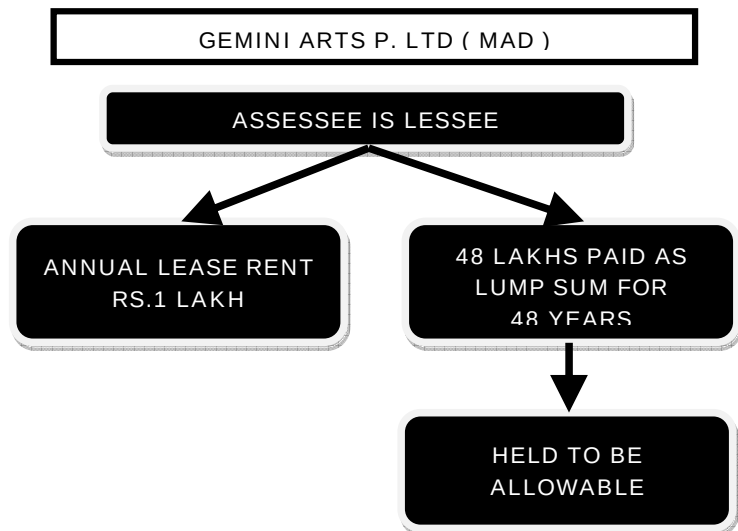
Premium paid for lease of land has been generally understood as capital expenditure. But in this case payment of a lump sum for a lease of 48 years was found to be eligible for deduction as revenue expenditure following the decision of the Supreme Court in CIT v. Madras Auto Service P. Ltd. [1998] 233 ITR 468. That "whatever substitutes for revenue expenditure should normally be considered as revenue expenditure".

Question

The assessee which had leasehold land for 48 years chose to pay with the consent of the lessor the rent for 47 years in lumpsum. The lease was for a period of 48 years and the lump sum payment was made. The terms of the lease did not contemplate any increase in the rate or rental during the period of lease. The lessee got no other advantage by reason of this lump sum payment except the relief of not having to make the annual payment during the period of lease. The contention of the officer was that the assessee had received an advantage of enduring nature by making such a lump sum payment. You are required to answer whether such contention is justified or not.

Answer

If the assessee chose to pay the rent annually for each and every year of lease such expenditure certainly would have to be regarded as revenue expenditure. To decide whether it is capital or revenue one has to look at the expenditure from a commercial point of view. The fact that the payment was made in lump sum for the entire duration of the lease does not alter the character of revenue expenditure. Thus the expenditure so incurred by the assessee being of a revenue character it had to be deducted from its income in the year in which the expenditure was incurred. [2002] 254 ITR 0201- Commissioner of Income-tax vs. Gemini Arts P. Ltd. (Madras High Court)

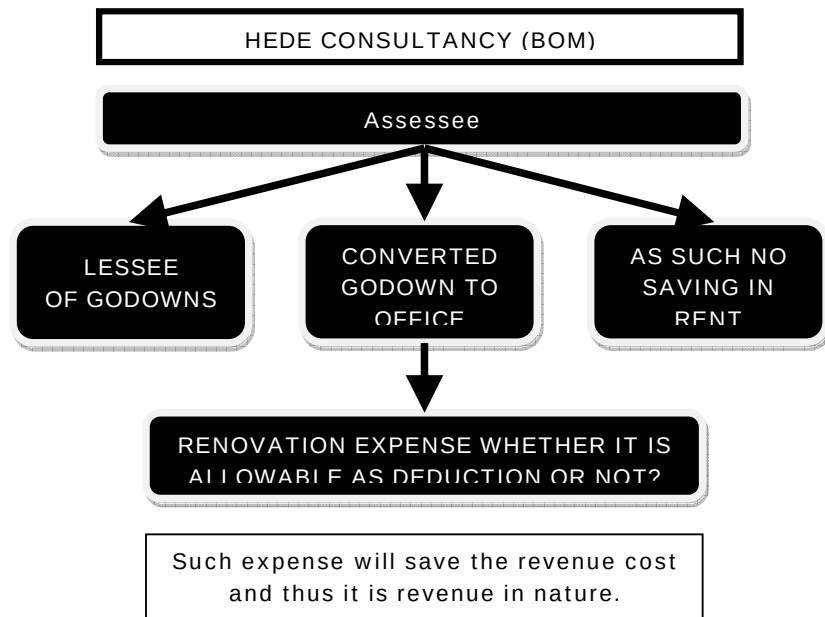


258 ITR 0380- CIT VS. HEDE CONSULTANCY PVT. LTD. (BOM)

The assessee had taken a godown on lease. It spent Rs. 9,20,436 for converting the godown premises into office by renovating it, incurring expenses on interior decoration, which resulted in replacement of the existing roof with that of cement sheets, replacement of floor with that of marble, plastering of walls and construction of bathrooms and W. C., etc. The assessee claimed the said expenditure of Rs. 9,20,436 as revenue expenditure. The Assessing Officer disallowed the claim but the Tribunal allowed it. On further appeal to the High Court Held, dismissing the appeal, that since the assets created by spending the said amounts did not belong to the assessee but the assessee got the business advantage of using modern business premises at a low rent, thus saving considerable revenue expenditure for a considerably long period, the Tribunal was perfectly justified in coming to the conclusion that the expenditure should be looked upon as revenue expenditure.

Question

The assessee had taken a godown on lease. It spent Rs. 9,20,436 for converting the godown premises into office by renovating it, incurring expenses on interior decoration, which resulted in replacement of the existing roof with that of cement sheets, replacement of floor with that of marble, plastering of walls and construction of bathrooms and W. C., etc. The assessee claimed the said expenditure of Rs. 9,20,436 as revenue expenditure since assessee got the business advantage of using modern business premises at a low rent, thus saving considerable revenue expenditure for a considerably long period. The Assessing Officer disallowed the claim. You are required to explain the tax treatment of the said expense.

**Answer**

The general principles applicable in determining whether a particular expenditure is capital or revenue expenditure are as follows

- 1) Outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment
- 2) Expenditure may be treated as properly attributable to capital when it is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade. If what is got rid of by a lump sum payment is an annual business expense chargeable against revenue, the lump sum payment should equally be regarded as a business expense, but if the lump sum payment brings in a capital asset, then that puts the business on another footing altogether
- 3) Whether for the purpose of the expenditure, any capital was withdrawn, or, in other words, whether the object of incurring the expenditure was to employ what was taken in as capital of the business. Again, it is to be seen whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital.

Since the assets created by spending the said amounts did not belong to the assessee but the assessee got the business advantage of using modern business premises at a low rent, thus saving considerable revenue expenditure for a considerably long period, the assessee was perfectly justified in coming to the conclusion that the expenditure should be looked upon as revenue expenditure. [2002] 258 ITR 0380-Commissioner of Income-tax vs. Hede Consultancy Pvt. Ltd. (Bombay High Court)

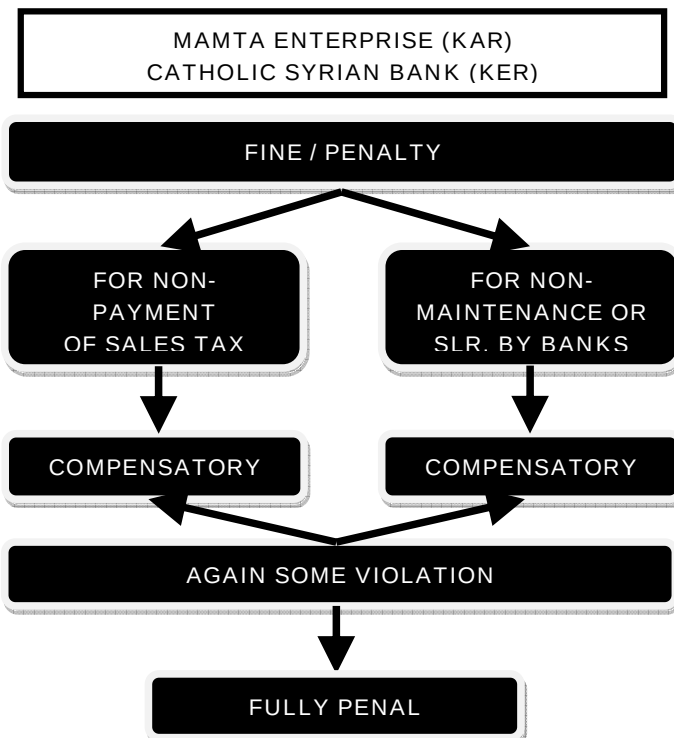
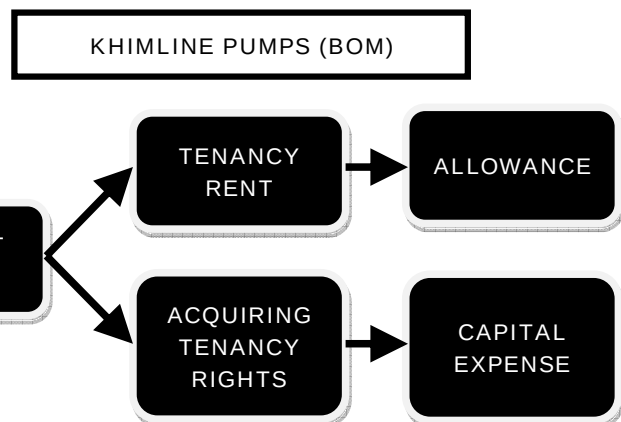
258 ITR 0459- CIT VS. KHIMLINE PUMPS LTD. (BOM)

Where a premium is paid for acquiring leasehold rights from a lessee with the unexpired period of such lease being about 70 years, such amount should necessarily be treated as capital expenditure. The Tribunal was, therefore, held to be not justified in directing such deduction of a rateable amount pertaining to each year in CIT v. Khimline Pumps Ltd. [2002] 258 ITR 459 (Bom). The High

Court did not accept the argument that the judgment of the Supreme Court in CIT v. Madras Auto Service P. Ltd. [1998] 233 ITR 468 supported the case for deduction. Where the payment is for the right of tenancy itself, the decision would have no application.

Question

An open plot of land was leased out to APVE Ltd., a company, for a period of 95 years commencing from August 1, 1965, on payment of a premium of Rs. 1,62,400 and yearly rent of Re. 1. Under the lease the company had, at the end of the 95 years, to deliver vacant possession of the land. It was entitled to remove any building or structure put up by it on the land. The company had erected building and plant and machinery thereon. APVE Ltd. was ordered to be wound up and its assets were sold under directions of the High Court. The assessee offered Rs. 75 lakhs, of which the Assessing Officer held that Rs. 45 lakhs related to acquisition of the leasehold land, but that amount could not be deducted as it was capital expenditure. You are required to answer whether views of the officer is justified or not.



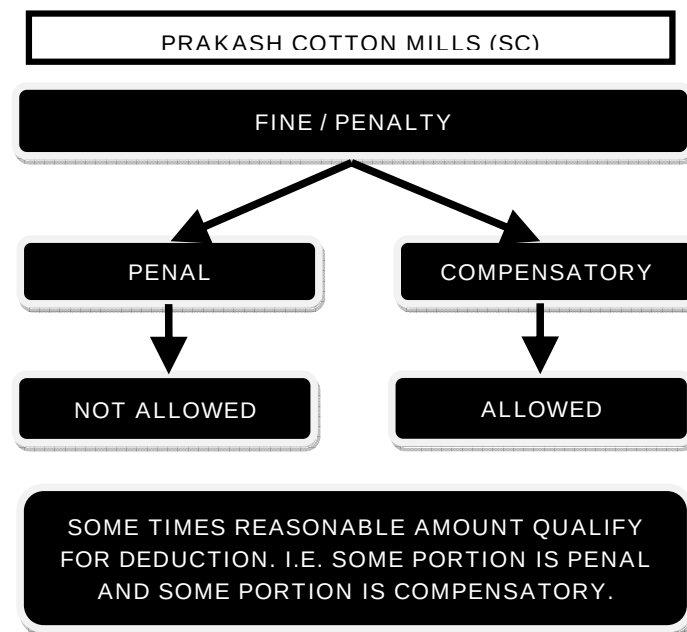
Answer

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amount pertaining to each year in CIT v. Khimline Pumps Ltd. [2002] 258 ITR 459 (Bom). The High Court did not accept the argument that the judgment of the Supreme Court in CIT v. Madras Auto Service P. Ltd. [1998] 233 ITR 468 supported the case for deduction. Where the payment is for the right of tenancy itself, the decision would have no application. Thus the whole of the amount offered does not qualify for the deduction. However assessee may claim depreciation of the same calling it as intangible assets which is commercial in nature.

265 ITR 0177- CIT VS. CATHOLIC SYRIAN BANK LTD. (KER)

Banks are obliged to pay interest to the Reserve Bank of India for shortfall in the prescribed cash reserves under the Banking Regulation Act, 1949, providing for punishment by way of bar for acceptance of



public deposits besides fine and prosecution of the officers but with a clear discretion to the Reserve Bank not to demand payment of penal interest or penalty for non-compliance. In similar circumstances, such payment of interest was held to be in the nature of penalty so as to require disallowance in CIT v. Syndicate Bank [2003] 261 ITR 528 (Karn) (see [2003] 261 ITR (Journal) 36 to 39). The view that it is in the nature of a fine or penalty, it was pointed out, could not be a correct one, since it has to be characterised either as compensatory, so that it should be treated as a permissible deduction as held in Mahalakshmi Sugar Mills Co. v. CIT [1980] 123 ITR 429 (SC) or Prakash Cotton Mills (P.) Ltd. v. CIT [1993] 201 ITR 684 (SC) or it

should be treated as incidental to the banking business not always possible to avoid in view of the exigencies of business, where the available cash and the demand for cash at any particular point of time is uncertain. The same issue arose in CIT v. Catholic Syrian Bank Ltd. [2004] 265 ITR 177 (Ker). The decisions relating to banks have proceeded on the basis that such payment would not generally be allowable. In the Catholic Syrian Bank case, it was claimed that the default was the first one and that the Reserve Bank had the discretion not to charge interest, so that in such a case the payment, it was understood, could not be treated as penal. It was for ascertaining this fact as to whether it was the first default or otherwise that the matter was remanded. Obviously in this case interest was not remitted, so that the inference of the High Court should be understood, as one that it would not amount to a penalty, if it was a first default, whether it was condoned by the Reserve Bank or not, while payment of interest for subsequent default should be treated to be in the nature of penalty.

265 ITR 0197- COMMISSIONER OF INCOME-TAX VS. P. SOMAN (KERALA HIGH COURT)

Where a fine and penalty under the Central excise law was paid by a jewellery shop for some discrepancies noticed during a search, the question arose whether it was deductible. The Tribunal considered it as compensatory. But this finding was challenged by the Revenue. The High Court found that the law on the subject was settled and that the issue as to whether it is compensatory or otherwise should have been decided in the light of the provisions of the Central Excise Act. The High Court

remitted the matter back to the Assessing Officer for fresh decision for this purpose in CIT v. P. Soman [2004] 265 ITR 197 (Ker).

BRIEF NOTE ON DEDUCTION FOR FINES OR PENALTY.

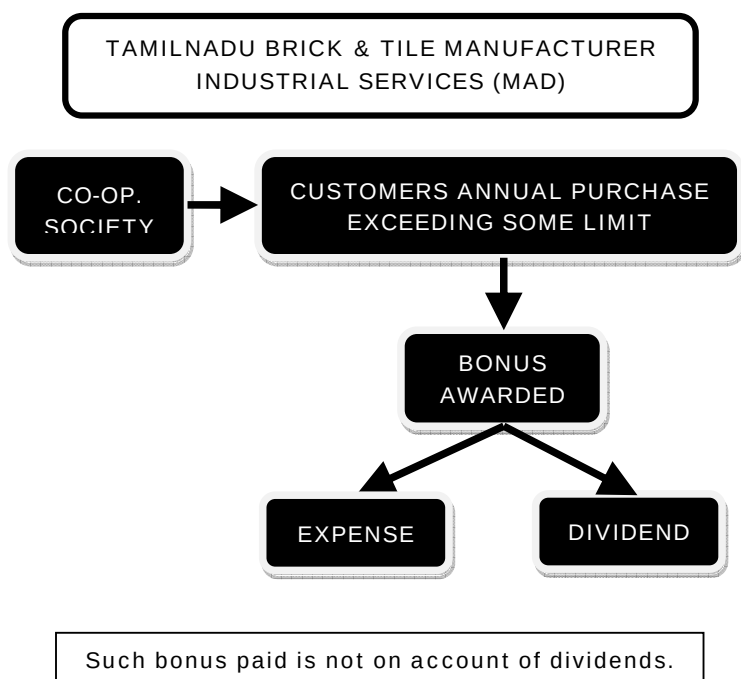
Whenever any statutory impost paid by an assessee by way of damages or penalty or interest is claimed as an allowable expenditure under section 37(1) of the Income-tax Act, the assessing authority is required to examine the scheme of the provisions of the relevant statute providing for payment of such impost notwithstanding the nomenclature of the impost as given by the statute, to find whether it is compensatory or penal in nature. The authority has to allow deduction under section 37(1), wherever such examination reveals the concerned impost to be purely compensatory in nature. Wherever such impost is found to be of a composite nature, that is, partly of compensatory nature and partly of penal nature, the authorities are obligated to bifurcate the two components of the impost and give deduction to that component which is compensatory in nature and refuse to give deduction to that component which is penal in nature.

In *Swedeshi Cotton Mills Co. Ltd. v. CIT* [1998] 233 ITR 199 the question which arose for consideration was as to whether the Tribunal was justified in allowing deduction of liability incurred by the assessee for payment of damages and for delayed payment of employees' contributions under section 14B of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, as also the question as to whether the penalty levied on the assessee under the Central Sales Tax Act for delayed payment of sales tax was an allowable deduction under section 37 of the Income-tax Act, 1961. The Supreme Court noted its earlier decision in *Prakash Cotton Mills (P.) Ltd.'s case* [1993] 201 ITR 684 and the decision of the Andhra Pradesh High Court in *Hyderabad Allwyn Metal Works Ltd.'s case* [1988] 172 ITR 113

265 ITR 0332 TAMIL NADU BRICK AND TILE MANUFACTURERS INDUSTRIAL SERVICE CO-OPERATIVE SOCIETY LTD. VS. CIT (MAD)

Section 72 of the Co-operative Societies Act, which specifically referred to the payment of "bonus" to the members with reference to the business done with or service rendered to the registered society, such payment is payable not because they are members, but because they have made certain purchases from the society on the basis of which the bonus is quantified. He further contended that as per the Co-operative Societies Act, in order to ensure that the co-operative society does not incur loss, the bonus to its members is paid only after closing the accounts and after ascertaining the net result of the profit or loss of the trading transaction. In substance, he contended that the purchase bonus paid to the members with reference to the business done is to be considered as a deferred discount. Thus the "purchase bonus" payable to the members is an allowable deduction

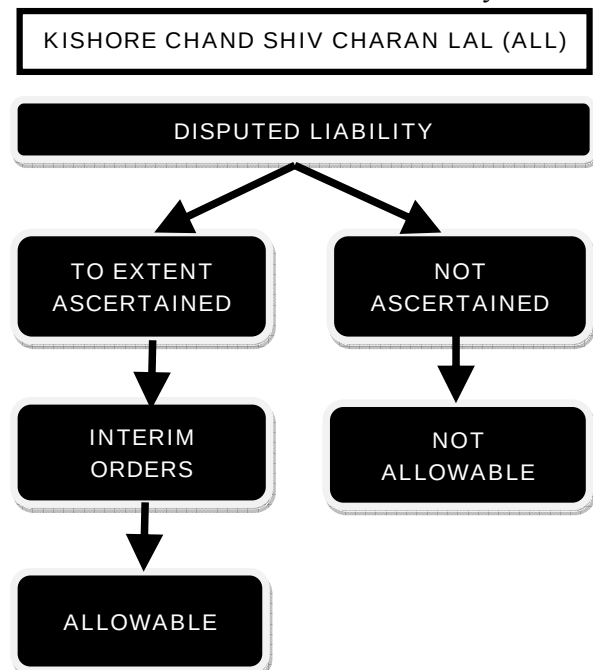
The placement regarding payment of bonus to members next to the placement of declaration of dividend on shares, is not conclusive in determining the question whether the payment of bonus to members is deductible expenditure or not. So also, the fact that under the Co-operative Societies Act, the payment of bonus to members is required to



be made out of the net profits of the co-operative society is not conclusive in determining the question whether the said amount is deductible expenditure in the computation of business income of the co-operative society under the Income-tax Act. The purchase bonus is really a deferred discount, that is paid to the members after determination of the net profits of the co-operative society. Therefore, this expenditure is paid for the business of the assessee and is a business expenditure and is allowable as a business deduction. When the statute has directed that the amount is liable to be paid by way of purchase bonus, the expenditure would be allowable even on the ground that the payments were required to be made under the provisions of the statute. The Central Board of Direct Taxes in consultation with the Department of Community Development and Co-operation has issued a circular to the effect that rebate or bonus would be in the nature of deferred discount passed on by consumer co-operative stores to their members and this is an allowable deduction in the computation of income of the co-operative society. Though the circular was issued in the case of consumer co-operative stores, there are no reasons to take a different view that it would not be a deferred discount in the case of other co-operative societies where bonus is paid to the members of the co-operative societies on the value of purchases made by them during the year.

266 ITR 0037- CIT VS. KISHORE CHAND SHIVCHARAN LAL (ALL)

While the law is that contingent expenditure is not deductible even under the mercantile system of accounting, the issue as to what is contingent and what is not, may present a problem in particular facts of a case. In *Alembic Chemical Works Ltd. v. Deputy CIT* [2004] 266 ITR 47 (Guj), the High Court after review of the precedents on the subject found that, while the liability was disputed and pending in the High Court, it was not possible to accept the contention that the liability was not contingent. In coming to this conclusion, the High Court followed the decision in *CIT v. Swadeshi Cotton and Flour Mills Pvt. Ltd.* [1969] 53 ITR 134 (SC). It would still appear that this principle relating to contractual liability as distinct from statutory liability should be subject to the overriding principles of prudence and conservatism ruling out deduction of only what is purely contingent. On the same issue, it was decided that to the extent to which disputed liability is ascertained, it can be allowed in the year in which it is so ascertained in *CIT v. Kishore Chand Shivcharan Lal* [2004] 266 ITR 37 (All).



266 ITR 0170- COMMISSIONER OF INCOME-TAX VS. MADRAS REFINERIES LTD. (MAD)

The concept of business is not static. It has evolved over a period of time to include within its fold the concrete expression of care and concern for the society at large and the people of the locality in which the business is located, in particular. Being known as a good corporate citizen brings goodwill of the local community, as also with the regulatory agencies and the society at large, thereby creating an atmosphere in which the business can succeed in a greater measure with the aid of such goodwill. Held, that the amount spent for bringing drinking water as also for establishing or improving the school meant for the

residents of the locality in which the business was situated could not be regarded as being wholly outside the ambit of the business concerns of the assessee, especially where the undertaking owned by the assessee was one which was to some extent a polluting industry. The expenditure was deductible.

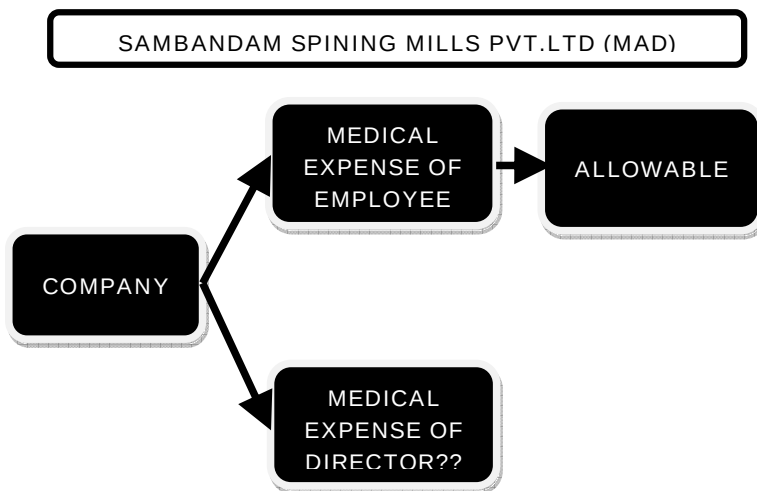
A landmark decision has been rendered by the Madras High Court in CIT v. Madras Refineries Ltd. [2004] 266 ITR 170, when it decided, that expenditure incurred by an assessee to bring water facilities to the residents in the vicinity of the refinery and also aid a school run for the benefit of children of the local residents, should be allowed as a deduction. Though there are precedents to allow such aid linked with benefit for own employees, the High Court found that, even if it is not so linked, it could be allowed as a deduction as a measure to promote goodwill, so that it will be a deductible expenditure. Expenditure incurred as a good corporate citizen has to be understood in the light of the modern concept of business, such concept not being static. The care and concern for the society and more particularly for the people in the locality creates an atmosphere in which the business can better succeed. It would neutralise adverse reaction against nuisance value that might be generated by refinery. Supply of drinking water being an important service is bound to create goodwill. It is on such reasoning, the amount was found to be a legitimate business deduction. It is an important precedent, which should encourage greater participation of business in social responsibility sparing tax cost. It is hoped that the decision would merit acceptance by the Revenue on principle.

266 ITR 0356- COMMISSIONER OF INCOME-TAX VS. MAMTA ENTERPRISES (KAR)

The Finance (No. 2) Act of 1998 has inserted an Explanation to section 37 of the Income-tax Act, 1961, with retrospective effect from April 1, 1962. The Explanation makes it clear that the assessee who incurs expenditure for any purpose which is an offence or which is prohibited by law is not entitled for deduction of such expenditure incurred by him. The Explanation declares that such an expenditure “shall not be deemed to have been incurred” for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure. When the provision is clear and unambiguous, it is not permissible for the courts to stretch the meaning attached to the provision of law to extend the benefit to a person who violates the law or the regulations/rules made by the Corporation or the municipal authorities with impunity. The claim for deduction has to be considered in the light of the Explanation given to section 37 of the Act and not with reference to the provision in the Corporation or the municipal law which permits the violator of the provisions of the Corporation or the municipal law to compound the offence either to save the unauthorised or illegal construction put up or to relieve such violator of law from the consequences provided in such Corporation or municipal law. Compounding fees paid to the municipal corporation is a penalty and is not deductible under section 37.

267 ITR 0149- COMMISSIONER OF INCOME-TAX VS. GOPAL DAS ESTATE (DEL)

The amount of brokerage was paid at the rate of 11/3 times the monthly rent. As against this, the benefits secured were also required to be taken into consideration as also the loss, which would be suffered by the brokers on the lower rate of monthly rent on account of higher security deposit and advance paid by the persons/tenants. In view of the totality of the situation, no interference was called for in this matter and the brokerage is to be allowed as deduction to assessee.

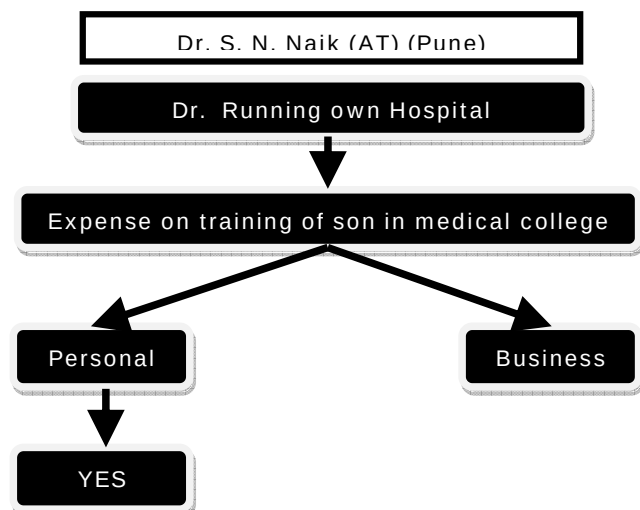
263 ITR 0115- CIT VS. SAMBANDAM SPINNING MILLS PRIVATE LTD. (MAD)

For the expense of directors its pure question of facts and to be allowed on reasonableness only.

employment, so that it is merely gratuitous, it may be possible to infer that medical expenses abroad for the managing director and his wife, who is also a director may not be admissible as was held in CIT v. Sambandam Spinning Mills Pvt. Ltd. [2003] 263 ITR 115 (Mad).

The assessee claimed the medical and travelling expenses incurred by the assessee-company for providing medical aid to its managing director in the USA in a sum of Rs. 5,34,655 as a revenue deduction treating the expenditure as expended solely for the business consideration. Likewise the air fare of the managing director's wife and another director, who accompanied the managing director was also claimed. The Assessing Officer rejected the claim which is upheld by this court.

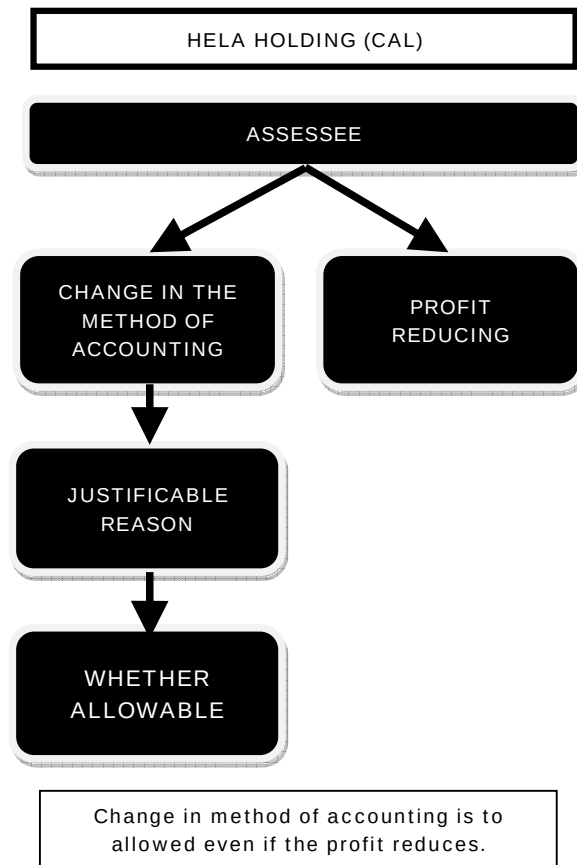
Medical expenses of an employee, whether it is to be treated as a perquisite or not in the hands of such employees should not ordinarily be disallowed in the hands of the employer in view of the interest which the employer has in the health of the employees for the purpose of his business. But where the employee is an interested person as in the case of a managing director, the question would arise whether such medical expenses could be allowed as a business deduction prompted by commercial expediency. Where the employer is not obliged to meet such medical expenses under the terms of

**263 ITR 0129- HELA HOLDINGS PVT. LTD. VS. CIT (CAL)**

The assessee is entitled to change his regular method of accounting by another regular method. It would be open to the assessee to produce records and show that it had followed such changed accounting method in subsequent years. The method of valuation of stock cost or market value whichever is less was acceptable. The method was the correct method, accepted by all the accountants. That the method gave rise to a picture of true accounting and a reflection of the true profits was also not disputed. The Tribunal should not have disallowed the assessee's claim by a mere reference to non-satisfaction of conditions, without mentioning those conditions specifically and without mentioning the breaches by the assessee, if any, equally specifically. An assessee is permitted to change its method of stock valuation honestly and in accordance with the principles of permitted tax avoidance. In this case the assessee changed its stock valuation method correctly and was entitled to the tax benefit arising therefrom.

Question

The assessee commenced the business of dealing in stocks and shares for the first time the assessee had adopted the method of taking the cost of acquiring of stocks for the purpose of valuing the closing stock-in-trade of shares held by the assessee at the end of the year. For the subsequent year return had been made on this basis of stock valuation, i.e., valuing the stock at the cost of acquiring and returning the profits, if any made during the year on account of stock dealings by taking into account the actual profits or losses if any made, computing the difference between the actual sale price and the cost price of stock for the accounting year 1993-94. The auditors of the assessee raised certain objections with regard to this type of stock valuation, and it was suggested that instead of taking the cost of stocks as the way of valuation, the assessee should adopt instead, the yardstick of cost of acquiring or market value, whichever is lower. Subsequently by passing the appropriate resolution it changed the stock valuation method to cost or market value whichever is lower which resulted in under statement of profit. The officer has rejected the change. You are required to discuss the correct position of law and also explain the principles regarding tax avoidance and tax evasion.

**Answer**

The following are the principles regarding tax avoidance and tax evasion.

- (1) The distinction between tax evasion and tax avoidance is still prevalent.
- (2) Generally speaking tax evasion is the result of such things as illegality, suppression, misrepresentation and fraud.
- (3) Tax avoidance is the result of actions taken by the assessee, none of which is illegal or forbidden by the law in itself and no combination of which is similarly forbidden or prohibited.
- (4) The permissibility of a tax avoidance, will fall to be decided, when and only when, on the basis of the facts and transactions truly and correctly disclosed by the assessee, a point of law arises, whether on a certain reasonable construction of one part of the taxing statute, as applied to the assessee's case, tax which would otherwise be payable by the assessee, becomes not payable in the case in hand.
- (5) When the court is faced with a task of construction in the above manner, the court is not bound to make the construction in favour of the assessee merely on proof by the assessee, that it has entered into no illegality and made no prohibited transaction.
- (6) The court would have to assess, in the facts and circumstances of each case, upon general principles of conscience and justice, whether the arrangement of affairs by the assessee, so as to cause the possibility of a reduction of tax incidence, can fairly be permitted to the assessee, as a genuine and legal means of tax reduction, employed by it in a commercial fair sense, or whether allowing the assessee to earn the reduction, in the facts and circumstances of the particular case, is

opposed to the public policy of not encouraging citizens to engage themselves in dealings and transactions designed primarily for the purpose of non-payment of tax only.

The above criteria should broadly conform to the decision of the Supreme Court in *UOI v. Azadi Bachao Andolan* [2003] 263 ITR 706.

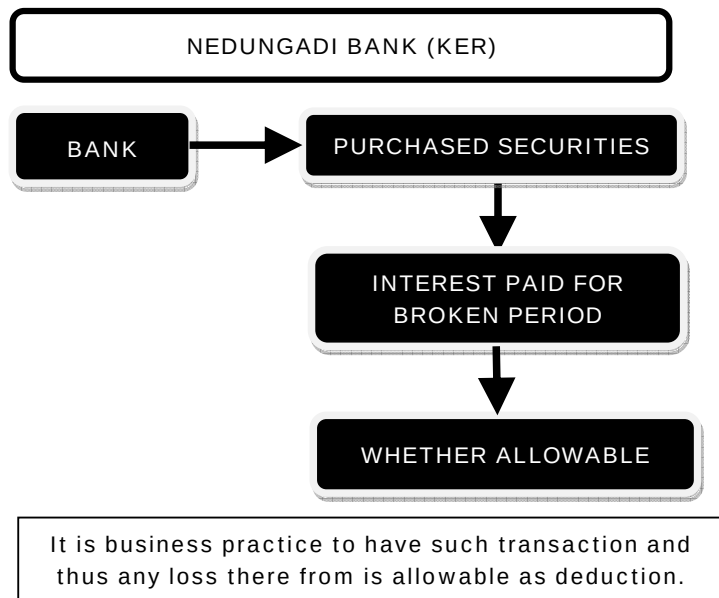
A change in method of accounting reducing tax liabilities for the year was questioned by the Revenue as hit by tax avoidance following the rationale of *McDowell and Co. Ltd. v. CTO* [1985] 154 ITR 148 (SC) in *Hela Holdings Pvt. Ltd. v. CIT* [2003] 263 ITR 129 (Cal), where the High Court elaborately reviewed the ruling decisions on the subject and came to the conclusion that the Tribunal was not justified in assuming that the conditions necessary for such change are not satisfied. The assessee is entitled to change his regular method of accounting by another regular method. It would be open to the assessee to produce records and show that it had followed such changed accounting method in subsequent years.

264 ITR 0545- CIT VS. NEDUNGADI BANK LTD. (KER)

Section 6 of the Banking Regulation Act, 1949, makes it clear that banks can engage in the business of buying and selling securities. As per section 24 of the Act banks have to maintain a percentage of the securities to meet the statutory liquidity requirement. It is now settled by a series of decisions of the High Courts and the Supreme Court that the securities held by the banks constitute their stock-in-trade or investment and consequently the loss claimed by the banks on the valuation of their securities should be allowed as a deduction in computing the taxable profits.

In *Vijaya Bank Ltd. v. Addl. CIT* [1991] 187 ITR 541, the Supreme Court had not considered the question with regard to the character of securities from which interest income is earned. No contention had been taken by any of the parties that the securities involved in the said case represented stock-in-trade. Hence, the decision rendered in the said case cannot be taken as an authority for the position that the securities held by the bank in compliance with the provisions of the Banking Regulation Act are held as a capital investment.

Where a bank purchases securities, the interest paid for the broken period for the acquisition of the securities till the date of such acquisition would constitute allowable outgo in the hands of the assessee and is an admissible deduction in the computation of the total income of the bank under the head “Profits and gains” of business or profession.



277 ITR (A.T.) 0057- PEERLESS SECURITIES LTD. VS. JOINT COMMISSIONER OF INCOME-TAX (CALCUTTA BENCH)

A business expenditure is deductible only against business which is carried on by the assessee. It follows that there should be a running business. In the first year of business, the question sometimes arises as to the precise date on which the business could be treated as set up, so as to qualify for deduction. It has been pointed out that the commencement of business is different from setting up of a business. A person

may commence business without having set up the same. During the period between commencement of business and setting up, the expenditure incurred cannot be allowed as a deduction. It may sometimes be capable of being capitalised as part of the assets of the business and to the extent to which they are depreciable assets, it may be possible to get a deduction as depreciation on staggered basis. In the case of a trader, it may be inferred that he had set up his business when he had acquired stocks for sale. However, in the case of a manufacturer, he should be in a position to manufacture on a commercial basis, before he could be inferred, that he has set up the business. This is the law which has been settled by a series of decisions.

In the case of a stock broking firm, where the claim related to a lump sum payment to a stock exchange as development fee and fees for operating on the floor of the exchange, besides training fee payable to the stock exchange for training of its employees, besides the fee for setting up a small apparatus, the Tribunal in *Peerless Securities Ltd. v. Joint CIT* [2005] 277 ITR (AT) 57 (Kolkata) found that except for payment of development fee which was capital expenditure, all the other expenses are deductible, whether they were lump sum payments or periodical payments, because the assessee had already set up its business, although the business had not commenced in the sense that it had not started booking transactions. Though ordinarily commencement would precede setting up, it was understood by commencement, that it had got the clientele during the year. After review of the case law on the subject and considering the nature of business of a stock broker, it was held that registration with the stock exchange should itself be treated as amounting to setting up of a business, so that the expenses claimed except for the development fee, which is of capital nature should have been allowed.

CIRCULAR NUMBER: 007 [2001] 248 ITR (STAT) 0268-

In relation to Voluntary Retirement Schemes (VRS) of the banking sector the question arises whether the ex-gratia amount is allowable as revenue expenditure or not. In this connection, the primary test is to see whether any enduring benefit has resulted to the assessee by making an expenditure. In the event, the expenditure is laid out for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business, it is properly attributable to capital and is of the nature of capital expenditure. If any such asset or advantage for enduring benefit of the business is thus acquired or brought into existence, it would be immaterial whether the source of payment was the capital or the income of the concern or whether payment was made once and for all or was made in instalments. While it is not ordinarily easy to evolve a fool-proof test for ascertaining whether in a given case, expenditure is capital or revenue, the Assessing Officers normally decide the character of expenditure on the facts and circumstances of each case. They consider the nature and the ordinary course of business and the objects for which the expenditure has been laid out. Towards this purpose, the test of enduring benefit is a useful tool in considering the ex-gratia amount, prima facie, as a capital expenditure. In this view of the matter, the expenditure, as said above, is to be treated as capital expenditure.

CIRCULAR NUMBER: 11 [2001] 250 ITR (STAT) 0084-

Section 14A was introduced retrospectively in order to clarify and state the position of law that any expenditure relatable to income which does not form part of total income cannot be set off against other taxable income. This section was not introduced with prospective effect, as that would have implied that before the introduction of the said provisions, expenditure incurred to earn exempt income was allowable.

Reopening of past completed assessments, having attained finality, on the basis of newly inserted provisions of section 14A is likely to cause hardship to a large number of taxpayers and would result in increasing avoidable litigation.

It is now directed that the assessments where the proceedings have become final before the first day of April, 2001 should not be re-opened under section 147 of the Act to disallow expenditure incurred to earn exempt income by applying the provisions of newly inserted section 14A of the Act.

CERTAIN CASES OF DEEMED INCOME

Section / Topic Name : 68 to 69

DISCHARGE OF BURDEN- CASH CREDIT FROM RELATIVE AND NON-RELATIVE

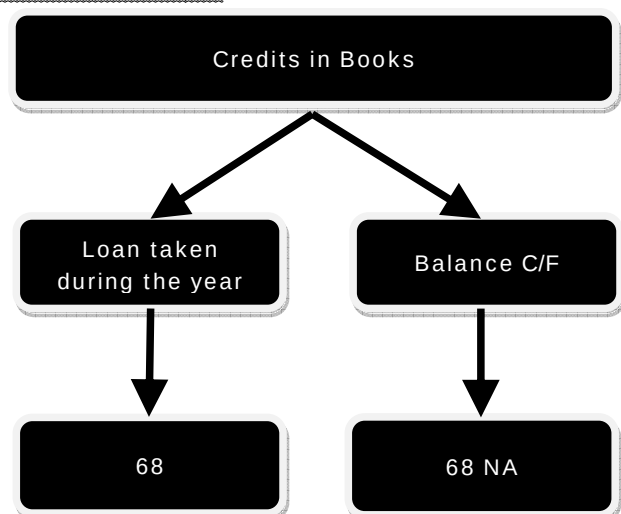
The Rajasthan High Court in Labh Chand Bohrav ITO [2010] 189 Taxman 141 following the Apex Court's decision in CIT v. Daulat Ram Rawat Mull [1973] 87 ITR 349 held that the assessee cannot be required to prove the source of the source. The Court read that it is settled law that the fact that lender has not been able to give satisfactory explanation regarding the source of the fund lent by him, would not be decisive, even of the matter, as to whether the lender was the owner of that sum, even though the explanation furnished by him regarding that source of money is found to be not correct. From the simple fact, that the explanation regarding source of money furnished by the lender whose money is lying deposited, has been found to be false, it would be a remote and far-fetched conclusion to hold that the money belongs to the assessee especially in the following circumstances :

the amounts found as cash credits in assessee's account books had been advanced by lenders by account payee cheques meaning that the identity of creditors had been established; the confirmations were available and the creditor had also confirmed credits by making statements on oath meaning therefore it could be said that assessee had discharged burden of proving identity and genuineness of transaction; so far as creditors' capacity to advance money to assessee is concerned, it is not a matter which would require assessee to establish, as that would amount to calling upon him to establish source of source.

Further, the Allahabad High Court in Banarsi Prasad v. CIT [2010] 189 Taxman 206 held that when the credits were received by the assessee from close relatives like his non-earning wife and minor son, the explanation to be furnished under section 68 in order to qualify it as 'satisfactory' would require him to disclose the source of the depositors for the purpose of establishing the 'capacity' of the creditor as above.

CARRIED FORWARD AMOUNT OF EARLIER YEARS

The assessee on the first day of the previous year relevant to the assessment year 1993-94 i. e. on April 1, 1992, credited an amount of investment/cash credit of Rs. 1,55,316 in his books of account. The Assessing Officer added this amount in the income of the assessee as unexplained investment in the assessment year 1993-94. The Tribunal held that this was not a case of cash credit entered in the books of account of the assessee during the year but it was a case in which the assessee had invested the capital in the business and this amount was shown as a closing capital as on March 31, 1992 and on April 1, 1992, it was an opening



(1)	Appellate Tribunal
(2)	Usha Stud Agricultural Farms Ltd. (Delhi)

balance. Therefore the Tribunal held that what was already credited in the books of account ending on March 31, 1992, for financial year 1991-92 relevant to assessment year 1992-93 could not be an unexplained cash credit or investment in the books of account maintained for the financial year 1992-93, the accounting period for which ended on March 31, 1993. On appeal held carried forward amount of the previous year did not become an investment or cash credit generated during the relevant year 1993-94. This alone was sufficient to sustain the order of the Tribunal in deleting the amount of Rs. 1,55,316 from the assessment for the assessment year 1993-94.

FRESH ENTRY

The Delhi High Court in CIT v. Usha Stud Agricultural Farms Ltd. [2009] 183 Taxman 277 held that the credit balance appearing in the accounts of the assessee which does not pertain to the year under consideration, cannot be a subject-matter of addition under section 68. In this case, the credit balance of Rs. 15 lakhs was found reflected in the accounts of the assessee over the past four to five years whereas section 68 would assume application viz-a-viz a fresh credit entry of the previous year under consideration and, thus, the assessee escaped addition under section 68.

RULES/PRINCIPLES OF NATURAL JUSTICE FLOUTED

The Assessing Officer is a quasi-judicial authority. He is thus under an obligation to adhere to the principles of natural justice. These facts are certain and unquestionable and, thus, every Assessing Officer must learn this fact at the inception of his service. The Delhi High Court in CIT v. Rajesh Kumar [2008] 172 Taxman 74 found that the revenue which relied upon the statement of a person should have made the same available to the assessee with an opportunity to cross-examine, and since that was not done by the Assessing Officer, it clearly showed that the principles of natural justice had been violated.

INADEQUATE ENQUIRIES- REVENUE TO DISCHARGE ITS ONUS

In CIT v. K.C. Fibres Ltd. [2010] 187 Taxman 53 (Delhi) the Assessing Officer on enquiries found that 111 deposits of Rs. 19,000 each in cash were made in the bank account of shareholders who converted such amounts in drafts and subscribed to the share capital of the assessee-company. Not satisfied with this the Delhi High Court insisted on that it was for the Assessing Officer to further inquire into affairs of the shareholders to ascertain whether the two companies were umbrella companies or had any relationship with each other. The Court further made a point that it was not for the assessee-company to prove as to the source from where the shareholders collected aforesaid money.

This case pertained to the assessment year 2003-04. As it is not very old it would have been better if the Court would have remanded the matter to the Assessing Officer to complete the enquiry rather than holding against the revenue. Such judgments do not hold justice in true sense. In such cases the revenue knowing well that the Court would comment on inadequate enquiry in the case must make a separate ground of appeal seeking remand of the matter for enquiry even at the ITAT stage. Further, the Commissioner (Appeals) in such cases must use his office to conclude on unfinished enquiry too. If required it must adduce unavoidable factors responsible for inadequate enquiry. Alternatively, the revenue may find lack of required enquiry as a good reason to reopen such cases.

In Aravali Trading Co. v. ITO [2010] 187 Taxman 338 the Rajasthan High Court also went to hold that a nexus has to be established by the revenue that sources of creditors' deposit flow from the assessee. In the parallel it thus held merely because depositors' explanation about sources wherefrom they acquired money was not acceptable to the Assessing Officer, it could not be presumed that deposits made by such creditors were moneys of the assessee itself.

Duty of assessing officer		
Adequate Inquiries	1	Yes
Principal of National Justice	2	Yes
Opportunity to cross examine to assessee	1	Yes
Independent inquiry by office	3	Yes

(1)	K. C. Fibres Ltd. (Delhi)
(2)	Rajesh Kumar (Delhi)
(3)	Vignesh Kumar Jewellers (Madras)

INDEPENDENT ENQUIRY BY THE ASSESSING OFFICER IS A MUST

The Madras High Court in CIT v. Vignesh Kumar Jewellers [2009] 180 Taxman 18 deleted addition made by the Assessing Officer based on findings of the custom authorities. The Court found following shortcoming in the assessment order:

- (a) that the Assessing Officer had not made any independent enquiry;
- (b) that there was no corroborating evidence to support the case of the revenue;
- (c) that even the assessee, whose statement was recorded by the Department of Central Excise, had not been examined by the Assessing Officer; and

- (d) that the assessee was not given an opportunity to cross-examine.

ONUS UNDISCHARGED

The P&H High Court in *Blowell Auto (P.) Ltd. v. Asstt. CIT* [2009] 177 Taxman 261 held that it is well-settled that it is for the assessee to prove not only the identity of the creditor, but the capacity of the creditor to advance the money and also the genuineness of the transaction. In the instant case, the assessee had though established the identities of both the aforesaid creditors by producing their affidavits stating full address particulars, etc., but failed to bring on record the capacity of these creditors to advance the money and genuineness of the transaction. The affidavits showed that the creditors had advanced the amount to the assessee from their savings, but no saving account number of the bank or any other material showing the source of income had been mentioned.

EXTENT OF ONUS

In *CIT v. Lul Transport Corpn.* [2009] 180 Taxman 185, the assessee had placed on record before the Assessing Officer sufficient material/evidence such as affidavit of loan creditor, confirmation and bank statement of creditor. The Punjab & Haryana High Court held that the assessee had discharged its onus to prove genuineness of such cash credit by placing on record sufficient material/evidence.

LANDLORD NOT TO PROVE CAPACITY OF TENANT

The position in regard to a deposit or advance paid by a tenant in regard to a lease of premises is different from a loan from a third party. A lease or tenancy is governed by the terms of the lease deed or tenancy agreement. When the premises are let out on terms mutually agreed and one such term relates to the deposit or advance which the tenant agrees to pay, it is not necessary for the landlord to ascertain the source from which the tenant gets the amount to pay as a deposit/advance. When persons take premises on rent invariably they will organise the funds required to pay an advance or deposit. Further, as the lessee/tenant will always be available for verification as he will be in occupation of the premises, the fact whether he has paid the deposit or not can be easily verifiable. Therefore, in regard to deposits from tenants, it is sufficient if the assessee proves the identity of the tenant and the genuineness of the transaction under which the deposit is made. It will not be necessary for the assessee to prove the capacity of the tenant to make the deposit/advance. Therefore, where the tenancy is established and the tenant is actually in occupation of the premises and a lease deed or tenancy agreement is produced showing the amount agreed to be paid as deposit and the deposit is paid by cheque or demand draft and is duly accounted for in the books of account of the assessee as also the tenant, then the assessee has discharged his burden under section 68 of the Income-tax Act, 1961. If the Assessing Officer still wants to treat such amount as unexplained income of the assessee, then the burden lies on the Revenue to establish that the deposit was not really a deposit by the tenant, but the unexplained income of the assessee channelised through the tenant. However the identity of the depositor and the genuineness of the deposit has to be established by showing that the person making the deposit is in occupation of the assessee's premises as a tenant or had occupied the premises for a considerable time and the deposit was paid by cheque/bank draft and borne out by books of account of both the assessee and the tenant and by the lease agreement, wherever such lease agreement exists. Held accordingly, that the Tribunal was justified in holding that in respect of deposit against tenancy, the assessee was only required to prove the identity of the depositors and that the deposits were made by the tenants. [2007] 290 ITR 0453- *Commissioner of Income-tax v. Nevendram Ahuja* (Madhya Pradesh High Court). *Orient Trading Co. Ltd. v. CIT* [1963] 49 ITR 723 (Bom), *Sarogi Credit Corporation v. CIT* [1976] 103 ITR 344 (Patna) and *Ashokpal Daga (HUF) v. CIT* [1996] 220 ITR 452 (MP) followed.

	Duty of assessee	
(1)	Produce documentary evidence	Yes
(2)	Identity of creditor	Yes
(3)	Credit worthiness of creditor	Yes
(4)	Capacity of creditor	Yes
(5)	Genuineness of transaction	Yes
(6)	Genuineness of creditors creditor	No
(7)	Landlord prove capacity of tenant	No

The assessee had received sums of Rs. 2,95,000, Rs. 1,05,000 and Rs. 85,000 during the accounting years relevant to the assessment years 1989-90, 1990-91 and 1991-92. The Assessing Officer did not accept the creditworthiness of the depositors by holding that the tenants/depositors had credited cash to their accounts either on the date of issue of cheques or only a few days earlier to the issue of the cheques to the assessee which showed that the depositors had apparently helped the assessee by depositing the assessee's funds to their account and then issuing cheques to the assessee by way of deposit for the tenancies. The Assessing Officer treated the receipts as unexplained income under section 68. The Commissioner (Appeals) granted relief only to an extent of Rs. 25,000 relating to the assessment year 1989-90 and Rs. 60,000 relating to the assessment year 1991-92 and confirmed the balance of Rs. 2,70,000 for the assessment year 1989-90, Rs. 1,05,000 for the assessment year 1990-91 and Rs. 25,000 for the assessment year 1991-92. The Tribunal noted that the assessee had produced confirmation of deposits from the tenants/depositors except in one case and the bank statements confirmed the payments ; the rental agreements produced by the assessee established that the depositors were tenants running their businesses in shops in the assessee's premises and the assessee had received rents from such tenants. The Tribunal held that the assessee had proved the identity of the tenants and the genuineness of the transaction and hence these tenancy deposits could not be added to the income under section 68 and deleted the entire additions. On a reference : Held, that there was nothing strange about the tenants remitting the cash to their bank accounts to meet the amount of the cheques issued by them towards rental deposit. Once the identity of the tenant was established and the genuineness of the transaction was also established by producing the lease agreement and by proving that such a tenant continues in possession and by showing that the books of account of the tenant also reflected the deposit, the fact that the tenants did not have the funds earlier to meet the cheque and had remitted the amount to their accounts to meet the cheques only a few days before the issue of the cheque was not relevant. The Revenue had not shown that the deposits were really funds of the assessee. Even if the Assessing Officer had some doubt about the capacity of the tenant, that would be a good ground for taking action against the tenant and not against the assessee. There was no documentary evidence with regard to one tenant who had deposited Rs. 40,000. Neither the bank statements establishing the payments nor any confirmation by the tenant were furnished. The addition with regard to the transaction was justified. Thus, the Tribunal was justified in holding that the assessee had discharged the burden in respect of deposits of Rs. 2,70,000, Rs. 1,05,000 and Rs. 85,000 received from tenants during the accounting years relevant to the assessment years 1989-90, 1990-91 and 1991-92.

The High Court in CIT v. Nevendram Ahuja [2007] 290 ITR 453 (MP) had dealt with the question of the limitations on the power to issue commission for examination of witnesses. The High Court pointed out to the guidelines on the subject in a decision of the Bombay High Court in Jamnadas Madhavji and Co. v.

J. B. Panchal, ITO [1986] 162 ITR 331 and Rina Sen v. CIT [1999] 235 ITR 219 (Patna), where it was held that existence of pending proceeding is a condition precedent for exercise of power to issue a commission following the powers of the court as laid down in the Civil Procedure Code, 1908. The fact that such power is to be exercised under section 131(1A), when there is a reason to suspect concealment, does not enlarge the power, so as to justify an exercise of the power when there are no pending proceedings. Any statement recorded on the basis of such wrong use of this power would be invalid. In this case, a commission was issued to a Departmental Valuation Officer to value certain premises prior to the commencement of proceedings, so that such valuation report became inadmissible as evidence.

LOOSE SHEETS

The Punjab and Haryana High Court in CIT v. Atam Valves (P.) Ltd. [2009] 184 Taxman 6 held that loose sheets by themselves may not be enough to justify addition on estimated basis even though the explanation of the assessee is found unbelievable and circumstances may be pointing otherwise. The stand of the assessee in this case was that the loose slips recording wage payment did not represent payment of wages during the year in question, but were for the earlier year. The Assessing Officer did not accept the explanation and made an addition without bringing any other material on record and this precisely worked against the revenue.

CIRCUITOUS PATH

In Indus Valley Promoters Ltd. v. CIT [2008] 174 Taxman 516 (Delhi) no shares were allotted to a director of the assessee-company, during the year-in-question and for the subsequent two assessment years against application money received from him. In this case substantial amount had been deposited in cash purportedly in the books of a partnership firm in which the director was a partner and from where the amounts had been withdrawn and credited to his account in the books of the assessee-company. The main argument of the director was that the source of the source could not be examined whereas the Delhi High Court found strong reasoning in the revenue's argument that the same cash deposits could have been made in the books of the assessee-company so that the method of choosing the circuitous path was only an attempt to circumvent the provisions of section 68 of the Act.

UNEXPLAINED COST OF CONSTRUCTION

In Smt. Prem Kumari Mudria v. Asstt. CIT [2008] 166 Taxman 1 (Raj.), the Assessing Officer made an addition on the basis of valuation report taking CPWD rates whereas the Commissioner (Appeals) allowed a reduction of 20 per cent from the CPWD rates to match the local PWD rates and such action attained finality after the seal of Rajasthan High Court.

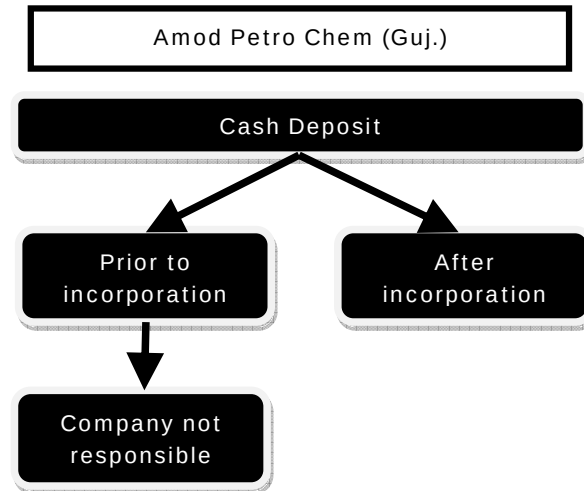
In this case, the assessee had maintained only self-made vouchers and that too only for wood, labour, gitti, sand and bricks, etc., without any supporting evidences for which reason the Assessing Officer rejected the books of account.

CASH CONSIDERATION IN PROPERTY SALE TRANSACTION

It was on the basis of a statement of the seller, who having received cash consideration chose to offer it in her return, that the authorities in Malik Bros. (P.) Ltd. v. CIT [2007] 162 Taxman 43 (Delhi) made subject to tax such sum under section 69 as unexplained investment in the hands of the purchaser. The purchaser did not avail the opportunity to cross-examine the seller to save himself except for approaching the settlement commission and, thus, had to suffer.

CASH DEPOSITS PRIOR TO INCORPORATION

Where there were cash deposits in the business taken over by the company prior to its incorporation, the question of taxing such amount, which had earlier surfaced in the hands of the predecessor of the assessee company should not arise. The assessee had merely taken over all assets and liabilities. Even if they were unexplained, they could not have been treated as income of the company. An outstanding liability is different from a cash receipt. It is in these circumstances, the High Court upheld the decision of the Tribunal not to treat such credits as the income of the assessee in *Deputy CIT v. Amod Petrochem P. Ltd.* [2008] 307 ITR 265 (Guj).



GIFT TRANSACTIONS

The Punjab and Haryana High Court in *Yash Pal Goel v. CIT* [2009] 181 Taxman 175 held that a simple identification of donor and showing movement of gift amount through banking channels are not sufficient to prove genuineness of a gift. The Court held that the onus lay on the assessee not only to establish the identity of the person making the gift but also his capacity to make a gift and that it had actually been received as a gift from the donor.

In this case financial position of the donor suggested that he was neither in the capacity to make gift nor was having the source from where the gift was made. Moreover, no reason whatsoever had been assigned for gifting such a huge amount by the donor to the assessee. The donor never visited home of the assessee. He had no knowledge about the family of the assessee so that the Assessing Officer rightfully doubted the genuineness of the gift.

The Court while imposing a cost of Rs. 30,000 upon the appellant aptly observed as under :

“The unscrupulous persons use every gimmick to avoid payment of income-tax. If the State exchequer is made the target of deceit and the revenue comes down, the development of the country will be a casualty. It is reprehensible that some citizens spend on litigation and unnecessarily bring matters before the Courts than to pay tax on their income. The tendency needs to be discouraged and curbed. . . .”

GIFTS FROM NON-RELATIVES

The Punjab & Haryana High Court in *Smt. Kusum Lata Thakral v. CIT* [2009] 185 Taxman 237 ordered moneys received as gifts taxable as it found that there was no relationship between the donors and the assessee. It opined that in the absence of a relationship there can be no natural love and affection and in its absence, gifts cannot be accepted to be genuine.

GIFT – UNEXPLAINED / UNRECORDED MONEYS, ETC.

The Delhi High Court in *Ashok Mahindru & Sons (HUF) v. CIT* [2008] 173 Taxman 178 held that even though the documentation may be in order, if there is enough material to raise a very strong suspicion that there is something not quite right with the nature of the transaction, the authorities under the Act may reject the documents and require the assessee to show that the transaction is really one which is above board. In this case the assessee had claimed to have received a gift of significant sums of moneys from a

Swiss national but for the reason that it failed to provide adequate material to show the resources or finances of the Swiss national such sums were taken as unexplained moneys in his hands.

UNEXPLAINED GIFTS

In P.P. Koya v. Dy. CIT [2008] 175 Taxman 4 (Ker.), the assessee suffered addition for unexplained money credited in his bank account alleged to have been received as gifts only for his failure to produce local addresses of foreign donors. The Kerala High Court felt that in the absence of such address, it was not possible for the Assessing Officer to verify the genuineness of gifts. In this case, when the Assessing Officer demanded confirmation of the gifts from the donors, the assessee furnished addresses of some people abroad and did not produce local address of any of the donors. At this, the Tribunal inferred that without producing local address, the assessee could not be said to have discharged the burden cast on him.

GIFT RECEIVED BY POLITICIANS

In CIT v. Rajesh Pilot [2008] 175 Taxman 8 (Delhi), the assessee escaped tax on a sum of Rs. 10 lakhs received by his election agent as a gift from an individual. It was found that the money received by the agent was spent on the expenditure for jeeps required for the election campaign of the assessee. As there was no evidence to show that the money was used by the assessee for acquiring movable or immovable properties in his name or in the name of his family members or even for his foreign travel or personal expenses, the Court deleted the addition in this case. The Delhi High Court held the above with the following perception of law :

“that it is well-settled that every receipt is not taxable as income. It may be a receipt, but not necessarily ‘income’. The question is whether the ingredients commonly embedded in the concept of ‘income’ are present.”

UN-VOUCHED GIFTS

The P&H High Court in Tirath Ram Gupta v. CIT [2009] 177 Taxman 294 held that the following factors count the most in judging the genuineness of a gift :

- (a) Occasion factor;
- (b) Help a relative/friend factor; or
- (c) Human probability factor.

Above all, in the Court’s premise to see the genuineness of a gift, the test of human probability is the most appropriate. The High Court further observed that a gift cannot be accepted, as such, to be genuine, merely because the amount has come by way of a cheque or a draft through banking channel, unless the identity of the donor; his creditworthiness; relationship with the donee and occasion are proved. Unless the recipient proves the genuineness thereof, the same can very well be treated to be an accommodation entry of the assessee’s own money.

UNEXPLAINED GIFTS INCLUDING GIFTS FROM NON RESIDENTS

In Subhash Chander Sekhri v. Dy. CIT [2007] 158 Taxman 177 (Punj. & Har.) certain cash credits were found in bank statements, which were explained as gifts though neither the relationship with the donor nor the occasion of gift was explained to the Assessing Officer. In the obvious result the sums were taken as undisclosed income. The similar action followed when the assessee in Jaspal Singh v. CIT [2007] 158 Taxman 306 claimed receipt of gifts from a non-resident. The Punjab & Haryana High Court held that mere identification of donor and showing the movement of gift amount through banking channels is not enough to prove genuineness of the gift. The assessee is required to establish that the donor had the means and the gift was genuine and was given out of natural love and affection.

UNEXPLAINABLE AND BOGUS NRI GIFTS

In Raghbir Singh v. ITAT [2007] 162 Taxman 21 (Punj. & Har.) when the assessee failed to produce the donor as well as provide the financial status and identity/source for such gift and even failed to bring on record the special reason for gift, the authorities chose to tax said sum under section 68. In this case, the drafts were purchased in cash (US Dollars) at Singapore when the donor himself was having his bank account in the same bank. The Punjab and Haryana High Court upheld the addition.

The Delhi High Court too in Sandeep Kumar (HUF) v. CIT [2007] 162 Taxman 91 also upheld similar addition for failure of the assessee to establish the capacity of the donor to make huge gifts.

In yet another decision, the Allahabad High Court in CIT v. Meghdoot Village Products (P.) Ltd. [2007] 162 Taxman 25 remanded the appeal to the Commissioner (Appeals) in the absence of any recorded finding of creditworthiness of creditors. The assessee did not provide PAN status or income status of the

creditors nor did it make any efforts to produce the creditors who perhaps were relatives of the assessee and even it had not made any prayer to the assessing officer to initiate action under section 131 of the Act.

These cases are a reminder to one and everyone to have adequate evidence in possession of the financial capacity of the cash/loan creditors to save skin from the Assessing Officer during assessment course. Thus, mere fact that the gifts have come through banking channels will not do or mere identification such as PAN, etc., will not yield much benefit either.

In *John George Vettath v. CIT* [2007] 162 Taxman 134 (Ker.), the Commissioner of Income-tax exercising powers under section 263 for setting aside an assessment, required the Assessing Officer to examine the factual position with regard to the credibility and genuineness of the source of funds through which the alleged gift was received by the assessee. The assessee challenged such direction under a writ before the Kerala High Court which directed the assessee to the Tribunal instead.

PURCHASES DOUBTED - WHAT SHOULD ASSESSING OFFICER DO?

In *CIT v. Hi Lux Automotive (P.) Ltd.* [2009] 183 Taxman 260, the Assessing Officer was provided with bank statements of the vendors to whom the assessee had made account payee cheque payments. Doubting genuineness of purchases the Assessing Officer issued summons which remained uncomplied with and, thus, he took them as unverifiable and made an addition. The Delhi High Court did not find this kind of approach appropriate and observed as under :

“10. The reason for disallowing expenditure in respect of other four parties was that when the notices were sent they were not available. We are of the opinion that even in their absence the assessee had produced sufficient material to show payments, namely the bank accounts of such parties. We are constrained to note that if the summons are not issued to those parties or the same could not be served at the given addresses, the Assessing Authority could have obtained their addresses from the banks as the bank statements were produced and could have made an endeavour to serve those parties at the said addresses.”

SUNDRY CREDITORS

The Kerala High Court in *CIT v. Smt. Annamkutty Jose* [2008] 174 Taxman 328, held that has even though there is no specific provision in the statute casting burden on the assessee to prove sundry credits, yet the principles contained in section 68 as well as in section 69(c) are squarely applicable to sundry credits in the case of a trader. The Court pointed out that, in fact, credit purchases are nothing but expenditure and if sundry credits are not proved by the assessee, addition can be made by resort to section 69(c) of the Income-tax Act. In this case the assessee did not furnish the names and addresses of creditors or confirmation letters from them. Since the assessee did not prove the sundry credits, the Assessing Officer made an addition.

ENTRIES IN CREDITORS BOOKS

The Gujarat High Court in *Krishna Textiles v. CIT* [2008] 174 Taxman 372 has held that addition under section 68 is possible for amount credited in the assessee's books and not for amounts shown to the credit of the assessee's account in creditor's books so that in this case certain drafts shown as received in creditor's books to the assessee's account are not held as income of the assessee. The Court held that the burden was on the department to show that the amount of demand drafts found to be credited in the assessee's account in the books of account of the GMDC belonged to the assessee by bringing proper evidence on record and the assessee could not be expected to explain the source of income or to call responsible officers of the GMDC or bank to discharge the burden that laid upon the department.

CASH DEPOSIT

In CIT v. Shailesh Rasiklal Mehta [2009] 176 Taxman 270 (Guj.), the assessee deposited cash in bank on two different dates. The Assessing Officer alleged that it had no cash balance in hand and this led to addition of undisclosed income only for the fact that it disbelieved the opening balance as it had rejected books of account for the earlier assessment year. After taking cognizance of the Tribunal's order in preceding year, the Tribunal deleted the addition in this case. The Gujarat High Court did not disapprove such action of the ITAT.

UNEXPLAINED CASH CREDIT-PROCESS CHECK

In CIT v. Goverdhan India (P.) Ltd. [2009] 177 Taxman 29 (Delhi), the Assessing Officer issued summons to a debtor and it found certain mismatch in the balances shown in assessee's books and that of the debtors. He, thus, made addition for the difference as unexplained credit. The assessee on the other hand requested the Assessing Officer in writing that if the debtor did not certify its account as per the assessee's books then he should be called to visit the Assessing Officer's office for the purpose of cross examination by the assessee.

As there was no material on record to suggest any defect found by the Assessing Officer in the purchases made by the assessee which had been sold during the relevant year and further since the Tribunal returned a finding that copies of sale bills were produced by the assessee before the Assessing Officer and those bills had been counter-signed by the debtor and especially for the reason that the assessee had requested for cross examination of the third party and such request had not been allowed by the Assessing Officer the Delhi High Court deleted the addition. Further the following observation needs careful reading:

“The Assessing Officer ought not to have relied upon the copy of the accounts submitted by Ambrose International Corporation, when the same were disputed by the assessee as not reflecting the true and correct position and particularly when the assessee's request for cross examining the representative of Ambrose International Corporation was not allowed.”

The revenue perhaps did not take a separate plea/ground before the Tribunal on the discrepancy and, therefore, the High Court declined to go into the merits in this regard. This is clear reminder that merits of the case should not be discounted whereas legal issues can be raised at any stage.

Banking channel transaction

In CIT v. Micro Melt Pvt. Ltd. [2009] 177 Taxman 35, the Gujarat High Court deleted the addition after it found that the subject transactions were made through banking channel.

TRADE CREDITORS

In Uplaksh Metal Industries v. CIT [2009] 177 Taxman 298 (Punj. & Har.) the assessee had neither been able to disclose the complete addresses of the trade creditors nor was able to give the complete addresses of the consignors nor the name had been mentioned on the challan forms, and, thus, the verification of the same by the Assessing Officer became totally impracticable on account of lack of this complete information supplied by the assessee. The assessee contended that it was unable to provide the information as the trade creditors were large in number. The P&H High Court held that the assessee failed in establishing the genuineness of the so called trade creditors appearing in its books of account.

LOANS FROM RELATIVE

In Sanil KMP v. CIT [2009] 177 Taxman 481 (Ker.) the loan creditors shown in the accounts were close relatives of the assessee. In this case, the Kerala High Court held that close relatives are prone to help the assessee in the income-tax proceedings and unless they prove their source, credits claimed by them

cannot be accepted and unless source is proved, the loan creditors cannot be said to have discharged the duty of proving that the loans shown in the accounts were genuinely advanced by them to the assessee.

EXCESS STOCK FOUND

The Rajasthan High Court in CIT v. Mehta Gwar Gum & Co. [2008] 173 Taxman 464 held that no addition could be made for excess stock once the Assessing Officer resorted to rejection of books and estimation of enhanced gross profits. Even otherwise the Court held that there was no reason for the assessee to escape stocks since its entire income was exempted under section 80-IA.

SOURCE OF SOURCE

The Delhi High Court in CIT v. Diamond Products Ltd. [2009] 177 Taxman 331 held that the Assessing Officer is not permitted to examine the source of the source, once the assessee has been able to establish that the transactions with his creditors are genuine and the creditors' identities and creditworthiness have been established.

The creditor in this case had been regularly assessed to income-tax and copies of his returns for the relevant years were also filed before the Assessing Officer by the assessee along with his confirmation. Further, he had also appeared before the Assessing Officer and had furnished all the information and details required by him. He had also produced the books of account of his proprietary concerns for verification by the Assessing Officer. A statement on oath of the creditor was also recorded by the Assessing Officer. As per the said statement, he admitted having advanced a sum of Rs. 23,00,000 to the assessee. He had also filed bank statements pertaining to the proprietary concerns indicating that the said sum of money had been advanced to the assessee through bank drafts. Further, he explained that the bank drafts were made out of the deposits to the extent of Rs. 23,00,000 made in the bank accounts of his proprietary concerns and were representing cash received from M/s. Punjab Tractors towards repayment of loan given earlier. In this case the attempt sought to be made by the Assessing Officer to verify the whereabouts of the M/s. Punjab Tractors was held to be nothing but an attempt to examine the source of the source which was not permissible as per the Court.

ONUS - RECEIPT OF SHARE CAPITAL CONTRIBUTIONS

The Delhi High Court in CIT v. Tulip Finance Ltd. [2009] 178 Taxman 182 held that the assessee has discharged the onus which laid upon it, of establishing identity of shareholders as well as genuineness of transactions in the following fact situation :

- (a) The assessee furnished permanent account numbers of shareholders;
- (b) places of their assessment;
- (c) confirmations from them;
- (d) amounts received from those shareholders were through cheques which had been duly credited in bank account of assessee;
- (e) those shareholders were also income-tax assesseees; and
- (f) they had also received dividends in respect of said shares.

Also in regard to the alleged unexplained security deposit sums, the High Court found that such security deposits were either eventually refunded or adjusted against sale of the assets to the customers upon termination of the lease and, thus, addition under section 68 did not lie either.

SHARE CAPITAL CONTRIBUTION FROM A LISTED ENTITY

In CIT v. Gangour Investment Ltd. [2009] 179 Taxman 1 the Delhi High Court dispelled the Assessing Officer's action in treating share capital contribution from a listed entity as the assessee's undisclosed

income. In this case the assessee-company produced the following evidence which was found sufficient by the Court :

- (a) Copy of subscription form giving identity of the subscribers, including information with respect to their addresses as well as their PAN;
- (b) Copy of the statements of the bank accounts of the shareholder.

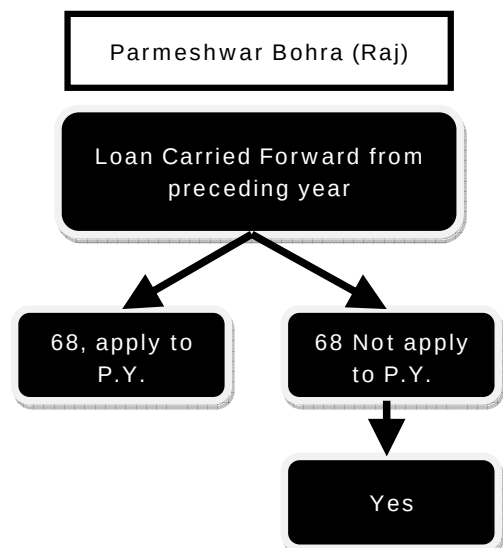
Interestingly the High Court found that the share capital of the investor company far exceeded its investment in the assessee-company and furthermore, it was found to be a member of the NSE being involved in sale and purchase of shares.

In fact, the Delhi High Court in Bhav Shakti Steel Mines (P.) Ltd. v. CIT [2009] 179 Taxman 25 reversed the order of the ITAT after it found that the Commissioner of Income-tax (Appeals) had verified such credit on scrutiny of the following documents :

- (a) PAN details;
- (b) Audited balance sheet of the shareholder.

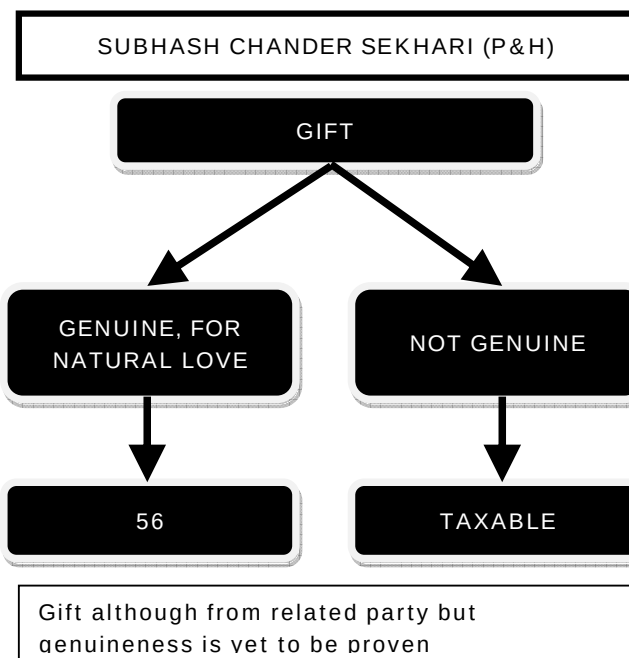
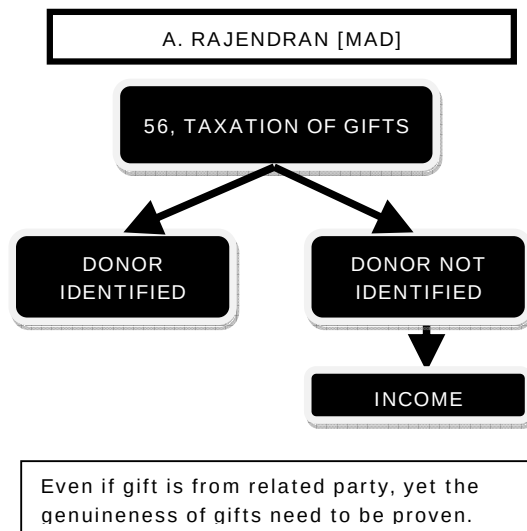
291 ITR 0278- COMMISSIONER OF INCOME-TAX VS. P. MOHANAKALA (SUPREME COURT OF INDIA)

A bare reading of section 68, suggests that (i) there has to be credit of amounts in the books maintained by the assessee ; (ii) such credit has to be a sum of money during the previous year ; and (iii) either (a) the assessee offers no explanation about the nature and source of such credits found in the books or (b) the explanation offered by the assessee, in the opinion of the Assessing Officer, is not satisfactory. It is only then that the sum so credited may be charged to income-tax as the income of the assessee of that previous year. The expression “the assessee offers no explanation” means the assessee offers no proper, reasonable and acceptable explanation as regards the sums found credited in the books maintained by the assessee. The opinion of the Assessing Officer for not accepting the explanation offered by the assessee as not satisfactory is required to be based on proper appreciation of material and other attending circumstances available on the record. The opinion of the Assessing Officer is required to be formed objectively with reference to the material on record. Application of mind is the sine qua non for forming the opinion.



291 ITR 0178- A. RAJENDRAN VS. ASSISTANT COMMISSIONER OF INCOME-TAX (MADRAS HIGH COURT)

Foreign gifts introduced in the assessee's books are in the nature of cash credits covered by section 68 of the Act requiring the assessee to prove the identity of the creditor (donor in this case) and the nature and source of the amount. In view of the wide-spread practice of money laundering through foreign gifts, authorities have natural suspicion as to the genuineness of such gifts, especially when they are not from close relatives. It is for this reason, that gifts from non-relatives are now subjected to tax by deeming them as income irrespective of their genuineness by an amendment to section 56 with effect from the assessment year 2005-06.



290 ITR 0300- SUBHASH CHANDER SEKHRI VS. DEPUTY COMMISSIONER OF INCOME-TAX (PUNJAB AND HARYANA HIGH COURT)

The burden of proving that a gift is genuine having been received on account of natural love and affection, is on the taxpayer. In two decisions, the Punjab and Haryana High Court in Subash Chander Sekhri v. Deputy CIT [2007] 290 ITR 300 and Jaspal Singh v. CIT [2007] 290 ITR 306 (P&H) has upheld the finding of the Tribunal, that the gifts under consideration were not proved to be genuine and that this inference being one of fact, the High Court did not interfere.

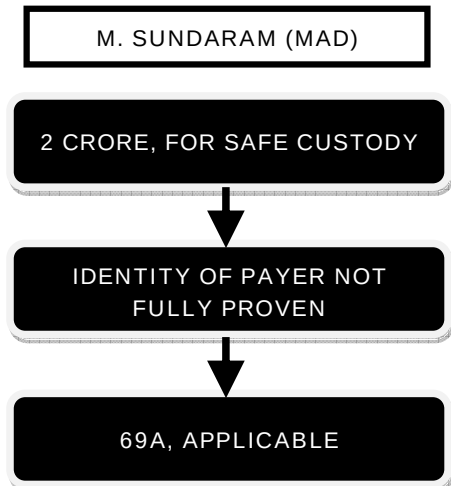
290 ITR (A.T.) 0306- DAVINDER SINGH VS. ASSISTANT COMMISSIONER OF INCOME-TAX (INCOME-TAX APPELLATE TRIBUNAL--AMRITSAR)

There is nothing in section 68 of the Income-tax Act, 1961, that books of account must be rejected before making an addition under this section. This is an independent and deeming provision and will apply if the assessee fails to offer an explanation of the source of a particular receipt/credit appearing in the books of account or if the explanation given by the assessee is found to be not satisfactory by the Assessing Officer.

Cash credits are generally understood as amounts credited in the books of the assessee in the names of third parties as creditors. Since unaccounted income has tendency to surface as borrowings or investments, the law would reckon such unexplained credits, payments and investments as income. Cash credits under section 68 were understood to include all amounts met for payments found in the assessee's books and not merely for cash receipts as loans : Davinder Singh v. Asst. CIT [2007] 290 ITR (AT) 306

(Amristar). In this case, the assessee was a katcha arhatia, a commission agent, for sale of agricultural produce like cotton and narma. The purchases were made through the marketing committee. Local enquiry by the inspector indicated that two sellers denied sale to the assessee. It was in this context, an amount of Rs. 60,87,926 standing to the credit of 51 sellers was treated as income. But the issue was remanded to the Tribunal after the finding that the assessee is responsible to prove the nature and source of the same. Such remand was necessary as the assessee had no opportunity. Though the amount under consideration was treated as covered by section 68, the issue in this case was verification of purchases made on behalf of the clients of the assessee. The issue as regards application of section 68 had arisen possibly because the Assessing Officer made the addition with reference to section 68. Even before the provisions of sections 68 to 69D were brought on the statute, the burden of proof was understood as on the assessee in all such cases to prove the source of amounts credited or invested.

There was no written agreement between the assessee and its sister concerns to whom seventy-five per cent. of the commission had been paid and therefore the assessee had to establish with documentary and cogent evidence that such expenditure was incurred for the purpose of the assessee's business. No evidence was produced about the nature of services rendered by the two sister concerns. Nothing was on record to show that the increase in the dami receipts was due to the efforts made by the assessee's two sister concerns. Thus, the assessee had not discharged the onus to prove that the commission was paid wholly and exclusively for the purpose of his business. Therefore the authorities below were justified in disallowing the claim.



287 ITR 0145- M. SUNDARAM VS. ASSISTANT COMMISSIONER OF INCOME-TAX (MADRAS HIGH COURT)

The assessee filed returns for the assessment years 1991-92 and 1992-93 declaring salary from U and K besides interest income from bank deposits. On the basis of news published in the newspapers on August 23, 1991, the Revenue conducted a search operation at Canara Bank and State Bank of India and found a sum of Rs. 2,04,27,106 credited at various branches of State Bank of India and Central Co-operative Bank in the name of the assessee. The assessee through his father withdrew all the money just prior to the date of raid. The assessee explained before the Assessing Officer that the said amount belonged to one M and one J who came for bleaching work to U but could not prove the address and other details of the said two persons. The Assessing Officer added the entire amount as unexplained money under section 69A of the Income-tax Act, 1961, to the total income of the assessee. The appellate authorities confirmed the addition made in the respective assessment years invoking section 69A in the reopened assessments. On appeal : Held, dismissing the appeals, that when the assessee claims that V and J who came for bleaching work to U handed over the huge sum of money for safe custody, he might have known the address, telephone number and other particulars. No businessman would receive a sum of Rs. 2 crores without knowing the identity and address. The admitted facts were that the entire sum was credited in the bank accounts of the assessee by cash and the entire amount was in the possession of the assessee. The assessee was receiving a small amount as salary and he had not disclosed the true picture of how he came into possession of such a huge amount. Since the assessee failed to prove that the money did not belong to him, the authorities were right in assessing it under section 69A.

274 ITR 0405- JAGMOHAN RAM RAM CHANDRA VS. CIT (ALL)

The assessee-firm had six partners. For the assessment year 1977-78, the Income-tax Officer required the firm to explain the nature and source of two cash credits standing in the names of two partners. The explanation offered by the firm was that these two partners had surrendered the amounts in question in their individual returns and that they had been assessed thereon. The Income-tax Officer rejected the explanation and treated the sum of Rs. 17,500 as its income by invoking the provisions of section 68 of the Income-tax Act, 1961.

Held, that if an entry of cash credit is found in the books of account of a firm, it is for the firm to give an explanation regarding the identity and source of such deposits and if the explanation is disbelieved then it is to be added as an income under section 68 in the hands of the firm. Similarly, if an assessee, who is a partner in the firm, has made investment which is not recorded in the books of account maintained by him for any source of income and the explanation given by the partner or individual regarding the source of deposits is disbelieved then such deposits which are an investment can be brought to tax as income from undisclosed sources under section 69 of the Act. There is no question of any double taxation. Full effect of the deeming provisions and the presumptions provided under sections 68 and 69 of the Act has to be given. The firm and the partners being treated as separate assessee under the Act, assessment of the income in the hands of different assessee under different provisions of the Act is permissible. On the facts and in the circumstances of the case, the Tribunal was justified in upholding the addition of Rs. 17,500 in the total income of the assessee even though the said amount was also assessed in the hands of the two partners, viz., U and G.

273 ITR 0206- COMMISSIONER OF INCOME-TAX VS. VIR BHAN AND SONS (PUNJAB AND HARYANA HIGH COURT)

The Assessing Officer made additions to the income of the assessee of Rs. 22,01,500 on account of unexplained cash credits and Rs. 94,602 on account of interest claimed thereon. The Commissioner (Appeals) and AT found that the amounts of the credits were received by the assessee by means of crossed account payee cheques, the creditors were existing income-tax assessee and the Assessing Officer had access to their records for verification and accordingly deleted the additions made by the officer.

Held that the approach of the two appellate authorities was totally erroneous. The assessment order showed that the assessee did not care to respond to the show-cause notice issued by the Assessing Officer requiring it to explain why in the absence of production of the creditors, the amount standing in their credit be not treated as unexplained cash credits under section 68 of the Income-tax Act, 1961. It was not the case of the assessee that the creditors were not responding to his letters or refusing to attend the office. The assessee did not even make a request to the Assessing Officer to make the necessary verification. The assessee had furnished certain materials before the Commissioner (Appeals) who straightaway accepted the same. The order did not show that he afforded any opportunity to the Assessing Officer to verify the correctness of the material produced before him and also no finding was recorded that he had himself made any verification from the records of the creditors. The appellate authorities had not dealt with the matter properly. Although the assessee might have discharged the initial onus by furnishing the permanent account numbers and copies of accounts of the creditors showing receipts and payment by way of account payee cheques, these could not conclusively prove the genuineness of the creditors.

270 ITR 0487- BHOLA SHANKAR COLD STORAGE PVT. LTD. VS. JOINT COMMISSIONER OF INCOME-TAX (CALCUTTA HIGH COURT)

Section 68 of the Income-tax Act, 1961, requires a taxpayer to prove the genuineness of credits in his books. If the explanation regarding credits is not satisfactory, the Assessing Officer can treat the credits as income of the assessee. Where most of the subscriber to share capital was farmers and being poor could not produce the certificate and proofs is not a satisfactory explanation,

280 ITR 0512- MURLIDHAR LAHORIMAL VS. COMMISSIONER OF INCOME-TAX (GUJARAT HIGH COURT)

Section 68 of the Income-tax Act, 1961, requires that there has to be a credit in the books maintained by an assessee ; such credit has to be of a sum during the previous year ; and the assessee offers no explanation about the nature and source of such credit ; or the explanation offered by the assessee is not, in the opinion of the assessing authority, satisfactory, then the sum so credited may be charged to tax as income of the assessee of the previous year. As section 68 of the Act denotes, once there is a credit in the books maintained by the assessee, the primary onus is on the assessee, namely, to offer an explanation as to the nature and source of the credit. An assessee can be asked to prove the source of credit in the books, but cannot be asked to prove the source of the source.

The identity of the donor was established, the donor having appeared in person before the Assessing Officer, the genuineness of the transaction was established, not only by the receipt of the bank draft, but also by the fact of the transaction having borne gift tax once the assessment was framed. The primary onus which rested with the assessee, thus, stood discharged. Thereafter, if the Revenue was not satisfied with the source of the funds in the hands of the donor, it was up to the Revenue to take appropriate action. The Tribunal considered the motivation for making the gift which was not relevant. The addition of Rs. 50,000 was not justified.

Gifts do not have the character of income. Now that section 56(v) has been introduced, it is deemed as income, if received from persons other than relatives. Though gifts are not liable to tax in law, where they are amounts received, they are required to be proved under section 68 as bona fide gifts. If they are not so established, they will be treated as income. Gifts in kind could also be similarly treated as unexplained investment under section 69. The burden of proof, even otherwise would ordinarily lie on the taxpayer, since he alone is in possession of all the relevant facts.

271 ITR (A.T.) 0014- HAJI NAZIR HUSSAIN VS. INCOME-TAX OFFICER (DELHI BENCH)

Section 68 is applicable only when any sum is found credited in the books of an assessee maintained by him. However, books of account do not mean cash book only. It would mean the complete records which a businessman is required to maintain to record his day-to-day transactions. According to the well-settled principles of accountancy, each transaction is required to be treated under two heads—under one head, a debit entry is made while under the other head, a credit entry is to be made. The cash book is nothing but the cash account which is debited if money is received and is credited if money is spent or invested by the assessee. In such cases, corresponding credit or debit entries are to be made by the assessee in the respective accounts. If such entries are not made, the accounts of the assessee would not tally. Therefore,

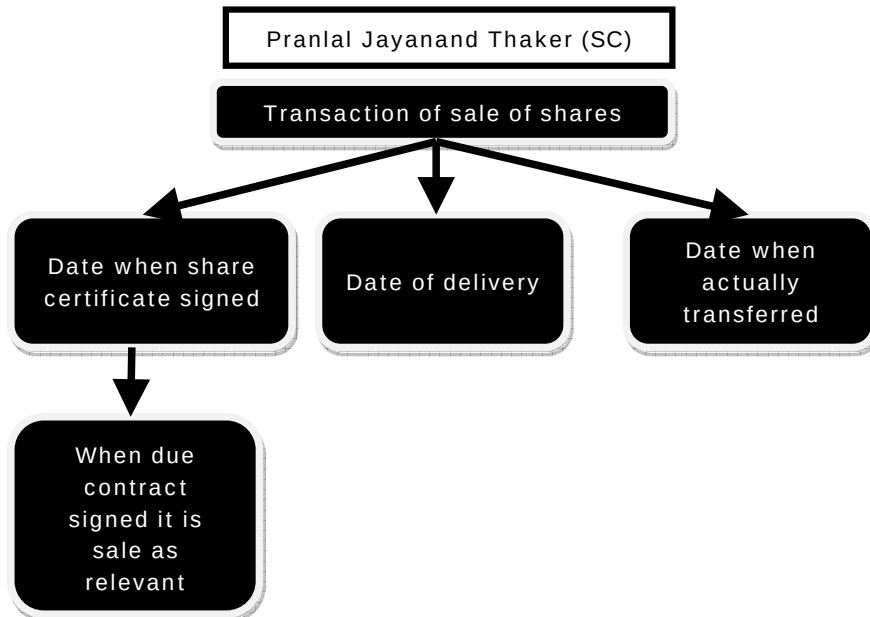
failure on the part of the assessee to make credit entry in the respective account would not entitle the assessee to claim that no account is credited. The assessee cannot be allowed to take undue advantage of his own lapses/mistakes. Therefore whenever any money is received by the assessee and is entered in the cash book, it can be said that the sum is credited in the books of the assessee even though the corresponding credit entry in the ledger account may be made subsequently. In the present case, there was no dispute that the note book/rough cash book related to the business of the assessee. There was no dispute that the cash receipts were recorded in this book on various dates. Hence, section 68 was applicable to the entries made in this book.

MEANING OF TRANSFER

Section / Topic Name : 45, 2(47), 2(14)

DATE OF TRANSFER

Where there is a contract of sale of shares by agreement, it is the said date, which should be treated as the date of transfer for purposes of capital gains tax, subject only to the condition, that there should have been a subsequent delivery of shares. The Income-tax Appellate Tribunal in *Max Telecom Ventures Limited v. Asst. CIT* [2008] 301 ITR (AT) 90 (Amritsar) held so, while pointing out that the Board Circular No. 704 dated April 28, 1995 [1995] 213 ITR (St.) 7 has also understood the law accordingly. The argument of the assessee was that the agreement was a conditional one and it is only on satisfaction of the conditions, that the share certificates were delivered to the purchaser and the sale consideration received. Since shares are movable property, the date of transfer should ordinarily be regulated with



reference to section 5(2) of the Sale of Goods Act, 1930, so that the date of delivery should be taken as the date of transfer. On the contrary, the assessee itself had taken the date of contract as the date of transfer, while pleading exemption under section 10(23G). In the assessee's case, the arguments have been discussed by the Tribunal, which found that even the Government approval for the transaction was received during the year and that the conditions of legal

opinion, approvals etc. were not such as to dislodge the inference of transfer on the date of agreement. The definition of transfer for purposes of capital gains, it was pointed out, is wide. The Tribunal also relied upon the decision in *K. N. Narayanan v. ITO* [1984] 145 ITR 373 (Ker) and [1988] 173 ITR 61 (Ker).

In respect of shares, it has been held that the provisions of the Transfer of Property Act, 1882 and not the Companies Act, 1956 would be relevant. Where the share scrips are handed over along with share transfer forms duly signed, the transfer is complete and the liability to tax follows. This accepted position of law follows the decision in the case of *Vasudev Ramchandra Shelat v. Pranlal Jayanand Thaker* [1975] 45 Comp Cas 43 (SC) where even in the case of shares given by gift, the transfer was held to have been complete on such delivery of scrips along with share transfer forms duly signed, though the donor had died before registration with the result that the gift having become complete, the donee was entitled to shares. The reasoning is that the shares are movable property, so that delivery is material for transfer under the Transfer of Property Act, 1882. But there may be circumstances when the agreement may lead to an inference of transfer as probably inferred by the Tribunal in this case.

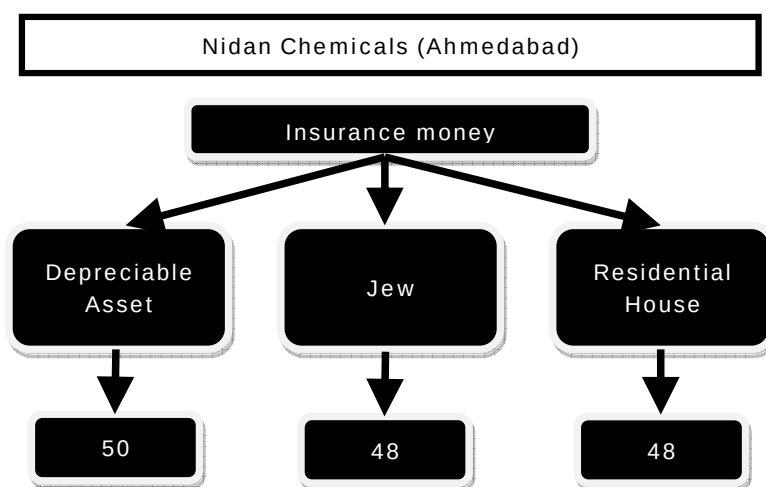
AGRICULTURAL LAND-THE PRINCIPLE OF MEASURING DISTANCE

As per section 2(14)(iii) a 'capital asset' would not include any agricultural land which is not situated in any area within such distance as may be specified in this behalf by a notification in the Official Gazette which may be issued by the Central Government. The maximum distance prescribed by section 2(14)(iii)(b) which may be incorporated in the notification, cannot be more than 8 kms from the local limits of the municipal committee or cantonment board, etc. For this purpose, the notification has to take into account the extent of and scope for urbanization of that area and other relevant considerations.

The Punjab and Haryana High Court in CIT v. Satinder Pal Singh [2010] 188 Taxman 54 held that to reckon such land as capital asset or not, the distance of the agricultural land belonging to the assessee had to be measured in terms of the approach by road and not by a straight line distance on a horizontal plane or as per crow flight distance.

INSURANCE CLAIM

In Asstt. CIT v. Nidan Chemicals (P.) Ltd. [2007] 158 Taxman 109 (Ahd.) (Mag.) the AO computed capital gain viz a viz insurance sums received by invoking section 45(1A) provisions. The Ahmedabad Bench had to intervene to resolve the issue in favour of the assessee when it held that such sums received are to be reduced from block of fixed assets. Since the amount received was much below the existing block of assets section 45(1A) was held inapplicable.



INVESTMENT OR STOCK-IN-TRADE

Following the Supreme Court's decision in Raja Bahadur Kamakhya Narain Singh v. CIT [1970] 77 ITR 253, the Delhi High Court in CIT v. Ess Jay Enterprises (P.) Ltd. [2007] 165 Taxman 465 held that the treatment given to a transaction in the books of account is of importance so that assessee's income from sale of shares is found to be assessable as capital gains instead of business income. In this case, the assessee had shown shares as investments in its books of account.

DELIVERY BASED TRANSACTIONS

The Bombay High Court in CIT v. Gopal Purohit [2010] 188 Taxman 140 held that it is open to the assessee to maintain separate portfolios, one relating to investment in shares and another relating to business activities involving dealing in shares. And in regard to delivery based transactions, the High Court upheld the reasoning that the same should be treated as those in the nature of investment transactions and profit therefrom should be treated either as short term or, as the case may be, long term capital gain depending upon the period of the holding.

Shares	
Held as Investment (Gopal Purohit (Bombay High Court))	CG
Held as Stock (Ess Jay Enterprises (P.) Ltd. (Delhi High Court))	BUSINESS
Purchase & subsequent resale (Raunaq Singh Swaran Singh (Delhi High Court) (if intention to keep as stock))	BUSINESS
Note:	
1) Treatment in books is of vital importance	
2) Purpose of purchase is vital importance (Ramnarain Sons (P.) Ltd. (SC))	

SALE OF SHARES - CAPITAL GAIN V. BUSINESS INCOME

The Delhi High Court in CIT v. Ess Jay Enterprises (P.) Ltd. [2008] 173 Taxman 1 followed the maxim that the treatment given to a transaction in the books of account is of vital importance. In this case the assessee was carrying on restaurant business and had shown a significant value of shareholding in listed company's shares as an investment and not as a stock-in-trade of business and there was no indication that it had converted such holdings into stock-in-trade at any point in time so that the Court held the profit on sale of shares assessable to capital gains tax.

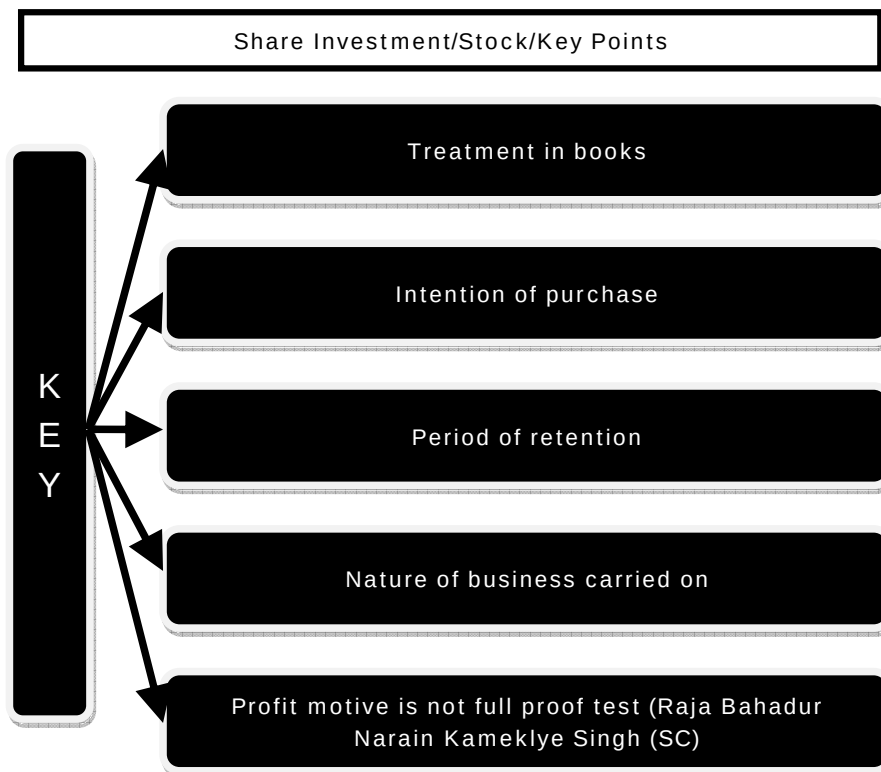
Also the Supreme Court in Ramnarain Sons (P.) Ltd. v. CIT [1961] 41 ITR 534 held that the principal consideration in determining whether income from sale of shares is revenue income or capital gain is to find out as to what was the purpose of purchase of those shares, and, if the purpose was investment, the fact that, in varying the investment, the sale of those shares had resulted in a profit would not make that profit revenue income. The Delhi High Court in CIT v. Raunaq Singh Swaran Singh [1972] 85 ITR 220 held that in order to find out whether a transaction of purchase and subsequent re-sale amounts to an adventure in the nature of trade or not, the sole intention of the purchase is the key.

While holding sale of shares held in the portfolio account to be on capital account the Chandigarh Bench of the ITAT in Vesta Investments and Trading Co. (P.) Ltd. v. CIT [1999] 70 ITD 200 held that no hard and fast rule may be laid down to determine the nature of an asset held by the assessee-whether it is a capital asset or stock-in-trade. A number of factors like the nature of the asset involved; the dominant intention of the assessee for acquiring it; the period of retention thereof; the attendant circumstances leading to the sale thereof; the nature of business activities carried out by the assessee, etc., are required to be taken into account before the asset-in-question is held to be capital asset or stock-in-trade. In each case it is the total effect of all relevant factors and circumstances that determines the nature and character of the asset. Thereafter, the fact that the assessee had itself made demarcation between the shares held as stock-in-trade and the shares held as capital investments in its books of account, the Tribunal held as under:

“7. On going through the facts on record, it is manifestly clear that the dominant intention of the assessee while purchasing the shares for the purposes of investment is unequivocally demonstrated by the conduct of the assessee in recording the purchases in a separate investment portfolio account. It has been held by the Hon'ble Supreme Court in the case of Ramnarain Sons (P.) Ltd. (supra) and Hon'ble Allahabad High Court in the case of Sohan Lal Gupta (supra) that

the intention of the assessee at the time of acquisition of the asset, whether the purchase is for the purposes of long-term investment or for the purposes of dealing in shares is the dominant factor for determining the nature of the asset. Applying this principle, in conjunction with the attendant facts and circumstances narrated above, we have no hesitation in holding that the income from sale of shares reflected in the investment portfolio account is liable to be assessed under the head “capital gains” and not “business income”.”

The Supreme Court in *Karam Chand Thapar & Bros. (P.) Ltd. v. CIT* [1971] 82 ITR 899 held that it is difficult to lay down cut and dried principles for deciding that question. It depends upon the facts and circumstances of each case. The Tribunal in this case relied only on the accounting entries and disclosure of shares as investments to which the Court pointed out that though the circumstance that the assessee had shown the shares as investment shares in its books as well as its balance-sheet is by itself not a conclusive circumstance, it is a relevant circumstance for drawing the inference that the profit/loss is a capital profit/loss. Likewise the Supreme Court in the case of *Ashoka Viniyoga Ltd. v. CIT* [1972] 84 ITR 264 upheld the finding of the Tribunal placing reliance on the resolution of the board naming the transaction as sale/purchase of investments and also for the fact that it was so recorded in the books of account as investment and not stock in trade.



In *Karnataka State Industrial Investment & Development Corpn. Ltd. v. Dy. CIT* [1996] 59 ITD 643 the Bangalore Bench of the ITAT found that the assessee had all along treated the shares as investments which fact according to it goes to show the motive of the assessee even at the time of acquisition of the shares. It held that the shares were held by the assessee under investment portfolio and, therefore, the profit/loss arising to it on sale of such shares was nothing but in the nature of capital gain/loss.

In judging whether a

transaction for sale of asset is to be regarded as sale of capital asset per se or a business transaction, the Bangalore Bench of the Tribunal in *M.V. Chandrashekar v. Dy. CIT* [2004] 91 ITD 543 held that what is of significance is the intention of the assessee at the time of acquisition of such asset. The Bench apparently took a clue from the Apex Court’s ruling in *CIT v. Holck Larsen (H.)* [1986] 160 ITR 67/26 Taxman 305. Therein the Supreme Court had to deal with the question whether the income arising from sale of shares by the assessee is to be taxed on revenue account or capital account. It held that in order to determine whether an assessee was a dealer in shares or an investor, the real question was not whether the transaction of buying and selling the shares lacks the element of trading, but whether the later stages of the whole operation show that the first step—the purchase of the shares—was not taken as, or in the course of, a trading transaction.

The Supreme Court in *Raja Bahadur Kamakhya Narain Singh v. CIT* [1970] 77 ITR 253 held that the conduct of the assessee is the determinative factor in judging whether shares are held on capital or trading account. More precisely it held as under:

“It is fairly clear that where a person in selling his investment realizes an enhanced price, the excess over his purchase price is not profit assessable to tax. But it would be so, if what is done is not a mere realization of the investment but an act done of making profits. The distinction between the two types of transactions is not always easy to make. Whether the transaction is of one kind or the other depends on the question whether the excess was an enhancement of the value by realizing a security or a gain in an operation of profit-making. If the transaction is in the ordinary line of the assessee’s business there would hardly be any difficulty in concluding that it was a trading transaction, but where it is not, the facts must be properly assessed to discover whether it was in the nature of trade. The surplus realized on the sale of shares, for instance, would be capital if the assessee is an ordinary investor realizing his holding; but it would be revenue if he deals with them as an adventure in the nature of trade. The fact that the original purchase was made with the intention to resell if an enhanced price could be obtained is by itself not enough but in conjunction with the conduct of the assessee and other circumstances it may point to the trading character of the transaction. For instance, an assessee may invest his capital in shares with the intention to resell them if in future their sale may bring in a higher price. Such an investment, though motivated by a possibility of enhanced value, does not render the investment of a transaction in the nature of trade. The test often applied is, has the assessee made his shares and securities the stock-in-trade of a business.”

Even the Circular No. 4/2007 issued by the Central Board of Direct Taxes (“CBDT”) which lays down principles for classification of shares as ‘investments’ and ‘stock in trade’ provides that it is possible for an assessee to have two portfolios with respect to investment in shares. The relevant extract from the Circular is provided below:

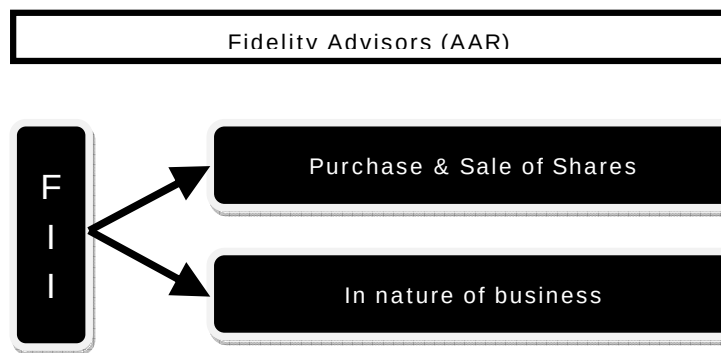
“CBDT also wishes to emphasise that it is possible for a tax payer to have two portfolios, i.e., an investment portfolio comprising of securities which are to be treated as capital assets and a trading portfolio comprising of stock-in-trade which are to be treated as trading assets. Where an assessee has two portfolios, the assessee may have income under both heads i.e., capital gains as well as business income.”

SHARES HELD AS INVESTMENT

The Madras High Court in CIT v. N S S Investments (P.) Ltd. [2007] 158 Taxman 13 accepted the stance of the assessee that the profit on sale of shares, which were never treated as stock in trade, should not be assessed under the head business. The Court made a point that a company can hold some shares as stock in trade for the purpose of doing business of buying and sale of shares, while at the same time it can also hold some other shares as its capital for the purpose of earning dividend income.

FII INVESTMENTS

The AAR in Fidelity Advisor Series VIII, In re [2004] 271 ITR 1/[2005] 142 Taxman 111 (AAR - New Delhi) held that profits from the purchase and sale of shares were in the nature of business profits, and, therefore, the business profits of the applicant could not be taxed in India in view of article 7 of the Double Taxation Avoidance Agreement. Once again in Morgan Stanley & Co. International Ltd., In re [2005] 272 ITR 416/142 Taxman 630 (AAR - New Delhi) The AAR held that the magnitude of the



purchases and sales was enormous (amounting to Rs. 3,932 crores in a year) and the ratio of purchases and sales was very high. Therefore, the income from the transactions of trading in derivatives was 'business income' and not 'capital gains'. Article 7 of the Agreement covered the income derived from trading in derivatives. It held that the income arising to the applicant from the transactions in

exchange derivatives was not classifiable as 'capital gains' under article 14 of the Double Taxation Agreement but was 'business profits' covered by article 7 of the Agreement.

In a recent ruling in Fidelity Northstar Fund, In re [2007] 158 Taxman 372 (New Delhi) the AAR took a contrary stand when it held that income will be taxable as capital gains instead and not as business income. The AAR ruled that the FIIs are not registered for trading in securities hence the gain made by them would assume the character of capital gains

NON COMPETE FEES – CAPITAL RECEIPT

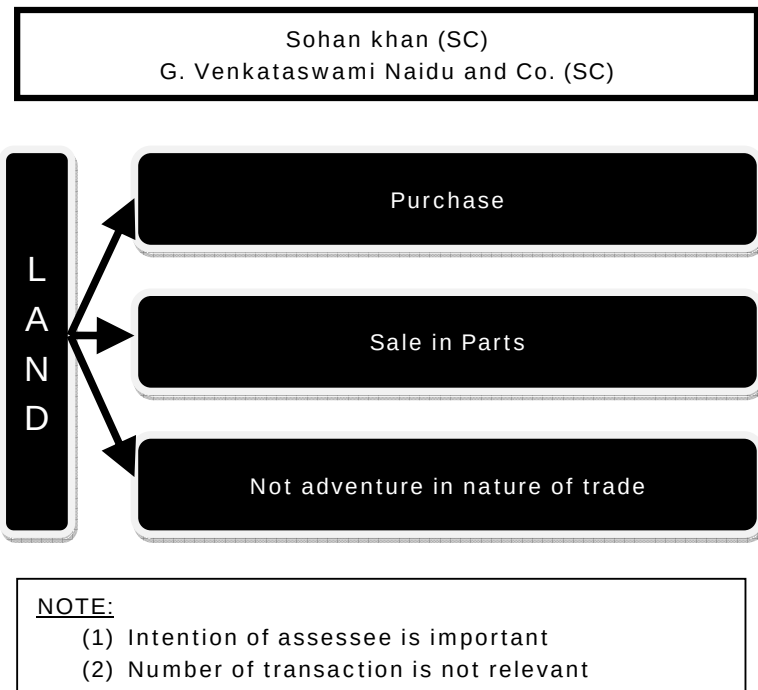
Where non-compete fee was paid to a director on loss of his office for not involving in software development, such an amount was held to be a capital receipt not liable to tax after referring to a number of precedents on the subject. The decision relates to an assessment prior to amendment to section 17(3) from April 1, 2002, and insertion of clause (va) into section 28 from April 1, 2003, so that this decision in Rohitasava Chand v. CIT [2008] 306 ITR 242 (Delhi) may possibly lead to a different inference after the amendments.

SALE OF LAND IN PARTS IS NOT ADVENTURE IN NATURE OF TRADE

The assessee had purchased a large extent of land in 1970 and after getting clearance under the land ceiling law after considerable time, the assessee prepared a site plan and sold some plots in driblets. The issue whether the sale was of a stock-in-trade or capital assets came up in CIT v. Sohan Khan [2008] 304 ITR 194 (Raj). The Tribunal with reference to the test laid down by the Supreme Court in G. Venkataswami Naidu and Co. v. CIT [1959] 35 ITR 594 found that there was no evidence to show that the transaction could give rise to business income or be treated as an adventure in the nature of trade in the absence of any evidence to show that the purchase had been made solely with the intention to resell at

a profit. It was also found that there was no repetitiveness of purchases, since it was of a single purchase. But at the same time, it could not also be adventure in the nature of trade without establishing the intention to resell even at the time of purchase. It will be treated as capital gains.

Most significant consideration to conclude whether the transaction gave rise to capital gains or not would be the regularity of transactions of purchase and sale. The mere fact that there was a series of transactions of sale only by selling part of the land, purchased in one go, or purchased once upon a time, piecemeal, would not render the activity of sale an “adventure in the nature of trade”. There was nothing to show that the land was purchased with the intention to sell it at a profit, or with requisite intention, to bring it within the parameters of “stock-in-trade”. It was also not shown that the assessee was a regular dealer in real estate. The transaction was of a capital asset only and not a transaction of any “stock-in-trade”. Therefore the sale proceeds were liable to be taxed as capital gains.



228 ITR 0163 KARTIKEYA VS. SARABHAI V. CIT; (SC)

Meaning of “transfer” as per scope of section 2(47). Reduction of face value of shares amounts to extinguishment of rights in shares and thus amounts received on such reduction are taxable as capital gain.

273 ITR 0165- ASHOK SOI VS. COMMISSIONER OF INCOME-TAX (DELHI HIGH COURT)

Where a property belonged to the assessee's wife and sons, but a part of consideration was made to the father of the assessee in pursuance of an alleged compromise settling his claim against the property on being made a confirming party to the sale deed, the question arose whether such payment would go to reduce the capital gains in the hands of the assessee's wife and their two children. It was found that the property had earlier belonged to the assessee as absolute owner and that it became a co-owned property between himself and the other family members, because he had thrown it into the family hotchpot and divided the same, so that the income had to be aggregated in the assessee's hands under section 64. His father had no right over the same, so that the alleged compromise would rule out the claim to exclude the payment made to him. The argument for the claim on the basis of a decision in CIT v. C. V. Soundarajan [1984] 150 ITR 80 (Mad) was found to be misplaced, because that was a case, where the payment was made to the mother, who had right of residence in the property. But in the case before the High Court in Ashok Soi v. CIT [2005] 273 ITR 165 (Delhi), the father had no right whatsoever in the property.

236 ITR 0327 CIT VS. NARASIMHAN (G.)(DECD.) (SC)

However, in the case of Kartikeya V. Sarabhai v. CIT [1997] 228 ITR 163, this court did not consider the provisions of section 2(22)(d) in the context of capital gains arising on a reduction of the share capital. Under section 2(22)(d) any distribution to its shareholders by a company on the reduction of its capital, is deemed to be a distribution of dividend to the extent that the company possesses accumulated profits whether such profits have been capitalised or not. Therefore, any distribution which is made by a company on a reduction of its share capital which can be correlated with the company's accumulated profits (whether capitalised or not), will be dividend in the hands of the assessee. Therefore, it will have to be treated as income of the assessee and taxed accordingly.

Assessee in the present case had been paid not merely cash but had also been given a property for the reduction in the value of his shares from Rs. 1,000 to Rs. 210. Out of the total amounts so received including the value of the property so received, the portion attributable to accumulated profits had to be deleted. Only the balance amount could be treated as a capital receipt. Thereafter looking to the cost of acquisition of that portion of the share which had been diminished, capital gains would have to be determined.

CONCLUSION:

In the Reduction of capital by company face value of shares reduces, Amounts distributed to shareholders as a result of reduction has two components

- (i) distribution attributable to accumulated profits, and
- (ii) distribution attributable to capital

Part attributable to accumulated profits is assessable as dividends and balance subject to capital gains tax.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee had subscribed to the shares of X Limited at the par value of 10 each. The scheme of reduction in the capital was sanctioned by the court and thus Rs. 12 per share was paid off to each share holder for the 50 % reduction in the share capital [accumulated reserve as per 2(22)(d) at the time of reduction is Rs. 3 per share]. Mr. X received 12 Rs. Per share against the reduction of Rs. 5 the excess was claimed as capital receipt not chargeable to tax. Is the stand taken by the assessee justified.

ANSWER

Kartikey vs. Sarabhai v/s CIT (SC) [1997] -- Section 2(47) of the Income-tax Act, 1961, defines "transfer" in relation to a capital asset. It is an inclusive definition which, inter alia, provides that relinquishment of an asset or extinguishment of any right therein amounts to a transfer of a capital asset. It is not necessary for a capital gain to arise, that there must be a sale of a capital asset. Sale is only one of the modes of transfer envisaged by section 2(47) of the Act. Relinquishment of the asset or extinguishment of any right in it, which may not amount to a sale, can also be considered as a transfer and any profit or gain which arises from the transfer of a capital asset is liable to be taxed under section 45. Such reduction of the right in the capital asset would clearly amount to a transfer within the meaning of that expression in section 2(47) of the Income-tax Act, 1961. [1999] 236 ITR 0327 CIT vs. Narasimhan (G.)(Decd.) (Supreme Court of India), However, in the case of Kartikeya V. Sarabhai v. CIT [1997] 228 ITR 163, this court did not consider the provisions of section 2(22)(d) in the context of capital gains arising on a reduction of the share capital. Under section 2(22)(d) any distribution to its shareholders by a company on the reduction of its capital, is deemed to be a distribution of dividend to the extent that the company possesses accumulated profits whether such profits have been capitalised or not. Therefore, any distribution which is made by a company on a reduction of its share capital which can be correlated with the company's accumulated profits (whether capitalised or not), will be dividend

in the hands of the assessee. Therefore, it will have to be treated as income of the assessee and taxed accordingly. Assessee in the present case had been paid not merely cash but had also been given a property for the reduction in the value of his shares from Rs. 1,000 to Rs. 210. Out of the total amounts so received including the value of the property so received, the portion attributable to accumulated profits had to be deleted. Only the balance amount could be treated as a capital receipt. Thereafter looking to the cost of acquisition of that portion of the share which had been diminished, capital gains would have to be determined.

CONCLUSION:

In the Reduction of capital by company face value of shares reduces, Amounts distributed to shareholders as a result of reduction has two components

- (iii) distribution attributable to accumulated profits, and
- (iv) distribution attributable to capital

Part attributable to accumulated profits is assessable as dividends and balance subject to capital gains tax.

Capital gains computed is as follows

Amount received on reduction	12
Less dividend under section 2(22)d	3
Full value of consideration	9
Cost of acquisition (50% since there is 50% reduction)	5
Capital gains per share	4

279 ITR (A.T.) 0053- JOINT COMMISSIONER OF INCOME-TAX VS. RASI SILKS (INCOME-TAX APPELLATE TRIBUNAL--CHENNAI)

For any capital receipt which can be brought under the provisions of section 45, there has to be disposal of an asset by any of the modes referred to in the definition of transfer under section 2(47). Unless and until there is a transfer of an asset as envisaged under section 2(47), no capital gain or loss can be computed under section 45, which means that if there is any gain or loss on account of any receipt, but transfer of asset is not involved, then the provisions of section 45 cannot be applied. The sine qua non of capital gains and/or capital loss is that receipt or accrual thereof must have originated in the transfer of a capital asset within the meaning of section 45(1) read with section 2(47).

Where a firm made some capital gains, but sought set off of the deficit in the retiring partner's account against capital gains, the Tribunal found that such loss is a capital loss not arising on transfer of an asset and therefore not admissible in Joint CIT v. Rasi Silks [2005] 279 ITR (AT) 53 (Chennai). The argument was that there was a transfer of interest on retirement of partners. The Bombay High Court had held that a transfer may be inferred if the agreement was by way of transfer of such interest, as for example, in N. A. Mody v. CIT [1986] 162 ITR 420 (Bom), while the Madras High Court in CIT v. N. Palaniappa Gounder [1983] 143 ITR 343 (Mad) would find that the manner in which the retirement took place, should make no difference and that there can be no liability for the retiring partner. The preponderant view was in favour of such view and the Bombay view can be taken to have been superseded by the decision of the Supreme Court in Tribhuvandas G. Patel v. CIT [1999] 236 ITR 515. But the past controversy as to the liability of partners is not relevant for the assessment of the firm. Also refer to other case laws we have noted in our class room.

279 ITR 0363- P. T. ANTONY AND SONS VS. UNION OF INDIA (KERALA HIGH COURT)

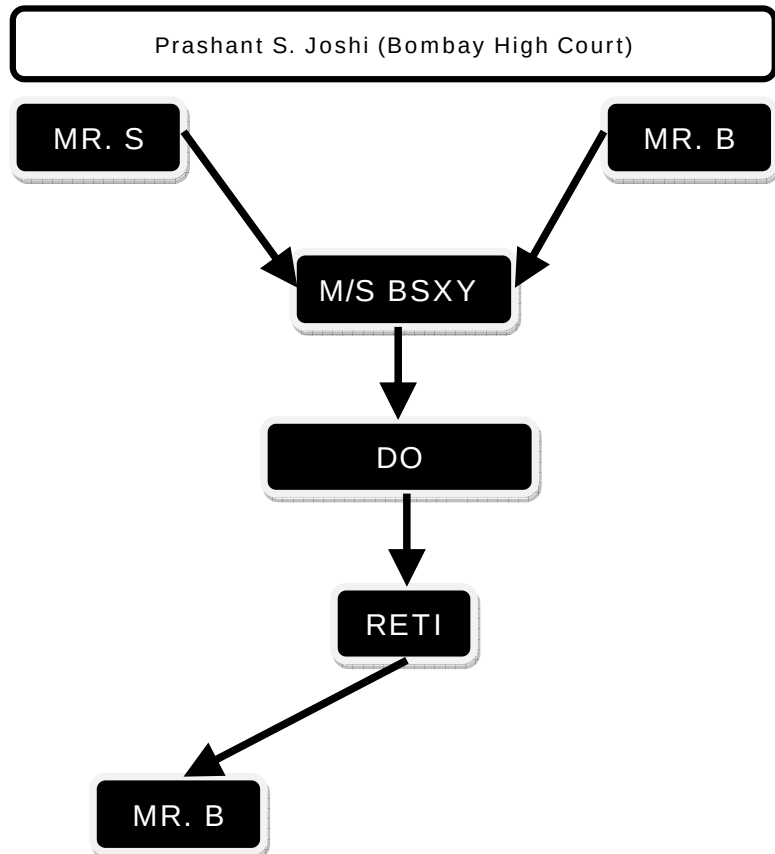
Settlement is no bar to the State proceedings. The order of settlement passed by the Settlement Commission may preclude any further action not only under the income-tax law, but also under any other central law, since section 245-I provides for immunity under other laws, which is possible under the Income-tax Act, which is a Central enactment. This provision can, however, have effect only as regards Central enactments, so that it cannot be a protection against any proceedings under the State sales tax law. It was so held in P. T. Antony and Sons v. Union of India [2005] 279 ITR 363 (Ker).

ASSESSMENT OF FIRMS

Section / Topic Name : 45(3) / 45 (4)

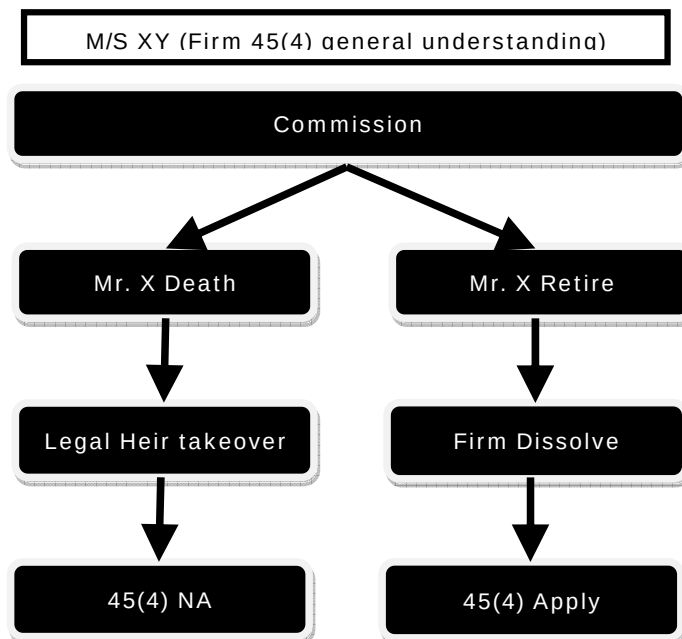
RETIREMENT OF PARTNER

The Bombay High Court in Prashant S. Joshi v. ITO [2010] 189 Taxman 1 held that an amount paid to a partner at the time of retirement after taking accounts and upon deduction of liabilities, would not fit into the situation warranted under sub-section (4) of section 45. In so pointing, the Court held that profits or gains, if any arising in such event shall be chargeable to tax only as income of the firm and certainly not in the hands of the partner. In this case, the retiring partner received a sum of Rs. 100 lakh, in addition to the balance lying to his credit in the capital and/or current account as reflected in the books of account on the retirement date in full and final settlement of his dues on account of retirement and claimed the said receipt as capital in nature. Later, noticing that the firm had claimed such payment as deduction, the Income Tax Officer attempted to reopen the case to bring such receipt to tax in the hands of partner under clause (iv) or (v) of section 28 without appreciating the settled legal position which leads to setting aside of the notice itself.



DEATH OF A PARTNER

Section 45(4) would fasten liability on distribution of assets of a partnership to a partner “on dissolution or otherwise” by deeming it a transfer for purposes of capital gains. Where a partner in a firm of two partners dies, there is dissolution under partnership law. The High Court in CIT v. Southern Tubes [2008]



306 ITR 216 (Ker) has held that in such cases, the distribution of the entire assets of the firm should be treated as having been made to the surviving partner in terms of section 45(4) and brought to tax by adopting the market value of the assets as consideration. The decisions relied upon by the High Court have inferred liability on reconstitution of the firm and dissolution. The decision of the High Court has overlooked the requirement that apart from dissolution, there should be distribution of assets. There can be no distribution, where a running business as a going concern is taken over as pointed out by the Supreme Court in Sakthi Trading Co. v. CIT [2001] 250 ITR 871 distinguishing its earlier decision in A. L. A. Firm v. CIT

[1991] 189 ITR 285 (SC) in the context of the necessity of revaluation of stock on dissolution. It was inferred that in the context of section 45(4) also, the same reasoning would have application as was held in CIT v. Moped and Machines [2006] 281 ITR 52 (MP) in a case on facts identical to those of Southern Tubes' case (supra). These relevant precedents do not appear to have been cited before the High Court in this case. If they had been cited, the decision could have been different.

265 ITR 0658- COMMISSIONER OF INCOME-TAX VS. MANGALORE GANESH BEEDI WORKS (KARNATAKA HIGH COURT)

Where the firm continues its business after dissolution without distribution of capital assets on dissolution, no capital gains would arise in the year of dissolution, even in the light of the language of section 45(4) of the Income-tax Act and section 47 of the Partnership Act, 1932. Non-liability was upheld on the rationale of decision of the Supreme Court in Saligram Ruplal Khanna v. Kanwar Rajnath, AIR 1974 SC 1094, where it was held that the mutual rights and obligations of the partners inter se would continue to the extent necessary for winding up of the affairs of the firm as provided under section 47 and that the firm would continue till all the necessary steps in connection with the adjudication of the dispute and other affairs of the partnership are concluded. Such has been the view taken in a number of other cases as well. Though the High Court did not disturb the finding, that the firm after dissolution was to be treated as an association of persons for the purpose of winding up, non-distribution in the year of dissolution, it was held, would avoid capital gains in the year of dissolution. This view is not acceptable to the Revenue, so that the matter has been taken up to the Supreme Court, which has granted special leave **[2003] 264 ITR (St.) 199**. Incidentally, it is also found in this case that even for purposes of determination of business profits, the continued valuation of closing stock at cost and not at market value was justified. The High Court referred to the decision in A. L. A. Firm v. CIT **[1991] 189 ITR 285 (SC)** which had actually decided otherwise, but the decision of the High Court accords with the subsequent

decision of the Supreme Court in Sakthi Trading Co. v. CIT **[2001] 250 ITR 871** (SC) to the effect that there is an exception to the rule in A. L. A. Firm in respect of a continuing business in that the same method as was followed by the firm prior to dissolution can continue to be adopted.

281 ITR 0052- COMMISSIONER OF INCOME-TAX VS. MOPED AND MACHINES (MADHYA PRADESH HIGH COURT)

Section 45(4) deems transfer of the assets distributed to a partner on dissolution or otherwise. There should not only be dissolution, but also distribution to attract the provision. Where one of the two partners of the firm dies, there is dissolution of the firm. But where the surviving partner carries on the business as a going concern with all assets and liabilities, there is no “distribution” within the meaning of the Supreme guidelines given in Sakthi Trading Co. v. CIT [2001] 250 ITR 871 distinguishing the earlier decision in A. L. A. Firm v. CIT [1991] 189 ITR 285 (SC). It was in this context that the Tribunal’s finding that there is no liability for capital gains tax was upheld in CIT v. Moped and Machines [2006] 281 ITR 52 (MP).

287 ITR 0404- SUVARDHAN VS. COMMISSIONER OF INCOME-TAX (KARNATAKA HIGH COURT)

There has been a persistent view that in the case of deemed incomes, a provision merely deeming any receipt as income by itself, would not be sufficient, unless the definition of income under section 2(24) is also amended to include such deemed income as income. It is true, that the drafting of law in different years does not follow the same pattern. While some classes of deemed income are included in the definition, others are not. Even so, where an amendment clearly records the intention of Parliament deeming a certain receipt as liable to tax as income, it has to be given effect. Section 45(4) is one such provision, which deems distribution of an asset to a partner by a firm on dissolution or otherwise as capital gains by treating the market value of such asset as consideration. It was held to be valid in Suvardhan v. CIT [2006] 287 ITR 404 (Karn). In coming to the conclusion, the High Court followed the decision in CIT v. A. N. Naik Associates [2004] 265 ITR 346 (Bom). In fact, the decision in A. N. Naik Associates’ case went further, when it held that section 45(4) would not only cover the dissolution as expressly provided, but would also include a change in constitution of the firm, a view which is not free from doubt as discussed in Income-tax Reports [2004] 265 ITR (Journal) 93. But that does not mean that the provision could be ignored even in the context of dissolution, which is specifically covered. The decision in Suvardhan’s case (supra) has also discussed a ruling in CIT v. Moped and Machines [2006] 281 ITR 52 (MP) distinguishing it, because that was a case where there was no distribution of assets, when the business was allotted to a partner as a going concern following the decision in Sakthi Trading Co. v. CIT [2001] 250 ITR 871 (SC).

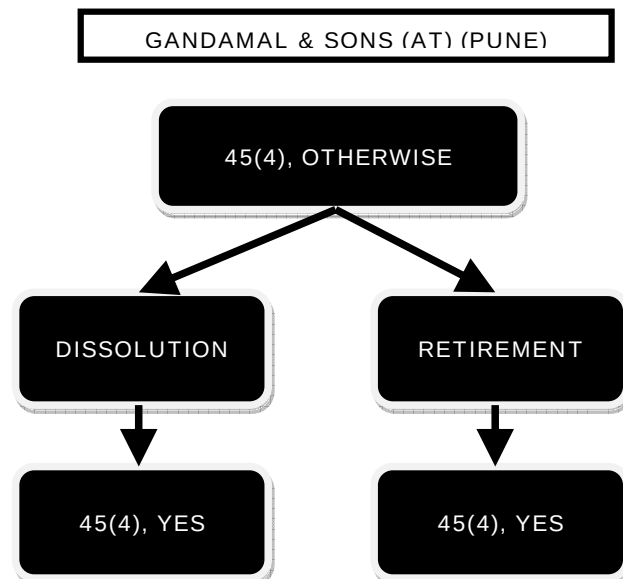
285 ITR (A.T.) 0163- GANDAMAL AND SONS VS. ASSISTANT COMMISSIONER OF INCOME-TAX (INCOME-TAX APPELLATE TRIBUNAL--PUNE)

The effect of the insertion of section 45(4) is that when a capital asset belonging to a firm is transferred to a partner on dissolution, reconstitution or on such similar occasion, such a transfer shall be deemed to be a transfer for the levy of capital gains tax under the provisions of section 45(4). The word “otherwise” in this section takes into its ambit, not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets to a retiring partner.

The expression “dissolution or otherwise” is understood by the Revenue to include “retirement”. The word “otherwise” was probably intended to cover distribution not only on “dissolution”, but also “before and after dissolution”, if connected with “dissolution”. The fact, that section 45(4) was brought along with section 45(3), which was concerned with formation should also justify the inference that what is implied in section 45(4) is only dissolution simpliciter. Even so, there is a decision of the jurisdictional High Court in CIT v. A. N. Naik Associates [2004] 265 ITR 346 (Bom) holding the view that the expression “or otherwise” in section 45(4) would comprehend retirement as well, so that the Tribunal followed the same in Gandamal and Sons v. Asst. CIT [2006] 285 ITR (AT) 163 (Pune). Even Board Circular No. 495 dated September 22, 1987 (1987) 168 ITR (St.) 87 on the amendment does not indicate the expression of the word “dissolution” to include “retirement”. Change in constitution vis-a-vis dissolution has always been explicitly provided under Chapter XVI of the Income-tax Act. The matter would appear to require further consideration. In the facts of the case, the issue involved was whether the land belonged to the partners of the firm or to the firm. In the absence of any evidence that the land was not treated as the partners’ personal property, it was found that the assessment on the firm and capital gains on the basis of the inference of distribution to any partner, would have to stand.

286 ITR (A.T.) 0121- ASSISTANT COMMISSIONER OF INCOME-TAX VS. UNITY CARE AND HEALTH SERVICES (INCOME-TAX APPELLATE TRIBUNAL--BANGALORE)

There can be no inference of transfer on conversion of a firm into company under the Part IX route. When a firm registers itself under Part IX of the Companies Act, 1956, the property of the firm gets vested in the company by operation of law under section 575 of the Companies Act, 1956. There is no bilateral transfer, so that there can be no liability for capital gains tax. Where tax was sought to be levied on the assumption of dissolution of the firm with distribution of assets to partners under section 45(4), the Tribunal in Asst. CIT v. Unity Care and Health Services [2006] 286 ITR (AT) 121 (Bangalore) following the decision of the High Court in CIT v. Texspin Engineering and Manufacturing Works [2003] 263 ITR 345 (Bom) found that there was no transfer. It was further found that the depreciation prior to and after registration should be the same as available for a single institution, but to be distributed on a pro rata basis, which follows from the inference that there is no change in the entity under company law.



COMPULSORY ACQUISITION

Section / Topic Name : 45(5)

265 ITR 0101- CIT VS. C.P. LONAPPAN AND SONS (KERALA HIGH COURT)

The charging provision for capital gains is section 45(1), clearly provides that the capital gains arising from the transfer of a capital asset shall be deemed to be the income of the previous year in which the transfer took place, and that in the case of compulsory acquisition, the crucial date of transfer is the date of award, and therefore, the liability to pay capital gains tax arises only on dispossession from the property pursuant to the award.

A reading of 45(5) makes it clear that it is with reference to the compensation awarded in the first instance, i.e., the award passed by the Collector, it is stated that it shall be chargeable as income under head “Capital gains” of the previous year in which such compensation or part thereof was received. The words “the compensation awarded in the first instance” refers to the compensation determined by the Collector as per his award and the words “such compensation or part thereof . . . received by the assessee” refers to the amounts received pursuant to the award passed by the Collector and not the amount received earlier to the award. The view which taken is not only on the basis of an understanding of 45(5), but also the provisions of 45(1) and with reference to the provisions of sections 11 and 12 of the Land Acquisition Act, 1894.

Section 45(5) would treat the date of receipt of compensation amount in compulsory acquisition case as the date on which capital gains arise. Where an advance has been received, such advance cannot obviously be treated as having the character of compensation, since it may be returnable in case the acquisition does not take place. Similarly in case of additional compensation it is not taxable, if disputed, even when it is received till it becomes final, even as held by the Supreme Court in CIT v. Hindustan Housing and Land Development Trust Ltd. [1986] 161 ITR 524. In such cases, where the advance is received earlier and the award follows later than the date of award, the taxable event occurs on the date of the award, since the earlier receipt is not to be construed as receipt of compensation. It was so held in CIT v. C. P. Lonappan and Sons [2004] 265 ITR 101 (Ker) following earlier precedents to the effect that the right to receive the compensation cannot arise earlier to the date of award.

267 ITR 0067- COMMISSIONER OF INCOME-TAX VS. SMT. SHANTAVVA (KAR)

The decision of the Supreme Court in CIT v. Hindustan Housing and Land Development Trust Ltd. [1986] 161 ITR 524 held that even receipt of compensation cannot justify levy of tax, if such amount is pending in dispute in further appeal, because the amount may have to be refunded if the appeal by the adverse party is successful. This was a decision rendered when the law did not require assessment of additional compensation in the year of receipt. The shift of liability to the year of receipt under section 45(4) was understood by some of the officers as justifying taxation of even such disputed amount in the year of receipt. The argument that it cannot be so done, because the law does not provide for refund of tax in the event of an adverse decision is now sought to be met by a further amendment to section 45(4) by the Finance Act, 2003, with effect from April 1, 2004, providing that any subsequent reduction in disputed compensation would justify recomputation. But the issue does not get resolved because the character of the disputed amount is not compensation, but it is in the nature of advance or deposit pending dispute. This character is not changed with the amendment. The amendment can be effective only, where such amount is taxed irrespective of the law on the subject.

In Chief CIT v. Smt. Shantavva [2004] 267 ITR 67 (Karn), the High Court pointed out that the disputed compensation in such cases even in the light of section 45(5) cannot be treated as compensation. What is received is an interim payment, subject to the final outcome of the dispute, so that it does not have the same character as compensation contemplated by the law relating to capital gains and more particularly under section 45(5) of the Act. Section 45(5) fixes only the year of taxation, so that, where it is taxable, it is taxed in the year of receipt.

COMPUTATION OF CAPITAL GAINS

Section / Topic Name : 48

NO COST – NO CAPITAL GAINS

The Supreme Court in the case of CIT v. B. C. Srinivasa Setty [1981] 128 ITR 294 has held with regard to capital gains that the charging section and the computation provision together constitute an integrated code. When there is a case to which the computation provisions cannot apply at all, it is evident that such a case was not entitled to fall within the charging section. It is further held that all the transactions encompassed by section 45 of the Income-tax Act, 1961, must fall under the governance of its computation provisions. A transaction to which those provisions cannot be applied must be regarded as never intended by section 45 to be the subject of the charge. What is contemplated by section 48(ii) is an asset in the acquisition of which it is possible to envisage a cost. It must be an asset which possesses the inherent quality of being available on the expenditure of money to a person seeking to acquire it. None of the provisions pertaining to the head “Capital gains” suggests that they include an asset in the acquisition of which no cost at all can be conceived.

Assessee became the owner of the land in respect of which he had earlier acquired only tenancy rights. Thus, the assessee had acquired the ownership rights in the land by operation of law and not by purchase or inheritance. There was no record of any payment made for the acquisition of the land in question either by the assessee or his predecessor-in-interest. Therefore, the assessee was not liable to pay any capital gains tax. CIT v. Srinivasa Setty (B. C.) [1981] 128 ITR 294 (SC) applied. [2008] 299 ITR 0014-Commissioner of Income-tax v. Amrik Singh (Punjab and Haryana High Court)

Where the erstwhile ruler had sold a property received as “choli bangdi” by his ancestors as shown from records in the Government archives, it was an asset acquired without cost, so that there could be no liability for capital gains as was decided by the Tribunal in HUF of H. H. Late Sir J. M. Scindia v. Asst. CIT [2008] 305 ITR (AT) 231 (Mumbai) following CIT v. Manoharsinhji P. Jadeja [2006] 281 ITR 19 (Guj).

H. H. Late Sir J. M. Scindia (Mumbai) Manoharsinhji P. Jadeja (Guj.)	
Mr. A (Ex-ruler)	100
COA	??
Capital Gains	Not taxable

BONUS ACQUIRED PRIOR TO 1-4-1981 BY NON RESIDENTS

Where a non-resident acquires shares in lieu of plant and machinery supplied and there were further accretions thereto by way of rights and bonus shares, and sells such shares, it has the right to adopt the fair market value of such bonus shares as on April 1, 1981 like any resident to exercise such option under section 55(2)(i)(b) of the Act. The adoption of nil value would not be correct in such cases. It was so ruled in Kern-Liebers International GmbH, In re [2008] 301 ITR 178 (AAR).

Kern-Liebers International GmbH (AAR)	
Mr. N (NR)	
FVC (Bonus shares)	80
FMV (1-4-81)	10
Capital Gains	70

INTEREST ON CAPITAL BORROWED FOR PURCHASE OF CAPITAL ASSET

In CIT v. Sri Hariram Hotels (P.) Ltd. [2010] 188 Taxman 170 (Ker.) the assessee-company by borrowing loan from some of the directors of the Company purchased an immovable property in order to put up a hotel building. The project could not be materialized on account of various reasons. Ultimately, the company sold the property and while filing the return for computation of the capital gain, it claimed a sum of Rs. 37,45,042 towards interest paid to the directors on the loan borrowed from them in order to purchase the property in question. The Assessing Officer disallowed the claim made by the assessee and so did the Commissioner (Appeals). The Tribunal held that out of the borrowed loan from the directors, the property had been acquired and any interest paid thereon would also be accounted towards the cost of acquisition of the asset. The Karnataka High Court did not find any fault with the order of the Tribunal, once it found that the Commissioner (Appeals) had held that interest had accrued to the directors.

INTEREST ON PURCHASE PRICE

The Delhi High Court in CIT v. Vinit Estate (P.) Ltd. [2007] 165 Taxman 260 held that interest paid to the vendor on unpaid price of listed shares would not form part of cost of acquisition/improvement. In this case, an agreement was made stating that the shares will be held in trust by the seller till the time it receives consideration along with interest. The Court found such agreement as commercially unsound and upheld the view of the Assessing Officer that the agreement was only an after, thought and disallowed the interest deduction.

	LAND	SHARES
FVC	80	70
COA	5	3
Interest (allowable)	2	1
CG	73	66

Note:

(1) In case of shares transaction some courts take view it is for purpose of earning dividends (Exempt) therefore, not allowable

INTEREST ON MONEY FOR PAYMENT TO VACATE TENANT

Interest on money borrowed for acquiring, constructing, repairing, renewing or reconstructing a property would be deductible under section 24(b) of the Act. Extended as the scope is, it may still not cover borrowings for vacating tenants as a purpose for which interest could be allowed. For coming to the conclusion, the Tribunal in Asst. CIT v. Virender Singh [2008] 303 ITR (AT) 412 (Delhi) referred to the decision in Bawa Shiv Charan Singh v. CIT [1984] 149 ITR 29 (Delhi) for the view that tenancy right is a capital asset within the meaning of section 2(14), so that the amount paid could be treated as cost of improvement of the property and not for acquiring the property of which the assessee is already the owner, so that deduction is not permissible as it is only for acquiring the property.

DEDUCTION OF STATUTORY COSTS AND EVICTION EXPENDITURE

In Mrs. June Perrett v. ITO [2008] 169 Taxman 124/298 ITR 268 (Kar.), the assessee incurred expenditure to secure probate including the Court fee expenditure to obtain the letter of administration as well as incurred expenditure to evict a maid-servant who had illegally occupied the house. Besides she also claimed litigation expenses, travelling expenses including stay and the fees paid to the lawyers towards litigation expenses.

Allowing such an appeal, the Karnataka High Court held that the executors who were residing in London were required to obtain probate and letters of administration and any expenses incurred by the executors in order to obtain probate and letters of administration were to be treated as expenses incurred by them in connection with the transfer of property-in-question, since the executors could not sell the property to any party without letters of administration. Similarly, without paying the Court fee, no letter of administration would be issued by the Court. Therefore, amount paid by the executors as the Court fee at the time of obtaining the letter of administration had to be treated as expenditure incurred in connection with the transfer of property. If the unauthorised occupant had not been evicted the value of the property would have decreased instead of increasing. It, thus, held that the expenditure incurred by the executors to evict the unauthorised occupant had to be treated as an amount spent towards cost of improvement of the property. The cost of evicting the unauthorised occupant was also held as deductible.

LONG PERIOD LEASE

In CIT v. C F Raju [2007] 158 Taxman 310 (Ker.) the assessee signed an agreement of lease for 20 years at a monthly rent of Rs. 5,000 along with a security deposit of Rs. 2 lacs. The Assessing Officer treated such agreement as transfer under section 2(47)(vi) on receipt of information that the owner had received Rs. 10 lacs as pagidi or salami or lump sum consideration from the tenant, which was unaccounted. The Kerala High Court upheld the view that the transaction amounted to transfer for invoking section 45. Since the assessee in this case did not get cross verification statement of tenant the matter was restored to the Assessing Officer.

COST OF EXECUTION OF WILL FOR INHERITED PROPERTY

As against receipt of sale consideration, what is allowable is expenses on sale from the sale consideration, besides cost of asset and cost of improvement. Where the property sold is acquired under a will, probate charges and travel expenses incurred in execution proceedings and expenses for vacating the tenants were found deductible in Mrs. June Perrett v. ITO [2008] 298 ITR 268 (Karn) as part of cost. Deduction was allowed apparently following the judgment of the Bombay High Court in

Mrs. JUNE PERRETT (KAR)

FVC (Prop A, Acquired / inherited by will.)	100
Cost of property	40

Expense on transfer

For obtaining Probate	2
Travel expense of executor	1
Evicting illegal Tenant	3
Capital Gains	54

CIT v. Miss Piroja C. Patel [2000] 242 ITR 582, but it was a case where the amount allowed was for payment to hut dwellers, who had encroached the land, so that it was treated as cost of improvement. Similar view was also taken in CIT v. Shakuntala Kantilal [1991] 190 ITR 56 (Bom) in respect of amounts incurred for removal of encumbrance. In the light of the same, the decision of the High Court allowing the payment for vacating the existing tenants would accord with the precedents. But the decision to allow other expenses relating to execution of the will would appear to be not directly relating to cost of the asset or cost of improvement. The expenses incurred to meet the cost of a civil suit against a right to transfer property was, no doubt, allowed as a payment for removal of encumbrance in CIT v. Abrar Alvi [2001] 247 ITR 312 (Bom) and CIT v. Bradford Trading Co. P. Ltd. [2003] 261 ITR 222 (Mad). But payment to a father by way of alleged compromise, so as to get his signature as confirming party to the sale deed was disallowed in Ashok Soi v. CIT [2005] 273 ITR 165 (Delhi) distinguishing the decision in CIT v. C. V. Soundarajan [1984] 150 ITR 80 (Mad), where payment allowed was to the mother, who had a right of residence and, therefore, an encumbrance to the property. Probate expenses incurred by the executors for probating the will of the testator were allowed by the court as admissible deduction, since without such probate the executors and the legal heirs will not be able to carry out the terms of the will, to make the title of the legal heirs perfect under the will. Hence this decision will be a precedent for allowance of probate expenses incurred by the executors or the legal heirs.

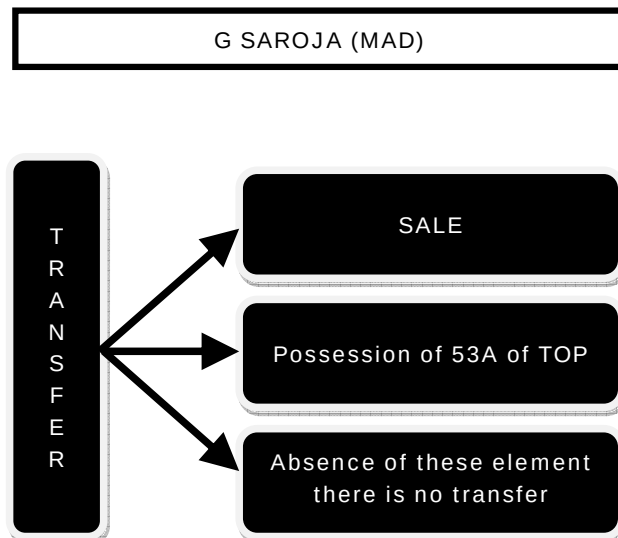
DEVELOPER CONTRACT

Where a property is transferred to a developer in pursuance of a development agreement, there has been dispute as to the date on which capital gains can arise to the owner. The assessee, a lady, had allowed a builder to construct a property on her land without any formal agreement, such builder being a partnership in which her sons-in-law were partners. The construction over the plot was part of the housing project of the firm. The assessee had acquired the property in March 1992, while the construction for the project of residential flats was started on February 10, 1995. The assessee had also received initially Rs. 5.8 lakhs for the property for which she is reported to have executed documents in favour of various purchasers from November 1995 onwards amounting to Rs. 32 lakhs. Consequent on search in the premises of the firm, the assessee filed a

voluntary return under section 158BD admitting income from short-term and long-term capital gains apparently with reference to the date of registration on transfer of such property and such return was regularised thereafter. The computation in the block return indicated income in three different years. The Assessing Officer computed the entire income as short-term capital gains in the very first year i.e., the assessment year 1995-96. The Tribunal set aside the order, so that the assessment became the subject matter of a departmental appeal before the High Court in CIT v. G. Saroja [2008] 301 ITR 124 (Mad). It was urged

by counsel for the Revenue that since the assessee allowed construction in the assessment year 1995-96 itself, it should be taken as the date of transfer, so as to be treated as short-term capital gains. On the other hand, it was argued on the assessee's behalf, that there was no agreement for sale in writing within the meaning of section 53 of the Transfer of Property Act, 1882. The High Court solely with reference to the argument based upon section 53A of the Transfer of Property Act, 1882 found that the Tribunal was right in holding that there was no transfer of property within the meaning of section 2(47)(v) of the Income-tax Act, 1961, so that the departmental appeal was dismissed.

It appears that not all the facts have been brought out in the order of the Tribunal. The property, if purchased within three years, was made available to the firm and the character of the asset, whether it was only a capital asset itself would have needed enquiry. Apart from this the definition of transfer is not solely with reference to section 2(47)(v), but under section 2(47)(vi), where the transaction has the effect of transfer or enabling the enjoyment in immovable property, "by way of any agreement or any arrangement or in any other manner whatsoever". There is a reference to the assessee having executed the sale itself and other documents in respect of interest in land, subject of course, that the purchaser of the undivided interest has to enter into a contract with the builder. It is precisely such arrangement, which should ordinarily be construed as falling under section 2(47)(vi). Further the search itself was conducted only on August 20, 1998, so that it would have made no difference in which year the income arises because the three years fall within the block period under the block assessment scheme. What is required in a block assessment is only computation of undisclosed income. Since the assessee had not filed returns, the entire income from the transaction, would be undisclosed income. The rate of tax applicable to the undisclosed income assessed under the block assessment scheme is at a flat rate, so that the issue, whether it is long-term or short-term should not have arisen. The case, it appears, had gone on



incomplete facts and mistaken law for failure on the part of the Assessing Officer to marshal all the facts.

256 ITR 0084- CIT VS. QUANTAS AIRWAYS LTD. (DEL)

When a non-resident sells an asset outside India, as in this case, an aircraft by a company carrying on air-transport business, it cannot be liable to tax in India merely because it has business connection with India. The High Court in CIT v. Quantas Airways Ltd. [2002] 256 ITR 84 (Delhi) reviewed the case law on the subject and found that the fact that there is business connection does not ipso facto justify liability, since the assessable income arising out of business connection has to be confined to such income as is reasonably attributable to the operations carried out in India. Transfer of a capital asset outside India cannot be treated as an operation in India. It found that the sale of aircraft could not be treated by itself as constituting a business connection. The very fact that capital gains on transfer of a capital asset in India is specifically made the subject matter of taxation would rule out liability for transfer of movable property outside India in the case of a non-resident. Hence, in any view it was found that there was no liability.

QUESTION

The assessee is a non-resident company incorporated in Australia. Its shares are owned by the Government of Australia and the assessee carries on worldwide air-transport business and maintains the centralized accounts in Australia. It had sold aircrafts, which were its capital assets. Such sales are effected outside India. You are required to answer whether the sale of such capital assets would be “income” assessable in India or not.

ANSWER

The expression “income” in terms of section 2(24), would include profits and gains and any capital gains chargeable under section 45 of the Act. Section 5(2) of the Act provides for the scope of the total income. In the case of a non-resident, it would include all income from whatever source derived, which is received or is deemed to be received in India in such year by or on behalf of such person or accrues or arises or is deemed to accrue or arise to him in India during such year.

What would be the scope of the legal fiction created in terms of section 5 of the Act, as specified in section 9 of the Act? Such income must arise or accrue (i) from any business connection in India, or (b) from any property in India, or (c) from any asset or source of income in India, or (d) through the transfer of a capital asset situate in India.

The expression “business connection” has not been defined in the Act. In the absence of any definition, the ordinary meaning of the said expression must be taken. The words “business connection” for the purpose of sections 5 and 9 of the Act must be confined to profits arising out of business. When an income accruing or arising from business by reason of a legal fiction becomes assessable, it must be held that the same must be confined to receipts out of business and not out of the sale of capital assets. Having regard to the purport and object thereof, if the words “business connection in India” were wide enough to cover all transactions including transactions in capital assets, there was no reason for Parliament to specifically include income (a) through or from any property in India, (b) through or from any asset or source of income from India, and (c) through or from sale of a capital asset situate in India. From the very fact that in terms of section 9 of the Act, the transfer of a capital asset situate in India has been brought within the purview of the deemed income under section 9 of the Act.

Thus the income in question had not arisen from business connection in India or from any asset or source of income in India or through transfer of a capital asset situate in India. The assessee carried on business of operating air transport business. The business activity of the assessee for the purpose of the Act must

be held to be confined to the transport of passengers. The assessee only had some part of its business operation in India. Its capital assets had nothing to do with its business connection in India.

227 ITR 0240 JAGADISHCHANDRA (V.S.M.R.) VS. CIT; (SC)

Assessee sold house property and plots of land subject of mortgage created by assessee himself and amount was paid by buyer directly mortgager to clear mortgage debt out of the sale proceeds. Tribunal justified in holding that amount could not be treated as cost of acquisition or cost of improvement since the mortgage was created by the assessee himself.

However if the mortgage was created by the previous owner than the amount could be treated as cost of acquisition since it was not the assessee's obligation to discharge the mortgage.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee created mortgage on the building owned by himself and took the advance of Rs. 50000. The said building was sold by the assessee for Rs. 350000 and the purchaser of the building paid consideration in cash Rs. 300000 to the assessee and balance to the mortgager to discharge off the liability. Assessee is of the opinion that since it received only Rs. 300000 the full value of consideration must be only Rs. 300000 and thus files the return computing the capital gains as 50000 taking FVC as 300000 and indexed cost as 250000 is the amount so computed is correct. Would your answer alter if it has been told to you that the said mortgage was created by the previous owner.

ANSWER

227 ITR 0240A, Jagadishchandra (V.S.M.R.) Vs. CIT; (SC) when assessee sold house property and plots of land subject of mortgage created by assessee himself and amount was paid by buyer directly mortgager to clear mortgage debt out of the sale proceeds. Tribunal justified in holding that amount could not be treated as cost of acquisition or cost of improvement since the mortgage was created by the assessee himself. However if the mortgage was created by the previous owner than the amount could be treated as cost of acquisition since it was not the assessee's obligation to discharge the mortgage --- conclusion--- amount paid directly to the mortgager by the purchaser of the property is part and parcel of the full value of consideration where mortgage was created by the assessee himself.

Computation of Capital Gains (Where Mortgage is created by assessee himself)

Full Value Of Consideration	350000
Indexed Cost Of Acquisition	250000
Capital Gains	100000

Computation of Capital Gains (Where Mortgage is created by previous owner)

Full Value Of Consideration	350000
Indexed Cost Of Acquisition of previous owner	250000
Cost of Acquisition (Discharge of Mortgage) (it has been presumed that assessee has agreed to bare the liability of mortgage in the year of transfer of the property and thus for the indexation purpose the base year and the current year is the same)	50000
Capital Gains	50000

261 ITR 0222- CIT VS. BRADFORD TRADING CO. P. LTD. (MAD)

Cost of removing an encumbrance is a deductible cost. Where the assessee, a private limited company, transferred a building belonging to it, a suit was filed by one of the shareholders, who had contributed a sum to the company towards share capital and the matter was taken to the court and finally settled by payment of Rs. 2 lakhs over and above the return of his contribution. The High Court held that it was deductible in CIT v. Bradford Trading Co. P. Ltd. [2003] 261 ITR 222 (Mad).

Expenditure on removal of an encumbrance may not always be deductible, if it is self-created as was found in Rm. Arunachalam v. CIT [1997] 227 ITR 222 (SC) and CIT v. Attili N. Rao [2001] 252 ITR 880 (SC). The Court distinguished these cases on the ground that in these cases, the liability was discharged subsequent to sale out of the sale proceeds. Where the sale itself is effected by removal of the encumbrance, it becomes part of the cost. This is a decision, which should save tax, in similar circumstances.

It had been held that where a mortgage was created by the previous owner during his lifetime and the same was subsisting on the date of his death, the successor obtained only the mortgagor's interest in the property and by discharging the mortgage debt he acquired the mortgagee's interest in the property and, therefore, the amount paid to clear off the mortgage was the cost of acquisition of the mortgagee's interest in the property which was deductible as cost of acquisition under section 48 of the Act. Jagadishchandra (V.S.M.R.) Vs. Commissioner of Income-tax 227 ITR 240.

Question

The main object of the assessee company was to construct a multistoreyed four star hotel and run them. Since the assessee was in need of finance it approached a hotelier at Chennai to participate in the venture. The hotelier paid advance sum of Rs. 5 lakhs for the purchase of undertaking. The assessee entered into an agreement that after the hotel was constructed, it should be sold to the hotelier for a sum of Rs. 43 lakhs. Meanwhile the assessee entered into an agreement with a company, ITC, for the sale of the entire undertaking for a total consideration of Rs. 46 lakhs. The hotelier filed a company petition to set aside the agreement for sale of the undertaking and also filed a company application for temporary injunction for restraining the assessee from implementing the agreement. Under the compromise, assessee shall return sum of Rs. 5 lakhs advanced by him and in consideration of the hotelier withdrawing the proceedings. The assessee paid to the hotelier a sum of Rs. 2 lakhs in full and final settlement of all claims, demands and outstandings. The prospective buyer ITC agreed to reimburse a sum of Rs. 1.5 lakhs to the assessee for the payment of Rs. 2 lakhs to be made to the hotelier. You are required to discuss the tax treatment of said transaction.

Answer

It was clear from the proceedings in the litigation that a sum of Rs. 2 lakhs was paid to the hotelier in settlement of his claim against the hotel undertaking which was to be transferred in favour of ITC and he received the money in full and final settlement of his claims. Unless the amount of Rs. 2 lakhs was paid, the transfer of property would not have taken place at all. Therefore, the payment had an intimate connection with the transfer of the undertaking as by allowing the litigation to go on the hands of the assessee would be tied against the transfer of the undertaking in favour of ITC and the assessee would not have realised the sale consideration from the prospective purchaser. Thus said payment shall be treated as expenditure on account of transfer. Though the sum of Rs. 1.5 lakhs was paid to the assessee to settle the claim of the hotelier, the money was received by the assessee in connection with the transfer of the hotel undertaking and it would form part of sale consideration (full value of consideration). [2003] 261 ITR 0222- COMMISSIONER OF INCOME-TAX VS. BRADFORD TRADING CO. P. LTD. (MADRAS HIGH COURT)

275 ITR 0203- COMMISSIONER OF INCOME-TAX VS. HINDUSTAN TIMES LTD. (DELHI HIGH COURT)

Where an assessee purchased a property occupied by his employee subject to such tenancy and much later sold the property subject to the same right of tenancy with the assessee receiving the compensation payable to the employee for surrender of tenancy rights, the argument as to whether such receipt was liable to tax in the assessee's hands as capital gains or income, had arisen in CIT v. Hindustan Times Ltd. [2005] 275 ITR 203 (Delhi). In view of the fact that both the purchase and sale were subject to tenancy, it was found that independent payment for surrender of the tenancy would not have the character of capital gains. It could not be taxed in the hands of the employee, because the amount was received by the employer-assessee, in whose hands, it could have been taxable as capital gains, but it was treated by the High Court as income with revenue character. Probably, this was a case of tax planning gone haywire. The special leave petition filed by the assessee was dismissed by the Supreme Court [2005] 273 ITR (St.) 239.

278 ITR 0240- GOPEE NATH PAUL AND SONS VS. DEPUTY COMMISSIONER OF INCOME-TAX (CALCUTTA HIGH COURT)

It is established law that the amount paid for clearing a charge on the property, where it is self-created could not be allowed as a deduction in computation of capital gains after the decision of the Supreme Court in Rm. Arunachalam v. CIT 227 ITR 222, V. S. M. R. Jagdishchandran v. CIT [1997] 227 ITR 240 (SC) and CIT v. Attili N. Rao [2001] 252 ITR 880 (SC). Possible scope for such deduction was indicated in CIT v. Thressiamma Abraham (Smt.) (No. 1) [1997] 227 ITR 802 (Ker), where the charge was self-created, but not for the benefit of the assessee, who created the charge. But this exception has yet to find approval from the apex court.

Meanwhile the decision of the Calcutta High Court in Gopee Nath Paul and Sons v. Deputy CIT 278 ITR 240 may revive the hope of those, who felt that there is no possible scope for deduction of the charge, where the property sold is under mortgage or charge. The court in this case found the way for deduction of bank loan on hypothecation of movable goods including stock-in-trade. On sale of the firm's business as a going concern, it was held that the liability was of capital gains on which the amount paid to the bank to have the charge lifted could be allowed as a deduction. However this judgement needs to be reviewed.

282 ITR 0126- COMMISSIONER OF INCOME-TAX VS. H. H. SRI RAJA RAJAGOPALA THONDAIMAN (MADRAS HIGH COURT)

The assessee the ex-Ruler of the Pudukkottai Samasthanam had sold his palace for a consideration of Rs. 17,76,020 and claimed exemption from tax on the sale proceeds. The Assessing Officer sought to tax the sum as long-term capital gains. Decided that the Tribunal was right in holding that there was no capital gains assessable in respect of the transfer of the site and palace at Pudukkottai belonging to the assessee for a consideration of Rs. 17,76,020 on the ground that there was no cost of acquisition and the capital gains could not be computed ignoring the fact that the property in question was obtained in consideration of his estate at Pudukkottai merging with erstwhile State of Madras.

Where there is no cost, the sale price, according to the Revenue, will constitute capital gains. But it cannot have the character of gains, since the gains are understood as the surplus of sale proceeds over the cost. If the entire sale price is assessed, it will not be a tax on income, but a tax on the value of the asset

itself or in other words, a wealth tax at income-tax rate. The Supreme Court recognised this difference in CIT v. B. C. Srinivasa Setty [1981] 128 ITR 294. Where an ex-ruler sold his palace under a merger agreement with the Indian Union at no cost, capital gains was found not assessable in CIT v. H. H. Sri Raja Rajagopala Thondaiman 282 ITR 126 (Mad).

Similar decision was rendered in respect of another ex-ruler of Rajkot State in CIT v. Manoharsinhji P. Jadeja [2006] 281 ITR 19 (Guj). This principle was stretched to a case, where there was difficulty in ascertaining the cost in Syndicate Bank v. Addl. CIT [1985] 155 ITR 681 (Karn), CIT v. Javerilal and Co. P. Ltd. [2004] 265 ITR 460 (Ker), Chintan N. Parikh v. CIT [2002] 253 ITR 564 (Guj) and CIT v. M. Appukutty [2002] 253 ITR 159 (Ker). Mere difficulty in ascertaining the cost, by itself, may not mean that the cost is not determinable. These decisions would require to be applied with a degree of caution.

284 ITR 0054- MRS. G. SEETHA KAMRAJ VS. COMMISSIONER OF INCOME-TAX (ANDHRA PRADESH HIGH COURT)

The assessee took on lease for 99 years a building from her husband and as per the terms of the deed. The assessee paid a sum of Rs. 5,000 as premium for obtaining the lease and was to pay a monthly rent of Rs. 300. The lessee had also a right to create a sub-lease and she actually created a sub-lease in favour of a third party. The assessee received a lump sum of Rs. 4,30,000 as consideration. It was stated to be adjustable against monthly rent. The Income-tax Officer assessed tax and was of the view that an amount of Rs. 3,87,500 was capital gain and an amount of Rs. 42,500 was the cost of acquisition. This was upheld by the Commissioner (Appeals) and the Tribunal. Held by high court that the Tribunal was correct in construing the sub-lease agreement and holding that the deposit (non refundable) of Rs. 4,30,000 received by the assessee was a consideration for granting sub-lease of the assessee's rights and not a payment of monthly rent in advance and as such was liable to tax as short term capital gains.

CONVERSION OF CAPITAL ASSET IN TO STOCK IN TRADE

Section / Topic Name : 45 (2)

CONVERSION OF STOCK IN TRADE TO CAPITAL ASSETS

The law provides for the contingency of a capital asset converted into shares under section 45(2), but there is no provision as to the treatment of stock-in-trade being converted into investments. But there are precedents on the subject, which would answer this issue as well. The House of Lords in Sharkey (Inspector of Taxes) v. Wernher [1956] 29 ITR 962, had held that the assessee's horses bred in its stud farm conducted as business was taken out for his hobby, so as to constitute non-business, with the result that there was conversion of trading stock into a capital asset. It was held that in such cases, the market value has to be adopted for determination of income of the stud farm. But the Supreme Court in India as decided in Sir Kikabhai Premchand v. CIT [1953] 24 ITR 506, took up an illustration of a dealer in rice, who had drawn part of his stock for his home consumption and held that he could adopt the transfer at cost, so that there was no profit taxable in such cases. The Revenue had sought review of this case in the light of the decision of House of Lords in Sharkey's case (supra) in CIT v. Bai Shirinbai K. Kooka [1962] 46 ITR 86 (SC), where on converse facts, the assessee was held entitled to treat the market price as cost of investments on sale after conversion as stock-in-trade in his business books, while distinguishing Kikabhai Premchand's case (supra) and deciding not to follow the English case and reiterating Kikabai Premchand's case (supra). The law, therefore, is that, in such cases of conversion of stock-in-trade into investments, no profit would be assessable on the date of such conversion, but would be taxable on realisation of investments with reference to market value as on date of conversion as cost in reckoning capital gains.

Stock in trade (Diamonds)	10
Convert to Capital asset (1999) (mv)	15
Business Income	5
Sale of Diamonds (P.Y.)	26
Lost of Diamonds	15
Capital Gains	11

The House of Lords in Sharkey
Sir Kikabai Premchand (SC)

The issue had come up in CIT v. Jannhavi Investments P. Ltd. [2008] 304 ITR 276 (Bom), where the assessee had acquired bonus shares in respect of shares held as stock-in-trade till 1987. The assessee had asked for adoption of the market value as on the date of conversion for purposes of computation of capital gains. In respect of shares acquired as stock-in-trade, which had become investments by conversion, the High Court apparently considered that the character of asset on the date of sale will be relevant as held in the case of agricultural land converted into non-agricultural lands consistently by the High Courts as for example in Alexander George v. CIT [2003] 262 ITR 367 (Ker). The High Court held that the assessee was entitled to take the fair market value of the shares as on April 1, 1981, as the cost of acquisition, though it was stock-in-trade on the relevant date. In coming to the conclusion, the High Court followed its own earlier decision in Keshavji Karsondas v. CIT [1994] 207 ITR 737 (Bom), which followed the rationale of the decision in Bai Shirinbai K. Kooka's case (supra) and that of Miss Dhun Dadabhoy Kapadia v. CIT [1967] 63 ITR 651 (SC). The amendment to section 45(2) took care to ensure that capital gains on conversion of capital asset into stock-in-trade does not escape tax. But there is no provision to assess that part of business income on conversion of stock-in-trade into investments as seen in this decision and that of Kikhabai Premchand's case (supra).

CIRCULAR NUMBER: 791 243 ITR (Stat) 0155-

Section 2(47) of the Income-tax Act provides that any conversion of capital assets into stock-in-trade shall be regarded as a transfer. This transfer arises in the year in which such conversion takes place and, accordingly, capital gain would normally arise in that very year. However, section 45(2) of the Act postpones the assessment of such capital gains to the year in which the stock-in-trade is actually sold or otherwise transferred by the assessee. In order to qualify for deduction under section 54E of the Act, the investment in specified assets was required to be made within six months from the date of transfer. A question had arisen as to whether the date of transfer, as referred to in section 54E of the Act, is the date of conversion of the capital asset into stock-in-trade or the date on which the stock-in-trade is sold or otherwise transferred by the assessee.

Sections 54EA, 54EB and 54EC also provide deduction from long-term capital gain if the sale proceeds/long-term capital gain is invested in specified assets within a period of six months from the date of transfer. It is not possible for an assessee to make the required investment under the aforesaid sections at the point of conversion of capital asset into stock-in-trade because the right to collect sales consideration in such cases arises only at the point of sale or transfer otherwise of stock-in-trade. The Board has considered the matter afresh in consultation with the Ministry of Law and has decided that the period of six months for making investments in specified assets for the purpose of sections 54EA, 54EB and 54EC should be taken from the date such stock-in-trade is sold or otherwise transferred, in terms of section 45(2) of the Act.

DE-MAT OF SHARES

Section / Topic Name : 45(2A)

CIRCULAR NUMBER: 768 232 ITR (Stat) 0005-

Now in India there is introduced the electronic shares instead of actual shares which is taking care of all the loop holes in the earlier system of holding the securities. The significant feature of the dematerialised securities is that they are fungible, i.e., all the holdings of a particular security will be identical and interchangeable and they will have no unique characteristic such as distinctive number, certificate number, folio number, etc. As the holdings of any securities in dematerialised form is represented only by the account with the depository and all transfers are effected through book entries in the accounts maintained by the depository, under this system it is not possible to link the purchase of a security with its sale by means of its distinctive number, etc.

It is for this reason that sub-section (2A) has been inserted in section 45 to provide for the computation of capital gains in respect of securities held in dematerialised form. This sub-section provides that for the purposes of calculating the date of transfer and period of holding in respect of shares held in dematerialised form, the FIFO method would apply. When applied to an account holding dematerialised stock, it implies that, out of the existing holdings, the item that first entered into the account is deemed to be the first to be sold out. However, once a sale is linked with an earlier purchase, for determination of their “date of transfer” and “period of holdings”. Board’s Circular No. 704 would be applicable. That is to say that the relevant contract notes as explained in Circular No. 704 will have to be referred to, for ascertaining the cost of the security sold and the date of transfer.

Date of credit	Particulars	Quantity
1-6-1997	Purchased directly in dematerialised form on	2,000
	25-5-1997	
5-6-1997	Dematerialised share originally purchased in	5,000
	November, 1985	
10-6-1997	Purchased directly in dematerialised form on	4,000
	10-6-1997	
5-6-1997	Dematerialised share originally purchased in	3,000
	May, 1962	

If say, 2,500 shares were sold from out of this account, then the period of holding and the cost of acquisition of the first 2,000 shares should be as from 25-5-1997 and the cost thereof, whereas the balance 500 shares will be treated as having been acquired in November, 1985, at the relevant cost. This is the effect of the FIFO method.

QUESTION THAT CAN BE SET IN THE EXAMINATION CONDITION

Mr. X, is confused with the new system of converting the shares in the electronic form. However he has actually converted his original shares in the electric form as advised by one of his good friends. In that regards he presents the following details for the computation of capital gains. You are required to help him out for the computation of cost of the shares.

Date of credit Date of converting shares in to electronic form	Date of acquisition	Quantity of shares in TISCO	Cost of Mr. X per share	Form in which acquired
01-06-98	25-05-98	2000	180	Electronic Credit
05-06-98	Nov. 1985	5000	120	Original Share
10-06-98	10-06-98	500	185	Electronic Credit
15-06-98	Nov. 1962	1500	50	Original Share

He has sold out of the above lot 2500 shares for Rupees 210 per share.

ANSWER

Cost of 2500 shares sold shall be computed as

Date of credit Date of converting shares in to electronic form	Date of acquisition	Quantity of shares in TISCO	Cost of Mr. X per share	Cost of Shares
01-06-98	25-05-98*	2000	180	360000
05-06-98	Nov. 1985*	500	120	60000

*holding period of the shares shall be recognised from these dates to determine the long term or short term.

272 ITR 0264- CIT VS. SMT. RADHA BAI (DEL)

In respect of sale of real property after holding it for a significant period, the issue that often arises is whether it was acquired by the assessee with intent to resell, in which case, it becomes an adventure in the nature of trade, even if the assessee were not a regular dealer in real property. The test is the intention of the assessee at the time of purchase, though he may later convert it into stock in trade, which contingency is covered under section 45(2) of the Act. The law as to adventure in the nature of trade has been laid down in G. Venkataswami Naidu and Co. v. CIT [1959] 35 ITR 594 (SC). In this case, the assessee firm had made purchase of land, the land being contiguous plots adjacent to a textile mill. The land was not cultivated and no effort was made to put up a superstructure. It was sold subsequently at a profit in two lots. It was the contention of the Revenue, that the assessee had already sensed possible purchase of these lands by the mill for provision of tenements to its workers, so that the intention of making profit by resale could be inferred from the facts. It was under these circumstances, the Supreme Court endorsed the concurrent finding of the Tribunal and the High Court, that the transaction amounted to an adventure in the nature of trade, so as to make it liable for tax as business income. The decision went against the assessee. The initial intention to resell is a fact, which, if it is established or inferable, would be a crucial factor for the inference that it is an adventure in the nature of trade.

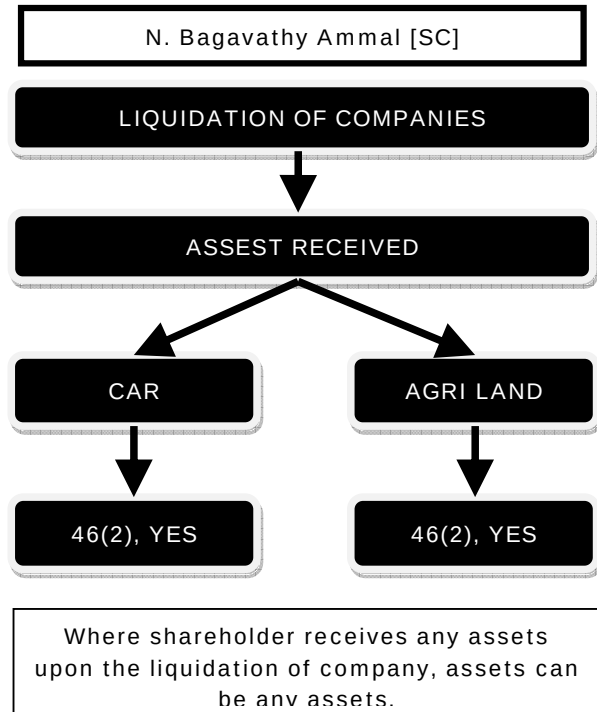
In CIT v. Smt. Radha Bai [2005] 272 ITR 264 (Delhi), the assessee, who has many pieces of land purchased in 1958 and sold the same in 1983. It was the assessee's case that she was interested in constructing group housing and deriving income therefrom but was unable to do so, because of the intervening land ceiling law and that she was unsuccessful in getting exemption for the same. The Revenue claimed that the agreement with the builder by which she was to realise the sale price in instalments indicated that there was a transaction of an adventure in the nature of trade. The High Court pointed out that merely because the sale had a business character, the transaction did not become an adventure in the nature of trade. The facts that power of attorney was given to the developer and the amount was realised in instalments, would not convert the capital asset, which was acquired long before to stock-in-trade. The Tribunal found that notwithstanding the development agreement, the assessee continued to be the owner as she bore all rates, taxes, duties, charges, etc., till registration, so that the sale could take place only on registration and that there was liability only for capital gains and not for business income in the light of the guidelines given in Venkataswami Naidu's case.

COMPANIES IN LIQUIDATION

Section / Topic Name : 46

259 ITR 0678- N. BAGAVATHY AMMAL VS. CIT (SC)

The character of money in the hands of the company is different in the hands of the shareholder on distribution. Where the company sells agricultural lands, it is not liable on capital gains but to the extent such amount reaches the hands of the shareholder on liquidation, the shareholder is assessable on his capital gains as stipulated under section 46(2). The Supreme Court reiterated this view in N. Bagavathy Ammal v. CIT [2003] 259 ITR 678. In this case the shareholders had received land on liquidation instead of cash. The argument that section 46(2) applies only where money and not a capital asset is received was found to be unacceptable. The market value of agricultural lands should be treated as amounts distributed, because what he received is in satisfaction of the right as a shareholder. The capital asset in question for the assessment of the shareholder is the share and not the land.



Question

Under a compromise decree in the liquidation of a company, the assessee received from the liquidator 479.89 acres of agricultural lands (Market Value 100 Lakhs) which were part of the assets of the company. Assessing officer was of the opinion that in construing the provisions of section 46(2) the definition of “capital asset” in section 2(14) had no relevance and the fact that agricultural lands, to the extent provided in section 2(14)(iii), were excluded from the definition of “capital asset” did not have any impact on the taxability of the market value of the agricultural lands received by the assessee in the distribution of the assets of the company in liquidation and that the market value of the agricultural lands could be assessed to capital gains tax in the hands of the assessee. You are required to answer whether the market value of the agricultural lands was assessable to capital gains tax in the hands of the assessee under the provision of section 46.

Answer

Shareholder of a company receives assets, whether capital or in any other form, from the company in liquidation, the assessee is liable to pay tax under the head “Capital gains” on the market value of the assets as on the date of the distribution as provided in section 46(2). The invocation of section 2(14) which defines “capital asset” is unnecessary for the purpose of construing section 46(2). [2003] 259 ITR 0678- N. Bagavathy Ammal vs. Commissioner of Income-tax (Supreme Court of India)

259 ITR 0054- CIT VS. RUBY TRADING CO. PVT. LTD. (RAJ)

Section 54EC permits reinvestment benefit, if the sale proceeds/capital gains on sale of long term capital assets are invested in the manner required by the section. Where a shareholder is made liable for deemed capital gains on amount received on liquidation of a company, the question whether there is eligibility for reinvestment benefit under section 54EC arose. One would have thought that the established law is that one should allow one's mind to boggle at the consequences of a fiction enjoined by law. After all, capital gains themselves are only deemed income. But the High Court felt that section 54EC would have application only where there is an actual transfer and not in a case, where there is only a deemed transfer.

Question

The assessee Mr. X had held 4,945 shares in a company C since 1954. The company C went into liquidation and the assessee realised the face value of the shares and during the year the official liquidator paid to the assessee a sum of Rs. 1,98,000 representing the share of the assessee in the reserves of the company. The company, thereafter, invested the sum of Rs. 1,98,000 in the bonds of SIDBI. The assessee claimed that there was no capital gain as the amount received had been invested as per the provisions contained in section 54EC. The Commissioner of Income-tax acting under section 263 directed the Income-tax Officer to include Rs. 1,98,000 in the income of the assessee to tax that amount as a capital gain and to charge the tax accordingly. You are required to answer whether the action of the commissioner is justified or not.

Answer

Section 46(1) provides that notwithstanding anything contained in section 45 if the company distributes assets or money to its shareholders on liquidation, that shall not be regarded as a transfer. Thus 46(1) has overriding effect over section 45. 46(2) provides that where the shareholder on liquidation of the company receives any money or other assets, he shall be chargeable to income-tax under the head of capital gains and therefore that makes it clear that it is not treated as a transfer under section 46 but at the same time the intention of the Legislature is that if the assessee has gained anything out of the assets and money received from the company on liquidation, that can be taxed as capital gains. However for the purpose of benefit of section 54EC transfer is a condition precedent. Since the distribution of assets to a shareholder on the liquidation of a company is not a transfer, the assessee is not entitled to the benefit of section 54EC, and therefore, the Commissioner of Income-tax had rightly revised the order of the Income-tax Officer under section 263. [2003] 259 ITR 0054- Commissioner of Income-tax vs. Ruby Trading Co. Pvt. Ltd. (Rajasthan High Court)

286 ITR 0066- COMMISSIONER OF INCOME-TAX VS. BRAHMI INVESTMENTS P. LTD. (GUJARAT HIGH COURT)

Section 46 of the Income-tax Act, 1961, is a complete code in itself for the purposes of transfer and working out the full value of consideration. Section 46(1) of the Act stipulates a fiction whereby even in a case where there is a transfer of assets on distribution by a company in liquidation such distribution of assets is not to be regarded as a transfer for the purposes of being exigible to capital gains tax under section 45 of the Act but under section 46(2) of the Act the recipient shareholder is charged to capital gains tax by deeming the transaction a transfer and also deeming the receipt of consideration upon such deemed transfer.

Once section 46(2) of the Act comes into play the full value of consideration has to be computed by the special mode laid down in the said provision and thereafter the provisions of section 48 of the Act have to be applied. Section 48(1) envisages the cost of acquisition of the asset being deducted from the full value of consideration. Since admittedly, in such a case there is no asset as such for which the shareholder-

assessee can claim the cost of improvement or expenditure incurred in connection with such transfer, because the distribution of assets on liquidation itself is a deemed transfer and no expenditure in connection with such transfer is actually incurred, only the cost of acquisition is required to be taken into consideration for the purposes of levying tax under the head “Capital gains”.

Section 49 of the Act stipulates cost of acquisition with reference to the specified modes of acquisition. Sections 47 and 49 of the Act go together and have to be read as part of one scheme, the legislative intent being that when the first transaction is not brought to charge, the assessee having benefited once, should not benefit once again by claiming a higher cost at the time of a subsequent transaction.

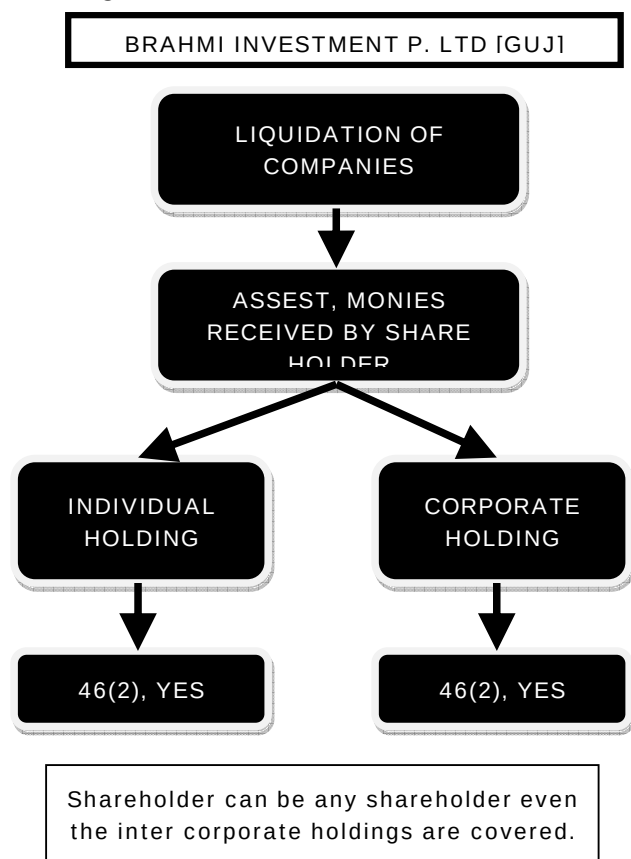
Going by the definition of the term “cost of acquisition” laid down in section 55(2)(b)(ii) of the Act, once the mode of acquisition is any one of the modes specified in section 49 of the Act, the cost of acquisition of the capital assets, even for the purposes of section 48 of the Act, has to be the cost of the capital assets to the previous owner on the day the capital assets became the property of the previous owner.

Though section 46 uses the word “shareholder” followed by the word “he” it is not possible to accept that the Legislature wanted to keep out shareholders who otherwise fall within the definition of the term “person” as per section 2(31) of the Act. There being no statutory prohibition for a company to hold shares in another limited company, it is not possible to accept the restrictive reading of section 46(2) that it does not apply to entities other than individuals.

The assessee, a private limited company, was a wholly owned subsidiary of K, which had earlier acquired all the 1,11,000 equity shares in a company A in July and August, 1973 at a total cost of Rs. 1,11,00,000.

As a consequence, A became a wholly owned subsidiary of K. In December, 1973, all the 1,11,000 shares of A were transferred to the assessee by K at a total consideration of Rs. 55,36,680. As a consequence, A became a wholly-owned subsidiary of the assessee-company. The assessee received assets valued at Rs. 93,24,000 on voluntary liquidation of A. The assessee claimed that the transaction was not liable to be taxed by virtue of the provisions of section 47(v) of the Income-tax Act, 1961, or in the alternative that for the purposes of computing the capital gains chargeable to tax, the cost of the previous owner in terms of section 49(1)(iii)(e) of the Act should be considered.

The assessee’s argument, that section 46(2) would not apply to a company shareholder, was easily found to be not tenable. The next question was whether the cost of the shares should be taken as one paid by the predecessor in title or the amount paid by the assessee. The amount paid by the predecessor being higher, it was contended that the predecessor’s cost should be applied in view of the fact that section 49(1)(iii)(e), covers section 47(iv), (v), (vi), (via) and (viaa) of section 47. All the transactions were as between the companies related as wholly owned subsidiary and a holding company or amalgamated companies. The High Court on the above facts and the law found in CIT v. Brahmi Investments P. Ltd. [2006] 286 ITR 66 (Guj) that once an amount is realized under section 46(2), the computation of capital gains has to follow the method



prescribed under section 48, so that section 47(iv) read with sections 49 and 55 would have application. In the result, there could be no liability, though not on the reasoning of the Tribunal, which had held that no capital gains had arisen, since presence or absence of gains would make no difference to the final decision in favour of the assessee in the view that there was no transfer at any stage. The reasoning of the High Court was that all provisions in this case being sections 45, 46, 47, 48, 49 and 55 had application and have to be read conjointly.

STOCK LENDING SCHEME

Section / Topic Name : 47

CIRCULAR NUMBER: 751 224 ITR (Stat) 0001-

In order to facilitate the quick settlement in the stock exchange the scheme of security lending has been prescribed by SEBI where a person can lend his securities to the other and lending charges would be earned. The question would arise

1. Can the lending charges earned be regarded as revenue income of the assessee?
2. After the specified period gets over the lender receives same quantum of security back but with different folio No. or an distinctive numbers does it give rise to capital gains considering transfer within the meaning of sec 2(47).

This scheme is approved by SEBI and is effective from 6 Feb 97

Following points must be remembered

1. One share of a company is good replacement for another share of the same company.
2. The market does not lay any emphasis on the distinctive numbers.
3. The Board are advised that when the lender gets back equivalent number of shares of the company with different distinctive numbers, it is not a case of exchange of assets.
4. The meaning of the word "exchange" necessarily involves exchange of two different assets. At no stage, the lender or borrower intended to "exchange" different assets.
5. The transaction of lending of shares or any other security under the securities lending scheme would not result in "transfer" for the purpose of invoking the provisions relating to capital gains.

In other words 'Whether the lending of shares under the securities lending scheme will amount to "transfer" under section 2(47) of the Income-tax Act in the hands of the lender?'

As far as the stock market is concerned, shares are fungible assets. "Fungible" has been defined in the Shorter Oxford English Dictionary on Historical Principles as "said of a thing which is the subject of an obligation when another thing of the same or another class may be delivered in lieu of it". One share of a company is good replacement for another share of the same company. The market does not lay any emphasis on the distinctive numbers. It is only for the purpose of reckoning the holding period of any particular share or to distinguish between an original share and a bonus share, that the Income-tax Department relies on the distinctive numbers. The Board are advised that when the lender gets back equivalent number of shares of the company with different distinctive numbers, it is not a case of exchange of assets. This is so because once the asset is fungible, when the lender receives back the same number of shares of the same company of the same face value and carrying the same rights, it is immaterial whether they have different distinctive numbers. He will be in a ready position to either sell the shares and realise their value or send them to the company for transfer to his name. The transaction of lending shares of some distinctive numbers and receiving back shares of some other numbers is not "exchange" of assets within the meaning of "transfer" as defined in section 2 (47) of the Income-tax Act. The meaning of the word "exchange" necessarily involves exchange of two different assets. The asset received back in the aforesaid type of transaction is no different from what was lent so long as it represents the same fraction of the ownership of the company. At no stage, the lender or borrower intended to "exchange" different assets. Hence, the transaction of lending of shares or any other security under the securities lending scheme would not result in "transfer" for the purpose of invoking the provisions relating to capital gains under the Income-tax Act.

AMENDMENT WITH EFFECT FROM A.Y. 99-2000

To make the legal position free from doubt, the Act has amended section 47 of the Income-tax Act by inserting clause (xv) to provide that any transfer in a scheme for lending of any securities under an agreement or arrangement, subject to the guidelines issued by the Securities and Exchange Board of India in this regard, which the assessee has entered into with the borrower of such securities, shall not be regarded as transfer.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Mr.X had landed its securities [listed on stock exchange] held as capital asset to y with the distinctive numbers 025852 – 025952 for period of 6 months at the expiry of the period received back securities with different distinctive numbers and the lending charges. Discuss whether lending charges received is taxable? and whether there would any capital gains on said transaction presuming that there is an exchange of asset u/s 2 (47)?

ANSWER

Act has section 47(xv) to provide that any transfer in a scheme for lending of any securities under an agreement or arrangement, subject to the guidelines issued by the Securities and Exchange Board of India or RBI in this regard, which the assessee has entered into with the borrower of such securities, shall not be regarded as transfer.

277 ITR 0219- DALMIA CERAMIC INDUSTRIES LTD. VS. COMMISSIONER OF INCOME-TAX (DELHI HIGH COURT)

Section 47(iv) and (v) would not regard any transfer of capital asset as between a holding company and a wholly owned subsidiary as transfer for purposes of capital gains tax. Consequently actual cost on any subsequent transfer by the transferee would be that of the transferor under section 49(1)(iii)(e). In the case of depreciable assets, the actual cost of transferee company would be the written down value of the transferor company under Explanation 6 of section 43(1). The statute is clear on the subject as was decided in Dalmia Ceramic Industries Ltd. v. CIT [2005] 277 ITR 219 (Delhi). If the transaction were not between the holding company and wholly owned subsidiary, the inference would have, no doubt, been different.

289 ITR 0312- HOECHST GMBH, IN RE VS. (AUTHORITY FOR ADVANCE RULING)

In the context of the holding company of an Indian subsidiary itself getting amalgamated with another foreign company, there is transfer of the shares in the Indian company as an asset located in India, but such transfer is not regarded as transfer under section 47(via), so that there is no liability as held by the Authority for Advance Rulings in Hoechst GmbH, In re [2007] 289 ITR 312. Where the holding company, which is a foreign company amalgamates with another foreign company, the exemption under section 47(via) is subject to two conditions, that there should be 25 per cent. identity of shareholding of the amalgamating company in the amalgamated company and that there should be no liability for capital gains tax in the country where the amalgamating company is incorporated. The first condition was easily satisfied, because amalgamation abroad was as between the holding company and the wholly owned subsidiary. It was, however, understood to be an impossible condition, so as not to be applicable in the view that the company cannot be its own shareholder. As for the second condition, that there should be no liability for capital gains in the country of transferor, that is also satisfied, since article 13(5) of the

Double Tax Avoidance Agreement between India and Germany provides for tax in the country where the alienator is a resident. Instead of amalgamation, if there had been transfer of shares of the Indian company, capital gains would have been taxable in India under article 13(4) of the Agreement.

DEPRECIABLE ASSETS

Section / Topic Name : 50

SALE OF FLAT

The Kerala High Court's decision in CIT v. Sakthi Metal Depot [2010] 189 Taxman 329 is a clear pointer to the assessee that once depreciation is claimed on an asset, its subsequent sale would give rise to short term capital gain only, no matter non-use of such asset before its sale. In this case, the assessee initially used the flat as branch office and claimed depreciation initially but later it discontinued claiming depreciation.

228 ITR 001 COMMONWEALTH TRUST LTD. VS. CIT; (SC)

The question relates to computation of capital gains. Capital asset in respect of which depreciation has been obtained and the scope of section 50(1). Option of substituting fair market value on prescribed date is not available to such a person in respect of asset on which depreciation has been claimed.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee was claiming depreciation on the block of asset whose WDV was Rs. 100000 all the asset in the block was sold for 500000 and there was gain of Rs. 400000 as per the provision of section 50. Assessee while computing the capital gains proposed to substitute the FMV as on 1-4-81 Rs. 7 Lakh and there after proposed to compute the capital loss is the action of the assessee justified.

ANSWER

Law allows substitution of the market value on April 1, 1981 as cost for assets acquired prior to such date at the option of the taxpayer. This was obviously intended to relax the incidence of tax in respect of old assets. However, in the case of depreciable assets, the capital gains have to be computed on the difference between the written down value (WDV) and the sale price. This is the position under section 50 of the Act.

In commercial parlance computation of capital gain would mean, the actual gain measured by the difference between the sale price and the cost of acquisition. It is the "cost of acquisition" that is required to be determined under the provisions of sections 48, 49, 50, and 55 of the Income-tax Act, 1961. Both under sections 48 and 49, cost of acquisition will have to be determined and adjusted as provided in sections 50 and 55. Section 55(2) gives an option to both kinds of assessee, that is, those who have purchased the capital asset as well as those who have acquired it by any of the modes mentioned in section 49 to substitute for the actual cost of acquisition, the fair market value of the asset. Section 55(2) will have application, only if one of the two classes of assessee exercises his option. Section 55(2), however, makes it clear that the option is available only for the purposes of sections 48 and 49 and it is not available for a case falling under section 50. Thus substitution of FMV as on 01-04-81 is not available for depreciable assets.

SLUMP SALE

Section / Topic Name : 50B

264 ITR 0193- PREMIER AUTOMOBILES LTD. VS. ITO (BOMBAY HIGH COURT)

Under section 2(14) of the Income-tax Act, 1961, capital asset is defined to mean property of any kind held by an assessee whether connected or not connected with his business or profession. The word “property” in the definition of “capital asset” in section 2(14) would include an undertaking acquired as a whole. In the case of a slump sale, there is a sale for consideration. That consideration is paid to the transferor-company and not to shareholders. A slump sale agreement is contractual in nature. The only condition in the case of slump sale is that the sale should be for a lump sum sale price. Therefore, in the case of a slump sale, there is a transfer of the entire business activity for a fixed price and sale value is not attributed to individual items of assets. Such capital gains to be computed on that basis.

279 ITR 0136- COMMISSIONER OF INCOME-TAX VS. GARDEN SILK WEAVING FACTORY (GUJARAT HIGH COURT)

After appreciating evidence on record (in the form of various agreements) and on facts that the transaction was a slump sale, i.e., the entire business undertaking was sold as a going concern and there was no itemised sale. Even the assessing authority had not been able to work out the itemised sale qua each building, machinery or plant as the case may be. The Tribunal was therefore right in holding that what was sold by the assessee-firm to the limited company was its running business as a going concern together with all the assets and liabilities and the provision of section 41(2) / 50 could not be invoked.

Where assessee sold one of the industrial undertakings retaining the other. The Assessing Officer computed capital gains relating to that part of the block of assets forming part of the transferred unit. The Tribunal found that the sale being for a slump price of the unit as a whole, it was not possible to deal with depreciable assets disjunctively. It was, however, found that a separate valuation was undertaken for machinery, so that a disjunctive sale was inferred following CIT v. Artex Manufacturing Co. [1997] 227 ITR 260 (SC). But the Tribunal also found that section 50 does not authorise segregation of any part of the block of assets. In the assessee's case, the block of assets was part of the assets of the business of the assessee comprising the assets of the transferred unit. Since the written down value was not reduced to nil on transfer of transferred assets, it was held that there was no liability for short term capital gains. If the businesses themselves were distinct, the block could have probably been taken to be distinct.

COST OF ACQUISITION AND IMPROVEMENT

Section / Topic Name : 49,55

275 ITR 0590- NAMITA SARKAR VS. COMMISSIONER OF INCOME-TAX (CALCUTTA HIGH COURT)

In valuing property for purposes of levying tax on capital gains, the valuation made by the valuer is simply an ordinary piece of evidence. It does not carry any weight more than that. The authorities are free to agree with the finding of the report or the certificate given by an approved valuer. At the same time, if it appears to the authority that the valuation was inaccurate or unreliable, it would be open to the authority to reject the same, and if there is no other evidence with regard to the market value of the property, the authorities would be justified in computing the value on well-established principles of valuation.

Where the Tribunal rejected the valuer's report and made its own estimate without indicating its basis of valuation, the valuer's report is to be preferred. A request for remand for fresh valuation was rejected in view of the long passage of time, though the Tribunal itself could have remanded the matter, if it found that valuer's report required further vetting. It is under these circumstances, the Tribunal's order was set aside and valuer's report directed to be accepted in *Namita Sarkar v. CIT* [2005] 275 ITR 590 (Cal).

285 ITR (A.T.) 0174- BHARAT S. SHAH VS. JOINT COMMISSIONER OF INCOME-TAX (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

Computation of capital gains has to follow the law prevailing in the relevant year. In the case of bonus shares, the spread over of the cost between original and bonus shares was permitted in *CIT v. Dalmia Investment Co. Ltd.* [1964] 52 ITR 567 (SC). In the case of rights shares, even a fall in value of the original shares could be reckoned as held in *Miss Dhun Dadabhoy Kapadia v. CIT* [1967] 63 ITR 651 (SC). However, section 55(2) has been amended with effect from April 1, 1996, so that the cost of such shares had to be taken as the amount paid for them, so that the cost of bonus shares would be nil. It was so decided by the Tribunal in *Bharat S. Shah v. Joint CIT* [2006] 285 ITR (AT) 174 (Mumbai).

290 ITR (A.T.) 0163- JAYAKUMAR B. PATIL VS. DEPUTY COMMISSIONER OF INCOME-TAX (INCOME-TAX APPELLATE TRIBUNAL--PUNE)

A revocable gift is excluded for wealth-tax. But where the gift is revoked and then sold, how is the cost of the previous owner ascertained ? It was held by the Tribunal in *Jayakumar B. Patil v. Deputy CIT* [2007] 290 ITR (AT) 163 (Pune), that section 55(3) permitting adoption of the cost of the predecessor would have no application, because the cost to the previous owner before revocation was nil and in computation of short-term capital gains in the hands of the assessee from the date of revocation, no cost is deductible. The decision does not appear to be consistent with law. If it were acquired without cost, there may be no liability at all. But consistent with the wealth-tax provision, it may be reasonable to infer that the property continued to belong to the assessee, so that the cost could have been allowed. The Tribunal found that in its view, cost would be nil, but since the cost was allowed by the Department, which was not appealed against, it did not disturb the computation. The assessee's contention was that he had paid gift tax and that there was no reason why the assessee's cost of Rs. 10 per share could not be allowed and

that there should probably be no objections to allow the indexed cost in computation of capital gains shorn of all technicalities.

In other words, assessee purchased shares at par and gifted to associations of persons with option to revoke gift after 74 months. Subsequent revocation of gift and sale thereafter. Cost of acquisition is cost to previous owner, i.e., association of persons, ascertainable at nil. section 55(3) does not apply.

ADVANCE MONIES FORFEITED

Section / Topic Name : 51

243 ITR 0158- TRAVANCORE RUBBER AND TEA CO. LTD. VS. CIT (SC)

Section 51 of the income tax act states that Where any capital asset was on any previous occasion the subject of negotiations for its transfer, any advance or other money received and retained by the assessee in respect of such negotiations shall be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition. Section 51 in fact what does is that, when in previous occasion when there were negotiations for transfer of capital asset, and if “advance or other money” had been received and retained by the assessee in respect of such negotiations, such amounts will in effect be added to the value of the capital asset impacting on the ultimate assessment of capital gains.

For this purpose, no distinction is made between moneys received and retained by way of “advance” and “other money”. The phrase “other money” would cover, for example, deposits made by the purchaser for guaranteeing due performance of the contracts and not forming part of the consideration. The monies received on the previous occasions and retained by the vendor/assessee cannot, therefore, be treated as revenue receipts. Section 51 to the extent stated thus preserves the rule in Tattersall’s case [1939] 7 ITR 316 (CA) that the quality and nature of a receipt for income-tax purposes were fixed once and for all when the subject of the receipt was received and that no subsequent operation could change the nature of the receipt.

There is a distinction between earnest money and advance, but that distinction loses its significance in the context of the express language of section 51 to include “other money” in addition to “advance”.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee agreed to sale a capital asset to purchaser Mr. P. Assessee received deposits at time of entering in to agreement to sale for guaranteeing due performance of the contracts and such deposits were not forming part of the consideration for sale. Subsequently Mr. P failed to tender the balance money at the time of effecting the actual sale and so the deposits were forfeited. You are required to answer the tax treatment of the forfeited amount Rs. 2 Lakhs.

In the next event assessee sold the said capital asset for 10 lakhs. The cost to the assessee is 3 lakhs. You are required to compute the capital gains for the assessee. Reason your answer in brief.

ANSWER

It is not always possible in business to observe all the terms of a contract. The sanctity of contract was Shylock's slogan but in business there is either novation of contract, where the parties agree to alteration of the terms of contract or there is a breach as a result of which the matter is settled by way of payment of damages. Such damages when received, while carrying out business transactions on revenue account may well be assessable. But where they are on capital account, they would be capital receipts without liability for capital gains tax, where there is no transfer of capital asset. Thus advance moneys forfeited Rs. 2 Lakhs is a capital receipt and not subject to capital gains.

In the next event when the asset is sold the provision of section 51, has provided that, where there is forfeiture of advance money received in respect of any capital asset, such advance would go to reduce the cost of acquisition of assets, so that such amount would get taxed at the time of sale of the asset. For this purpose, no distinction is made between moneys received and retained by way of “advance” and “other money”. The phrase “other money” would cover, for example, deposits made by the purchaser for

guaranteeing due performance of the contracts and not forming part of the consideration.

Computation of Capital Gains

Full Value Of Consideration	10
Cost Of Acquisition	3
Less: Advance Money Forfeited [U/S 51]	2 1
(Indexation Is Ignored)	
Capital Gains	9

EXEMPTION OF CAPITAL GAINS

Section / Topic Name : 54

ACQUIRING MORE THAN ONE HOUSE - ADVANTAGE TO HUF

The Special Mumbai Bench of the Tribunal in ITO v. Ms. Sushila M. Jhaveri [2007] 14 SOT 394 held that the exemption under section 54 of the Act would be allowable in respect of one residential house only. If the assessee has purchased more than one residential house, then the choice would be with assessee to avail of the exemption in respect of either of the houses provided the other conditions are fulfilled. However, where more than one unit is purchased which are adjacent to each other and are converted into one house for the purpose of residence, it would be a case of investment in one residential house, and the assessee would be entitled to the exemption.

In this case the assessee and her husband were co-owners of a residential flat in a building in Mumbai, having a 50 per cent share each. They sold the flat for a total consideration of Rs. 3.03 crores, the share of the assessee in the sale consideration being Rs. 1.515 crores. The assessee reinvested the sale proceeds in purchase of a half share in a flat in Varsova while another half share was invested in a flat in Bandra by the assessee's husband. The Special Bench allowed exemption in respect of only one of the two houses.

Here came another ruling of the Karnataka High Court in CIT v. D. Ananda Basappa [2009] 180 Taxman 4/309 ITR 329 where an HUF had sold a residential house and purchased two residential flats adjacent to each other under two different sale deeds. Yet further in this case the apartments were situated side by side and the builder had also stated that he had effected modification to the flats to make them as one unit by opening the door in between the two apartments. Irrespective of the above the Court in particular held that the proposition that when residential house is sold, the capital gain should be invested for the purchase of only one residential house may not hold good in the case of an HUF where its property is held by the members as joint tenant and if the members, keeping in view the future needs in event of separation, purchase more than one residential building, it cannot be said that the benefit of exemption is to be denied under section 54(1).

Moreover the fact that the Court has held that the expression "a" residential house should be understood in a sense that the building should be of residential nature and "a" should not be understood to indicate a singular number perhaps makes a good case for HUF indulging in purchase of more than one unit even at distant locations and yet avail section 54 exemption of more than one house.

PURCHASE OF HOUSE IN DIFFERENT NAME RISKY

The Delhi High Court in Vipin Malik (HUF) v. CIT [2009] 183 Taxman 296 held that to claim the benefit of section 54F, the residential house which is purchased or constructed has to be of the same assessee whose agricultural land is sold and since in this case, the agricultural land which was sold was of 'V' (HUF) and the flat purchased in the co-operative society was in the name of mother of 'V' and not in the name of the HUF, the assessee lost exemption.

SCOPE OF NEW ASSET – 54 / 54F

The benefit under section 54F is available for construction of a house. Where a person purchases an old building, demolishes it and constructs a new building, the entire exercise could be understood as one of construction, so that relief need not be limited to the cost of the old building but the entire cost including cost of construction as held by the Tribunal in M. Vijaya Kumar v. ITO [2008] 307 ITR (AT) 4 (Bangalore).

	Ex 1	Ex 2
	54	54F
	House	Diamonds
FVC	80	70
ICOA	10	12
	70	58
Investment –		
HOUSE – B (110)	70	40*70/58
HOUSE C (30)	-	-

(1)	Any one house exemption can be taken, if house B & C are adjacent then it is one house
(2)	HUF can purchase more than one house & set exemption
(3)	It must be purchased in name of the assessee
(4)	Purchase of old Building & new construction is fully allotted
(5)	Plot with boundary and garage is not residential house
(6)	Substantial construction complete is sufficient
(7)	Constructing additional house on existing bungalow not allowed (need to be revised)

(1)	Sushila M. Jhaveri (Special Mumbai Bench)
(2)	D. Ananda Basappa (Karnataka High Court)
(3)	Vipin Malik (Delhi High Court)
(4)	Vijaya Kumar (Bangalore)
(5)	Rajesh Surana (Raj.)
(6)	D. P. Mehta (Delhi)
(7)	V. Pradeep Kumar (Madras High Court)

SCOPE OF RESIDENTIAL HOUSE

Transfer of a residential house attracts deduction under section 53 (now deleted) and section 54. Reinvestment in another residential house is a requirement of both sections 54 and 54F, so that the meaning of residential house sometimes assumes importance. The predominant intention of the nature of construction was held to be a decisive factor in *Rajesh Surana v. CIT* [2008] 306 ITR 368 (Raj), where a plot having a boundary wall with a garage-cum-room was found to be not a residential house as inferred from the nature of the property on the ground that a residential house could only be a dwelling house.

The issue is relevant even under the wealth-tax law, where concessional valuation is available for residential house property under self-occupation. Neither the income-tax law nor the wealth-tax law has a definition of residential house. The meaning of residential house has also been the subject matter of other enactments. In *Poonen (T. J.) v. Rathi Varghese*, AIR 1967 Ker 1 [FB], a residence was understood as a place where a person intended for stay permanently other than casual stay. A flat could be a residential house as conceded in Board Circular No. 471 dated October 10, 1982. A residential house, it was held in *CWT v. Smt. Muthu Zulaikha* [2000] 245 ITR 800 (Mad) [FB], does not necessarily require to be occupied for residential purpose. Location in a residential area could be a pointer for the inference of residential house, though there could be residential houses in a business or industrial area. A provision for a kitchen ordinarily made only for residential house property is another pointer as is understood in town planning.

ACQUIRING MORE THAN ONE HOUSE

The cardinal rule of interpretation is that where the language used by the Legislature is plain, simple and unambiguous, the plain and natural meaning of the words used should be applied in construing the provisions of a statute. But where the language is ambiguous the courts can have recourse to aids to the interpretation to unearth the intention of the Legislature in enacting such provisions.

The word “a” means “any” which in turn means “many” or “more than one”. According to various dictionary meanings, it also includes “one” or “one out of many”. The word “any” may have several meanings according to the circumstances. It may mean “all”, “each”, “some” or “one or more out of several” but it is not confined to a plural sense. It may also be used to denote “one”. So, both the words “a” and “any” are ambiguous and, therefore, the meaning of these words has to be seen with reference to the context in which these words are used. Therefore, the exemption under sections 54 and 54F of the Act would be allowable in respect of one residential house only. If the assessee has purchased more than one residential house, then the choice would be with assessee to avail of the exemption in respect of either of the houses provided the other conditions are fulfilled. However, where more than one unit are purchased which are adjacent to each other and are converted into one house for the purpose of residence, it would be a case of investment in one residential house, and the assessee would be entitled to the exemption. *B. B. Sarkar v. CIT* [1981] 132 ITR 150 (Cal) relied on.

The assessee and her husband were co-owners of a residential flat in a building in Mumbai, having a 50% share each. In the year under consideration, they sold the flat for a total consideration of Rs. 3.03 crores, the share of the assessee in the sale consideration being Rs. 1.515 crores. The assessee reinvested the sale proceeds in purchase of a half share in a flat in Varsova, on May 12, 1994, for Rs. 28.65 lakhs and another half share in a flat in Bandra, on December 1, 1994, for Rs. 47.79 lakhs. The other half share in these two flats was purchased by the assessee’s husband. The assessee claimed exemption under section 54 of the Income-tax Act, 1961, of Rs. 76.44 lakhs against long-term capital gains arising from the sale of her share in the residential flat but the Assessing Officer, taking the view that exemption was available only in respect of investment in one residential house, restricted the exemption to Rs. 47.79 lakhs being the investment in the Bandra flat. The Commissioner (Appeals) held that exemption was available in

respect of the investment made in both flats. On appeal by the Revenue : Held, accordingly, that since investment was made in two flats located at different localities in Mumbai, the assessee was entitled to exemption in respect of investment in one house only of her choice. The Assessing Officer having already allowed exemption in respect of the house which permitted higher deduction, the order of the Assessing Officer was to be restored. [2007] 292 ITR (A.T.) 0001- Income-tax Officer v. Ms. Sushila M. Jhaveri (Income-tax Appellate Tribunal--Mumbai)

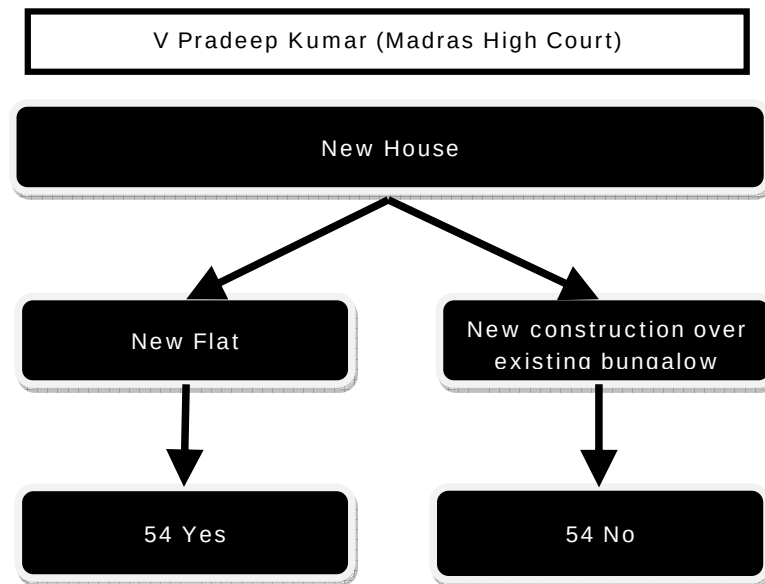
In computing the capital gain the Assessing Officer disallowed Rs. 1,51,500 being brokerage paid, on the ground that the assessee failed to produce the proof of payment. The photocopy of the brokerage bill was not considered evidence. On appeal, the assessee produced proof of payment along with her bank statement and the Commissioner (Appeals) allowed the assessee's claim. On appeal by the Department : Held, that the Assessing Officer not having disputed the allowability of the assessee's claim and the Commissioner (Appeals) having allowed the claim after considering the proof of payment, no interference was called for. [2007] 292 ITR (A.T.) 0001- Income-tax Officer v. Ms. Sushila M. Jhaveri (Income-tax Appellate Tribunal--Mumbai)

One of the outstanding issues in understanding reinvestment benefit under section 54 is whether it is possible for an assessee to get the benefit of investment in more than one residential house. Section 54F clearly permits investment in a single house. As for section 54, reinvestment is possible in "a residential house", so that it has been understood in some quarters, that the expression being singular can refer only to a single house. There were conflicting decisions on this point. The decision of the Bombay High Court in Kaushik (K. C.) v. P. B. Rane, Fifth ITO [1990] 185 ITR 499, is not an answer to the issue, because the dispute itself related to the issue, whether the assessee could claim relief with reference to the second property purchased by him. It was only this claim which was adjudicated in the taxpayer's favour. In the light of the object of promoting housing and the difference in language as between section 54 and section 54F, one would imagine that there is scope for a more liberal interpretation for section 54. The Special Bench of the Tribunal in ITO v. Ms. Sushila M. Jhaveri [2007] 292 ITR (AT) 1 (Mumbai), however, opted for a narrower interpretation on the comparison of these two provisions with other provisions, which would appear to be incorrect, since they are not comparable. So is the reliance of the Tribunal upon Kaushik's case (supra), which as pointed out did not deal with this issue. It referred to the decision in B. B. Sarkar v. CIT [1981] 132 ITR 150 (Cal), where again this issue was not directly involved.

It was in its view that the Tribunal held that the assessee could avail of the benefit for either of the two flats acquired by her at her choice in preference to the more liberal view based on the General Clauses Act, which would understand the singular to mean the plural and the policy of the Government to promote housing in enacting section 54. This is a matter pending in a large number of cases, which would have to await the final solution from the courts. It would be reasonable to expect that the Board would accept the more liberal view for section 54 in contrast with the limitation placed to section 54F itself, so as to avoid litigation instead of waiting for a final solution before the courts.

ADDITIONAL CONSTRUCTION OVER EXISTING ONE

The conditions precedent for getting exemption are transfer of any long-term capital assets not being a residential house and purchase within a period of one year before or two years after the date on which the transfer took place or construction within a period of three years after the date of transfer, of any residential house. The burden is on the assessee to prove that he had actually constructed a new residential house for purpose of the exemption under section 54F. Section 54F emphasises construction of residential house. The construction must be a real one. It should not be a symbolic construction. Mere construction by way of extension of the old existing house would not mean constructing a residential house as contemplated under section 54F. [2007] 290 ITR 0090- Commissioner of Income-tax v. V. Pradeep Kumar (Madras High Court)



The finding of the Tribunal was not based on any evidence. The order of the Tribunal was perverse and patently erroneous and unreasonable. It was clear from the contemporaneous evidence available on record that there were no new residential houses exhibited on the plot in question. The assessee got approval from the Corporation of Madras only on February 9, 1990, for demolishing the existing old building at the said plot, and the completion of the full demolition had been carried out by the assessee only at the end of March 1990.

It could be seen from the finding of the Tribunal that the assessee had undertaken an extension work in the old building in the ground floor and first floor. From the above finding it was clear that there was no residential house and it was only an extension of the old building. A mere extension of the existing building will not give benefit to the assessee as contemplated under section 54F. The assessee failed to satisfy the conditions contemplated under section 54F. They were not entitled to the benefit under section 54F. [2007] 290 ITR 0090- Commissioner of Income-tax v. V. Pradeep Kumar (Madras High Court)

INVESTMENT IN JOINT NAMES – 54B

Where an assessee had sought to reinvest sale proceeds of agricultural lands in other agricultural lands, so as to avail of the benefit of section 54B, but had committed the mistake of reinvestment in the name of his son and grandson, the High Court in *Jai Narayan v. ITO* [2008] 306 ITR 335 (P&H) upheld the disallowance of deduction dissenting from the decision of the Madras High Court in *CIT v. V. Natarajan* [2006] 287 ITR 271, where investment in wife's name was accepted.

A more liberal view was taken in *Late Mir Gulam Ali Khan v. CIT* [1987] 165 ITR 228 (AP), where it held that the word “assessee” must be given a wide and liberal interpretation so as to include legal heirs, so that investment in their joint names should not lose the benefit.

DEPOSIT IN CG-1988 SCHEME – TIME LIMIT

Section 54F, like section 54, requires that the amount not utilised in reinvestment before the due date for filing returns is required to be kept in deposit under Capital Gains Accounts Scheme. Where the assessee files a belated return after the permissible period under section 139(4), does the time limit for deposit get extended to such date of return ? This was the issue posed before the Tribunal in *Nipun Mehrotra v. Asst. CIT* [2008] 297 ITR (AT) 110 (Bangalore). It was held that section 54F refers to section 139 and not to any sub-section, so that the time should be available even till the date of filing return belatedly under section 139(4). As pointed out in the comments in the case now followed by the Tribunal being that of *CIT v. Rajesh Kumar Jalan* [2006] 286 ITR 274 (Gauhati) in [2007] 286 ITR (Journal) 26, the provision refers to section 139 in the context of filing of the return of income, but refers in the context of date of deposit, to the due date applicable to return under section 139(1), so that unless this decision is accepted by the Revenue it will be risky for the taxpayer to depend on it.

WHETHER SUBSTANTIAL CONSTRUCTION SUFFICIENT FOR RELIEF UNDER SECTION 54F ?

The assessee had purchased the land by investing the capital gains and had constructed residential houses. Circular No. 667 dated October 18, 1993 ([1993] 204 ITR (St.) 103), did not stipulate that the construction would have to be completed in order to have the benefit under section 54F of the Act. In order to get the benefit under section 54F of the Act, the assessee need not complete the construction of the house and occupy it ; it was enough if the assessee established the investment of the entire net consideration within the stipulated period. *D. P. Mehta v. CIT* [2001] 251 ITR 529 (Delhi) distinguished. [2008] 302 ITR 0286 - *Commissioner of Income-tax v. Sardarmal Kothari* (Madras High Court)

Purchase of land is also part of cost of acquisition of property. Where the sale proceeds had been invested in purchase of land with a view to put up construction thereon, section 54F is available on such outlay. The Assessing Officer, however, felt that the construction had not been completed as found by him on a personal visit. The assessee had contended that he had completed the construction substantially. The Commissioner of Income-tax (Appeals) directed deduction and the Tribunal affirmed such direction. The High Court found that completion of construction was inferred by the Commissioner (Appeals) on the basis of the invitation card printed for house-warming ceremony within the stipulated period and that, there was, therefore, no case for interference. It was so held in *CIT v. Sardarmal Kothari* [2008] 302 ITR 286 (Mad).

ENHANCED COMPENSATION AND EXEMPTION

Tax on capital gains can be saved by reinvestment in specified bonds under section 54EA (earlier section 54E and now section 54EC). The assessee was awarded compensation by a civil court by an order dated December 1, 1995, but this order was the subject matter of appeal before the High Court, which had granted stay, but allowed the assessee to withdraw 25 per cent. of such amount on furnishing securities. The amount was received on July 21, 1999, which later formed part of the enhanced compensation awarded by the High Court in the assessment year 2000-01. The assessee had claimed the amount deposited in these bonds out of the amount received earlier, subject to security. The Assessing Officer denied the benefit, because the remaining enhanced compensation was received only on July 21, 1999, while the investment was made on June 1, 1999, out of the amounts received earlier. The High Court in *CIT v. Late N. Kasi Viswanathan* [2008] 305 ITR 371 (Mad) held that this difference in date will make no difference. The assessee had already received part of it and he had not, therefore, to depend upon the balance amount. The investment was made even before the time limit but out of compensation. It was in

this context, the High Court upheld the order of the Tribunal. The High Court found that the finding of the Tribunal was rendered on the facts, so that it could not even otherwise interfere with the order of the Tribunal. Board Circular No. 359, dated May 10, 1983 [1983] 143 ITR (St.) 2 has conceded that investment even anterior to the date of transfer, as for example, from earnest money or advance will qualify for the benefit of reinvestment under section 54E (now 54EC) in the light of “the purpose and spirit of the section”. In this context, the appeal to the High Court should not have been authorised at all.

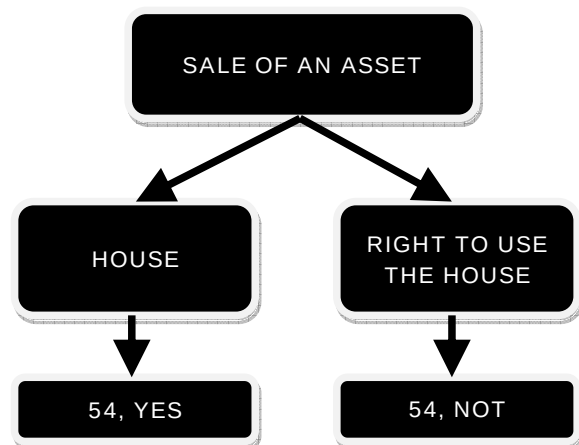
N. Kasi Vishwanathan (Mad)

Compulsory Acquisition	2001	2010
FVC	10	-
Additional compensation	-	5
COA/ICOA	2	-
	8	5
Exemption of 54EC	Yes	Yes

287 ITR (A.T.) 0142- SMT. NARGIS A. IRANI VS. INCOME-TAX OFFICER (INCOME-TAX APPELLATE TRIBUNAL--PUNE)

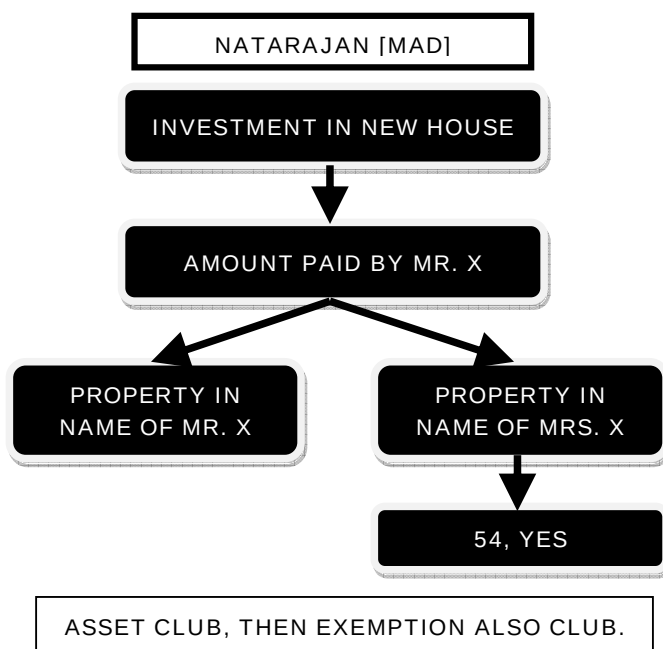
Property is a bundle of rights. Title is different from possession. Right to enjoyment of the property may belong to different persons as co-owned property or belonging to different persons at different points of time, when one holds for life with right to remainder in favour of another. It was the claim of the assessee, that she had interest only during her life-time looking after her parents and husband, so that consideration received for surrender of the life-interest could only be a capital receipt not liable for capital gains tax. Since she had received compensation for her right, which in this case, was Rs. 60 lakhs in lieu of her life-interest, she could not contend that there was no capital asset involved. Her right to enjoy the property during her life-time to the exclusion of her brothers was a valuable right. Such right to possession and enjoyment and control over the property itself constituted as a capital asset as held by the Tribunal in Smt. Nargis A. Irani v. ITO [2006] 287 ITR (AT) 142 (Pune). It was further found, that she was also not entitled to benefit of section 54F on reinvestment in another property, since she already had a property. The fact, that it was self-occupied and therefore not assessed as property income could not justify relief under section 54F under the law as it stood for the year. However in scheme of present law one property is allowed to be owned at time of transfer must be kept in mind, so on this point judgment would not be relevant.

SMT NARGIS A. IRANI (AT) (PUNE)



287 ITR 0271- COMMISSIONER OF INCOME-TAX VS. V. NATARAJAN (MADRAS HIGH COURT)

Reinvestment benefit, whether under section 54, 54F or 54EC, would ordinarily require that such reinvestment should be in the name of the same assessee, who is liable for capital gains tax. Where an assessee reinvests in another residential property in his wife's name, the Assessing Officer found that the assessee could not be treated as beneficiary of reinvestment of such amount, so that benefit under section 54 was denied and capital gains was assessed in the assessee's hands without relief. The High Court confirmed the finding of the Tribunal that the relief need not be barred in such cases, since the income from property was assessed in the assessee's hands. The judgment in this case in CIT v. V. Natarajan 287 ITR 271 (Mad) has not referred to the circumstances under which it was so included, because it would be treated as a benami investment, which is permissible even after the Benami Transactions (Prohibition) Act, 1988 or it might have been included under section 64(iv) of the Act. The High Court understood that the assessee was entitled to relief because "he also admits that he purchased a property at Madras in the name of his wife Smt. Meera out of money obtained by him by sale of property at Bangalore". Hence, what was considered material was that the reinvestment was made out of funds obtained on sale of property, which was liable to capital gains tax and that the property was purchased admittedly by the assessee in the name of his wife.

286 ITR (A.T.) 0054- ASSISTANT COMMISSIONER OF INCOME-TAX VS. RISHIROOP POLYMERS P. LTD. (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

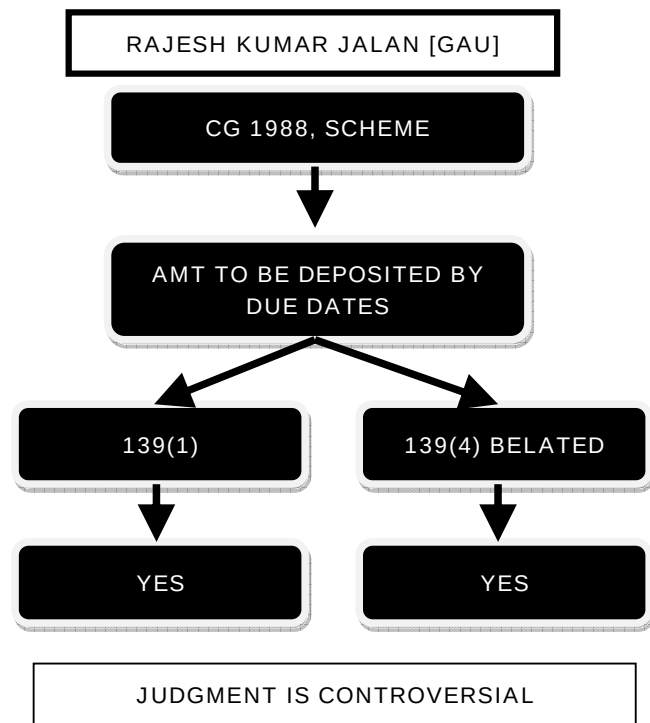
Reinvestment benefit according to the Revenue is available only for a single house under section 54, though such an inference is not free from doubt. Even on this limited inference, where an assessee purchases two adjoining flats converting them into a single residence, there can only be an inference of a single property as held by the Tribunal in ACIT v. Mrs. Leela P. Nanda [2006] 286 ITR (AT) 113 (Mumbai). It was pointed out that both the units were purchased within the time allowed under section 54. The flats were adjacent and were used for self-occupation. It is under these circumstances, that the Tribunal conceded relief under section 54 in this case. The same view has been taken in a number of decisions of the Tribunal itself and the High Court in Shiv Narain Chaudhari v.

CWT [1977] 108 ITR 104 (All), where the flats were situated in the same building though with different municipal numbers.

286 ITR 0274- COMMISSIONER OF INCOME-TAX VS. RAJESH KUMAR JALAN (GAUHATI HIGH COURT)

Reinvestment, whether under section 54 or 54F in a residential property is required to be made before the due date for filing return for the relevant year. If it could not be so made, it is required to be deposited under the Capital Gains Account Scheme till such time as it is utilised within the permissible time. It had always been understood, that the time-limit is the due date for filing the return under section 139(1), so that the extended time-limit for belated return under section 139(4) would have no application. But then, the High Court in CIT v. Rajesh Kumar Jalan [2006] 286 ITR 274 (Gauhati) found that the assessee, who had made the deposit after the due date under section 139(1), but before the due date under section 139(4) and had also utilised such deposit within the prescribed time was eligible for deduction. For inference of deposit “within the time”, it did refer to section 54(2) and section 54F(2), which refer to both section 139 and 139(1). The High Court felt that the more liberal interpretation to understand reference to section 139 as covering all sub-sections would accord with the intention of law. The Tribunal, however, had made an additional point, that part payment was also made in pursuance of agreement for sale even before the due date for filing return under section 139(1). It was, therefore, felt that the assessee should be deemed to have complied with the requirement of section 54 in view of section 53A of the Transfer of Property Act, 1882. The High Court agreed that the assessee is entitled for exemption even for utilisation on this inference in view of the decision of the Kerala High Court in K. C. Gopalan (citation not given), where it was held that utilisation is not the requirement of section 54, where purchase has been made before the due date.

Unless this decision is accepted by the Revenue, it may not be safe for the taxpayer to rely on this decision and delay the return/deposit. Nor is it safe to assume, that part performance under section 53A should be treated on par with purchase.



291 ITR (A.T.) 0169- SALEEM FAZELBHOY VS. DEPUTY COMMISSIONER OF INCOME-TAX (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

Circular No. 471, dated October 15, 1986*, makes it clear that the provisions of section 54F are incentive provisions intended to augment the investment in residential houses. It is the settled legal position that incentive provisions should be construed liberally in such a manner that the object of the statute is fulfilled. Hence investment in residential house would not only include the cost of purchase of the house but also the cost incurred in making the house inhabitable subject to the condition that the payment was made during the period specified in section 54F. The question whether the house purchased by the assessee was in an inhabitable condition or not would depend on the condition of the house at the time of purchase. Hence, this aspect would have to be kept in mind while adjudicating such issue. In the instant case the assessee was entitled to exemption under section 54F with reference to the expenditure incurred

for making the house inhabitable. However, the factual matrix required examination. (The Assessing Officer was directed to re-adjudicate the issue in accordance with the guidelines given and after considering the entire material produced by the assessee before him).

282 ITR (A.T.) 0211- MRS. PREMA P. SHAH VS. INCOME-TAX OFFICER (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

Where an assessee sells a residential property in India and purchases within the permissible time another property in the U. K., the requirement of section 54 for deduction is satisfied. The fact that such acquisition was by way of lease for 150 years or that the property was in the U. K. would not come in the way of relief as was found in Mrs. Prema P. Shah v. ITO [2006] 282 ITR (AT) 211 (Mum).

That the case of the assessee was that in the UK the property belongs to the Sovereign. The subjects enjoy it. The lease in the case of the assessee was valid for 150 years, which was in perpetuity and as such, the assessee was as good as absolute owner of the property.

That the word “peppercorn” means a small or insignificant thing or amount. In the agreement where the rent was fixed as peppercorn it was also mentioned “if demanded” on the first day of January every year. It also means that the assessee was as a matter of duty, not bound to pay but it was only on demand an insignificant rent was to be paid. Therefore, the assessee could be treated as the owner of the property.

That long-term capital gains is defined as a capital gain relating to a capital asset, being a foreign exchange asset. There was no doubt that this was not a case of foreign exchange asset and, hence, the provisions of section 115D were not applicable.

264 ITR 0076- COMMISSIONER OF INCOME-TAX VS. SMT. LAKSHMI B. MENON (KERALA HIGH COURT)

A perusal of sections 45 to 48 shows that if a residential house consisting of building and land appurtenant thereto is sold the capital gain that arises from the transfer has to be assessed to tax under the head “Capital gains”. The question of separately dealing with the land and building assumes importance only in the matter of availing of the deduction under section 54 series. If the capital asset which is transferred is a long-term capital asset an assessee will be entitled to exemption from assessment as to capital gains tax under section 54 series in case the requirements of the said section are satisfied. Land can be regarded as a capital asset as per section 2(14) of the Act and in accordance with the scheme of the Act, land would be considered as a separate capital asset, even if a building is constructed thereon. Where the land has been held for more than the prescribed period, the gains arising from the sale of land could be considered as long-term capital gains, though the building thereon was a new construction held for a period of less than 36 months. The land and the superstructure can be assessed separately as a “long-term capital asset” and as a “short-term capital asset” for the purposes of capital gain.

275 ITR 0017- P.K. LAHIRI VS. COMMISSIONER OF INCOME-TAX (ALLAHABAD HIGH COURT)

A perusal of section 54 of the Income-tax Act, 1961, makes it clear that the exemption under the provision is available only where a building or land appurtenant thereto is sold and within two years immediately preceding the date on which the transfer took place, was being used by the assessee or a

parent of his mainly for the purposes of his own or the parent's own residence and the assessee has within a period of one year before or after that date purchased, or has within a period of two years after the date constructed, a house property for the purpose of his own residence. Land appurtenant to the building implies that the ownership of the building and the land appurtenant should be of the same person. If the building is owned by one person and the land is owned by another person then it will be the case of land adjoining the building and by no stretch of imagination can it be called land appurtenant to the said building.

There is exemption for reinvestment of capital gains arising on sale of residential house under section 54. Such residential property may consist of appurtenant land. It is an inference on which there could possibly be no controversy. But where the plot is large one admeasuring about 3.5 acres containing a residential bungalow of only 5700 sq.ft., the application of section 54 on the capital gains on sale proceeds of the entire land was obviously not correct, since the adjacent land could not be treated as really appurtenant. In coming to this conclusion, the High Court in *P. K. Lahiri v. CIT* [2005] 275 ITR 17 (All) followed the guidelines in *CIT v. Zaibunnisa Begum* [1985] 151 ITR 320 (AP) discussing the concept of appurtenant land in some detail and laying down the proposition in that a contiguous area need not necessarily be appurtenant, unless it is an indivisible part of the plot, so that it is not capable of independent user with such appurtenant land being for convenient use of the building on which it is put up. The decision of the Allahabad High Court is consistent with the detailed criteria laid down by the Andhra Pradesh High Court.

284 ITR 0020- COMMISSIONER OF INCOME-TAX VS. SMT. SUNITA AGGARWAL (DELHI HIGH COURT)

Section 54 allows deduction from capital gains on reinvestment of such capital gains on sale of a residential property in any other residential house property. Since the expression used is "a residential house", it is sometimes understood as confined to a single property. Such interpretation is not free from doubt. Section 13 of the General Clauses Act, 1897 provides that "singular shall include the plural and vice versa", though application of this principle in the General Clauses Act is possible only where such interpretation would not be "repugnant" to the subject or context. The context is to allow the benefit of rerolling for all profits on sales of a residential house in residential housing. Section 54 has also to be construed in contradistinction to section 54F, which limits the relief to a single house owner and specifically not to a person with more than one house on sales of assets other than a residential house.

The Board in Circular No. F. No. 207/24/76-ITA-II dated March 25, 1971, had clarified that the benefit would be available to the seller of more than one house, if each such houses had been under self-occupation as required under the then law. Hence, the entire approach to section 54 need not be confined to the idea of a single house either for sale or for reinvestment. In view of the different understanding of the Revenue, when it relates to reinvestment, taxpayers seek to claim more than one residential unit as one. Such a plea was accepted in some cases by the Tribunal as in *K.G. Vyas v. 7th ITO* [1996] 16 ITD 195 (Bom), when the units were housed in the same building allegedly all for use by the same assessee. It was conceded in *K. C. Kausik v. P.B. Rane*, 5th ITO [1990] 185 ITR 499 (Bom), that the assessee could get relief with reference to any one house of his choice, when he reinvests in more than one house. The issue, whether he could have got exemption for both houses was not raised, as it was not obviously necessary in this case.

The Delhi High Court in *CIT v. Smt. Sunita Aggarwal* [2006] 284 ITR 20 (Delhi) has found that, when

the assessee had acquired four portions of property by four different sale deeds, but they all constitute one residential house, where she was residing with her husband and children, the benefit will be available in respect of all. On the facts which were not disputed, it was held that it could not be assumed that the assessee had acquired more than one house, so that the Tribunal's finding that the assessee was eligible for deduction on the aggregate investment in all the units was upheld on the ground that it is a decision on the facts not involving a substantial question of law.

The issue whether the assessee would have been eligible, even if the assessee acquired more than one residential unit in different places in the light of the objective of the Government to encourage housing, is still a matter which awaits adjudication at the level of High Court/Supreme Court.

261 ITR 0570- COMMISSIONER OF INCOME-TAX VS. CITIBANK N.A. (BOM)

The definition of capital asset includes property of any kind and land held by the assessee is a capital asset and a building held by the assessee is also a capital asset and it is possible to bifurcate the capital gain arising with reference to the sale of the land and building even if they are sold as one unit, if the lands are held by the assessee for a period more than that prescribed under section 2(42A) of the Income-tax Act, 1961, namely, 36 months. It is not possible to say that by construction of the building, the land which was a long-term capital asset, has ceased to be a long-term capital asset. The land is an independent and an identifiable capital asset, and it continues to remain as an identifiable capital asset even after construction of the building. In such cases it is right in law to bifurcate the capital gains into long-term capital gains pertaining to land and short-term capital gains pertaining to superstructure as per section 50. CIT v. Vimal Chand Golecha [1993] 201 ITR 442 (Raj) followed. Where an assessee puts up a superstructure on land owned by it, depreciation is allowed on the cost of the superstructure, which has to be treated distinctly from the land, even where such superstructure is married to the land. This was decided by the apex court in the context of depreciation in CIT v. Alps Theatres [1967] 65 ITR 377.

Question

The assessee, a resident company engaged in banking purchased a plot of land on 15th December, 1975. In the next year, the assessee started construction of a bungalow as a residence for the assessee's manager in New Delhi. The construction was completed in three years time. During the previous year assessee sold the entire property for Rs. 30,00,000. In the conveyance the price was allocated as follows: for the land, it was Rs. 14,00,000 ; for the building, it was Rs. 16,00,000. You are required to discuss how the capital gains will be charged to tax. State your assumptions if any.

Answer

As Held in [2003] 261 ITR 0570- Commissioner of Income-tax vs. Citibank N.A. (Bombay High Court) the surplus realised on the sale of land shall be treated as long term capital gains and the surplus (if any) on the sale of building shall be treated as short-term capital gain as per section 50. since the cost of the land is not given in the problem it is assumed that indexed cost of acquisition is 10,00,000 after substituting the fair market value as on 01-04-81. The gain arising out of transfer of land is long term in nature. The entire sale price of building i.e. 16,00,000 shall be reduced from the written down value of block of asset (of Building).

251 ITR 0693- CIT VS. HEMSONS INDUSTRIES (AP)

Section 54D of the Income-tax Act, 1961, provides relief from tax in the case of persons owning industrial undertakings in respect of capital gains arising on compulsory acquisition of any land or

building used by them for the purposes of the business of the undertaking. Section 54D granting an exemption must be construed liberally and the expression “industrial undertaking” occurring therein must be given its popular meaning. An undertaking mentioned in section 54D must be one maintained by a person for the purpose of carrying on his business. The demonstrative objective “industrial” qualifying the word “undertaking” unmistakably and with precision shows that the undertaking must be one which partakes of the character of a business. The word “business” connotes some real, substantial and systematic or organised course of activity with a set purpose. Since the word “business” is of wide import, the words “industrial undertaking” should be understood to have been used in section 54D in a wide sense, taking in its fold any project or business a person may undertake.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

The assessee is an individual. He was owning an ice factory by name Beena Ice Factory. Government acquired on 01-06-2001 the land and building forming part of the ice factory. The capital gain arising there from was determined at Rs. 30,000. Assessee has started new business of running hotel and has acquired a lodge building for the same on 01-12-2002 and claimed the capital gains as exempt in 54D. You are required to answer whether assessee is right in holding that the business of running a lodging house as an industrial undertaking for the purpose of section 54D of the Income-tax Act ?

ANSWER

The Government acquired the land and building forming part of an ice factory belonging to the assessee. The assessee claimed exemption from tax under section 54D on the ground that he had invested the capital gain in the construction of a lodging house. Held in case of [2001] 251 ITR 0693-COMMISSIONER OF INCOME-TAX VS. HEMSONS INDUSTRIES (AP) that the running of a lodge could be said to be an industrial undertaking within the meaning of section 54D. The assessee was entitled to the exemption under section 54D. Section 54D of the Income-tax Act, 1961, provides relief from tax in the case of persons owning industrial undertakings in respect of capital gains arising on compulsory acquisition of any land or building used by them for the purposes of the business of the undertaking. Section 54D granting an exemption must be construed liberally and the expression “industrial undertaking” occurring therein must be given its popular meaning. An undertaking mentioned in section 54D must be one maintained by a person for the purpose of carrying on his business. The demonstrative objective “industrial” qualifying the word “undertaking” unmistakably and with precision shows that the undertaking must be one which partakes of the character of a business. The word “business” connotes some real, substantial and systematic or organised course of activity with a set purpose. Since the word “business” is of wide import, the words “industrial undertaking” should be understood to have been used in section 54D in a wide sense, taking in its fold any project or business a person may undertake.

255 ITR 0315- HARSUTRAI J. RAVAL VS. CIT (GUJ)

The expression “for the purpose of his own residence” in section 54(1) would suggest that the benefit of the provision is intended for the new asset which is meant at the time of purchase or construction, to be used for dwelling purposes by the assessee and this will rule out use by way of mere temporary occupation which will not be a use for permanent residence. The word “residence” has a variety of meanings, according to the statute in which it is used and position in which it is found. The word “residence” in the present context refers to a place of permanent and not merely temporary abode. The word permanent here, is a relative term and is not synonymous with everlasting. A stop gap arrangement for stay in a house property not intended to be purchased or constructed for permanent residence, that is

as an abode where the assessee would ordinarily dwell, cannot deny the entitlement to the benefit of the provisions of section 54(1).

Therefore, if an asset purchased or constructed not for residential purpose, but only for temporary accommodation is transferred within three years, that will not affect the benefit that attaches to the purchase or construction of the new asset for residential purposes and no question of reduction of cost by the amount of capital gain will arise qua the transfer of the asset which was not purchased or constructed for residential purpose. The transfer within three years of the asset not purchased for residential purpose as contemplated by section 54(1), would be an independent transaction and sale of such asset to which no benefit of section 54(1) applied, would not attract violation of section 54(1).

Question

Mr. X presents the following details for the computation of capital gains, you are required to explain correct position of law.

Full Value of Consideration (Residential House A)	01-07-2001	100
Indexed Cost of acquisition (Residential House A)		30
Investment in Residential House B	01-12-2001	35
Investment in Residential House C	02-07-2001	40
Sale of House C	01-10-2002	80

He further submits that he sold a property (Residential House A), which was used for residential purposes for acquiring another property (Residential House B), but during the intervening period, before he could construct/acquire a permanent residence for himself, he used the funds for acquisition of a flat by way of temporary residence (Residential House C), which he had sold within three years of acquisition. You are also required to explain the tax treatment on sale of Residential House C.

Answer

Computation of capital gains for the year ending 31.03.2002

Full Value of Consideration (Residential House A)	01-07-2001	100
Indexed Cost of acquisition (Residential House A)		30
Capital Gains		70
Exemption under section 54		
Investment in Residential House B	01-12-2001	35
Long term capital gains		35

The expression “for the purpose of his own residence” in section 54(1) would suggest that the benefit of the provision is intended for the new asset which is meant at the time of purchase or construction, to be used for dwelling purposes by the assessee and this will rule out use by way of mere temporary occupation which will not be a use for permanent residence. The word “residence” in the present context refers to a place of permanent and not merely temporary abode. Thus house C shall not qualify for the benefit of exemption of section 54.

Computation of capital gains for the year ending 31.03.2003

Full Value of Consideration (Residential House C)	01-10-2002	80
Cost of acquisition (Residential House C)	02-07-2001	40

Short Term Capital Gains

40

If an asset purchased or constructed not for residential purpose, but only for temporary accommodation is transferred within three years, that will not affect the benefit that attaches to the purchase or construction of the new asset for residential purposes and no question of reduction of cost by the amount of capital gain will arise qua the transfer of the asset which was not purchased or constructed for residential purpose. The transfer within three years of the asset not purchased for residential purpose as contemplated by section 54(1), would be an independent transaction and sale of such asset to which no benefit of section 54(1) applied, would not attract violation of section 54(1).

278 ITR (A.T.) 0171- DEPUTY COMMISSIONER OF INCOME-TAX VS. UDAY S. KOTAK (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

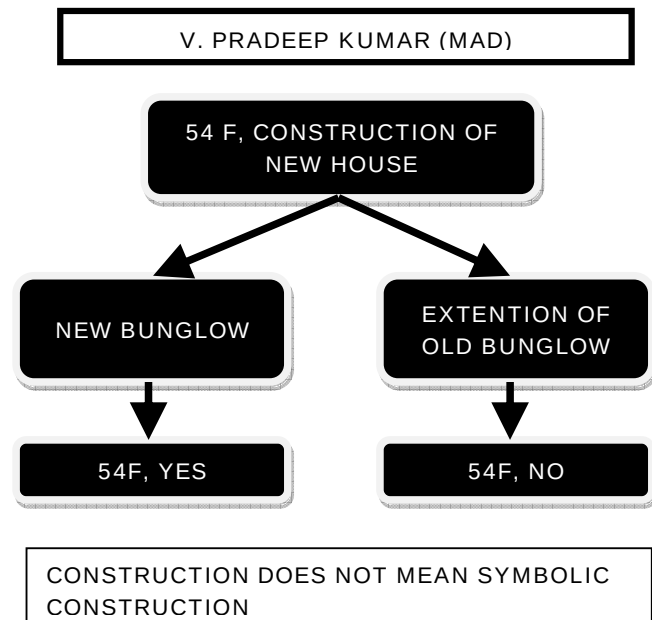
The word “purchase” is not defined. Therefore, it has to be construed according to its plain and natural meaning. On the plain language of section 54F, the meaning of the word “purchase” cannot be extended to “cost of acquisition”. The specific word “purchased” is used by the Legislature in section 54F. If the intention of the Legislature had been to allow exemption with regard to “cost of acquisition” and “cost of improvement” these terms could have been used in this section as well, as the same have been used in section 48. Thus, the word “purchased” in section 54F cannot be interpreted in a manner to include within its ambit the terms “cost of acquisition” and “cost of improvement”.

Where an assessee after purchase of a property had incurred expenditure by payment of a huge sum due to erstwhile tenants, the issue was, whether such payment also would qualify for the re-rolling benefit under section 54F. The Tribunal in Deputy CIT v. Uday S. Kotak [2005] 278 ITR (AT) 171 (Mum) found that the payment having been made after the completion of sale would not qualify for the benefit. Since a right to possession is also an integral part of the ownership right, which is a bundle of rights, the inference could have been different on analogous reasoning approved in considering such cost of removal of encumbrances as cost in CIT v. Miss Piroja C. Patel [2000] 242 ITR 582 (Bom) and CIT v. Abrar Alvi [2001] 247 ITR 312 (Bom) and similar other precedents.

The assessee sold his shares and earned long-term capital gains of Rs. 5,87,48,102. He invested the sale consideration of shares for acquisition of a residential house. The house comprised ground floor plus two floors. The assessee purchased a half undivided share of the second floor of the house on “as is where is” basis from his brother, who owned the legal title, for a consideration of Rs. 6 lakhs. After purchase, the assessee paid Rs. 1.60 crores and Rs. 2.85 crores to the tenants on the ground and first floors in lieu of the tenancy rights owned by them, in favour of the assessee. He claimed exemption under section 54F in respect of the purchase consideration of Rs. 6 lakhs plus the amounts of Rs. 1.60 crores and Rs. 2.85 crores paid to the erstwhile tenants against the said long-term capital gain. The claim of the assessee was that the payment made to the tenants was payment of purchase price for a residential house and, therefore, qualified for exemption under section 54F. The officer did not agree with the claim of the assessee. The court has upheld the views of the officer.

290 ITR 0090- COMMISSIONER OF INCOME-TAX VS. V. PRADEEP KUMAR (MADRAS HIGH COURT)

Section 54F of the Income-tax Act, 1961, was inserted by the Finance Act of 1982, with effect from April 1, 1983. The conditions precedent for getting exemption are transfer of any long-term capital assets not being a residential house and purchase within a period of one year before or two years after the date on which the transfer took place or construction within a period of three years after the date of transfer, of any residential house. The burden is on the assessee to prove that he had actually constructed a new residential house for purpose of the exemption under section 54F. Section 54F emphasises construction of residential house. The construction must be a real one. It should not be a symbolic construction. Mere construction by way of extension of the old existing house would not mean constructing a residential house as contemplated under section 54F.

**CIRCULAR NUMBER: 743 219 ITR (Stat) 0050-**

Under sections 54, 54B, 54D, 54F and 54G of the Income-tax Act, 1961, capital gain is not chargeable to tax if the amount of capital gain or net consideration has been utilised for specified purposes by the assessee within the stipulated period laid down in the relevant section. These provisions also provide for the deposit in specified banks, etc. of the amount of capital gain which is not utilised by the assessee for the acquisition of new assets before the date of furnishing the return of income under section 139(1). The amount of capital gain already utilised for the acquisition/construction of new asset together with amount deposited is deemed to be the cost of new asset and consequently this amount is not chargeable to capital gain in the year of transfer of asset. The provisions of section 54, 54B, 54D, 54F and 54G further provide that if the amount deposited is not utilised wholly or partly for the prescribed purposes, within the period specified, the amount not so utilised shall be charged under section 45 as the income of the financial year in which the period of two/three years (as prescribed in the relevant section) from the date of transfer of the original asset expires.

A question has been raised regarding the taxability of the unutilised deposit amount in the case of an individual who dies before the expiry of the stipulated period. The matter has been considered by the Board and it is clarified that in such cases the said amount cannot be taxed in the hands of the deceased. This amount is not taxable in the hands of legal heirs also as the unutilised portion of the deposit does not partake of the character of income in their hands but is only a part of the estate devolving upon them.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Amount at the credit in the capital gain scheme 1988 was received by the legal heir of the assessee in the event of death of assessee. The amount was not utilised for the purpose of deposit u/s 54. Discuss its tax incidence.

ANSWER

Under sections 54, 54B, 54D, 54F and 54G of the Income-tax Act, 1961, capital gain is not chargeable to tax if the amount of capital gain or net consideration has been utilised for specified purposes by the assessee within the stipulated period laid down in the relevant section. These provisions also provide for the deposit in specified banks, etc. of the amount of capital gain which is not utilised by the assessee for the acquisition of new assets before the date of furnishing the return of income under section 139(1). The amount of capital gain already utilised for the acquisition/construction of new asset together with amount deposited is deemed to be the cost of new asset and consequently this amount is not chargeable to capital gain in the year of transfer of asset. The provisions of sections 54, 54B, 54D, 54F and 54G further provide that if the amount deposited is not utilised wholly or partly for the prescribed purposes, within the period specified, the amount not so utilised shall be charged under section 45 as the income of the financial year in which the period of two/three years (as prescribed in the relevant section) from the date of transfer of the original asset expires. A question has been raised regarding the taxability of the unutilised deposit amount in the case of an individual who dies before the expiry of the stipulated period. CBDT in its circular 743 has considered the matter and it is clarified that in such cases the said amount cannot be taxed in the hands of the deceased. This amount is not taxable in the hands of legal heirs also as the unutilised portion of the deposit does not partake of the character of income in their hands but is only a part of the estate devolving upon them.

270 ITR 0040- COMMISSIONER OF INCOME-TAX VS. SMT. SAVITA RANI (PUNJAB AND HARYANA HIGH COURT)

From a plain reading of section 54B of the Income-tax Act, 1961, it is clear that to claim the benefit of this provision, the following conditions are required to be satisfied : (i) the capital gain must arise from the transfer of land which, in the two years immediately preceding the date on which the transfer took place, was being used by the assessee or his parent for agricultural purposes ; and (ii) the assessee must have purchased the land within a period of two years after the sale of the above land for being used for agricultural purposes.

Section 54B permits reinvestment benefit, where profits on sale of agricultural lands liable for tax on capital gains because of their location in an urban area will be spared, if the capital gains are reinvested in other agricultural lands. The condition under section 54B is that the land so acquired must have been used for agricultural purposes. Where there is evidence of such use, neither the fact that the assessee's intention was to use it for non-agricultural purposes nor the fact that the land was in a commercial area can come in the way of exemption under section 54B as held in CIT v. Smt. Savita Rani [2004] 270 ITR 40 (P&H).

262 ITR 0657- CIT VS. ANILABEN UPENDRA SHAH (GUJ)

The member of a co-operative housing society only owns the shares in that society. The right to enjoy, or derive from, any land or building belonging to the co-operative housing society is merely an incidental right flowing from the ownership of the shares. A member of a co-operative housing society cannot sell all his shares in a co-operative housing society and still retain any interest in any property, whether land or building, belonging to the co-operative housing society and allotted/let out to the member. Similarly, a member of a co-operative housing society to whom a flat or land is allotted cannot transfer such land or building without selling the shares held by him. Hence, when the question comes up for consideration as to which is the relevant date, while computing the capital gains tax in case of transfer of his shares by a person who is a member in a co-operative housing society, the relevant date would be the date on which

the member acquires the shares in the co-operative housing society and the date on which the member had sold his shares in the said co-operative housing society.

Question

On September 6, 2000, by depositing a sum of Rs. 5,000 which included entrance fees of Rs. 55 and share capital of Rs. 250, the assessee had become a member of a co-operative housing society. A flat was allotted to her by the society in November, 2000. Possession of the flat was however delivered by the said society to the assessee only in October 2001. Thereafter, the assessee entered into an agreement to sell the flat on October 8, 2003, and in performance of such contract the assessee sold the same on December 4, 2003, for Rs. 1,40,000. The Income-tax Officer subjected said transaction to tax as short-term capital gains. However assessee is of the opinion that gain is long term in nature. You are required to discuss the correct position of law.

Answer

It is possible for a person, who is a member of a co-operative society to acquire the right of possession in a property by merely being a shareholder in a co-operative society, which holds the title to such property. It is for this reason that, where such shares are held for more than 36 months, it can be treated as a long term asset, though the possession of the property might have been for a shorter period. This was the view taken in CIT v. Anilaben Upendra Shah [2003] 262 ITR 657 (Guj). The matter would not appear to be free from doubt, since it would appear that the factual enjoyment of the property may well be a relevant fact in view of the definition of transfer under section 2(47)(vi), which would include “any transaction (whether by way of becoming member or acquiring share in a co-operative society . . .), which has the effect of transferring or enabling the enjoyment of any immovable property”. [2003] 262 ITR 0657- Commissioner of Income-tax vs. Anilaben Upendra Shah (Gujarat High Court)

The High Court in this case found that though possession of property was for less than this period. It was in this context that the allotment was treated on par with purchase with sole reference to transfer of shares. Thus in the given case since shares were held for period more than 36 months (From September 6, 2000, To December 4, 2003,) it shall be long term capital gains. [2003] 262 ITR 0657- Commissioner of Income-tax vs. Anilaben Upendra Shah (Gujarat High Court)

262 ITR 0587- CIT VS. ASSAM PETROLEUM INDUSTRIES (P.) LTD. (GAU)

Section 54EC (Old Provision 54E), is a provision whereby the assessee is entitled to claim exemption or deduction from his income if the condition laid down therein is fulfilled. The essential requirements or ingredients to attract the provisions of section 54E are (i) the capital gains has arisen from the transfer of a long-term capital asset and not from any short term capital asset ; (ii) the assessee has within a period of six months after the date of transfer invested or deposited any part or whole of the net consideration in any specified asset. If these essential conditions are complied with by the assessee then he would be entitled for the exemption as specified under section 54EC. Section 54EC is an independent provision which is not controlled by section 50. Section 50 only provides that if depreciation has been allowed under the Act on the capital asset then the assessee’s computation of capital gain would not be under sections 48 and 49 of the Act and it would be with modification as provided under section 50. For application of section 54EC the necessary pre-requisite condition and enquiry would be whether the assessee had transferred a long-term capital asset and whether the consideration so received is invested or deposited within the time limit in a specified asset. Capital gain may have been received by the assessee on depreciable assets, if the conditions necessary under section 54EC are complied with by the assessee, he will be entitled to the benefit envisaged in section 54EC.

Question

During the previous year, the assessee had received compensation from the appropriate authority, for acquisition of its land and building. The assessee had invested the entire receipt of compensation by purchasing specified Bonds and claimed exemption of the capital gain under section 54EC. The claim made by the assessee in regard to land was allowed by the Assessing Officer whereas in regard to building the Assessing Officer was of the view that depreciation of the said building having been claimed and allowed, capital gain arising out of transfer of the said building had to be construed as short-term capital gain under section 50 of the Act and not a long-term capital gain as claimed by the assessee and thus the assessee was not entitled to claim benefit under section 54EC. You are required to answer whether the officer is justified in his opinion or not.

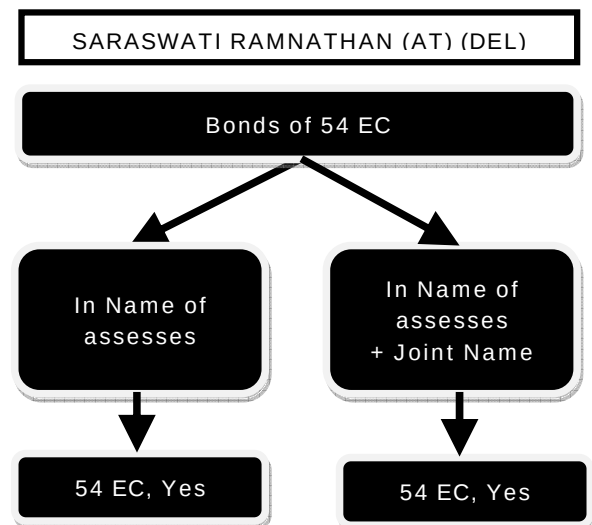
Answer

Section 54EC spares liability for capital gains where the sale proceeds are invested in specified bonds. The issue that arose in CIT v. Assam Petroleum Industries (P) Ltd. [2003] 262 ITR 587 (Gauhati) was whether sale of long term depreciable asset would be eligible for such benefit. The departmental view is that it is not so eligible, because the surplus in case of sale of depreciable asset is taxable as short term capital gains under section 50 of the Income-tax Act. In fact, there may be no liability on some sales, because of the depreciation in block of assets. The assessee's argument, however, was that section 54EC does not exclude short term capital gains, as long as the sale is of a long term capital asset. Such an argument found favour in this case. The decision would appear to be consistent with the language of the provision, though it does create complications under block of assets, where there is such rerolling benefit except what is available within the block itself. Thus the assessee is entitled for exemption or deduction as provided under section 54EC of the Act on capital gains.

280 ITR (A.T.) 0243- INCOME-TAX OFFICER VS. SASIKLAL N. SATRA (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

The word "residence" means a building or part of the building where one can eat, drink and sleep. House is not equal to a building since a building may comprise many houses. Therefore, "house" means an independent unit where one can eat, drink and sleep.

The Legislature has used the word "a" before the words "residential house" in section 54F. It must mean a complete residential house and would not include a shared interest in a residential house. Where the property is owned by more than one person, it cannot be said that any one of them is the owner of the property. No individual person of his own can sell the entire property. He can sell his share of interest in the property but as far as the property is concerned, it would continue to be owned by co-owners. Joint ownership is different from absolute ownership. In the case of a residential unit, none of the co-owners can claim that he is the owner of a residential house. Ownership of a residential house means ownership to the exclusion of all others.



Section 54F is not available for a person, who own more than one residential house on the date of transfer. Earlier the relief was available only for those, who did not have any residential house. But where a husband and wife jointly owned a property, both of them were treated as owners of residential house, though with only 50 per cent. ownership each. The Revenue treated both of them as having a residential

house for purposes of relief under section 54F. In ITO v. Rasiklal N. Satra [2006] 280 ITR (AT) 243 (Mumbai), part ownership was held not to be a disqualification. However, reinvestment in a part of property was recognised by the Supreme Court in CIT v. Aravinda Reddy [1979] 120 ITR 46. The reasoning which has been adopted by the Tribunal is a fair decision enlarging what was hitherto understood as the law on the subject. But unless this decision is accepted by the Revenue, the matter is not free from doubt. The decision of the Supreme Court in Seth Banarsi Dass Gupta v. CIT [1987] 166 ITR 783 where fractional ownership was not considered eligible for depreciation before amendment to section 32 to cover ownership “wholly or partial” was cited as precedent for its conclusion.

CIRCULAR NUMBER: 795 245 ITR (Stat) 0061-

Since agriculturists are not required to pay any tax on income arising from agricultural operations, the applicability of these provisions to the holders of Kisan Credit Cards, is likely to cause avoidable inconvenience to them. It is hereby clarified that, unlike the normal credit card, Kisan Credit Cards are issued based on the land holding of agriculturists. The Prov 1 to 139(1) should therefore, be made applicable to holders of credit cards other than Kisan Credit Cards.

COST OF ACQUISITION AND IMPROVEMENT

Section / Topic Name : 56 to 59

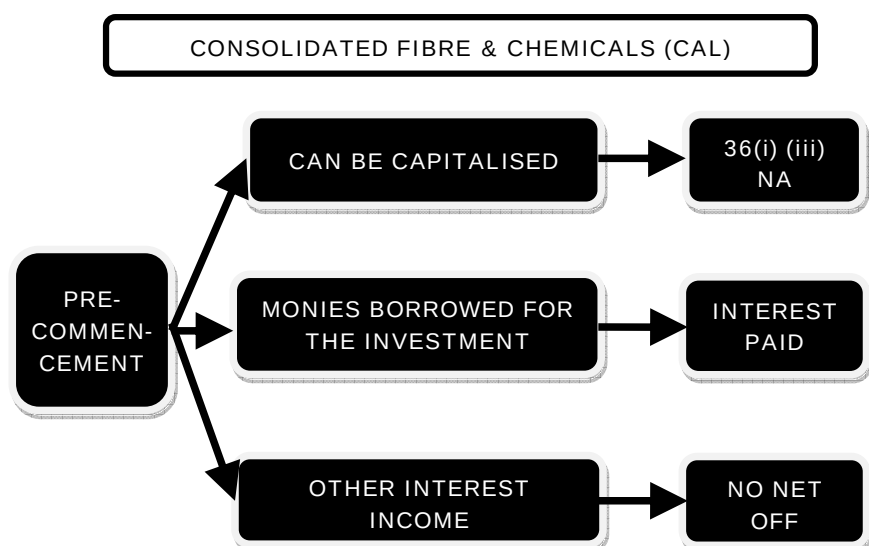
278 ITR (A.T.) 0001- HARISH KRISHNAKANT BHATT VS. INCOME-TAX OFFICER (AHMEDABAD BENCH)

It is one of the consistent principles of law that precedents are followed. This is well-established, since this is what makes the law stable. In Harish Krishnakant Bhatt v. ITO [2005] 278 ITR (AT) 1 (Ahmedabad) on an issue relating to deduction of interest borrowed for investment in shares, when dividend income was exempt, the Tribunal had to consider an earlier decision of the Mumbai Bench in Mafatlal Holdings Ltd. v. Addl. CIT [2004] 85 TTJ 821 (Mumbai), which had held that though the dividend was exempt in the hands of the shareholders, tax had been paid by the company and that what is taxed is only net income requiring deduction of interest on borrowings for investment, even if the assessee were not a dealer in shares and that, at any rate, interest was deductible as the assessee was in fact carrying on business activities during the year and where the assessee was dealing in investments, the deduction could not be denied. This decision, it was found, was not correct in the light of section 14A according to the Tribunal in the present decision in view of the decision of the Supreme Court in ITO v. S. Radha Krishnan [2002] 254 ITR 561 and some other precedents.

Interest on capital borrowed for the investment in shares where dividend is exempt is not allowed as deduction. In light of section 14A.

273 ITR 0353- CONSOLIDATED FIBRES AND CHEMICALS LTD. VS. COMMISSIONER OF INCOME-TAX (CALCUTTA HIGH COURT)

The issue had come up in a different form in Consolidated Fibres and Chemicals Ltd. v. CIT [2005] 273 ITR 353 (Cal), where the assessee had claimed at off of interest paid against interest received from short term deposits during the period, when the project was under construction. Apparently, the income itself was considered taxable under the head “Other sources”, so that the High Court had little difficulty in dismissing the assessee's claim on the ground that the borrowing was not for purpose of investment following the rationale of the decision in CIT v. Dr. V. P. Gopinathan [2001] 248 ITR 449 (SC). The claim that the interest could be allowed under section 36(1)(iii), though the business had not commenced was also bound to fail on the same reasoning and because there was no income to be assessed under the head “Business”. However, the case was argued from first principles with reference to later decisions especially that in CIT v. Bokaro Steel Ltd. [1999] 236 ITR 315 (SC).



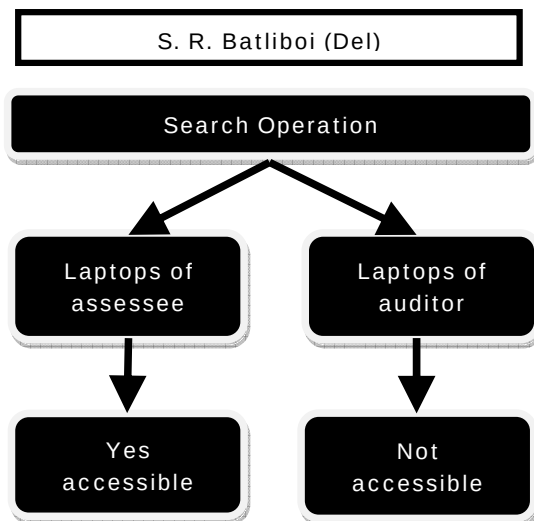
In this case the income was identified as “income from other sources”. Therefore, it had to be taxed only under the provisions of that head and deductions would not be available unless the amount for which deduction was claimed was eligible for deduction under the provisions of the said head. Income from other sources under section 56 is computed under section 57 where the eligibility for deduction is specified in no uncertain terms in clause (iii), which, does not qualify the amount of interest paid on the borrowed capital for acquiring the asset before it was first put to use. The purpose of the borrowing was construction of the project and the interest would have been paid even if it had not been invested. Therefore, this interest could not be said to have been laid out or expended for the purpose of earning the income and particularly when the interest paid was eligible for being capitalised it would not come within the purview of section 57(iii).

POWERS OF INCOME TAX AUTHORITY

Section / Topic Name : 119 to 132

AUDITOR PROTECTED IN SEARCH OPERATION

When it comes to the right of the seizure of laptop/computers belonging to auditors of the assessee the Delhi High Court in *S.R. Batliboi & Co. v. DIT (Investigation)* [2009] 181 Taxman 9 refuted the claim of the revenue that it is entitled to demand an unrestricted access to and/or right to acquire electronic records present in such laptops, that do not belong to the assessee itself including electronic records pertaining to third parties unconnected with the assessee. The Court made a point that the words 'other person' employed in section 158BD must only be construed as referring to the 'other person' having dealings or



transactions with the party who is being searched or whose material is being seized and not an auditor.

Upon consideration of the objects and scheme of search operations the Court in this case only by the consent of counsel for the parties directed the department to return the laptops. Subsequently, the Supreme Court in their decision dated August 17, 2009 directed that the two laptops-in-question be de-sealed and the data be examined by the Director General of the National Informatics Centre or his nominee/representative in the presence of the representatives of the Income-tax Department, the appellants and the EMAAR-MGF Group. All the data on the laptops shall be available for inspection by the Income-tax Department to verify whether the data pertains to the

assessee-in-question.

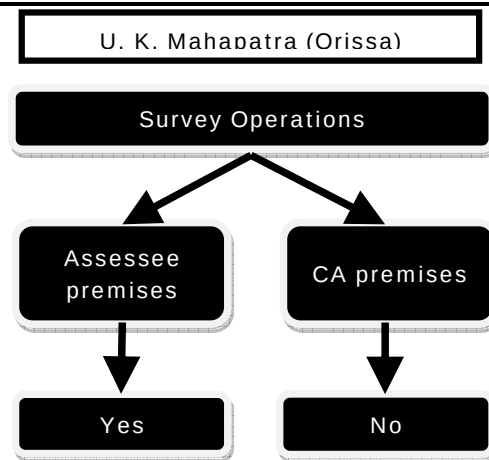
One fails to understand how the firm of such a stature would be writing or maintaining any day-to-day accounts of any client. It is wrong on the part of the revenue to insist on laptop screening of auditor for any books of account even if it is so desired by the assessee itself. This is sheer destruction of the independence of the auditor. The institute must do something about it immediately, else every time there is a search the auditor would be asked to surrender his laptop.

ILLEGAL SURVEY

In *CIT v. Kamal & Co.* [2008] 168 Taxman 246, the Rajasthan High Court held that that even materials collected during the course of an illegal search or survey can be used for making additions.

SURVEY AT CA/ADVOCATE PREMISES

The Orissa High Court in *U. K. Mahapatra & Co. v. ITO* [2009] 176 Taxman 293 held that an income-tax authority cannot assume any power to enter business premises/office of chartered accountant/lawyer/tax-practitioner to conduct survey under section 133A in connection with survey of premises of their client, unless the client, in course of survey, states that his books of account/documents and records are kept in office of his chartered accountant/lawyer/tax-practitioner.



ILLEGAL SEIZURE OF CASH DURING TRANSIT

In *Dr. D C Srivastava v. DIT (Investigation)* [2007] 162 Taxman 290, the doctor-petitioner at the airport security check made a declaration of cash amounting to Rs. 10 lakhs in his briefcase. After receiving the declaration form, the Customs Official made enquiries about the status of the petitioner and then he produced a photocopy of his PAN Card and informed the official concerned that the amount which he was carrying formed part of the income. Thereafter, on receiving information communicated by customs officials, the officers of the Income-tax Department, who introduced themselves as officers authorised by the DIT (Inv.), seized the cash. The action was challenged in writ for quashing warrant of authorisation issued under section 132(1).

The Allahabad High Court held that the authorisation issued in this case under section 132 was without jurisdiction. On the basis of information given by the officers of Customs Department to the effect that the petitioner had made a declaration of sum of Rs. 10 lakhs and had given his PAN number, income-tax department could not have entertained said information for initiating the proceedings under section 132(1). Said information could hardly be said to constitute information which could be treated as sufficient to believe that the amount of Rs. 10 lakhs was unaccounted money, which was not disclosed. or would not be disclosed Before taking any action under section 132, the condition precedent is information in the possession of the DIT (Inv.), which gives him reason to believe that a person is in possession of some article, jewellery, bullion or money, which represents wholly or partly his income which was not disclosed or would not be disclosed. If the aforesaid condition is missing, the Commissioner or the DIT (Inv.) will have no jurisdiction to issue the warrant of authorisation under section 132(1). The Court held that search and seizure cannot be a fishing expedition. Before search is authorised, the director must on the relevant material, have reasons to believe that the assessee has not or would not disclose his income. If the reason to believe comes into existence later, i.e., after issuance of the warrant of authorisation, the entire search and seizure will be illegal.

SCOPE OF NOT PRACTICAL

That the three fishing trawlers were found during the course of search on November 6, 1996, itself and the restraint order was passed in respect of the same mainly because it was not possible or practicable to take physical possession thereof and to remove the same to a safe place due to their volume, weight or other physical characteristics. Therefore, the restraint order ought to have been passed under the second proviso to section 132(1) and not under section 132(3) and there was a deemed seizure of the said trawlers making the lifting of the restraint order subsequently as well as preparation of panchnama totally irrelevant. The restraint order passed by the authorised officer under section 132(3) wrongly was utilised

by the Assessing Officer to circumvent the provisions of section 132(1). This was not permissible. [2007] 290 ITR (A.T.) 0128- Sarb Consulate Marine Products P. Ltd. v. Assistant Commissioner of Income-tax (Income-tax Appellate Tribunal--Delhi)

281 ITR 0199- HARIHAR SHAH VS. COMMISSIONER OF INCOME-TAX (GAUHATI HIGH COURT)

Search and seizure. Warrant of authorisation in the name of a particular person and there was a discovery of fixed deposits belonging to third person. Consequent to that search of bank premises and seizure of fixed deposits held to be not valid.

There was no satisfaction recorded by the authorised officer to the effect that the amount covered by the fixed deposit certificates was in any way relatable to D in respect of whom satisfaction as regards suppression or concealment of income had led to the initiation of search on the strength of the original warrant. In the absence of such satisfaction, the consequential warrant authorizing the search of the premises of the ANZ Grindlays Bank could not be held to be authorised under section 132. The action of the respondents in converting the property of the petitioner in the form of the fixed deposit certificates and the further action of the respondents in obtaining a bankers' cheque for the amount covered by the two certificates and the consequential deposit of the amount of the bankers' cheque into the account of the Commissioner were unauthorised actions. [The court directed refund of the amount by the Income-tax Department to the petitioner with interest at 11 per cent., the rate of interest on fixed deposits prevailing in the year 2000 for the period of 5 years for which money was illegally retained.]

282 ITR 0553- USHAKANT N. PATEL VS. COMMISSIONER OF INCOME-TAX (GUJARAT HIGH COURT)

The presumption regarding seized materials is that materials found during search belong to the person in possession and control of the premises under section 132(4A), but such presumption does not extend to the inference that the handwriting in the documents found is also that of the same person. No concealment could have been presumed on the basis of such inference under section 132(4A) of the Act.

The authorities and the Tribunal could have raised a presumption that the books had been recovered from the possession of the assessee (though disputed by the assessee), and belonged to the assessee and the contents thereof were true ; but from that, it did not necessarily follow that a presumption would arise as to the books or the documents being in the handwriting of the assessee. The Tribunal had not recorded any findings. Even if the presumption available under section 132(4A) of the Act could be raised against the assessee the ingredients, by way of prerequisite conditions of section 69 of the Act, had to be satisfied and could not be presumed to have been established on the basis of section 132(4A) of the Act simpliciter. The Tribunal was not justified in remanding the matter to the Commissioner (Appeals). It was necessary for the Tribunal to have dealt with the applicability of the provisions of section 69 together with the provisions of section 132(4A). [Matter remanded to the Tribunal.]

Although there is presumption but assessee's duty of section 68, 69 . . . can not be absolved.

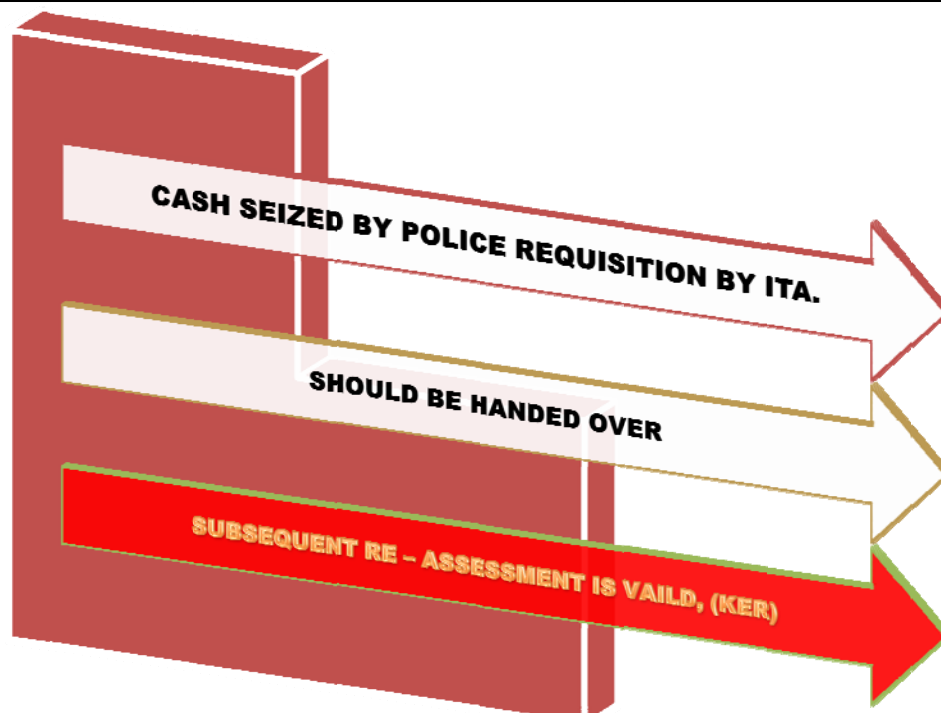
282 ITR 0435- DISTRICT SUPERINTENDENT OF POLICE, CHENNAI VS. K. INBASAGARAN (SUPREME COURT OF INDIA)

Where a search reveals cash or other assets, it is presumed to belong to the person in possession and control of the premises. It is not unusual that it may be under the joint control of more than one person. In such a case, the entire undisclosed income, if any, relating to the assets found, cannot be laid at the door of both or either of them without considering the probabilities as to to whom the income may relate. This was the issue considered in a case under the Prevention of Corruption Act, but the decision itself was the fallout of income-tax treatment in District Superintendent of Police, Chennai v. K. Inbasagar [2006] 282 ITR 435 (SC). The assessee was a public servant with his wife in business. The search by the Income-tax Department disclosed moneys disowned by the husband, while the wife admitted the same as her undisclosed income and paid tax thereon. The Supreme Court held that since the husband had disowned the assets and the wife had substantiated the same as her own with some corroborating evidence and the entire money was also assessed in the hands of the wife by the Income-tax Department, the husband could not be found guilty under the Prevention of Corruption Act, 1988.

282 ITR 0158- COMMISSIONER OF INCOME-TAX VS. DR. C. BALAKRISHNAN NAIR (KERALA HIGH COURT)

Where power is exercised bona fide, and in furtherance of the statutory duties of the tax officers, any error of judgment on the part of the officers will not vitiate the exercise of the power. Any irregularity in the course of entry, search and seizure committed by an officer acting in pursuance of the authorisation will not be sufficient to vitiate the action taken, provided the officer has in executing the authorisation, acted bona fide.

RAJIV AGARWAL OR SUCCESSORS (GUJ)

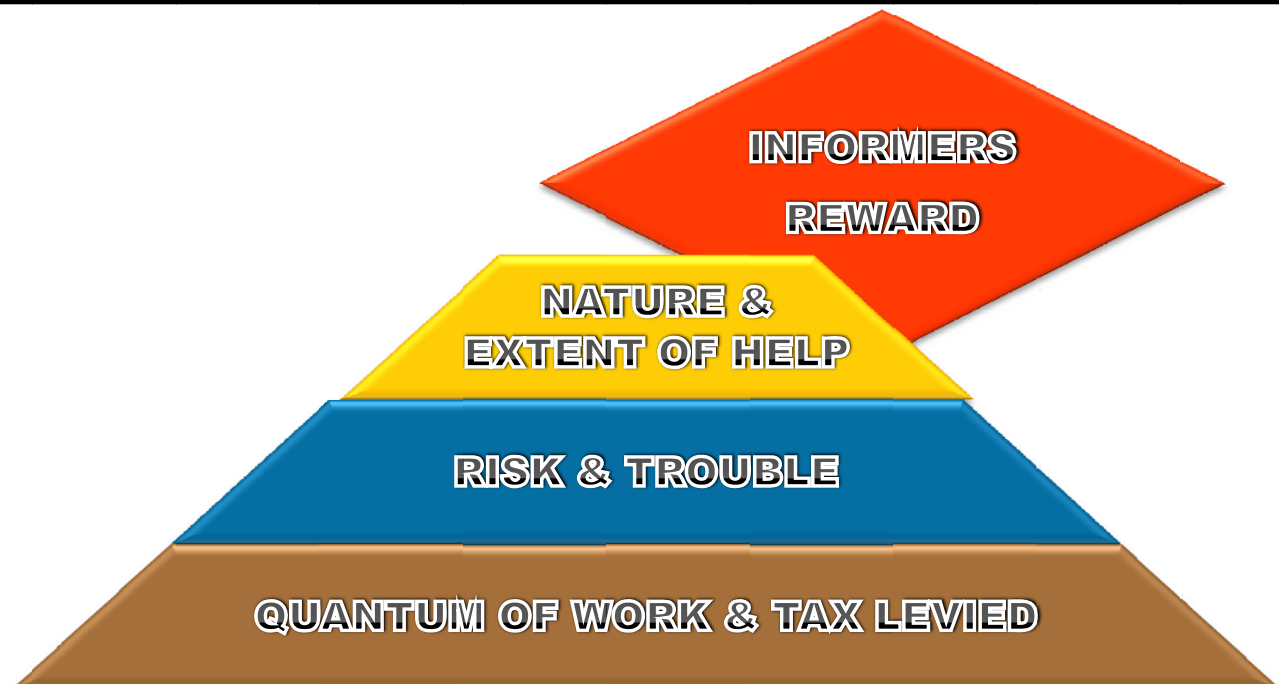


The Assessing Officer has the right to issue a prohibitory order, when a search could not be completed at one stretch on the same day. It is not unusual that a search is prolonged, so as to put pressure on the assessee and extort an admission of concealment. The time-limit itself has been prescribed for ensuring expeditious completion of searches. Where the assessee complained of prolonging the search beyond reasonable time of 15 days for which alone a prohibitory order should be available, a single judge held that it was irregular and invalid in *Dr. C. Balakrishnan Nair v. CIT* [1999] 237 ITR 70 (Ker). But the decision stands reversed by a Division Bench of the Kerala High Court in *CIT v. Dr. C. Balakrishnan Nair* [2006] 282 ITR 158 on the ground that, in the absence of any allegation of “ill-motive or malice” in the light of the explanation of the Income-tax Department, there was no arbitrary exercise of power in contravention of section 132(3). It is indeed extremely difficult for the taxpayer to prove mala fides, since the law would assume that all official acts are bona fide done in accordance with law placing the burden on the taxpayer. In view of the widespread complaints of excessive use of search powers, there should be an administrative remedy like an ombudsman, so that there could be immediate relief, where the assessee has a reasonable grievance, which he can air at the relevant time. After all, search provision itself has been held to be valid only because of various safeguards provided for the searched party under the Act.

288 ITR 0578- E. SANKARAN VS. UNION OF INDIA (KERALA HIGH COURT)

The authority competent to grant the reward for a tax informer is required to keep in mind the following circumstances : (a) the accuracy of the information given by the informant ; (b) the extent and nature of the help rendered by the informant ; (c) the risk and trouble undertaken and the expense and odium incurred by the informant in securing and furnishing the information and documents ; (d) the quantum of work involved in utilising the information furnished and in making the assessment ; (e) the quantum of extra taxes levied and actually realised or realisable which are directly attributable to the information and

E. SANKARAN (KER)



documents supplied by the informant : the quantum of extra taxes realisable will be determined only after all the assessments have become final and no appeal, etc., is pending or filed and the time for filing of appeal has expired ; (f) in cases where the information led to recovery of otherwise irrecoverable taxes,

the facility with which such taxes could be recovered as a result of the information. Upon directions of the court the petitioner's case was considered and the reward given to him was Rs. 1,50,000. Held, that the entire case of the petitioner was considered and the various aspects on the basis of which reward was due were considered. The committee had taken a proper and just decision on the facts and circumstances. Moreover this was not a matter in which the High Court, in exercise of writ jurisdiction, was to adjudicate as if it were sitting in appeal against the said decision.

288 ITR (A.T.) 0106- JOINT COMMISSIONER OF INCOME-TAX VS. INVESTMENT TRUST OF INDIA LTD. (PRESENTLY KNOWN AS HFCL INFOTEL LTD.) (INCOME-TAX APPELLATE TRIBUNAL--CHENNAI)

Sale and lease back transactions have been suspect. In fact, the amended Accounting Standards on the one hand and the depreciation rule, which binds the purchaser to the written down value of the seller on the other would take away the tax advantage of sale and lease back transactions. Controversies continue in respect of earlier transactions. Genuine sale and lease back transactions cannot be dismissed as mere financial transactions by ignoring the legal effect of such finance lease. It is also not necessary that the lessee should have put the asset to use because the very fact that it is leased out in the course of business would be sufficient to satisfy the condition of use for depreciation purposes.

The decision of the Tribunal in Joint CIT v. Investment Trust of India Ltd. [2007] 288 ITR (AT) 106 (Chennai) is consistent with the law on the subject. It is a third member case, where there had been differences on every issue, with the third member agreeing with one or the other. The majority decided that in a genuine case, depreciation is admissible.

One of the issues related to an objection to depreciation on the boiler ammonia plant embedded to earth on the ground, that it would be immovable property, which cannot be transferred without a registered instrument. The Tribunal found that a plant, merely because it is installed in the earth, does not cease to be movable property. In respect of one of the other transactions in the group of three cases dealt with, the matter was remanded for further enquiry.

290 ITR 0449- RAJIV AGRAWAL OR HIS SUCCESSOR IN OFFICE VS. STATE OF GUJARAT (GUJARAT HIGH COURT)

Cash amounting to Rs. 20 lakhs was seized by the police from two persons. The police informed the Income-tax Department about the seizure. On the basis of the information, enquiry was made under section 131 of the Income-tax Act, 1961. The Income-tax Department found that no satisfactory explanation was given regarding the amount by the two persons. Respondent No. 2 submitted an application under section 451 of the Code of Criminal Procedure and prayed that the cash amount of Rs. 20 lakhs seized by Athawa police be handed over to him as it was seized from his possession and police had not made any report that the amount was received through illegal activities. The Deputy Director of Income-tax also made a claim for the seized amount not only pending the conclusion of the criminal trial of the case but also in connection with the income-tax proceedings. The magistrate ordered that Rs. 14 lakhs should be handed over to the second respondent and the remaining Rs. 6 lakhs be handed over to the Deputy Director of Income-tax and he imposed certain conditions. Held, that the lower court had ignored the provisions of the Income-tax Act. Hence, the order passed by the judge was required to be set aside. [The police authority was ordered to hand over the amount of Rs. 20 lakhs to the applicant forthwith.]

RETURNS OF INCOME

Section / Topic Name: 139/140

DOCTRINE OF RELATION BACK-IRREGULARITY IN THE ORIGINAL RETURN

The Delhi High Court in CIT v. Haryana Sheet Glass Ltd. [2010] 188 Taxman 7 held that signing of return by secretary is a curable irregularity and, therefore, in this case when managing director had signed and filed revised return, it should relate back to date when original return was filed under signature of company secretary.

On the other hand, the doctrine of relation back would lack application where original Income-tax return filed was unsigned and unverified. In these circumstances, it would be treated as an invalid return vide judgment of the same Court in the case of Electrical Instrument Co. v. CIT [2001] 250 ITR 734/116 Taxman 807 (Delhi).

SIGNING OF RETURN, APPEALS ETC.

The Punjab & Haryana High Court in Hind Samachar Ltd. v. Union of India [2008] 169 Taxman 302, held that return of income is mandatorily to be signed by the managing director of the company and in his absence, by any director thereof. In this case, the return was signed by an employee under an authority from the board of directors. The return was treated as defective. Even a return signed by an executive director would not hold good if there is a Managing Director in the company.

272 ITR 0309- PT. LASHKARI RAM VS. CIT (ALLAHABAD HIGH COURT)

Officer called for some information of assessee say pass book, and some investment in to assets. Assessee appeared before him on the next day. Assessment order was passed in the notice of demand issued under section 156 of the Act on the next day of the hearing. From a perusal of the order, it was clear that it was not a speaking order. Moreover, no reasons had been assigned. In the assessment order it had also not been mentioned that earlier the assessee was asked to furnish certain details and the assessee had furnished those details by filing a revised return. There was no mention of the details, which had been furnished by the assessee. The order of revision was valid.

SCRUTINY ASSESSMENT

Section / Topic Name : 141 to 144

SCOPE OF PRIMA-FACIE ADJUSTMENT

Section 143(1)(a) of the Income-tax Act, 1961, mandates that on processing the return by following the procedure prescribed therein, if it is found that any tax or other amount is due from the assessee or any refund is due to the assessee, an intimation has to be sent to the assessee. Apart from correction of arithmetical errors in the returns, accounts or documents accompanying the same, the Assessing Officer in the course of processing of the returns is authorised under clause (iii) of the first proviso to section 143(1)(a) to grant prima facie admissible deductions and allowances or set off of carried forward loss claimed by the assessee. The Act is silent as to which are the items of allowances and deductions that could be disallowed as prima facie inadmissible. However, Circular No. 689 dated August 24, 1994 (see [1994] 209 ITR (St.) 75), issued by the Central Board of Direct Taxes among other things states that claims which are patently inadmissible in law could be disallowed under clause (iii) of the first proviso to section 143(1)(a). [2007] 291 ITR 0262- A. I. Kurian v. Commissioner of Income-tax (Kerala High Court)

The return is always accompanied by a statement of computation of income and tax liability which would certainly show the head of income under which income is computed claiming deductions and allowances. The Assessing Officer should therefore consider the prima facie admissibility of a claim with reference to the relevant provisions applicable to the head of income under which the income is declared. If the statute expressly prohibits the allowance or deduction claimed, then the claim is patently inadmissible in law so much so, it is within the powers of the officer to disallow the claim under the clause. On the other hand if the claim of deduction or allowance is maintainable under any provision of the Act, the disallowance whether in full or in part, calls for adjudication and in that event, the officer cannot disallow the claim as one prima facie inadmissible. [2007] 291 ITR 0262- A. I. Kurian v. Commissioner of Income-tax (Kerala High Court)

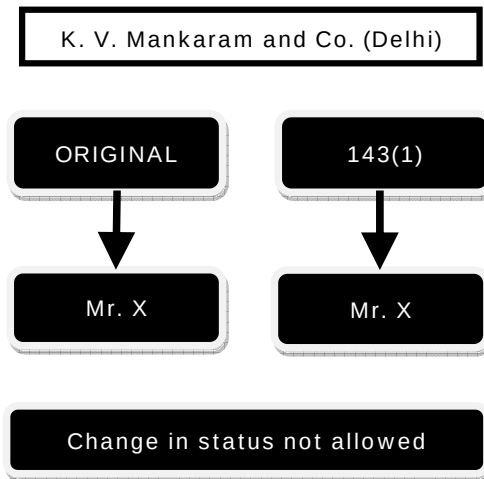
[2008] 300 ITR (A.T.) 0108- Herbert Smith v. Deputy Director of Income-tax (International Taxation) (Income-tax Appellate Tribunal--Delhi) The assessee filed a return of income in the status code "04" on October 1, 2002, declaring total income of Rs. 26,16,700. The tax payable, after taking into account tax deducted at source, advance tax and self assessment payments, was worked out at nil. The Assessing Officer processed the return under section 143(1) of the Income-tax Act, 1961, and levied tax at 35 per cent., applicable to "04" status against the tax rate of 30 per cent. applied by the assessee. The assessee filed an application under section 154 of the Act requesting inter alia computation of tax at 30 per cent. This application was rejected by the Assessing Officer and this was upheld by the Commissioner (Appeals). On appeal to the Tribunal : Held, that the processing under section 143(1) can be done on the basis of the return only. The Assessing Officer is not empowered to make any alteration in the income or status without making inquiry which cannot be done in such processing. Past records regarding status can also be not taken into account. The return as a whole was ambivalent about the status of the assessee as at other places it was described as a "firm". This ambivalence could only be resolved by questioning the assessee failing which a favourable view to the assessee ought to have been adopted in applying the rate of tax. The Assessing Officer could not have changed the rate of tax on the peculiar facts of this case.

CHANGE OF STATUS NOT PERMISSIBLE IN 143(1)

The scope and ambit of the powers vested in the Assessing Officer for making prima facie adjustments at the time of processing the return under section 143(1)(a) of the Income-tax Act, 1961, are very limited. The assessee-trust filed its return for the assessment year 1995-96. While processing the return under

section 143(1)(a) the Assessing Officer found that the claim of the assessee for exemption under section 11 of the Act was not allowable in the absence of registration certificate. Hence, the Assessing Officer proceeded with the computation of total income under section 143(1)(a) of the Act and treated the status of the trust as an association of persons and all the income for the assessment year was treated as an association of persons and was taxed accordingly. The Assessing Officer changed the status of the assessee from trust claimed in the return to an association of persons. The Tribunal set aside the order. On appeal to the High Court : Held, dismissing the appeal, that the change of status of the

assessee from trust to an association of persons was not covered in the nature of adjustments mentioned in any of the provisos to section 143(1)(a) much less under the proviso (iii) of the said section. It was immaterial that the trust was not registered with the Commissioner and was not eligible for the exemption under section 11. *Samtel Color Ltd. v. Union of India* [2002] 258 ITR 1 (Delhi) and *CIT v. K. V. Mankaram and Co.* [2000] 245 ITR 353 (Ker) followed.



ISSUE OF NOTICE ON LAST DAY OF LIMITATION

The Delhi High Court in *CIT v. Inderpal Malhotra* [2008] 171 Taxman 359 held that a notice issued by registered post on the last day of the period of limitation is invalid. The Court explained that the statute requires actual service and not mere despatch or issuance of the notice and, thus, in such a case service by hand on the last day would have been the only escape.

INFLATED AGRICULTURAL INCOME

In *Smt. Kusum Sharma v. CIT* [2007] 158 Taxman 303 (Punj. & Har.), the assessee inflated sale of agricultural produce and she was asked to produce evidence of sale of such produce. Such evidence was disbelieved since it was managed and non-genuine. Even the assessee did not made claim for expenditure on account of authorities. The Assessing Officer however made assessment of agricultural income based on revenue records instead which attained finality.

GUESS WORK

The Supreme Court in *Kachwala Gems v. Jt. CIT* [2007] 158 Taxman 71 held that in a best judgment assessment there is necessarily some amount of guess work and it is the assessee himself who is to be blamed as he did not submit proper accounts. In this case the following cogent reasons were given for rejection of books of account to the acceptance of the Apex Court:

- (a) The assessee had not maintained and kept any quantitative details/stock register for the traded goods;
- (b) There was no evidence on record or document that formed basis of valuation of stock;
- (c) GP rate in comparable cases was found to be high.

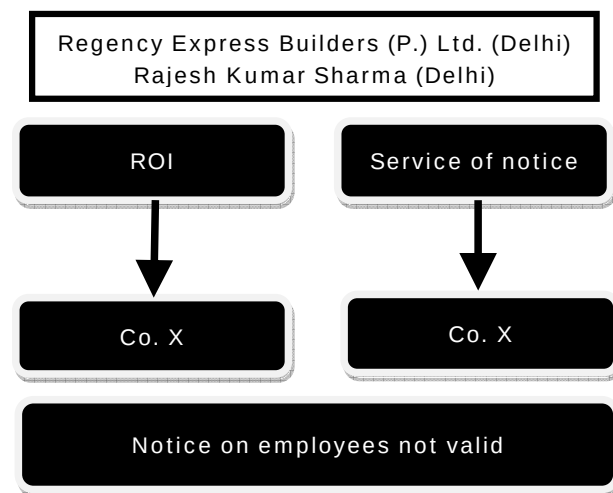
Accounting does not consist merely of tally of cash transactions. There should be similar tally of goods

handled in the business. If the goods in the opening stock and purchases do not match the aggregate of sales and closing stock, there is need for explanation. It is for this reason that the Assessing Officer would insist upon a stock account to enable verification as to whether there is a tally. It will not be possible in certain lines of trade like retail grocery or hardware to keep item-wise stock account, so that the financial result is not capable of verification. But then, if the gross profit is reasonable in comparison with similar other trade, the books may still be acceptable. Where it is not so comparable, the discrepancy may well be added or income estimated by way of additional gross profit at comparable rate either on purchases or sales, which may again be estimated unless proved. Such computation is generally described as best judgment assessment. The law in this regard is well-established.

A case of best judgment assessment came before the Supreme Court in *Kachwala Gems v. Jt. CIT* [2007] 288 ITR 10, wherein the Assessing Officer found that the assessee did not keep stock account. The valuation of the closing stock was also not acceptable. Purchases to the extent of Rs. 42 lakhs were not proved beyond doubt. The gross profit of 14 per cent. was low compared to 35 per cent. and 44 per cent. in similar cases. The Assessing Officer had adopted 35 per cent. gross profit, while the first appellate authority reduced it to 30 per cent., which was confirmed by the Tribunal. The assessee's appeal was dismissed by the High Court at the admission stage itself, so that the assessee took up the matter in the Supreme Court. It was urged that the inference of bogus purchases was not justified. The Supreme Court found that whether the purchases made were bogus or not, there were other reasons for making a best judgment. Apparently, the major one was lack of stock account. The law expects stock reconciliation as a basic accounting requirement for the inference of acceptability.

In *Bimal Kumar Anant Kumar v. CIT* [2007] 288 ITR 278 (All), it was held that, where the profits are much lower than in similar other businesses and the assessee does not maintain a stock register, rejection of accounts and the estimate of income cannot be avoided.

SERVICE OF NOTICE TO EMPLOYEE



In the case of *CIT v. Regency Express Builders (P.) Ltd.* [2007] 161 Taxman 1 (Delhi), the assessee for the first time before the Commissioner (Appeals) claimed that no notice as required under the law had been served upon it or any of its authorized agents. The Delhi High Court, however, found that there had been appearance by a Chartered Accountant/his Assistant seeking an adjournment which fact showed that notice u/s 143(2) had been duly served on the assessee. It held that such a plea did not hold water when the assessee raised no objection in its first place before the Assessing Officer and also joined in the proceedings.

SEIZURE OF THIRD PARTY DOCUMENTS

In *CIT v. Ram Kumar* [2007] 163 Taxman 253 (Punj. & Har.), the Assessing Officer made an addition on the basis of a document seized from a third party. The Punjab and Haryana High Court had to order deletion of addition on two counts, firstly, for the reason that the Assessing Officer did not confront the assessee with the seized document and secondly, such document was not seized from the assessee's possession.

In *CIT v. S. Muthukarupani* [2007] 163 Taxman 45, the Madras High Court held that it would be travesty of justice if the assessee, one of the co-owners was solely picked out and an enhanced income was

attributed in his hands for the same property whereas in case of other five co-owners, returned income from same property had not been disturbed.

SERVICE OF NOTICE TO EMPLOYEE

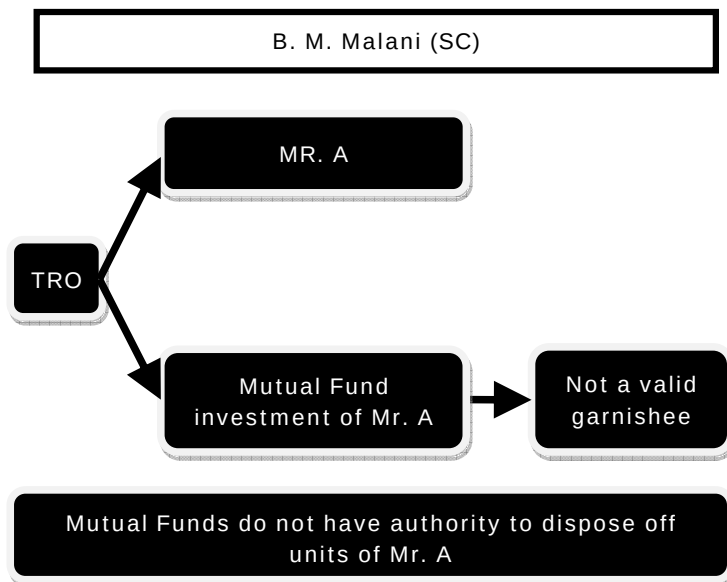
The Delhi High Court in CIT v. Rajesh Kumar Sharma [2007] 165 Taxman 488 held that receipt of the notice by employee is not receipt of the notice by the assessee unless he is authorized to receive any summons on behalf of the assessee.

TAX RECOVERY AND GARNISHEE PROCEEDING

A show cause notice should be required in every case of a garnishee order. It was so held in Mahindra and Mahindra Ltd. v. Assessing Officer [2007] 295 ITR 42 (Bom). It would appear that what is necessary is that there should be a formal hearing before the garnishee proceedings are enforced. In KEC International Ltd. v. B. R. Balakrishnan [2001] 251 ITR 158 (Bom), the moneys coercively collected from the bank, it was found, should be returned in the matter of an excise demand. But the moneys were not returned, so that the assessee had to approach the court again, since its accounts were frozen. There was no indication of readiness to restore the money, illegally collected. This action, it was pointed out by the High Court, shocked its judicial conscience as it gives a total go-by to the rule of law. The High Court, therefore, directed the deposit of an identical amount so collected with the Registrar-General of the court and expected its direction to be carried out, the direction “having been pronounced loudly in the open court” in the presence of counsel for the Government and the concerned Chief Commissioner.

RECOVERY FROM MUTUAL FUND – GARNISHEE PROCEEDING

Garnishee proceedings of the Unit Trust of India (UTI) is essentially one of attachment. In the case of units of mutual funds and the UTI, handing over the proceeds to the unitholder on redemption is barred. Even where the authorities ask for such redemption, the UTI is not justified in redeeming them without the consent of the holder of the units. The UTI had no authority to dispose of the units on its own without any notice to the holder of the units. The UTI could not have ignored the terms of its contract with the unit-holder. The assessee was meanwhile making arrangement for payment of tax, while the units remained under attachment as security for the Government. The Supreme Court in Administrator, Unit Trust of India v. B. M. Malani [2008] 296 ITR 31, reversing the order of the High Court held that the assessee was entitled to the value of the units along with dividend during the period from the date of their allotment to the date of discharge of the garnishee proceedings, because the assessee was entitled to be restituted. This kind of mistakes occur in the case of garnishee proceedings, since the authorities persuade or pressurise especially the banks to foreclose fixed deposits before maturity without notice or consent or discharge certificate of the deposit-holder. It is necessary that the authorities must know the limits of their powers and should not act over-zealously to the detriment of the taxpayer's interest, when the arrear collection is not in jeopardy. The Supreme Court endorsed in this



case, the decision of the Karnataka High Court in Vysya Bank Ltd. v. Joint CIT [2000] 241 ITR 178, where it was pointed out that the amount under attachment becomes payable only on maturity, so that foreclosure, if any, should be treated as ineffective and the deposit-holder restituted for the interest otherwise receivable by it.

271 ITR 0337- COMMISSIONER OF INCOME-TAX VS. VIJAY KUMAR RAJENDRA KUMAR AND CO. (MADHYA PRADESH HIGH COURT)

All that section 142(2A) of the Act requires is that the Assessing Officer should get prior approval of the Chief Commissioner or the Commissioner for directing special audit. Hence, the arguments of the assessee that the special audit without a show cause notice to the assessee would be invalid and that the assessment, which was made within the extended time in special audit cases would, therefore, be time-barred, were dismissed by the High Court in CIT v. Vijay Kumar Rajendra Kumar and Co. [2004] 271 ITR 337 (MP). It was pointed out by the High Court, that the real issue is whether the accounts are complex in nature, an inference, which may well be subjective. The word “complex” is not defined, so that it has to be given wide and liberal meaning.

In deciding whether a special audit is required it is the subjective satisfaction of the authority concerned to decide on the basis of the material on record, as to whether the accounts are complex in nature, or not. The word “complex” is not defined in the Act and, hence, it has to be given its wide and liberal meaning. Held, that, in the facts and circumstances of the case, the Assessing Officer was justified in issuing a direction for special audit under section 142(2A) of the Income-tax Act, 1961, and the time taken in special audit had to be excluded. The assessment was made within limitation.

271 ITR 0466- SMT. RITU DEVI VS. COMMISSIONER OF INCOME-TAX (MADRAS HIGH COURT)

The Department served notice dated March 30, 2000, on the petitioners only in the afternoon of that day. However, the petitioners were directed to forward their comments so as to reach the office by 10.30 a.m. on the very next day. The petitioners requested time for submitting their reply but assessment was completed without giving an opportunity to forward their comments. Appeal against the order of assessment was also dismissed by the appellate authority. Held, allowing the petitions, that it was apparent on the face of the record that the petitioners had not been given proper opportunity to submit their reply and there was a gross violation of the principles of natural justice. Hence the assessment orders were quashed with liberty to the income-tax authorities to proceed afresh by issuing fresh notice, giving sufficient time for the petitioners to submit their reply and proceed further in accordance with law.

291 ITR 0055- COMMISSIONER OF INCOME-TAX VS. REGENCY EXPRESS BUILDERS P. LTD. (DELHI HIGH COURT)

No assessment can be made without a notice under section 143(2) served within the specified time. In what manner the notice should be worded is not important as long as such notice in substance is given before assessment giving opportunity to the assessee to prove the income returned by him. It was the view taken by the High Court in CIT v. Regency Express Builders P. Ltd. [2007] 291 ITR 55 (Delhi), where a formal notice under section 143(2) was served on someone named Gunanand, who, according to the assessee was not its representative, but all the same the assessee’s authorised representative, a chartered accountant, did attend the hearing on the date specified in the notice and responded to the other

requirement of the Assessing Officer by furnishing various information. During the next hearing also, a chartered accountant accompanied by the assessee's employee did attend and ask for adjournment. It was finally heard in the presence of the assessee's representative and the order was passed under section 143(3). It is under these circumstances, the Tribunal was faulted by the High Court for having cancelled the assessment merely on the ground that the original service of notice on Gunanand was invalid ignoring the subsequent development. Further, there was no assertion at any stage that Gunanand was not an employee or was a fictitious person. The High Court, therefore, sent the matter back to the Tribunal for entertaining the appeal on the merits.

290 ITR (A.T.) 0061- FATEH INTERNATIONAL VS. DEPUTY COMMISSIONER OF INCOME-TAX (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

Where a notice under section 143(2) is issued, the assessment is expected to be completed within the time limit set for such completion. Having failed to complete the assessment within such time, it is not open to the Assessing Officer to issue fresh notice under section 148 by giving himself extra time for such completion. The Tribunal in Fateh International v. Deputy CIT [2007] 290 ITR (AT) 61 (Mum) found that reassessment proceedings so completed beyond the time limit with reference to first notice were invalid ab initio and required to be cancelled. It, inter alia, relied upon the decision of the Calcutta High Court in Mohindra Mohan Sirkar v. ITO [1978] 112 ITR 47 and CIT v. Rajendra G. Shah [2001] 247 ITR 772 (Bom). In the latter case, the Assessing Officer lost sight of all the pending proceedings and issued a fresh notice. Since the assessment was not completed within time with reference to the initial notice, the assessment was found to be bad in law.

287 ITR 0370- COMMISSIONER OF INCOME-TAX VS. BHAN TEXTILES P. LTD. (DELHI HIGH COURT)

There is a clear distinction between "issuance of notice" and "service of notice". Held, that the assessee had filed the return on November 20, 1996, and the time stipulated under the proviso to section 143(2)(ii) of the Income-tax Act, 1961, for service of notice expired on November 30, 1997. Notice under section 143(2) though issued on November 27, 1997 and dispatched on November 28, 1997, was actually received by the assessee only on December 1, 1997. According to this provision, the notice must be served on the assessee. Therefore, the assessment was not valid. CIT v. Vardhman Estate P. Ltd. [2006] 287 ITR 368 (Delhi) followed.

271 ITR 0073- INDIAN ALUMINIUM CO. LTD. VS. UNION OF INDIA (CALCUTTA HIGH COURT)

It has been held positively that intimation under section 143(1)(a) is not a substitute for scrutiny under section 143(2). All the same, where both the notices are issued on the same date, there is redundancy, which was held to be not authorised by law in Indian Aluminium Co. Ltd. v. Union of India [2004] 271 ITR 73 (Cal). The High Court found that there is some conflict in case both the steps are taken together, because of demand notice in pursuance of intimation, while section 143(2) is meant for ascertaining the tax liability for the year. It is settled law that notice under section 143(2) can be issued subsequent to intimation. It is also settled law that, once notice under section 143(2) has been issued, no intimation is possible as was held in CIT v. Gujarat Electricity Board [2003] 260 ITR 84 (SC). Where both the notices are issued on the same date, the intimation issued would not be valid.

260 ITR 0084- CIT VS. GUJARAT ELECTRICITY BOARD (SC)

It is not open to the Revenue to issue intimation under section 143(1), after notice for regular assessment is issued under section 143(2). The Legislature intended that where the summary procedure under section 143(1) has been adopted, there should be scope available for the Revenue, either suo-moto or at the instance of the assessee, to make a regular assessment under section 143(2). The converse is not available. Where a regular assessment proceeding having been commenced under section 143(2), there is no need for a summary proceeding under section 143(1).

255 ITR 0268- LIVING MEDIA LTD. VS. COMMISSIONER OF INCOME-TAX (SUPREME COURT OF INDIA)

The assessing authority while issuing the impugned order of special audit formed an opinion that the order was necessary in view of the nature and complexity of the accounts of the assessee. On his own showing, the petitioner has filed voluminous details running into approximately 500 pages to explain the queries raised by the Assessing Authority. Further details running into about thousand pages were also filed by the assessee before the assessing authority. This prima facie supports the formation of the opinion by the assessing authority for conducting special audit under section 142(2A) of the Act.

267 ITR 0345- WEST BENGAL STATE CO-OPERATIVE BANK LTD. VS. JOINT COMMISSIONER OF INCOME-TAX (CAL)

Special audit cannot be ordered in a routine manner. The Assessing Officer should examine the books of account and form an opinion, that the accounts are complex and require special audit. The Commissioner too should apply his mind before according sanction. An inference that a special audit is required cannot be lightly formed, where the accounts of a co-operative bank has already been subject to co-operative audit. It is in this context that the order requiring special audit was found to be not valid in West Bengal State Co-operative Bank Ltd. v. Joint CIT [2004] 267 ITR 345 (Cal). In coming to this conclusion, the High Court reviewed a number of decisions. After analysis of the decisions, the High Court found that there should have been an examination of the accounts prior to his conclusion that the accounts are complex and require special audit. Where the accounts have not been examined at all, an inference of such complexity by mere allegation of a possible accounting jugglery cannot be entertained as a basis for such an order. In a number of cases, allegations, sometimes without basis, are made and special audit is ordered, merely to get an extended time limit for completion of the assessment. In other times, the Assessing Officer would like to avoid the responsibility of examining the accounts, even where there is no complexity involved.

280 ITR 0100- U. P. FINANCIAL CORPORATION VS. JOINT COMMISSIONER OF INCOME-TAX (ALLAHABAD HIGH COURT)

Special audit under section 142(2A) is a matter of discretion on the part of the Chief Commissioner/Commissioner of Income-tax, so that a writ would not lie against the order directing special audit, where the approval is granted after application of mind in pursuance of the guidelines issued by the Central Board of Direct Taxes. Where the assessee himself is unable to furnish information required and would need several months to comply while discrepancies in the accounts have been pointed out by the statutory auditors, the special audit in such circumstances cannot be questioned as held in U. P.

Financial Corporation v. Joint CIT [2006] 280 ITR 100 (All). The same view was taken in Jharneshwar Nagrik Sahakari Bank Maryadit v. Union of India [2006] 280 ITR 339 (MP), where the assessee had not responded to the return issued under section 158BC in pursuance of search and seizure disclosing unaccounted moneys, with the accounts themselves being found complex. The opinion formed in such a case cannot be said to be improper.

280 ITR 0339- JHARNESHWAR NAGRIK SAHAKARI BANK MARYADIT VS. UNION OF INDIA (MADHYA PRADESH HIGH COURT)

There was an allegation of “benami transactions” made by S and its director of a co-operative bank. They were using the assessee-bank for depositing their unaccounted money in benami names. Search operations had been carried out in the head office and four branches. In spite of being required, the assessee had not filed a return for the block period and had not produced the account books. The large number of papers which were seized from the bank had been found to be complex in nature. The opinion formed inter alia on the basis of the seized and impounded material to appoint an auditor under section 142(2A) could not be said to be improper in the peculiar facts of the case. The direction was valid.

269 ITR 0563- SAHARA INDIA MUTUAL BENEFIT CO. LTD. VS. COMMISSIONER OF INCOME-TAX (ALLAHABAD HIGH COURT)

The assessee petitioner had more than 1,200 branches and a large number of depositors disclosed the complexity of the accounts. It was a matter of satisfaction of the authorities concerned and they had arrived at a definite conclusion on the basis of available material and exercised their powers under section 142(2A). It was the duty of the petitioners to have got their accounts audited by the chartered accountant and placed the audit report before the income-tax authorities. The petitioners should not worry about the audit of accounts, because the auditor who was a chartered accountant would examine the relevant account books and submit his report thereafter. The petitioners shall be given an opportunity to show cause against the same and only thereafter the assessment shall be made.

282 ITR 0395- WELSPUN INDIA LTD. VS. ASSISTANT COMMISSIONER OF INCOME-TAX (BOMBAY HIGH COURT)

Assessee requested extension of time to submit special audit report of section 142(2A). Subsequently filed writ petition challenging order for special audit. Decided that such writ petition is not maintainable.

283 ITR 0056- ATLAS COPCO (INDIA) LTD. VS. V. S. SAMUEL. ASSISTANT COMMISSIONER OF INCOME-TAX (BOMBAY HIGH COURT)

The law makers while enacting section 142(2A), empowered the Assessing Officer to direct the assessee to get the accounts audited by a special auditor. The Legislature, to ensure that such power is not abused, provided safeguards. For forming an opinion as to whether it is necessary to have the accounts of the assessee audited by a special auditor, the Assessing Officer has to have regard to the nature of complexity of the accounts of the assessee and the interests of the Revenue. After forming such opinion, he has to seek the approval of the Chief Commissioner or the Commissioner, as the case may be, before any direction is issued to the assessee to have his accounts audited by a special auditor. This by itself is a vital safeguard in preventing abuse of power. Such order does not entail any civil consequences. No decision is given. Merely because the assessee is required to pay the auditor's fee, that does not mean that any

liability is created against the assessee. The audit by the special auditor, in the circumstances, is a step for the completion of the assessment proceedings and, therefore, there is no substance in the contention that the confidential documents shall be disclosed to third party. The assessee is not required to be heard before passing an order under section 142(2A).

It was admitted by the assessee in the proceedings on September 20, that the transaction with U was very complicated and the matter needed to be considered with regard to the provisional agreement which also contained the non-compete agreement. Various queries that were raised by the Assessing Officer were not fully answered by the assessee. This aspect was reflected from the proceedings dated September 20. That there was complexity of accounts was evident from the consideration of the matter by the Assessing Officer and the Chief Commissioner of Income-tax. The order dated September 11, giving direction to the assessee for special audit under section 142(2A) did not suffer from lack of jurisdiction or error of law. It was valid.

284 ITR 0323- GOETZE (INDIA) LTD. VS. COMMISSIONER OF INCOME-TAX (SUPREME COURT OF INDIA)

It is possible for an assessee to claim relief, which he had omitted to claim in the return of income by filing a revised return, if it is in time. Where he had failed to file such revised return in time, he cannot circumvent the requirement by merely filing a letter asking for relief. This is what was decided in Goetze (India) Ltd. v. CIT [2006] 284 ITR 323 (SC). If the Assessing Officer had issued notice under section 143(2), such a request could have been made even by a letter or for that matter orally during the hearing. But apparently in this case before the Supreme Court, the assessment was not pending. In view of the present system of acceptance of return without scrutiny (i.e. intimation), except in those cases specifically chosen, the taxpayer would be bound by the return. If he is not careful enough to make all claims for deductions in the return itself or within the time available for filing a revised return, he has himself to blame.

The Supreme Court dismissed the appeal, making it clear that the decision was restricted to the power of the assessing authority to entertain a claim for deduction otherwise than by a revised return.

281 ITR 0001- COMMISSIONER OF INCOME-TAX VS. LUNAR DIAMONDS LTD. (DELHI HIGH COURT)

Notice under section 143(2) has to be served within the time specified in the statute. This is a threshold requirement for a valid assessment. Where the assessee claims that he has not received the notice, it is for the Revenue to prove such service. The mere fact that notice was sent by registered post, is not sufficient when there was no acknowledgment of such service, so that the Tribunal's order setting aside the assessment on the basis of an affidavit from the assessee that he has not received the same within the prescribed time-limit, was upheld by the Delhi High Court in CIT v. Lunar Diamonds Ltd. [2006] 281 ITR 1.

270 ITR (A.T.) 0189W RAMESH CHAND GUPTA VS. INCOME-TAX OFFICER (INCOME-TAX APPELLATE TRIBUNAL--LUCKNOW)

The case of the assessee, engaged in the business of civil construction, was selected for scrutiny under section 44AD and notice under section 143(2) was served on the assessee. After availing of several

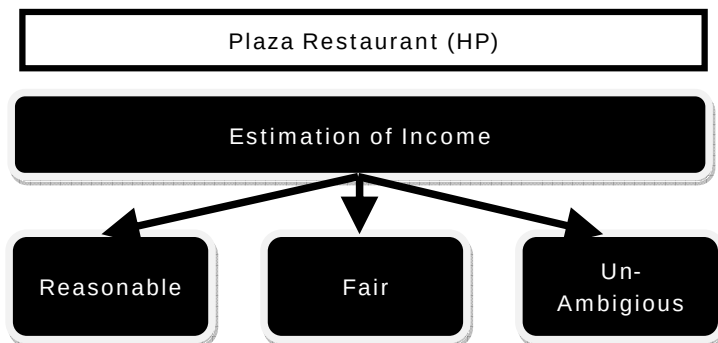
adjournments to produce books of account, the assessee filed a revised return. Based on the revised return, his assessment was completed under section 143(3) of the Act. Held that such assessment was validly done in light of revised return validly filed. Although there should be no penalty for such bonafide revision in course of the assessment.

METHOD OF ACCOUNTING

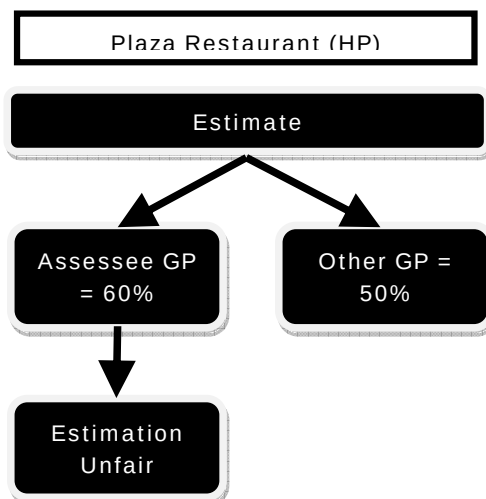
Section / Topic Name : 145

SALES ESTIMATION-RESTAURANT BUSINESS

The Himachal Pradesh High Court in *New Plaza Restaurant v. ITO* [2009] 183 Taxman 33 held that the Assessing Officer is bound to follow the same yardstick for similar sorts of business; and when it does not follow a uniform practice and applies different yardsticks in similar cases, then such action would be hit by article 14 and becomes arbitrary and capricious. In this case, the Assessing Officer/CIT estimated the sales at 2.5 times the value of the raw material purchased by the assessee whereas in the parallel cases of two other restaurants the sales were estimated at 2.2 times multiple and, thus, the assessee challenged such premise. The Court brushed aside the reasoning given in this regard altogether that in respect of over the counter sales in case of one such comparable restaurant for sweet items, the consumption of the raw materials was bound to be on the lower side.



In *CIT v. Nahar Spinning Mills Ltd.* [2008] 172 Taxman 1 (Punj. & Har.) the assessee claimed that no income was generated to the extent of the Modvat credit on unconsumed raw material and, thus, he made an adjustment to the valuation of opening stock which was challenged by the revenue. Following the



decision of the Apex Court in *CIT v. Indo Nippon Chemicals Co. Ltd.* [2003] 261 ITR 275/130 Taxman 179, the Punjab and Haryana High Court held that it is not open to the Assessing Officer to treat outgoings as income under section 145 of the Act. The Apex Court in *Indo Nippon Chemicals Co. Ltd.*'s case (supra) held that merely because the Modvat credit was an irreversible credit available to the manufacturers upon purchase of duty-paid raw material, that would not amount to income which would liable to be taxed under the Act; and that the said income was not generated to the extent of the Modvat credit on unconsumed raw material. It had been further held in this case that the Assessing Officer is bound to adopt the method of computation of income

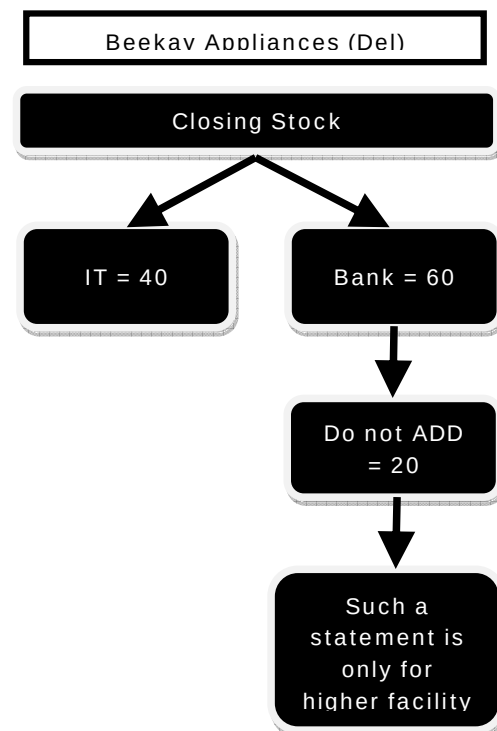
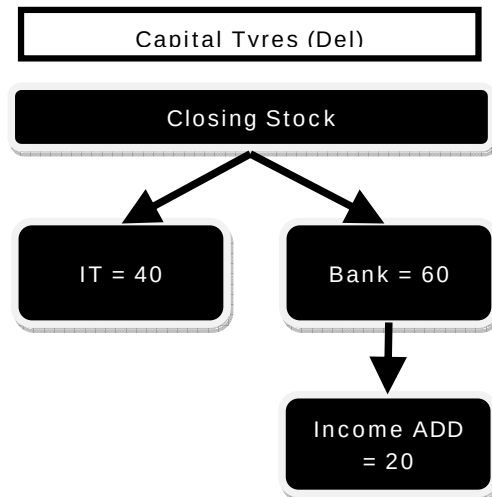
regularly employed by the assessee. However, if he comes to the conclusion that the method of accounting employed by the assessee makes it impossible to correctly compute the income, then he is entitled to adopt any other suitable accounting method. It has also been held that whatever method the Assessing Officer adopts, it has to be consistent with the accepted principles of accountancy and it is not open to the Assessing Officer to treat outgoings as income under section 145.

GROSS PROFIT RATE DISPUTE

In CIT v. Inani Marbles (P.) Ltd. [2008] 175 Taxman 56 (Raj.), the Tribunal held that profit rate declared and accepted in preceding years constituted a good basis for working out gross profit rate, especially in the absence of any change in factual position. The Rajasthan High Court had little difficulty in affirming this view of the Tribunal.

INFLATED STOCK STATEMENTS TO BANKS

The Delhi High Court in CIT v. Capital Tyres Mfg. Unit [2009] 176 Taxman 178 upheld the addition in the value of stock as the stock statement given to bank was much higher than value of stock declared in the assessee's books of account. The only respite it gave was that it required similar adjustment for the difference in the valuation of the opening stock. No one bought the argument that the valuation of stock was inflated in the statement furnished to the bank for obtaining the maximum cash credit limit.



STOCK STATEMENT TO THE BANK HAS NO CREDENCE

The Delhi Bench of ITAT in Beekay Appliances (P.) Ltd. v. Dy. CIT [2007] 158 Taxman 67 (Mag.) held that the book results could not be rejected for the simple fact that there lie a difference between in the stock position as shown in the balance sheet and as reflected in the stock statement given to the bank. More so the Madras High Court in CIT v. Apcom Computers (P.) Ltd. [2007] 158 Taxman 363 held that even no action lie under section 69 to tax the difference in value of stock as unexplained investment for mere inflated stock statement given to the bank for obtaining higher loan facilities.

CHANGE IN METHOD OF VALUATION - AUDITOR'S QUALIFICATION

In CIT v. Hindustan Zinc Ltd. [2007] 161 Taxman 162 (SC) the assessee in the past had been valuing zinc concentrates for captive consumption at net realizable value at the domestic prices or at their weighted average cost, whichever was lower and the weighted average cost being lower, the stock was valued at cost. However, in the relevant assessment year, it valued such stock at their international prices which was even lower than the weighted average cost. It was for that reason that the auditors in their report had categorically stated that if the net realizable value stood estimated in accordance with the past

accounting policy (at domestic prices), the profits of the company would have been higher by Rs. 27.08 crores. In other words, the inventory had been written down in the instant case and behind that fact there had been a rational too since the inventory of such item had exceeded the domestic demand and eventually such stock were to be sold in the export market at low prices. Also there was no dispute in the instant case that as on closing date the international prices of zinc concentrates were lower than the domestic prices thereof.

The Supreme Court by making reference to their earlier decision in CIT v. British Paints India Ltd. [1991] 188 ITR 44 / 54 Taxman 499, held that if the fall in the price has the effect of merely reducing the prospective profits (which appeared to be the instant case if one looked at the auditors' report), there would be no justification to discard the valuation at cost and it labelled the instant case as not the case of anticipated loss, but as the case of reduction in the prospective profits.

This case is a pointer to the corporate world to be cautious while resorting to change in method of valuing inventories as any auditor's qualification may come under tax net. The entire decision rests on qualification in the report of the auditor.

STOCK VALUATION

In CIT v. Hindustan Zinc Ltd. [2007] 291 ITR 391, the Supreme Court held that the established rule of commercial practice and accountancy was that the closing stock had to be valued at cost or market price, whichever was lower, and the goods ought not to be written down except when there was an actual or anticipated loss and if the fall in price was only such that it would reduce the prospective profit, there was no justification for discarding the initial valuation at cost and therefore, the assessee was not right in writing down the inventory (zinc concentrate) below the cost price by estimating its net realizable value at the London Metal Exchange price and not at the domestic price. The assessee preferred a review petition. The Supreme Court dismissed the review petition.

In export business, where the stock was valued at cost or market price, whichever is lower, the adoption of this method with reference to the quotation in the London market, which was lower than the cost price, was found to be unjustified, because there were no exports during the year. This decision of the Tribunal was endorsed both by the High Court and later by the Supreme Court in Hindustan Zinc Ltd. v. CIT [2007] 291 ITR 391. The reasoning of the Supreme Court was that by allowing the market value to be adopted, an anticipated loss would have to be allowed. In fact, that is the very principle of permitting cost or market price, whichever is lower, so that the assessee can claim a potential loss, while potential profit need not be taken into account on principles of conservatism and prudence recognised in stock valuation in a number of precedents from the Supreme Court itself as noted in the comments on this case in [2007] 291 ITR (Journal) 34-35. It is not, therefore, surprising that the assessee moved for review of this decision. But in a short judgment, such review was declined by the Supreme Court on the ground that no case for review was made out: Hindustan Zinc Ltd. v. CIT [2007] 295 ITR 453. The decision should probably be treated as confined to the facts of the case.

The Supreme Court in CIT v. Alfa Laval (India) Ltd. [2007] 295 ITR 451 upheld the decision of the Bombay High Court in Alfa Laval India Ltd. v. Deputy CIT [2004] 266 ITR 418, wherein it was held that valuation of obsolete stock at 10 per cent. of the cost could not be treated as an under-valuation. However, the Supreme Court, while dismissing the Departmental appeal "left the question of law open". Probably, it was so decided, because it was an ex parte decision. Since there were two other points involved in the High Court decision, it should apparently be assumed that even in respect of other two points, the Supreme Court has not decided the law.

240 ITR 0355 UNITED COMMERCIAL BANK VS. COMMISSIONER OF INCOME-TAX (SC)

The appellant was a nationalised bank and followed the mercantile system of accounting both for book keeping purpose as well as for tax purposes. Further

1. The appellant consistently and for over 30 years prior had been valuing its stock-in-trade (investments) “at cost” in the balance-sheet. In other words from the form of the prescribed balance-sheet under the Banking Regulation Act it was evident that scheduled nationalised banks were directed to put the value of shares and securities at cost and if the market value was lower, it was to be shown separately in brackets.
2. Whereas for the same period of time the appellant had been valuing the very same investment “at cost or market value whichever is lower” for income-tax purposes.

That practice was accepted by the Department and there was no justifiable reason for not accepting the same.

Preparation of the balance-sheet in accordance with the statutory provision would not disentitle the assessee in submitting income-tax return on the real taxable income in accordance with a method of accounting adopted by the assessee consistently and regularly. That could not be discarded by the Departmental authorities on the ground that the assessee was maintaining the balance-sheet in the statutory form on the basis of the cost of the investments.

The principles applicable in valuation of stock are

- 1) That for valuing the closing stock, it is open to the assessee to value it at the cost or market value, whichever is lower
- 2) In the balance-sheet, if the securities and shares are valued at cost, from that no firm conclusion can be drawn. A taxpayer is free to employ for the purpose of his trade, his own method of keeping accounts, and for that purpose, to value stock-in-trade either at cost or market price
- 3) A method of accounting adopted by the taxpayer consistently and regularly cannot be discarded by the Departmental authorities on the view that he should have adopted a different method of keeping accounts or of valuation
- 4) Under section 145 of the Act, in a case where accounts are correct and complete but the method employed is such that in the opinion of the Income-tax Officer, the income cannot be properly deduced there from, the computation shall be made in such manner and on such basis as the Income-tax Officer may determine.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee a nationalized bank was following “COST OR MARKET VALUE WHICH EVER IS LESS” system of accounting for the purpose of valuing securities in the Income Tax assessment. However in the statutory balance sheet it has to show it at cost only. In the given year market value of the securities was 8 lacs and cost was 10 lacs. Income tax officer is proposing to tax 10 lacs in the income tax assessment. You are required to answer whether assessing officer is justified or not.

ANSWER

Preparation of the balance-sheet in accordance with the statutory provision would not disentitle the assessee in submitting income-tax return on the real taxable income in accordance with a method of accounting adopted by the assessee consistently and regularly. That could not be discarded by the Departmental authorities on the ground that the assessee was maintaining the balance-sheet in the statutory form on the basis of the cost of the investments. Thus the officer is not justified in valuing the stock at Rs. 10 Lakhs.

271 ITR (A.T.) 0050- CONNEMARA BUSINESS ASSOCIATES VS. ASSISTANT COMMISSIONER OF INCOME-TAX (COCHIN)

An item of expenditure can be allowed in computing the taxable income of an assessee as a deduction only if the assessee has actually incurred that expenditure. Therefore, the crucial test to be applied in examining the deductibility of a claim of expenditure is whether the expenditure was actually incurred or not, during the relevant previous year. The question of examining the method of accounting, whether cash system or accrual system, arises only after the finding of fact that the expenditure was actually incurred during the relevant previous year. If the expenditure itself was not incurred during the relevant previous year, the question of examining the method of accounting does not arise at all.

Where an amount was advanced by a firm to partners for foreign travel expenses, only the amount which was spent on such travel could be treated as having been incurred. Merely because the cash system was followed, the amount of advance could not be treated as expenditure. It was so decided by the Tribunal in Connemara Business Associates v. Asst. CIT [2004] 271 ITR (AT) 50 (Cochin).

RE-ASSESSMENT

Section / Topic Name : 147 to 152

NOTICE – A PRE-CONDITION

The proposition that no re-assessment is possible without valid service of notice under section 148 should not be one, which should require adjudication before the High Court, since the law requires service of notice as a pre-condition of jurisdiction. In a case relating to a deceased person with no notice under section 148 issued on any one of the legal representatives, the assessment made in pursuance of only notice under section 143(2) was held to be invalid in CIT v. Harish J. Punjabi [2008] 297 ITR 424 (Delhi). The Revenue had contested the order of the Tribunal holding that the assessment is void on this ground. Counsel for the Revenue relied upon a decision which related to a case, where service was effected by registered post. The High Court found that there was not even an attempt to send any notice under section 148 by registered post nor was the notice otherwise served. It is yet another case, where the Commissioner should have spared the High Court and the assessee from dealing with such an appeal, where the answer to the issue raised is self-evident. Probably, the alternative of a fresh service of notice on legal representatives was also missed and got time-barred, because of the time taken in defending a bad assessment.

REOPENING ON THE BASIS OF SURVEY / OTHER INFORMATION

In Dr. Lata Chouhan v. ITO [2010] 189 Taxman 45 (MP), a survey under section 133A was conducted in the assessee's business premises wherein it was noticed that she had made substantial investments in the construction of her hospital building, whereas as per her return, she had disclosed much less quantum of investment. This led to issue of notice of re-opening of past assessments which the assessee challenged in writ. Dismissing her petition, the M.P. High Court held that a notice under section 147 can be issued on basis of material found by department during survey conducted in business premises of the assessee. In the instant case, the Court did not find any merit in the plea that the notice did not disclose the assessee's status.

Information from the Enforcement Directorate showing possible inflation of purchases could justify notice under section 147 as decided in Sterlite Industries (India) Ltd. v. Asst. CIT [2008] 302 ITR 275 (Mad).

CHANGE OF OPINION-EXPENSES ON LEASEHOLD IMPROVEMENTS

In Legato Systems (India) (P.) Ltd. v. Dy. CIT [2010] 187 Taxman 294 (Delhi) the Assessing Officer in original proceedings allowed deduction of renovation costs such as partition made of wood, wall Panelling, show windows, etc., grouped as leasehold improvements. Later on, he reopened the case and instead allowed depreciation on such expenditure treating it as capital in nature, in view of the provisions of the Explanation 1 to section 32 of the Income-tax Act.

The Delhi High Court on reference to assessment record held that the instant cases clearly fell beyond the scope of the requirement of section 147 of the Act because this very issue was considered and dealt with in the regular assessment proceedings and the Assessing Officer applied its mind to the issue.

THIN LINE BETWEEN POWER TO REVIEW AND POWER TO REASSESS

The Supreme Court in CIT v. Kelvinator of India Ltd. [2010] 187 Taxman 312 held that, though post 1-4-1989, power to re-open is much wider, yet that does mean that the section gives arbitrary powers to the Assessing Officer to reopen assessments on the basis of 'mere change of opinion'. The Apex Court lamented emphasis on the conceptual difference between power to review and power to reassess. It further held that after 1-4-1989, the Assessing Officer has power to reopen, provided there is 'tangible material' to come to conclusion that there is escapement of income from assessment.

MATERIAL FOR REOPENING

The Delhi High Court in Diwakar Engineers Ltd. v. ITO [2010] 187 Taxman 327 held that it is trite and has been laid down in a catena of decisions that powers under section 147/148 can only be exercised when there is material found for reopening of the assessments and a mere change of opinion is not sufficient. At the same time it held that it is not necessary that the materials must be extensive and detailed. This is a case where the AO formed his belief on the basis of assessment proceedings in the subsequent assessment years.

DISCLOSURE METHOD

In Prehladbhai Naranbhai Patel v. ITO [2009] 180 Taxman 122 (Guj.), the assessee along with return of income had placed a note pointing out factum of fire and factum of his having made claim before insurance company. The note also read that claim had not been settled till point of time of filing of return. Further, the assessee had also categorically stated in said note that when claim would be settled and received, same would be offered as income of year of receipt. In this case perhaps the Assessing Officer initiated reassessment action on the basis of surveyor report without reference to actual settlement details. The Gujarat High Court held that there was no failure on the part of the assessee in returning income and, thus, it quashed the notice issued under section 148 having been issued beyond a period of four years from the end of the relevant assessment year.

SUBSEQUENT YEAR VIEW / PRONOUNCEMENT BY TRIBUNAL HAS NO EFFECT ON REOPENING

In Siemens Information System Ltd. v. Asstt. CIT [2008] 168 Taxman 209/ 295 ITR 333, the Bombay High Court held that a mere change of opinion on an interpretation of a provision by itself in subsequent year assessment without adding anything more, cannot give rise to reason to believe for the purpose of reopening of previously completed assessment. Moreover, the High Court held that the subsequent decision of the Tribunal is held not an authority for the proposition that losses suffered being undisputedly covered by section 10A as it then stood could be set off against profits of other business income of the assessee or vice versa to facilitate reopening. The notice was, thus, held to be not valid and was quashed.

Yet again in Sesa Goa Ltd. v. Jt. CIT [2008] 168 Taxman 281/294 ITR 101 (Bom.), the assessment was sought to be reopened only on the ground of change of opinion of the Assessing Officer based upon the subsequent decisions of the Bombay High Court rendered in CIT v. K.K. Doshi & Co. [2000] 245 ITR 849/112 Taxman 503 and CIT v. Kantilal Chhotalal [2000] 246 ITR 439/[2001] 117 Taxman 526 on the manner of computation of the deduction under section 80HHC. The Bombay High Court held that the reassessment was not on the ground of non-disclosure of the facts fully and truly but on the ground of change of opinion based upon the subsequent decisions of the Court so that the writ petition was held as not maintainable.

REOPENING BASED ON SUBSEQUENT SC DECISION

The Madras High Court in CIT v. Premier Mills Ltd. [2009] 179 Taxman 13 held that where the assessment is completed under section 143(3) of the Income-tax Act, the reopening of the assessment under section 148 beyond the period of four years at the end of the relevant assessment year can be sustained only if it is established that there is a failure on the part of the assessee to disclose fully and truly all material facts. In this case the Assessing Officer reopened assessment based on a subsequent Supreme Court decision but for want of any finding on the failure on the part of the assessee to disclose fully and truly all material facts the departments appeal got dismissed.

SECOND THOUGHT

The Bombay High Court in Cartini India Ltd. v. Addl. CIT [2009] 179 Taxman 157 held that where the Assessing Officer, at the time of original assessment, entertained a prima facie belief that deduction claimed by the assessee could not be allowed in view of accounting system adopted by it and after considering explanation given by the assessee deemed it fit to allow deduction as claimed by passing an assessment order under section 143(3), then it would not be open to him to form a contrary opinion based on very same material and reopen the assessment. In this case, the Assessing Officer had formed a reasonable belief that income chargeable to tax had escaped assessment on two counts, viz., treatment of tools, dies, jigs, moulds as capital items instead of inventory items and allowance of project launch expenses on proportionate basis instead of allowance in one year. The Court found that each of the two points had been replied by the assessee during original assessment proceedings so that any second thought would be impermissible under the law.

CHANGE OF OPINION

In CIT v. Eicher Ltd. [2007] 163 Taxman 260 (Delhi), the assessee made a disclosure in its return and treated the waiver of funded interest loan as capital receipt and also made a written submission on such disclosure and the department accepted such stance in the original assessment. Subsequently, it reopened the assessment treating such credit as income under section 41(1). Without going into merits, the Delhi High Court thrashed the notice issued in this case as a result of change in opinion.

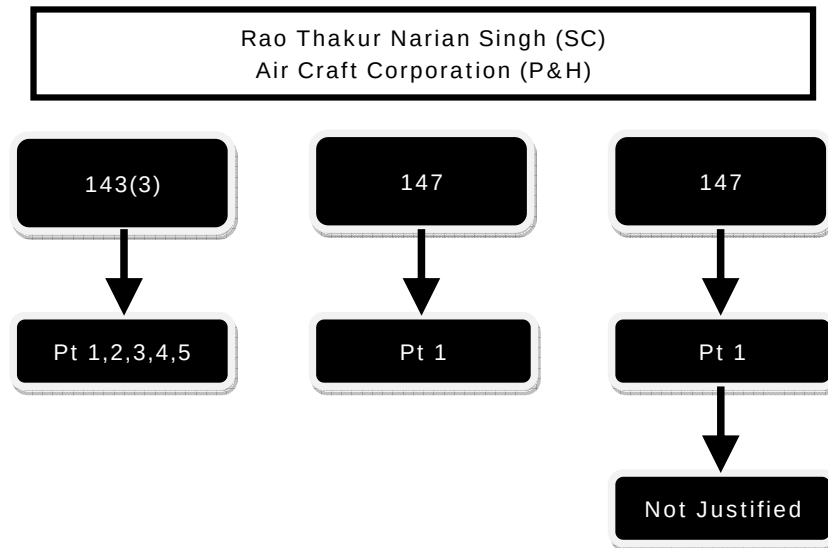
One would wonder why the Tribunal/Courts do not decide the cases on merits instead so that at least the assessee knows what is taxable and what is not taxable. It is easier said and done that the issue is accepted by the revenue in the past and/or subsequent years rather than putting the merits of either case of either side and decide.

SHODDY REOPENING ON THE BASIS OF INTER-DEPARTMENTAL REPORT

The Delhi High Court following the Supreme Court decision in Chhugamal Rajpal v. S.P. Chaliha [1971] 79 ITR 603 dismissed the appeal of the revenue when it held that the only information in possession of the Assessing Officer is in the form of a statement of report from a fellow jurisdiction to the effect that the assessee had taken a bogus entry of capital gains by paying cash along with some premium for taking a cheque of that amount and he did not verify the correctness of the information received or otherwise of such information for issuing notice under section 148 of the Act. He merely accepted the truth of the vague information in a mechanical manner. It held that what has been recorded by the Assessing Officer as his reasons to believe is nothing more than a report given by him to the Commissioner of Income-tax.

SECOND REOPENING ON SAME FACTS NOT POSSIBLE

In CIT v. Air Craft Radio Corporation [2007] 163 Taxman 387/292 ITR 64 (Punj. & Har.), the assessment was reopened without recording due satisfaction. The same was set aside in the first course by the Commissioner (Appeals). To correct the technical mistake yet again another notice under section 148 was issued and the assessment order was framed. Once again these were cancelled by the Appellate Commissioner. Finally, the Punjab and Haryana High Court too confirmed the action of the Commissioner (Appeals) following the Supreme Court decision in CIT v. Rao Thakur Narayan Singh [1965] 56 ITR 234.



PRIMA FACIE INFORMATION

The Delhi High Court in CIT v. High Gain Finvest (P.) Ltd. [2007] 164 Taxman 142 in restating the understanding of the law laid down by the Supreme Court in Raymond Woollen Mills Ltd. v. ITO [1999] 236 ITR 34, pointed out that for reopening matters what had to be considered was whether there was some material, even though of a prima facie nature, which would constitute ‘information’ enabling the Assessing Officer to have a ‘reason to believe’ that income had escaped assessment. In this case the Assessing Officer acted on the basis of information received from a the Assessing Officer acted on the basis of information received from a chartered accountant during the course of survey operations. It reiterated that the sufficiency or correctness of the material cannot be gone into at the time of issue of notice.

Basis of Re-opening		147
Survey & other information	1	Justified
ED-Showing possible inflation of purchase	2	Justified
Objection of audit party	3,5	Not Justified (controversial)
Change of opinion	9,4,6,7	Not Justified
Inter departmental report	8	Not Justified

(1)	Dr. Lata Chouhan (MP)
(2)	Sterlite Industries (India) Ltd. (Mad.)
(3)	Carlton Overseas (P.) Ltd. (Delhi)
(4)	Legato Systems (India) (P.) Ltd. (Delhi)
(5)	Sant Ram Mangat Ram (P&H)
(6)	Cartini India Ltd. (Bombay)
(7)	Eicher Ltd. (Delhi)
(8)	Chhugamal Rajpal (Delhi)
(9)	Kelvinator of India Ltd. (SC)

INTER-DEPARTMENTAL REPORT

The Delhi High Court following the Supreme Court decision in Chhugamal Rajpal v. S.P. Chaliha [1971] 79 ITR 603 dismissed the appeal of the revenue in CIT v. Atul Jain [2007] 164 Taxman 33 when it held that the only information in possession of the Assessing Officer is in the form of a statement of report from a fellow jurisdiction to the effect that the assessee had taken a bogus entry of capital gains by paying cash along with some premium for taking a cheque of that amount and he did not verify the correctness of the information received or otherwise of such information for issuing notice under section 148 of the Act. He merely accepted the truth of the vague information in a mechanical manner. It held that what has been recorded by the Assessing Officer as his 'reason to believe' is nothing more than a report given by him to the Commissioner of Income-tax.

OPINION OF AUDIT PARTY

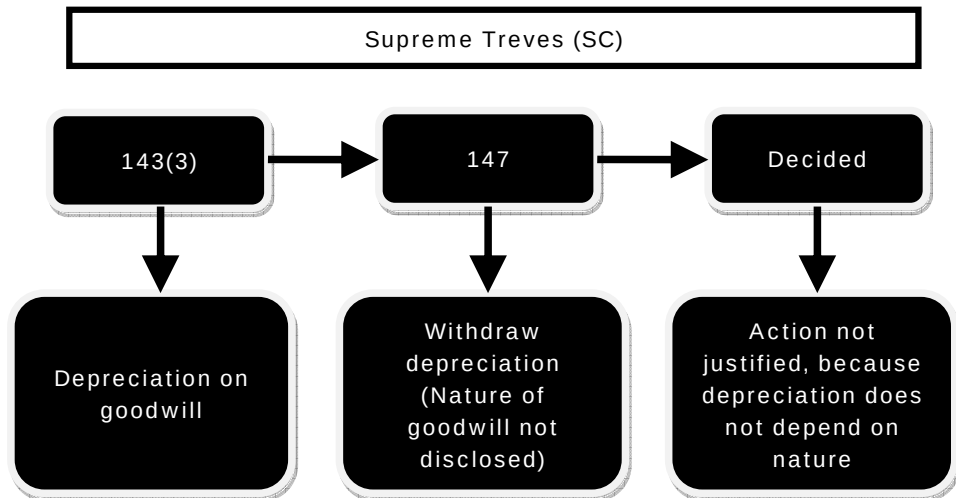
The Punjab & Haryana High Court in CIT v. Sant Ram Mangat Ram [2009] 180 Taxman 177 held that an opinion of an audit party of the Income-tax Department on a point of law cannot be regarded as information within the meaning of section 147(b) of the Income-tax Act, 1961 for the purpose of re-opening of an assessment in view of decision of Supreme Court in Indian & Eastern Newspaper Society v. CIT [1979] 119 ITR 996/2 Taxman 197.

NON-DISCLOSURE OF PRIMARY FACTS-DEPRECIATION ON GOODWILL

In *Supreme Treves (P.) Ltd. v. Dy. CIT* [2009] 182 Taxman 216 (Bom.), the assessee was allowed depreciation on goodwill in original assessment. Later, after four years, the Assessing Officer took a view that no depreciation was admissible on goodwill, so he reopened the assessment.

When it came to disclosure requirement and to make a case for reopening, the Assessing Officer alleged that the assessee had not disclosed the nature of goodwill on which it had claimed depreciation. The

Bombay High Court in quashing the reassessment, held that disclosing the nature of the goodwill would be relevant only if the contention of the revenue was that grant of depreciation would depend upon the nature of goodwill. The specific case of the revenue was that the goodwill was not an



intangible asset and, hence, not eligible for depreciation. In such a case, reopening of the assessment on the ground that the assessee had not disclosed the nature of the goodwill and, therefore, there was failure on the part of the assessee to disclose fully and truly all material facts, was held to be not acceptable.

OBJECTION OF AUDIT PARTY- REOPENING FAILED TO SURVIVE

In *Carlton Overseas (P.) Ltd. v. CIT* [2010] 188 Taxman 11 (Delhi), the Assessing Officer reopened the case based on audit para alleging allowance of deduction under section 80HHC without reducing section 80-IA deduction amount from the profit of the business for the purpose of calculating deduction under section 80HHC. In allowing writ, the Delhi High Court pointed out that the Audit Report merely gives an opinion with regard to the non-availability of the deduction both under section 80-IA and under section 80HHC; and that the deduction under section 80-IA was not deducted from the profits of the business while computing deduction under section 80HHC. And since it is a settled law that mere change of opinion cannot form the basis for issuing of a notice under section 147/148 of the Act, the Court quashed the notice. The Court went on to make a point that except the opinion of the revenue Audit Party there was no new or fresh material before the Assessing Officer to justify reopening.

INFERENCE OF ESCAPEMENT BASED ON DISCLOSURES BY ASSESSEE IS NOT JUSTIFIED

In *Bhavesh Developers v. Assessing Officer* [2010] 188 Taxman 123 (Bom.), the Assessing Officer issued notice under section 148 seeking to reopen the assessment on the ground that the assessee had been allowed deduction under section 80-IB on other incomes such as society deposit, stilt parking, sundry credit balance appropriated and discount received which did not qualify for deduction under section 80-IB. In quashing the notice, the Bombay High Court held that it was impossible to say that

there was a failure on part of the assessee to disclose fully and truly all material facts necessary for its assessment especially for the following reasons :—

1. That the return of income included a duly filled-up Form 10CCD which was certified by a chartered accountant;
2. That the profit and loss account for the year ending 31-3-2002 contained a disclosure of the other income;
3. That schedule G to the balance sheet contained a breakup of the other income;
4. That a letter was addressed on behalf of the assessee by its chartered accountant to the Assessing Officer in regard to an explanation of the other income as reflected in the profit and loss account.

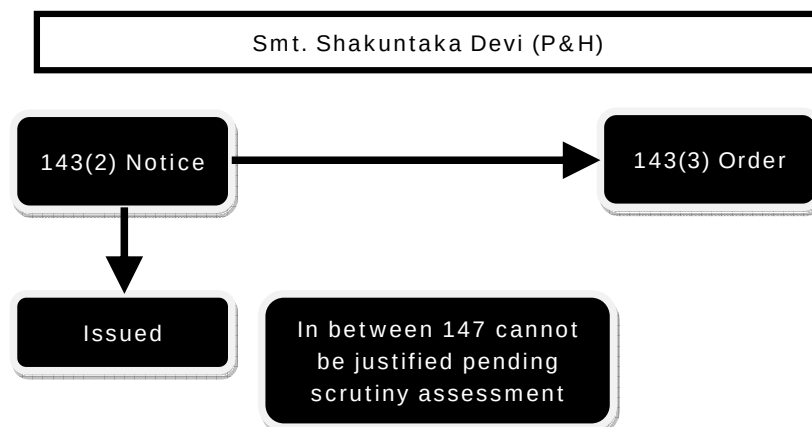
The High Court made a point that ex facie, the reasons, which had been disclosed to the assessee drawing the inference that the income had escaped assessment, were based on the disclosures made by the assessee itself. Further, the High Court brushed aside the plea of the revenue that the assessee should be relegated to the ordinary remedy of an appeal against the order of the assessment. Such an action as per the High Court purported to reopening the assessment only on the basis of change of opinion which is held not permissible under the law.

In yet another case of *Satnam Overseas Ltd. v. Addl. CIT* [2010] 188 Taxman 172, the Delhi High Court held that since reasons given for reopening assessment simply relied upon record which was already available before the Assessing Officer while completing assessment proceedings under section 143(3), there was no scope for initiating reassessment action. The High Court felt that the new logic, rationale and option, which had been formed by the Assessing Officer for seeking reopening of the assessment were nothing but a change of opinion and a new approach to the existing facts and materials which the Assessing Officer could well have done during the regular assessment proceedings of the relevant assessment years.

PURE LEGAL POINT- REOPENING DURING PENDENCY OF ORIGINAL ASSESSMENT

In *CIT v. Smt. Shakuntala Devi* [2009] 185 Taxman 8 the Punjab & Haryana High Court considered the effect of amendment by way of the Explanation 2(b) to section 147 in a case where the CIT(A) set aside the notice under section 148 of the Act on the ground that the same could not be issued during the pendency of the assessment. In this case the Assessing Officer proceeded under section 147 without disposing of return either under section 143(2), read with section 143(3), or under section 143(1)(a) and issued a notice under section 148 even before the expiry of 12 month's limitation period for issue of a notice under section 143(2). The Court held that assessment framed in such manner would be perfectly valid. In other words, the old law that proceedings could not be initiated under section 147 in respect of pending assessment is no longer valid.

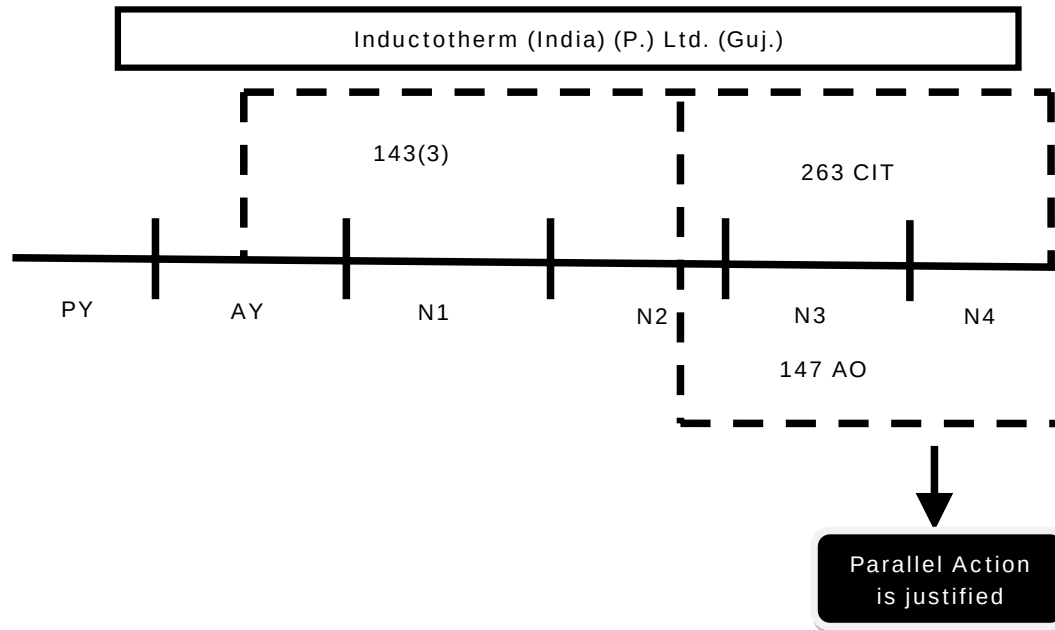
In this case, even though the revenue took refuge under the Explanation 2(b) for the first time before the High Court it was admitted with the following remarks (Quote)



“Even though this aspect was not raised by the revenue before the CIT(A) or before the Tribunal but this being purely legal point arising out of the admitted facts, we allow this point to be raised at this stage.”

PARALLEL ACTION UNDER SECTION 263 POSSIBLE

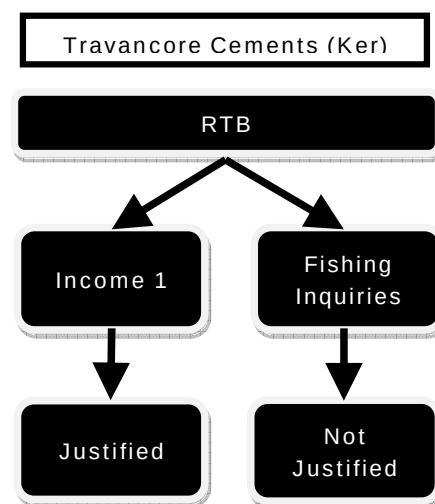
In *Inductotherm (India) (P.) Ltd. v. James Kurian*, Asstt. CIT [2008] 169 Taxman 240/294 ITR 341, the Gujarat High Court held that there is no bar under the provisions of the Income-tax Act, 1961, for parallel



proceedings in consequence of notices under section 148 and under section 263. After issuance of notice under section 148, the Assessing Officer himself can pass a fresh assessment order and under section 263 if the original assessment order of the Assessing Officer is erroneous and prejudicial to the interests of the revenue, the Commissioner of Income-tax can revise that order. Both the authorities are empowered under different provisions of the Act, though both have to ensure that the income escaped in the original assessment should be taxed.

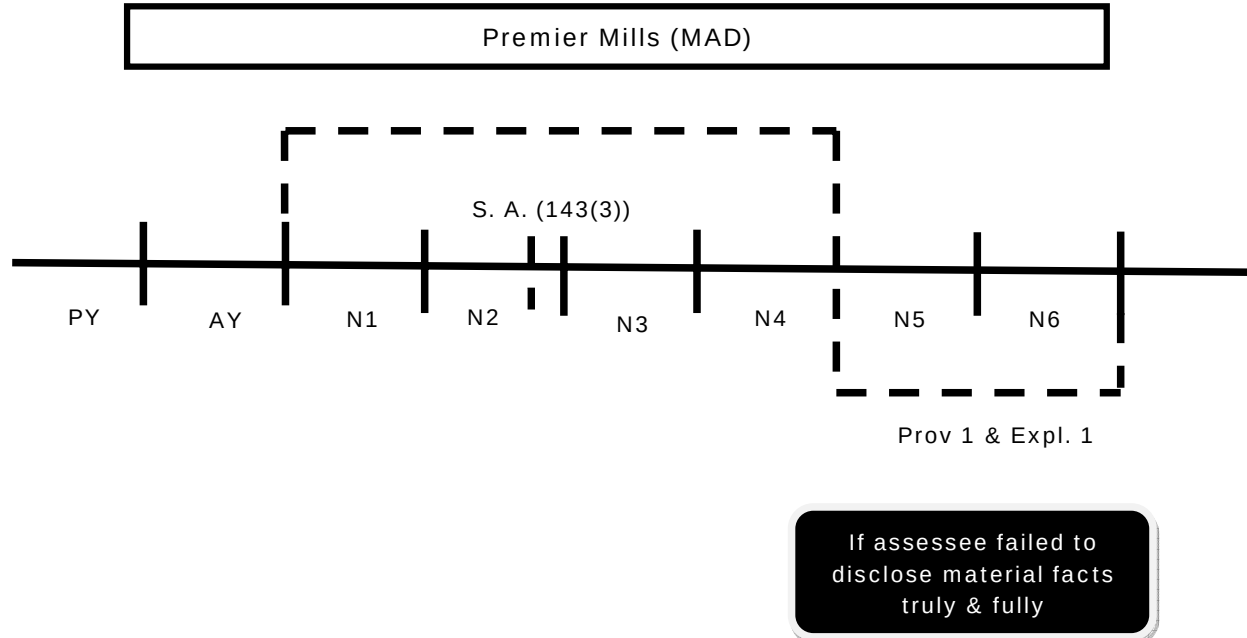
FISHING INQUIRIES

The Kerala High Court in *Travancore Cements Ltd. v. Asstt. CIT* [2009] 179 Taxman 117 held that the Assessing Officer cannot make any fishing enquiry in concluded matters unconnected with issue on basis of which proceedings under section 147 have been initiated. The remedy in such cases in the Court's view is that the Assessing Officer should follow sub-section (2) of section 148 with regard to the escaped income, i.e., record reasons for issuing fresh notice consequent to the knowledge acquired by him during the course of the proceedings.



REOPENING RULES

In Universal Subscription Agency (P.) Ltd. v. Jt. CIT [2007] 159 Taxman 64 (All.) the assessee made a claim for deduction under section 80-O in the course of assessment proceedings by filing a letter. The Assessing Officer also allowed such claim in a speaking order passed under section 143(3). Later against a reopening action the assessee filed a petition before the Allahabad High Court. The Court held that such



an action was a sheer result of change in opinion without any fresh facts hence does not warrant action under section 147 except when in one year where the assessment was framed under section 143(1)(a) where claim is made as such in the return filed. In this case the department even made reference to the Supreme Court decision in the case of Goetze India Ltd. v. CIT [2006] 284 ITR 323/157 Taxman 1 so as to plead that claim could not have been entertained by way of a letter. To this the Court pointed out that the Apex Court has not laid down as a matter of law that the assessing authority is prevented from entertaining a claim otherwise than by filing of a revised return.

The Court thus summed up the principles of reopening as under: -

- (i) the proceedings under section 147 of the Act can be initiated only when the Assessing Officer has reasons to believe that the income chargeable to tax has escaped assessment;
- (ii) the belief must be an opinion based on relevant materials and the reasons for reopening the assessments have to be reduced in writing;
- (iii) even after the amendment made under section 147 by Direct Tax Laws (Amendment) Act, 1987, with effect from 1-4-1989, the proceeding for reassessment cannot be initiated on mere change of opinion, even in cases where the deeming provision of Explanation II applies;
- (iv) where assessment has been made under section 143(3) of the Act, reassessment can be initiated after four years from the end of the assessment year only where any income chargeable to tax has escaped assessment for such assessment year by reason of failure on the part of the assessee to make a return under section 139 or in response to a notice issued under sub-section (1) of section 142 or section 148 or to disclose fully and truly all material facts necessary for the assessment for that assessment year and shall also apply in cases which are covered and treated to be deemed escaped assessment under various clauses of Explanation II to section 147 of the Act; and

- (v) proceeding for reassessment can be initiated even where assessment has been made under section 143(1)(a) of the Act provided preconditions mentioned in section 147 are fulfilled.

NET PROFIT ESTIMATION

In *Yakub Ali Gopal Singh v. Dy. CIT* [2007] 163 Taxman 526 (Raj.), the Assessing Officer reopened the case after four years on the understanding that the net profit declared by the assessee is not matching the net profit rate in case of liquor business in general. The Rajasthan High Court held that it becomes a matter of opinion that what should be the reasonable rate of profit arrived at from the business of the assessee on any estimate basis. Holding such an opinion according to the Court was neither material to hold a further belief, nor had any nexus with the formation of belief, that there had been failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment.

SUFFICIENCY/INSUFFICIENCY OF REASONS

The Punjab and Haryana High Court in *CIT v. New India Rubber & Chemicals Industries Ltd.* [2007] 164 Taxman 200 held that the sufficiency or insufficiency of material on record would not be within the domain of the instant Court as it cannot constitute the basis for reversing the view taken by the Tribunal. Once the Tribunal in its wisdom has held that the material was insufficient for reopening of the assessment under section 148 then it is not possible for the instant Court to record a contrary finding. In this case the Tribunal in its wisdom has held that material was insufficient for reopening of the assessment under section 148. This decision is an eye opener for the two sides to stop litigation on the subject of sufficient or insufficiency of reasons beyond the stage of the Tribunal.

289 ITR (A.T.) 0105- SHIVALIKA CO-OPERATIVE GROUP HOUSING SOCIETY LTD. VS. INCOME-TAX OFFICER (INCOME-TAX APPELLATE TRIBUNAL--DELHI)

The assessee a co-operative housing society filed its return, declaring nil income. Refund was granted to the assessee on the basis of the return. Subsequently the Assessing Officer found that the assessee had derived interest income on bank deposits which had escaped assessment. The Assessing Officer, therefore, proceeded to initiate assessment proceedings under the provisions of section 147, after issuing notice under section 148.

- (i) that on the reasons recorded it was apparent that the Assessing Officer entertained an honest belief that the assessee's income chargeable to tax had escaped assessment. The belief was based on application of mind to relevant facts. The notice was valid.
- (ii) That there is a marked distinction in law between want of inherent jurisdiction and irregular exercise or assumption of jurisdiction. As far as the provisions of the Income-tax Act are concerned, there is no express provision for an interim order on the assessee's objections to initiation of proceedings under section 147 before completion of the assessment order under section 143(3) read with section 147. The Supreme Court have held that in a case where initiation of proceedings is objected to by an assessee, the Assessing Officer must dispose of the objections by passing a speaking order. It, therefore, follows that in a case where this course is not adopted by the Assessing Officer, the Assessing Officer is required to be directed to decide the preliminary objections of the assessee to the notice under section 147 and pass a speaking order.
- (iii) That interest income earned by an assessee on surplus funds of a mutual society deposited with a banking institution is covered by the principle of mutuality. The additions made in the orders under section 147 read with section 143(3) for the assessment years 1997-98 and 1998-99 were not justified.

285 ITR 0057- COMMISSIONER OF INCOME-TAX VS. ABDUL KHADER AHAMED (KERALA HIGH COURT)

Record of proceedings of the court should ordinarily be taken as true. Where a party wishes to dispute the record of what transpired during hearing, the remedy for correction of the same is by a review by the same court and not by filing an appeal. It was so held in CIT v. Abdul Khader Ahamed [2006] 285 ITR 57 (Ker). In this case, the issue related to reassessment proceedings allegedly initiated on the Commissioner's order, so that the relevant records became a matter of dispute. It is in this context, that the decision of the High Court was rendered. On the facts, it was also found that merely because the Commissioner might have drawn attention to the statutory duty of the Assessing Officer, there is no miscarriage of justice. The reassessment was held invalid. While review is a direct remedy, it would appear that in tax proceedings, which do not provide for review, an appeal should be the only feasible remedy.

272 ITR 0650- CIT VS. DARSHAN SINGH (P&H)

The proceedings under section 147 of the Income-tax Act, 1961, had been initiated solely on the report of the Valuation Officer. The proceedings were not valid. The matter could be viewed from another angle also. The Departmental Valuation Officer cannot be called upon to give a report to the Assessing Officer under the Act except when a reference is made. The Assessing Officer, therefore, could not have obtained the report of the Departmental Valuation Officer for the purposes of determining the cost of construction. Thus the report of the Departmental Valuation Officer was clearly invalid. The notices under section 148 were liable to be quashed.

CIT v. Smt. Usha Mathur 252 ITR 179 (P&H) and Smt. Amiya Bala Paul v. CIT 262 ITR 407 (SC) followed.

272 ITR 0210- RAUNAO FINANCE LTD. VS. JCIT (RAJ)

In the original assessment the proof of acquisition of asset was submitted. The depreciation there on was claimed. Subsequently officer believed that the said proof may not be genuine. And so issued notice for the re-assessment. Held, (i) that at the stage of notice, no final finding of fact is necessary that the transaction was not genuine. If on the material information, a prima facie view can be taken regarding escapement of income, the Assessing Officer is well within his jurisdiction to issue the show cause notice for reopening of the assessment. The notice of reassessment was valid. (ii) That depreciation cannot be allowed only on the basis of payment made by cheque, specially in cases where the receiver of the cheque states that after depositing the cheque, the cash has been withdrawn and has been paid back to the assessee after deducting his commission. On the other hand the mere statement of the proprietor was also not enough to disallow the depreciation, specially when the payment had been made by an account payee cheque. In such cases, the Assessing Officer should depute his inspector and make a detailed enquiry by visiting the places and contacting the concerned persons and then submit a report regarding the genuineness of the transaction.

271 ITR 0300- FLOTECH WELDING AND CUTTING SYSTEMS LTD. VS. CHANDER SINGH (BOMBAY HIGH COURT)

Where the assessee's accounts had been audited, but the accounts were also made subject to a different audit at the instance of the third party intending to acquire the assessee's business, with such audit report

also having been considered by the regular auditors, the mere fact that there was material difference between the income reported and such special audit does not make the return invalid. The Assessing Officer's intimation treating it as invalid for this reason was struck down by the High Court on a writ petition by the assessee in *Flotech Welding and Cutting Systems Ltd. v. Chander Singh* [2004] 271 ITR 300 (Bom).

231 ITR 0200 COCO-COLA CORPORATION VS. ITO; (SC)

Indian branch of foreign company incurred liability to pay home office and service charges in dollars to foreign company. Assessments completed allowing deductions for home office and service charges as per the international allocation of expense made by H.O. in New York. Letters issued by Government of India limiting dollar remittances under provisions of Foreign Exchange Regulation Act because some information had come into the possession of RBI that there is some mistake in allocation of the international expense by H.O. Income tax officer proposed to reopen the assessment u/s 147 on the basis of letter issued by the Govt. of India. Income-tax Act and Foreign Exchange Regulation Act operate in different fields. Letters are not "information in possession of ITO" for purposes of reopening income-tax assessments.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Company X a foreign company made payment of international service charge to its HO. Service charges was paid as per the allocation statement prepared by the HO. Govt of India issued letter on the company to verify the allocation and it was of the opinion that allocation was erroneous and there was over allocation to the Indian branch. On the said information assessing officer issued notice u/s 148 very next day of the issue of the letter is it a valid notice or can the reassessment proceeding be rightly initiated. (Assuming that such proceeding are initiated after the 4 years of the assessment year)

ANSWER

Indian branch of foreign company incurred liability to pay home office and service charges in dollars to foreign company. Assessments completed allowing deductions for home office and service charges as per the international allocation of expense made by H.O. in New York. Letters issued by Government of India limiting dollar remittances under provisions of Foreign Exchange Regulation Act because some information had come into the possession of RBI that there is some mistake in allocation of the international expense by H.O. Income tax officer proposed to reopen the assessment u/s 147 on the basis of letter issued by the Govt. of India. Income-tax Act and Foreign Exchange Regulation Act operate in different fields. Letters are not "information in possession of ITO" for purposes of reopening income-tax assessments. Thus the action of the officer is not justified.

280 ITR 0077- DASS FRIENDS BUILDERS P. LTD. VS. DEPUTY COMMISSIONER OF INCOME-TAX (ALLAHABAD HIGH COURT)

Under section 147, the words are "has reason to believe" and not "reason to suspect". The belief entertained by the Assessing Officer must not be arbitrary or irrational. It must be reasonable and based on reasons, which are relevant. It must be in good faith and not a mere pretence, should have a rational connection and relevant bearing on the formation of the belief, and should not be extraneous or irrelevant. The material should be relating to the particular year for which the assessment is sought to be reopened. It is not any and every material, howsoever vague and indefinite or distant, remote and far-fetched, which would warrant the formation of the belief relating to escapement of income.

The reopening based on the reason that there was defect in accounts is not valid. As the information was based on presumption and on extraneous and irrelevant considerations.

236 ITR 0034 RAYMOND WOOLLEN MILLS LTD. VS. ITO (SC)

In determining whether commencement of reassessment proceedings was valid it has only to be seen whether there was prima facie some material on the basis of which the Department could reopen the case. The sufficiency or correctness of the material is not a thing to be considered at this stage.

Held, that the case of the Revenue was that the assessee was charging to its profit and loss account, fiscal duties paid during the year as well as labour charges, power, fuel, wages, chemicals, etc. However, while valuing its closing stock, the elements of fiscal duty and the other direct manufacturing costs were not included. This resulted in undervaluation of inventories and understatement of profits. This information was obtained by the Revenue in a subsequent year's assessment proceedings. The commencement of reassessment proceedings was valid.

237 ITR 0013 CIT VS. P.V.S. BEEDIES PVT. LTD. (SC)

The assessment of the assessee was completed by the Income-tax Officer by granting deduction under section 80G of the Income-tax Act, 1961, on account of donation to a charitable trust. The Income-tax Officer reopened the assessment on the ground that subsequently it was pointed out by the internal audit party that the recognition which had been granted to the charitable trust had expired, and therefore in the relevant years of account the trust was not a recognised charitable trust and that the donation made to the charitable trust did not qualify for deduction under section 80G of the Act, as a donation made to a recognised charity.

Internal audit party had merely pointed out a fact which had been overlooked by the Income-tax Officer in the assessment. The fact that the recognition granted to the charitable trust had expired was not noticed by the Income-tax Officer. This was not a case of information on a question of law. The internal audit party was entitled to point out a factual error or omission in the assessment. Reopening of a case on the basis of a factual error pointed out by the audit party was permissible under law. Therefore, the reopening of the assessment was valid.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Based on the information of internal audit party that 80G was allowed to assessee even if certificate of 80G had expired, ITO wants to reopen the assessment under section 147. Assessee is of the view that, this is merely the change of opinion and thus reason to believe is absent. Any action under section 147 should not be justified. You are required to advise the assessee.

ANSWER

Internal audit party had merely pointed out a fact which had been overlooked by the Income-tax Officer in the assessment. The fact that the recognition granted to the charitable trust had expired was not noticed by the Income-tax Officer. This was not a case of information on a question of law. The internal audit party was entitled to point out a factual error or omission in the assessment. Reopening of a case on the basis of a factual error pointed out by the audit party was permissible under law. Therefore, the reopening of the assessment was valid.

RECTIFICATION

Section / Topic Name : 154

OMISSION TO GRANT INTEREST

Assets seized in a search operation are to be applied against the liability determined in search assessment under section 153A. If the assets seized exceed the liability, they are to be refunded along with interest of one-half percent for every month or part thereof. In CIT v. Krishna Saraf [2010] 186 Taxman 1 (Mad.), the revenue contended that non-grant of interest in the appeal effect order against the search assessment, could not fall under section 154 to enable the assessee to seek for rectification of a mistake apparent on the face of the record. Here is a case of an assessee in which search was conducted and certain assets such as cash, the Indira Vikas Patras and bullion were seized from the locker but later they were released upon the order of the Commissioner (Appeals).

The revenue claimed that the assets were not recovered from the premises of the assessee so that the question of interest on refund of such retained assets does not arise. The Madras High Court refuting such plea held that the assets seized from lockers form nexus to the search upon the.

LIMITED SCOPE

The Delhi High Court in CIT v. R. K. Shrivastav (HUF) [2008] 172 Taxman 147 held that the Assessing Officer has no authority under section 154 to disallow certain selling expenses claimed against capital gains income only for the reason that such expenses were to be borne by the vendee company as per the agreement. The Court held that this would tantamount to review which is not permissible under section 154. More so, it held that the issue under consideration was debatable so no action was possible under section 154.

It is well-established that rectification is not possible where the issue is debatable. The issue whether the amount of prize money obtained by the participants in a television show “Kaun Banega Crorepati”, should be taxed at maximum marginal rate or at normal rate is not free from doubt, so that the mistake in adoption of normal rate of tax could not be treated as a glaring one, so as to justify rectification. It was so held by the Tribunal in Asst. CIT v. Pradeep Gupta [2007] 290 ITR (AT) 278 (Jodh).

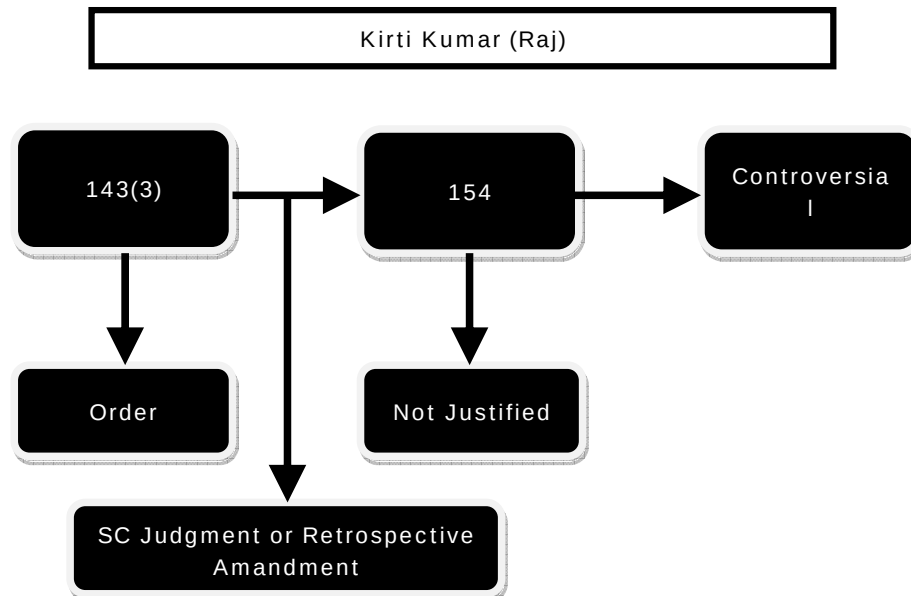
UNFORTUNATE SITUATION - OMISSION OF THE ASSESSEE TO CLAIM

DEDUCTION

The Punjab and Haryana High Court in Punjab State Co-op. Supply & Marketing Federation Ltd. v. Dy. CIT [2008] 173 Taxman 15 held that the omission of the assessee to claim deduction of arrears of salary of Rs. 7 crores to its employees in the income-tax return or during the course of assessment proceedings was not a mistake apparent from the record of the case to which proceedings provision of section 154 could get attracted. Recently, the Delhi High Court decision in Poddar Pigments (under reporting) warranted an application under section 264 in such cases.

RETROSPECTIVE AMENDMENTS/SUBSEQUENT SC DECISION

The Rajasthan High Court in CIT v. Kirti Kumar Shah [2009] 176 Taxman 29 held that the Assessing Officer cannot make rectification in the guise of retrospective provisions or subsequent rulings of the Supreme Court as the matter remains a debatable question on the date of passing of the original order on which there can be no debate.



228 ITR 0463 CIT VS. HERO CYCLES PVT. LTD.; (SC)

Assessee made a Claim for weighted deduction which was not allowed by ITO. CIT (Appeals) directing such allowance under section 154 by ITO allowing weighted deduction. Held that there was no mistake apparent from record. Question regarding weighted deduction was debatable. Point was not examined on facts or in law and thus Order of rectification was not valid.

RAJIV GUPTA (AT) (CHAND)

CG- sale of gold (Long term)	10
CG- sale of listed shares (Long term)	-3
Is it a mistake apparent ? Yes	07

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee while computing the total income had claimed the weighted deduction for the foreign sales promotion expense ITO did not allow the claim in the scrutiny order passes at the first point of time but there after proposed to allow it as deduction by passing an order under section 154. Can the said order be passed.

ANSWER

Assessee made a Claim for weighted deduction which was not allowed by ITO. CIT (Appeals) directing such allowance under section 154 by ITO allowing weighted deduction. Held that there was no mistake apparent from record. Question regarding weighted deduction was debatable. Point was not examined on facts or in law and thus Order of rectification was not valid.

249 ITR 0304 - CIT VS. SOUTH INDIA BANK LTD. (SC)

Held that on purchase and sale of securities in course of business of banking when interest was paid for broken periods and were allowed as deduction in assessment cannot be rectified as a mistake apparent from the record u/s 154. on the grounds that a debatable issue was involved and that the assessing authority was not justified in invoking the machinery for rectification under section 154

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

The assessee is a scheduled bank. It is required to buy and sell Government securities. During the years, it deducted the interest paid for broken periods and this was originally allowed. Later, the assessing authority invoked the provisions of section 154 of the Income-tax Act, 1961, and cancelled such allowance. You are required to answer whether the action of the officer is justified or not.

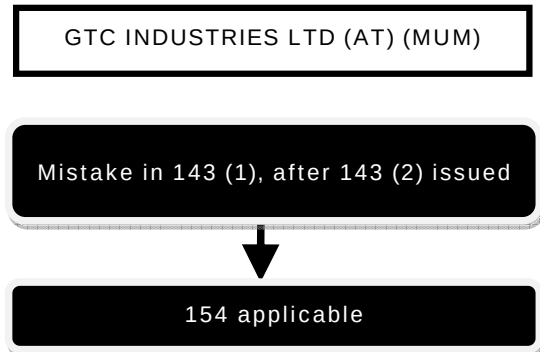
ANSWER

Held in case of [2001] 249 ITR 0304- COMMISSIONER OF INCOME-TAX VS. SOUTH INDIA

BANK LTD. (SC) that on purchase and sale of securities in course of business of banking when interest was paid for broken periods and were allowed as deduction in assessment cannot be rectified as a mistake apparent from the record u/s 154. on the grounds that a debatable issue was involved and that the assessing authority was not justified in invoking the machinery for rectification under section 154

255 ITR 0458 - CIT VS. ARIHANT INDUSTRIES LTD. (P&H)

The power under section 154 of the Income-tax Act, 1961, can be invoked only to correct mistakes apparent on the record. The scope of proceedings under section 143(2) is far wider. It is only on consideration of the matter and on being satisfied that it is necessary or expedient to do so, that the Assessing Officer issues the notice under section 143(2). Once that has been done, the Assessing Officer has to proceed under sub-section (3) and make an assessment of the total income or loss of the assessee and determine the sum, if any payable by it. It is no doubt correct that an error apparent on the record can be corrected under section 154 of the Act. However, if parallel proceedings are permitted it would only result in waste of time. It would serve no purpose. Hence, proceedings under section 154 for rectification cannot be initiated after the Assessing Officer has issued notice under section 143(2) to the assessee.



Question

Can proceedings under section 154 of for rectification of mistake be initiated after the Assessing Officer has given a notice under section 143(2) to the assessee ?

Answer

Once notice under section 143(2) is issued, no order of rectification is possible. It was so held in CIT v. Arihant Industries Ltd. [2002] 255 ITR 458 (P&H) following the decision in Gujarat Poly-AVX Electronics Ltd. v. Dy. CIT [1996] 222 ITR 140 (Guj) and CIT v. Punjab National Bank [2001] 249 ITR 763 (Delhi). Provision under section 143(2)(i) empowering the Assessing Officer to make limited scrutiny, which may or may not be followed by a regular notice under section 143(2), would bring back the controversy. In such cases, the mistake, if any, in the original order is best corrected only in the regular assessment so that multiplicity of proceedings is avoided.

262 ITR 0209- D.S. SRINIVAS VS. INCOME-TAX OFFICER (KAR)

A mistake (for the purpose of 154) found on the face of the record must be an obvious and patent mistake and not something which can be established by a long drawn process of reasoning on points on which there may be conceivably two opinions. A decision on a debatable point of law is not a mistake apparent from the record. The assessee claimed depreciation on motor vehicle in terms of 32(1). It was accepted. Even in the regular assessment after verification of the books of account, statements and other particulars filed by the petitioner, the claim was allowed by the officer. Thereafter a notice under section 154 was issued to withdraw the depreciation on the ground that the assessee being a hirer was not liable to claim depreciation. Held, that in the guise of a mistake the Income tax authority were trying to set aside the view taken earlier. Section 154 was not applicable. The order of rectification was liable to be quashed.

262 ITR 0237- GEO MILLER AND CO. LTD. VS. DCIT (CAL)

The Supreme Court does not lay down the law. It only interprets the law, so that once there is an interpretation from the apex court, the law should be so understood from the inception of that law. All the decisions contrary to such interpretation become erroneous. It is for this reason that the Income-tax Department considers itself entitled to correct closed matters, so as to bring them to conform to such interpretation by resorting to power of rectification under section 154 or by re-opening back assessment under section 148, if within time. It was so understood by the Supreme Court itself in *S. A. L. Narayana Row, CIT v. Model Mills Nagpur Ltd.* [1967] 64 ITR 67, but if some further investigation is required before decision of the Supreme Court could be applied, rectification would not lie as was found in *Poothundu Plantations Pvt. Ltd. v. Agrl. ITO* [1996] 221 ITR 557 (SC).

In an analogous matter relating to retrospective amendment, the view that the completed assessments could be rectified in the light of such amendment was accepted in *M. K. Venkatachalam, ITO v. Bombay Dyeing and Mfg. Co. Ltd.* [1958] 34 ITR 143 (SC).

265 ITR 0479 CIT VS. INDIA CEMENTS LTD. (MADRAS HIGH COURT)

It is well established that the jurisdiction for rectification is not available, where the matter to be rectified is debatable. In respect of sales tax collected but not paid, because both sales tax collected and paid do not enter the profit and loss account, the departmental view has been that the tax collected should be treated as income, whether credited to profit and loss account or not and that to the extent it is unpaid section 43B would have application barring deduction. This inference, it was found in *CIT v. India Cements Ltd.* [2004] 265 ITR 479 (Mad) is debatable and that, therefore, it could not be subject matter of rectification under section 154.

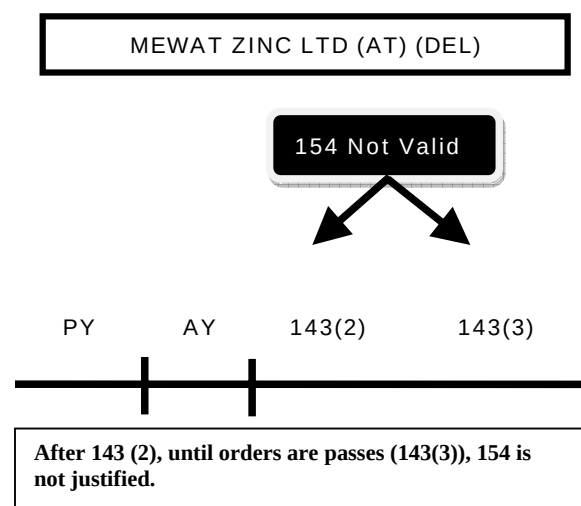
263 ITR 0041- VIJAY MALLYA VS. ACIT (CAL)

Section 154 of the Income-tax Act, 1961, empowers the income-tax authority to rectify a mistake apparent from the record. The mistake contemplated under section 154 must be a mistake apparent on the face of the records. It must be obvious, clear and patent.

It must not be a mistake, to establish which a long and elaborate reasoning and arguments is required on points on which there may conceivably be two opinions. It must not be a debatable point of law.

The issue as to whether a resident is ordinarily resident or not ordinarily resident depends upon the facts relating to the period of his stay in the past years, so that there may not be any information and much less non-controversial facts on record to justify rectification changing the status from not ordinarily resident to ordinarily resident thereby fastening a larger liability. After an elaborate discussion of the law on the subject, it was held that the issues in the facts and circumstances

of the case have to be considered as debatable and, therefore, outside the purview of rectification proceedings in *Vijay Mallya v. Asst. CIT* [2003] 263 ITR 41 (Cal).



POWERS CIT

Section / Topic Name : 263 and 264

INTIMATION CAN NOT BE REVISED

In CIT v. Kartar Singh and Co. P. Ltd. [2008] 300 ITR 440 (P&H), revisional jurisdiction against an intimation was found to be unavailable considering the fact that an intimation is a summary order. Section 263 makes no reference to such an order. The High Court relied upon the decision of the Supreme Court in Asst. CIT v. Rajesh Jhaveri Stock Brokers P. Ltd. [2007] 291 ITR 500 pointing out to the difference between intimation and assessment. It is true that no adjustment, even if it is prima facie, could be made to the income after June 1, 1999, but the decision of the High Court in this case referred to an intimation passed on December 12, 1990. A contrary decision of the Madras High Court in CIT v. Smt. R.G. Umaranee [2003] 262 ITR 507 was not noticed by the High Court.

TWO VIEWS POSSIBLE-REVISION IMPOSSIBLE

The Bombay High Court in Grasim Industries Ltd. v. CIT [2010] 188 Taxman 327 reaffirmed the settled principle that where the Assessing Officer has adopted one of the courses permissible in law or where two views are possible and the Assessing Officer has taken one of the views with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the revenue, unless the view taken by the Assessing Officer is unsustainable in law. In the instant case, it was found that two views were inherently possible, viz-a-viz, timing of relief against prices of forest produce procured by the assessee from the State Government pursuant to the Kerala High Court ruling. Whereas the liability of the assessee for three years stood reduced by a corresponding amount which was taxed in the assessment year 1983-84. The Commissioner, in exercise of powers under section 263, however held that when judgment of the High Court was delivered in early part of accounting year relevant to the assessment year 1982-83, liabilities, which ceased as a result of judgment, ought to have been written back in the assessment year 1982-83. The High Court held that the view taken by the Assessing Officer, in the instant case to tax such reliefs in the assessment year 1983-84, was a possible view on account of subsequent developments transpired after the judgment of the Kerala High Court so that the assessee could not be subjected to the exercise of the jurisdiction under section 263.

INCORRECT ASSUMPTION OF FACT OR INCORRECT APPLICATION OF

LAW

A Commissioner has the power to exercise jurisdiction, if the order of the Assessing Officer is erroneous and prejudicial to the interest of the revenue. The Himachal Pradesh High Court in CIT v. Himachal Pradesh Financial Corporation [2010] 186 Taxman 105, held that an incorrect assumption of fact, or an incorrect application of law would satisfy the requirement of the order being erroneous. In their view, the expression 'prejudicial to the interest of revenue' as understood in its ordinary meaning is of wide import and not confined to the loss of tax alone and if due to an erroneous order of the Assessing Officer, the revenue is losing tax lawfully payable by a person, it should be certainly prejudicial to the interest of the revenue.

ROVING ENQUIRY

The Calcutta High Court in CIT v. Pradeep Kumar Todi [2009] 181 Taxman 29, held that section 263 powers are not to be used for making a roving enquiry. After the Court found that the impugned assessment was made in accordance with guidelines prescribed under the CBDT circular and upon reliance on decision of jurisdictional High Court, there was no reason to call such order erroneous and prejudicial to the interest of the revenue. The High Court put on record the following finding in this case as the assessment was found to have been made in accordance with the guidelines prescribed under the circular dated 12-9-1960 issued by the Central Board of Direct Taxes and upon reliance on the decision in the case of CIT v. New India Investment Corpn. Ltd. [1994] 205 ITR 618/[1993] 69 Taxman 285 (Cal.) :

“In this case, the Assessing Officer, while making the assessments, acts in a quasi-judicial capacity and, therefore, discipline of such function demands that he should follow the binding decision rendered by the superior courts including by the jurisdictional High Court. . . .” (p. 32)

DIVERGENT VIEWS

The Kerala High Court in CIT v. Veepees Enterprises [2008] 175 Taxman 11 held that the Tribunal could not interfere with the order of the Commissioner passed under section 263, except on merits. In this case, the Tribunal had considered divergent views expressed by various the High Courts and held that in view of difference of opinion, the assessee was entitled to a view that was favourable to it. This did not impress the High Court which held that the Tribunal should have considered the issue on merits. In this case, the Commissioner noticed that since assessee had not filed returns or claimed depreciation for the theatre building for several years, depreciation should not be reckoned in the computation of capital gains on the sale of the theatre building.

FAILURE TO CLAIM CHAPTER VI-A DEDUCTION

In Poddar Pigments Ltd. v. CIT [2008] 175 Taxman 302, the Delhi High Court directed the Commissioner to condone the delay in filing a petition under section 264 and, thus, the assessee was given a fair chance to make claim for statutory deduction even when it failed to file a revised return within the prescribed time.

ERRONEOUS ORDER IN FACTS

In CIT v. Sunil Goyal [2009] 176 Taxman 184 (Uttarakhand) the Commissioner of Income-tax while perusing the order of the assessment of the Assessing Officer found that sundry credits were not proved to be genuine by the assessee and, thus, he issued notice to the assessee under section 263 of the Act, which was never replied. The Tribunal quashed the order by a casual assertion that loans were confirmed by the Assessing Officer without any fact of such verification or details. The Uttarakhand High Court held that the word ‘erroneous’ used in the section includes the expression ‘erroneous in law’ as well as ‘erroneous in fact’ and, thus, when the Commissioner of Income-tax was satisfied that the sundry credits were not duly verified, it rightly found that the Assessing Officer had erred in accepting the huge sundry credits. As such it held that the condition of invoking section 263 was fulfilled in the present case. In the apt manner, the Court pointed out that the heavens would have not fallen if one more opportunity was given by the Tribunal to the assessee before passing the order.

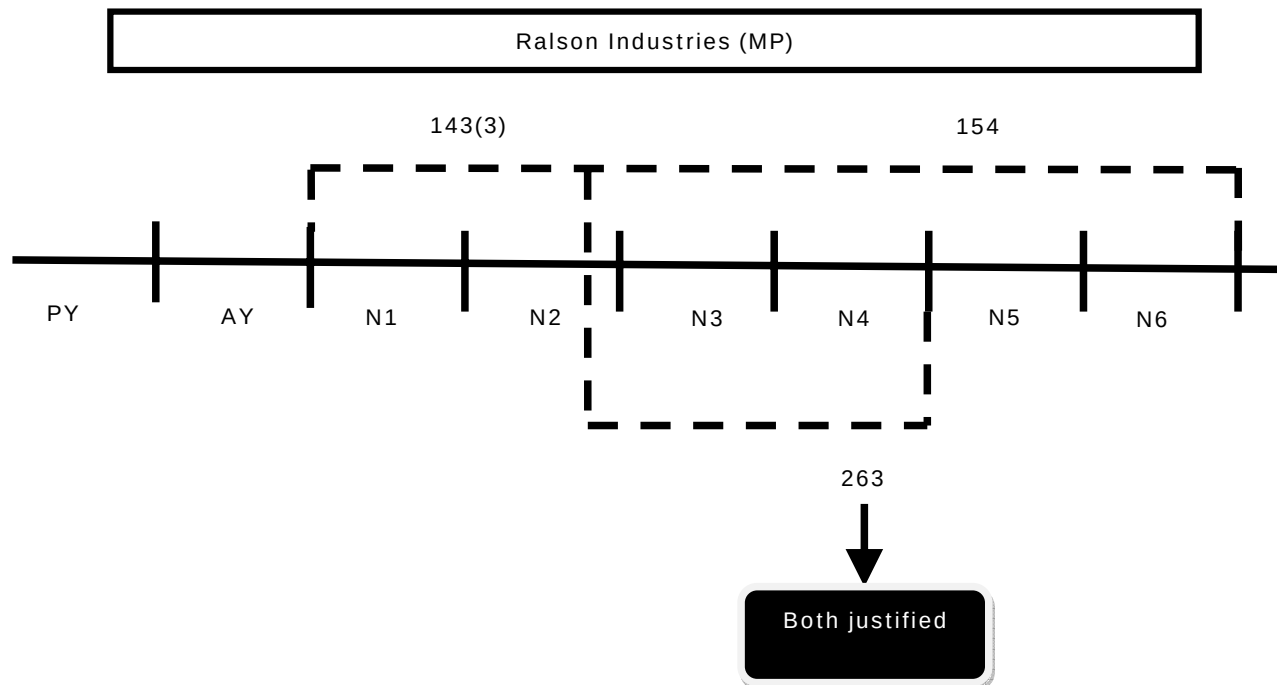
LIMITATION

In CIT v. Goyal M.G. Gases (P.) Ltd. [2009] 176 Taxman 189 (Delhi) the Commissioner while passing the order under section 263 gave a specific direction that the Assessing Officer would pass the consequential orders within a period of three months approximately, whereas the Assessing Officer

passed the order after more than a period of three years and, thus, the Tribunal concluded that the time for passing the order had expired. The Court held that even where no period of limitation is prescribed, then, in any event, a reasonable period of limitation ought to be adopted. The non-specification of a period of limitation in the Court's opinion did not mean that the Assessing Officer can wait for an infinite period before passing the consequential order and, thus, it dismissed the appeal of the revenue.

SUO MOTU REVISION PROCEEDING MAY BE INITIATED EVEN AFTER RECTIFICATION

In CIT v. Ralson Industries Ltd. [2005] 276 ITR 368 (MP), the AO completed the assessment under section 143(3). The Commissioner set aside the assessment under section 263, with direction to the Assessing Officer to make a fresh assessment on the ground that the Assessing Officer did not exclude certain accounts, transport receipts and interest amounts from the assessee's total income for the purpose of allowing deduction under sections 80HH and 80-I. The assessee contended before the Tribunal that after passing the assessment order under section 143(3), the Assessing Officer had issued a notice under section 154 to which he had furnished a detailed reply and thereafter the Assessing Officer had passed an



order of rectification under section 154 in which no modification on the point of excess deduction under sections 80HH and 80-I on account of exclusion of transport receipts and interest from the total income was made, although the Assessing Officer had modified the assessment order on other points. The Tribunal held that the original assessment order had ceased to be in existence because of its rectification under section 154 which was passed by the Assessing Officer after due application of his mind and on consideration of the explanation on the proposed rectification on the point of excess deduction under sections 80HH and 80-I and in view of fact that the Commissioner lacked jurisdiction to revise the assessment order which was not available for revision on the relevant date. The M P High Court held that since admittedly the revisional proceeding was initiated after the rectification, the Commissioner lacked jurisdiction to revise the original assessment, which was not in existence after its rectification under section 154.

This decision now stands reversed by the decision of Apex Court in CIT v. Ralson Industries Ltd. [2007] 158 Taxman 160 when the Court pointed out that the two sections 154 and 263 confer different

jurisdictions and they do not overlap each other and each of the two have defined and confined role under the statute.

MERGER PRINCIPLE DOES NOT VITIATE ACTION UNDER SECTION 263

The M P High Court in *Simran Farms Ltd. v. CIT* [2007] 158 Taxman 130 upheld action under section 263 to set aside order of AO allowing deduction under sections 80HHA and 80-I to an assessee engaged in business of hatching eggs in the light of subsequent decision of the Supreme Court in *CIT v. Venkateshwara Hatcheries (P). Ltd.* [1999] 237 ITR 174/103 Taxman 503. When the assessee claimed that the order of the AO had since merged into the order of the Commissioner (Appeals), the High Court held that the impugned issue was not subject matter of appeal before Commissioner (Appeals) and hence Explanation (c) has application.

SILENT ORDER

The Mumbai Bench of Tribunal, in *Anil Shah v. Asstt. CIT* [2007] 162 Taxman 39, held that according to the normal practice whenever any claim of the assessee is accepted, the Assessing Officer may not give any discussion in his order and the discussion is confined only to disallowance made by him and hence this could not be a good ground to initiate inquiry under section 263. The Bench, more particularly on the basis of Bombay High Court's decision in *CIT v. Gabriel India Ltd.* [1993] 203 ITR 108/71 Taxman 585 held that the order of the Assessing Officer cannot be read as erroneous for the mere fact that it did not contain elaborate discussion on the subject issues.

REVISED COMPUTATION FURNISHED DURING ASSESSMENT

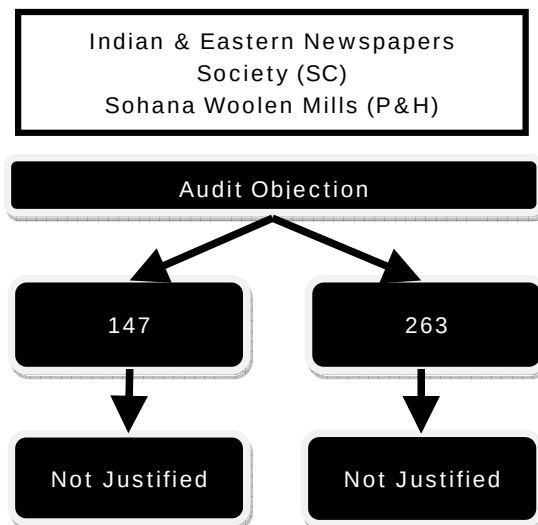
PROCEEDINGS

In *CIT v. Bharat Aluminium Co. Ltd.* [2007] 163 Taxman 430 (Delhi), the Assessing Officer allowed certain claims on the basis of revised computation made before him during the course of assessment proceedings. The Commissioner in an order under section 263 held that such furnishing of revised computation amounted to furnishing of revised return for which the time was over. He, thus, recalled such allowances. The Delhi High Court held that a legal representative is also competent to correct the original return. The Court found that the order could be prejudicial, though there was nothing erroneous about it since the claim was legitimate. In this case, the assessee who initially claimed 1/5th deduction of certain repair expenditure on CPP, subsequently, revised its claim for 100 per cent deduction under section 37(1).

REVISION PURSUANT TO SETTLEMENT COMMISSION ORDER

Settlement Commission would have taken note of the individual assessments in the names of the partners, namely, the petitioners, representing remuneration and salary. It was for the firm to have brought this to the notice of the Settlement Commission. The individual assessments of the partners on income received in the form of remuneration and salary from the very same firm and whatever relief was eligible should have been considered in the assessment of the firm in the settlement. Therefore, the Commissioner rightly assumed that the Settlement Commission had not made any specific disallowance under section 40A(2)(b) and rightly declined to interfere with the assessments of the petitioners which were completed based on the returns filed Smt. Leelamma John Thoppil v. Asst. CIT [2007] 295 ITR 368 (Ker).

Where the firm and not its partners were before the Settlement Commission involving additions in respect

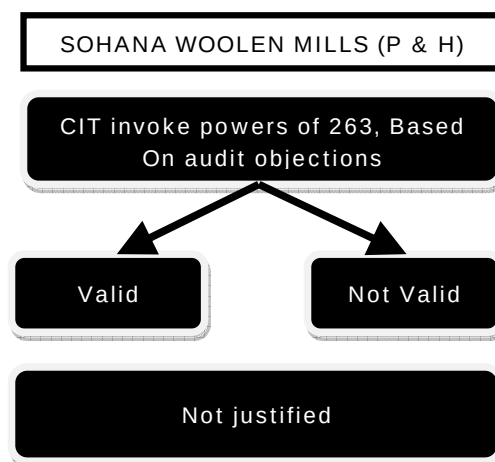


of payment of salary to partners, a corresponding reduction was necessary in the case of partners. But the firm had not brought the consequential amendment necessary in the partner's case to the notice of the Settlement Commission. Where the assessee sought revision before the Commissioner, the Commissioner pleaded helplessness as he had no authority to interfere with the decision of the Settlement Commission. He added that the assessee should have no grievance, because the assessee's return was accepted. The High Court declined to interfere with the revisional order in Smt. Leelamma John Thoppil v. Asst. CIT [2007] 295 ITR 368 (Ker). It felt that any relief to the partner should have been considered in the settlement of liability in the case of the firm, an inference which is rather

difficult to understand in the light of the fact that the partner's assessment was not before the Settlement Commission. In fact, section 155(1A)(iii) specifically authorises the Assessing Officer to make a consequential rectification in the partner's case in pursuance of a settlement in the firm's case. Apparently this was not brought to the notice of the authorities or the High Court.

REVISION BY AUDIT OBJECTION

Audit objection by itself has been found to be not a justification for notice under section 148 in Indian and Eastern Newspaper Society v. CIT [1979] 119 ITR 996 (SC). This decision along with similar other decisions were followed in the matter of revisional jurisdiction under section 263 in CIT v. Sohana Woollen Mills [2008] 296 ITR 238 (P&H), where it was held that a mere audit objection cannot lead to an inference that the order of Assessing Officer was erroneous or prejudicial to the interest of the Revenue, where there was no indication that the Commissioner was him-self satisfied about it prior to issue of notice, so that his order in pursuance of a notice based on an audit objection would be bad in law. The High Court, therefore, upheld the order of the Tribunal on its finding on the facts, that the order of the Commissioner was prompted solely by the audit objection.



APPEAL AND REFERENCE

The assessee had filed both a revision petition under section 264 and an appeal. The revision petition was dismissed because the assessee had filed an appeal. But the appeal was also not entertained because the assessee had not paid the admitted tax, which was paid after a delay along with a fresh appeal with a request for condonation of delay. Where the Commissioner (Appeals) had not examined the reasons for the delayed appeal with reference to the facts of the case and where the reasons justified condonation, refusal without examining such reasons was held invalid and the Tribunal remitted the matter for consideration afresh in *Mayfair Builders and Developers v. Deputy CIT* [2008] 306 ITR (AT) 308 (Pune).

289 ITR 0226- SMT. LILA CHOUDHURY VS. COMMISSIONER OF INCOME-TAX (GAUHATI HIGH COURT)

The power conferred by section 263 of the Income-tax Act, 1961, to interfere with an assessment made can be exercised only if the Commissioner is of the opinion that such assessment order is erroneous and prejudicial to the interests of the Revenue. An erroneous order does not mean a wrong order ; it does not mean an order with which the Commissioner is unable to agree. An erroneous order would be an order which suffers from a patent lack of jurisdiction ; the error must be with reference to jurisdiction. Prejudicial to the interests of the Revenue would mean an erroneous order which goes against the interests of the revenue collection. Both the conditions must pre-exist to enable the Commissioner to exercise the power under section 263. There has to be an opinion that the assessment which has been set aside is, indeed, erroneous and prejudicial to the interests of the Revenue. Furthermore, the power under section 263 being quasi-judicial, such conclusion must be reached after hearing the assessee which is mandated by the statute itself and after recording the reasons for the conclusions reached.

242 ITR 0659 EIMCO K.C.P. LTD. VS. CIT (SC)

Assessee in the given case had disputed the allowability of an expenditure which was pending before the AAC. While so, the Commissioner of Income-tax in exercise of his power under section 263(1) of the Act revised the said order of the Income-tax Officer holding that the amount in question could not be treated as expenditure and that granting of the said amount as deduction was erroneous and prejudicial to the interests of the Revenue and thus set aside the same. Held in the Supreme Court that the Commissioner of Income-tax could interfere, acting under section 263 of the Income-tax Act, with the order of the Income-tax Officer on a point which was directly in appeal before the Appellate Assistant Commissioner.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee in its return of income claimed a deduction of Rs. 2 lacs. Which was disallowed by the assessing officer. The act of the officer was challenged and the matter was pending before the AAC. Mean while CIT invoked its power under section 263 to disallow the claim. You are required to answer whether the action of the CIT under section 263 is justified or not.

ANSWER

Assessee in the given case had disputed the allowability of an expenditure which was pending before the AAC. While so, the Commissioner of Income-tax in exercise of his power under section 263(1) of the Act revised the said order of the Income-tax Officer holding that the amount in question could not be treated as expenditure and that granting of the said amount as deduction was erroneous and prejudicial to

the interests of the Revenue and thus set aside the same. Held in the Supreme Court that the Commissioner of Income-tax could interfere, acting under section 263 of the Income-tax Act, with the order of the Income-tax Officer on a point which was directly in appeal before the Appellate Assistant Commissioner. [2000] 242 ITR 0659 EIMCO K.C.P. LTD. VS. COMMISSIONER OF INCOME-TAX (SC).

243 ITR 0083 MALABAR INDUSTRIAL CO. LTD. VS. CIT (SC)

An incorrect assumption of facts or an incorrect application of law will satisfy the requirement of the order being erroneous. The phrase “prejudicial to the interests of the Revenue” is not an expression of art and is not defined in the Act. Understood in its ordinary meaning it is of wide import and is not confined to loss of tax. The scheme of the Act is to levy and collect tax in accordance with the provisions of the Act and this task is entrusted to the Revenue. If due to an erroneous order of the Income-tax Officer, the Revenue is losing tax lawfully payable by a person, it will certainly be prejudicial to the interests of the Revenue. The phrase “prejudicial to the interests of the Revenue” has to be read in conjunction with an erroneous order passed by the Assessing Officer. Every loss of revenue as a consequence of an order of the Assessing Officer, cannot be treated as prejudicial to the interests of the Revenue, for example, when an Income-tax Officer adopted one of the courses permissible in law and it has resulted in loss of revenue, or where two views are possible and the Income-tax Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue unless the view taken by the Income-tax Officer is unsustainable in law.

The Commissioner before invoking section 263 has to be satisfied of twin conditions, namely,

- (i) The order of the Assessing Officer sought to be revised is erroneous ; and
- (ii) It is prejudicial to the interests of the Revenue.

if the order of the Income-tax Officer is erroneous but is not prejudicial to the Revenue or if it is not erroneous but is prejudicial to the Revenue recourse cannot be had to section 263(1).

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee a public limited company entered into an agreement with S for sale of the estate of a rubber plantation for a consideration of Rs. 210 lakhs. However, the purchaser could not adhere to the schedule of payment and on his request, the parties agreed to extension of time for payment of installments on condition of his paying compensation/damages for loss of agricultural income and other liabilities in a sum of Rs. 3,00,000 and the purchaser paid the said amount. In the return filed by it the amount was noted as compensation and damages for loss of agricultural income. Income-tax Officer accepted the same and endorsed nil assessment for that year. Subsequently commissioner of Income tax invoked his power under section 263 to revise the order passed by the officer and taxed Rs. 3,00,000 in the hands of the assessee. You are required to answer whether CIT is justified in invoking section 263. You are also required to explain the scope of section 263.

ANSWER

An incorrect assumption of facts or an incorrect application of law will satisfy the requirement of the order being erroneous u/s 263. The phrase “prejudicial to the interests of the Revenue” is not an expression of art and is not defined in the Act. Understood in its ordinary meaning it is of wide import and is not confined to loss of tax. The scheme of the Act is to levy and collect tax in accordance with the provisions of the Act and this task is entrusted to the Revenue. If due to an erroneous order of the Income-tax Officer, the Revenue is losing tax lawfully payable by a person, it will certainly be prejudicial

to the interests of the Revenue. The phrase “prejudicial to the interests of the Revenue” has to be read in conjunction with an erroneous order passed by the Assessing Officer. Every loss of revenue as a consequence of an order of the Assessing Officer, cannot be treated as prejudicial to the interests of the Revenue, for example, when an Income-tax Officer adopted one of the courses permissible in law and it has resulted in loss of revenue, or where two views are possible and the Income-tax Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue unless the view taken by the Income-tax Officer is unsustainable in law. However in the given case orders passed by the officer is not based on the evaluation of the facts the action of the CIT is justified u/s 263.

263 ITR 0101- PAUL MATHEWS AND SONS VS. CIT (KER)

The provisions of section 263 cannot be invoked by CIT to correct each and every type of mistake or error committed by the Assessing Officer. It is only when an order is erroneous that the section will be attracted. An incorrect assumption of facts or an incorrect application of law will satisfy the requirement of the order being erroneous. In the same category fall orders passed without applying the principles of natural justice or without application of mind. The phrase “prejudicial to the interests of the Revenue” is not an expression of art and is not defined in the Act. Understood in its ordinary meaning it is of wide import and is not confined to loss of tax. The scheme of the Act is to levy and collect tax in accordance with the provisions of the Act and this task is entrusted to the Revenue. If due to an erroneous order of the Income-tax Officer, the Revenue is losing tax lawfully payable by a person, it will certainly be prejudicial to the interests of the Revenue. The phrase “prejudicial to the interests of the Revenue” has to be read in conjunction with an erroneous order passed by the Assessing Officer. Every loss of revenue as a consequence of an order of the Assessing Officer cannot be treated as prejudicial to the interests of the Revenue. For example, when an Income-tax Officer adopted one of the courses permissible in law and it has resulted in loss of revenue, or where two views are possible and the Income-tax Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue unless the view taken by the Income-tax Officer is unsustainable in law. The statement elicited during the survey operation had no evidentiary value and the Income-tax Officer was well aware of this. At the same time, the assessee having found that there were some omissions on its part, offered certain amounts as additional income for the years in question and gave a written offer to the Additional Commissioner. It was after verifying the account books and various materials gathered in the survey and after considering the offer made by the assessee that the Income-tax Officer had exercised a judicial discretion in the matter while completing the assessment. In the light of the voluntary disclosure in the letter given in writing by the assessee the facts given by it had been verified with the books of account and it was only after consideration of the various aspects of the matter and related facts that the Assessing Officer accepted the offer made by the assessee. In such circumstances, the view taken by the Income-tax Officer could not be said to be prejudicial to the Revenue nor could it be said to be erroneous. The order of revision under section 263 is not valid.

Question

The assessee-firm was a contractor. There was a survey operation under section 133A and a statement was recorded from the managing partner admitting that there were irregularities and discrepancies in the books of account, in that there was excess payment of cash over what was available as per the cash book and also unaccounted investment in properties and suppression of receipts and inflation of expenses. In the course of such statement given by the managing partner he offered an amount of Rs. 43 lakhs as additional income. The Assessing Officer determined the business income taking the net profit at 8 % of the total receipt. But according to the Commissioner of Income-tax this was erroneous and prejudicial to

the interests of the Revenue and invoked his power under section 263 and set aside the assessment. You are required to answer whether the action of the CIT is justified or not.

Answer

In *Paul Mathews and Sons v. CIT* [2003] 263 ITR 101 (Ker), the Assessing Officer framed an assessment on a firm at Rs. 8.26 lakhs on the basis of the materials gathered by him during survey. The Commissioner of Income-tax purporting to act under section 263 set aside the order as prejudicial to the Revenue in the light of the confessional statement and the Tribunal endorsed this. The High Court pointed out that the Assessing Officer had computed the income after considering the confessional statement and all other evidence. It was not that he had accepted the income declared by the assessee in a mechanical way, and his order could not have been treated as prejudicial to the Revenue merely because confessional statement was for a larger amount. It was incidentally pointed out that the statement recorded during survey had even less legal sanctity than that recorded during search as is evident from the difference in language between section 132(4) and 133A, because the statement in the former section required treatment of such statement as evidence, while the latter did not make such a reference. Action taken by the officer under section 263 is not justified.

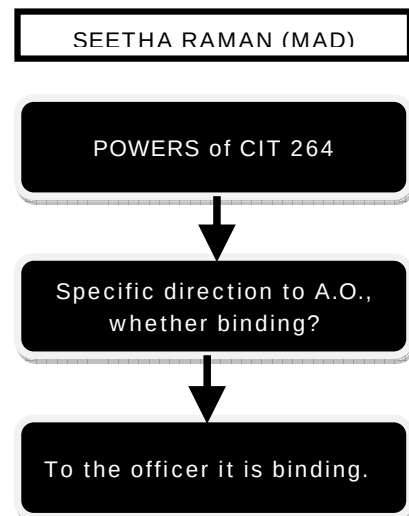
280 ITR 0385- COMMISSIONER OF INCOME-TAX VS. VINCAST ENGINEERING (ALLAHABAD HIGH COURT)

Retrospective amendment can be the reason to invoke the powers of section 263 by the CIT.

280 ITR 0377- COMMISSIONER OF INCOME-TAX VS. ASSOCIATED FOOD PRODUCTS P. LTD. (MADHYA PRADESH HIGH COURT)

It should not be presumed that initiation of power under suo motu revision is merely an administrative act. It is an act of a quasi-judicial authority and based on formation of an opinion with regard to existence of adequate material to satisfy that the decision taken by the Assessing Officer is erroneous as well as prejudicial to the interests of the Revenue. The concept of “prejudicial to the interests of the Revenue” has to be correctly understood. It means an order which has not been passed in consonance with the principles of law which has affected realisation of lawful revenue by the State.

The orders were passed by the officer in very short time. However provisions of the law was applied correctly. The orders were passed by the Commissioner and it was perceptible that the said authority had not kept in view the requirement of section 263 of the Act inasmuch as the order did not reflect any kind of satisfaction that the assessment order was erroneous and prejudicial to the Revenue. The Commissioner had been influenced by a single fact which was not relevant. The order of revision was not valid.



280 ITR 0368- COMMISSIONER OF INCOME-TAX VS. ASHOK CONSTRUCTION CO. (ALLAHABAD HIGH COURT)

Scope of order which is erroneous and prejudicial to revenue u/s 263. There was failure to comply with compulsory audit of accounts. Also there was failure to initiate penalty proceedings. The credit wrongly

given for tax deducted at source based on certificates dated outside assessment year. For which CIT took action u/s 263 and held that order of officer was erroneous and prejudicial to revenue. Revision proceedings were valid.

243 ITR 0808- HINDUSTAN AERONAUTICS LTD. VS. CIT (SC)

Section 264 provides that the Commissioner shall not revise any order under this section in a case where the order has been made the subject of an appeal to the Appellate Tribunal. The Commissioner of Income-tax has no power to revise any order under section 264 if the order has been made subject to an appeal to the Appellate Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal and irrespective of the fact whether the appeal is by the assessee or by the Department.

Under section 263 where a revision is permissible in cases of orders which are prejudicial to the interests of the Revenue, in Explanation (c) thereto it has been provided that where any order referred to in this sub-section and passed by the Assessing Officer had been the subject-matter of any appeal, the powers of the Commissioner under this sub-section shall extend to such matters as had not been considered and decided in such appeal. The Legislature does not make such a distinction in the scheme of section 264.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

In the assessment of Mr. X he claimed deduction under section 80 HHC as well as 80 D. Both of them were disallowed by the assessing officer on the grounds that assessee was not entitled for the same. Assessee preferred an appeal against claim of 80D and the matter was before the ITAT. On the other hand assessee made an application under section 264 before the CIT to consider the issue of 80 HHC. CIT has considered the issue and has passed the appropriate orders. You are required to answer whether the action of the CIT is justified or not.

ANSWER

Under section 263 where a revision is permissible in cases of orders which are prejudicial to the interests of the Revenue, in Explanation (c) thereto it has been provided that where any order referred to in this sub-section and passed by the Assessing Officer had been the subject-matter of any appeal, the powers of the Commissioner under this sub-section shall extend to such matters as had not been considered and decided in such appeal. The Legislature does not make such a distinction in the scheme of section 264. Thus in the given case CIT can not consider the matter under section 264. [2000] 243 ITR 0808-HINDUSTAN AERONAUTICS LTD. VS. COMMISSIONER OF INCOME-TAX (SC)

249 ITR 0786- CIT VS. T.V. SURESH CHANDRA (SC)

A plot of land was transferred by two transferors [joint owners], to four brothers [joint owners], in separate defined shares by one sale deed. Held, that the sale transaction could not be held to be a sale in favour of an association of persons but was of individual plots of land in favour of each purchaser.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

The property being land was transferred by the two transferors who are jointly co-owners of the said property to four brothers in separate defined shares as prescribed in one sale deed. The officer was of opinion that the purchase was made by the four brothers as an association of persons. You are required to answer that whether the sale can amount to the sale to the AOP or not and also explain the tax treatment of any income if arises out of that plot of land.

ANSWER

A plot of land was transferred by two transferors, who were joint co-owners, to four brothers in separate defined shares by one sale deed. The competent authority initiated acquisition proceedings on the basis that there was one transaction of sale in favour of four brothers as an association of persons. It was decided in case of [2001] 249 ITR 0786- COMMISSIONER OF INCOME-TAX VS. T.V. SURESH CHANDRA (SC) that there were four sale transactions reflected in the sale deed and the competent authority had to consider the matter of acquisition afresh and the sale transaction could not be held to be a sale in favour of an association of persons but was of individual plots of land in favour of each purchaser.

278 ITR 0501- HILLTOP HOLDINGS INDIA LTD. VS. COMMISSIONER OF INCOME-TAX (CALCUTTA HIGH COURT)

Power under section 263 can be exercised in relation to a proceeding in which the Assessing Officer has passed an erroneous order prejudicial to the Revenue. Therefore, in order to attract section 263, the following four conditions need be satisfied viz., (1) there should be a proceeding ; (2) there should be an order passed by the Assessing Officer in such proceeding ; (3) such order should be erroneous ; (4) and such order should be prejudicial to the Revenue. In order to attract section 263, the order must be an order passed by the Assessing Officer in the proceeding. A proceeding is to be understood in its common ordinary dictionary meaning. The word “proceeding” has not been defined in the Act. According to Shorter Oxford Dictionary, the word “proceeding” means “the formal manner in which legal proceedings are conducted”. A proceeding can be said to be initiated and conducted only when the Assessing Officer proceeds to assess the income. Section 143(1) does not envisage initiation of any proceeding and the intimation is not an order passed in any proceeding to attract section 263.

LEGAL HEIRS AND EXECUTORS

Section / Topic Name : 159,168

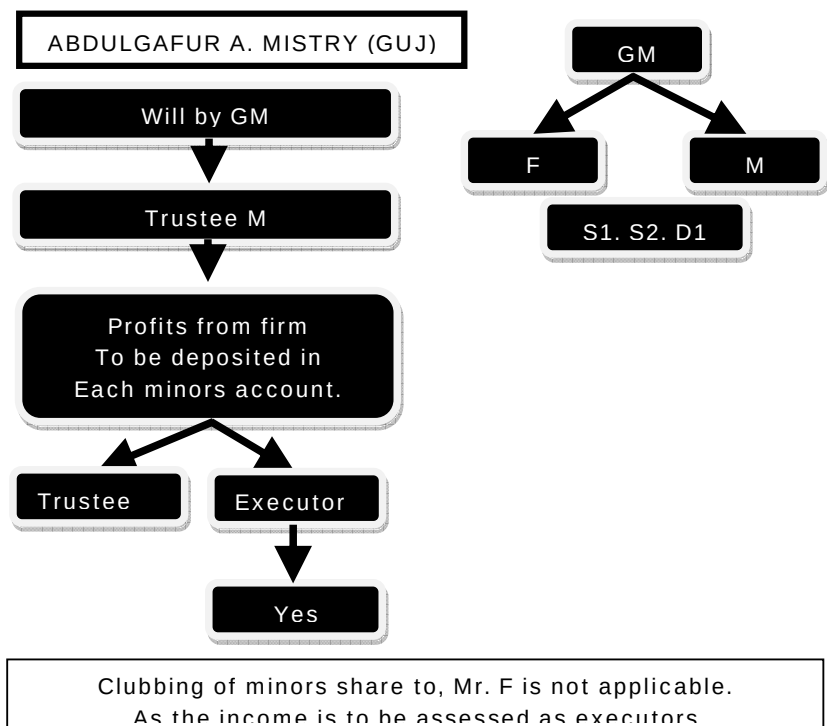
SCOPE OF EXECUTOR

The assessee and his mother were partners in a firm. In a will executed by the mother of the assessee, she bequeathed certain ornaments belonging to her in favour of her four minor grand children. There was a mention in the will that on the death of the testator the said four children would be entitled to all movable properties belonging to her. The assessee's brother's wife was appointed as an executor of the will and the assessee's wife and the assessee's brother's wife were described as the guardians and trustees of the minor children. The will also mentioned that the profit income from the firm would be divided in equal shares and would be deposited in four different accounts of each minor. The Assessing Officer held that as trust was created in favour of the minors, the assessee was liable to tax. The Tribunal held that as a fact no trust was ever created and the words "trustee, executor and guardian" had been used as synonyms and that they were loose expressions. On a reference : Held, that on the facts no trust was ever created by the testator under the will. If the executor of the will was to join the partnership to represent the interest of the minors and was to deposit the business income in a separate account of each of the beneficiaries, then such executor would not gain the capacity of a trustee and would only be an executor of the will. Therefore, the Tribunal was justified in holding that the provisions of Explanation 2A to section 64(1)(iii) of the Income-tax Act, 1961, were not applicable.

Where a person dies intestate, the assets vest in the legal heirs on the date of death. Where he leaves a will, the estate of the deceased would vest in the executor, who would be assessable under section 168, so that there is no scope for application of the clubbing provision under section 64(1)(iii) (now substituted by sub-section (1A) of section 64) for aggregation of the minor's income. It was so held in CIT v. Abdulgafur A. Mistry [2007] 292 ITR 515 (Guj).

LEGAL HEIR AND EXECUTORS

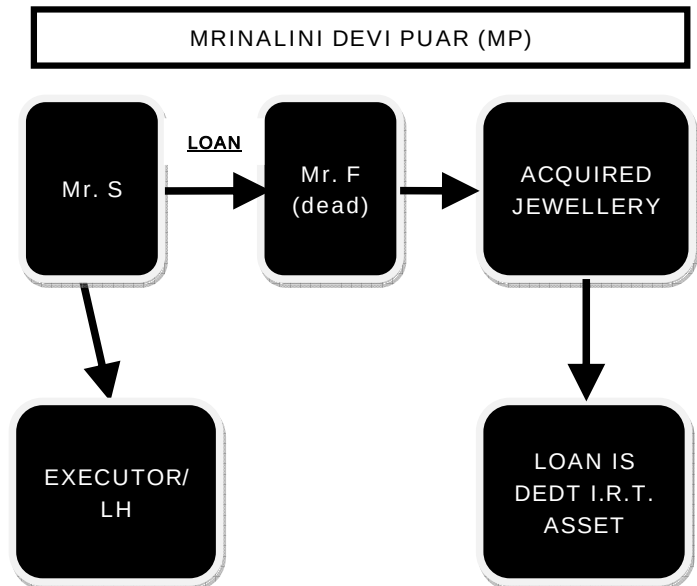
Section 168 provides for assessment on the executor of the will, where there is succession by will. The legal heirs are assessable only after distribution as and when such distribution takes place and on the amount prior to such distribution, it is the executor alone who is responsible for filing the return and payment of tax. It would make no difference even if there were only a sole beneficiary of the will. It was so held in CIT v. Mrunalinidevi Puar of Dhar [2008] 305 ITR 263 (Guj). A similar view was taken in CIT v. Mrs. A. Ghosh [1986] 159 ITR 124 (Cal). It may be pointed out that if there had been no will, the property would be



treated as passing to the legal heirs on the date of death, so that each legal heir would be assessable on the income from his share of the property from the date of death.

286 ITR 0607- ASSISTANT COMMISSIONER OF WEALTH-TAX VS. MRINALINI DEVI PUAR (MADHYA PRADESH HIGH COURT)

An executor may be a legal heir. He may even be a sole legal heir. But where the property is inherited by a will, it is in the capacity of an executor that the property is managed till disbursement of the estate. It was so held in Asst. CWT v. Mrinalini Devi Puar [2006] 286 ITR 607 (MP) following the decision in identical circumstances in CIT v. Mrs. A. Ghosh [1986] 159 ITR 124 (Cal). It was in this context, that it was further found that, where a loan was advanced by the executor towards payment of estate duty, such amount will go to reduce the wealth assessable in the hands of the individual beneficiary for wealth tax purposes, as money owed by the assessee to the executor.



COMPANIES IN LIQUIDATION

Section / Topic Name : 178

290 ITR 0643- ASSISTANT COMMISSIONER OF INCOME-TAX VS. OFFICIAL LIQUIDATOR OF MINAL OIL AND INDUSTRIES LTD. (GUJARAT HIGH COURT)

An important decision was rendered in the context of priority of the Government dues over other creditors. Preferential payments in favour of secured creditors and workmen have priority over the claim of the Income-tax Department as was held in ACIT v. Official Liquidator of Minal Oil and Industries Ltd. [\[2007\] 290 ITR 643](#) (Guj) on consideration of the provisions of section 178(3) of the Income-tax Act, 1961 and section 529A of the Companies Act, 1956. The demand related to a company under liquidation and the issue related to priority of claim over the sale proceeds of company's assets. The liquidator had held that there was a prior claim from the Export-Import Bank of India, besides workers' dues, which were to rank pari passu with secured creditors'. The Revenue relied upon the decision of the Supreme Court in Imperial Chit Funds (P) Ltd. v. ITO [\[1996\] 219 ITR 498](#) and ITO v. Official Liquidator [\[1975\] 101 ITR 470](#) (AP). The High Court found that the reliance was misconceived, since the decision of the Supreme Court related to the claim of creditors under section 530 of the Companies Act, so that the right of the secured creditors under section 529A was not under consideration. It was pointed out that the court had understood the decision of the Supreme Court accordingly in Syndicate Bank v. Official Liquidator, Wester Works Engineers Ltd. [1999] 98 Comp Cas 487 (Bom) and Venad Pharmaceuticals and Chemicals Ltd. (In liquidation), In re [2003] 114 Comp Cas 185 (Ker). The High Court further considered section 178(2) of the Income-tax Act and found that the claim that whatever is intimated as amount due should be accepted by the liquidator is not correct. Such an interpretation would be contrary to sub-section (3) of section 178 itself which only requires that the amount so claimed should be set apart and not parted with. Sections 529A and 530 of the Companies Act would be required to be followed by the liquidator. While the State dues would have precedence, they need not have precedence over prior claims of secured creditors or workmen.

LIABILITY IN SPECIAL CASES

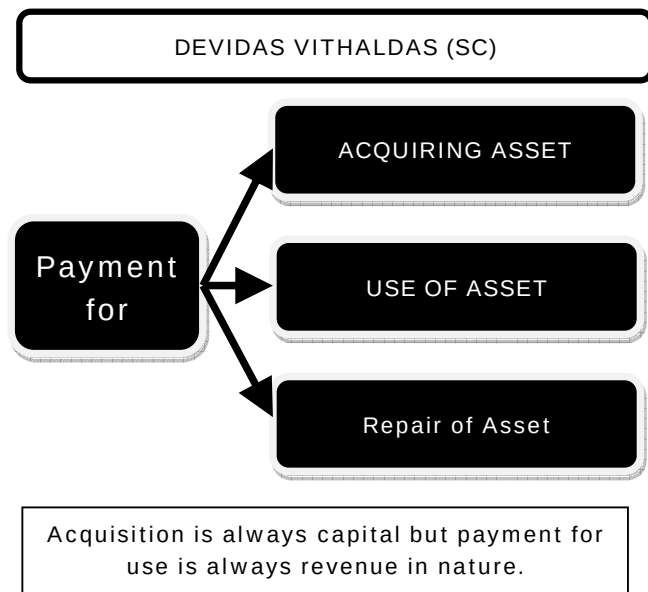
Section / Topic Name : 160 TO 166, 9

REFERRAL FEE NOT ACCRUED IN INDIA

An issue, whether an amount described as referral fee paid to a non-resident for referring potential customers desirous of obtaining real estate consultancy offered by the Indian company, was the subject matter of taxability in India before the Authority for Advance Rulings in Cushman and Wakefield (S) Pte. Ltd. In re [2008] 305 ITR 208. It was ruled that the activities of the non-resident were carried out entirely outside India. The referred customer was not bound to enter into a deal nor had the non-resident to do anything further beyond making the reference. In fact, he merely brought about a contact between the resident Indian company and the prospective non-resident customers for the Indian company. It was not in the nature of managerial, technical or consultancy service in the sense consultancy is understood in the definition of technical fees either under section 9(1)(vii) of the Income-tax Act or article 12(4)(b) of the Double Taxation Avoidance Agreement between India and Singapore. There may be business connection in such agreement, but there is no operation in India, so that there is no liability under domestic law. The description of the service as consultancy service as sometimes used in contracts may be misleading. What is necessary to be ascertained is the nature of service. There have been similar decisions in Asst. CIT v. Paradigm Geophysical Pty. Ltd. [2008] 11 DTR (Delhi) 174 in respect of charges for data processing and Diamond Services International v. UOI [2008] 304 ITR 201 (Bom) in respect of certification fee. Such services as referral fees are more in the nature of brokerage services for finding clients or customers for the resident assessee from abroad. Board Circular No. 786 dated February 7, 2000 [2000] 241 ITR (St.) 132 concedes that payment to non-resident commission agents or brokers for getting orders for the resident company will not be taxable in India.

TRANSFER OF ASSETS IN INDIA

If the transfer is of a capital asset situate in India, the charge of tax is attracted by virtue of section 9(1)(i) of the Income-tax Act, 1961. It is immaterial in such a case that the actual process of transfer, such as the execution of transfer documents, had taken place outside India. Income arising from the transfer of a capital asset situated in India by a non-resident is deemed to be his income liable to be taxed in India in view of the explicit mandate of section 9(1). "Property of any kind" undoubtedly includes intellectual property which is but a species of intangible property. Trade mark, brand, goodwill, technical know-how relating to the manufacture of goods would all qualify to be treated as capital assets within the meaning of section 2(14) of the Act. Section 55(2), which deals with the cost of acquisition of a capital asset, makes it clear that goodwill, trade mark or brand name associated with a business and other incorporeal rights mentioned therein, are treated as capital assets under the Act for the purpose of capital gains. Haji Abdul Kader Sahib v. CIT [1961] 42 ITR 296 (Ker); Devidas Vithaldas and Co. v. CIT [1972] 84 ITR 277 (SC) and Pfizer Corporation, In re



[2004] 271 ITR 101 (AAR) relied on.

There is no legal principle that the situs of an intangible asset such as trade mark or goodwill would always go with the ownership or that the intangible asset such as the trade mark or goodwill has no situs other than the country of fiscal residence of the owner. An intangible asset or an incorporeal property can have more than one situs. Goodwill is territorial in the sense that it exists at the place where the related business exists. As goodwill and trade mark are intertwined, the same principle would apply to both.

The registration of a trade mark has no bearing on the ownership ; nor does the registration of a trade mark create an asset. Registration confers statutory remedies for its effective protection. CIT v. Finlay Mills Ltd. [1951] AIR 1951 SC 464 relied on.

Registration of a trade mark in India is one of the relevant factors pointing to the roots it had taken and the recognition it has gained in India.

Section 9(1) would foist tax liability on a non-resident having income “through transfer of a capital asset situate in India”. An intangible asset has also a location. Goodwill is territorial, so that it is located in the country where the business is carried on. The trade mark along with goodwill has no situs other than the country of fiscal residence of the owners. But there can be more than one situs where the business itself is in more than one country. Goodwill and trade mark are inter-twined. The place of registration of the trade mark has no bearing on the ownership. In fact, mere registration does not create an asset by itself. It only gives statutory protection and remedies for the owner on registration.

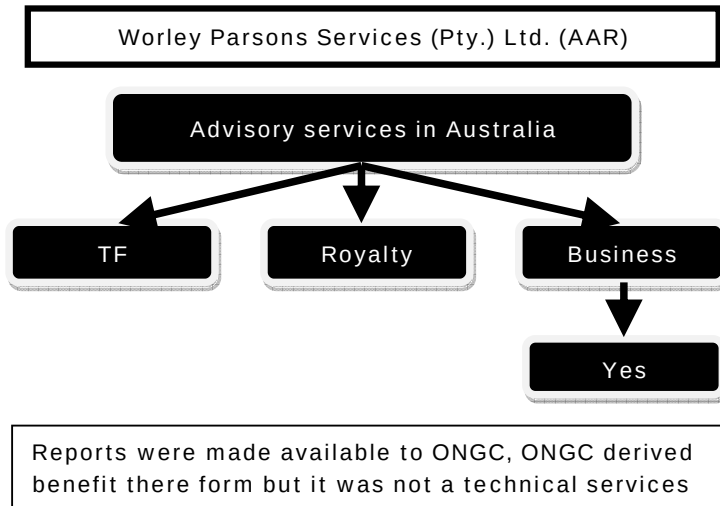
The Authority for Advance Rulings in Foster’s Australia Ltd., In re [2008] 302 ITR 289 after citing these principles, ruled on the liability of various assets to Indian tax in the context of the transfer of shares and other intangible assets in the nature of intellectual property from the assessee to a U. K. firm. The ruling was given after elaborate discussion as to the terms of the contract, the nature of assets and precedents from the U. S. and the U. K. and distinguishing an earlier ruling in Pfizer Corporation, In re [2004] 271 ITR 101 (AAR) on the ground that it related to rights regarding a dossier containing technical information comparable to the brewing manual in the case for ruling. Foster’s trade mark and brand I. P. (intellectual property) were found to have nexus as an integral part of business along with its goodwill, so as to be located in India. On the relevant date, these assets were in India. These assets were transferred by the assessee company along with transfer of the controlling interest in Foster’s India to Sab Miller. The location, if any, in Australia, could be construed to be only notional or fictional. The mere fact that the trade mark originated or was initially registered in Australia should make no difference.

As for brewing manual containing the brewing I. P., which was transferred with all connected materials with licence divested, it could not be treated as an asset located in India, so that corresponding intellectual property rights could not be subjected to tax in India as they fell squarely within the ruling in Pfizer Corporation’s case (supra) and the rationale of the decision in Associated Cement Companies Ltd. v. Commissioner of Customs [2001] 124 STC 59 (SC), the only difference being that the latter case dealt with tangible property. The alternate argument usually associated with determination of income attributable to permanent establishment was also found unacceptable. Since trade mark and brand intellectual property were property located in India, the entire income accrued in India, so that there was no legal basis for conceding apportionment.

As for computation of taxable capital gains, the Authority for Advance Rulings had no objection to an independent valuer’s report being considered by the Assessing Officer on the merits. The Revenue’s contention based on the substance theory, so as to bring to tax the entire profits treating the routing of the transaction through group companies as a smokescreen was negated in the absence of relevant materials for such a conclusion on the facts and the ruling of the Supreme Court in Union of India v. Azadi Bachao Andolan [2003] 263 ITR 706, virtually de-recognising the principle in McDowell and Co. Ltd. v. CTO [1985] 154 ITR 148 (SC) in law.

ADVISORY SERVICES

The Authority for Advance Ruling in WorleyParsons Services (Pty.) Ltd., In re [2009] 180 Taxman 296 held that advisory services carried out by the applicant in Australia would not come under the purview of the definition of 'Fees for technical services' and as such services do not make available to recipient of services, technical knowledge, skills, know-how, etc. The following words deserve reading as drawn from Para 6.3 of the judgment:



“By undertaking such services under the contracts, the applicant, no doubt, furnished to the ONGC valuable information or inputs of technical nature in order to proceed with the work relating to the two projects. The reports/recommendations furnished by the applicant, undoubtedly, have a technical content which, in turn, helped ONGC in many ways. ONGC derived benefit from the use of end-product, namely, reports/recommendations provided by the applicant. From that it does not follow that

technical knowledge of the applicant and the inputs deployed by it for preparing those reports are acquired or applied by the applicant. It cannot be said that the recipient of the service, namely, ONGC will get equipped with the knowledge and expertise of the service provider and be able to make use of it in future, independent of the service provider. The reports are project/contract-specific and can hardly be of any use of ONGC, once the particular contract comes to an end. The revenue has argued that the ‘make available’ criterion is satisfied in the instant case for the reason that the review and report would help or assist ONGC to make use of the information while interacting with the bidders and in preparing tender documents insofar as the contract No. 1 is concerned. For the reasons stated above, this argument, which proceeds on a misinterpretation of the phrase ‘make available’, cannot be accepted. It is not a case where any technology has been made available to ONGC, though ONGC has benefited by the advisory services rendered by the applicant. A failed attempt was also made by the revenue to invoke the second link by contending that the work done by the applicant amounts to development of a technical plan. It is contended that the expression ‘technical plan or design’ ought not to be construed in a narrow sense. But it includes the technical data and specifications contained in the report and in respect of contracts (2), (3) and (5), the work involved modification of designs prepared by third parties. The technical plan or design was transferred to the ONGC after making value additions, imposed from a technical angle, it is contended. However, when the expression ‘technical plan or design’ is understood in a wider sense, it cannot be held that in the instant case, any technical plan or design was evolved by the applicant and was transferred to ONGC.” (p. 300)

Royalty / TF income is of great advantage u/s 115A. if business income is there it is not royalty, thus no tax rate advantage is available for business income.

		Tax Rate
Royalty/TF	115A	10%
Business Income	115A not apply	Regular Rate

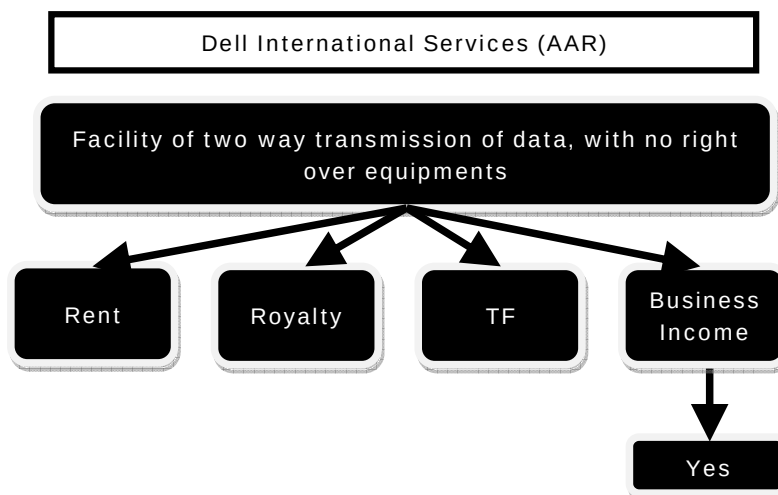
NOTE :

The benefit of tax rate is only for NR/foreign company having Royalty/TF as income.
Business income is not Royalty Income, thus tax rate benefit not available

In the case of *Raymond Ltd. v. Dy. CIT* [2003] 86 ITD 791 the Mumbai Bench of the Tribunal previously held that the normal, plain and grammatical meaning of the language employed using the expressions ‘making available’ and ‘making use of’ is that mere rendering of services is not roped in unless the person utilizing the services is able to make use of the technical knowledge, etc., by himself in his business or for his own benefit and without recourse to the performer of the services in future. The technical knowledge, experience, skill, etc., must remain with the person utilizing the services even after the rendering of the services has come to an end. The fruits of the services should remain available to the person utilizing the services in some concrete shape such as technical knowledge, experience, skill, etc.

RENT V/S ROYALTY

Where a non-resident offers the facility of two way transmission of voice and data through telecom bandwidth with no right for the resident Indian company over the equipment, the monthly payment cannot be treated as rent, because what is paid is not for use of the equipment in any legal sense. No royalty is involved nor is there a technical service. It is a business arrangement offering a facility from abroad. If the non-resident has no permanent establishment in such cases, there can be no liability in India under the Double Taxation Avoidance Agreement between India and the U. S. as ruled by the Authority for Advance Rulings in *Dell International Services (India) P. Ltd., In re* [2008] 305 ITR 37.

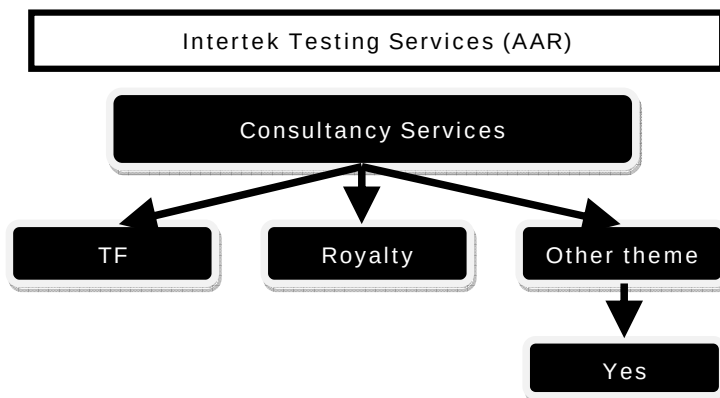


The Authority had made a survey of the case law on the subject before coming to the decision, so that this comprehensive ruling should be of assistance in solving many similar issues, which are pending because of the wrong understanding of the law on the part of the authorities in such cases. Hopefully, the Revenue would have no reservations on this ruling, so that the outstanding issues could be solved in similar cases on the basis of the reasoning in this ruling.

CONSULTANCY SERVICE V/S ROYALTY

Whether consultancy service could be treated as technical service can only be considered in the light of the nature of the service. Not all consultancy services could be technical service even in the wider definition of technical service under Explanation 2 to section 9(1)(vii). However, a non-resident assessee in an application for ruling conceded that the consultancy fees received by it would be taxable under the domestic law in India. But it contended that it was entitled to relief under the provisions of the Double Taxation Avoidance Agreement between India and the U. K. The Authority for Advance Rulings in Intertek Testing Services India P. Ltd., In re [2008] 307 ITR 418 considered the definition of technical service in the Agreement as well as the nature of service rendered by the assessee in detail. The definition of technical service under article 13 of the Agreement requires that what is made available should be “technical knowledge, experience, skill, know-how or processes, or consist of the development and transfer of a technical plan or technical design”. In the light of this, the consultancy service was found not technical service, since it did not make available any of these items listed in article 13(4)(c).

Professional service by itself may be covered under section 9(1)(vii) in view of the wide meaning given to it as found by the Supreme Court in Continental Construction Ltd. v. CIT [1992] 195 ITR 81. But in the light of the definition in the Agreement, mere advisory services of routine nature or furnishing of information though out of expertise or special knowledge of the consultant may not be technical service, merely because of the technical knowledge of the consultant, as long as he does not transmit such technical knowledge. If the payer for such service does not derive an enduring benefit, so as to be able to



utilise the knowledge or know-how in future on his own account without the aid of the service provider, such consultancy service cannot be technical service within the meaning of article 13(4)(c) of the Agreement between India and the U. K.

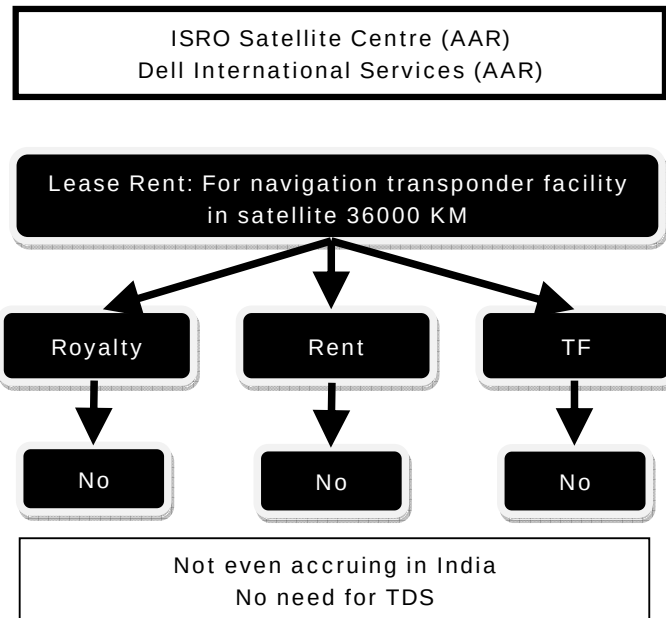
In this case before the Authority for Advance Rulings, the non-resident was providing centralised services to a group, e-mail, video-conference, developing system design and net works and updating

desktop and internet standards, besides management of global internet site in order to provide a key point of contact for new customers. This, no doubt, involves technology, but other services like reviewing and challenging business plans, building new and maintenance of relationship with key customers, finance and tax related services, risk management inherent in trading activities, advice on contractual/commercial claims against the company and legal support, were more in the nature of service without parting technology.

As for the technical knowledge that may be made available, there can be liability. Since no details of actual services were made available, it was for the Assessing Officer to identify the extent of technical service, if any, from actual services rendered. It is under these circumstances, the Authority for Advance Rulings held that there can be no liability, subject, however, that the transaction price was at arm's length, subject to check with reference to actual service by the Assessing Officer. It is on this basis, it was further found, that there was no duty to deduct tax at source, but advised the assessee to ask for a certificate under section 195(2) as to the requirement of any portion of the payment for tax to be deducted at source with reference to actual service, though such certificate would not bind the parties in the matter of assessment.

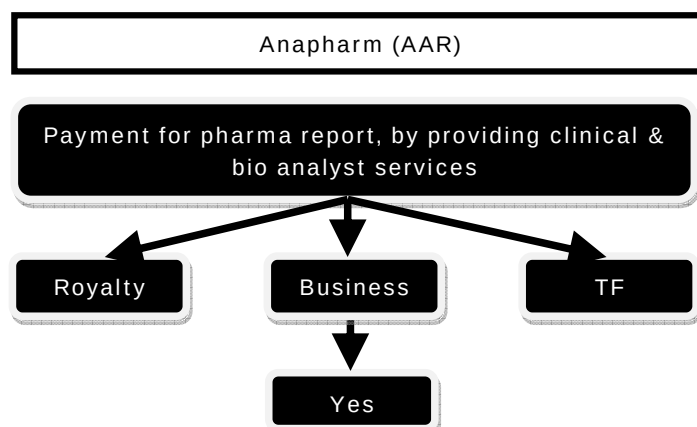
BUSINESS INCOME V/S ROYALTY INCOME

Lease rent paid for use of a navigation transponder facility in a satellite 36,000 km. above the earth's atmosphere without actual use of the transponder by the space department, with the non-resident not having a permanent establishment in India, will not be liable to tax in India. It is not royalty. Such an inference follows from article 13 of the Double Taxation Avoidance Agreement between India and the U. K., which also does not contemplate such payment to be in the nature of royalty. It was pointed out that the transponder as understood in McGraw Hill's Dictionary of Scientific and Technical Terms is a transmitter-receiver capable of accepting the challenge of an interrogator and automatically transmitting an appropriate reply. In Chamber's Dictionary of Science and Technology would understand transponder as an equipment forming part of a communications satellite, which receives signals from the ground station at one frequency and retransmits them to another ground station or to domestic satellite receivers at another frequency. It was found that the analogy of TV operations by means of remote control is not appropriate. In the light of the earlier Rulings in Dell International Service P. Ltd. In re [2008] 305 ITR 37, that the provision of two way transmission of voice and data through telecom bandwidth would be business, there can be no liability, unless there is a permanent establishment in India. The Authority for Advance Rulings in this case in ISRO Satellite Centre [ISAC], In re [2008] 307 ITR 59 had also referred to Prof. Klaus Vogel's Commentary on Double Taxation Conventions for the proposition that the use of a satellite is a service and not for a rental, unless the entire direction and control over the satellite, such as piloting and steering, were transferred to the user. It was held that since there is no liability, there is no need to deduct tax at source. A Board circular offering guidance relating to such issues is overdue.



BUSINESS INCOME V/S ROYALTY

Where a payment was made by resident pharmaceutical companies to a non-resident Canadian company undertaking contract research by providing clinical and bio-analytical service to assist Indian companies in the development of new drugs or generic copies of drugs already marketed, the question arose whether there could be any liability in India for the non-resident on such receipts from Indian companies. It was ruled by the Authority for Advance Rulings in Anapharm Inc., In re [2008] 305 ITR 394, that the non-resident was only giving final reports and conclusions of its evaluation of the products given for analysis by its clients. Such report was necessary for purposes of the registering authorities in order to enable sales abroad by Indian companies. The issue was whether



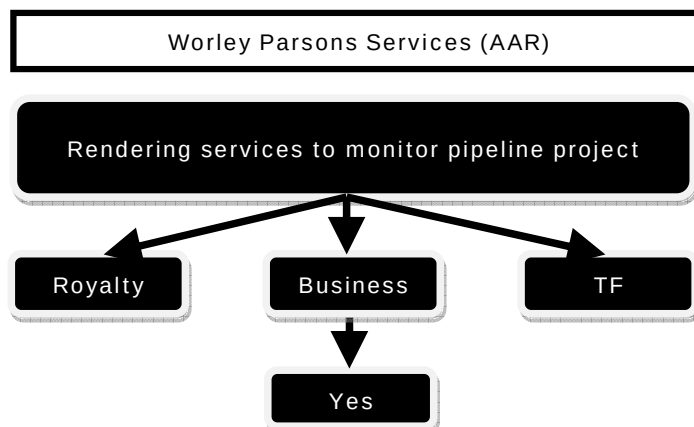
such payment could be treated either as royalty or fees for technical service. The AAR found that there is some difference between the definition of technical service under section 9(1)(vii) of the Income-tax Act and the definition under article 12 of the Double Taxation Avoidance Agreement between India and Canada. The latter required that technical knowledge, experience, etc., should be “made available” in India to be treated as technical service. By this test, the non-resident did not equip its clients to independently perform the technical function, which it itself performed. It could not, therefore, be treated as fees for technical services. The fact that the service was highly technical in content, therefore, did not make any difference to the conclusion. Mere handing over tested samples along with the report is not technical service. The fees could not also be considered as royalty, since the amount was not paid for any information relating to the method, procedure or protocol used for the purpose of providing this service. The receipts were merely in the nature of business receipts falling under article 7 of the Agreement between India and Canada, so that there could be no liability for the non-resident, unless it had a permanent establishment in India. In coming to this conclusion, the AAR referred to two decisions of the Tribunal in *Raymond Ltd. v. Deputy CIT* [2003] 86 ITD 791 (Mum) and *McKinsey and Co. Inc (Philippines) v. Asst. Director of Income-tax (International Taxation)* [2006] 284 ITR (AT) 227 (Mum). It also referred to the decision of the High Court in *Diamond Services International v. UOI* [2008] 304 ITR 201 (Bom), which related to certification fee paid for quality of diamonds assessed abroad.

BUSINESS INCOME V/S ROYALTY

Rendering services as monitoring consultants for a pipeline project in India has to be treated as a business activity, so that the payment therefor cannot be treated as royalty. The income from such activity can only be treated as profits from business.

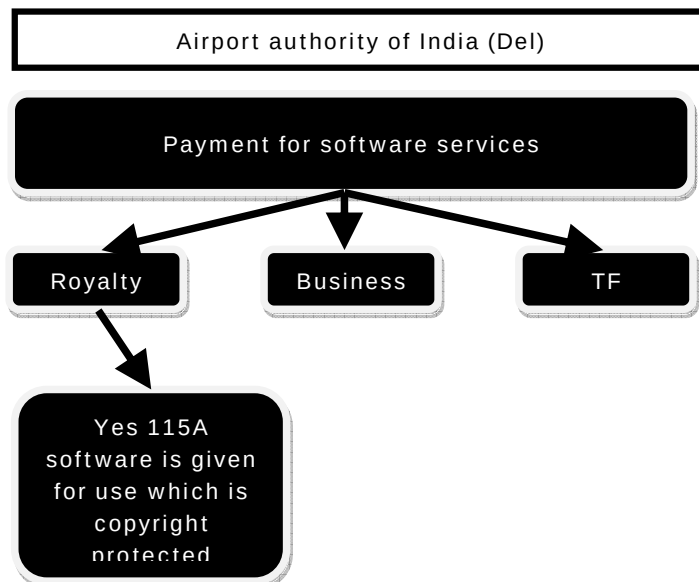
There was also no parting with technology involved as required under the definition of “technical services” under article 12(3)(g) of the Double Taxation Avoidance Agreement between India and Australia to constitute technical fees. The assessable income, therefore, would be the profit attributable to the permanent establishment which the non-resident

had in India for the purposes of its activity. It was so ruled by the Authority for Advance Rulings in *Worleyparsons Services Pty. Ltd., In re* [2008] 301 ITR 54.



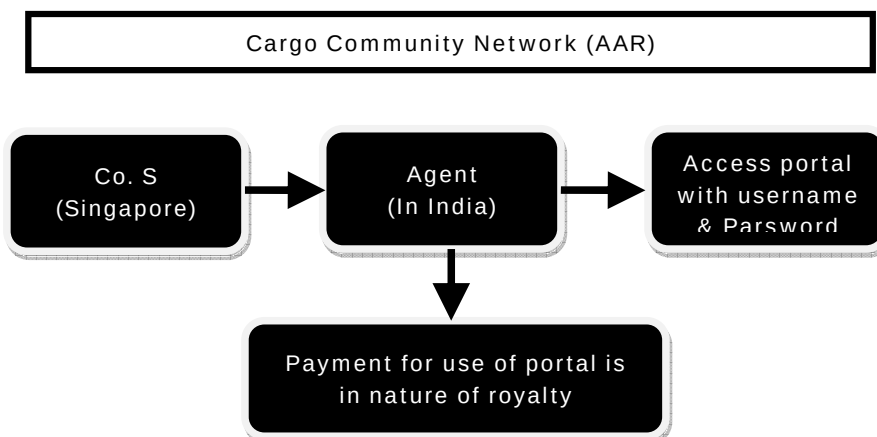
SOFTWARE PAYMENTS

The AAR in *Airports Authority of India, In re* [2008] 172 Taxman 284 (New Delhi) held that the payment received by the non-resident in respect of supply of documents and software will be taxable as royalty, as documents and software in question are copyrights which have been given to applicant for use and said payment shall be charged at rate of 10 per cent per section 115A plus applicable surcharge and cess under the Act. Similarly, it held that payment in respect of provision of services of installation, testing and training shall be taxable as fee for technical services under the Act, read with DTAA and shall be charged at the rate of 10 per cent as per section 115A plus applicable surcharge and cess under the Act.



ROYALTY PAYMENTS

The applicant, a company incorporated in Singapore, was engaged in the business of providing access to an internet based air cargo portal at Singapore. An agent who booked cargo through various airlines could subscribe for the portal which enabled him to access the data bank of the airlines like flight schedules,



availability of cargo space, etc. In addition the portal performed other functions like furnishing the status of booking to the agent, creating data base for various bookings by furnishing the status of the shipment, etc. The portal transmitted data from the agent to the airlines by converting from simple English language to Cargo IMP data and on receiving the reply of the

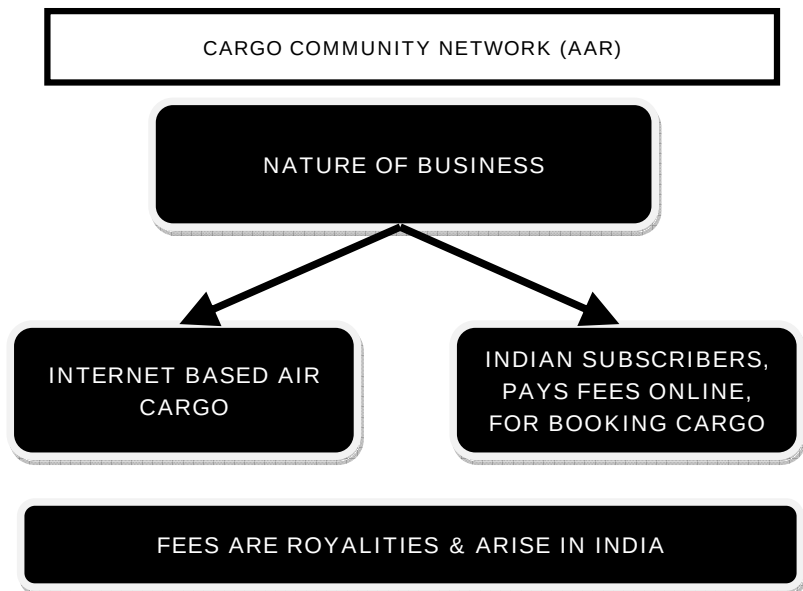
airlines converting the Cargo IMP into simple English language and transmitting the same to the agent. For the services the applicant charged subscription fee, systems connect fee, helpdesk support fee, etc. The applicant opened a liaison office in Chennai (India) to act as a communication channel between the head office and parties in India. The liaison office did not take up any activity of a training or commercial nature. Nor did it provide any consultancy or other service. The expenses of the liaison office were met exclusively out of funds remitted from Singapore. There were two employees in the liaison office who received messages from subscribers in India for the purpose of communicating with the head office and supplying information to the intending agents. The agents made subscription directly to the head office at Singapore and the agreement for the use of the portal was also signed at the head office of the applicant in Singapore. No software programme was installed in the computer system of the agent who was given an exclusive password to access the portal. The applicant also imparted training, consisting of only

demonstration, to agents to use the portal in its entirety. On these facts the applicant sought an advance ruling from the Authority on the question whether the payments by Indian subscribers to the applicant for providing passwords to secure access and use the portal hosted from Singapore was taxable in India and was subject to deduction of tax at source.

The Authority for Advance Rulings in *Cargo Community Network Pte. Ltd.*, In re [2007] 289 ITR 355 has ruled that the payment for access to internet based air cargo portals outside India would be royalty, because it is not merely for getting access to data, but use of the portal for booking cargo, besides training of subscribers and rendering help connected therewith.

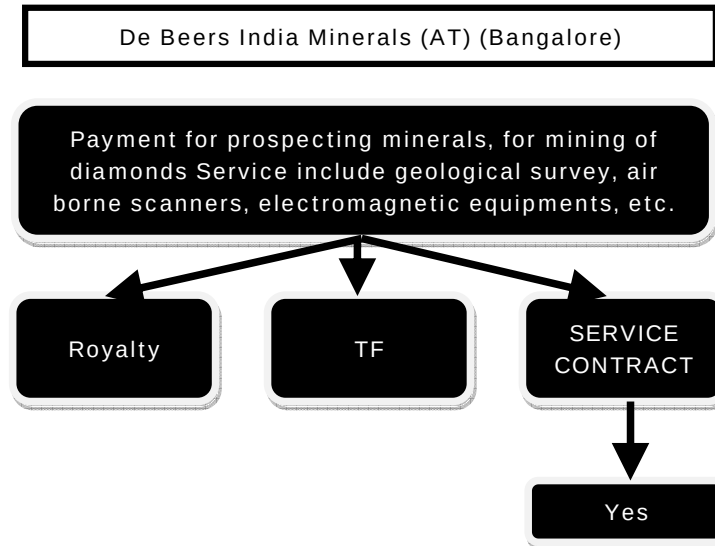
The mere right to use technical equipment does not mean that technology gets transferred or that it constitutes a payment for royalty. What is obtained is just information,

it had been held, and there could be no element of royalty, in *CIT v. HEG Ltd.* [2003] 263 ITR 230 (MP). The provision of cellular mobile telephone services was held to be a service, which did not have the character of technical service in *Skycell Communications Ltd. v. Deputy CIT* [2001] 251 ITR 53 (Mad). The Tribunal in *Wipro Ltd. v. ITO* [2005] 278 ITR (AT) 57 (Bang) had held that payment to a foreign publishing house for access to certain data could not amount to royalty, as it was a case of payment for mere information. The Authority for Advance Rulings in taking the view in *Cargo Community Network's* case (supra), that the payment is taxable as royalty and fees for technical service distinguished these cases by pointing out that it was not a case of provision of mere internet access to information, but use of the portal for booking cargo with airlines, training subscribers and rendering connected help. Even so, it would appear that these services are in the nature of business rendered abroad, so that this ruling could have been different.



TECHNICAL SERVICES

A payment made to a non-resident for prospecting reconnaissance of minerals made by a resident licensee for prospecting of mining for diamonds and other minerals had come up for adjudication on the question whether it is for technical service. The service to be rendered involves various activities like collection of samples, geophysical survey by use of airborne multispectral scanner and electro magnetic equipment with such exploration being considered at different stages of preliminary, advanced and feasibility. The non-resident made available such services with a team of experts making reports from time to time called acquisition and processing reports. The Assessing Officer held it to be technical service taxable under article 12 of the Double Taxation Avoidance Agreement between India and the Netherlands covering “technical knowledge, experience, skill, know-how or processes” being made available or consisting of development and transfer of a technical plan or a technical design.



The Commissioner (Appeals), however, inferred that it could not be so treated, since there was no transfer of technology and the Tribunal dismissed the departmental appeal on the ground that though knowledge and expertise were involved, such knowledge and expertise themselves were not made available to the resident assessee. The data collected were further processed by use of software technology, which was not made available. The resident assessee was merely supplied with computer readable conclusions from the data collected. This was an agreement for mere service and not for transfer of technology. Reports and maps only contain data, which could not also be treated as technical plan or technical design. Incidentally, it was also interpreted that the language in article 12(5)(b) pointing out that the two activities of service or supply of technology are linked by the word “or”, which is to be understood conjointly and not disjunctively. The decision is a well-reasoned one. In taking this view, it has followed the stricter meaning of technical service in contradistinction to other services by drawing support from law lexicons, the guidelines from the decision of the Supreme Court in *Commissioner of Customs v. Parasrampuriah Synthetics Ltd.* [2002] 253 ITR 274 and other decisions of the Tribunal as in *C.E.S.C. Ltd. v. Deputy CIT* [2003] 87 ITD 653 (Kolkata), *Raymond Ltd. v. Deputy CIT* [2003] 80 TTJ 120 (Mum) , *Nga Quality Systems Registrar Ltd. v. Deputy CIT* [2005] 92 TTJ 946 (Delhi) and *Mckinsey and Co. Inc. (Philippines) v. Asst. Director of Income-tax (International Taxation)* [2006] 284 ITR (AT) 227 (Mum) in this persuasive decision rendered by the Bangalore Bench of the Tribunal in *ITO (International Taxation) v. De Beers India Minerals P. Ltd.* [2008] 297 ITR (AT) 176.

ADVERTISING-MARKETING

In Set Satellite (Singapore) Pte. Ltd. v. Dy. DIT, International Taxation [2008] 173 Taxman 475 (Bom.) the assessee sold advertising time through its agents in India against commission payment. Quite naturally either the assessee is liable for agency operations/activities in India if a PE is established in India or its agent if the transaction between the two is on principal-to-principal basis. The department alleged that the assessee-company had a permanent establishment in India whereas the assessee claimed that the transactions between it and its agents were on principal-to-principal basis where the assessee had remunerated the agents on arm's length basis and once such agent was assessable in India on such remuneration and no further tax was payable by the assessee-company in view of the Board's Circular No. 23, dated 23-7-1969. Further, when the revenue argued for application of Circular No. 742, dated 2-5-1996 so as to compute taxable income at 10% of gross profits the assessee claimed set-off of commission paid to agent being more than 10% of net Ad revenue so that the resulting net income turned into negative.

The Bombay High Court held that advertisement revenue earned by the assessee-company was not taxable in India on the basis of the Circular No. 23 of 1969 as well on the basis of treaty provisions, more so for the reason that the assessee had remunerated the agents in India for agency business on an arm's length basis under Article 7(2), read with Circular No. 742, dated 2-5-1996.

The decision of the Bombay High Court, thus, calls for introspection of percentage defined in the Circular No. 742 to protect the interest of the revenue.

PE INDICATORS - REGULAR/CONTINUOUS TRADE OR CASUAL/ SOLITARY EVENT/ACTIVITY

The AAR in Golf in Dubai, In re [2008] 174 Taxman 480 (AAR – New Delhi) has held that the phrase used in article 5 of the Double Tax Avoidance Agreement (DTAA) between India and the United Arab Emirates is 'carried on' as against other possible phrase 'carried out' or 'carried', meaning thereby that the use of preposition 'on' in conjunction with 'carried' suggests that the business should not be one of activity, but a regular, continued exercise even if it be an intermittent one and of a short duration every time. In its view the expression 'carry on business', in its ordinary meaning, signifies a course of conduct involving the performance of a succession of acts, and not the effecting of one solitary event. The phrase means more or less a continuous venture which, if not taking place incessantly, should at least be regular in its occurrence so that ventures like travel circuses, musical troupes, stalls in exhibition and game shows, etc., will have a fixed place PE in a State only if they carry on their activities on a regular basis. It is on that basis that the AAR held in the instant case that any income generated by the applicant from golf tournaments held in Delhi and Bangalore would not be liable to tax in India in terms of Article 7 of the DTAA. At the end the AAR also left a pointer that such receipts, i.e., management fees could have been brought to tax within the purview of 'Fees for technical services' (FTS). However, in the absence of any provision in the Treaty with regard to FTS, the same has been held to be not taxable as FTS.

PERMANENT ESTABLISHMENT

At no point of time had the Airports Authority of India alleged that the premises were used for a purpose other than that for which the licence was granted and the Commissioner (Appeals) had erred on the facts in holding to the contrary. The assessee did not receive any income other than the profits from the operation of aircrafts in international traffic and therefore, the amount was not subject to tax in India as admittedly the effective management of the assessee was not situated in India. Since there was a direct nexus between the two activities of availing of and using the space, the receipt from one would be set off

against the expenses on the other. The additions made were to be deleted. [2008] 307 ITR (A.T.) 0142-KLM Royal Dutch Airlines v. Deputy Commissioner of Income-tax (Income-tax Appellate Tribunal--Delhi)

Where a Dutch company was engaged in operation of aircraft in international traffic and incidentally runs premises made available by the Airports Authority of India, through its agent for cargo handling, such income from cargo handling should also be treated as operation of aircrafts in international traffic, so that it could be assessable under the terms of the Double Taxation Avoidance Agreement only in the place of effective management, which in this case was Netherlands. It was, therefore, held not liable to tax in India in KLM Royal Dutch Airlines v. Deputy CIT [2008] 307 ITR (AT) 142 (Delhi)

FOREIGN SOLICITORS

In Clifford Chance v. Dy. CIT [2009] 176 Taxman 458 (Bom.), the assessee was appointed as english law legal adviser for four projects in India and further the number of days, when the assessee's partners were present in India during the relevant previous year, had also exceeded 90 days and, thus, both conditions were satisfied. The assessee filed its return of income showing income attributable to its operations in India in respect of the said four projects whereas the revenue held a view that the determining factor for Indian Taxation was place where the assessee's services were utilized and not the place where they were performed and, thus, the entire fees received by the assessee from the clients engaged in the said four projects, whether services were rendered in India or outside India, was subject to tax in India.

The Bombay High Court held that for a non-resident to be taxed in India on income for services, the following two conditions must be fulfilled simultaneously:

- (i) That the services which are source of income sought to be taxed in India must be utilized in India; and
- (ii) That such services must be rendered in India.

As per the Court, both those conditions had not been satisfied simultaneously in this case and, thus, it held that only income of the assessee charged on hourly basis in India and utilized in India would only be chargeable to income-tax. The territorial nexus doctrine plays an important part in the assessment of tax. Finding support from the Supreme Court decision in Ishikawajima Harima Heavy Industries Ltd. v. Director of Income-tax [2007] 288 ITR 408/158 Taxman 259, it held that tax is levied on one transaction where the operations, which may give rise to income, may take place partly in one territory and partly in another territory.

LIAISON OFFICE

The Authority for Advance Rulings in Ikea Trading (Hong Kong) Ltd. , In re [2009] 176 Taxman 344 (AAR-New Delhi) held that activities of applicant, who maintained only a liaison office in India, which are confined to purchase of goods meant for export would fall within clause (b) of Explanation 1 to section 9(1)(i) and, therefore, no income can be attributed or apportioned on account of such purchase operations. In this case, there was a categorical finding that purchased items are invoiced by Indian suppliers directly to applicant who, in turn, sells same to wholesale companies outside India and sale price is received by applicant outside India.

AMALGAMATION OF TWO FOREIGN COMPANIES

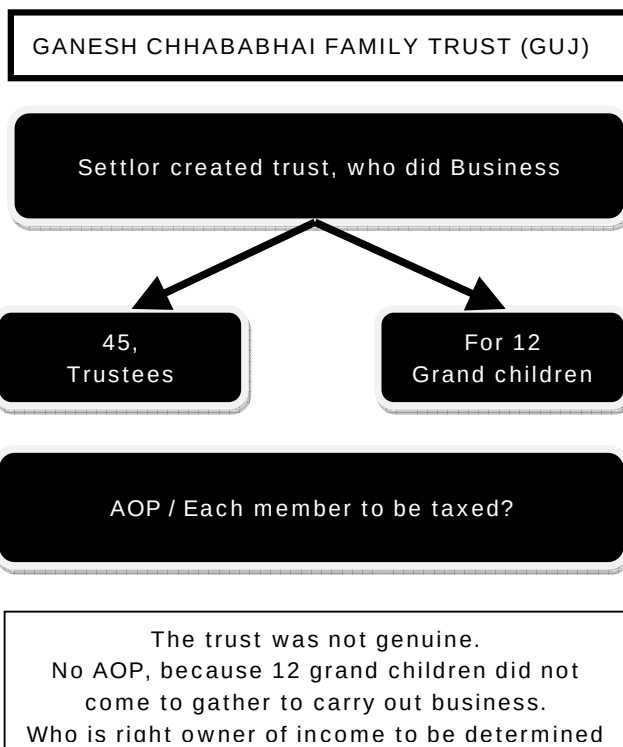
In the context of the holding company of an Indian subsidiary itself getting amalgamated with another foreign company, there is transfer of the shares in the Indian company as an asset located in India, but such transfer is not regarded as transfer under section 47(via), so that there is no liability as held by the Authority for Advance Rulings in Hoechst GmbH, In re [2007] 289 ITR 312. Where the holding company, which is a foreign company amalgamates with another foreign company, the exemption under section 47(via) is subject to two conditions, that there should be 25 per cent. identity of shareholding of the amalgamating company in the amalgamated company and that there should be no liability for capital gains tax in the country where the amalgamating company is incorporated. The first condition was easily satisfied, because amalgamation abroad was as between the holding company and the wholly owned subsidiary. It was, however, understood to be an impossible condition, so as not to be applicable in the view that the company cannot be its own shareholder. As for the second condition, that there should be no liability for capital gains in the country of transferor, that is also satisfied, since article 13(5) of the Double Tax Avoidance Agreement between India and Germany provides for tax in the country where the alienator is a resident. Instead of amalgamation, if there had been transfer of shares of the Indian company, capital gains would have been taxable in India under article 13(4) of the Agreement.

PRIVATE TRUST OR AN AOP

Section 161(1) requires that a trustee or any other legal representative is assessable “in like manner and to the same extent” as the beneficiary. Where the beneficiaries are not specified, section 164(1) would provide for adoption of the maximum marginal rate. Section 164(1A) provides for the maximum marginal rate in respect of income from business. It is also established law that the beneficiary could also be directly assessed. In fact, one would imagine that the normal assessment should be on the beneficiary, while the law would permit an assessment on the representative assessee in the case of a trust to enable recovery among other things.

In Ganesh Chhababhai Family Trust v. CIT [2008] 296 ITR 129 (Guj), two settlors created as many as 45 trusts for their 12 grandchildren. The Assessing Officer felt that the creation of a trust was not genuine and clubbed the income of all the trusts in the hands of an association of persons being beneficiaries. Since an association is a voluntary act of persons coming together for earning profit, the beneficiaries of the trust cannot be treated as a single association. The Tribunal found that there was no genuine trust with beneficiaries

in each trust determinate and identifiable. It further found that such multiple trusts are devices for carrying on business and, therefore, not genuine trusts. But the inference that there was an association of persons was not apparently dealt with by the Tribunal according to law, because such an inference would not have been possible as pointed out by the High Court in this case with reference to the law laid down by the Supreme Court in CIT v. Indira Balkrishna [1960] 39 ITR 546. The High Court found that the



finding of the Tribunal that the inference of association of persons cannot be upheld, though it did not have any objection to the inference that the trust was not genuine. The inference that the association of persons is liable to be charged at the maximum marginal rate under section 167A, therefore, did not follow. The matter was therefore remitted back to the Tribunal to take additional evidence. If the trust were not genuine as indicated in the judgment, the entire income from the assets would have been assessable in the hands of the settlors. Considering the fact that the assessment years were 1982-83, it would be an uphill task to follow this line especially for all later years. The proper inference is to tax the trust or the beneficiaries at the maximum marginal rate, since a trust cannot be treated as invalid merely because the settlors might have intended some tax savings. Where a person gives up some property, it cannot be treated as a device, because device can be inferred only where a person keeps the property but saves tax. But such a course of action in the light of the finding that the trust is not genuine may not be possible for the Tribunal, so that what would be necessary is a review by the High Court itself.

289 ITR 0310- COMMISSIONER OF INCOME-TAX VS. SMT. COMILLA MOHAN (ALLAHABAD HIGH COURT)

The assessee created two trusts for the first son of V and the first son of H by transferring 60,000 equity shares. The Department took the view that these two trusts were not validly created as the sole beneficiary of each of the two trusts was neither in existence nor identifiable at the time of creation of these trusts and in action under section 147(a)/148 of the Income-tax Act, 1961, added the dividend income on these shares in the hands of the assessee. The Commissioner (Appeals) deleted the dividend income from the assessment made in the assessee's hands. This was confirmed by the Tribunal. On a reference Held, that the two trusts were validly created though the sole beneficiary of each of the trusts was neither in existence nor identifiable at the time of creation of the trusts. The income on the shares / debentures could not be included in the hands of the assessee.

286 ITR 0662- COMMISSIONER OF INCOME-TAX VS. WESTERN COMPANY OF NORTH AMERICA (ALLAHABAD HIGH COURT)

The assessees were foreign residents and employees of W. The non-resident company entered into a contract with Oil and Natural Gas Corporation for drilling of oil. The contract of employment of the assessees with their employees provided 28 days of rest outside India after 28 days of working on rigs extracting oil for Oil and Natural Gas Corporation. In the return filed by the assessees for the assessment year 1984-85 income from salary paid for the period of actual working by the assessees on the rig alone was shown. It was contended that salary for the 28 days period spent by the assessees outside India after 28 days working on the rig was not taxable. This contention was not accepted by the Income-tax Officer. The Commissioner upheld the order of the Income-tax Officer but the Tribunal reversed it. On a reference held, that the Income-tax Appellate Tribunal was legally correct to hold that the salary paid to the assessee for the laid off period outside India was not chargeable to the Indian Income-tax Act, in terms of section 9(1)(ii). CIT v. Hammet (E.) [2006] 286 ITR 657 (All) followed.

274 ITR 0310- SPECIALITY MAGAZINES P. LTD., IN RE VS. (AAR)

The applicant, an Indian company, was an advertisement concessionaire, of a non-resident company registered in the UK, which was carrying on the business of publishing magazines from London. As advertisement concessionaire the applicant got 15 per cent. commission on the gross value of the invoices raised outside India directly from Indian advertisers. The advertisement cost was payable in US dollars

either by draft or wire transfer. To enable the Indian advertisers including Government undertakings to secure international market the non-resident company extended facility of payment of advertisement charges in Indian currency. Under a proposed agreement the foreign company was to authorise the applicant to collect the advertisement charges from Indian advertisers in Indian currency and remit the same in US dollars to the foreign company. On these facts it was questioned whether there was a business connection. Decided that there was no business connection what so ever.

The essential features of “business connection”, in relation to the tax liability of a non-resident in India, are (a) a real and intimate relation must exist between the trading activities carried on outside India by the non-resident and the activities within India (b) such relation, should contribute, directly or indirectly, to the earning of income by the non-resident in the business (c) a course of dealing or continuity of relationship and not a mere isolated or stray nexus between the business of the non-resident outside India and the activity in India, would furnish a strong indication of “business connection” in India.

274 ITR 0097- JAY SHREE TEA AND INDUSTRIES LTD., IN RE VS. (AAR)

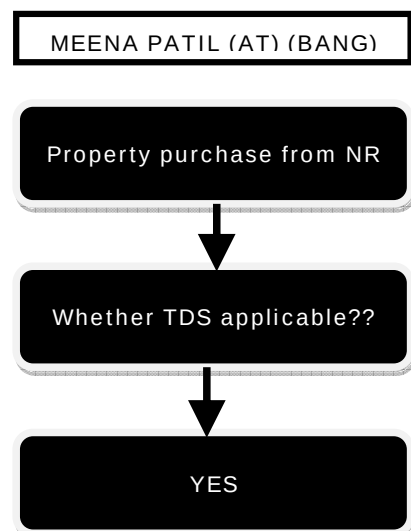
The applicant, a resident company, had taken a loan of US \$ 34,00,000 from R of Singapore. Under the loan agreement the tax liability of R, the non-resident, was to be borne by the applicant and payment was to be made to R net of all taxes. R did not have any permanent establishment in India. The applicant applied to the Authority for a ruling on whether the interest payable to R would constitute income in the hands of the non-resident and whether tax was deductible at source from the interest under section 195 of the Income-tax Act, 1961. On the facts stated the Authority ruled

- (i) Such a transaction of interest would give rise to tax liability of non resident and thus application was allowable.
- (ii) That, under article 11(1) of the Agreement for Avoidance of Double Taxation and Prevention of Fiscal Evasion between India and Singapore¹ the interest accruing in India and paid to a resident of Singapore could be taxed in Singapore, but under paragraph 2 of article 11 such interest might also be taxable in India where it arose. Paragraph 5 of article 11 governed the position where the interest was deemed to arise in the Contracting State. In this case it would be deemed to arise in the Contracting State, i.e., India, where the payer was a resident.

That tax was deductible at source under section 195 since such interest income is chargeable to tax in India.

272 ITR 0099- DUN AND BRADSTREET ESPANA S.A., IN RE. VS. (AAR)

Payment to a non-resident for information, which is downloaded for Indian customers' use, is not technical fee, because the information, that is paid for, is in the nature of business information and not technology. It is an incident of e-commerce between two independent parties, so that the resident cannot be branded as a branch or sales outlet of the non-resident, so as to constitute a permanent establishment in India, the income being essentially from business. Article 7 of the Agreement for Avoidance of Double Taxation between India and Spain would rule out liability for the non-resident in the absence of a permanent establishment for it in India.



Consequently, there is no duty to deduct tax at source on such payment. It was so held by the Authority for Advance Rulings in *Dun and Bradstreet Espana S. A., In re* [2005] 272 ITR 99 (AAR). In coming to the conclusion, the Authority for Advance Rulings distinguished its two earlier decisions. In *Ericsson Telephone Corporation India AB v. CIT* [1997] 224 ITR 203 (AAR), the information being protected by copy right did not rule out the character of royalty. In *P. No. 30 of 1999, In re* [1999] 238 ITR 296 (AAR), strict confidentiality was required to be observed, so as to constitute the payment as one for use of protected software. It was for this reason that these two cases were distinguishable.

Indian company making payment to non-resident Spanish company for permission to download for Indian customer business information is not agent or permanent establishment of Spanish company. Such payment to Spanish company is not taxable in India. Indian company not bound to deduct tax at source from payments to spanish company.

272 ITR 0371- CIT VS. KWALITY TEXTILE ASSOCIATE PVT. LTD. (MAD)

The assessee was engaged in the business of export of textile spares and equipment. The assessee disputed the assessability of an amount of fees received for technical and engineering services rendered by the assessee outside India. The Commissioner (Appeals) and the Tribunal held that the amount was not assessable in India. On appeal to the High Court Held, that the income earned in Malaysia was not assessable in India.

268 ITR 0156- SUTRON CORPORATION, IN RE VS. (AUTHORITY FOR ADVANCE RULING)

Where a US non-resident company had an agreement with the Government of Andhra Pradesh for installation and commissioning of gauging equipment and associated systems and ancillary services besides undertaking training of personnel with some part of the contract being rendered in India and paid in Indian rupee, undertaking varied services like marketing research and other tasks authorised by the non-resident, there is a business connection within the meaning of domestic law and permanent establishment within the meaning of double tax avoidance agreement, so that the non-resident becomes liable for any income attributable to the activities in India. The Authority for Advance Rulings inferred so in *Sutron Corporation, In re* [2004] 268 ITR 156 and found from the elaborate discussion of the terms of the agreement, that there was a real and intimate relationship between the non-resident and the Indian customer with activities in India including sale of goods, so that an inference of taxable profit in India could not be avoided. The fact that the functions in India were substantially rendered by another Indian concern did not in the view of AAR, rule out the involvement of the non-resident, since it was inferable that such service was rendered by internal arrangement between the applicant with such other concerns constituting division of work and sharing of the profits as between them. However, the AAR made it clear that only such part of the income of the non-resident as arising on sale of equipment, installation and service agreement will be deemed to accrue or arise in India.

268 ITR 0009X UAE EXCHANGE CENTRE LLC, IN RE VS. (AUTHORITY FOR ADVANCE RULING)

A liaison office is distinct from a branch. An inference of permanent establishment depends on what the liaison office does in India and not what is ordinarily expected of the liaison office. An Advance Ruling is, therefore, difficult without knowing the precise activity. The AAR in *P. No. 28 of 1999, In re* [2000]

242 ITR 208 found that a liaison office used for supply of executive personnel for developing, management, finance and marketing can be a permanent establishment, but the matter as to the income attributable to activities in India was left to be decided by appropriate decision.

In UAE Exchange Centre LLC, In re [2004] 268 ITR 9 (AAR), the liaison office was engaged in downloading information regarding remittances through electronic media and transfer of amounts from the UAE to various places in India for a commission, by getting cheques printed by it in India and sending them to the addresses of beneficiaries in India according to instructions received. Since this service itself was understood as business in view of the continuity of such service, the liaison office was to be treated as permanent establishment. There was both business connection under domestic law as well as inference of permanent establishment under the DTA Agreement, so that the income attributable to operations in India through such office would be taxable in India. The argument on behalf of the applicant was that the services rendered were only auxiliary services with the liaison office having no role in any core activity in India. But downloading data, preparing cheques and despatch of the same, it was found, was part-performance of the contract and therefore not mere auxiliary service. However, the AAR did not suggest any formula as to the extent of income attributable to such activities obviously because the application did not ask for the same.

279 ITR 0310- SEDO FOREX INTERNATIONAL DRILL INC VS. COMMISSIONER OF INCOME-TAX (SUPREME COURT OF INDIA)

Where a non-resident enjoys his off-period drawing the salary for such period from the Indian employer, the law as understood thus far was, that the salary for the off-period would be treated on par with the salary for on-period. The Supreme Court, however, found in Sedco Forex International Drill Inc v. CIT [2005] 279 ITR 310, with reference to the agreement, that the employees were free to serve anywhere in the world during the break and that they were not employees of the assessee during such period, so that the salary during the off-period cannot be treated as taxable in India. The assumption of the Revenue endorsed by the High Court, that it was in the nature of rest period, it was found, was not inferable from the agreement.

280 ITR (A.T.) 0117- ABN AMRO BANK NV VS. ASSISTANT DIRECTOR OF INCOME-TAX (CALCUTTA BENCH)

A non-resident is taxable on income attributable to a permanent establishment, if any, in respect of his business income. A branch may constitute a permanent establishment, so that the income attributable to such permanent establishment is taxable. It is in this context, it was decided that though the branch constitutes a permanent establishment, it cannot get the deduction of interest paid as expenditure as decided by the Tribunal in ABN Amro Bank NV v. Asst. Director of Income-tax [2006] 280 ITR (AT) 117 (Kolkata) (SB), on the ground that payment of interest by a branch to head office is payment to self. It follows that there can also be no requirement to deduct tax at source, so that failure to deduct tax would not justify the disallowance under section 40(a)(i) of the Income-tax Act. The reasoning of the Special Bench for disallowance of the interest is that the computation of income has to follow the domestic law.

Since the branch profit is computed as that of the permanent establishment, interest may appear to be deductible in the light of Board Circular No. 740 dated April 17, 1996 [1996] 219 ITR (St.) 8, referred to by the Tribunal requiring the branch to be treated as a separate entity for the purpose of taxation, subject only to the limitation under section 115A of the Act. The Tribunal agreeing with this proposition in the circular rightly observes that the circular requiring tax deduction at source on this account would not be

correct. But then, the Tribunal itself in disallowing the payment of interest raises a conundrum, in that, it would treat the branch as permanent establishment without the right to have the income computed, as though the permanent establishment were a separate entity in the context of the definition of “business” in the article relating to business requiring interest to be considered as part of business income in such cases, because lending could not be an independent business activity between head office and branch. It is not surprising, therefore, that there was a difference between the Members of the Division Bench requiring reference to a Special Bench.

284 ITR 0564- RAJIV MALHOTRA, IN RE VS. (AUTHORITY FOR ADVANCE RULING)

The applicant, engaged in organizing food and wine shows in India, intended to organize the 4th India Food & Wine Show in which foreign concerns, undertakings and Government Departments were to participate. He wanted to appoint agents abroad to furnish information about the terms and conditions to foreign participants in respect of their participation in the Food and Wine Show in India and for booking space in the exhibition. A French agency was responsible for planning, directing and executing the sales campaign. The services to be provided by the agent were, inter alia, (i) liaison with government departments and trade associations to obtain pavilions/joint participation ; (ii) distributing contract forms, etc. ; (iii) briefing the foreign concerns before their departure to India, etc. The exhibitors were to make all their payments direct to the applicant and the agent was not to accept any payment from the foreign participators unless authorized. On these facts the applicant applied to the Authority for an advance ruling on the questions: (i) whether the non-resident agent was liable to tax in India ; and (ii) whether the applicant was to deduct tax at source on the payments to be made to the foreign agents.

Though the agent rendered services abroad and pursued and solicited exhibitors there, the right of the agent to receive the commission arose in India only when the exhibitor participated in the Food and Wine Show to be held in India and made full payment to the applicant in India. The commission income would, therefore, be taxable in India, as income arising from a “source of income” in India in view of the specific provisions of section 5(2)(b) read with section 9(1) of the Income-tax Act, 1961. The facts that the agent rendered services abroad in the form of pursuing and soliciting participants and that the commission was to be remitted to him abroad were wholly irrelevant for the purpose of determining the situs of the income.

That the applicant was required to deduct tax at source under section 195 from the payments which were to be remitted by the resident applicant to the non-resident agent.

284 ITR 0260- MORGAN STANLEY & CO. INC., IN RE VS. (AUTHORITY FOR ADVANCE RULING)

An Indian subsidiary does not necessarily constitute a permanent establishment of a holding company. Where a group company was set up in India to render support service like IT support, account reconciliation and research etc., without undertaking any market risk, the payment merely for availing of some staff deputed by the group concern for short duration may not attract liability as was held in Morgan Stanley & Co. Inc. In re [2006] 284 ITR 260 (AAR). But where such deputed persons are key management personnel to give basic guidance for stewardship activities for fairly longer duration exceeding 90 days, there is an inference of permanent establishment, so that any income received in excess of the arm’s length price for service or sale of software will be income attributable to such permanent residence, so as to be taxable. The Indian concern should not be treated as a dependent agent on the fact, that it did not conclude contract or undertake any core activity of the non-resident. The issue,

whether services charged at 29% mark-up could be accepted as a transaction price at arm's length was not decided as it involved valuation, which if decided, will not fall within its purview. The ruling of the AAR is to some extent inconclusive as regards the non-resident's liability, when it held that it would depend upon the nature of service rendered by the employees deputed to India and the inference of permanent establishment in India, which would also depend upon such fact.

284 ITR 0001- ABC LTD., IN RE VS. (AUTHORITY FOR ADVANCE RULING)

Where the Indian company is permitted to download information from its data base relating to world-wide business information reports for a consideration, the income of the non-resident in such cases is income from business. Since what is available is mere information, it cannot partake of the character of either of royalty or technical fees. Since the business income of the non-resident is assessable only where the non-resident has permanent establishment in India, it was found in ABC Ltd. In re [2006] 284 ITR 1 (AAR), that there can be no liability in the absence of such a permanent establishment. The situation faced by the assessee in this case is a common one and has already been the subject matter of the decision of the Authority for Advance Rulings in Dun and Bradstreet Espana In re [2005] 272 ITR 99 (AAR). The resident company, which availed of the information, being a sister company or an associate company, cannot be treated as a branch or sales outlet. It was further pointed out that in the case of e-commerce, there is no need to maintain physical stock and inventory, so that there is really no establishment, which is required. When the resident company in India has its own business with independent activity, it cannot be treated as a permanent establishment solely because it is able to download information from the network, so that such payment made for this purpose does not attract liability for the non-resident.

276 ITR (A.T.) 0001- SAMSUNG ELECTRONICS CO. LTD. VS. INCOME-TAX OFFICER (BANGALORE)

Where the payment to a non-resident is for acquiring ready-made, off-the-shelf computer programme from the non-resident without any right over the copyright for the resident except the right to use, it is a payment of consideration for purchase of a right to use it, so that it cannot be royalty within the meaning of the double tax avoidance agreement as held by the Tribunal in Samsung Electronics Co. Ltd. v. ITO [2005] 276 ITR (AT) 1 (Bang.). Where the copyright is with the seller, it was generally believed that the payment would be in the nature of royalty, though it is a one-time payment for an indefinite period of use. But in the case of software, the impact of the decision of the Supreme Court in Tata Consultancy Services v. State of A. P. [2004] 271 ITR 401 would require consideration. In this case, the Supreme Court found that computer software packages are goods, whether they are in CD, floppy, diskettes, papers or any other media or whether it is canned or uncanned or licensed or unlicensed, branded or unbranded, tangible or intangible being commodity capable of being transmitted, transferred, delivered, stored, processed etc. If they are goods themselves, should the payment be anything other than consideration for the goods purchased ? Though the decision in Tata Consultancy Services' case was under sales tax law, a similar view was taken for customs purposes in Sprint RPG India Ltd. v. Commissioner of Customs [2000] 2 SCC 486 in respect of levy of customs duty on imported computer software loaded on a hard disk drive, classified as software irrespective of the media by which such software is conveyed.

On the inference that it is a product and not a copyright, there could have been no liability even under the domestic law. Probably such issues could be understood with reference to the purpose for which the software is acquired by the assessee and sold by the copyright owner. If the intention is for use of the software for the purchaser's own business and not for replicating, what is sold is a product, but if it is for

use of that right for any specified period or is confined to a mere right to use, royalty may be inferred.

282 ITR 0129- COMMISSIONER OF INCOME-TAX VS. POONAM TRUST (PUNJAB AND HARYANA HIGH COURT)

A discretionary trust is liable to tax at the maximum marginal rate, unless it is a trust created under a will, such trust being the only trust created by the will. The Revenue had taken the stand that the exception would have no application, since the trust was one of the four trusts created by the testator, though for different beneficiaries. The High Court found that in the case of a sole beneficiary, the share stands specified, so that the maximum marginal rate provided for trusts, where shares are not specified, would have even otherwise no application as held in CIT v. Poonam Trust [2006] 282 ITR 129 (P&H).

282 ITR 0120- INDUBHAI T. VASA (HUF) VS. INCOME-TAX OFFICER (GUJARAT HIGH COURT)

Section 179 would hold the directors of a private company to be responsible for the dues of the company on its liquidation. It could, however, be enforced, inter alia, only when the amount could not be recovered from the company. When the property or income was under attachment and the director had ceased to be a director except for a period of one year with no finding as to the demand relatable to that year, recovery action could not be sustained as was found in Indubhai T. Vasa (HUF) v. ITO [2006] 282 ITR 120 (Guj).

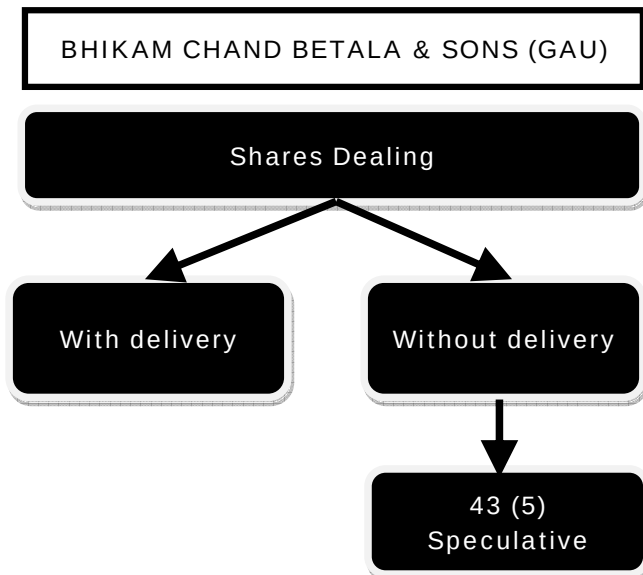
SET OFF AND CARRY FORWARD

Section / Topic Name : 70 to 80

SPECULATION ACTIVITY

The Mumbai Bench of the Tribunal in Pioneer Equity Trade (India) (P.) Ltd. v. ITO [2008] 168 Taxman 76 held that the essential ingredients of the provisions of section 73 are both purchase and sale of shares so that the section has no application on the basis of mere purchase of shares without their corresponding sale during the previous year. The Bench held that mere intention to hold shares as stock-in-trade would not lead to application of section 73 for which actual sale transaction is a must.

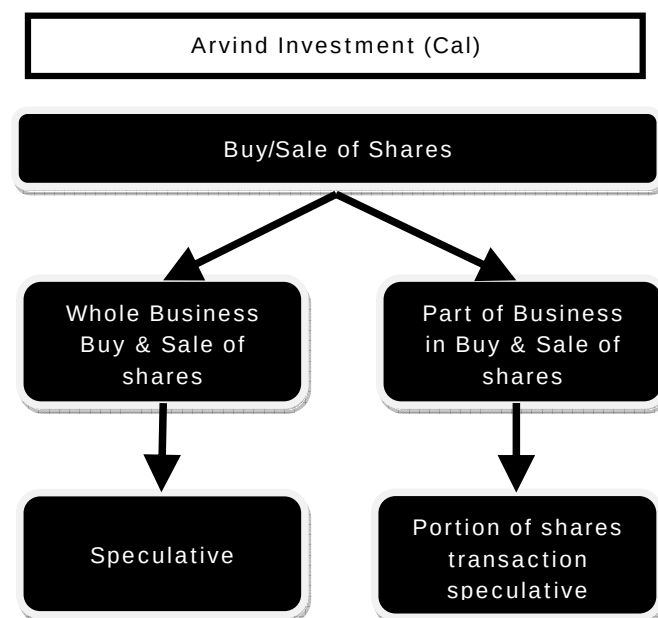
In yet another case of Bhikamchand Betala & Sons v. ITO [2008] 169 Taxman 357 (Gau.), the assessee purchased shares from a person and resold them to the same person without a delivery and the Court uprightly held that the loss incurred in such transaction as speculative loss no matter the assessee contended that it had no initial intention to settle the contract by payment of difference but it was only subsequently forced by the circumstances to do so.



SCOPE OF EXPL. TO 73 - DEEMED SPECULATIVE TRANSACTION

The assessee was a private limited company engaged in the business of purchase and sale of shares of other companies. This was the only business activity of the assessee and there was no other source of income. In the return of income filed by the assessee, the assessee disclosed loss of Rs. 63,67,946 on trading of shares where delivery was not taken and profit of Rs. 5,32,963 on trading of shares where delivery was taken. For the assessment year 2000-01 with regard to the profit of Rs. 5,32,963, the claim of the assessee was that this profit had to be treated as profit from speculation business as per the Explanation under section 73 of the Income-tax Act, 1961, and accordingly the aforesaid speculation loss had to be set off against the profit from speculation business. The Assessing Officer did not accept this claim. According to him the Explanation to section 73 was not applicable in

the case of the assessee as the only business activity of the assessee was trading in shares. He, therefore, held that the profit of Rs. 5,32,963 was not in the nature of profit from speculation business and accordingly the speculation loss could not be set off against this income. The Commissioner of Income-



tax (Appeals) directed the Assessing Officer to set off the speculation loss against the profit of Rs. 5,32,963 and to carry forward the balance loss to be set off against future speculation profits. On appeal to the Tribunal : Held, that in CIT v. Arvind Investments Ltd. [1991] 192 ITR 365, the Calcutta High Court had categorically held that the business activity consisting of purchase and sale of shares has to be treated as speculation business even if the entire business activity of a company consists only of purchase and sale of shares. The entire business will be treated as speculation business. The Calcutta High Court decision was squarely applicable to the facts of the present case. Judicial propriety demands that a judgment rendered by the High Court must be followed in preference to the order of the Tribunal. The Assessing Officer had to set off the speculation loss against the profit of Rs. 5,32,963 and carry forward the balance loss to be set off against future speculation profits. CIT v. Arvind Investments Ltd. [1991] 192 ITR 365 (Cal) followed. [2007] 290 ITR (A.T.) 0379- Assistant Commissioner of Income-tax v. Sucham Finance and Investments (I) Ltd. (Income-tax Appellate Tribunal--Mumbai)

The Income-tax Department would subject loss on share dealings as not genuine in view of the practice of some assesseees to purchase loss in collusion with share brokers. In such cases of abuse of law, the Revenue usually resorts to a remedy which is sometimes worse than the disease inasmuch as it hits genuine cases. The Explanation to section 73 is one such draconian provision intended to curb this practice. The result is often genuine losses on sale of shares held as investments for any number of years, which are subject to delivery both at the time of purchase or sale are deemed to be speculation loss, depriving assesseees of the right to set off such loss against the income of the year, so that the assessee is assessed on a larger income than it has made during the year. It is also discriminatory in the sense that it is applicable only to companies with exceptions only for investment companies or those in money lending business.

The provision in Explanation to section 73 was rightly understood by a Third Member in Deputy CIT v. Jindal Exports Ltd. [2006] 287 ITR (AT) 172 (Delhi), when it was held that the loss on sale of shares held as investments will not be covered by the Explanation, a decision which has not yet been formally accepted by the Revenue. A decision which aggravates the agony on wrong application of this provision has been rendered by the Tribunal in ACIT v. Sucham Finance and Investments (I) Ltd. [2007] 290 ITR (AT) 379 (Mum). In this case, the only business of the assessee was dealing in shares. It had made a loss of Rs. 63,67,946 after netting a profit on trading in shares, where delivery was taken, to the extent of Rs. 5,32,963. The Assessing Officer, following the definition of speculation under section 43(5) of the Act, split up the transactions as between those where deliveries were taken and those where deliveries were not taken by the assessee, so that the amount of Rs. 5,32,963, where delivery was taken, was brought to tax as non-speculative income and the balance carried forward as speculation loss. The Commissioner (Appeals) should have understood the provision correctly as applicable both for speculation under section 43(5) and deemed speculation loss under the Explanation to section 73, but he allowed the appeal on the ground that the Explanation to section 73 would have no application, where the sole business was one of dealing with investments. In effect, he treated it as an investment company, which had been excepted by the Explanation, so that his decision was even otherwise supportable. The further arguments of the case went on the rails laid by the Commissioner (Appeals). The reasoning of the Commissioner (Appeals) that the Explanation to section 73 had no application was no doubt accepted in Swamini Leasing and Investment P. Ltd. in I. T. A. No. 2150 (Mum) of 2000, on which the assessee relied. The Tribunal, therefore, had either to follow the same or refer the matter to a Special Bench. But it had its reasons for not adopting this course, since it understood the decision in CIT v. Arvind Investments Ltd. [1991] 192 ITR 365 (Cal) as having rejected this view. If the loss was loss from sale of shares as defined under section 43(5) not involving delivery of shares, such loss will be loss from speculation business, so as to be unavailable for set off even without the assistance of the Explanation to section 73. This is what was decided by the High Court. The issue as to whether a distinction could be made in the case of a company

having both speculation business within the meaning of section 43(5) and income/losses from ready business in shares was not the issue. In fact, the Tribunal in Jindal Exports Ltd's case (supra) has understood the decision in Arvind Investments Ltd. case (supra) as under :

“It is important to bear in mind that the Explanation employs the expression ‘any part’. Thus, even if the purchase and sale of shares constitute a minuscule activity, it would be hit by the provisions of the Explanation to section 73. This aspect has been considered by the hon'ble Calcutta High Court in CIT v. Arvind Investments Ltd. [1991] 192 ITR 365. The word ‘any’ should be given a meaning as wide as possible in the context. We, therefore, hold that in the case of a company where loss is incurred on purchase and sale of shares of another company, it would ordinarily fall to be caught in the mischief of the Explanation to section 73.”

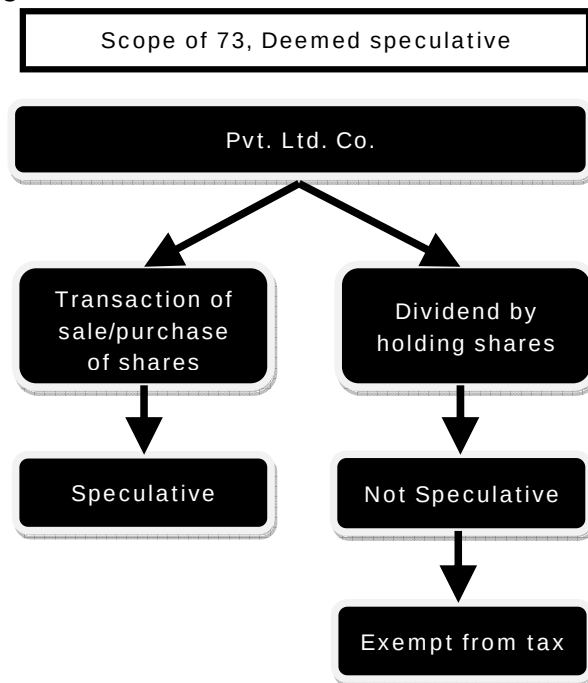
Where delivery is taken by a sharebroker on behalf of his client as per rules of the stock exchange, when badla trade was not permitted, such transactions would not be speculative transactions even under section 43(5). But such an argument was not taken. Irrespective of availability or otherwise of such argument, the role of the Explanation to section 73 is to treat all transactions in share dealings by a company, which is not an investment company or a money lending company, on par, so that section 43(5) would have no application. This aspect of law was not appreciated by the Tribunal in Sucham Finance and Investments' case. After all, the loss in such deemed speculation is permitted to be set off against the profits in a later year. If it could be so done, it cannot be that such loss cannot be set off against the profits in the same category of transactions falling under the Explanation to section 73 in the same year. In other words, the loss should have been a netted one. In the decision of the Tribunal, apart from oversight of this point, there is confusion between the definition of speculative transaction in section 43(5) and deemed speculation under the Explanation to section 73. These could not have been mixed up. The Explanation to section 73 is much wider than the definition of speculation under section 43(5).

The Tribunal had gone by its understanding of the assessee's case as solely dependant upon the argument that where share dealing is the only business of the assessee, the Explanation to section 73 has no application. In fact, it has application on the assessee's facts and it was on such application that the assessee is entitled to succeed. It is also possible that the assessee had a case as an investment company excepted by the Explanation even as indicated by the name of the company.

DEEMED SPECULATIVE TRANSACTION

Income from dividend would be business income if the shares are held as stock-in-trade and the loss incurred by the assessee in business transactions would be set off against the same. The Explanation to section 73 of the Income-tax Act, 1961, deems an assessee to be carrying on speculation business to the extent to which the business consists of purchase and sale of such shares. It is only this part of the activity, i.e., purchase and sale of shares, which is held to be speculative in nature. The earnings of the assessee from those shares or other shares held by an assessee as stock-in-trade have not been so deemed to be income from speculation. Therefore, though it may be true that dividend income is business income and is an earning on account of the shares held by the assessee before the dividend was earned and it would be business income it is not treated to be income from speculation business because of the Explanation to section 73 which deems the loss arising out of carrying on a speculation business only to the extent to which the business consists of purchase and sale of such shares. The dividend is not earned by transfer of shares. It is earned by holding the shares on a particular day when the dividend was declared

Business loss of the assessee was Rs. 8,23,70,792 and the loss under the head “Capital gains” was Rs. 3,23,86,938 and the income from dividend, being income under the head “Other sources” was Rs. 67,87,702. The assessee ignored the business loss of Rs. 8,23,70,792 and that was more than the income. Therefore, the business loss exceeded the income computed under the two other heads and, consequently, the assessee could not be a company whose gross total income consisted mainly of income chargeable under the head “Interest on securities”, “Income from house property”, “Capital gains” and “Income from other sources” so as to exclude it from being treated as carrying on speculative business. Therefore, the contention of the assessee that its gross total income consisted mainly of dividend income of Rs. 67,87,702 which was chargeable under the head “Income from other sources” could not be accepted. *Eastern Aviation and Industries Ltd. v. CIT* [1994] 208 ITR 1023 (Cal) and *Aryasthan Corporation Ltd. v. CIT* [2002] 253 ITR 401 (Cal) followed. [2008] 303 ITR (A.T.) 0380- *Torrent Finance P. Ltd. v. Joint Commissioner of Income-tax (Assessment) (Income-tax Appellate Tribunal--Ahmedabad)*

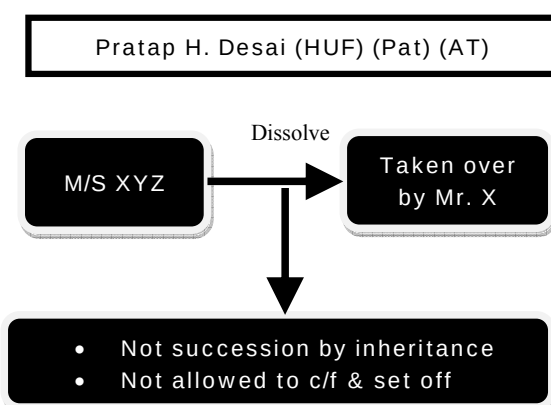


Torrent Finance P. Ltd. v. Joint Commissioner of Income-tax (Assessment) (Income-tax Appellate Tribunal--Ahmedabad)

An investment company is immune from denial of set off under the Explanation to section 73 in respect of loss on realising investments in shares. Whether the assessee is an investment company depends upon the extent of its activity from investments vis-a-vis business. The investment income, which would include capital gains and income from other sources would require to be compared with business loss or business income. Where such business loss exceeds the other income, it was held by the Tribunal in *Torrent Finance P. Ltd. v. Joint CIT* [2008] 303 ITR (AT) 380 (Ahmedabad) following the settled law on the subject, that the application of section 73 could not be avoided. Comparison of positive income with negative loss is rather odd, but the accepted position now in the absence of better guidelines in the statute for the inference, whether a company is a investment company or otherwise.

SUCCESSION BY INHERITANCE

Section 78(2) would bar set off of past business losses to a different assessee, unless the business has been succeeded by way of inheritance. Where there had been a dissolution of firm with the business taken



over by one of the partners, such partner though carrying on the same business, had succeeded to such business on account of dissolution and allotment of business to him and not by way of inheritance, so that the bar under section 78(2) would disentitle the assessee to such right of set off. The assessee relied upon section 75 which permits the loss which could not be set off in the partner's hands to be brought back to the firm under the then prevailing law prior to the assessment year 1993-94, when partners were assessed on their respective share income, so that the section could have no application. Reliance placed on

behalf of the assessee on the decision in *CIT v. Madhukant M. Mehta* [2001] 247 ITR 805 (SC) was also

found inapplicable, because it was a case where the legal heirs formed a partnership and succeeded to the proprietary business, so that the bar under section 78(2) had no application. It was in this context, that the Assessing Officer's action not to permit set off of past losses of the business taken over by the partner was upheld by the Tribunal in *Pratap H. Desai (HUF) v. Asst. CIT* [2008] 307 ITR (AT) 311 (Patna).

291 ITR 0258- COMMISSIONER OF INCOME-TAX VS. CHENSING VENTURES (MADRAS HIGH COURT)

During the course of survey under section 133A it was noticed that the assessee made certain cash payments to the bank out of which Rs. 28.50 lakhs could not be explained. The sum was surrendered voluntarily for taxation. Later, the assessee filed a return of income declaring a business loss of Rs. 11.95

CHENSING VENTURES (MAD)

BUSINESS LOSS	-3
UN – DISCLOSED INCOME	4
TOTAL INCOME	1

Undisclosed income is eligible for set off.

lakhs. The Assessing Officer determined the business loss at Rs. 8,20,384 and did not allow the set off of the loss against the undisclosed income of Rs. 28.50 lakhs. The Commissioner of Income-tax (Appeals) and the Tribunal held that the loss had to be set off against the income of Rs. 28.50 lakhs. On appeal : Held, dismissing the appeal, that no reasons were given by the Assessing Officer to deny the benefit under section 71 (set off) . The Assessing Officer had made an addition of Rs. 28,50,000 as undisclosed income under section 69 of the Act. Once the loss was determined, the same should be set off against the income determined under any other head of income. The assessee was entitled to the set off.

260 ITR 0167- RAJASTHAN RAJYA SAHAKARI SPINNING AND GINNING MILLS FEDERATION LTD. VS. INCOME-TAX APPELLATE TRIBUNAL (RAJASTHAN HIGH COURT)

Section 72 of the Income-tax Act, 1961, provides for carry forward and set off of business loss of an assessee. The word “assessee” has been used in section 72A. Under this section in case of merger of companies, the losses suffered by a company before amalgamation can be carried forward and set off after amalgamation against the profits of the amalgamated company, but no such provision has been made in the case of merger of societies. When there is no specific provision like section 72A for companies, that the Legislature has no intention to extend a similar benefit in the case of merger of societies. Section 78(2) also extends the benefit of carry forward or set off of losses only in the case of succession.

Where there is a merger of two co-operative societies, the carried forward loss of the merging society cannot be set off against profit of the merged society, because section 72A, which permits such set off for merger between two companies, will have no application for merger of two co-operative societies. However, the claim was made on the ground of succession under section 78(2). It was found in Rajasthan

Rajya Sahakari Spinning and Ginning Mills Federation Ltd. v. ITAT [2003] 260 ITR 167 (Raj) that a merger cannot constitute succession, because after merger, a new federation came to be formed. The federation itself is merger of four societies. It is under these circumstances, the claim was found inadmissible.

Question

There were four co-operative societies. The Registrar, Co-operative Societies, made an order for merger of the aforesaid four co-operative societies with all their assets and liabilities into Rajasthan Rajya Sahkari Spinning and Ginning Mills Federation Ltd. The registration of the merged societies stood cancelled on the registration of the assessee and the four co-operative societies ceased to exist. The assessee-society (Rajasthan Rajya Sahkari Spinning and Ginning Mills Federation Ltd.) filed its return of income showing total income at Rs. 1.58 crore after setting off brought forward losses of Rs. 2.68 crore and claiming that the assessee-society was entitled to set off the said loss under section 72. The Assessing Officer negated the claim of the assessee and dis-allow the claim of setoff. You are required to discuss the correct position of law.

Answer

The assessee (Rajasthan Rajya Sahkari Spinning and Ginning Mills Federation Ltd.) was not entitled to the benefit of setting off losses carried forward by the four co-operative societies against its profits because the four separate societies which had their own identity and independence in the earlier year, their own profits and losses, could not be treated the same as the assessee in the year under consideration. Further, after the merger of the four societies it could not be said that the federation had succeeded or inherited the four societies. Therefore under section 78(2) also, the benefit of carry forward and set off of losses of the four societies could not be allowed in the hands of the assessee federation. Rajasthan Rajya Sahakari Spinning and Ginning Mills Federation Ltd. v. ITAT [2003] 260 ITR 167 (Raj)

277 ITR (A.T.) 0020- DEPUTY COMMISSIONER OF INCOME-TAX VS. VENKATESWAR INVESTMENT AND FINANCE P. LTD. (CALCUTTA BENCH)

The Explanation to section 73 of the Income-tax Act, 1961, provides that the loss in purchase and sale of shares shall not be treated as speculation loss in the case of a company, the principal business of which is the business of granting of loans and advances. The Explanation to section 73 is in the nature of a deeming provision and as such has to be strictly construed and the onus is on the Revenue to show that the case of the assessee falls within the four corners of the deeming provision of law.

Since the inception of the assessee-company, it was engaged in the business of financing by way of granting loans and advances and earned interest income therefrom. During the year the assessee started a new line of financing business of leasing and also derived income by way of lease rentals. Subsequent year, the assessee started another line of business of dealing in stock and shares. Then incurred a loss in purchase and sale of shares amounting to Rs. 51,00,000 and it claimed to set off this loss against the business income. The Assessing Officer held the loss to be speculative loss in accordance with the provisions of the Explanation to section 73. Decided that the assessee's case was not hit by the Explanation to section 73 and that the assessee was entitled to the set off as claimed by it.

287 ITR (A.T.) 0172- DEPUTY COMMISSIONER OF INCOME-TAX VS. JINDAL EXPORTS LTD. (INCOME-TAX APPELLATE TRIBUNAL--DELHI)

The Explanation to section 73 dealing with the “losses in speculation business”, as indicated in the title to the section, provides that loss from purchase and sale of shares of other companies, where it is part of

business of the company, will be deemed to be a speculation loss. The only exceptions are where the company itself is an investment company or a company engaged in banking and money lending business. While it was generally understood that investment companies will not be affected by the Explanation, the decision of the Tribunal in Deputy CIT v. Jindal Exports Ltd. [2006] 287 ITR (AT) 172 (Delhi) goes one step further, when it held that the loss on sale of shares held as investments cannot be covered by the Explanation, which would have no application in such cases. Such an inference is possible, when the section is read as a whole, since it covers losses in speculation business even as indicated by the title to the section. There was a difference between members, who originally heard the case. The President of the Tribunal acting as Third Member dealt with the same and agreed with the liberal view, that the loss in a transaction in shares must be part of the business activities of the assessee, as in a case, where shares are purchased as stock-in-trade. Where the shares are acquired as investments, the loss in realisation of the same cannot be subject to the inference, that it is from speculation business with reference to the Explanation to section 73. In other words, the company need not be an investment company. Exclusion of investment companies can be understood as intended to ensure that even the losses on sale of shares held as stock-in-trade would not be deemed as speculation loss. In other cases, it is sufficient if the shares in which losses are incurred are held as investments for avoiding application of the Explanation to section 73. Though there has been discussion of various precedents, none of them is directly on the point, so that this far-reaching decision, which is reasonable, with reference to language of the statute, should help in warding off liability on disallowance of set off of genuine losses from investments, so that this provision, which is even otherwise artificial and again harsh by confining such deeming provision only to companies is not made more artificial than it needs to be. It may be pointed out that the right to carry forward the deemed speculative loss has little meaning for most companies, which have no similar profit in later years to avail of it. But then, loss on sale of investments would give rise only to loss under the head capital gains, which would not even otherwise be set off against income from other sources. Even so, treatment of such loss as speculation loss in most cases will be more unfavourable.

273 ITR (A.T.) 0010- GODAVARI CAPITAL LTD. VS. DEPUTY CIT (HYDERABAD BENCH (AT))

Section 73 of the Income-tax Act, 1961 is applicable only in cases where losses are incurred in speculation business. The object of this section is to curb the device being resorted to by some business houses to manipulate and reduce the taxable income by booking speculative losses. This section cannot be invoked in a case where there is a profit from a speculative transaction.

Speculation loss can be set off only against income from speculation. Similarly, speculation loss can be carried forward and set off only against speculation profits. The Explanation to section 73 would deem even normal loss on realisation of shares held as capital asset as speculative loss, except for banking and investment companies. This applies only for loss and not for gains, so that the Explanation to section 73 cannot convert profit in non-speculative transactions into deemed speculation profits, so as to deny the assessee set off otherwise available. The argument that loss in the Explanation will include profit was found unacceptable in Godavari Capital Ltd. v. Deputy CIT [2005] 273 ITR (AT) 10 (Hyd).

290 ITR 0389- COMMISSIONER OF INCOME-TAX VS. MICRO INDIA LTD. (GAUHATI HIGH COURT)

Section 43(5) defines “speculative transaction” as a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by

the actual delivery or transfer of the commodity or scrips. Explanation 2 to section 28 of the Act provides that where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business, i.e., the speculation business shall be deemed to be distinct and separate from any other business. Section 73(1) provides that any loss, computed in respect of a speculation business carried on by the assessee, shall not be set off except against profits and gains, if any, of another speculation business. The Explanation to section 73 of the Act further clarifies that where any part of the business of the company consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares. However, there is an exception given in the Explanation, which stipulates that a company whose gross total income consists mainly of income which is chargeable under the heads Interest on securities, Income from house property, Capital gains and Income from other sources or a company the principal business of which is the business of banking or the granting of loans and advances will not be covered within the purview of the section 73.

Held, that to come within the exception stipulated in the Explanation to section 73, the assessee-company had to prove that it was either a company whose gross total income consisted mainly of income which was chargeable under the heads “Interest on securities”, “Income from house property”, “Capital gains” and “Income from other sources” or a company the principal business of which is the banking or the granting of loans and advances. The Tribunal without discussing whether the assessee-company could prove that its principal business was of granting loans and advances and thus came within the scope of the exception stipulated in the Explanation to section 73, had held that section 73 was not applicable in the case of the assessee-company, by simply relying on the submission made by the assessee. The order of the Tribunal had to be set aside.

247 ITR 0805- CIT VS. MADHUKANT M. MEHTA (SC)

Assessee as sole proprietor, carried on a speculation business. Within one month of his death, his heirs, who had succeeded to and carried on the business in the meanwhile, drew up a partnership deed, to carry on the same business, narrating these facts. The firm claimed carry forward and set off of the loss incurred by M in the business.

Held that the partners, as heirs, had succeeded to assessee's business and there was inheritance for the purposes of section 78(2) and firm entitled to carry forward loss of sole proprietor.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Mr. Madhukant was carrying on proprietary business of speculation in shares, cotton and other commodities. He died leaving behind his widow, a son and a daughter. Three heirs of Madhukant entered into a partnership and executed a partnership deed wherein they agreed to carry on the said business of speculation. In the said speculation business carried on in the name of the M/s MM a partnership firm, profits were earned and the assessee sought to carry forward and set off the losses incurred by the deceased in his proprietary business against the income from the speculation business of the partnership firm. Assessee M/s MM was of the opinion that there was succession by inheritance and, therefore, the assessee is entitled to carry forward and set off the deceased Shri Madhukant's loss in business against the income.

ANSWER

The provisions of 78(2) provide that, where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance, no set off carry forward benefit shall be available to a person other than the person incurring the loss to have it carried forward

and set off against his income. I.e. speculative loss shall be allowed to be carried forward and set off in the hands of the successor if it is succession by inheritance. Where assessee as sole proprietor, carried on a speculation business. Within one month of his death, his heirs, who had succeeded to and carried on the business in the meanwhile, drew up a partnership deed, to carry on the same business, narrating these facts. The firm claimed carry forward and set off of the loss incurred by assessee in the business. Held in case of [2001] 247 ITR 0805- CIT VS. MADHUKANT M. MEHTA (SC) that the partners, as heirs, had succeeded to assessee's business and there was inheritance for the purposes of section 78(2) and firm M/S MM is entitled to carry forward loss of sole proprietor.

TDS / TCS

Section / Topic Name : 192 to 206

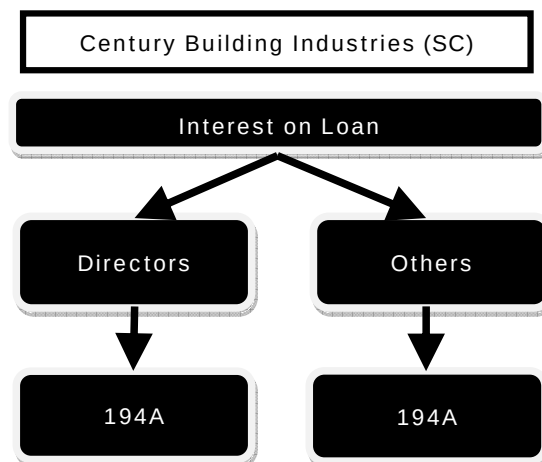
PREVIOUS EMPLOYMENT PARTICULAR

The Delhi High Court in CIT v. Marubeni India (P.) Ltd. [2007] 165 Taxman 467 held the following:

- (a) that where an assessee is employed simultaneously under more than one employer, he is required to furnish to the employer responsible for deducting tax at source “such details of the income under the head ‘Salaries’ due or received by him from the other employer;
- (b) that under section 192(2), it is mandatory that once the above information is furnished, ‘the person responsible for making payment referred to above shall take into account the details so furnished for the purposes of making the deduction under sub-section (1)’. In other words, under the statutory scheme the liability of the employer who is expected to deduct TDS in terms of section 192(1) would get triggered after the employee furnishes such employer the details of the income due or received by him from the other employer;
- (c) that TDS should be deducted on the ‘estimated income of the assessee’ so that one time deduction of tax on performance incentive instead of monthly deduction is fair and proper since the payment of the incentive was not only uncertain but the amount was also likely to vary.

DIRECTOR'S PERSONAL LOANS

Where director's personal loans were routed through the company's books by back-to-back transactions/cheques, the Supreme Court, in CIT v. Century Building Industries (P.) Ltd. [2007] 163 Taxman 188, held that the company has an obligation to deduct tax on interest payment, no matter that it has only acted as a medium for collecting and disbursement purpose. The Apex Court held that the TDS should have been deducted at the time of credit notwithstanding the arrangement between the company, directors and the loan agency.



DIRECTOR'S LOANS

The Karnataka High Court in CIT v. Century Building Industries (P.) Ltd. [2007] 165 Taxman 251/293 ITR 80 held that where the assessee merely acted as an agent of its directors/managing director in receiving the loan amount from the lenders and forwarding it to the directors/managing director and similarly where the loan was repaid, it received the amount from the directors/managing director and paid it to the lenders the assessee had no obligation to deduct any tax under section 194A. Reversing such view the Supreme Court in CIT v. Century Building Industries (P.) Ltd. [2007] 293 ITR 194 held that the Department was right in invoking the provisions of section 201 and 201(1A); and the material expression in section 194A(1) of the Act is “at the time of credit of such income to the account of the payee” and whenever interest is credited to the account of the payee the payer has to deduct the TDS. The crux of the matter is that the debit is for a specific amount calculated with reference to the deductor's liability to a particular creditor in accordance with the terms and conditions of the loan. In the present case, the lender

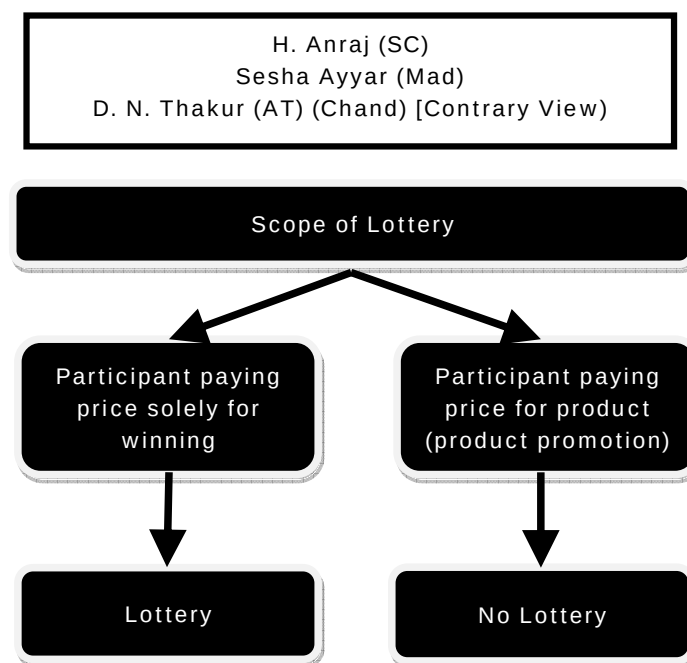
had advanced the loan to the assessee-company. Debit was made by the assessee-company to the 'Interest account' for a specific amount calculated with reference to the deductor's liability to a creditor.

In the absence of any resolution of the assessee-company to the effect that the company had agreed to act as a medium for routing the borrowings and repayments it held that the assessee-company was not in charge of disbursing the repayments made by directors in their individual capacities.

Where a company takes loans from a bank and re-lends the same at the same rate, it may be merely acting as an intermediary without any stake of its own. Under such circumstances, it was decided by the High Court that tax need not be deducted. But the Supreme Court reversed the same in CIT v. Century Building Industries P. Ltd. [2007] 293 ITR 194, though the loans were merely routed through a company, because there were two transactions one between the bank and the company and the other between the company and the directors for whom loan was taken. This conclusion was reached also on the further fact that there were loans advanced by the company to its directors and that there were corresponding entries in respect of receipts of interest from the directors and payments to the bank. It was, therefore, held that tax should have been deducted and that where it is not done, section 201 would have application.

SCOPE OF LOTTERY

Where a dealer in refrigerators had a sales scheme by which every purchaser would receive a scratch card, which on being scratched, would entitle the lucky winner to a Matiz car, the issue was whether the value of the gift could be subjected to tax in the hands of the purchaser as income from lottery. The courts



have not taken a uniform view of the matter. The Tribunal in D. N. Thakur v. ITO [2007] 292 ITR (AT) 382 (Chand) had held that it would be a lottery, following the decision of English case in Imperial Tobacco v. Attorney-General [1980] 1 All ER 866 (HL), where a buyer of a pack of cigarettes having a lucky card in the packet was entitled to a cash gift. The decision understood this to be a lottery on the wider definition that any winning by chance would be a lottery.

Where the Government promoted small savings scheme by awarding a Maruti car chosen by lot among the investors, it was held assessable and also liable to tax deduction under section 194B of the Income-tax Act in K.C. Suresh v. Director of Lotteries [1993] 199 ITR 266 (Ker) observing that the

petitioner was lucky in the lottery, but unlucky with the Income-tax Department. On the contrary, the High Court in CIT v. Deputy Director of Small Savings [2004] 266 ITR 27 (Mad) held that the prizes were given with a view to encourage thrift and were in the nature of a gift limited only to the investors. An investor was not paying for the price of the coupon, since the prizes were awarded to the holder of lucky coupon, which was not so purchased, since what was purchased was consideration in kind.

A similar issue came up before the Kerala High Court in Canaan Kuries and Loans (P) Ltd. v. ITO [2005] 272 ITR 534, regarding prize schemes by dealers for sale of consumer goods or by kuri companies rewarding subscribers who made prompt payments, by a draw among them. The High Court reviewed the case law on the subject including that of the Madras High Court and the cases relied upon therein and the further observation of the Supreme Court itself in H. Anraj v. Government of Tamil Nadu [1986] 61 STC

165, where a reference was made to *Sesha Ayyar v. Krishna Ayyar*, AIR 1936 Mad 225 [FB] with approval. In *Sesha Ayyar's* case, a lucky prize scheme for sale of books was found to be not a lottery. A similar view was found in *H. M. M. Ltd. v. Director General, Monopolies and Restrictive Trade Practices Commission* [1998] 94 Comp Cas 132 (SC) in respect of a prize scheme known as “hidden wealth prize offer” with some Horlicks bottles containing prize coupons. In the light of these persuasive authorities, the High Court remanded the matter to the Assessing Officer to consider the detailed objections to be given by the assessee.

Jackpot winnings should be treated as part of horse racing for which there is a separate provision in the statute, so that they cannot be treated as lottery winnings. While deciding so, the Delhi High Court in *G. N. Pant v. CIT* [2001] 248 ITR 718, pointed out the distinction between a contest involving skill and a lottery which involves a lot or chance. It has been pointed out that the English decision of the *Reader's Digest Association Ltd. v. Williams* [1976] 3 All ER 737 (QB) and of the House of Lords in *Imperial Tobacco Ltd. v. Attorney-General* [1980] 1 All ER 866 would require notice, since a distinction is possible as between such prizes, where participants make contribution solely for the purpose of the prize and not where the prize is given with a view to promote sales.

It is necessary that the distinction between a lottery simpliciter and sales schemes should be recognised, so that a consumer who saves on his expenditure by availing of such schemes is treated differently from a participant in a game of chance simpliciter.

Where the assessee had given away prizes by draw of lots prior to the assessment year 2002-03, there was no obligation to deduct tax at source under section 194B of the Act. It was so decided in *CIT v. Jhaveri Industries* [2008] 300 ITR 300 (Guj).

PURCHASE OF PRINTED PACKING MATERIAL

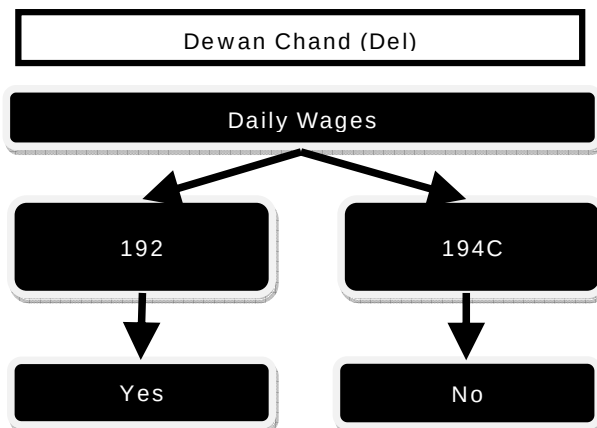
The Punjab and Haryana High Court in *CIT v. Dy. Chief Accounts Officer, Markfed Khanna Branch* [2008] 173 Taxman 149 held that where the predominant object underlying the contract was sale/purchase of goods and only intention of the assessee was to buy packing materials then factum of such packing material carrying some printed work could only be regarded as the work executed by the supplier incidental to the sale to the assessee and, thus, it would constitute a case of sale and not a contract for carrying out any work for the purpose of section 104C. Admittedly, the raw material for the manufacturing of such packing material in this case was not supplied by the assessee.

FREIGHT PAYMENTS

Under section 194C of the Income-tax Act, any person responsible for paying any sum to any resident for carrying out any work in pursuance of a contract shall at the time of credit of such sum or at the time of payment thereof in cash or by cheque deduct a tax thereon at the prescribed rate. The Punjab and Haryana High Court in *CIT v. United Rice Land Ltd.* [2008] 174 Taxman 286, however, has held that the assessee would not be liable to deduct tax at source on freight charges paid to truck owners/operators where there has neither been any oral or written agreement between the assessee and the transporters for carriage of goods, nor any sum of money regarding freight charges has been paid to them in pursuance of a contract for a specific period, quantity or price.

TRANSPORT CONTRACT

Payment for transport in transport contracts is tax deductible under section 194C, but where the payment is made to truck owners and drivers and not to either suppliers or agents, there was no occasion for tax deduction at source. The assessee himself was engaged in the business of transportation of goods, so that it was only receiving payment for transport. The agents were given only commission. The Tribunal in ITO v. Bhoruka Roadlines Ltd. [2008] 300 ITR (AT) 193 (Mumbai) held that there was no liability to deduct tax in the facts of the case by pointing out that each G.R. should be treated as separate contract according to Board Circular No.715 dated August 8, 1995 [1995] 215 ITR (St.) 12. This decision was rendered prior to amendment to section 194C by the Finance (No.2) Act, 2004, with effect from October 1, 2004, requiring tax deduction, where aggregate of payments to the same party exceeds Rs.50,000.



DAILY WAGES

In Dewan Chand's case the Delhi High Court ruled that the payments made to the employees employed by the assessee on daily wages cannot be said to be in the nature of contractual payments for deduction of tax at source under section 194C

SCOPE DEFINED OF 194C

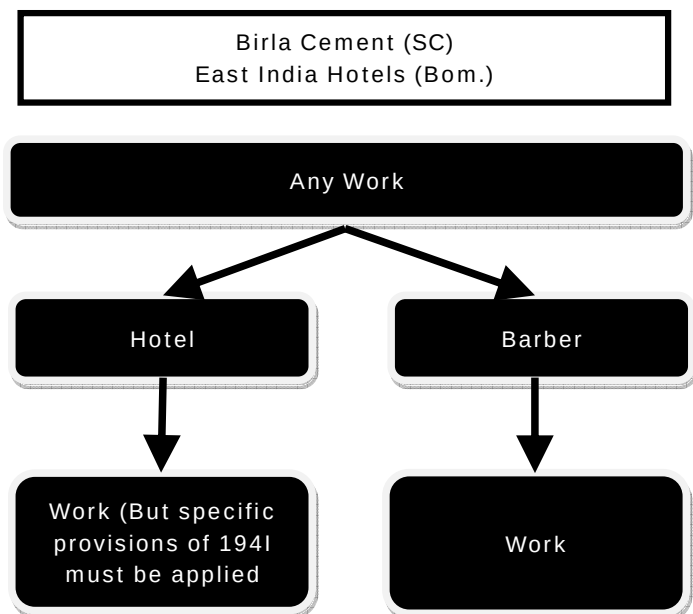
Following the Apex Courts ruling in Birla Cement Works v. CBDT [2001] 248 ITR 216/115 Taxman 359 the Bombay High Court in East India Hotels Ltd.

v. CBDT [2009] 179 Taxman 17 held that the words 'carrying out any work' in section 194C are limited to any work which on being carried out culminates into a product or result. In other words, the word 'work' in section 194C is limited to doing something with a view to achieve the task undertaken or carry out an operation which produces some result.

In a path breaking ruling the High Court held a view that the section would extend only to service contracts specifically included in Explanation III to said section. In particular in this case the Court, thus, held that the services rendered by the assessee hotel to its customers by making available certain facilities/amenities like providing multi-lingual staff; 24 hours service for reception, telephones, selected restaurants, bank counter, beauty saloon, barber shop, car rental, shopping centre, laundry/valet, health club, business centre services, etc., do not involve

carrying out any work which results in production of the desired object and, therefore, would be outside the purview of section 194C.

The following observations cast a burden upon the revenue for introspection as this ruling may mean loss to the revenue :



“2. If the contention of the revenue that the words ‘any work’ in section 194C is very wide enough to include all types of work is accepted, then it would mean that even the hair cutting work done by a barber would be a ‘work’ covered under section 194C and the person making payment to the barber would be covered under section 194C. Such a wider interpretation is uncalled for, especially when the revenue itself had considered since inception that section 194C is restricted to the works done by contractors/sub-contractors. . . .”

C&F AGENTS

The Delhi High Court in CIT v. Cargo Linkers [2009] 179 Taxman 151 held that the assessee C&F Agent is not liable to deduct tax at source under section 194C on the payments made to the airlines since the contract is actually between the exporter and the airlines and the assessee happened to be only an intermediary.

OCEAN FREIGHT AND INLAND HAULAGE

The Delhi High Court, in CIT v. Continental Carriers (P.) Ltd. [2007] 163 Taxman 479, held that an agent cannot be made liable to pay taxes on payments received on behalf of the shipping company so that there is no requirement of deduction of tax at source on ocean freight and inland haulage paid to the freight forwarding agent. A confirmation in this regard of the return filed by shipping company under section 172 in respect of such payments and tax thereon will mitigate hardship in such cases.

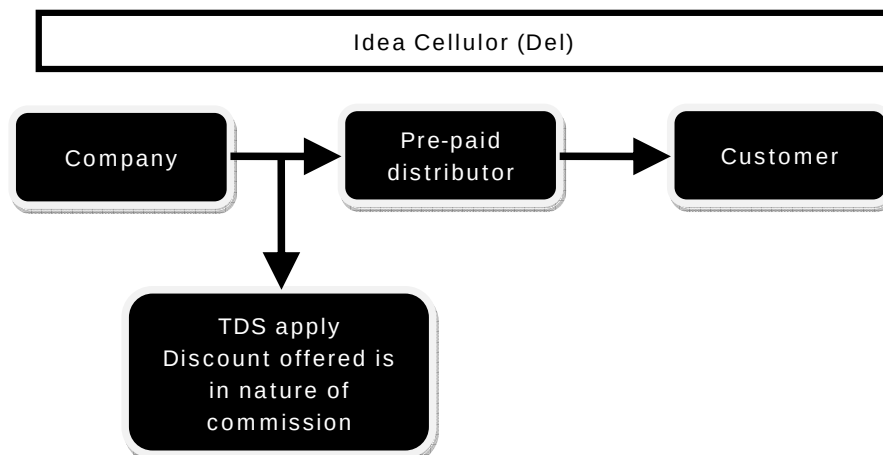
CABLE OPERATORS

The Punjab & Haryana High Court in Kurukshetra Darpan (P.) Ltd. v CIT [2008] 169 Taxman 344 held that cable operators are responsible for deduction of tax on amounts they pay to the licensors of various TV channels for obtaining telecast signals for local cable distribution systems.

DISCOUNT ON PRE-PAID CALLING SERVICES

The Delhi High Court in CIT v. Idea Cellular Ltd. [2010] 189 Taxman 118, held that transactions between the assessee and pre-paid distributors (PMA) were that of a principal and an agent at all times and, consequently, amount of discount offered to pre-paid distributors was in the nature of commission liable to tax deduction at source under section 194H.

The strong reason for this has been the level of control exercised by the cellular operator on the



distributor's business as the Court read the following from the agreements: (quote)

“As per the agreement, the distributors were required to store the SIM cards and recharge coupons in such a way as to clearly indicate at all times that pre-paid SIM cards/recharge coupons were owned by the assessee and they were not allowed to remove, obscure or to delete the marks made on pre-paid SIM card/recharge coupons. The distributors were not free to sell similar products offered by the competitors of the assessee-company. PMAs further appointed the retailers after the written approval of the assessee. The maximum price of SIM cards/recharge coupons was also

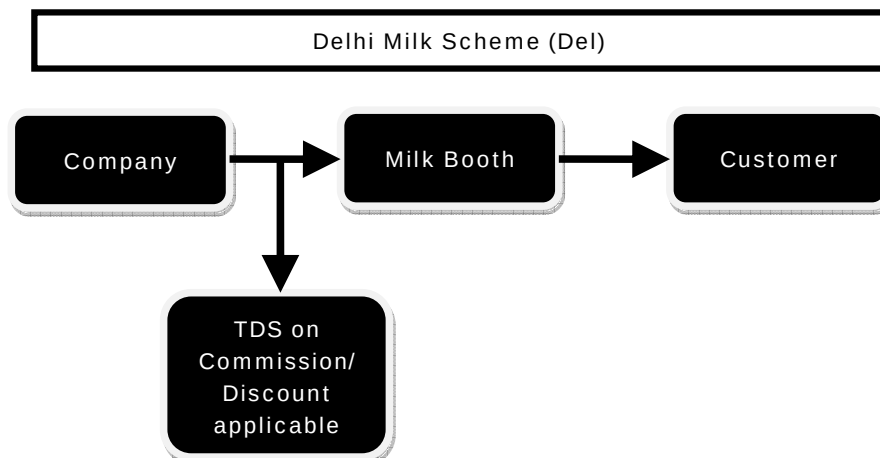
decided by the assessee. PMAs had to comply with all the requirements of the assessee in respect of invoicing and accounts, maintenance of brand image and to provide monthly sale reports and other information relating to the business. The assessee's representative could inspect the things or materials of the business which were the subject-matter of the agreement. Further, minimum performance targets for the distributors were also set by the assessee company which reserved the right to terminate the agreement unilaterally." (Unquote)

Perhaps the Court did not appreciate the point that such exercise of control by the assessee is necessary to promote its product. In other words, the distributor's actions are controlled by the assessee except to the extent necessary to promote the products of the assessee and, thus, the relationship between the two cannot be described as one of principal and agent.

DISCOUNT V/S COMMISSION

Section 194H provides for tax deduction at source from brokerage and commission. Where the assessee appointed some persons to act as concessionaires for selling milk and was distributing milk through them, the question arose, whether such milk is sold to them or they were merely rendering service in consideration of commission or brokerage for sale of milk. It was found in *Delhi Milk Scheme v. CIT* [2008] 301 ITR 373 (Delhi) that the concessionaires were only agents, since the milk booth belonged to the assessee, who did not charge any rent from the concessionaires, unsold milk was taken back and the concessionaires were prohibited from selling any other produce or any other brand. Sales collections were made by a clerk of the assessee on daily basis with the concessionaires being paid a reward as commission for their service. The transaction between the assessee and the concessionaires was only as between principal and agent and not as between principal and principal. It was not a case of discount of sale of milk, but commission for distribution work undertaken by the concessionaires. On these findings of fact by the Tribunal, the decision that tax was required to be deducted from the payment under section 194H was found to be justified, since such decision could not be treated as perverse. The court would not interfere with such finding.

COMMISSION TO DAIRY/BOOTH AGENTS



The Delhi High Court in *Delhi Milk Scheme v. CIT* [2008] 173 Taxman 54/218 CTR 630 held that the transaction between the assessee and the concessionaires for supply of milk through milk booths was a principal to agent transaction where the concessionaires only rendered a service to the assessee for selling milk to the customer. DMS, thus, held an

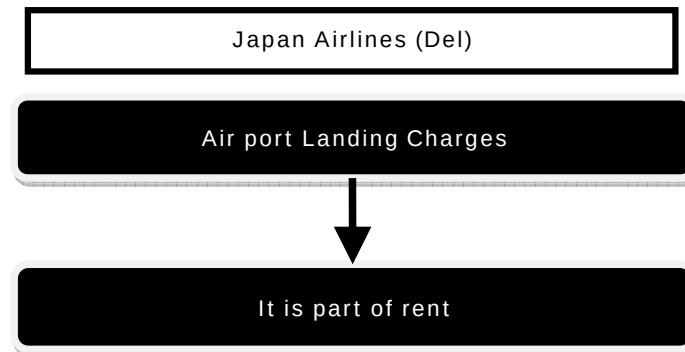
obligation to deduct tax on the amount of commission or discount made to the agents. The following findings at the instance of the Tribunal were worth noticing:—

- (a) that the milk booths were owned by the assessee;
- (b) that the assessee had a right to enter the milk booth and take charge thereof at any time without assigning any reason or without any intimation to the concessionaires;
- (c) that the unsold milk was taken back by the assessee from the concessionaires ;
- (d) that the cash collection was daily handed over to the assessee by the concessionaires;

- (e) that the concessionaires only rendered a service to the assessee for selling milk to the customers; and
- (f) finally that the ownership of the goods did not pass from the assessee to the concessionaires inasmuch as there was no sale of the milk or milk products to the concessionaires.

LANDING & PARKING CHARGES

The Delhi High Court in CIT v. Japan Airlines Co. Ltd. [2009] 180 Taxman 188 held that the landing and parking charges would be deemed to be rent under section 194-I of the Act inasmuch as when the wheels

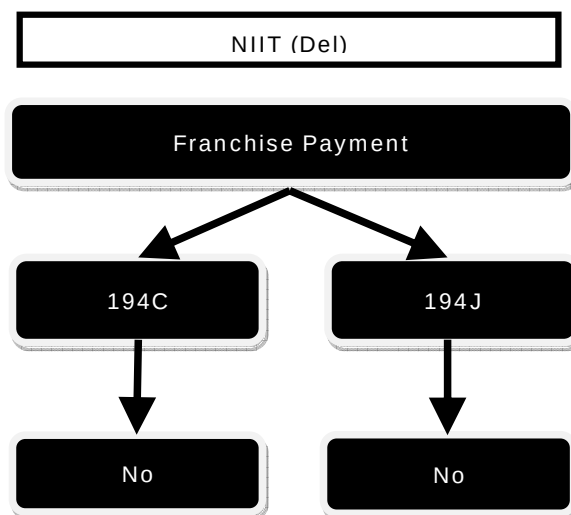


of an aircraft coming into an airport touch the surface of the airfield, use of the land of the airport immediately begins. Similarly, for parking the aircraft in that airport, again, there is use of the land. In this case the assessee in the contrary deducted tax at source under section 194C as per instruction received from the Airports Authority of India . The Court held that whereas the instruction letter may

benefit the assessee in the course of the penalty proceedings inasmuch as the letter reflected the bona fide of the assessee, the same would not serve much purpose in quantum appeal.

PAYMENTS TO FRANCHISEE

In CIT v. NIIT Ltd. [2009] 184 Taxman 472, the Delhi High Court held that payments made by the assessee to its franchisee would not bear the character of rent in the absence of any lessor-lessee relationship. Further, the fee sharing between the assessee and the franchisee was found to be fluctuating and, thus, the payment did not acquire the character of 'rent' which is generally fixed in nature.

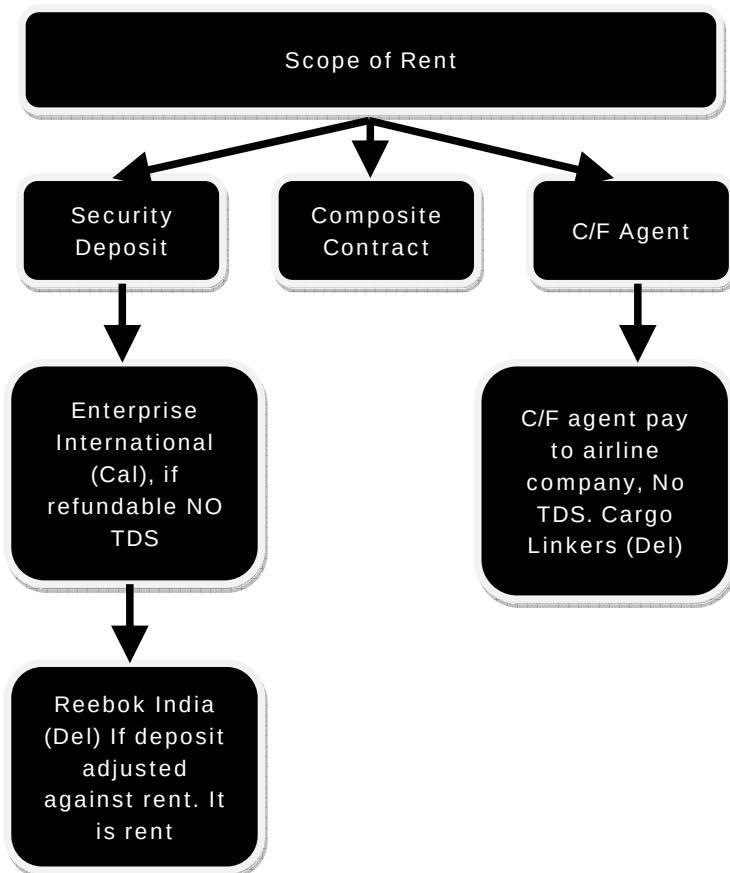


AIRPORT LANDING AND PARKING CHARGES

The Delhi High Court in CIT v. Asiana Airlines [2008] 175 Taxman 177 held that payments made for landing and parking charges would be deemed to be 'rent' and the same would warrant deduction at source under section 194-I of the Act.

SECURITY DEPOSIT

Advance payment of rent is also required to be taken into consideration for the purpose of section 194-I. However, refundable deposits do not attract the provisions of section 194-I - Enterprise International Ltd. v. ITO [2001] 77 ITD 189 (Cal). Adjustment of interest-free security deposit refundable at the fag end of the lease or to be adjusted against the rent payable if the lease is not renewed against the rent amount would tantamount to refund of security deposit only so that the assessee is held not liable to deduct tax thereon P.S. Cars (P.) Ltd. v. ITO [2005] 4 SOT 143 (Delhi). On the other hand, where the security deposit was adjustable every six months it was held that the deposit was, in fact, rent and the assessee was required to deduct tax at source from the amount of security deposit - CIT v. Reebok India Co. [2007] 163 Taxman 61 (Delhi).

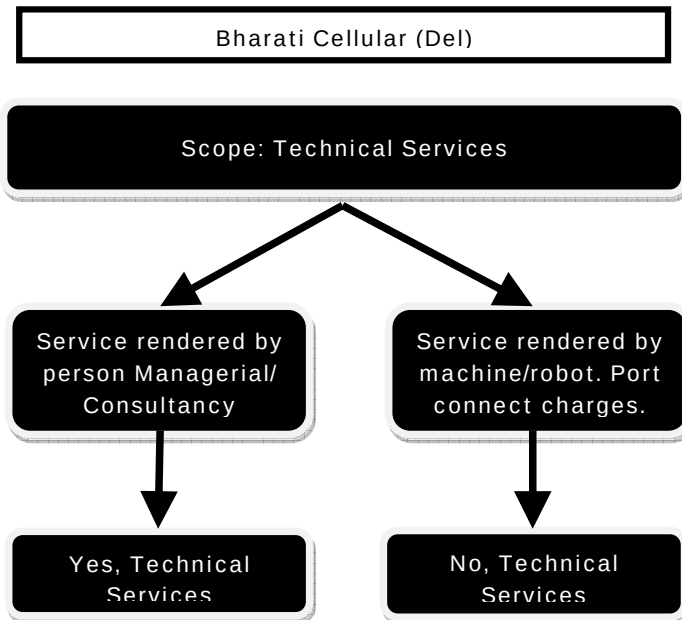


COMPOSITE CONTRACT

In Haryana Power Generation Corporation Ltd. v. ITO [2007] 164 Taxman 64 the Delhi ITAT held that even a composite contract for supply and erection must be broken up by excluding payments towards supply of machinery, spare parts as well as freight and insurance so that the assessee is liable to deduct tax at source only in respect of consideration attributable to civil work as well as erection, designing and commissioning. The Bench held that the contract for supply of the equipments and the contract for erection and commissioning of the plant were two separate contracts even though there was only one common purchase order.

INTERCONNECT/PORT ACCESS CHARGES

The Delhi High Court in CIT v. Bharti Cellular Ltd. [2008] 175 Taxman 573 held that the expression ‘technical service’ would have reference to only technical service rendered by a human and not to those



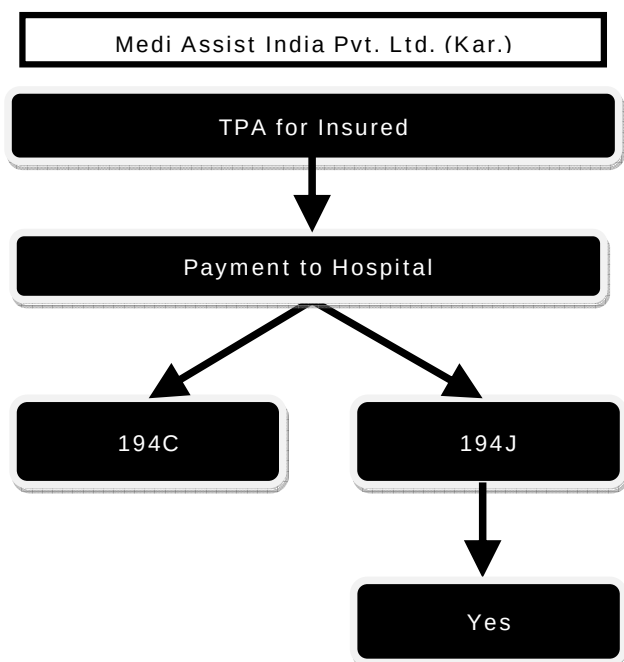
provided by machines or robots. The Court in particular in this case found that the interconnect/port access facility was only a facility to use the gateway and the network of MTNL/other companies and MTNL or other companies did not provide any assistance or aid or help to the assessee in managing, operating and setting up their infrastructure and networks. It held that the expression ‘technical service’ must be understood as one requiring use of human touch as in the case of expressions viz. ‘managerial service’ and ‘consultancy service’ also appearing in the Explanation 2 to section 9(1)(vii).

But one would wonder in the case of assessee which is a service provider the equipments are

used to provide telecom service and, thus, it must be read as provision of service with the help of equipments. Indeed a very far sighted view.

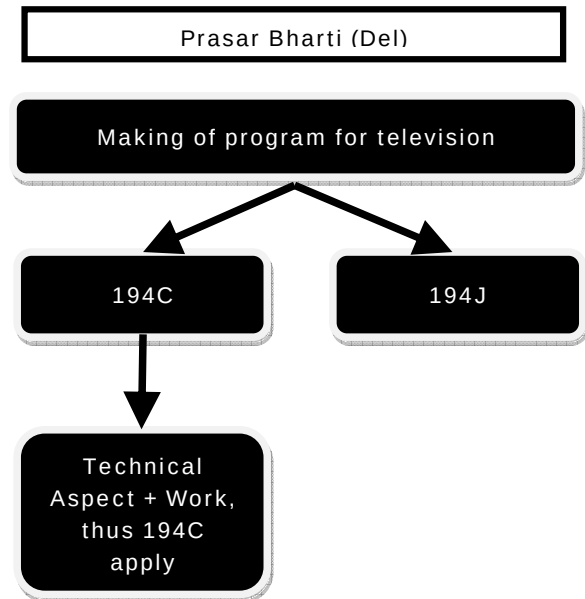
PAYMENTS TO HOSPITALS

In Medi Assist India TPA (P.) Ltd. v. Dy. CIT [2009] 184 Taxman 359, the Karnataka High Court ruled that Third Party Administrator (TPA) engaged in the business of providing health insurance claim services and who is responsible for making payment to hospitals for rendering medical services to policy holders under various health insurance policies issued by several insurers, is obliged to deduct tax at source under section 194J from payments made to hospitals. The High Court upon reading the terms of the agreement between the insurance companies and TPA’s found that a TPA is an independent person having an authority and duty to pay the amount to the hospital in cashless insurance format out of a float account maintained by him.



PAYMENT TO PRODUCERS OF PROGRAMMES

In CIT v. Prasar Bharti (Broadcasting Corpn. of India) [2007] 158 Taxman 470 (Delhi), the revenue held the stand that the making of the programmes for television involves the utilisation of professional services and that there are several technical aspects of producing such programmes which will attract the Explanation (a) to section 194J. The Delhi High Court held that Explanation III to section 194C which was introduced simultaneously with section 194J, is very specific in its application to not only broadcasting and telecasting but also includes 'production of programmes for such broadcasting and telecasting'. If, on the same date, two provisions are introduced in the Act - one specific to the activity sought to be taxed and the other in more general terms, resort must be made to the specific provision which manifests the intention of the Legislature. The Court, thus, held that programmes produced for television, including 'commissioned programmes', will fall within the realm of section 194C, Explanation III and not under section 194J.



EXEMPT INCOMES

In Vijay Ship Breaking Corporation v. CIT [2008] 175 Taxman 77, the Supreme Court held that TDS obligation arises only if the tax is assessable in India. Since in this case usance interest was read as exempt under the Act, the Apex Court held that there was no question of TDS being deducted by the assessee.

TDS QUESTIONS

In Airports Authority of India, In re [2008] 168 ITR 158 (AAR – New Delhi) held that though the question of tax deduction under section 195(1) is linked up with the tax liability of the non-resident/foreign company there is, however, no embargo under the proviso to section 245R(2) to seek such answer even when a separate appeal is pending at the instance of the non-resident with an appellate authority on the sole question of determination of non-resident's liability under the provisions of the Act so that an application for advance ruling in the parallel is even maintainable on the point of determination of withholding tax rate. That is perhaps for the reasons that implications of such non-deduction at source are serious causing both, disallowance of expenditure under section 40(a) and levy of penalty under section 271C. The AAR also held that the alternative route available under section 195(2) does not operate as a legal bar to the maintainability of application before the AAR.

Yet again the AAR in Mcleod Russel India Ltd's case (supra) held that in relation to the tax liability of a non-resident arising out of a transaction for purchase of shares from a non-resident, the resident-applicant can very well file an application for determination of withholding tax rate.

CIRCULAR NUMBER: 761 229 ITR (Stat) 0072-

Section 192 refers to the deduction of tax from salaries in that case pension must also be included. For the purpose of 192 the employer employee relation ship is not necessary. Merely because Payer of pension does not have the knowledge about the other income of the payee that cannot be the grounds for non deduction of tax.

1. As per section 17(1)(ii) of the Income-tax Act, 1961, the term "salary" includes pension
2. Once tax has been deducted under section 192 of the Income-tax Act, 1961, the tax-deductor is bound by section 203 to issue the certificate
3. No employee-employer relationship is necessary for this purpose
4. The certificate in Form No. 16 cannot be denied on the ground that the tax-deductor is unaware of the payee's other income.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Mr. X was receiving the pension through bank Rs. 8500 P.m. Bank denied to deduct the tax from payment of pension on the grounds that section 192 applies only to salary and not to pension, Bank was also of the opinion that there did not exist the employer employee relation ship between Mr. X and itself and thus TDS provisions are not applicable. Is the opinion of bank justified.

ANSWER

Section 192 refers to the deduction of tax from salaries in that case pension must also be included. For the purpose of 192 the employer employee relation ship is not necessary. Merely because Payer of pension does not have the knowledge about the other income of the payee that cannot be the grounds for non deduction of tax.

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- 4) The certificate in Form No. 16 cannot be denied on the ground that the tax-deductor is unaware of the payee's other income.

Thus the opinion of the bank is not justified.

CIRCULAR NUMBER: 756 228 ITR (Stat) 0015-

As per section 192 of the Income-tax Act, 1961, the person responsible for paying any income under the head "Salaries" is required, at the time of payment, to deduct income-tax on the amount payable, at the average rate of income-tax computed on the basis of the rates in force for the financial year in which the payment is made, on the estimated income of the assessee for that financial year. All DDOs must, therefore, ensure that proper and adequate tax is deducted from the disbursement to employees of not only additional pay and allowances but also of arrears payable to Central Government employees as a result of the implementation of the revised pay scales.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Government had increased the salary of government servants retrospectively and thus government was liable to pay the arrears of salary to its employees. DDO while making the payment does not propose to deduct the tax at source from the arrears of salary. Can the payments be so made.

ANSWER

As per section 192 of the Income-tax Act, 1961, the person responsible for paying any income under the head "Salaries" is required, at the time of payment, to deduct income-tax on the amount payable, at the average rate of income-tax computed on the basis of the rates in force for the financial year in which the payment is made, on the estimated income of the assessee for that financial year. All DDOs must, therefore, ensure that proper and adequate tax is deducted from the disbursement to employees of not only additional pay and allowances but also of arrears payable to Central Government employees as a result of the implementation of the revised pay scales.

271 ITR 0395- COMMISSIONER OF INCOME-TAX VS. HALLIBURTON OFFSHORE SERVICES INC. (UTTARANCHAL HIGH COURT)

Where the payer has not deducted tax in respect of salary for offshore period in view of the conflicting decisions of the Tribunal, there can be no levy of interest on the payee. The High Court in CIT v. Halliburton Offshore Services Inc. [2004] 271 ITR 395 (Uttaranchal) had taken the view that interest under section 234B of the Act would not be leviable merely because it is compensatory.

In respect of tax deductible items, there can even otherwise be no question of liability for interest under section 234B. Where tax is deductible at source, the recipient is entitled to take into account, the amount that should have been deducted at source in reckoning his liability for advance tax in view of the clear language of section 209 of the Act by requiring advance tax on “the estimated liability as would be reduced by the amount of income-tax which would be deductible or collectible at source during the said financial year under any provisions of this Act....”

CIRCULAR NUMBER: 758 228 ITR (Stat) 0145-

However, it has come to notice that a large number of drawing and disbursing officers have not deducted the full quantum of tax liability on the arrears paid to Central Government employees as a consequence of the recently announced revision of the pay scales. The deductions have been made in an ad hoc manner. This is in gross violation of the provisions of the Income-tax Act, and is liable to attract penal consequences including prosecution.

All drawing and disbursing officers in the Central Government and various organisations under it are advised to recompute the correct tax liability of every employee, on the arrears drawn by him and immediately recover the full tax liability thereon.

284 ITR 0357- COMMISSIONER OF INCOME-TAX VS. NHK JAPAN BROADCASTING CORPORATION (DELHI HIGH COURT)

The assessee did not deduct tax at source under section 192 of the Income-tax Act, 1961, in respect of the retention money paid outside the country to the Japanese expatriates working in India. Penalty was levied upon the assessee under section 271C. The Tribunal held that the facts of three cases decided earlier which were affirmed by the High Court were similar to the case of the assessee and that there was reasonable cause for not deducting the tax at source, and accordingly cancelled the penalty.

Decided that there was no mala fide intention on the part of the assessee. There was no real basis for holding that the facts in the two sets of cases were dissimilar warranting a different view and no substantial question of law arose from the order of the Tribunal. Thus tribunal was right in holding that penalty could not be imposed.

268 ITR 0473- AROUND THE WORLD TRAVEL AND TOURS P. LTD. VS. UNION OF INDIA (NO.1) (MAD)

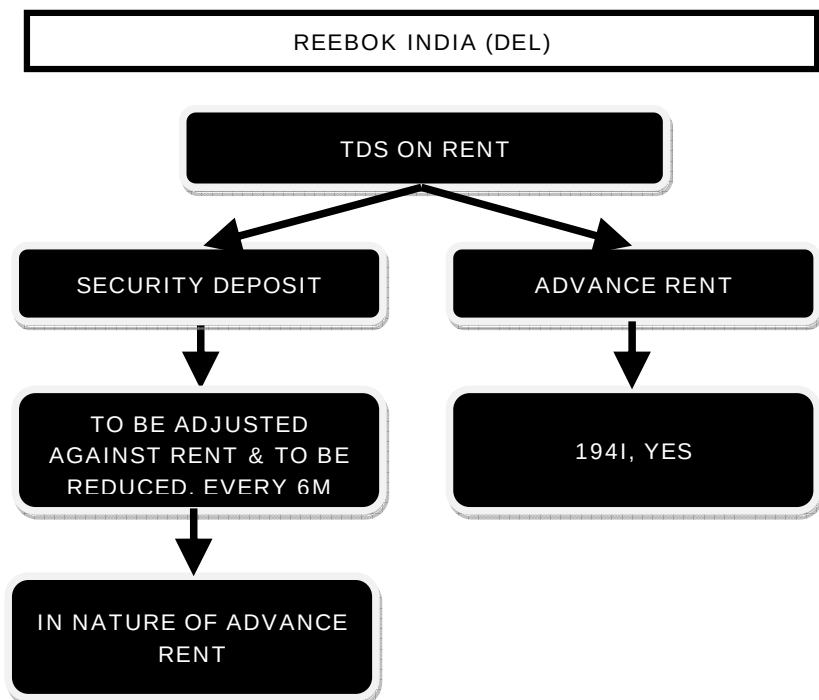
Discount is normally an abatement of price, so that it would not ordinarily be treated as brokerage and commission, where it is allowed against the list price. But where it is allowed to an agent from the list price for services rendered by him for resale on behalf of the principal, it may well be treated as

brokerage and commission liable for tax deduction under section 194H. In the context of such discount given by airlines to their agents in the service of booking of tickets, it is in the nature of commission as was argued by the Revenue against a writ petition filed by an agent in *Around the World Travel and Tours P. Ltd. v. Union of India* (No. 1) [2004] 268 ITR 473 (Mad). In this decision, the High Court passed only an interim order, wherein the injunction earlier granted against deduction was removed leaving the matter of the merits to be considered in regular course. The High Court pointed out that the continuation of the injunction would place heavier burden on the agent, if the final decision should be against it, so that it is in the interest of the agency itself that the injunction is not in operation.

291 ITR 0455- COMMISSIONER OF INCOME-TAX VS. REEBOK INDIA COMPANY (DELHI HIGH COURT)

On the perusal of the lease agreement showed that the sum of Rs. 1,50,24,000 paid by the assessee to ABCO was in the nature of “advance rent” and not a security deposit as according to this clause “such security deposit shall stand reduced every six months when the rent becomes due and payable.” If it had been a security amount, then, firstly, it would have been in the nature of “refundable amount” at the time of the termination of the lease. Secondly, there would have been no reduction in the security amount, after every six months and thirdly, as per clause 14 of the lease agreement, the assessee was “obliged to refund the unadjusted portion, if any, of advance/security deposit,” which meant that this amount was adjustable against rent and was adjusted also, and thus this amount was in the nature of advance rent. The assessee was

required to deduct tax at source from the payment of such advance rent.



Tax is required to be deducted at source from rent. Rent paid in advance, no doubt, similarly requires tax deduction. Should the deposit described as security deposit also require tax deduction? This was the issue in *CIT v. Reebok India Company* [2007] 291 ITR 455 (Delhi). The High Court found from the rent agreement, that though the amount was described as security deposit, it was in the nature of advance rent, since it was required to be adjusted every six months as and when the rent becomes due and payable. If it had been a matter of deposit, it would have been made refundable only at the time of termination of the lease. The periodical adjustment and the requirement of only unadjusted amount in the case of termination of lease would, it was held, indicate that it was only an advance rent requiring tax deduction at source.

The Assessing Officers have often been taking the view that all deposits would be in the nature of advance rent. Explanation (i) to section 194-I defining rent would cover “any payment” and also uses the expression “by whatever name called”. Circular No. 715 dated August 8, 1995, in answer to Q. No. 22

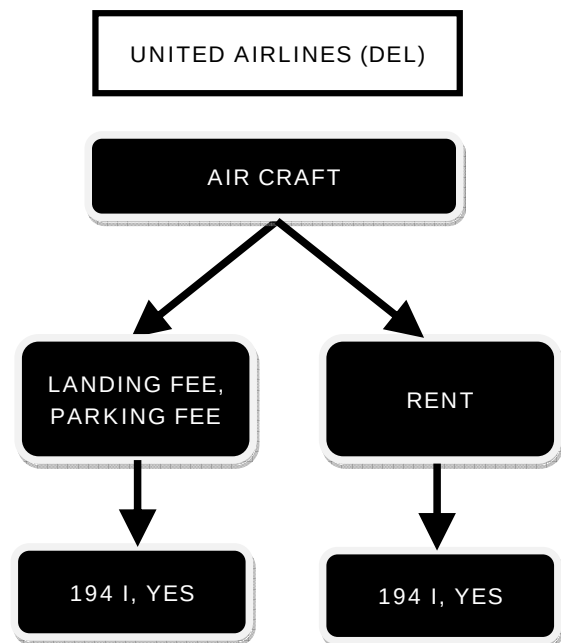
would require tax deduction from non-refundable deposit to be treated as rent. It also adds that “if the deposit is adjustable against future rent, the deposit is in the nature of advance rent, subject to TDS”. The normal rule is that, the rent can be treated as paid only as and when it is adjusted, but then the High Court has endorsed the Departmental view in the circular.

287 ITR 0281- UNITED AIRLINES VS. COMMISSIONER OF INCOME-TAX (DELHI HIGH COURT)

Rent is widely defined under section 194-I for purposes of tax deduction at source to cover “any lease, sub-lease, tenancy or any other agreement or arrangement for use of any land . . .”. It was in this context, that the High Court in United Airlines v. CIT [2006] 287 ITR 281 (Delhi) came to the conclusion, that the amounts charged by the airport authorities should be treated as rent. It was held that the moment the wheels of the aircraft touch the surface of the airfield, the use of the land of the airport immediately begins. It was in this context that the High Court came to the conclusion that it is liable for tax deduction at source. The High Court surveyed the rules of interpretation of taxing statutes elaborately to apply the principle of strict interpretation of taxing statutes. Arguments based on equity were easily answered, since tax and equity are strangers. One cannot also go by the notion as to what is just and expedient. The High Court further found that the definition of rent is “very clear” and that landing of an aircraft and its parking amounts to use of land of the airport. It was in this context that the decision of the Tribunal was reversed by the High Court.

The definition of rent for use of the land should ordinarily be in “pursuance of lease, sub-lease, tenancy or any other agreement or arrangement”. The principle of ejusdem generis would mean that the agreement or arrangement should be in the nature of lease, sub-lease or tenancy. Even where the arrangement may not strictly fall under any of these categories of agreements, it has still to be different from a mere service charge. The charges are collected by the civil aviation authorities more for the facilities and service rendered by the airport authorities than as hire or rent for the fleeting presence. Parking charges are more often collected for caretaker service and not as rent. The aircraft has only temporary or fleeting use of the premises without any specific right over any part of the airport. It does not also have exclusive right for any part of the area of the airport. It would appear that such charges as landing and parking fee, whether it is an airport area or elsewhere, may not fall under the definition of rent. At any rate, the inference does not appear to be “very clear” as found by the High Court. Probably, the services rendered by airport authorities for the fee they are collecting, if brought on record, would have clarified the nature of the receipt better.

A contract for collection of parking fee in an allotted area as an exclusive parking area would certainly amount to rent paid by such contractor to the owner, but the amount collected by such contractor from the users may not as easily qualify for inference of rent. The decision of the High Court may have far-reaching effect, because the authorities are bound to extend the meaning of rent even further on the basis of this decision, which would need review.



257 ITR (STAT) 0036- CIRCULAR NUMBER: 009

Representations have been received in the Board seeking clarification as to whether a member of a co-operative bank may receive without TDS interest on time deposit made with the co-operative bank. The Board has considered the matter and it is clarified that a member of a co-operative bank shall receive interest on both time deposits and deposits other than time deposits with such co-operative bank without TDS under section 194A by virtue of the exemption granted vide 194A(3)(v). The provisions of clause 194A(3)(viia) is applicable only in case of a non member depositor of the co-operative bank, who shall receive interest only on deposits other than time deposits without TDS under section 194A.

It is hereby clarified that the exemption is available only to such members who have joined in application for the registration of the co-operative society and those who are admitted to membership after registration in accordance with the bye-laws and rules. A member eligible for exemption under section 194A(3)(v) must have subscribed to and fully paid for at least one share of the co-operative bank, must be entitled to participate and vote in the general body meetings and/ or special general body meetings of the co-operative bank and must be entitled to receive share from the profits of the co-operative bank.

258 ITR 0337- GHAZIABAD DEVELOPMENT AUTHORITY VS. DR. N.K. GUPTA (NATIONAL CONSUMER DISPUTES REDRESSAL COMMISSION)

Where the purchaser of a flat from the DDA was found entitled to interest for deficiency and delay in handing over the flat under an order from the State Consumer Disputes Redressal Commission, the requirement for tax deduction under section 194A was not applicable because the character of the payment though described as interest fixed at 18 per cent. per annum, was only compensation measured with reference to the yardstick of interest.

It is held in case of Govinda Choudhury and Sons [1993] 203 ITR 881 (SC) if the amounts under a contract were not paid at the proper time and interest was awarded to the respondent for such delay, the interest was only an accretion to the respondent's receipts from the contract and was attributable to and incidental to the business carried on by it. The interest payable to the respondent partook of the same character as the receipts for the payment of which it was otherwise entitled under the contracts and which payment had been delayed as a result of disputes between the parties. The interest awarded could not be separated from the other amounts granted to the respondent under the awards and treated as "Income from other sources". It is well-settled that interest can be assessed under the head "Income from other sources" only if it cannot be brought within one or the other of the specific heads of charge.

In case of B.N. Agarwala and Co. 259 ITR 754 (SC) The assessee entered into a contract with the Government for executing certain works. A dispute arose between the assessee and the Government and the dispute was referred to arbitration. The arbitrator awarded a certain amount by way of compensation for work done and also awarded interest. The question was whether the interest awarded by the arbitrator was income assessable tax. The High Court held that the interest was of capital nature and could not be assessed as income. On appeal to the Supreme Court Held, reversing the decision of the High Court, that the interest awarded by the arbitrator was income and it had to be assessed as a business receipt of the assessee.

Question

The assessee Mr. Solanki had applied for a flat under a scheme proposed by the Surana Builders Limited (The Builder). Under the scheme many facilities including certain infrastructure facilities were to be provided. After delay of about two years from the date specified for handing over possession, the builder

revised the price and demanded some extra payment. When the respondent went to take possession of the flat, he found that there was no approach road or lift and many facilities including the infrastructural facilities advertised had not been provided. On his complaint, the State Consumer Disputes Redressal Commission held that the assessee's complaint was fully justified and directed the builder to refund the amounts paid by the assessee with interest at the rate of 18 per cent. p.a. from the dates of deposit till date of payment. The builder is of the opinion and has deducted tax at the time of payment of interest. You are required to state the correct position of law for the deduction of tax at source.

Answer

Section 194A, did not apply to the payment made by the builder. The builder was asked to pay interest on the amount refunded to the complainant because of its failure to construct the promised flat and to provide the necessary facilities. The amounts deposited by the assessee with the builder were not paid by way of deposit, nor had the builder borrowed those amounts. Interest payment in this case was by way of damages. Merely because the damages were described as by way of interest that did not convert them into interest under the Act. Interest, in the order of the Commission, meant compensation or damages for delay in construction or handing over possession of the same causing consequential loss to the complainant by way of escalation in the price of the property and also on account of distress and disappointment faced by him. Interest, in the order, had been used merely as a convenient method to calculate the amount of compensation in order to standardise it. Otherwise, each case of an allottee would have to be dealt with differently. Nomenclature did not decide the issue. In view of the definition of "interest" in section 2(28A), the provisions of section 194A were not applicable and the builder was wrong in deducting tax at source from the interest payable to the assessee. [2002] 258 ITR 0337- Ghaziabad Development Authority vs. Dr. N.K. Gupta (National Consumer Disputes Redressal Commission)

260 ITR 0284- SHANKAR VS. UNION OF INDIA (DEL)

In view of the decision of the Supreme Court in Bikram Singh v. Land Acquisition Collector [1997] 224 ITR 551 wherein it was held that the interest received on delayed payment of compensation under the Land Acquisition Act, 1894, was a revenue receipt exigible to tax and section 194A of the Income-tax Act, 1961. The person entitled to compensation would be entitled to a spread over of the income for the period for which payment came to be made so as to compute the income for assessing tax for the relevant accounting year.

It is established law that interest on delayed compensation on compulsory acquisition arises from year to year as decided by the Supreme Court in CIT v. T. N. K. Govindarajulu Chetty [1987] 165 ITR 231. But where tax is deducted at the time of payment in one lump sum, there is usually a mismatch between the amount required to be deducted and what is actually deducted under section 194A of the Income-tax Act. A writ was filed in Shankar v. Union of India [2003] 260 ITR 284 (Delhi) questioning the deduction without considering the effect of spread-over of income. The High Court found that since the payment was taxable, tax deduction cannot be avoided as found by the Supreme Court in Bikram Singh v. Land Acquisition Collector [1997] 224 ITR 551. The manner in which it is assessable in the hands of the assessee cannot determine the amount of tax that is required to be deducted under the statute. However, it is open to the recipient to offer the income on year to year basis by filing returns and claiming refund for excess tax.

Question

DCIT communicated to Land Acquisition Collector, directing him to deduct tax at source at the time of making payment of interest to the assessee on account of enhancement of compensation. According to

assessee, since the amount of interest payable on account of delay in payment of enhanced compensation is not liable to be taxed, the Land Acquisition Collector cannot be asked to deduct tax at source. You are required to discuss the correct position of law.

Answer

No relief could be granted to the petitioners in view of the decision of the Supreme Court in *Bikram Singh v. Land Acquisition Collector* [1997] 224 ITR 551 wherein it was held that the interest received on delayed payment of compensation under the Land Acquisition Act, 1894, was a revenue receipt exigible to tax and section 194A (TDS on interest). The person entitled to compensation would be entitled to a spread over of the income for the period for which payment came to be made so as to compute the income for assessing tax for the relevant accounting year.

272 ITR 0534- CANAAN KURIES AND LOANS (P.) LTD. VS. ITO (KER)

The essential elements that go to constitute a lottery are : (1) a prize or some advantage in the nature of a prize ; (2) distribution thereof by chance, and (3) consideration paid or promised for purchasing the chance. The chance of a person getting the prize cannot be treated as part of the bargain unless independent consideration is there with respect to the prize awarded.

Where a Maruti car was won as a prize on the basis of a lottery promoted by the Government to promote a small savings scheme, such winning even in kind was held in *K. C. Suresh v. Director of Lotteries* [1993] 199 ITR 266 (Ker) to be assessable and tax deductible under section 194B of the Income-tax Act after pointing out that the petitioner was lucky in a lottery, but unlucky with the Income-tax Department. But on a similar prize, it was held in *CIT v. Deputy Director of Small Savings* [2004] 266 ITR 27 (Mad) that the fact that the prize winner was chosen by lot did not by itself convert it into a lottery winning, since the subscriber had not purchased the coupon. He won the prize as a subscriber, though chosen by lot. It is true that there was a narrower view, that whenever the winner is chosen by lot, there is lottery winning following earlier English and Indian decisions. But there are subsequent decisions of the English court in *Reader's Digest Association Ltd. v. Williams* [1976] 3 All ER 737 and *Imperial Tobacco Ltd. v. Attorney General* [1980] 1 All ER 866. There have been favourable decisions as regards similar winnings among purchasers of books in Indian law as well in *Sesha Ayyar v. Krishna Ayyar*, AIR 1936 Mad 225 [FB]. A similar issue came up before the Kerala High Court in *Canaan Kuries and Loans (P) Ltd. v. ITO* [2005] 272 ITR 534, regarding prize schemes by dealers for sale of consumer goods or by kuri companies rewarding subscribers who make prompt payments, by a draw among them can not be regarded as lottery. A similar view was expressed in *H. M. M. Ltd. v. Director General, Monopolies and Restrictive Trade Practices Commission* [1998] 94 Comp Cas 132 (SC) in respect of a prize scheme known as “hidden wealth prize offer” with some Horlicks bottles containing prize coupons.

272 ITR 0095- ERNAKULAM DISTRICT CO-OPERATIVE BANK LTD. VS. ACIT (TDS) (KERALA HIGH COURT)

Bona fide failure to deduct tax, it had been held, would not only avoid penalty but even interest as held in *CIT v. Nestle India Ltd.* [2000] 243 ITR 435 (Delhi). Where no loss is caused to the Revenue because of direct payment by the payee, there is an abatement of liability for tax, as held in *CIT v. Rishikesh Apartments Co-operative Housing Society Ltd.* [2002] 253 ITR 310 (Guj) ; *Kannan Devan Hill Produce Co. Ltd. v. CIT* [1986] 161 ITR 477 (Ker) ; *CIT v. Life Insurance Corporation of India* [1987] 166 ITR 191 (MP). In the matter of tax deduction from salary, it was pointed out in *P. V. Rajagopal v. Union of India* [1998] 233 ITR 678 (AP), that since tax deduction is on the estimated liability, there can be no

default in any shortfall merely on the ground that the tax deducted does not strictly accord with the computation under the Act, a view which is most reasonable and accords with law, avoiding unnecessary hassles for minor deviations.

However, in *Ernakulam District Co-operative Bank Ltd. v. Asst. CIT* [2005] 272 ITR 95, the Kerala High Court chose to follow the rigid line upholding the levy of interest for failure to deduct tax on advance of salary and held that levy of such interest is warranted because it is not only compensatory but also mandatory.

262 ITR 0033- KRANTI KUMAR SAXENA, IN RE VS. (MADHYA PRADESH HIGH COURT)

Under 194A tax deduction at source is permissible in respect of interest on compensation on compulsory acquisition of land and also in respect of interest accrued on enhanced compensation of the Land Acquisition Act. This section has to be read in conjunction with section 204 which furnishes the meaning of “person responsible for paying”. Where land is compulsorily acquired and the money to be paid as enhanced compensation, is deposited in the execution court and interest is awarded on such compensation, the court is not the person responsible for paying any income by way of interest to the assessee. In terms of sections 194A and 204 the real person responsible for paying income by way of interest is the Land Acquisition Officer/Collector who has money in his possession. The court acts only as a conduit for getting the payment made to the claimant in execution of a decree passed by the court. Since there is no liability of the court to deduct tax under section 194A, the court need not retain the amount of approximate tax and inform the concerned Income-tax Officer to collect it by means of voucher.

264 ITR 0036- INCOME-TAX OFFICER VS. THODUPUZHA URBAN CO-OPERATIVE BANK LTD. (KER)

An agricultural co-operative society would not be liable in terms of sub-section (1) of section 194A to deduct tax at source. Decision of the single judge in *Thodupuzha Urban Co-operative Bank Ltd.*, In re [1999] 238 ITR 630 (Ker) affirmed.

270 ITR 0394- NEW INDIA ASSURANCE CO. LTD. VS. MANI (MADRAS HIGH COURT)

Section 194A would require tax deduction from interest other than interest on securities. Where interest is granted in its discretion, such interest ordinarily partakes of the character of the principal amount itself, so that the interest on compensation may be treated as a capital receipt as part of damages, where damages themselves are not taxable, with interest being understood as part of damages measured with reference to the period of delay. But where interest is paid on compensation determined under statute as arising on the date of injury with interest itself stipulated in the statute till the date of payment, such interest has only the character of interest simpliciter as was found by the Supreme Court in *CIT v. T. N. K. Govindarajulu Chetty* [1987] 165 ITR 231. In respect of compensation awarded by a Motor Accident Claims Tribunal, it is an instance of statutory payment of interest, so that it is liable to tax and duty to deduct at source under section 194A as was found in *New India Assurance Co. Ltd. v. Mani* [2004] 270 ITR 394 (Mad).

The compensation amount which earned interest, because of the delayed payment is liable to be taxed and because of the amended provision, when the interest amount exceeding Rs. 50,000 has been paid by the insurance company, during the financial year, they are bound to deduct the income-tax at source under

section 194A of the Income-tax Act, 1961. Thus tax should be deducted only where the interest payment exceeds the limit of 194A.

277 ITR (A.T.) 0133- INCOME-TAX OFFICER VS. MALAYALA MANORAMA CO. LTD. (INCOME-TAX APPELLATE TRIBUNAL--COCHIN)

The word “lottery” in its etymological sense is derived from the word “lot”. Lottery is also governed by the State Act prohibiting and regulating lotteries. Lottery income is liable to tax under the head “other sources” and there is liability for tax deduction at source on lottery winnings. It is in this context, that various sales promotion schemes involving choice of the customers eligible for certain incentives is often sought to be treated as lottery by the tax collector. Where skill is involved as in poll-forecast or World Cup football results, there is the factor of knowledge and skill and not mere chance. Further, where there is no fee for participation, it is not a game purely of chance as a lottery is. It was in this context, it was found in ITO v. Malayala Manorama Co. Ltd. [2005] 277 ITR (AT) 133 (Cochin) that distribution of prizes, for those who predicted the results of election and sports were found by the Tribunal to be not lottery winnings liable for tax deduction at source. In coming to the conclusion, the Tribunal reviewed the case law on the subject and found that, where there is no collection of fee, so that a free chance is given to an investor as under the savings schemes promoted by the State Governments, there is no lottery involved so as to require tax deduction at source as was found by the Madras High Court in CIT v. Deputy Director of Small Savings [2004] 266 ITR 27, after a similar review of the case law on the subject. The fact that there was no sale of lottery ticket was the ruling consideration in this case.

The view that every prize awarded by taking lot would constitute a lottery for purposes of income-tax would require review. Similarly, where skill is involved, though the final prize may involve a choice of the winner by lot, when there are many successful respondents, there could be no inference of lottery. One can probably assume that what is governed by the Lotteries Act alone would be lotteries even for purposes of the income-tax law. Various sales promotion schemes by which awards are given by choice of customers by lot should also on this test not be treated as lottery, because there is no separate payment required as contribution for participation in the lottery except the price paid for the purchase.

281 ITR 0099- BDA LTD. VS. INCOME-TAX OFFICER (TDS) (BOMBAY HIGH COURT)

Section 194C require tax deduction at source in respect of a contract of any work including supply of labour for carrying out any work. The section also covers advertisement, broadcasting, telecasting, carriage of goods and passengers and catering services. There is, however, only a sale in a contract of purchasing, printing and packing of materials carrying printed labels. It could not be treated as a case of works contract by any stretch of imagination merely because ancillary cost is incurred for the labels, ink, papers, screen printing etc. Supply of printed labels by itself does not convert a contract of sale simpliciter into a work contract. This conclusion was arrived at after review of a number of cases and the law on the subject under sales tax, Central excise and income-tax law in BDA Ltd. v. ITO (TDS) [2006] 281 ITR 99 (Bom).

282 ITR 0003- COMMISSIONER OF INCOME-TAX VS. POMPUHAR SHIPPING CORPORATION LTD. (MADRAS HIGH COURT)

Where an assessee uses transport in pursuance of a contract for transporting coal by hiring it, the payment made by it as hire charges cannot be subject to tax deduction at source. The fact that the hired ships were

used for transport does not render the payment as one for payment for hire of transport. Section 194C was held inapplicable in such a case in CIT v. Poompuhar Shipping Corporation Ltd. [2006] 282 ITR 3 (Mad). There is no tax deduction at source on payment of hire charges.

Payment of hire charges for taking temporary possession of the ships by the assessee-company would not fall within the provision of section 194C and hence no tax was required to be deducted. The hiring of ships for the purpose of using them in the assessee's business did not amount to a contract for carrying out any work as contemplated in section 194C.

283 ITR 0197- COMMISSIONER OF INCOME-TAX VS. DABUR INDIA LTD. (DELHI HIGH COURT)

Section 194C would require tax deduction at source in respect of payments for carrying out any work including supply of labour. In a case of sale of goods, it could have no application. In the case of purchases of goods made to order, the Assessing Officers are prone to infer the same as works contract, merely because the product is designed to meet the purchaser's requirements. Though there are a number of decisions of the Tribunal, the issue had come to the High Court in BDA Ltd. v. ITO (TDS) [2006] 281 ITR 99 (Bom) in respect of supply of wrapper labels for bottles containing liquor sold by the assessee. The Tribunal had found that the printing work was carried on in the premises of the supplier according to the specifications given by the assessee. The supply was for quantity ordered by the assessee. It was the supplier, who had incurred the cost of the labels for screen-printing etc., so that it was a contract of sale and not works contract. In coming to the conclusion, the Bombay High Court had undertaken an elaborate review of the case law from the excise and sales tax cases including those from the apex court for concluding that the inference for purposes of section 194C cannot be different from that under other laws.

In other words printing of labels on corrugated boxes did not require any special skill or involve any confidence or secrecy. In the circumstances, the Tribunal was justified in holding that the predominant object underlying the contract was one for sale of goods which took the contract out of the purview of section 194C of the Income-tax Act, 1961.

CIRCULAR NUMBER: 740 219 ITR (STAT) 0008-

Taxability of interest remitted by branches of banks to the head office situated abroad, under the Foreign Currency Packing Credit Scheme of Reserve Bank of India.

Interest under FCPCS remitted from branch to head office outside India is taxable u/s. 115A.

Foreign branch for purpose of 115 A is regarded as distinct entity all together and said amount will be taxable and tax will have to be deducted there on.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

A foreign bank has remitted interest income from India to its head office abroad without the deduction of tax on the grounds that there is no payment of interest to third person is it justifiable. Also state whether said amount is taxable in India or not.

ANSWER

CBDT in its circular no. 740 has clarified that the branch of a foreign company/concern in India is a separate entity for the purposes of taxation. Interest paid/payable by such branch to its head office or any branch located abroad would be liable to tax in India and would be governed by the provisions of section

115A of the Act. If the double taxation avoidance agreement with the country where the parent company is assessed to tax provides for a lower rate of taxation, the same would be applicable. Consequently, tax would have to be deducted accordingly on the interest remitted as per the provisions of section 195 of the Income-tax Act, 1961. Such amount will also be taxable in India.

CIRCULAR NUMBER: 005 248 ITR (STAT) 0241-

Problems were being faced by the assesseees in getting due credit for tax deducted at source in respect of tax deducted in terms of section 194-I of the Act. Such problems in getting due credit for tax deducted at source mainly relate to the following situations :

Sometimes tax is deducted at source under the provisions of section 194-I of the Act on advance rent pertaining to more than one financial year to be adjusted against future rent. Difficulty in getting due credit for tax deducted arises because the entire amount of advance rent does not accrue to the assesseees as income in one financial year since the income from the property is taxed on the basis of annual letting value whereas the tax is deducted at source on the entire amount of advance rent pertaining to more than one financial year. Therefore, credit for entire amount of tax deducted at source is not allowed in terms of section 199 of the Act because the credit is to be given for the assessment year for which such income is assessable. Thus, the assesseees do not get credit for the entire amount of tax deducted at source in the first assessment year, in which part of the advance rent is offered as rental income, on the basis of the certificate furnished under section 203 of the Act. Further there is a difficulty in claiming the credit in the remaining assessment years to which balance of advance rent relates in the absence of the certificate for tax deducted at source for these years.	In such cases where advance rent is spread over more than one financial year and tax is deducted thereon, credit shall be allowed in the same proportion in which such income is offered for taxation for different assessment years based on the single certificate furnished for tax so deducted on the entire advance rent.
Sometimes subsequent to the deduction of tax at source on advance rent pertaining to one or more financial years. Rent agreement gets terminated/cancelled resulting into refund of balance amount of advance rent to the tenant, or Rented property is transferred by way of sale, lease, gift, etc., with tenant in occupation or otherwise resulting into refund of balance amount of advance rent to the transferee or the tenant, as the case may be. Difficulty in getting due credit for tax deducted at source arises because rental income ceases to accrue to the assesseees on account of termination/cancellation of rent agreement or transfer of the rented property subsequent to the deduction of tax at source on advance rent pertaining to one or more financial years. The credit is not given in the hands of the assesseees in whose names certificate for tax deduction at source stands because there is no relatable rental income and, further credit for tax is not allowed to any person other than the person in whose name certificate for tax deducted at source has been issued. Thus, in such cases, even though tax has been deducted at source and paid to the Government, due credit for such tax deducted is not allowed.	Credit for the entire balance of tax deducted at source, which has not been given credit so far, shall be allowed in the assessment year relevant to the financial year during which the rent agreement gets terminated/cancelled or rented property is transferred and balance of advance rent is refunded to the transferee or the tenant, as the case may be.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Mr. X is in receipt of advance rent of property from YoYo Limited and tax is deducted at source under the provisions of section 194-I on advance rent pertaining to more than one financial year. The entire amount of advance rent does not accrue to the assessee as income in one financial year since the income from the property is taxed on the basis of annual letting value whereas the tax is deducted at source on the entire amount of advance rent pertaining to more than one financial year. Therefore, credit for entire amount of tax deducted at source was not allowed by the assessing officer in terms of section 199 of the Act because the credit is to be given for the assessment year for which such income is assessable. Thus, Mr. X is denied credit for the entire amount of tax deducted at source in the first assessment year. You are required to assist him in getting the due credit of tax in his assessment.

ANSWER

Kindly reproduce the circular as explained above.

257 ITR (STAT) 0004- CIRCULAR NUMBER: 005

Earlier CBDT had clarified regarding payments made to a hotel for rooms hired during the year would be of the nature of rent? where in its opinion Payments made by persons other than individuals and Hindu undivided family for hotel accommodation, taken on regular basis will be in the nature of rent subject to TDS under section 194-I. In this context, doubts have been raised as to what constitutes “hotel accommodation taken on regular basis” for the purpose.

First, it needs to be emphasised that the provisions of section 194-I do not normally cover any payment for rent made by an individual or Hindu undivided family except in cases where the total sales, gross receipts or turnover from business and profession carried on by the individual or Hindu undivided family exceed the monetary limits specified under clause (a) or clause (b) of section 44AB. Where an employee or an individual representing a company (like a consultant, auditor, etc.) makes a payment for hotel accommodation directly to the hotel as and when he stays there, the question of tax deduction at source would not normally arise (except where he is covered under section 44AB as mentioned above) since it is the employee or such individual who makes the payment and the company merely reimburses the expenditure.

Where earmarked rooms are let out for a specified rate and specified period, they would be construed to be accommodation made available on “regular basis”. Similar would be the case, where a room or set of rooms are not earmarked, but the hotel has a legal obligation to provide such types of rooms during the currency of the agreement.

However, often, there are instances where corporate employers, tour operators and travel agents enter into agreements with hotels with a view to merely fix the room tariffs of hotel rooms for their executives/guests/customers. Such agreements, usually entered into for lower tariff rates, are in the nature of rate contract agreements. A rate contract, therefore, may be said to be a contract for providing specified types of hotel rooms at pre-determined rates during an agreed period. Where an agreement is merely in the nature of a rate contract, it cannot be said to be accommodation “taken on regular basis”, as there is no obligation on the part of the hotel to provide a room or specified set of rooms. The occupancy in such cases would be occasional or casual. In other words, a rate contract is different for this reason from other agreements, where rooms are taken on regular basis. Consequently, the provisions of section 194-I while applying to hotel accommodation taken on regular basis would not apply to rate contract agreements.

264 ITR 0016- AMALENDU SAHOO VS. INCOME-TAX OFFICER (CAL)

Section 194-I of the Income-tax Act talks about a person as well as an individual. There appears to be a conscious decision to keep them separate. A person may be an individual and may be a body of individuals. While the liability under section 194-I is foisted the moment rent is to be paid to a person which as aforesaid may be an individual or a body of individuals. But the rate of tax to be deducted has been fixed for an individual at a separate rate and for a body of individuals at a separate rate. The proviso to the section deals with the payee. If the payee is an individual entitled to receive rent in excess of Rs. 1,20,000 per annum then the payer is obliged to deduct 15 per cent. thereof as tax deducted at source. If the payee is a body of individuals and if the rent payable exceeds Rs. 1,20,000 per annum, the payer is required to deduct 20 per cent. thereof as tax deducted at source.

Where the assessee as undivided joint owners had let out the property to the bank the bank correctly deducted tax at source while agreeing to pay a balance sum to the petitioners jointly as and by way of rent.

Where the assessee individually had let out specified areas of the property to the bank, the rent payable was required to be apportioned and accordingly if upon such apportionment the assessee were not individually entitled to receive a sum in excess of Rs. 1,20,000 per annum the bank was not entitled to make any deduction of tax at source.

Where a property is let out to a body of individuals, the limit should be a collective one. But if it is let out to each member of such body, the limit has to be a split one. It was so decided in *Amalendu Sahoo v. ITO* [2003] 264 ITR 16 (Cal).

Question

Mr. Amit and Mr. Harshad made a joint investment equally in a property with the view to let it out and earn rental income therefrom. The property is let to Standard Chartered Bank for the monthly rent of Rs. 15,000. The bank seek your opinion on the point whether tax is required to be deducted or not. Also your opinion is required on the applicable rate of TDS.

Answer

Where the assessee as undivided joint owners had let out the property to the bank the bank deducted tax at source while agreeing to pay sum to the petitioners jointly as and by way of rent. Since in the given case letting is joint limit is to be considered. Thus tax is required to be deducted on $15,000 \times 12 = 180,000$.

The rate of tax to be deducted has been fixed for an individual at a separate rate and for a body of individuals or association of persons at a separate rate. The proviso to the section deals with the payee. If the payee is an individual entitled to receive rent in excess of Rs. 1,20,000 per annum then the payer is obliged to deduct 15 per cent. thereof as tax deducted at source. If the payee is a body of individuals or association of persons and if the rent payable exceeds Rs. 1,20,000 per annum, the payer is required to deduct 20 per cent. thereof as tax deducted at source. Thus in the given case tax shall be deducted at 20 %. However surcharge as applicable should also be added.

CIRCULAR NUMBER : 736 218 ITR (STAT) 0097A

Applicability of the provisions of Section 194(I) of the Income-tax Act to the Film Distributor and Exhibitors - Clarification regarding.

No tax is to be deducted while sharing proceed between film distributor and exhibitor on following grounds ;

- (a) Exhibitor does not let out the cinema hall to the distributor.

- (b) Generally share of the exhibitor is on account of composite services.
- (c) Distributor does not take cinema building on lease or tenancy.

282 ITR (A.T.) 0224- INCOME-TAX OFFICER VS. TEJMALBHAI AND CO. (INCOME-TAX APPELLATE TRIBUNAL--RAJASTHAN)

The services rendered by the assessee were the result of its activities carried on continuously in an organised manner with a set purpose and with a view to earn profit. Therefore, all these activities were in the nature of adventure in the nature of trade and liable to be assessed as business income and not as income from house property. The frequency of transactions for the hire charges received by the assessee gave ample indication and evidence that the entire activity was in the nature of business activity. The balance-sheet of the assessee also showed godown as business asset and not as asset of any personal investments. The asset involved was a warehouse and commercial use was the only use which was possible and the resultant income as a natural corollary had to be assessed under the head "Income from business" and not "Income from house property". Even though the customers making payments to the assessee had booked the expenditure in their books of account under the head rental expenditure and deducted tax at source thereon under section 194-I, the income so received was assessable in the assessee's hands as income from business and not as income from rent or income from house property.

251 ITR 0053 SKYCELL COMMUNICATIONS LTD. VS. DCIT (MAD)

Section 194J provides for tax deduction at source at 5% on payments exceeding Rs.20,000 for fees for professional and technical services. The provision of cellular mobile telephone facility to subscribers cannot be treated as technical service and that it does not fall under any other listed services nor has it been notified. Merely because the service is linked to science and technology as are found in most of the gadgets now in use in every day life, every such instrument or gadget to make life easier cannot be treated as involving provision of technical service. [However, the issue may still arise whether it is liable for TDS at the lesser rate of 2% under section 194C or not]

"Technical service" contemplates rendering of a "service" to the payer for the fee. Mere collection of a "fee" for use of a standard facility provided to all those willing to pay for it does not amount to the fee having been received for technical services.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Orange Ltd. is engaged in the business of providing cellular mobile telephone facility to subscribers. Chief Commissioner of Income-tax has directed to treat the payments made to them by their subscribers as coming within the definition of "fees for technical services" in section 194J read with section 9(1)(vii), Explanation 2 and require the firms and companies subscribing to the petitioners' network, to deduct tax at source on the payments made by them to the assessee. You are required to answer whether the direction of the CIT is justified or not.

ANSWER

Section 194J provides for tax deduction at source at 5% on payments exceeding Rs.20,000 for fees for professional and technical services. The provision of cellular mobile telephone facility to subscribers cannot be treated as technical service and that it does not fall under any other listed services nor has it been notified. Merely because the service is linked to science and technology as are found in most of the gadgets now in use in every day life, every such instrument or gadget to make life easier cannot be

treated as involving provision of technical service. Provision of agency service, railway or air service also involves high technology, but such service does not become technical service. So is the service made available by way of supply of electricity, satellite telephone and various other sophisticated equipments. Mere service or collection of a fee does not become a technical service. Thus the CIT is not justified in issuing the direction. [2001] 251 ITR 0053 SKYCELL COMMUNICATIONS LTD. VS. DEPUTY COMMISSIONER OF INCOME-TAX (MAD)

255 ITR 0236- ACIT VS. DIRECTOR OF STATE LOTTERIES, ASSAM (GAU)

Winnings from lottery are subject to tax deduction at source under section 194B. But where an agent receives the prize money on unsold ticket or becomes entitled to an unclaimed prize, should such amount be treated as lottery winnings?

Sometimes a ticket which wins the prize remains unsold and is in the hands of the agent. The agent in such a case cannot be said to be the winner of the lottery, inasmuch as, firstly, the agent did not purchase the ticket from the Director of Lotteries and, secondly, the unsold tickets in the hands of the agent *stricto sensu* did not participate in the lottery. If this was not so, then the agent might as well go to the Director of Lotteries after the stipulated period for claiming the prize lapses and tell him that since nobody has come to claim the prize he should be refunded the money, though he himself may be holding the ticket which may have won the prize. The agent did not become the purchaser of the ticket. The unsold tickets in the hands of the agent were not participating in the lottery.

Conclusion

The character of receipts in the hands of the agent is different from the one in the hands of the subscriber to the lottery ticket. Prize money in the hands of the agent forms part of his business income and therefore not liable for tax deduction under section 194B. Refund by the Director of State Lotteries to the organising agent of the prize money from the unsold tickets of lotteries and unclaimed prizes does not attract the provisions of section 194B. The tax in the hands of the agent will be at the rate appropriate to his income from business.

Question

The Director of Lotteries, appointed M. S. Associates as an organising agent. Further, the organising agent was to be solely responsible for sale of the entire lot of tickets for each draw and the Director of State Lotteries was not liable for any loss caused to the organising agent on account of lottery tickets remaining unsold. All prize from unsold tickets of the lotteries shall be the property of the organising agent. Similarly, all unclaimed prizes shall also be property of the organising agent and shall be refunded to the organising agent. You are required to answer whether the refund by the Director of State Lotteries to the organising agent of the prize money from the unsold tickets of lotteries and unclaimed prizes attracts the provisions of section 194B ?

Answer

Analysis of section 194B would clearly indicate that the person responsible for payment under section 194B is only to make deduction if he is paying the money as an income by way of winning from any lottery and not otherwise. Supposing in a case an agent sells a ticket which wins prize, the prize winner does not come forward to claim the prize within the stipulated period. As per the agreement that money has to be refunded by the Director of Lotteries to the agent. Surely, when the agent gets the refund, he is not getting the refund as income by way of winning from a lottery ticket, inasmuch as, the winner was

somebody else who did not come forward to claim the prize. The agent does not become a prize winner from a lottery when the real prize winner does not come forward to claim the prize. In these circumstances the question of attracting the provision of section 194B would not arise.

Now, take for instance a ticket which wins the prize but remains unsold and is in the hands of the agent. In such an eventuality also, according to us, the unsold ticket in the hands of the agent cannot be said to be the winner of the lottery, inasmuch as, firstly, the agent did not purchase the ticket from the Director of Lotteries and, secondly, the unsold tickets in the hands of the agent *stricto sensu* do not participate in the lottery. If this was not so, then the agent might as well go to the Director of Lotteries after the stipulated period for claiming the prize lapses and tell him since nobody has come to claim the prize he should be refunded the money, though, he himself may be holding the ticket which may have won the prize. The intention behind section 194B is that the person must receive the money as winner of lottery. In view of the above discussions, the income accrued to an agent/trader/stockist in respect of prize on unsold/unclaimed tickets in the possession of an organising agent is income from business and does not constitute winnings from lotteries.

266 ITR 0027- COMMISSIONER OF INCOME-TAX VS. DEPUTY DIRECTOR OF SMALL SAVINGS (MADRAS HIGH COURT)

Before a scheme can be regarded as a lottery, there must be the element of distribution of prizes which should be by chance or lot and such distribution should be among those who had paid a price for participating in the scheme. Mere gratuitous distribution without any price having been paid by the participants for acquiring the chance and receiving a prize that is ultimately distributed, would not amount to a lottery. That appears to be the reason why the Explanation was added under section 2(24)(ix) of the Income-tax Act, 1961, with effect from April 1, 2002, to bring within the purview of section 194B, winnings from prizes awarded to any person by a draw of lots under any scheme or arrangement, whether or not the persons taking part in that arrangement, had paid a price for acquiring the chance of winning the prize. The Explanation lays emphasis on the winnings awarded by a draw of lots or chance.

Are prizes awarded by savings schemes operated by the Government, though chosen by lot, to be treated as winnings from lotteries? The High Court in CIT v. Deputy Director of Small Savings [2004] 266 ITR 27 (Mad) held that the prizes are given with a view to encourage thrift and were in the nature of a gift for the same having been limited only to the investors. An investor was not paying for the prize of the coupon, since the prizes were awarded for the holder of lucky coupon, which was not so purchased and since what was given were goods in kind, the question of treatment of the same as liable for tax does not arise and consequently liability for tax deduction at source cannot also be inferred under the law. It was in this context that penalty levied under section 201(1A) on the officer of the State Government in CIT v. Deputy Director of Small Savings [2004] 266 ITR 27 (Mad) was found to be without jurisdiction.

Penalty was for the alleged default on the aggregate value of the prizes distributed to the extent of Rs. 73 lakhs during the year. Since the proviso to section 194B introduced with effect from June 1, 1997, had roped in distribution of lottery winnings in kind by requiring the distributor not to part with the winnings without ensuring that tax has been paid by the winner. The fact, that the payment was made in kind, could not have spared the distributor from liability though it could have applied only for the period beginning from June 1, 1997. Further it could have applied only in respect of amount exceeding Rs. 5,000 in value which could be treated as lottery winnings. The scheme was not one for the promotion of sale of any goods. The investor was not offered interest payable on a larger sum, even when a smaller sum is invested. When the investment was made the full amount was payable and interest was paid thereon for the specific period, the investment as also the interest being eligible for concessions/exemptions under the

Income-tax Act. The chance given to the investor to win a prize was a free chance, and not a chance given in return for a price or contribution paid. The scheme was not a lottery. No penalty could be imposed once it was found that there had been no violation of the law.

284 ITR (A.T.) 0218- K. R. SYAMKUMAR VS. INCOME-TAX OFFICER (INCOME-TAX APPELLATE TRIBUNAL--COCHIN)

Lottery income is taxed at flat rate. Even where the assessee has no other income, the basic exemption is not available to him. It was so held in K. B. Syamkumar v. ITO [2006] 284 ITR (AT) 218 (Cochin).

257 ITR 0202- AHMEDABAD STAMP VENDORS ASSOCIATION VS. UOI (GUJ)

Where the State Government supplies stamp papers at a discount to its vendors/agent, the Assessing Officers expected the agent to make good what the Government should have deducted at source under section 194-H by treating the discount on sale as commission. Licensed vendors of stamp paper pay a price at a discount and that it cannot be said that there is any commission received by them, since they only purchase the stamp paper at a discount acquiring ownership of such stamp papers and bearing any loss or destruction, etc. Though they may get a refund of outdated stamp papers, there is still a sale at a discount. It is not a case of an agency, where sale of stamp paper is made on behalf of the principal, so that it does not fall within the ambit of the definition of commission or brokerage. This decision points out the distinction between commission/brokerage and discount. Discount is an abatement of cost, where it is given at the time of sale. It is not for services rendered by the purchaser, so as to constitute commission or brokerage. Such discount even including cash discount for prompt payment has been treated consistently for sales tax purposes as abatement of cost, so that sales tax becomes leviable only on the net amount as was decided in Dy. CST v. Advani Oerlikon Pvt. Ltd. [1980] 45 STC 32 (SC) and Dy. CST v. Kerala Rubber and Allied Products [1993] 90 STC 170 (SC). Bonus, discount or rebate have been all understood as abatement of price. The discount made available to the licensed stamp vendors under the provisions of the Gujarat Stamps Supply and Sales Rules, 1987, does not fall within the expression “commission” or “brokerage” under section 194H of the Act.

Question

A licensed vendor of stamp paper has to pay the price of the stamp papers less the discount at the rates provided. Where government offered 10% discount i.e. Stamp Paper of face value Rs. 50,000 were issued at discount for Rs. 45,000. The assessee is a registered stamp vendors of Ahmedabad. The officers called upon the State Government to deduct tax at source under section 194H on commission or brokerage to the persons carrying on the business as “stamp vendors”. You are required to answer whether officer is justified in so doing or not.

Answer

There is a distinction between a contract of sale and a contract of agency by which the agent is authorised to sell or buy on behalf of the principal. The essence of a contract of sale is the transfer of title to the goods for a price paid or promised to be paid. The transferee in such a case is liable to the transferor as a debtor for the price to be paid and not as agent for the proceeds of the sale. The essence of agency to sell is the delivery of the goods to a person who is to sell them, not as his own property but as the property of the principal who continues to be the owner of the goods, and will therefore be liable to account for the sale proceeds. The concept of sale has undergone a revolutionary change, having regard to the complexities of modern times and the expanding needs of society, which has made a departure from the

doctrine of laissez faire by including a transaction within the fold of a sale even though the seller may by virtue of an agreement impose a number of restrictions on the buyer, e.g., fixation of price, submission of accounts, selling in a particular area or territory and so on. These restrictions per se would not convert a contract of sale into one of agency, because in spite of these restrictions the transaction would still be a sale and subject to all the incidents of a sale. If these licensed stamp vendors were mere agents of the State Government, no sales tax would have been leviable when the stamp vendors sell the stamp papers to the customers because it would be “sale” by the Government through the stamp vendors. The discount made available to the licensed stamp vendors does not fall within the expression “commission” or “brokerage” under section 194H of the Act. Thus no tax is required to be deducted there on.

CIRCULAR NUMBER: 787 243 ITR (STAT) 0001-

Taxation Issues Concerning National And International Events Or Shows For Entertainment, Sports, Etc.

Such shows are often characterised by substantial incomes being earned by organisers, sponsors, players, athletes and artists during very short periods of time. In many cases the performers leave the country within a few hours of the show or event. The events or shows normally involve an event manager, artist management or intermediate company. Their receipts may be of the following nature Sponsorship money, Gate money, Advertisement revenue, Sale of broadcasting or telecasting rights, Rents from hiring out of space, etc, Rent from caterers. In turn, the event manager, etc., may, inter alia, incur expenditure on guarantee money, prize money, rental or premises or equipment, payments to labour contractor, for decoration, salaries, royalties, fees for technical services, insurance premium for the event, etc. Such receipts and payments may be liable to deduction of tax at source. In the case of residents, the applicability of the provisions of sections 194C, 194J and 194-I and in addition in the case of non-residents, the applicability of section 194E and section 195 should be examined.

In the case of non-residents, the applicability of Double Taxation Avoidance Agreement (DTAA) should be examined. The Income-tax Act provides that in case of sportsmen or artists participating in such events or shows, all income accruing or arising or deemed to be accruing or arising, received or deemed to be received in India is taxable in India.

The income earned by non-resident sportsmen, who are not citizens of India or the income earned by non-resident sports associations or institutions is required to be determined in accordance with the provisions of section 115BBA. In the case of sportsmen, this would include income by way of participation in India in any game or sport, from advertisement or contribution to any newspapers, magazines or journals of any articles relating to any sport or game in India. The tax should be deducted at source under section 194E from such payments.

CIRCULAR NUMBER: 749 223 ITR (STAT) 0127-

Under the provisions of section 203, the Drawing and Disbursing Officers (DDOs) of various Central Government Departments are deducting tax from payments made to its employees, contractors, etc. The taxes so deducted are being paid into Government account by book adjustment. Consequently, the TDS certificates issued by such DDOs do not carry details like challan numbers, dates of payments into Government account, etc. For these reasons, the same are being rejected by the Assessing Officers and this is creating hardship for the assesseees.

TDS certificates issued by Central Government Departments should be accepted by Assessing Officers if it indicates that credit has been afforded to the Income-tax Department by book adjustment.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Department of government has deducted the tax at source from the salaries of its employees and the certificate of TDS did not mention challan Number or date of payment of tax to government (Since paid by book entry to IT Department). The assessing officer did not allow the credit to such persons is the action justified.

ANSWER

Under the provisions of section 203, the Drawing and Disbursing Officers (DDOs) of various Central Government Departments are deducting tax from payments made to its employees, contractors, etc. The taxes so deducted are being paid into Government account by book adjustment. Consequently, the TDS certificates issued by such DDOs do not carry details like challan numbers, dates of payments into Government account, etc. For these reasons, the same are being rejected by the Assessing Officers and this is creating hardship for the assessee. It is now clarified by circular CIRCULAR NUMBER: 749 [1997] 223 ITR (Stat) 0127- TDS certificates issued by Central Government Departments should be accepted by Assessing Officers if it indicates that credit has been afforded to the Income-tax Department by book adjustment.

CIRCULAR NUMBER: 744 219 ITR (STAT) 0051-

Board's Circular No. 719 states that where the head office or the branch office is already filing the returns under section 206, no other Assessing Officer shall require the assessee to file such return with him. Where, however, the return is not being filed, the Assessing Officer having jurisdiction may proceed so as to enforce compliance to the provisions relating to deduction of tax at source from "salary".

It has been decided to extend this procedure to all other TDS returns.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

A Indian company generally files all the return of income from head office but the return of TDS is filed by branch office. Assessing officer is of the opinion that company must file again return of TDS from head office only. Is the opinion justifiable.

ANSWER

Board's Circular No. 719 states that where the head office or the branch office is already filing the returns under section 206, no other Assessing Officer shall require the assessee to file such return with him. Where, however, the return is not being filed, the Assessing Officer having jurisdiction may proceed so as to enforce compliance to the provisions relating to deduction of tax at source from "salary". It has been decided to extend this procedure to all other TDS returns.

CIRCULAR NUMBER: 785 241 ITR (Stat) 0002-

Under section 203 the person deducting tax is required to furnish a certificate to the effect that tax has been deducted and to specify therein, inter-alia, the amount deducted and any other particulars that may be prescribed.

In a number of cases, the payers of income agree to bear the tax on such income and make payment only "net of tax" in terms of section 195A of the Income-tax Act. It has been brought to the notice of the Board that in such cases, payers, however, sometimes refuse to furnish a certificate on the ground that

there is no obligation to furnish such certificate where the tax on the income is required to be borne by them under any agreement.

In view of the above, it is clarified that in all cases of deduction of tax at source, the payer is under legal obligation to furnish a certificate for the tax deducted at source in the prescribed form to the payee within the time prescribed.

CIRCULAR NUMBER: 790 243 ITR (Stat) 0058- (WITHDRAWN)

Procedure For Refund Of Tax Deducted At Source Under Section 195 To The Person Deducting The Tax.

The Board has issued Circular No. 769 laying down procedure for refund of tax deducted under section 195, in certain situations to the person deducting the tax at source from the payment to the non-resident. After reconsideration, Circular No. 769 is revoked with immediate effect and refund to the person deducting tax at source under section 195 shall be allowed in accordance with the provisions of this circular.

The cases referred

1. Where the contract is cancelled and no remittance is made to the non-resident ; (non-resident not having received any payment would not apply for a refund.)
2. Where the remittance is duly made to the non-resident, but the contract is cancelled. In such cases, the remitted amount may have been returned to the person responsible for deducting tax at source. (No claim may be made by the non-resident where he has no further dealings with the resident deductor of tax. This resident deductor is therefore put to genuine hardship as he would not be able to recover the amount deducted and deposited as tax.)

In the cases mentioned above, income does not accrue to the non-resident. The amount deducted as tax under section 195 and paid to credit of the Government therefore belongs to the deductor. At present, a refund is given only on a claim being made by the non-resident with whom the transaction was intended. Where no income has accrued to the non-resident due to cancellation of contract, the amount deposited to the credit of Government under section 195, cannot be said to be "tax". It has been decided that this amount can be refunded, with prior approval of the Chief Commissioner concerned to the person who deducted it from the payment to the non-resident under section 195.

The refund being made to the person who made the payment under section 195, the Assessing Officer may after giving intimation to the deductor, adjust it against any existing tax liability of the deductor under the Income-tax Act, 1961, Wealth-tax Act, 1957 or any other direct tax law. The balance amount, if any, should be refunded to the person who made such payment under section 195.

A refund in terms of this circular should be granted only after obtaining an undertaking that no certificate under section 203 of the Income-tax Act has been issued to the non-resident. In cases where such a certificate has been issued, the person making the refund claim under this circular should either obtain it or should indemnify the Income-tax Department from any possible loss on account of any separate claim of refund for the same amount by the non-resident.

CIRCULAR NUMBER: 769 232 ITR (STAT) 0025-

The Board has received a number of representations for granting approval for refund of excess deduction or erroneous deduction of tax at source under section 195 of the Income-tax Act. The cases referred to the Board mainly relate to circumstances where :

- (i) after the deposit of tax deducted at source under section 195,
 - (a) the contract is cancelled and no remittance is required to be made to the foreign collaborator ;
 - (b) the remittance is duly made to the foreign collaborator, but the contract is cancelled and the foreign collaborator returns the remitted amount to the person responsible for deducting tax at source ;
 - (c) the tax deducted at source is found to be in excess of tax deductible for any other reason ;
- (ii) the tax is deducted at source under section 195 and paid in one assessment year and remittance to the foreign collaborator is made and/or returned to the Indian company following cancellation of the contract in another assessment year.

In all the cases mentioned above, where either the income does not accrue to the non-resident or excess tax has been deducted thereby resulting in a refund being due to the Indian enterprise which deposited the tax, at present a refund can be issued only if a valid claim is made by filing a return.

- 2. In the absence of any statutory provision empowering the Assessing Officer to refund the tax deducted at source to the person who has deducted tax at source, the Assessing Officers insist on filing of the return by the person in whose case deduction was made at source. Even adjustment of the excess tax or the tax erroneously deducted under section 195 is not allowed. This has led to a lot of hardship as the non-resident in whose case the deduction has been made is either not present in the country or has no further dealings with the Indian enterprise, thus making it difficult for a return to be filed by the non-resident.

CBDT in this circular has clarified that when excess payment of TDS has been made to the department there is no provision under the act to give the refund and moreover a genuine assessee must be given back the amount of such excess payment. It has been refund may be granted independent of the provision of the Income tax act and must be granted to the person responsible for the deduction of tax after taking prior approval of the CIT. Where such payment is made by the branches than said refund shall be granted to the respective branches after taking the prior approval of the CIT since each branch for the purpose of TDS is to be considered as separate unit.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Company X made payment of royalties to a foreign enterprise and it was suppose to deduct the tax at source of Rupees 50000 by mistake it has deducted the amount of Rupees 65000 and has paid to the credit of Income tax department. TDS certificate issued to foreign enterprise is of Rs. 50000. Now Managing director of the company seeks to claim the adjustment of excess payment towards the normal tax liability of Rupees 95000. Can it be so done. What is the other remedy available to the MD if such set off is denied by the officer.

CIRCULAR NUMBER: 774 236 ITR (STAT) 0250-

Section 197 provides for Certificate for deduction at lower rate.

Where, in the case of any income of any person, income-tax is required to be deducted at the time of credit or, as the case may be, at the time of payment at the rates in force under the provisions of sections 192, 193, 194, 194A, 194D, 194-I, 194K and 195, the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of income-tax at any lower rates or no deduction of income-tax, as the case may be, the Assessing Officer shall, on an application made by the assessee in this behalf, give to him such certificate as may be appropriate. Where any such certificate is given, the person responsible for paying the income shall, until such certificate is cancelled by the Assessing Officer, deduct income-tax at the rates specified in such certificate or deduct no tax, as the case may be.

It has come to the notice of the Board that in certain charges a practice has developed to issue certificates under section 197 of the Income-tax Act even after the credit or payment of amounts subject to tax deduction at source. This is not in accordance with the provisions of law. It is, therefore, clarified that the certificate issued under section 197 of the Income-tax Act will be applicable only in respect of credit or payments, as the case may be, subject to tax deduction at source, made on or after the date of such certificate.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee made an application of lower deduction of tax at source. Sanction for the lower deduction was granted by the assessing officer on 15-01-99. Assessee company deducted the tax at the lower rate for the credit dated 05-01-99. Discuss whether action of the company is right in lower deduction of tax at source.

266 ITR 0364- HARVANSH AND SONS VS. UNION OF INDIA (MADHYA PRADESH HIGH COURT)

A perusal of the M. P. Excise Act, 1915, makes it clear that when liquor is purchased from a warehouse, payment of excise duty is to be made at the rate of duty in force on the date of issue. Excise duty is to be paid separately to the State. Hence, tax has to be collected at source on the cost price of liquor excluding the amount paid towards excise duty.

248 ITR 0105 UOI VS. OM PRAKASH S.S. AND COMPANY (SC)

To licence fees paid for licences issued by the Government permitting the licensee to carry on liquor trade, the provisions of section 206C, for collection of tax at source are not attracted, as the licensee does not fall within the concept of "buyer" referred to in that section. The payment made by the licensee by way of licence fee does not ipso facto entitle the licensee to lift goods. For obtaining the goods mentioned in the Table appended in the section, the licensee has to place an order on the manufacturer or supplier of the goods and it is at that point of time that section 206C would get attracted. "Buyer" means a person who, by virtue of the payment, gets a right to receive specific goods and not one who is merely allowed/permitted to carry on business.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee paid licence fees for licences issued by the Government permitting the licensee to carry on liquor trade. Government officer is of the opinion that the provisions of section 206C, for collection of

tax at source are attracted, and thus has demanded extra money on account of the collection of tax. You are required to state whether department is justified in demanding more money or not.

ANSWER

Section 206C is very clear in terms. In the liquor trade, e.g., the seller of liquor has to collect tax at source from the buyer. In spite of such clear words, the Department claimed that tax at source should be collected at the stage when the licence fees are paid by the liquor contractor to the Government. In a petition for special leave to appeal, the Supreme Court has taken pains to explain, in a speaking order, the correct approach. In *Union of India v. Om Prakash S. S. and Company* [2001] 248 ITR 105 (SC), the Supreme Court has explained what, in their opinion, was quite evident, "When the Government issues a licence, it only enables the licensee to carry on trade in that item. The payment made by the licensee by way of licence fee does not ipso facto entitle the licensee to lift the goods." Their Lordships also clarified that the expression "buyer" would mean a person who, by virtue of payment, gets a right to receive specific goods and not where he is merely allowed/permitted to carry on business in trade by the issue of a licence. Thus department is not justified in demanding the tax.

278 ITR 0122- VIOND RATHORE VS. UNION OF INDIA (MADHYA PRADESH HIGH COURT)

Tax collection at source on specified products is required on the sale price. In ascertaining sale price, excise duty payable cannot be excluded. It was so held in *Vinod Rathore v. Union of India* [2005] 278 ITR 122 (MP). In coming to the conclusion, the decision in *McDowell and Co. Ltd. v. CTO* [1985] 154 ITR 148 (SC), where exclusion of excise duty under identical circumstances for purposes of sales tax, was found impermissible. A letter addressed by the Finance Minister to a Member of Parliament, that tax collection would be limited to the cost of liquor supplied by the Government, cannot be treated as law on the subject.

284 ITR 0022- COMMISSIONER OF INCOME-TAX VS. DISTRICT EXCISE OFFICER (UTTARANCHAL HIGH COURT)

Where the amount collected is in the nature of basic licence fee being part of bid money and not consideration for sale of goods, but for parting with a privilege, tax is not collectible at source under section 206C. It was in the light of the provisions in the Rules under the U. P. Excise Licences (Auction-cum-Tender) Rules, 1991, that the decision was in favour of the assessee in *CIT v. District Excise Officer* [2006] 284 ITR 22 (Uttaranchal).

INTEREST PAYMENT

Section / Topic Name : 234A, 234B, 234C, 234D, etc.

BOOK PROFIT ASSESSMENT

The Himachal Pradesh High Court joined the league of Gauhati, Madhya Pradesh, Bombay, Punjab and Haryana and Madras High Court in ruling that the assessee would be liable to pay interest under sections 234B and 234C even if the Assessing Officer frames assessment by applying the provisions of section 115J. The Himachal Pradesh High Court in CIT v. United Vanaspati Ltd. [2010] 187 Taxman 20 showed its dissent with the Karnataka High Court's decision in Kwaliti Biscuits Ltd. v. CIT [2000] 243 ITR 519/110 Taxman 47. Further, showing its discord with the Supreme Court's decision in CIT v. Kwaliti Biscuits Ltd. [2006] 284 ITR 434/155 Taxman 658 as well the High Court pointed out that the same was a non-speaking order which did not lay down any law and, therefore, could not be taken as a binding precedent.

On the subject of advance tax obligation the Court was point blank when it said that every company must be aware of the provisions of section 115J. The assessee should have been aware that this section mandates that tax shall be levied not only on the actual income but by fiction of law on the taxable income which shall be deemed to be equivalent to the 30 per cent of the book profit. Every company is supposed to maintain proper accounts. Therefore, at the end of each quarter the assessee could have visualized what could be its book profits and should have deposited the advance tax accordingly. The mere fact that the assessment had been made under section 115J was not a ground to hold that the assessee was not liable to deposit advance tax.

BOOK PROFITS

Lot of money and efforts have gone into the question whether provisions of sections 234B and 234C are attracted to a situation where tax liability of an assessee is determined in terms of provisions of section 115JA. Here comes a ruling from the Karnataka High Court in CIT v. Brindavan Beverages Ltd. [2010] 186 Taxman 233, which speaks that estimation of tax in the case of a company cannot be an impossibility because in respect of companies, it is recognized business practice in commercial parlance that even quarterly results of the performance of the company are published for the benefit of the shareholders and other members of the public and if this is a possibility, it cannot be said that it is impossible for the purpose of computation of tax liability in terms of the provisions of section 115JA.

WAIVER OF INTEREST-BENEFIT TO FILM INDUSTRY

In S. Nagoor Babu v. Chief CIT [2009] 181 Taxman 33 (Mad.), the assessee, a popular playback singer, having filed belated returns also filed applications separately for condoning the delay in filing the returns for each of the three assessment years. In other words, he defaulted tax filing for three consecutive years. In his petition, he claimed that his peak period had been from 1992 to 1998 during which he spent most of his time in Hyderabad and normally worked for 16 hours a day and because of his commitment, he could not file returns in time. The Madras High Court instantly acknowledged the fact that a person in cinema industry is continuously committed to work so that his busy schedule can be read as a circumstance beyond his control. In the consequence, the assessee was extended full waiver of interest.

INTEREST NOT MANDATORY

The Delhi High Court in CIT v. Anand Prakash [2009] 179 Taxman 44 made an impasse statement to the effect that the revenue can justify levy of penalty under section 234B only if it has suffered loss. In this case the revenue demanded interest for failure to pay advance tax when the assessee was subjected to charge of interest income on enhanced land compensation on year to year basis so that the Court had to intervene to set aside such a demand / levy. It further held that interest payable on account of enhanced compensation was not even in the assessee's knowledge till completion of the assessment of the relevant assessment years so that he could not be expected to have paid advance tax on amount of interest.

Yet again the Supreme Court in CIT v. Pranoy Roy [2009] 179 Taxman 53 held a view that interest is not a penalty and that interest is levied by way of compensation to compensate the revenue in order to avoid it from being deprived of payment of tax on due date, so that the assessee in this case was relieved of interest under section 234A even when he had delayed filing of return for the reason that he had paid the taxes before the due date of filing taxes.

PARTNERSHIP FIRMS

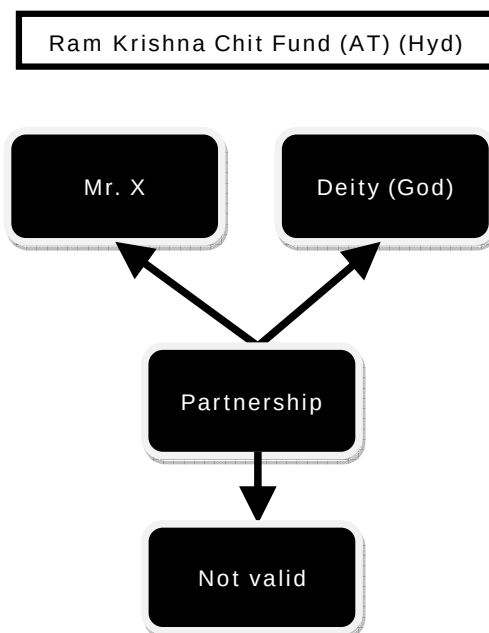
Section / Topic Name : 184 to 189, 40(b)

REMUNERATION FOR SPECIFIC SERVICES

Section 40(b) provides for payment of salary and interest, where it is stipulated in the partnership deed. But where payments are made for specific services rendered by partners to the firm not in the capacity of partners, but because of contractual relationship undertaken by the partner for specific services, no disallowance could be made. It was so held in CIT v. Rajam Ramaswamy and Sons [2008] 298 ITR 325 (Mad).

PARTNERSHIP WITH DEITY

It is not unusual for partnership firms to allocate a small percentage of profits for charities before division of the remaining profits among the partners. There could be no objection to such a clause under partnership law or even under income-tax law, which requires specification of respective shares of partners in the partnership deed. Where, however, as a matter of drafting



settled law on the subject.

error, a charity or a deity is shown as a partner instead of being shown merely as eligible for a share of profit, the validity of the partnership itself may be questioned on the technicality, that a person who has no legal status to enter into a contract cannot be a partner, in the light of the law that every partnership agreement is a contract. The Income-tax Appellate Tribunal followed this law after review of case law on the point in coming to the conclusion that there was no valid partnership in the facts of the case, where the deity Goddess Santoshi Mata was shown as a partner with 20 per cent. share with none of the other partners being a shebait for the deity entitled to act on behalf of such deity. The deed was, no doubt, amended later to make good the defect. But that cannot justify the inference of valid partnership prior to amendment. This decision of the Tribunal in Ramakrishbna Chit Fund Co. v. ITO [2008] 297 ITR (AT) 192 (Hyderabad) follows the well-

285 ITR 0206- COMMISSIONER OF INCOME-TAX VS. M. KATHIRESAN (MADRAS HIGH COURT)

It is an established rule of commercial practice and accountancy that where there was no discontinuance of business, the closing stock is to be valued at cost or market price, whichever is lower by conversion. Though the conversion of a proprietary business into partnership is undoubtedly a transfer, it could not be said that the nominal value credited to capital account in the hands of the firm is the consideration for the transfer. It is only when the business is closed forever, that the question of valuing the stock at the market price might arise.

The Madras High Court in A. L. A. Firm v. CIT [1976] 102 ITR 622 decided that in a case of take over of stock by a partner, the market value has to be adopted. This decision would have no application, if the business itself has been taken over as was pointed out by the Supreme Court in Sakthi Trading Co. v. CIT [2001] 250 ITR 871.

281 ITR 0139- ISHWAR BHUVAN HINDU HOTEL VS. COMMISSIONER OF INCOME-TAX (BOMBAY HIGH COURT)

A partnership between the karta of a Hindu undivided family and an individual member of the family, where the latter is taken in as a working partner is valid.

281 ITR 0139- ISHWAR BHUVAN HINDU HOTEL VS. COMMISSIONER OF INCOME-TAX (BOMBAY HIGH COURT)

A partnership between the karta of a Hindu undivided family and an individual member of the family, where the latter is taken in as a working partner is valid.

227 ITR 0260 CIT VS. ARTEX MANUFACTURING CO.; (SC)

There was sold entire business as a going concern by firm to company formed for the purpose of such take over excess of sale price over written down value of assets were received. Finding that portion of price was attributable to plant, machinery and dead stock and thus difference between actual cost and written down value of business assets was assessable as business income under section 41(2) and surplus over such difference was assessable as capital gains regarding it as goodwill of the business chargeable to capital gains.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee a partnership firm transferred its business to a private limited company and received Rs. 10 Lakhs which represented 3 lakhs towards the transfer of business stock in trade against the value 2 lakhs and balance over the other assets and liabilities of the firm and there was surplus 4 lakhs that was called as purchase consideration and firm filed its return stating that for the assessment year there is no income since the business was transferred to private limited company and there is no implication of chapter of capital gains also. Is the stand taken by the firm justified.

ANSWER

There was sold entire business as a going concern by firm to company formed for the purpose of such take over excess of sale price over written down value of assets were received. Finding that portion of price was attributable to plant, machinery and dead stock and thus difference between actual cost and written down value of business assets was assessable as business income under section 41(2) and surplus over such difference (Rs. 4 Lakhs) was assessable as capital gains regarding it as goodwill of the business chargeable to capital gains. Thus excess received over the cost of the stock (Rs. $3 - 2 = 1$ Lakh) shall be chargeable to tax as business income of the assessee.

229 ITR 0458 RASHIK LAL AND CO. VS. CIT; (SC)

Partnership firm paid Commission to partner (a HUF) where a member of HUF was partner in representative capacity on behalf of the HUF. Commission paid to such partner cannot be regarded as payment to HUF and thus Section 40(b) applies and payment has to be disallowed.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Partnership firm paid commission to its partner who was Mr. Kalpesh. Said partner was in the representative capacity as Karta of its HUF and actually HUF was the partner. Firm proposed to claim it as deduction under section 40 (b) of the income tax act can it do so. Presuming amount of deduction was within the limit of said section.

ANSWER

A firm is a compendious way of describing the individuals constituting the firm. A Hindu undivided family directly or indirectly cannot become a partner of a firm because the firm is an association of individuals. Under Hindu law, not all members of the joint family, but only such of its members as have, in fact, entered into partnership with the stranger, become partners. Provisions under partnership law relating to mutual rights and liabilities are only applicable to the individual partners who are members of the firm. There is no way that a Hindu undivided family can intrude into the relationship created by a contract between certain individuals. The only right of the Hindu undivided family is possibly to call upon its nominee partner to render accounts for the profits that he has made from the partnership business. But that is something between the nominee and the Hindu undivided family, with which the partnership is not concerned. Section 40(b) of the Income-tax Act, 1961, will apply, even when there is such a special contract. The remuneration or the commission that is paid to the partner cannot be claimed to be a remuneration or commission paid to the Hindu undivided family. The partner may be accountable to the family for the monies received by him from the partnership. But, in the assessment of the firm, the partner cannot be heard to say that he has not received the commission as a partner of the firm, but in a different capacity.

If any remuneration is paid or a commission is given to a partner by a partnership firm, section 40(b) will apply even if the partner has joined the firm as a nominee of a Hindu undivided family. The Hindu undivided family or its representative, does not have any special status in the Partnership Act. Although the partnership firm is not a legal entity, it has been treated as an independent unit of assessment under the Income-tax Act. The assessment of a firm will have to be made strictly in accordance with the provisions of the Income-tax Act. The law has to be taken as it is. Section 40(b) applies to certain payments made by a firm to its partners. Neither the firm nor its partners can evade the tax law on the pretext that although in law he is a partner, in reality he is not so. He may have to hand over the money to somebody else. That may be his position qua a third party. But the firm has nothing to do with it. It has paid the commission to one of its partners. Since in the given case amount of commission is in limits of 40(b) it shall be allowed as deduction to partnership firm.

231 ITR 0278 CIT VS. TRILOK NATH MEHROTRA; (SC)

Member of HUF joined partnership in a firm. Karta (Member) was given salary for managing firm or rendering special services to firm. Salary is individual income of member if salary is part of return of investments made by HUF in firm and salary would be added to income of HUF.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

X – HUF was partner in a firm M/s AB. M/s AB paid salary to Mr. X (Karta) of the HUF for the services rendered by the Mr. X. Mr. X proposed to claim it as its individual income and to claim the standard deduction on it. Where as ITO is of the opinion that it is the income of the HUF and should be taxed in the hands of HUF. You are required to analyse the issue both from Assessee and ITO's point of view.

ANSWER

The salary given to the partner was for services rendered by him and, hence it belonged to him and it was, therefore, rightly assessable in his individual hands. This was the decision rendered in CIT v. Trilok Nath Mehrotra [1998] 231 ITR 278 (SC). In other words the salary should not be assessed in the hands of the Hindu undivided family as it was separately given to the managing partners individually for their services. Since it is salary paid by firm to its partner it is covered by 28 and chargeable under the head business and profession. Thus standard deduction is not available on such salary income in the hands of the partner.

236 ITR 0350 - CIT VS. PARTHASARATHY NAIDU (G.) AND SONS (SC)

In the instant case, the two partnerships constituted by different partnership deeds carried on different businesses. Though they had the same partners their shares were different. It was clearly specified that the business of one partnership shall not be deemed to be part and parcel of the other. There was no inter-lacing or inter-locking between the two firms. As it is well-settled that it is open to any person to arrange his affairs by adopting legal device to reduce his tax liability to the minimum under the law, in the absence of prohibition in any law for creation or existence of two partnership firms with the same set of partners, the assessment of such firms cannot be clubbed and one assessment cannot be made merely because the partners are the same in both the firms. Though the question whether a firm is genuine or bogus or benami is a pure question of fact, that must be considered.

Conclusion:

Assessment cannot be clubbed merely because Partners in both the firms is same.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Mr. A B and C, together has started TWO partnership firm in which their profit sharing ratio is same. Turn over of both the firm is 30 lakhs and they have filed two different returns of income. Their books of accounts are not audited u/s 44 AB. Assessing officer considers firm as one and levies the penalty for not getting books of accounts audited. Is the action of the officer justified.

ANSWER

In the instant case, the two partnerships constituted by different partnership deeds carried on different businesses. Though they had the same partners and same sharing. It was clearly specified that the business of one partnership shall not be deemed to be part and parcel of the other. There was no inter-

lacing or inter-locking between the two firms. As it is well-settled that it is open to any person to arrange his affairs by adopting legal device to reduce his tax liability to the minimum under the law, in the absence of prohibition in any law for creation or existence of two partnership firms with the same set of partners, the assessment of such firms cannot be clubbed and one assessment cannot be made merely because the partners are the same in both the firms. Thus the action of the officer is not justified in clubbing the assessment. (However he would be justified in so doing if there was interlacing and inter connection in both the firms)

260 ITR 0662- CIT VS. B.S. SUNDARAVADIVEL MUDALIAR AND SONS (MAD)

Where a HUF had funds in the firm, which were divided as a result of partial partition as a result of which, the interest which was hitherto payable to the HUF became payable to the divided members, who were partners, the question arose whether in the absence of recognition of such partition under section 171 of the Income-tax Act, such interest could be treated as interest paid to partners and not interest paid to the Hindu undivided family. Under the partnership law, it would be treated as interest paid to partners, while under the Hindu law partial partition is recognised, so that the funds could be treated as belonging to the members, but under the income-tax law, a partition has to be recognised under section 171 and till such partition is recognised, even a partitioned family will continue to be assessed only as a HUF. Actually partial partitions effected after 31st December, 1978, is not so recognized under section 171(9). The authorities took the view that notwithstanding non-recognition of partial partition for assessment of HUF under section 171, it may be recognised for application of section 40(b) to disallow interest to partners. The High Court in CIT v. B. S. Sundaravadivel Mudaliar and Sons [2003] 260 ITR 662 (Mad) found that in view of section 171, the partial partition has to be ignored and that the joint family should be treated as continuing for income-tax purposes not only for assessment of the income of the joint family, but also for purposes of section 40(b).

QUESTION

The assessee firm consist of five partners. All the partners were members of a Hindu undivided family. The Hindu undivided family deposited from family funds a sum of Rs. 1,80,000 as a deposit in the assessee-firm. There was a partial partition in the family in, in respect of the deposit of Rs. 1,80,000 and the same was divided among the members and each coparcener was allotted a sum of Rs. 36,000. In assessment proceedings, the assessee claimed that the interest paid to the divided coparceners in the Hindu undivided family should be allowed as deduction in the computation of its business income. You are required to answer whether in the assessment of firm interest is allowable or not.

ANSWER

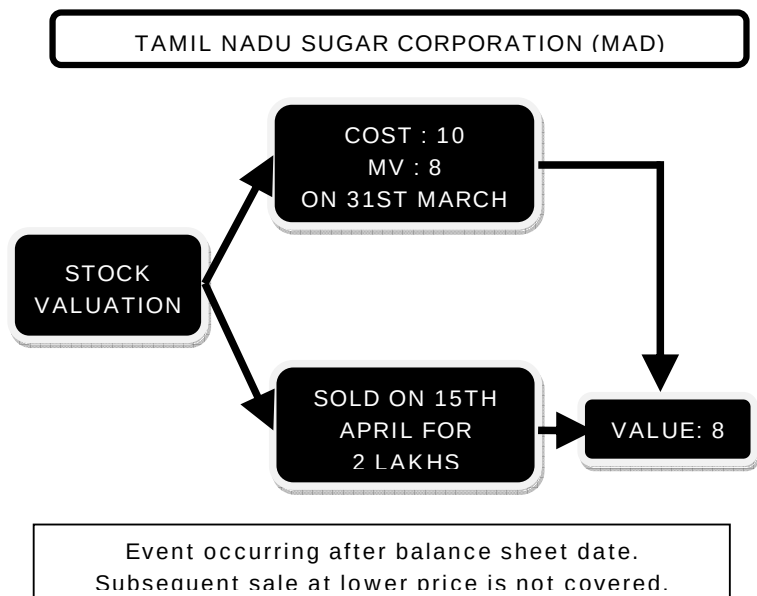
When section 171(9) statutorily declares a partial partition taking place after December 31, 1978, as null and void, the consequences and incidents which flow from such statutory declaration are that the Hindu undivided family shall be deemed to continue for the purpose of the Income-tax Act and it shall be the owner of the property and further it shall be deemed to be the recipient of the income from such property for the purposes of the Income-tax Act. Therefore, the interest payments made by the firm, though to the partners, had to be treated as interest payments to the joint family and such payments were not hit by section 40(b). Thus such payment is not to be disallowed under section 40(b). (Hindu undivided family (HUF) and firms are both taxable entities under the income-tax law, while they are not recognised as legal entities for all purposes. The partnership law does not recognise the HUF as a partner. Where a HUF is represented by its karta, the karta would be understood to act in his own capacity and not in the capacity of the joint family for purposes of partnership law.) B. S. Sundaravadivel Mudaliar and Sons [2003] 260 ITR 662 (Mad)

265 ITR 0466- CIT VS. TAMIL NADU SUGAR CORPORATION LTD. (MAD)

Valuation of closing stock has to be made as on the last day of the accounting year. Where market rate becomes relevant either because the assessee follows valuation at market rate or at cost or market rate whichever is lower, the market rate prevailing on the last day of the accounting year has to be taken. In CIT v. Tamil Nadu Sugar Corporation Ltd. [2004] 265 ITR 466 (Mad), a lesser value prevailing 25 days later than that date was adopted. The Assessing Officer insisted on substitution of the market value as on the last day of the accounting year. It was argued on behalf of the assessee that the accounting standards permit even the value occurring after the balance-sheet. The High Court, however, found that even if the system of accounting followed by the assessee were such as to treat the value after the relevant date, it would not be a proper system of

accounting, so that the Assessing Officer can discard the same following the rationale of the decision in CIT v. British Paints India Ltd. [1991] 188 ITR 44 (SC). The adoption of such accounting would not reflect the true profits of the accounting year and was, therefore, not justified. In fact, the argument that events after the end of the accounting year could be taken into consideration would be acceptable only in the case of extraordinary events

occurring after the close of the accounting year and before the accounts are finalised, such as earthquake, fire or such other events, which would clearly indicate that the balance sheet without considering such loss of such magnitude, though after the last day of the accounting year, would give a wrong picture of the true net worth of the enterprise. Hence, the accounting standards for taking into account events after the last day of the accounting year cannot possibly cover instances of fluctuation in market rates in inventory valuation.

**250 ITR 0871- SAKTHI TRADING CO. VS. CIT (SC)**

It was so observed in A. L. A. Firm v. CIT [1991] 189 ITR 285 (SC) There can be no manner of doubt that, in taking accounts for purposes of dissolution, the firm and the partners, being commercial men, would value the assets only on a real basis and not at cost or at their other value appearing in the books. The real rights of the partners cannot be mutually adjusted on any other basis. That the partners of the assessee firm having revalued the stock-in-trade for the purposes of mutual adjustment which was the only basis on which the real rights of the partners had to be adjusted, it was untenable for them to contend that the valuation should be on some other basis for income-tax purposes. The stock-in-trade had been valued at market price, the surplus had to be reflected in the profits of the firm and had to be charged to tax.

The assessee in Sakthi Trading's case was a registered firm. As a result of death of one of its partners the firm was dissolved and reconstituted with remaining partners. As the business of the firm was never discontinued but was taken over on succession by another firm, the closing stock of the assessee firm had

to be valued at cost or market price whichever was lower. In other words, since there was no cessation of business, the closing stock had to be valued at cost or market price, whichever was lower.

This decision of the Court will have application even after section 45(4) requiring the market value to be adopted for distribution of assets to partners because section 45(4) has application only for distribution of capital assets for purposes of capital gains and not stock in trade.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

The assessee is a firm. As a result of the death of one out of its six partners, the firm was dissolved. It was, however, reconstituted with effect from the next day, with the remaining five partners. On the dissolution of the firm the business is taken over by other partners without discontinuance and the value of the closing stock determined under the regular method of accounting is accepted by the partners in the settlement of accounts for dissolution purposes. You are required to answer whether Income-tax Officer can substitute the market value in respect of the closing stock for the purpose of determining the income of the firm up to the date of dissolution.

ANSWER

The assessee in Sakthi Trading's case was a registered firm. As a result of death of one of its partners the firm was dissolved and reconstituted with remaining partners. As the business of the firm was never discontinued but was taken over on succession by another firm, the closing stock of the assessee firm had to be valued at cost or market price whichever was lower. In other words, since there was no cessation of business, the closing stock had to be valued at cost or market price, whichever was lower. [2001] 250 ITR 0871- SAKTHI TRADING CO. VS. COMMISSIONER OF INCOME-TAX (SC). Thus officer is not justified in valuing the stock at market value. However if there would have been only discontinuation without succession of the business then officer would have been right in valuing the stock at market value.

AOP / BOI

Section / Topic Name : 167B

SCOPE OF AOP

An association of persons is formed by persons coming together voluntarily. On a partner's death, there was dispute between the legal heirs and the business itself was being carried on by the company, so that the firm had to be treated as dissolved by operation of law. There was also no volition between the partners to come together. In the result, the assessment in the name of an association of persons was held to be unjustified in CIT v. Sehgal Oil and General Mills [2008] 303 ITR 102 (P&H) following the rationale of the decision in G. Murugesan and Brothers v. CIT [1973] 88 ITR 432 (SC). Though the order of the Tribunal setting aside the assessment was upheld by the High Court, the status of the person/s receiving the income after the death of one of the partners has not been indicated. If it did not form an association of persons for lack of volition, it could still be a body of individuals. At any rate, there can be no direct assessment of each of the person's interest in the business, which was apparently being carried on. The inference that the decision of the Supreme Court is against a single assessment would necessitate a review in such cases especially where the respective interest of the parties was not identified.

Where four persons have joined together in a joint venture in construction and sale of commercial complex, the income there from is assessable as business income in the hands of such persons as an association of persons. This would be so even if the respective share income has been assessed in the hands of members. The Supreme Court in ITO v. Ch. Atchiaiah [1996] 218 ITR 239, has held that the language of the definition of "person" in section 2(31) would not admit of assessment in the hands of members. It was also found by the Tribunal in Asst. CIT v. S. Prabhakar Kamath [2008] 305 ITR (AT) 380 (Bangalore), that reopening of assessment under section 147, where no return was filed by such association of persons was justified. The notice of hearing under section 143(2) was belated as it was issued beyond one year, but it was saved by the proviso to section 148 inserted by the Finance Act, 2008, with retrospective effect from October 1, 1991.

BENEFICIARIES OF TRUST DO NOT CONSTITUTE AOP

Where the beneficiaries of the trust were treated as an association of persons (AOP) on the ground that the shares of the beneficiaries were not determinable and the Special Bench of the Tribunal had held that joint assessment as an AOP was not justified in an earlier year and such decision had become final, there was no case for taking a different view for the later year as held in CIT v. Babulal Grandsons Family Trust [2008] 301 ITR 271 (All). The High Court also made an observation that an AOP involves a voluntary act of joining together, but not where it is imposed by a trust to which they were not parties. If the shares are not specified, the law already provides for assessing the trust at the maximum marginal rate in the assessment of the trust under section 164(1) of the Act.

257 ITR 0059- CIT VS. SHIVSAGAR ESTATE (SC)

The income from property held by 65 co-owners had to be assessed separately in the hands of the individual co-owners and not in the hands of an association of persons.

262 ITR 0520- L.R. PATEL FAMILY TRUST VS. ITO (BOM)

It is possible to make a direct assessment on the beneficiaries of a non-discretionary trust, i.e., a trust where the shares of beneficiaries are specified and determinate. The trustee/s may be assessable, if there is no direct assessment on the beneficiary, but such assessment has to be in "like manner and to the same extent" as in the hands of each beneficiary. This law is well established. But the Revenue sought to tax trustees as an AOP on sale of capital assets, the sale proceeds of which were to be distributed to the beneficiaries, on the ground that such distribution entailed dissolution of the AOP covered by section 45(4), which required the association to be assessed on capital gains by adopting the market value. The High Court had little difficulty in rejecting the claim in L. R. Patel Family Trust v. ITO [2003] 262 ITR 520 (Bom), where it was found that the assessment has to be in the hands of each beneficiary in terms of section 164 and that section 45(4) would have no application in view of the fact that there is no case for presuming an AOP.

262 ITR 0593- COMMISSIONER OF INCOME-TAX VS. P.N. BAJAJ (MAD)

It is, surprising that the issue should have come up in CIT v. P. N. Bajaj [2003] 262 ITR 593 (Mad), where the Assessing Officer included the income already assessed in the hands of the trustee as the income of the assessee for rate purposes. The argument of the Assessing Officer was that he is entitled to tax the share income under section 86, which permits the share income from an AOP to be included for rate purpose. But this argument was found to be not tenable, since the trustee is assessable as a representative assessee in the same status as that of the beneficiary and not as AOP. It was further found that since the trustee in this case had been assessed at maximum rate as the trust was a discretionary trust, the question of including it in the hands of the beneficiary for rate purposes should not have arisen even otherwise. It was in this context that the departmental reference was dismissed.

236 ITR 0037 MOTI TRUST VS. CIT (SC)

Section 5 of the Act defines the total income of any person to include income received by him or received on his behalf or which accrues or arises to him. A person may be directly assessed in respect of such income. The income of a discretionary trust which is within the accounting year distributed to and received by the beneficiary would, therefore, be subject to assessment in his hands and tax thereon would be recoverable from him. Such income would squarely fall within the broad sweep of total income under section 5 and the beneficiary would be liable to assessment and recovery of tax thereon under section 4

The word "charged" in the context in which it is used in section 164 means only "levied". Section 164 does not make the trustee of a discretionary trust liable to assessment or the recovery of tax on the income of the trust. It harks back to section 161 when it refers to "persons . . . liable as representative assessee". It is section 161, therefore, which has to be read to make the trustee even of a discretionary trust liable to assessment and recovery of tax on income received by him as a trustee. Further, section 161 protects the representative assessee by stating that assessment upon him shall be deemed to be only in his representative capacity, by mandating that tax can be levied upon and recovered from him only in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him and by stating that he may not be assessed under any other provisions of the Act.

Section 166 is clarificatory. It does not empower any assessment or recovery by itself. It only makes it clear that sections 160 to 165 do not bar the direct assessment of the person on whose behalf or for whose benefit the income is receivable or the recovery from such person of the tax payable thereon, provided

that is permissible under any other provisions of the Act. But that is not to say that the beneficiary of a discretionary trust, because he does not fall within the ambit of section 166, may not be assessed upon income received by him and tax recovered from him thereon if that is permissible under any other provisions of the Act for section 166 is merely clarificatory.

Conclusion:

The Revenue has the option to assess and recover tax from either the trustees or the beneficiaries of a discretionary trust in respect of such income thereof as has been distributed to and received by the beneficiaries in the course of the accounting year.

265 ITR 0212- MANIK CHANDRA VS. ASSISTANT COMMISSIONER OF INCOME-TAX (UTT)

Where the trust for the benefit of the minor was a partner, was a mode adopted for avoiding application of section 64(1)(iii) providing for clubbing of the income of the minor child from the benefit of partnership. Such issue has now to be decided in the light of section 64(1A) and the clubbing of the income is to be done. But this decision is on the grounds that a right gets vested in the minor, while only the payment is deferred. On this interpretation, the fact that the clubbing is automatic is accepted.

264 ITR 0052- CIT VS. T.A.V. TRUST (KER)

The position under section 161(1) is that a trustee under a trust cannot be assessed on the aggregate income received by it as a single unit. The assessment in the name of the trustee in terms of the sub-section can be made in two ways. The Assessing Officer may make as many assessments in the name of the trustee as there are beneficiaries and levy the tax appropriate to such income at the rate of tax applicable to the total income of each beneficiary. The assessing authority, in the alternative, can make a single assessment on the trustee, but has to indicate in the order the share income of each beneficiary and the tax attributable to it. Section 161(1A) is an exception to the above rule. Under section 161(1A) this rule of apportionment and determination of proportionate tax attributable to the beneficiary will not apply to any income earned by the trustee as profits and gains of a business. The whole of such income shall be taxed at the maximum marginal rate. This section opens with a non-obstante clause under which where any income in respect of which a representative assessee is liable consists of or includes profits and gains of business, tax shall be charged on the whole of the income in respect of which such person is so liable at the maximum marginal rate. However, under the proviso to the said sub-section profits and gains receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance, where such trust is the only trust so declared by him are excluded from the applicability of this sub-section. Sub-section (1A) only says, “notwithstanding anything contained in sub-section (1)” ; in other words, it does not say “notwithstanding anything contained in this Act”. As per sub-section (1A), where any income in respect of which a representative assessee is liable consists of or includes, income by way of profits or gains of business, tax shall be charged on the whole of the income in respect of which such person is so liable at the maximum rate. The income so liable referred to in the said sub-section is only the business income of the trust and not any other income. It is only the income by way of profits and gains of business that can be charged at the maximum marginal rate. Any other interpretation would be against the very scheme of the Act and further such an interpretation will make the provisions of sub-section (1A) of section 161 unconstitutional.

283 ITR 0301- COMMISSIONER OF INCOME-TAX VS. KULWANT SINGH AND CO.
(PUNJAB AND HARYANA HIGH COURT)

Merely because an excise licence was stated to have been issued in the name of three persons, who constituted a firm with effect from April 1, 1988, it could not be said that a firm or an association of persons had in fact come into existence prior to the said date. Whether or not a firm or association of persons came into existence is a pure question of fact, to be determined on the basis of evidence on record. Admittedly, in the present case, except the excise licence, no other material was placed before the Tribunal in support of the stand of the Revenue that an association of persons was in fact in existence. Neither a firm nor an association of persons being in existence, no assessment could be framed in the said status of association of persons..

In other words co-licencees can not be regarded as an association of persons.

274 ITR 0217- CIT VS. S.C. SHAH (GUJ)

In the present case, as could be seen from the facts on record, three individuals were jointly donated a sum by the donor under a declaration. The said sum was invested by them and interest income returned in the status of body of individuals. Meera and Co. v. CIT [1997] 224 ITR 635 (SC) applied.

CO-OPERATIVE SOCIETY

Section / Topic Name : 80P

283 ITR 0116- COMMISSIONER OF INCOME-TAX VS. JAMNAGAR JILLA SAHAKARI KHARIDVECHAN SANGH LTD. (GUJARAT HIGH COURT)

Section 80P has been inserted in Chapter VI-A with a view to encourage and promote the growth of the co-operative sector in the economic life of the country and in pursuance of the declared policy of the Government. While interpreting section 80P of the Act the object of the provision must be borne in mind and a liberal construction should be made so as to achieve the object of the provision. It is settled legal position that when two views are possible, the one which favours the assessee must be adopted.

Where the taxpayer has one indivisible business with part of the income eligible for deduction, the issue that arose in CIT v. Jamnagar Jilla Sahakari Kharidvechan Sangh Ltd. [2006] 283 ITR 116 (Guj) was, whether the expenditure common both for deductible and non-deductible activities should also be similarly split up. The inference that it need not be so split up had been the established law as was found in CIT v. Maharashtra Sugar Mills Ltd. [1971] 82 ITR 452 (SC) and in Rajasthan State Warehousing Corporation v. CIT [2000] 242 ITR 450 (SC). There is an elaborate review of the case law cited by both the parties, but surprisingly in a matter decided long after the retrospective amendment made to section 14A with effect from April 1, 1962, arming the Revenue with power to disallow such expenditure in relation to income, which does not form part of the total income under the Act, the impact of the unsettling effect of the amendment was not discussed. No doubt, a proviso was inserted by the Finance Act, 2002 with retrospective effect from May 11, 2001, that in respect of an assessment already made for any assessment year before the assessment year 2001-2002, no reassessment or rectification is possible. It would, however, mean that cases already under appeal may well be covered by the amendment.

There is also another area of controversy, whether the provision would have application, where the income is deductible as in the case of incentive reliefs under Chapter VI-A or only where income is exempt as when it falls under Chapter III. Meanwhile, another amendment has been made to section 14A by the Finance Act, 2006 to take effect from the assessment year 2007-2008 vesting the power to prescribe the manner of splitting up the expenditure as between the income which is not taxable and that which is taxable. The decision of the Gujarat High Court in Jamnagar Jilla Sahakari Kharidvechan Sangh Ltd.'s case (supra) may not have been different even on consideration of section 14A, but some explanation might have well been necessary.

233 ITR 0282 CIT VS. BANGALORE DISTT. CO-OPERATIVE CENTRAL BANK LTD. (SC)

Co-operative society engaged in banking and interest on Government securities and dividends on shares of Industrial Finance Corporation was earned. Tribunal held that interest income was attributable to assessee's business and assessee was entitled to special deduction under section 80P(2)(a)(i) in respect of such income. Supreme Court:Held, affirming the decision, that there was no dispute that the assessee was a co-operative society carrying on the business of banking. The Tribunal had found in this case that the interest income was attributable to the business of the assessee. That finding had not been challenged on factual basis by the Revenue. And special deduction under section 80P(2)(a)(i) was allowable.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

A co-operative bank is in receipt of interest on government securities and dividends on the shares of financial corporation. Its aggregate income is 10 Lakhs out of banking business and it is inclusive of 3 lakhs of interest and dividend as mentioned above. Bank is of the opinion that entire income is eligible for deduction under section 80(P) and its total income is Nil. You are required to advise the bank on the view taken.

ANSWER

The Supreme Court had rendered an important judgment in respect of co-operative societies engaged in banking business, when it held that special deduction under section 80P(2)(a)(i) is available for income from "Interest on securities" and dividend on shares of the Industrial Finance Corporation on the ground that it would constitute business income, when it upheld the view of the Karnataka High Court in CIT v. Bangalore District Co-operative Central Bank [1998] 233 ITR 282 on the ground that the interest income being attributable to the business of banking should be qualifying for deduction. It is because such securities form part of the current assets required to be kept in such form for easy encashment in case of financial contingencies. Thus entire income of the society shall qualify for the purpose of deduction.

237 ITR 0574 U.P. CO-OPERATIVE CANE UNION FEDERATION LTD. VS. CIT (SC)

Section 80P(2)(a)(i) of the Income-tax Act, 1961, gives a special deduction to a co-operative society in respect of income from carrying on the business of banking or providing credit facilities to its members. The expression "members" is not defined in the Act.

Since a co-operative society has to be established under the provisions of the law made by the State Legislature in that regard, the expression "members" in section 80P(2)(a)(i) must be construed in the context of the provisions of the law enacted by the State Legislature under which the co-operative society claiming exemption has been formed.

In section 80P(2)(a)(i) when Parliament has used the expression "members", it has used it in the normal sense of a member of a co-operative society. The intention was to extend the exemption to co-operative societies directly extending credit facilities to its members. There is nothing in the said provisions to show that the intention was to grant exemption to co-operative societies which were extending credit facilities to persons, who, though not the members of the said society, were members of another co-operative society which was a member of the co-operative society seeking exemption.

Hence, a federation of co-operative societies would not be entitled to special deduction under section 80P(2)(a)(i) on income from providing credit facilities to co-operative societies which were its members.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

A co-operative bank is providing banking services to its members and has made profit of Rs. 15 Lacs which it proposes to claim it as deduction under section 80P. The list of members include other co-operative societies also and some of the credit facilities were extended to members of the member societies. You are required to answer whether under section 80P benefit is available to assessee co-operative bank or not.

ANSWER

In section 80P(2)(a)(i) when Parliament has used the expression "members", it has used it in the normal sense of a member of a co-operative society. The intention was to extend the exemption to co-operative societies directly extending credit facilities to its members. There is nothing in the said provisions to show that the intention was to grant exemption to co-operative societies which were extending credit

facilities to persons, who, though not the members of the said society, were members of another co-operative society which was a member of the co-operative society seeking exemption. Hence, a federation of co-operative societies would not be entitled to special deduction under section 80P(2)(a)(i) on income from providing credit facilities to co-operative societies which were its members.

249ITR0330 MADRAS AUTO RICKSHAW DRIVERS' CO-OPERATIVE SOCIETY VS. CIT (SC)

A co-operative society, was formed to promote the economic interests of its members by purchasing auto-rickshaw vehicles and selling them on hire purchase terms to the members. The society purchased auto-rickshaws in its own name from out of its own funds or from funds borrowed from banks. Thereafter the auto-rickshaws were sold to members who made applications therefor under hire purchase agreements, under which the member had to pay an overall consideration in instalments during a period of five years. If the member paid all the instalments the society was under an obligation to convey the vehicle outright to the member on a nominal consideration of Re. 1.

Held in the court that co-operative society providing credit facilities to members by purchasing auto-rickshaws and selling them to members under hire purchase agreement cannot be treated as providing credit facilities and is not entitled to deduction u/s. 80p(2)(a)(i)

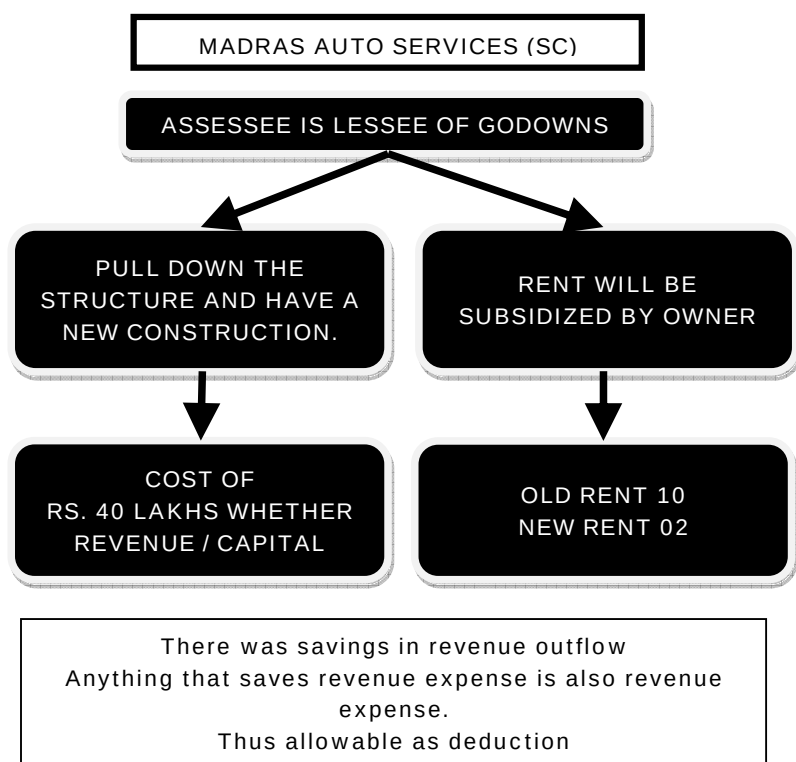
QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

A co-operative society, was formed to promote the economic interests of its

members by purchasing autorickshaw vehicles and selling them on hire purchase terms to the members. The society purchased autorickshaws in its own name from out of its own funds or from funds borrowed from banks. Thereafter the autorickshaws were sold to members who made applications therefor under hire purchase agreements, under which the member had to pay an overall consideration in instalments during a period of five years. If the member paid all the instalments the society was under an obligation to convey the vehicle outright to the member on a nominal consideration of Re. 1. The assessee claimed deduction under section 80P(2)(a)(i) of the Income-tax Act, 1961, on the ground that it was carrying on the business of providing credit facilities to its members. You are required to answer whether assessee is entitled to the deduction or not.

ANSWER

Co-operative societies engaged in providing credit facilities are eligible for exemption under section 80P(a)(i). The provision of credit may be made by financing hire purchase, lease or loans. In Madras Auto Rickshaw Drivers' Co-operative Society v. CIT [2001] 249 ITR 330 (SC), the co-operative society



had the object of purchase and sale of auto rickshaws but having acquired them sold them on hire purchase basis on instalments to members. The Supreme Court in a short judgment endorsed the conclusion of the High Court "while we sympathise with what the assessee is doing, we do not think that its activity can be said to provide 'credit facilities' to its members". The difference between selling of goods on credit and providing credit for purchase is rather thin. It was in this context that the Supreme Court has indicated its sympathy. Held in the court that co-operative society providing credit facilities to members by purchasing auto-rickshaws and selling them to members under hire purchase agreement cannot be treated as providing credit facilities and is not entitled to deduction u/s. 80p(2)(a)(i).

251 ITR 0194 CIT VS. KARNATAKA STATE CO-OPERATIVE APEX BANK (SC)

Interest arising from investment made, in compliance with statutory provisions to enable it to carry on banking business, out of reserve fund by a co-operative society engaged in banking business, is qualifies for deduction under section 80P(2)(a)(i). The placement of such funds being imperative for the purpose of carrying on banking business the income therefrom would be income from the assessee's business. There is nothing in the phraseology of section 80P(2)(a)(i) which makes it applicable only to income derived from working or circulating capital.

Interest arising from investment made out of reserve fund to enable it to carry on banking business is income from banking business. Deduction is not restricted to income derived from working or circulating capital. [Madhya Pradesh Co-operative Bank Ltd. v. Addl. CIT [1996] 218 ITR 438 (SC) overruled.]

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

You are required to answer whether the officer is right in holding that the interest income arising from the investment made out of reserve fund is allowable as deduction under section 80P(2)(a)(i) of the Income-tax Act.

ANSWER

Interest arising from investment made, in compliance with statutory provisions to enable it to carry on banking business, out of reserve fund by a co-operative society engaged in banking business, is qualifies for deduction under section 80P(2)(a)(i). The placement of such funds being imperative for the purpose of carrying on banking business the income therefrom would be income from the assessee's business. There is nothing in the phraseology of section 80P(2)(a)(i) which makes it applicable only to income derived from working or circulating capital. Interest arising from investment made out of reserve fund to enable it to carry on banking business is income from banking business. Deduction is not restricted to income derived from working or circulating capital.

251 ITR 0522- MEHSANA DISTRICT CENTRAL CO-OPERATIVE BANK LTD. VS. ITO (SC)

That provision of safe deposit vaults is part of the ordinary banking business of a bank as shown by section 6(1)(a) of the Banking Regulation Act, 1949, and, therefore, income derived by the assessee from the hiring out of safe deposit vaults was income from the business of banking and deductible under section 80P(2)(a)(i).

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

You are required to answer whether the officer is right in holding that the locker rent in the banking business is not deductible under section 80P(2)(a)(i).

ANSWER

That provision of safe deposit vaults is part of the ordinary banking business of a bank as shown by section 6(1)(a) of the Banking Regulation Act, 1949, and, therefore, income derived by the assessee from the hiring out of safe deposit vaults was income from the business of banking and deductible under section 80P(2)(a)(i).

258 ITR 0088- CIT VS. RAJASTHAN RAJYA BUNKER SAHAKARI SANGH LTD. (RAJ)

The assessee was a co-operative society engaged in the manufacture of cloth under the Janta Cloth Scheme of the Government of India through the conduct of primary societies which carried out the manufacture at grass-root level by individual weavers in their cottages. The assessee purchased the yarn and gave it to the weavers for weaving and in turn, the assessee gave weaving charges to the weavers through the primary society and the whole production process was monitored/supervised by the assessee. After the manufacture of the cloth, the cloth was sold by the assessee. Held, that the assessee society had power to direct, supervise and control the manufacturing of cloth through the primary societies which were members of the assessee-society. The members of primary societies ran cottage industries in their houses. In these circumstances, it could not be said that the assessee-company was not engaged in manufacturing activities carried on by the weavers. When the society had full control over the manufacturing activities of weavers, the assessee-society was engaged in the cottage industry. The assessee was entitled to the special deduction under section 80P(2)(a)(ii).

Question

The assessee co-operative society (apex society) is engaged in the manufacture of cloth through the conduct of primary societies which carried out the manufacture at grass-root level by individual weavers in their cottages. The assessee purchased the yarn and gave it to the weavers for weaving and in turn, the assessee gave weaving charges to the weavers through the primary society and the whole production process was monitored/supervised by the assessee. After the manufacture of the cloth, the cloth was sold by the assessee. The assessee claimed special deduction under section 80P. Assessing officer disallowed the claim of the assessee. You are required to discuss the correct position of law.

Answer

The assessee society is a co-operative society engaged in the manufacturing of cloth through the conduct of primary societies carried out at grass-root level by individual weavers at their cottages for which the assessee purchases the yarn and gives it to weavers for weaving and in turn, the assessee gives weaving charges to the weavers through the primary society and the whole production process is monitored/supervised by the assessee. After the manufacturing of the cloth, the cloth is sold by the assessee. The members of the primary society run cottage industries in their houses, in these circumstances, it cannot be said that the assessee-company is not engaged in the manufacturing activities carried on by the weavers. The weavers get the raw material, i.e., yarn, through their primary society, but thereafter weaving charges are paid by the assessee and it purchases those cloths through the primary societies. When the society has full control over the manufacturing activities of weavers, the assessee-society is engaged in the cottage industry. When the assessee is engaged in the cottage industry though through the primary society, the benefit of 80P cannot be denied considering the scheme of the Act and the object of the provision to be achieved to give benefit to the weavers and to encourage such societies for the benefit of the weavers.

The issue as to whether an apex co-operative society of which the members were only the primary societies could be treated as one for the benefit of members of such primary society, so as to entitle it to the benefit meant for co-operative societies under section 80P, had been the subject matter of some controversy. In CIT v. Rajasthan Rajya Bunker Sahakari Sangh Ltd. [2002] 258 ITR 88 (Raj), the High

Court found its way to accept the claim of apex society to the benefit of exemption on the ground, that it was in full control of the manufacturing activities of the weavers, who were members of the primary societies, so that the assessee-society itself could be treated as engaged in cottage industry. Thus the deduction under section 80P shall be allowed to the assessee society in question.

258 ITR 0594 CIT VS. KRISHAK SAHKARI GANNA SAMITI LTD. (ALL)

The assessee, a co-operative society, was formed with the main object of organizing increase in sugarcane cultivation and purchase and sale of sugarcane crops at profitable price, expeditious supply of sugarcane to mills and ensuring prompt payment to the farmers from the mills. One of its main objects, was “providing better quality of seeds of sugarcane, manure and fertilizer, pesticides, agricultural implements, irrigation equipment and arrangement of other articles for agricultural purposes and to provide or to arrange credit facilities for this purpose to its members.” The Appellate Tribunal held that section 80P(2)(a)(i) was applicable as one of the main objects was to lend to its members and the interest earned by the assessee-society from its members qualified for deduction thereunder. Held, affirming the decision of the Appellate Tribunal, that it was clear from its main object that the assessee-co-operative society would lend to its members or would arrange finance to its members to enable them to purchase good seeds of sugarcane, fertilizers, etc., and that loans would not be given to non-members, and interest was to be realised from its members on such lending realisation of interest was not on account of goods sold on credit. Therefore, the interest earned by the assessee-co-operative society from its members was covered by the provisions of section 80P(2)(a)(i) and, therefore, exempt from tax.

QUESTION

The assessee, a co-op-society was formed with the main object of organizing increase in sugarcane cultivation and purchase and sale of sugarcane crops at profitable price, expeditious supply of sugarcane to mills and ensuring prompt payment to the farmers from the mills. One of its object is to arrange for funds for the fulfillment of these objects. In the course of the proceedings for assessment, it was claimed before the Income-tax Officer that the interest received by the assessee-society from its members was also entitled to deduction under section 80P but the Income-tax Officer held that since the business of the society was not banking or providing credit facilities to its members deduction [80P(2)(a)(i)] on interest received from them is not entitled to deduction.

Answer

It was clear from its main object that the assessee-co-operative society would lend to its members or would arrange finance to its members to enable them to purchase good seeds of sugarcane, fertilizers, etc., and that loans would not be given to non-members, and interest was to be realised from its members on such lending realisation of interest was not on account of goods sold on credit. Therefore, the interest earned by the assessee-co-operative society from its members was covered by the provisions of section 80P(2)(a)(i) and, therefore, entitled for deduction from tax.

262 ITR 0452 CIT VS. KOTA CO-OPERATIVE MARKETING SOCIETY (RAJ)

The assessee is a co-operative society deriving income from sale of fertilizers, agricultural commodities, pesticides, controlled sugar, etc. It also derives income from tractor, matador, truck, godown rent, interest and receipts. On the basis of computation furnished by the assessee, the assessee had claimed relief under section 80P(2) at Rs. 4,75,999. The Income-tax Officer, however, required it to furnish the working of the net income from the business done with the members only. The assessee, in compliance

with the directions of the Income-tax Officer, has given working of the income earned in dealings with the members at Rs. 76,723. The Income-tax Officer restricted the relief to that extent only.

When the assessee himself has given the working of the income earned in dealings with the members of the society which is exempt, that means the business of the assessee can be segregated regarding the income earned from a part of the business from dealings with the members of the society and the income which is derived from the dealings with the non-members of the society, therefore, in the case in hand, it cannot be said that the business of the assessee is not segregable or indivisible in respect of the exempted income. When the business of the assessee is segregable for the purpose of exempted income, the Income-tax Officer has rightly restricted the income for the purpose of section 80P(2) which was earned in dealings with the members of the society.

Question

The assessee was a co-operative society deriving income from sale of fertilizers, agricultural commodities, pesticides, controlled sugar, etc. On the basis of computation furnished by the assessee, the assessee had claimed relief under section 80P(2) at Rs. 4,75,999. The Income-tax Officer, however, required it to furnish the working of the net income from the business done with the members only. The assessee, in compliance with the directions of the Income-tax Officer, gave the working of the income earned in dealings with the members at Rs. 76,723. The Income-tax Officer restricted the relief to that extent only. The Commissioner (Appeals) did not allow the claim in respect of the income. You are required to discuss the correct position of law.

Answer

As held, in case of [2003] 262 ITR 0452- Commissioner of Income-tax vs. Kota Co-operative Marketing Society (Rajasthan High Court) that the assessee itself had given the working of the profits earned from the activity referred to in 80P(2)(a)(iii). That meant the business was divisible and the profits and gains from the activity referred to in 80P(2) could be shown separately. The profits and gains could be arrived at on segregation of the business activities of the assessee. Therefore, the assessee was entitled for the benefit of section 80P(2) only in respect of the income earned from the marketing of agricultural produce of its members. The income earned from the marketing of agricultural produce of non-members was not exempted and no benefit of section 80P(2) could be given in respect of that income. Thus the action of the officer is justified in restricting the deduction to the extent of 76,723.

265 ITR 0540 CIT VS. GANGANAGAR SAHKARI SPINNING MILLS LTD. (RAJ)

An unresolved controversy in interpretation of incentive provisions is whether the eligible income for benefit should be diluted by setting off past losses against current profits under different incentive provisions. Such an issue arose in respect of matters of eligible profits under section 80P in CIT v. Ganganagar Sahkari Spinning Mills Ltd. [2004] 265 ITR 540 (Raj), wherein the High Court came to the conclusion against the taxpayer by assuming that section 80P required that the income referred to therein would refer to the income after setting off the past losses.

For the purpose of making deduction under section 80P of the Income-tax Act, 1961, it is necessary to first determine the gross total income in accordance with the other provisions of the Act. This means that the gross total income must be determined by setting off against the income the business losses of the earlier years as required under section 72 of the Act before allowing deduction under section 80P.

It is worth noting here that Supreme Court itself in CIT v. Canara Workshops P. Ltd. [1986] 161 ITR 320 had held that current loss in another undertaking eligible for relief even under the same section cannot be set off against the income of the profitable undertaking, so as to dilute the relief. It follows that even if current loss cannot be set off, there is lesser reason for setting off past losses against eligible profits computed under the relevant provision. However it is necessary that the decision is reviewed and at any

rate, for the Government to bring in appropriate clarificatory amendment, so that the benefit of deduction is not diluted by past losses.

264 ITR 0038- CIT VS. AHMEDNAGAR DISTRICT CENTRAL CO-OPERATIVE BANK LTD. (BOM)

Banking is not restricted to receiving deposits for the purposes of lending. Banks offer various facilities to its customers. Section 6(1)(a) of the Banking Regulation Act, provides for various forms of business akin to banking. Section 6(1) states, inter alia, that in addition to the banking business, a banking company may engage in specified forms of business enumerated therein. Section 6(1) states that in addition to the business of banking, a banking company may engage itself as agent for Government or local authority or any other person for giving receipts and discharges.

The assessee was a co-operative bank earned income by way of commission from the Maharashtra State Electricity Board and from Mula Pravara Co-operative Society for collecting electricity bills from the public on their behalf. According to the assessee, collection of electricity bills was a facility extended by the bank to its customers and such an activity was a part of banking business. These contentions of the assessee were not accepted by the Income-tax Officer. On a reference Held, that the income by way of commission from MSEB and MPCS was attributable to the business of banking and as such relief under section 80P(1) read with section 80P(2)(a)(i) of the Income-tax Act, is allowable to the assessee.

Question

The assessee a co-operative bank earned income by way of commission from the Maharashtra State Electricity Board and from Mula Pravara Co-operative Society (MPCS) for collecting electricity bills from the public on their behalf. It was contended by the assessee that the commission earned from the aforesaid two public undertakings was income derived from business of banking and, as such, the said income was exempt under section 80P(2)(a)(i). You are required to discuss the correct position of law.

Answer

The judgment of the Supreme Court in the case of Mehsana District Central Co-operative Bank Ltd. [2001] 251 ITR 522 shows that the word “banking” is not restricted only to accepting deposits from customers for the purposes of lending and that the word “banking” has been interpreted by the Supreme Court to cover even rent charged by the banks for hiring out safe deposit vaults to its customers. In the circumstances, the income earned by the assessee-bank by way of commission/fees from its customers being public sector undertakings would be exempt under section 80P(2)(a)(i).

271 ITR 0022- COMMISSIONER OF INCOME-TAX VS. DISTRICT CO-OPERATIVE FEDERATION (ALLAHABAD HIGH COURT)

Section 80P(2)(e) allows deduction of the whole of the income from letting godowns and warehouses for storage, processing or facilitating marketing of commodities. In CIT v. District Co-operative Federation [2004] 271 ITR 22 (All), the issue was whether a cold storage could be treated as a godown or warehouse for the purpose of this deduction. The High Court found, that godowns and warehouses are words, which are synonymous and interchangeable in meaning and, that in the context of the object of the provision, it has to be found that the assessee is eligible for the deduction, even what it runs is a cold storage, which serves the same purpose of storage of vegetables and other articles. It was found that there is justification for giving liberal interpretation for such incentive provision. It came to this conclusion, that the assessee eminently deserved relief, after review of a number of cases relating to cold storages and the meaning, that is ordinarily assigned to warehousing in different contexts.

CHARITABLE OR RELIGIOUS TRUST

Section / Topic Name : 11 to 13

UTILIZATION OF RENTAL INCOME

The Uttarakhand High Court in CIT v. Jyoti Prabha Society [2009] 177 Taxman 429 found that the rental income earned by the assessee-society was being utilized again for the purposes of imparting education by maintaining the buildings and constructing new building for the same purpose and, thus, in the Court's opinion the charitable purpose was not lost and it could not be said that the assessee was not entitled to the exemption claimed by it under section 11.

Jyoti Prabha Society (UTT)
Sri Rao Baghadur ADK Dharmaraja Education Charity Trust (MAD)

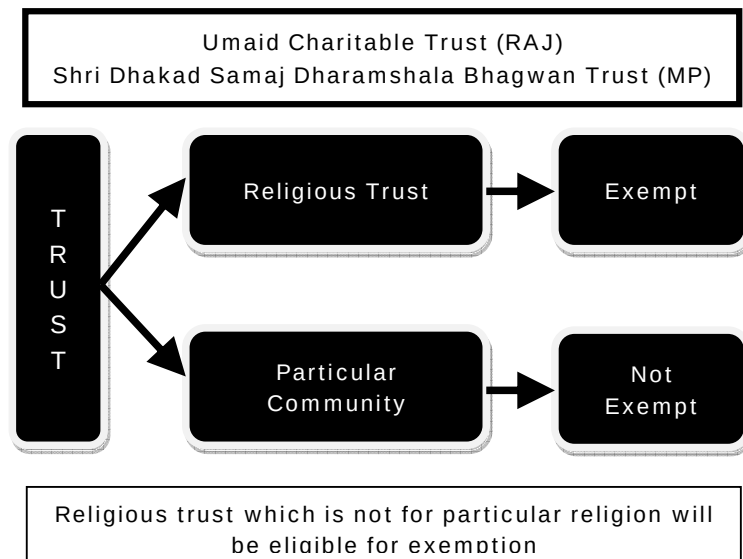
Educational Trust	
Income from Trust - Rent from Property	80
Accumulation 15 %	12
Balance	68

Where an educational institution has a number of properties, the Assessing Officer was of the view that such activity of letting out properties would itself constitute business. The first appellate authority found that the income was from investment, a view endorsed by the Tribunal and upheld by the High Court in CIT v. Sri Rao Baghadur ADK Dharmaraja Educational Charity Trust [2008] 300 ITR 365 (Mad). The High Court also noticed, the exemption should be decided in the light of the objects of the trust, which in this case was one of education, which qualifies for exemption as decided in CIT v. Kshatriya Girls Schools Managing Board [2000] 245 ITR 170 (Mad).

TRUST FOR SPECIFIC RELIGIOUS

A religious trust is recognised for benefit of section 11 in law. But if it is for the benefit of any particular religious community, it would not qualify for exemption under section 11. Where a religious trust is not for any particular religion, there is no reason why it should not qualify for exemption. It was so held in Umaid Charitable Trust v. Union of India [2008] 307 ITR 226 (Raj). In this case, the issue was a consequential one, whether the trust could be recognised under section 80G for deduction of the donations paid to the trust in the hands of the donors. The assessee was found eligible for exemption as well as deduction under section 80G in the past. The High Court found that the trust deed nowhere indicated that the income should be applied for any particular religion. The mere fact, that there was a single contribution to the repairs and maintenance of Lord Vishnu's temple, should not mean that the trust itself was formed for the purposes of any particular religion. Persons of different sects and different religions also visit the temple, which is open to all communities including Sikhs and Jains. The entry was not barred for others. Hinduism itself is not one particular religion. In the context of right to freedom of religion being guaranteed under article 25 of the Constitution, it was inferred that the Revenue cannot take a pedantic and narrow approach. A direction to recognise the trust for 80G was, therefore, issued. In coming to the conclusion, the High Court distinguished the decisions, which were in the Revenue's favour in Upper Ganges Sugar Mills v. CIT [1997] 227 ITR 578 (SC) and Sri Marudhar Kesari Sthanakwasi Jain Yadgar Samiti Trust v. Union of India [2005] 273 ITR 475 (Raj).

The liberal view, prompted by this decision of the High Court under comment, would however have to await either the approval of the Supreme Court or the acceptance of the Income-tax Department before one may expect conformity on the part of the Income-tax Department with this broader view of a religious trust.



TRUST FOR ANY PARTICULAR COMMUNITY

Where a charitable trust running a dharmshala provided accommodation to the dhakad community, besides some other communities named in the deed and the trust was not a religious trust providing accommodation for pilgrims, denial of registration was upheld in *Shri Dhakad Samaj Dharamshala Bhawan Trust v. CIT* [2008] 302 ITR 321 (MP). The reasoning was that it benefited particular communities and such communities did not belong to backward class nor were protected by an exception.

PUBLICATION OF NEWS PAPERS IS NOT INCIDENTAL BUSINESS

Publication of a newspaper itself was considered an object of general public utility by the Privy Council in *Trustees of the "Tribune", In re* [1939] 7 ITR 415. However, after the insertion of section 11(4A) relating to exemption of business income, the conditions thereunder are to be satisfied. Section 11(4A) itself had undergone changes from time to time. The issue had come up in *Ideal Publications Trust v. CIT* [2008] 305 ITR 143 (Ker) in relation to an assessment for the assessment year 1991-92. For the period 1984-85 to 1991-92, the law expected the beneficiaries of the trust to carry on the business, unless it is a case of public religious trust engaged in printing and publications of books following the principle decided in *Asst. CIT v. Thanthi Trust* [2001] 247 ITR 785 (SC). The High Court found that the assessee was not eligible for exemption.

BREACH OF CONTRACT IS NOT BREACH OF LAW

If the terms of a trust deed are violated by the trustees, it does not justify rejection of exemption for income-tax purposes under section 11 of the Act in every case. A trust consisted of two cinema halls settled on it with income to be used for the purpose of the trust. Exemption was allowed for all the years from 1969. The Assessing Officer noticed that there was a breach of trust, but it was found by the Tribunal that this by itself need not disentitle the trust to the exemption, which had been granted for the past several years as held in *CIT v. Karimia Trust* [2008] 302 ITR 57 (Jharkhand) upholding the concurrent finding in the assessee's favour, since the finding was that the income was used for objects of the trust. A similar view was taken in *Deputy CIT v. Cosmopolitan Education Society* [2000] 244 ITR 494 (Raj), that in such cases, if the trustees cause loss to the Revenue, the trust meant for the public should not suffer. It may be added that action under law should be taken against the erring trustees and not the trust.

264 ITR 0110- COMMISSIONER OF INCOME-TAX VS. INSTITUTE OF BANKING (BOM)

Normal depreciation can be considered as a legitimate deduction in computing the real income of the assessee on general principles or under section 11(1)(a) of the Income-tax Act, 1961. Income of a charitable trust derived from building, plant and machinery and furniture is liable to be computed in a normal commercial manner although the trust may not be carrying on any business and the assets in respect whereof depreciation is claimed may not be business assets. In all such cases, section 32 of the Act providing for depreciation, for computation of income derived from business or profession is not applicable. However, the income of the trust is required to be computed under section 11 on commercial principles after providing for allowance for normal depreciation and deduction thereof from the gross income of the trust. Income derived from the trust property has also got to be computed on commercial principles and if commercial principles are applied then adjustment of expenses incurred by the trust for charitable and religious purposes in the earlier years against the income earned by the trust in the subsequent year will have to be regarded as application of income of the trust for charitable and religious purposes in the subsequent year in which adjustment had been made having regard to the benevolent provisions contained in section 11 of the Act and such adjustment will have to be excluded from the income of the trust under section 11(1)(a).

Question

The assessee was a registered trust. The object of the assessee was charitable in nature. The income of the assessee was exempt under section 11. The assessee had claimed depreciation which was rejected by the Assessing Officer on the ground that capital expenditure incurred during the accounting year was allowed as a deduction from the income of the assessee. The Assessing Officer did not allow depreciation on fixtures and furnitures on the ground that full deduction had been allowed in respect of capital cost of furniture and fixtures and if the depreciation was allowed, as claimed by the assessee, it would result in double deduction. You are required to answer whether the action of the officer is justified or not.

Answer

Computation of income from charitable institution poses problems for charities, because of the misunderstanding as to the difference between deductions for running the business to arrive at the income and application of such income for the objects. Deduction for expenditure for managing the trust is inevitable and does not amount to application, since this has to be allowed for ascertaining the income available for application. If the institution has business, expenses including depreciation were found admissible as business expenditure as has been held in a number of cases as in CIT v. Society of the Sisters of St. Anne [1984] 146 ITR 28 (Karn) ; CIT v. Raipur Pallottine Society [1989] 180 ITR 579 (MP) ; CIT v. Sheth Manilal Ranchhoddas Vishram Bhavan Trust [1992] 198 ITR 598 (Guj) and CIT v. Bhoruka Public Welfare Trust [1999] 240 ITR 513 (Cal). Where a depreciable asset had been received as a gift, the actual cost for purposes of depreciation would be the value of the property, because depreciation as a charge on current income is required to be provided for, whether the property is acquired out of own funds or out of voluntary donations as held in CIT v. Munisuvarat Jain [1994] Tax LR 1084 (Bom). The rationale of this decision is that depreciation is to be allowed on commercial principles and not with reference to provisions of section 32, which has no application in computation of income of a charity. Following this view, it was decided depreciation has to be allowed as a business deduction in CIT v. Institute of Banking [2003] 264 ITR 110 (Bom). Thus the action of the officer is not justified in dis-allowing the depreciation.

262 ITR 0194- CIT VS. HYDERABAD RACE CLUB CHARITABLE TRUST (AP)

The Hyderabad Race Club created a separate public charitable trust. The main objects of the trust were advancement and propagation of education, medical aid and relief of poor, etc. The trust obtained a licence for conduct of races and intervenue betting from the Government of Andhra Pradesh and every year conducted such activity for two or three days and the income therefrom was added to its funds. The assessee-trust claimed exemption of such income under section 11. Held, that the objects of the trust were purely charitable in nature. The main objects of the trust were advancement and propagation of education, medical aid and relief of the poor. In fact, promotion of sports and games was also one of the charitable objects. Merely because a discretion was vested in the trustees to utilise the income to any one or more of the objects that would not make any difference. The transactions in conducting the races and intervenue betting were meant for achieving the primary objects of the trust and could not be called a business and the income derived from such transactions could not be called an income from the business. Assuming that it was a business as contemplated under section 2(13) of the Act, the same was exempted under section 11. The licence to run races and betting itself could be treated as property and the said property was obtained with the consent of the club and with the licence granted by the Government of Andhra Pradesh. The term “property” itself had widest import for income-tax purposes and was inclusive of holding a licence. The income derived by the trust for the relevant assessment years was from property held under trust and, as such, it was exempted under section 11. Even if it were not treated as income from the property held under trust, it could be treated as voluntary contribution given by the club to the assessee-trust as contemplated under section 12. Such voluntary contributions could be characterised only as a capital receipt in the assessee’s hands. The trust was entitled to exemption.

239 ITR 0502 COMMISSIONER OF INCOME-TAX VS. THANTHI TRUST (SC)

Assessee trust gave money to college run by registered charitable society. Amount was given by making credit entries in favour of society in its accounts. As there was no challenge to genuineness of credits amounts representing credits was entitled to exemption. Donation by book entry is valid so long as it is genuine.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

A trust qualifies for the exemption under section 11. It made some donation to another trust Rs. 2 lacs which is also entitled to similar exemption. This 2 lacs was simply credited in the books of accounts of the donor trust. You are required to state whether said donation by the donor trust is valid or not.

ANSWER

Supreme court observed in [1999] 239 ITR 0502 COMMISSIONER OF INCOME-TAX VS. THANTHI TRUST (SC) that assessee trust had given money to college run by registered charitable society. Amount was given by making credit entries in favour of society in its accounts. As there was no challenge to genuineness of credits amounts representing credits was entitled to exemption. Donation by book entry is valid so long as it is genuine.

258 ITR 0548- CIT VS. JODHPUR CHARTERED ACCOUNTANTS SOCIETY (RAJ)

An object beneficial to a section of the public is an object of general public utility. To serve a charitable purpose it is not necessary that the object should be to benefit the whole of mankind or all persons in a country or State. It is sufficient if the intention to benefit a section of the public as distinguished from a

specified individual is present. The section of the community sought to be benefited must be sufficiently definite and identifiable by some common quality of a public or impersonal nature. Ahmedabad Rana Caste Association v. CIT [1971] 82 ITR 704.

The predominant object of the society is dissemination of knowledge and education of commercial laws, tax laws for the benefit of general public to inculcate a sense of responsibility towards the nation and foster law abiding citizens. The objects clause of the constitution emphasises to propagate and disseminate knowledge about the auditing, accounting, direct and indirect taxes by holding seminars, conferences and workshops, etc. The fruits of such seminars, conferences, etc., would be available to the public at large, thus, it appears that the society is not for the benefit of a small group of individuals and it is also not only for the benefit of members but to promote awareness and education of the commercial and tax laws for the general public without any profit motive. As observed by the Supreme Court, to serve a charitable purpose it is not necessary that the object should be to benefit the whole of mankind or all persons in a country or State, even if a section of the public is given benefit, it cannot be said that it is not a trust for charitable purpose in the interest of the public. In the situation of explosion in population, the vast changes brought by the scientific technology and other developments, more particularly, the universal concept of globalisation, new trends in the world order to meet the ever growing challenges to organising seminars, conferences and workshops to educate the people of commercial laws, tax laws, auditing, accounting, direct and indirect taxes are of great general public utility, at least to a section of people falling in the category of charitable institution. Thus, the Tribunal has rightly directed the Commissioner of Income-tax to grant registration to the applicant-society under section 12A of the Income-tax Act, 1961.

Question

The assessee, a society was registered under the Rajasthan Societies Registration Act. The object of the society was dissemination of knowledge and education of commercial laws and tax laws for the benefit of the general public to inculcate a sense of responsibility towards the nation and foster law abiding citizens. It filed an application under section 12A of the Income-tax Act, 1961, for registration which was rejected by the Commissioner on the ground that the object of the society did not fall within the category denoted by the words “advancement of any other object of general public utility” appearing in section 2(15) of the Act. You are required to state whether the action of the commissioner is justified or not.

OR

Is the object of an association of chartered accountants to organise seminars, conferences and workshops to educate people on commercial laws, tax laws, auditing, accounting, direct and indirect taxes, an object of general public utility, so as to entitle such society to be treated as a charitable institution and therefore eligible for registration under section 12A and exempt under section 11 ?

Answer

Where the predominant object of the society was dissemination of knowledge and education of commercial laws and tax laws for the benefit of the general public to inculcate a sense of responsibility towards the nation and foster law abiding citizens. The objects clause emphasised the propagation and dissemination of knowledge about auditing, accounting, direct and indirect taxes by holding seminars, conferences, workshops, etc. The fruits of such seminars would be available to the public at large. Therefore, the society was not for the benefit of a small group of individuals and it was also not only for the benefit of members but to promote awareness and education of the commercial and tax laws for the general public without any profit motive. Therefore, action of the commissioner is not justified and he must grant registration to the assessee society under section 12A. [2002] 258 ITR 0548 - Commissioner of Income-tax vs. Jodhpur Chartered Accountants Society (Rajasthan High Court)

278 ITR 0180- COMMISSIONER OF INCOME-TAX VS. SACRED HEART CHURCH (GUJARAT HIGH COURT)

Where loans were advanced to economically weaker persons for housing purposes in pursuance of the objects of a public charitable trust and such amounts are subsequently written off, the amount so written off could be treated as application for the object of general public utility. It was so held in CIT v. Sacred Heart Church [2005] 278 ITR 180 (Guj) after review of case law on the subject. It is established law that even what is utilisation out of the income of past years would count for application as was decided in CIT v. Maharana of Mewar Charitable Foundation [1987] 164 ITR 439 (Raj) ; CIT v. Ganga Charity Trust Fund [1986] 162 ITR 612 (Guj) and CIT v. Sheth Manilal Ranchhoddas Vishram Bhavan Trust [1992] 198 ITR 598 (Guj).

278 ITR 0152- DIRECTOR OF INCOME-TAX (EXEMPTION) VS. KESHAV SOCIAL AND CHARITABLE FOUNDATION (DELHI HIGH COURT)

The assessee was a charitable trust providing medical advice for needy people in various parts and remote villages of Uttar Pradesh. It was registered under section 12A. The assessee claimed benefit under section 11 of the Act for the donations it received during the relevant previous year. The assessee had furnished the list of donors. The Assessing Officer disallowed the claim stating that the assessee could not furnish details regarding the donors and that it was just a way of introducing unaccounted money into the books of the assessee trust and thus treated the amount as cash credit under section 68 of the Act.

But being a charitable institution, the amount received by way of donations except in the case of corpus donations is bound to be treated as income to be utilised for the professed charitable purposes. In the result, if it has been so utilised, there can be no further liability as was pointed out in Director of Income-tax (Exemption) v. Keshav Social and Charitable Foundation [2005] 278 ITR 152 (Delhi). The High Court in coming to the conclusion, followed the decision in S. RM. M. CT .M. Tiruppani Trust v. CIT [1998] 230 ITR 636 (SC). But a better view indicated in the present decision of the High Court is that section 68 itself could have no application, when the donations are offered as income, because the very purport of section 68 is to treat what is not explained as income, so that when they are offered as income, the question of proving them does not arise. The inference might have been different, if they were corpus donations, because in such cases, they are not treated as income under section 12. It may also be pointed out that, there is no law as yet requiring the identity of the donors to be indicated or established, as for example required under section 13A for political parties.

278 ITR (A.T.) 0049- INDO-AMERICAN SOCIETY VS. ASSISTANT DIRECTOR OF INCOME-TAX (EXEMPTION)-II(1) (INCOME-TAX APPELLATE TRIBUNAL--MUMBAI)

To serve a charitable purpose, it is not the sine qua non that the object should be to benefit the whole of mankind or even all persons living in a particular country or province. It is sufficient if the intention is to benefit a section of the public as distinguished from specified individuals. The section of the community sought to be benefited must undoubtedly be sufficiently defined and identifiable. Relief to the poor cannot be construed conjointly with education. Education also comes within the ambit of charitable purpose.

The assessee-society was constituted for the dissemination of knowledge and education and the promotion of understanding between the people of India and the people of the USA. The main source of income for the society was from running educational programmes. From the annual report of the society the Assessing Officer found that these programmes did not bear any nexus with the objects of the society and the courses were conducted purely in a professional manner with high charges at five-star hotels. The Assessing Officer was also noticed that for a number of courses the assessee charged a percentage for earning large profits, which was spent for receiving and entertaining American ambassadors, councillors and other such people. It was also noticed that the other sources of income comprised Rs. 20 lakhs from sponsorship and interest income. Based on this fact, the Assessing Officer held that the object of the assessee could not be construed to be an object of general public utility and as such the benefit claimed under section 11 was denied. The Assessing Officer also examined the case on the touchstone of section 11(4A) of the Income-tax Act, 1961, and denied the benefit claimed under section 11.

It has been decided that the fact that the elite class benefits from a public activity is not a bar for exemption. In *Indo-American Society v. Asst. Director of I.T. (Exemption)-II(1)* [2005] 278 ITR (AT) 49 (Mumbai), the Tribunal found that the educational activity involved in conducting programmes at five-star hotels after charging hefty fees apart from collections of sponsorship amounts, it cannot be said that the assessee was doing business with a view to earn profits from conducting such educational programmes. As long as the surplus realised was used for the objects of the society, admittedly public in character, exemption could not be denied. The fact that the surplus was used for public purposes should be taken into consideration and should not be treated as a profit-earning business activity. Section 11(4A) does permit such incidental business activity.

259 ITR 0280- DIRECTOR OF INCOME-TAX VS. BHARAT DIAMOND BOURSE (SC)

Where the main object is to promote export of diamonds and develop the trade and export market and for this purpose a diamond bourse is established to facilitate liaison between industries in India and abroad, so that there could be a modern diamond market, the object is one of general public utility and the company, which was formed for the purpose is entitled to exemption.

In the case of a charitable institution formed as a company, every signatory to the memorandum of association has to be treated as founder, so that money lent to such a person without adequate security constitutes a benefit, which would deprive the exemption for the company.

Question

The assessee, a diamond bourse, was a company limited by guarantee. The predominant objects of the assessee were: (i) to establish common facilities required to promote export of diamonds ; (ii) to establish and promote effective liaison between the diamond trade and industry in India and abroad ; (iii) to promote, advance, protect and develop trade, commerce and industry in India relating to export and import of diamonds ; and (iv) to develop India as a modern and sophisticated diamond market by establishing and maintaining an international trading centre. The assessee claimed the benefit of section 11, on the ground that it was an institution established wholly for charitable purposes. You are required to answer whether assessee qualifies for the benefit of section 11 or not.

Answer

Where the main object is to promote export of diamonds and develop the trade and export market and for this purpose a diamond bourse is established to facilitate liaison between industries in India and abroad,

so that there could be a modern diamond market, the object is one of general public utility and the company, which was formed for the purpose is entitled to exemption. It was so held in Director of Income-tax v. Bharat Diamond Bourse [2003] 259 ITR 280 (SC) following Addl. CIT v. Surat Art Silk Cloth Manufacturers Association [1980] 121 ITR 1 (SC).

262 ITR 0187- CIT VS. V.G.P. FOUNDATION (MAD)

The assessee was a trust. It had advanced in the previous year, a sum of Rs. 53,950 to its sister concern, a private limited company of which the trustees of the assessee were also directors. The assessee's claim that the monies so given were meant to be used to meet the cost of construction of a hospital and therefore should be regarded as having been applied for charitable purposes in this year. Held, that had the money remained with the assessee, it certainly could not have been regarded as having been utilised for charitable purposes. By giving it to a sister company which merely retained the money with it for the whole of the year, it was not possible to give the assessee the benefit regarding the amount as having been applied for a charitable purpose. There had also been contravention of section 13(1)(d) read with section 11(5) of the Income-tax Act, 1961, inasmuch as the trustees were also directors of the company and that company had the benefit of this amount throughout the year. The assessee did not realise any interest on that amount nor did it have any security for the amount so made available to the sister company. The assessee was not entitled to exemption in respect of the advance.

277 ITR 0158 - COMMISSIONER OF INCOME-TAX VS. SHRI RADHA KRISHNA TEMPLE TRUST (ALLAHABAD HIGH COURT)

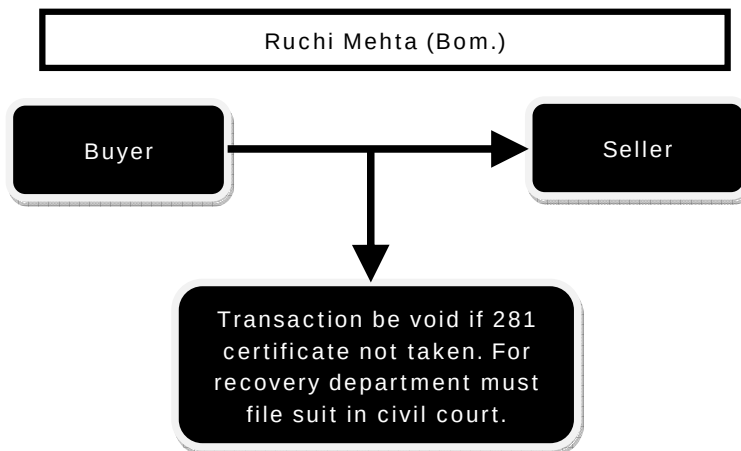
A charitable trust or institution is barred from making any investment in a concern in which a person is an interested person as defined under section 13(3). Where the trust is in receipt of gift of shares in a company, it was held in CIT v. Shri Radha Krishna Temple Trust [2005] 277 ITR 158 (All), that no violation could be inferred of the provisions in section 13. It is because, it is not an investment made by the assessee, but received as gift. It is a point on which there are a number of decisions, which are listed in this case apart from other cases, which were not listed. The same inference has been drawn, where violation of section 11(5) was wrongly inferred as in Auditor Dasaradha Rami Reddy Charities v. CIT [1989] 177 ITR 249 (Mad). It is odd that the Commissioner should have thought it fit to file a reference on such a settled matter and such a reference as a question of law should have been made by the Appellate Tribunal under section 256(1) of the Act (now replaced by appeal).

CERTAIN TRANSFERS TO BE REGARDED AS VOID

Section / Topic Name : 281 and 281B

DECELERATORY PROVISIONS – SCOPE OF

Recovery by pursuing the present title holder of property as a person, who has obtained such title on a fraudulent transfer by the tax defaulter, is beyond the power of the Tax Recovery Officer. Neither section



281B nor the Second Schedule would be sufficient for declaring the transfer as void under the law. The only recourse open to the Income-tax Department in such cases is to file a suit for declaration that the transaction is void. It has been so held by the apex court in *TRO v. Gangadhar Viswanath Ranade (Decd.)* [1998] 234 ITR 188. This was followed in *Ms. Ruchi Mehta v. UOI* [2007] 294 ITR 614 (Bom). The frequency of such wrong exercise of power indicates the

need for proper instruction to the Tax Recovery Officers as to the correct course of action. Following a wrong course may jeopardise recovery by right means.

248 ITR 0209- STOCK EXCHANGE, AHMEDABAD VS. ACIT (SC)

Is the membership card in a stock exchange a property capable of being attached and sold ? This was the issue which arose, when a stock exchange card was sought to be attached in garnishee proceedings for recovery of outstanding taxes. The attachment was questioned by the Ahmedabad Stock Exchange before the High Court by way of writ. The reasoning of the Court, while rejecting the case of the stock exchange was, that it is possible for the member to nominate a successor and that such right can be sold in certain circumstances.

The Supreme Court, however, has reversed this decision pointing out that the right of nomination is not an automatic one and that even in a case of succession, it is subject to conditions. Membership constituted a personal permission for participation in stock exchange recognised under the Securities Contracts Act and governed by regulations and bye-laws thereunder apart from the rules of the stock exchange for exercising the rights and privileges of membership. The rules provide for forfeiture of membership, vesting such card in the stock exchange itself in case of default. Neither the fact that there may be margin money or security deposit kept in the stock exchange in relation to the membership card, nor the fact that the card may be sold or auctioned by the stock exchange can make it a property, since the membership is governed by rules. It is not a property which could be attached under section 281B.

In coming to the conclusion, the Supreme Court referred to its earlier decision in *Vinay Bubna v. Stock Exchange, Mumbai* [1999] 97 Comp Cas 874 (SC), where the card was held not to be a private asset, but a personal permission given by the stock exchange so that the powers under the membership card thus vested in the stock exchange.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

The Stock Exchange, Ahmedabad, admitted Rajesh Shah as its member who died on February 20, 2001. On February 22, 2001, the heirs and legal representatives of Rajesh Shah wrote to the stock exchange that they were unable to meet the liabilities of the deceased. The Governing Board of the stock exchange is said to have passed a resolution declaring Rajesh Shah, the deceased member, as a deemed defaulter and further resolving that his membership rights vested in the stock exchange be disposed of by inviting offers within a minimum floor price of Rs. 25 lakhs. Since Rajesh was a defaulter under income tax as well a provisional attachment order under section 281B of the Income-tax Act, was issued by the Assistant Commissioner of Income-tax in respect of the stock exchange card in the name of Rajesh Shah and margin money and security deposits kept by him with the stock exchange. You are required to answer whether assistant commissioner is justified in issuing the provisional attachment order or not.

ANSWER

That the right of membership of the stock exchange was not a private asset. It was merely a personal privilege granted to a member. It was non-transferable and incapable of alienation by the member or his legal representatives except to the limited extent provided in the rules and subject to fulfilment of conditions. The nomination wherever provided was not automatic, it was hedged by rules. On the right of nomination vesting in the stock exchange under the rules, that right belonged to the stock exchange absolutely. In the case of the death or default of a member, his right of nomination ceased and vested in the stock exchange. The membership right or membership card of R was not the property of R and, therefore, it could not be attached under section 281B.

MODE OF ACCEPTANCE OF LOAN OR DEPOSITS

Section / Topic Name : 269 SS / T

CURRENT ACCOUNT TRANSACTIONS

The Madras High Court, in CIT v. Idhayam Publications Ltd. [2007] 163 Taxman 265, held that current account transactions involving successive deposits and withdrawals from a sister concern whose proprietor was its director do not come under the ambit of section 269SS prohibition. The Court in this regard drew their satisfaction from the Companies (Acceptance of Deposit) Rules, 1975 whereunder deposit does not include amounts received either from a director or shareholder.

285 ITR 0221- COMMISSIONER OF INCOME-TAX VS. IDHAYAM PUBLICATIONS LTD. (MADRAS HIGH COURT)

The assessee was running a company engaged in publication of books. In the assessment proceedings the Assessing Officer noted that the assessee had accepted a cash loan of Rs. 2,94,000 from M, a sister concern, in violation of the provisions of section 269SS of the Act. With the above information, the Deputy Commissioner initiated penal proceedings under section 271D. The assessee contended that there was no loan or deposit. The contention was rejected and penalty was imposed. The Tribunal found that M, the proprietor of the sister concern, was one of the directors of the company and there was a running account in his name. It deleted the penalty. Held, dismissing the appeal, that the transaction between the assessee and the director-cum-shareholder was not a loan or deposit and it was only a current account in nature and no interest was being charged for the above transaction. The deletion of penalty was justified.

273 ITR (A.T.) 0109- MRS. RUPALI R. DESAI VS. ADDITIONAL COMMISSIONER OF INCOME-TAX (BOMBAY BENCH)

During the course of assessment proceedings, the Assessing Officer found that the assessee had taken a cash loan from TSL amounting to Rs. 41,50,000. After obtaining the above amount in cash, the assessee had deposited the same in her bank account with the Canara Bank. Thereafter she had withdrawn the amounts and purchased fixed deposit receipts. She encashed the FDRs and returned the amount to TSL by cheque. The Assessing Officer imposed a penalty under section 271D. Special transaction during the course of winding up is a reasonable cause and thus penalty should not be imposed.

283 ITR 0329- COMMISSIONER OF INCOME-TAX VS. KUNDRATHUR FINANCE AND CHIT CO. (MADRAS HIGH COURT)

Where there is a reasonable explanation for acceptance of cash in violation of the requirement of section 269SS, penalty under section 271D is not exigible as was found in CIT v. Kundrathur Finance and Chit Co. [2006] 283 ITR 329 (Mad), where the borrowing was claimed to have been made from person, who did not have bank accounts and the transactions themselves were otherwise genuine with a bona fide explanation from the assessee.

In yet another case, where penalties were levied and were cancelled by the Appellate Tribunal, the High Court upheld the order of the Tribunal in Director of Income-tax (Exemptions) v. All India Deaf and Dumb Society [2006] 283 ITR 113 (Delhi) on the finding that cash transactions were not on account of

any mala fides on the part of the society, which depends on grants from the Government, but because it had to borrow from private parties for its day-to-day expenses. The High Court found that there was no case for interference, because the decision of the Tribunal was on the facts not found to be perverse. It is odd that this Government aided institution should have not only been subjected to penalty under both sections for acceptance of loans and return to the extent of nearly Rs. 2 lakhs and Rs. 3.5 lakhs respectively, but such penalty should have been confirmed by the first appellate authority and what is more, the matter should have been taken up by the Revenue to the High Court against the judgment of the Tribunal. In administering the law, the purpose of such provisions like sections 269SS and 269T as well as penalties for infringement under sections 271D and 271E is often forgotten.

283 ITR 0113- DIRECTOR OF INCOME-TAX (EXEMPTION) VS. ALL INDIA DEAF AND DUMB SOCIETY (DELHI HIGH COURT)

Tribunal had recorded a finding that the funds were not available for meeting day-to-day expenses, and therefore, loans were taken in cash and when the funds were available, the same were returned in cash. The assessee was running a school for deaf and dumb children/persons and met all its expenses from donations or grants. Keeping in mind the cumulative effect of these facts and circumstances, the Income-tax Appellate Tribunal came to the conclusion that there were no mala fides on the part of the assessee and there was no intent of violating the law. The cancellation of penalty under sections 271D and 271E was valid.

283 ITR (A.T.) 0203- DEWAN CHAND AMRIT LAL VS. DEPUTY COMMISSIONER OF INCOME-TAX (INCOME-TAX APPELLATE TRIBUNAL--CHANDIGARH)

The authority competent to impose penalty under sections 271D and 271E is the Deputy Commissioner (now the Joint Commissioner) and the Assessing Officer does not have the power either to initiate the penalty proceedings or impose the penalty. There is no procedure for reference by the Assessing Officer to the competent authority for imposition of penalty under section 271D or 271E. Therefore, the limitation for completion of penalty proceedings as provided under section 275(1)(c) has to be computed from the date of issue of show-cause notice by the competent authority. Even if a show-cause notice is issued by the Assessing Officer for imposition of penalty under section 271D or 271E that notice would be without any jurisdiction as the Assessing Officer has no authority under law either to initiate or impose the penalty under section 271D or 271E. Under section 271, recording of satisfaction before initiation of penalty in the course of proceedings is a condition precedent for imposition of penalty for specified defaults. Under sections 271D and 271E, there is no such requirement of recording of satisfaction in the course of any proceedings.

The validity of penalty proceedings has to be seen with reference to the authority empowered to impose the penalty on the relevant date.

284 ITR 0609- COMMISSIONER OF INCOME-TAX VS. RATNA AGENCIES (MADRAS HIGH COURT)

The assessee-firm filed its returns. The Assessing Officer while processing the returns, noticed that the assessee had contravened the provisions of sections 269SS and 269T by accepting cash loans exceeding Rs. 20,000 and hence levied penalty under sections 271D and 271E. The Commissioner (Appeals) deleted the penalty imposed by the Assessing Officer holding that the contravention alleged against the assessee did not result in any unaccounted transaction such as lending and repayment and that both

lending and repayment were entered in the books of the assessee and the figure involved was meagre and that the same was incurred only for meeting the sudden demand of overdraft account. On appeal by the Revenue the Tribunal endorsed the view of the Commissioner (Appeals) and dismissed the appeal which was accepted by high court.

253 ITR 0103- CIT VS. GOVIND KUMAR (RAJ)

The Commissioner (Appeals) came to the conclusion that the book entries made by the assessee with reference to the payment made on its behalf by the other party was at the most a type of accommodation or loan and not a deposit which otherwise is contemplated by section 269T and held that there was no justification in treating the assessee to have contravened the provisions of section 269T.

260 ITR 0590- CIT VS. MANOJ LALWANI (RAJ)

“no penalty shall be imposable on the person or the assessee, as the case may be, for any failure if he proves that there was reasonable cause for the said failure”, will have its full operation. Section 273B permits the assessing authority not to impose a penalty under section 271D. Under section 273B a judicial discretion is left with the assessing authority not to levy a penalty under section 271D if the authority is satisfied that there was a reasonable cause for not complying with the provisions of section 269SS.

Where the assessee has accepted a deposit in cash, penalty is not automatically exigible, since it could be saved notwithstanding violation of section 269SS, if there was reasonable cause. Where the assessee had taken a loan of Rs. 2.5 lakhs of which Rs. 2.45 lakhs was deposited immediately in the bank to meet the urgent demand for a time bound supply, there was reasonable cause. In such cases, the Assessing Officer has no jurisdiction to impose penalty, so that the Tribunal had to waive the same, where it has been wrongly levied.

262 ITR 0163- CIT VS. INDORE PLASTICS P. LTD. (MP)

The assessee was a private limited company. One RCK was its promoter and managing director during the period relevant to assessment year 1990-91. During that year, the assessee-company accepted deposits in cash from the promoter from time to time aggregating in all Rs. 2,31,320. According to the Assessing Officer as also the Commissioner (Appeals), the said payment was in contravention of section 269SS and the assessee was liable to pay penalty under section 271D. However, held that the penalty so imposed is to be vacated on the finding that the said payment was not by way of deposit or loan, but towards adjustments of the amount drawn by the promoter from the company's account.

In other words section 271D provides for penalty for acceptance of loan or a deposit by any means other than account payee cheque or account payee draft where the amount involved exceeds Rs. 20,000. The provision is confined to loans or deposits and not to other trading transactions. In CIT v. Indore Plastics P. Ltd. [2003] 262 ITR 163 (MP), the assessee-company received moneys from its promoter to the extent of about Rs. 2 lakhs. Since it was received in cash, penalty of an equal amount was levied. The court found that the receipt was neither a deposit nor a loan, but merely an adjustment of amount, which he owed to the company, so that the receipt did not fall within the meaning of loan or deposit under section 269SS of the Act.

275 ITR 0399- BHALOTIA ENGINEERING WORKS PVT. LTD. VS. COMMISSIONER OF

INCOME-TAX (JHARKHAND)

Section 269SS of the Income-tax Act, 1961, was inserted with a view to prevent transactions in black money and to ensure that payments of Rs. 20,000 and above are traceable to transactions through a bank. If the mischief that is sought to be averted is kept in mind, it will be appropriate to hold that any payment of Rs. 20,000 or above made to a company as share application money should be as provided in section 269SS. Even if share application money cannot be considered to be a loan within the meaning of section 269SS it partakes of the character of a deposit, since it is repayable in specie on refusal to allot shares and is repayable if recalled by the applicant, before allotment of shares and the conclusion of the contract. Hence the acceptance of share application money in cash amounting to Rs. 20,000 or more violates the provisions of section 269SS.

Both loans or deposits are ordinarily repayable in cash. In the case of a person other than a company, a loan or deposit of any nature is included, while in the nature of the company, the deposit should be repayable after notice or after a period. Moneys paid towards share capital could not have been understood as deposit within the meaning of the definition of deposit in the case of company. Section 269SS is an artificial provision, so that it has to be strictly construed. In *A. M. Shamsudeen v. Union of India* [2000] 244 ITR 266 (Mad), the issue was whether repayment was of a loan or a deposit under the then law, which excused repayment of loan and not of deposit, which alone was vulnerable. In this context, it was observed, inter alia, that in a loan, the debtor seeks the creditor for repayment, while in the case of deposit, it is generally the duty of the depositor to go to the depositor to make a demand for repayment. Such a reasoning was found in a number of precedents.

The further argument for the conclusion was that it was certainly not a loan and that, therefore, it should be a deposit, an argument which is simplistic. Even allotment, it was inferred, was only repayment in specie. What is repayable in specie is not a deposit even according to the definition. The inference of the High Court gives too wide a meaning to deposit to cover any receipt in cash. An advance for goods under this logic would be so covered.

279 ITR 0136- COMMISSIONER OF INCOME-TAX VS. GARDEN SILK WEAVING FACTORY (GUJARAT HIGH COURT)

After appreciating evidence on record (in the form of various agreements) and on facts that the transaction was a slump sale, i.e., the entire business undertaking was sold as a going concern and there was no itemised sale. Even the assessing authority had not been able to work out the itemised sale qua each building, machinery or plant as the case may be. The Tribunal was therefore right in holding that what was sold by the assessee-firm to the limited company was its running business as a going concern together with all the assets and liabilities and the provision of section 41(2) / 50 could not be invoked.

ZUARI INDUSTRIES LTD (AT) (MUMBAI)

Slump Sale (Cost of acquisition)	
Asset	10
(-) liabilities	12
Net Asset (Can not be negative, Now treated as NIL).	Nil

Where assessee sold one of the industrial undertakings retaining the other. The Assessing Officer computed capital gains relating to that part of the block of assets forming part of the transferred unit. The Tribunal found that the sale being for a slump price of the unit as a whole, it was not possible to deal with depreciable assets disjunctively. It was, however, found that a separate valuation was undertaken for machinery, so that a disjunctive sale was inferred following CIT v. Artex Manufacturing Co. [1997] 227 ITR 260 (SC). But the Tribunal also found that section 50 does not authorise segregation of any part of the block of assets. In the assessee's case, the block of assets was part of the assets of the business of the assessee comprising the assets of the transferred unit. Since the written down value was not reduced to nil on transfer of transferred assets, it was held that there was no liability for short term capital gains. If the businesses themselves were distinct, the block could have probably been taken to be distinct.

DIVIDEND TAX

Section / Topic Name : 115O / 115P / 115Q / 115R / 115S / 115T

253 ITR 0608- JAYASHREE TEA AND INDUSTRIES LTD. VS. UOI (CAL)

Fact that company derives income from growing and manufacturing tea does not make dividend agricultural income. Section 115-O is not invalid in so far as it pertains to companies deriving income from growing and manufacturing tea.

Question

Assessee being the tea company has filed this writ petition challenging the vires of sections 115-O in so far as it relates to levy of additional income-tax on the profits which are distributed as dividend amongst the shareholders to the extent the same represents agricultural income of the assessee and also refund of the tax already levied.

Answer

Fact that company derives income from growing and manufacturing tea does not make dividend agricultural income. Section 115-O is not invalid in so far as it pertains to companies deriving income from growing and manufacturing tea.

MINIMUM ALTERNATE TAX (MAT)

Section / Topic Name : 115JB

BOOK PROFITS NOT AS PER HEADS OF INCOME

The book profits tax is on book profits computed under section 115J/115JA/115JB. It is a code by itself with other provisions relating to computation inapplicable in view of the non obstante clause at the beginning of the section. The schedular system of computing head-wise income is also not applicable. Though capital gains are taxable at a lower rate compared to the general rate, no such concession is provided when such capital gains form part of the book profits. It was so held in *Nafab India P. Ltd. v. Dy. CIT* [2008] 303 ITR (AT) 403 (Delhi). The claim in this case raised by the assessee was for adoption of a pro rata lesser rate of tax for capital gains. The argument that capital gains cannot form part of the book profits within the meaning of income under company law was not raised and, therefore, not considered.

SOFTWARE EXPENDITURE

The Delhi High Court in *CIT v. G E Power Services India Ltd.* [2008] 171 Taxman 10 held that software expenditure debited to profit and loss account is an allowable deduction in computing book profits. The Court refuted the argument of the revenue that such expenditure would be capital in nature after amendment to section 32 for the reason that the amendment is not retrospective in nature. Also it found such argument as unworthy, perhaps for the reason that section 32 has no relevance as far as determination of book profits goes.

This judgment thus provides a good tax planning method and, thus, an assessee can charge off software costs in accounts even while it resorts to depreciation claim in tax computation after taking disallowance first. Before the statutory auditor, the assessee can take the contention that the software in use has a short span of life and further it needs updation from time to time.

PRIOR PERIOD/EXTRAORDINARY ITEMS

The Delhi High Court in *CIT v. Khaitan Chemicals & Fertilizers Ltd.* [2008] 175 Taxman 195 held that net profit (as referred to in section 115JA) was to be computed only after deducting the expenses on prior period/extraordinary items which were business expenditure, but were shown separately in the profit and loss account due to the specific requirement of the AS prescribed by the Institute of Chartered Accountants of India.

POWER GENERATION DEDUCTION

The Delhi High Court in *CIT v. DCM Sriram Consolidated Ltd.* [2009] 176 Taxman 49 held that the term 'Business', which prefixes generation of power in clause (iv) of the Explanation to section 115JA(2), is not limited to one business which is prosecuted only by engaging with an outside third party and, thus, it allowed deduction of profit which was derived from transfer of energy from its Captive Power Plants in arriving at book profits amenable to tax under section 115JA.

EXCESS DEPRECIATION

In *CIT v. CJ International Hotels Ltd.* [2009] 177 Taxman 39 (Delhi) the Commissioner had given a direction to the Assessing Officer to recompute the income under section 115JA considering the impact of excess depreciation claimed by the assessee. The Tribunal reversed such an order on the basis of the decision of the Supreme Court in the case of *Apollo Tyres Ltd. v. CIT* [2002] 255 ITR 273 and noted that

once the accounts had been certified by the auditor to have been prepared in accordance with the provisions of the Companies Act, then the Assessing Officer did not have any jurisdiction to go behind the net profit shown in the Profit and Loss Account, except to the extent provided in the Explanation to section 115J. The Delhi High approved of such a stance.

Book profit calculation		
Software expense	1	allowable
Prior period/extraordinary items	2	allowable
Power generation deduction	3	allowable
Excess depreciation	4,5	allowable
Warranty provisions	6	allowable
Loss on sale of capital asset	7	allowable
Lease equilisation change	8,5	allowable

(1)	G. E. Power Services India Ltd. (Delhi)
(2)	Khaitan Chemicals & Fertilizers Ltd. (Delhi)
(3)	DCM Sriram Consolidated Ltd. (Delhi)
(4)	CJ International Hotels Ltd. (Delhi)
(5)	Apollo Tyres Ltd. (Delhi)
(6)	Hero Briggs & Stratton Auto Ltd. (Delhi)
(7)	Asian Diet Products Ltd. (Delhi)
(8)	Goodwill India Ltd. (Delhi)

WARRANTY PROVISION

The Delhi ITAT in Hero Briggs & Stratton Auto Ltd. v. CIT [2007] 161 Taxman (AT) 127 held that once the assessee is maintaining his account on the mercantile system and a liability accrued, though to be discharged at a future date, it would be proper to allow deduction of the same while working out the profit and loss of his business, regard being had to the accepted principles of commercial practices and accountancy. The Commissioner was, thus, held unjustified in directing the Assessing Officer to add back amount of warranty provision as unascertained liability while working out profits u/s 115JA.

LOSS ON SALE OF CAPITAL ASSETS

The Delhi Tribunal, in Asian Diet Products Ltd. v. Dy. CIT [2007] 162 Taxman 210 (Mag.) held that the computation of book profit under section 115JA is quite different from computation of profits liable to be computed as per provisions of sections 28 to 44. Any loss on sale of fixed assets debited to the profit and loss account is liable to be added while computing the taxable income as per Act and the depreciation as per the WDV of the block of assets is required to be reduced. However, while computing book profit

under section 115JA, such loss is not required to be added. The Bench disapproved action under section 154 in this case to make such unauthorized adjustment.

CHANGE IN METHOD OF DEPRECIATION

The Madhya Pradesh High Court, in Gilt Pack Ltd. v. Union of India [2007] 163 Taxman 331, held that any change in method of depreciation must take effect from the perspective effect contrary to the Bombay High Court decision in Kinetic Motors Co. Ltd. v. Dy. CIT [2003] 262 ITR 330.

LEASE EQUALIZATION CHARGE

That the lease equalization charge was not an amount set aside for meeting any liability which was unascertained. It was a recognized method for preparing the financial statement of non-banking financial companies. The sum in question did not fall within any of the other clauses of the Explanation to section 115JA. The claim made by the assessee for the assessment year 1998-99 was to be allowed. Apollo Tyres Ltd. v. CIT [2002] 255 ITR 273 (SC) followed. [2008] 306 ITR (A.T.) 0034- Goodwill India Ltd. v. Deputy Commissioner of Income-tax (Income-tax Appellate Tribunal--Delhi)

Where the assessee, while accounting for leases, charges lease equalisation charges to the profit and loss account, a recognised accounting practice, so as to recognise income on an even basis, it is not open to the Assessing Officer while computing book profits under section 115JA to disallow such debit as notional. The Tribunal in coming to this conclusion in GE Capital Transportation Financial Services Ltd. v. Asst. CIT [2008] 301 ITR (AT) 69 (Delhi) followed the Supreme Court's decision in Apollo Tyres Ltd. v. CIT [2002] 255 ITR 273.

290 ITR (A.T.) 0183- IBM INDIA LTD. VS. COMMISSIONER OF INCOME-TAX (APPEALS) **(INCOME-TAX APPELLATE TRIBUNAL--BANGALORE)**

(i) that the liability to pay for warranty claims arises no sooner the sales are effected. The assessee had provided for liability on the basis of sales made during the year. The amount set apart to meet the liability was deductible.

(ii) That the concept of payment made once and for all and of “enduring benefit” must respond to the changing economic realities of the business. It was clear that the amount was paid for application software and not system software. The application software enables the assessee to carry out its business operation efficiently and smoothly. However, such software itself does not work on a stand alone basis. It has to be fitted to a computer system to work. Such software enhances the efficiency of the operation. It is an aid in the manufacturing process rather than the tool itself. Thus, by payment for such application software, though there is an enduring benefit, it does not result in acquisition of any capital asset. It merely enhances the productivity or efficiency and hence has to be treated as revenue expenditure.

(iii) That the assessee had received a sum of Rs. 18.4 crores being consideration for the value which inheres in the human resources by reason of training, skill, practical experience and work culture for transfer of the personnel. To facilitate such transfer, the amount was paid. Undisputedly, the training, skills and experience as well as work culture was imparted by the assessee. Acquisition of such training, skill, experience and work culture was at the cost of the assessee-company. Thus, it could be connected with the office or occupation which the assessee carried on. The amount was income of the assessee.

(iv) That while computing the book profit, one has to refer the provision of the Companies Act, 1956. As per the definition of provision in Part III of Schedule VI to the Companies Act the provision can be for diminution in value of asset or for meeting any liability. Under clause (c) of the Explanation to section 115JA, the amount to be increased is “the amount set aside to provision made for meeting liabilities other than ascertained liabilities”. The amount being provision made for bad and doubtful debts cannot be

considered as provision for meeting any liability which is not an ascertained liability and hence the book profit is not to be increased by such amount provided for.

Kwality Biscuits Ltd. v. CIT [2000] 243 ITR 519 (Karn) followed.

255 ITR 0273 APOLLO TYRES LTD. VS. CIT (SC)

While so looking into the accounts of the company, the Assessing Officer has to accept the authenticity of the accounts with reference to the provisions of the Companies Act, which obligate the company to maintain its accounts in a manner provided by that Act and the same to be scrutinised and certified by statutory auditors and approved by the company in general meeting and thereafter to be filed before the Registrar of Companies who has a statutory obligation also to examine and be satisfied that the accounts of the company are maintained in accordance with the requirements of the Companies Act. Sub-section (1A) of section 115J does not empower the Assessing Officer to embark upon a fresh enquiry in regard to the entries made in the books of account of the company.

Question

Can an Assessing Officer while assessing a company for income-tax under section 115JB of the Income-tax Act question the correctness of the profit and loss account prepared by the assessee-company and certified by the statutory auditors of the company as having been prepared in accordance with the requirements of Parts II and III of Schedule VI to the Companies Act ?

Answer

While so looking into the accounts of the company, the Assessing Officer has to accept the authenticity of the accounts with reference to the provisions of the Companies Act, which obligate the company to maintain its accounts in a manner provided by that Act and the same to be scrutinised and certified by statutory auditors and approved by the company in general meeting and thereafter to be filed before the Registrar of Companies who has a statutory obligation also to examine and be satisfied that the accounts of the company are maintained in accordance with the requirements of the Companies Act. section 115JB does not empower the Assessing Officer to embark upon a fresh enquiry in regard to the entries made in the books of account of the company.

262 ITR 0330- KINETIC MOTOR CO. LTD. VS. DEPUTY CIT (BOM)

The assessee was a public limited company engaged in the business of manufacture and sale of two wheelers. For the previous year in the books of account maintained the assessee debited an amount of Rs. 6,32,65,430 on account of depreciation. This depreciation was calculated on the written down value method, which is one of the permissible methods under the Companies Act as well as under the Income-tax Act, although the assessee earlier used to provide the depreciation on the straight line method in its corporate accounts. The above change in treatment resulted in a book loss of Rs. 1,64,49,937. These accounts were certified to be true and fair by the auditors. The Assessing Officer took the view that there was no justification for the assessee to change the basis of providing depreciation. The Assessing Officer re-worked the depreciation and arrived at a revised figure of book profit. Held, that it was not in dispute that under the Companies Act both the straight line method and written down value method are recognised. Therefore, once the amount of depreciation actually debited to the profit and loss account was certified by the auditors, it was not permissible for the Assessing Officer to make book adjustments.

252 ITR (STAT) 0050- CIRCULAR NUMBER: 13

The provision of section 115JB provides that if tax payable on total income is less than 7.5% of book profit, the tax payable under this provision shall be 7.5% of book profit.

It may be emphasised that the new provision of section 115JB is a self-contained code. Except for substitution of tax payable under the provision and the manner of computation of book profits, all the provisions of the tax including the provision relating to charge, definitions, recoveries, payment, assessment, etc., would apply in respect of the provisions. It is abundantly clear that all companies are liable for payment of advance tax having regard to the provisions contained in new section 115JB. Consequently, the provisions of sections 234B and 234C for interest on defaults in payment of advance tax and deferment of advance tax would also be applicable where facts of the case warrant.

284 ITR 0434- COMMISSIONER OF INCOME-TAX VS. KWALITY BISCUITS LTD. (SUPREME COURT OF INDIA)

The Supreme Court has resolved the controversy regarding the liability to pay advance tax and the consequent levy of interest, if it is so payable, but not paid. The Gauhati High Court in Assam Bengal Carriers Ltd. v. CIT [1999] 239 ITR 862 the Bombay High Court in CIT v. Kotak Mahindra Finance Ltd. [2004] 265 ITR 119, the Madras High Court in CIT v. Holiday Travels P. Ltd. [2003] 263 ITR 307 and the Punjab and Haryana High Court in CIT v. Upper India Steel Manufacturing and Engineering Co. Ltd. [2005] 279 ITR 123 decided in favour of the Revenue, while the Madhya Pradesh High Court in Itarsi Oils and Flours P. Ltd. v. CIT [2001] 250 ITR 686 (MP) and the Karnataka High Court in Kwaliti Biscuits Ltd. v. CIT [2000] 243 ITR 519 (Karn) decided in favour of the taxpayer. The latter decision had become final in CIT v. Kwaliti Biscuits Ltd. [2006] 284 ITR 434 (SC), wherein the appeal was dismissed without any discussion on the subject, so that it can be inferred that the arguments accepted by the High Court have been found to be valid. The reasoning of the High Court was that the Minimum Alternate Tax (MAT) gets determined only after the end of the relevant year, but then, so is the normal tax. The better reason probably is that sections 234B and 234C, which authorise levy of interest refer to tax on total income, which has to be understood as total income defined under section 2(45) of the Income-tax Act as total income computed in the manner laid down under the Act. Section 209 requiring computation of advance tax also refers to tax on total income and not on book profits.

The present form of MAT under section 115JB levies tax on book profits as against the preceding system of estimating 30% of the income as liable for tax at the normal rate. It has been canvassed by the departmental authorities, that the amended law would rule out the controversy inasmuch as tax payable is computed in the provision itself, but such an argument cannot prevail in the light of the rationale of the present Supreme Court decision and the language of section 209, 234B and 234C continues to be the same.

POWERS OF INCOME TAX AUTHORITIES

Section / Topic Name : 119 TO 126

262 ITR 0428- AMWAY INDIA ENTERPRISES VS. UNION OF INDIA (KER)

Section 131 grants power to the Assessing Officer to issue summons for discovery or inspection or for production of books of account. Where a Deputy Director of Income-tax (Inv.) in Kerala required information from a company with its head office in New Delhi on payments made by the company to their distributors in Kerala under section 131, such power was challenged unsuccessfully in Amway India Enterprises v. Union of India [2003] 262 ITR 428 (Ker). Apart from the question of jurisdiction, it was also contended that such a general enquiry calling for information on commission to all the distributors was not justified. The High Court felt that the enquiry was justified in that the Deputy Director under section 131(1A) has the power under section 131, that such power is not restricted and that the requirement of information relating to disbursements beyond a limit in the context of information that many of the distributors are not paying tax.

Question

Amway Limited having registered office and filing return in Mumbai was engaged in the business of selling consumer goods. The Amway Limited was requested to furnish the true and complete details of all payments made by it to its distributors in Kerala, with the names and complete addresses of the respective payees and the amount paid etc., and any other relevant details. The Amway Limited was informed that the distributors of the Amway Limited's products in Kerala were in receipt of remuneration (by whatever name called) from the Amway Limited which had not been fully and properly offered for income-tax assessment in their respective hands. For the purpose of making necessary enquiry and investigation thereto, relevant details were called for, from the Amway Limited. A formal summons was also enclosed as per section 131. It was further informed that the personal appearance of the managing director was not essential provided the particulars called for were furnished on or before the specified date. Assessee apart from the question of jurisdiction, also contended that such a general enquiry calling for information on commission to all the distributors was not justified. You are required to discuss whether the powers exercised by the Director was proper.

Answer

Section 131 of the Income-tax Act, 1961, grants power to the Assessing Officer, during the course of assessment proceedings, to issue summons for discovery or inspection or for production of books of account as the case may be as are vested in the civil court. On the other hand, section 131(1A) empowers the specific officer referred to therein including the Deputy Director to exercise the power under sub-section (1) notwithstanding the fact that no proceedings are pending before such authority and the summons so issued could be for the purpose of conducting an enquiry or investigation thereto provided he had reason to suspect that any income has been concealed or is likely to be concealed by a person or class of persons within his jurisdiction. If there is any reason to suspect concealment of income of any class of persons within his jurisdiction then he can exercise the power vested in him under section 131. In order to invoke the power under section 131 read with section 131(1A) the person to whom the summons is issued need not be within the jurisdiction of the officer concerned. On the other hand, if the officer concerned has reason to suspect that any person or class of persons in his jurisdiction is likely to conceal the income then he can invoke section 131 calling for the details from whomsoever concerned as empowered under section 131(1A).

It has been Held in [2003] 262 ITR 0428- Amway India Enterprises vs. Union of India (Kerala High Court), that the Deputy Director of Income-tax had merely asked the petitioner to furnish the details

regarding commission/remuneration if any paid to the distributors within the State of Kerala. The summons was issued under section 131 read with section 131(1A) by an officer specified under section 131A. Therefore, the fact that the petitioner was not an assessee within the jurisdiction of the income-tax authorities in Kerala was of no relevance. A counter affidavit had been filed wherein it was averred that on the basis of the income-tax inspector's report and as personally directed by the Director of Income-tax the letter had been sent to the managing director of the petitioner. In the light of the clear statement that the details called for were only relating to distributors within the State of Kerala to whom the total commission, etc., paid during the accounting year amounted to Rs. 50,000 and above and further limiting the period, and the power having been exercised by the Deputy Director of Income-tax as per the provisions specified under section 131(1A) of the Act and the fact that there was likelihood of concealment of income, it could not be said that the Deputy Director of Income-tax had exceeded his jurisdiction. The letter and summons was valid.

262 ITR 0338- DDI VS. MAHESH KUMAR AGARWAL (CAL)

Section 132(1) requires satisfaction of the conditions precedent for exercising the power as provided therein. The conditions precedent are that the officer must be (i) in possession of information on the basis whereof, (ii) he has reason to believe that (iii) the concerned person has not produced or would not cause to be produced the books of account or has not or would not disclose the money, bullion, jewellery or other valuable articles or things in his possession. This condition has to be fulfilled before a decision to issue a notice under section 132(1) is taken. A search is a serious invasion into the privacy of a citizen. Therefore, section 132(1) is to be construed strictly. The formation of the opinion or belief by the authorised officer must be apparent from the note recorded by him. Such information must be something more than mere rumour or gossip or hunch and not merely a suspicion. The information must exist before the opinion is formed. The authorised officer must actively apply his mind to the information in his possession and form an opinion that there are reasons to believe. Such opinion must be formed on the basis of the material available at that time. The materials must have rational nexus or bearing to the reasons for formation of the belief. Such formation of belief, through active application of mind, shall be bona fide and not actuated by mala fides, bias or extraneous or irrelevant materials.

However commissioner is the best judge for drawing an inference from the information available to him. Merely because the name of one enterprise was mentioned wrongly or because it is believed that the information may be exaggerated or it might be prompted by rumour or gossip, his decision cannot be challenged as long as he has applied his mind to the information and formed an opinion without mala fides, bias or extraneous or irrelevant considerations. It was found that the search was authorised on the basis of two newspaper reports and further discreet enquiries on the spot, besides information showing receipts by way of slips rather than cash memos indicating large scale cash transactions. There was justification for the issue of notice, so that the writ petition filed by the assessee was liable to be dismissed. At the same time, the High Court required the authorities to return the documents, which were no longer necessary and to pass a reasoned order after giving adequate opportunity. It follows that the exercise of such powers cannot be lightly questioned.

263 ITR 0161- KECHERY SERVICE CO-OPERATIVE BANK LTD. VS. CIT (KER)

The object of section 133(6) as explained by the Central Board of Direct Taxes in its circular shows that the legislative intention was to give wide powers to the officers, of course, with the permission of the Commissioner of Income-tax or the Director of Investigation to gather general particulars in the nature of

survey and store those details in the computer so that the data so collected can be made use of for checking evasion of tax effectively. It is clear that it is not a condition for the issuance of a notice under section 133(6) of the Act that any proceedings under the Act against the person with respect to whom the information is called for should be pending. The only limitation is that before issuing a notice requiring a banking company to furnish information in respect of such points or matters as may be useful or relevant it is necessary to get the prior approval of the Director or the Commissioner, as the case may be. Notices were issued to certain co-operative societies and co-operative banks calling for information such as a list of persons, who had made term/recurring deposits of Rs. 50,000 and above as on date along with their complete postal addresses, etc. Held, that, The notices were valid.

AUTHORITY OF ADVANCE RULING

Section – AAR

268 ITR 0029- CONNECTEURS CINCH S.A., IN RE VS. (AUTHORITY FOR ADVANCE RULING)

The applicant, a non-resident foreign company in France, had a wholly owned Indian subsidiary which manufactured various types of electronic connectors. Upon the Indian subsidiary being allowed to set up a unit in a hardware technology park and its existing factory being bonded by the Customs Authority, the foreign company intended to make a substantial investment in the unit. It applied to the Authority for a ruling on whether the Indian company would be entitled to exemption under section 10A, for the period from March 18, 2002, to March 31, 2010. The Authority rejected the application on the ground that an advance ruling had to be in relation to a transaction undertaken or proposed to be undertaken by a non-resident applicant. The tax exemption of the Indian subsidiary was not a consequence of a transaction undertaken or proposed to be undertaken by the non-resident applicant and the application was, therefore, not maintainable.

285 ITR 0001- RASHTRIYA ISPAT NIGAM LTD., IN RE VS. (AUTHORITY FOR ADVANCE RULING)

After the extension of the jurisdiction of the Authority for Advance Rulings to disputes relating to public sector undertakings, an application as to the manner of set off of past losses/ depreciation to arrive at the taxable book profit under section 115JB was raised in Rashtriya Ispat Nigam Ltd., In re 285 ITR 1 (AAR). It was not in dispute that the loss or depreciation, whichever is less, alone should be reduced from the current book profits to arrive at the taxable profits. If the lesser of the two is taken in a year, such amount could have been exhausted to that extent for future set off, so that the set off provision loses its effectiveness for the taxpayer for later years, since only the remaining loss on depreciation being the lesser amount is admissible. Such an interpretation appears to be harsh in the case of a company with eroded capital not in keeping with the objective of taxing only prosperous companies with no taxable statutory income, and which avoid tax in the hands of shareholders by not distributing the dividend. The Assessing Officer set off the depreciation, which was lower, on a continuing basis, while the assessee would like the set off provisions to be applied afresh for each year, as though it is the first year reducing what is already set off only against total loss including depreciation. The assessee's method is fair and consistent with the objective and probably not ruled out specifically in the statute, so that the benefit of its interpretation should be available to it.

RASHTRIYA ISPAT NIGAM (AAR)

MAT, BOOK PROFITS



C/F, SET OFF, AS PER
GENERALLY ACCEPTED A/C

APPEALS

Section: 246 to 255

273 ITR 0119- TSAI TEA ENTERPRISES (P.) LTD. VS. COMMISSIONER OF INCOME-TAX (CAL)

An order giving effect to an appellate order can be the subject matter of further appeal only to the extent to which the order giving effect travels beyond the finding in the appellate order. There cannot be a review of matters which are already concluded in the appellate order.

288 ITR 0278- BIMAL KUMAR ANANT KUMAR VS. COMMISSIONER OF INCOME-TAX (ALLAHABAD HIGH COURT)

Additional evidence can be filed along with an application stating the reason for filing such additional evidence. A party cannot file any additional document as a matter of right which was not before the authorities below. An application has to be filed seeking leave of the Tribunal to bring on record the additional evidence.

Apart from the fact that the stock register was not produced by the assessee, the profits were also low as compared to other assessees dealing in the same trade coupled with the fact that the assessee had voluntarily surrendered a sum of Rs. 30,000 appearing as deposit in the name of V in its books of account as it was not in a position to explain the same and, therefore, the trading result disclosed by the assessee had rightly not been accepted. The Tribunal was justified in sustaining the ad hoc addition of Rs. 13,000.

TRANSFER PRICING

Section 92

288 ITR 0052- SONY INDIA P. LTD. VS. CENTRAL BOARD OF DIRECT TAXES (DELHI HIGH COURT)

The Central Board of Direct Taxes had issued instructions for computation of income from international transactions having regard to arm's length price by Instruction No. 3 of 2003 dated May 20, 2003, [2003] 261 ITR (St.) 51. This was challenged on the ground that the classification of assessee as those with such turnover below and above Rs. 5 crores was not within the powers of the Board under section 119. Further, the creation of a Transfer Pricing Officer, it was alleged, is unconstitutional, since it supplants and curtails the jurisdiction of the Assessing Officer. The High Court in Sony India P. Ltd. v. Central Board of Direct Taxes [2007] 288 ITR 52 (Delhi) considered the objections elaborately, while upholding the constitutionality of the Instruction.

The High Court found that instructions are based on correct interpretation of relevant provisions of the Act, so as to guide the Assessing Officer. The classification is on a recognisable basis having nexus with the objectives of the provisions. As for the creation of the Transfer Pricing Officer, the intention is not to supplant the judicial discretion of the Assessing Officer, but to assist the Assessing Officer. It was also pointed out that circulars can be reviewed in the light of the working of the provisions, so that these are not final. The role of the Transfer Pricing Officer is to collect a data base of different cases, so that it will be a useful guide. The challenge was, therefore, found to be not sustainable for any of the reasons urged on behalf of the petitioner.

OTHERS

243 ITR 0143- KARAMCHARI UNION VS. UNION OF INDIA (SC)

In view of this specific inclusion and exclusion in the meaning of the word “income” and “salary”, the payment received by an employee has no connection with the profits of the employer. The word “profits” is used only to convey any “advantage” or “gain” by receipt of any payment by the employee. Webster’s Comprehensive Dictionary gives the meaning of the word “profit”, inter alia, as advantage or benefit. Applying the general meaning of the word “profits” and considering the dictionary meaning given to it under sections 17(1), it can be said that “advantage” in terms of payment of money received by the employee from the employer in relation or in addition to any salary or wages would be covered by the inclusive definition of the word “salary”. Because of the inclusive meaning given to the phrase, “profits in lieu of salary” would include “any payment” due to or received by an assessee from an employer, even though it has no connection with the profits of the employer.

243 ITR 0383 V.M. SALGAOCAR AND BROS. PVT. LTD. VS. CIT (SC)

Income-tax Officer found that the assessee, which was a company, was borrowing large sums by paying interest at 15 per cent. per annum. This interest was claimed by the assessee as deductible expenditure. The Income-tax Officer found that the directors of the assessee-company were drawing amounts from the company without paying interest. He, therefore, held that, to the extent of the interest that the company could have charged, a benefit was granted to the directors and hence the said amount of interest on the amount advanced to the directors was not to be deducted as an expenditure and will also constitute the perquisite in the hands of the director.

Appellate Tribunal observed no evidence had been led by the Revenue to show that the borrowed funds were directly diverted for the benefit of the directors and that non-charging of interest on the debit balance in the running account would not amount to providing a perquisite. The High Court, observed that it was impossible to expect the Revenue to prove that the monies lent to the directors were from the borrowed monies because ordinarily the funds borrowed by a company would fall within the hotchpot and intermingle with its own funds, and held in favour of the Department although, by an earlier order in the case of the same company the High Court had confirmed the deletion of the addition made on account of non-charging of interest on debit balances of the directors. This order was appealed before the supreme court.

Supreme court observed that when high court said that it was impossible to expect proof from the Revenue that the monies that were advanced to directors were monies that were borrowed monies, the High Court had gone beyond the finding of the Appellate Tribunal which was not permissible. Keeping in mind the circulars of the Central Board of Direct Taxes, non-charging of interest on the debit balance in the running account of the directors would not constitute a perquisite and would not be subject to disallowance.

In assessments of a director of the same company, the Income-tax Officer held that non-charging of interest on his debit balance with the company would amount to a perquisite in the hands of the director within the meaning of section 17(2) of the Act. He computed the value of the perquisite at the rate of 15 per cent. of the debit balance standing in the name of the director in the accounts of the company and brought the same to tax in the hands of the assessee-director. Held in the supreme court that non-charging

of interest could not be regarded as being a perquisite in the hands of the employee-directors who were advanced interest-free loans by the company.

QUESTION THAT CAN BE SET IN AN EXAMINATION CONDITION

Assessee which was a company, was borrowing large sums by paying interest at 15 per cent. per annum. This interest was claimed by the assessee as deductible expenditure. The Income-tax Officer found that the directors of the assessee-company were drawing amounts from the company without paying interest. He, therefore, held that, to the extent of the interest that the company could have charged, a benefit was granted to the directors and hence the said amount of interest on the amount advanced to the directors was not to be deducted as an expenditure and will also constitute the perquisite in the hands of the director. You are required to state whether the opinion of the officer is justified or not.

ANSWER

Supreme court observed in case of [2000] 243 ITR 0383- V.M. SALGAOCAR AND BROS. PVT. LTD. VS. COMMISSIONER OF INCOME-TAX (SC) that when high court said that it was impossible to expect proof from the Revenue that the monies that were advanced to directors were monies that were borrowed monies, the High Court had gone beyond the finding of the Appellate Tribunal which was not permissible. Keeping in mind the circulars of the Central Board of Direct Taxes, non-charging of interest on the debit balance in the running account of the directors would not constitute a perquisite and would not be subject to disallowance.

254 ITR (STAT) 0241- CIRCULAR NUMBER: 02

OLD SYSTEM OF TAXING DEEP DISCOUNT BOND

A review of the tax treatment of income arising from Deep Discount Bonds has been under consideration in the Board for some time. The Board had earlier clarified by way of certain letters issued to the Reserve Bank of India and others that the difference between the bid price (subscription price) and the redemption price (face value) of such bonds will be treated as interest income assessable under the Income-tax Act. On transfer of the bonds before maturity, the difference between the sale consideration and the cost of acquisition would be taxed as income from capital gains where the bonds were held as investment, and as business income where the bonds were held as trading assets. On final redemption, however, no capital gains will arise. It was further clarified that tax would be deducted at source on the difference between the bid price and the redemption price at the time of maturity.

PROBLEMS INVOLVED IN OLD SYSTEM OF TAXATION

- 1) Taxing the entire income received from such a bond in the year of redemption as interest income gives rise to a sudden and huge tax liability in one year whereas the value of the bond has been progressively increasing over the period of holding.
- 2) Where the bond is redeemed by a person other than the original subscriber, such person becomes taxable on the entire difference between the bid price and the redemption price as interest income, since he is not able to deduct his cost of acquisition from such income.
- 3) A company issuing such bonds and following the mercantile system of accounting may evolve a system for accounting of annual accrual of the liability in respect of such a bond and claim a deduction in its assessment for each year even though the corresponding income in the hands of the investor would be taxed only at the time of maturity.
- 4) Taxing the entire income only at the time of maturity amounts to a tax deferral.

NEW SYSTEM OF TAXING DEEP DISCOUNT BONDS

GENERAL TREATMENT

Every person holding a Deep Discount Bond will make a market valuation of the bond as on the 31st March of each financial year (the valuation date) and mark such bond to such market value in accordance with the guidelines issued by the Reserve Bank of India for valuation of investments.

In a case where the bond is acquired during the year by an intermediate purchaser (a person who has acquired the bond by purchase during the term of the bond and not as original subscription)

Transfer before maturity

Where the bond is transferred at any time before the maturity date,

Holding Period

Redemption

Where the bond is redeemed by the original subscriber

The difference between the market valuations as on two successive valuation dates will represent the accretion to the value of the bond during the relevant financial year and will be taxable as interest income (where the bonds are held as investments) or business income (where the bonds are held as trading assets).

The difference between the market value as on the valuation date and the cost for which he acquired the bond, will be taxed as interest income or business income, as the case may be, and no capital gains will arise as there would be no transfer of the bond on the valuation date.

The difference between the sale price and the cost of the bond will be taxable as capital gains in the hands of an investor or as business income in the hands of a trader. For computing such gains, the cost of the bond will be taken to be the aggregate of the cost for which the bond was acquired by the transferor and the income, if any, already offered to tax by such transferor up to the date of transfer.

Since the income chargeable in this case is only the accretion to the value of the bond over a specific period, for the purposes of computing capital gains, the period of holding in such cases will be reckoned from the date of purchase/subscription, or the last valuation date in respect of which the transferor has offered income to tax, whichever, is later. Since such period would always be less than one year, the capital gains will be chargeable to tax as short-term capital gains.

The difference between the redemption price and the value as on the last valuation date immediately preceding the maturity date will be taxed as interest income in the case of investors, or business income in the case of traders.

Where the bond is redeemed by an intermediate purchaser

The difference between the redemption price and the cost of the bond to such purchaser will be taxable as interest or business income ; as the case may be. For this purpose, again, the cost of the bond will mean the aggregate of the cost at which the bonds were acquired and the income arising from the bond which has already been offered to tax by the person redeeming the bond.

THIS GUIDELINES IS NOT APPLICABLE FOR SMALL INVESTORS (AT OPTION)

Considering the difficulties which might be faced by small non-corporate investors in determining market values under the RBI guidelines and computing income taxable in each year of holding, it has further been decided that such investors holding Deep Discount Bonds up to an aggregate face value of rupees one lakh may, at their option, continue to offer income for tax in accordance with the earlier clarifications.

Membership Type	1	2	3
Membership Name	Free	DT	IDT
Description	Wealth Tax (excluding valuation rules and questions / answers.)	Direct Taxes for CA final (Includes membership type 3) (also included 130 + Class work problems and solution)	Indirect taxes of CA final. (included +100 Class work problems and solution)
Hours of video access Granted	5 Hrs	100 Hrs	75 Hrs
Membership commence (May 2011 Exam)	16 th May	16 th May	16 th May
Fair Usage of Hours for attending all lectures for given subject once. (approximately in this many hours once all lectures can be attended, some extra time is given considering revision of any chapters that may be required. Particularly for DT if students attend basic topics of IPCC lectures also when we post from time to time then students will have to buy more hours at additional cost.)	5 Hrs	100 Hrs	65 Hrs
Time of Access / Viewing (You can access the lectures any time with user name and password. Subject to your membership expiry date and hours of usage.)	24/7	24/7	24/7
Download of video files (Video files are copy right protected, It is not allowed to be downloaded. User must not copy or distribute it any manner what so ever, audio or video or both.)	Yes (Selected Files Only)	No	No
Viewing online (You must be connected to internet with at least broadband connection. You can also access these lectures with help of smart mobile phone if it supports Java and gives you speed of 384 kbps minimum.)	Yes	Yes	Yes
Web meeting with professor (From time to time it will be scheduled for solving doubt and important discussion.)	No	Yes	Yes
E-mail support for handling queries (generally accepted response time of 48 hours.)	No	Yes	Yes
Maximum time each video can be Logged in. (This limit is kept for security purposes. Video Logged in for less then 3 min is not counted for this purpose.)	10	10	10
Fees (Including taxes if any) (Not Refundable in any circumstances.)	Rs. Nil	Rs. 15,500	Rs. 12,500
Charges for additional hours (if required).	Not available	100 P/hr	100 P/hr
Membership Activation time. (You can Commence online lectures any time, you are never too late for classes.)	automatic	48 Hours of payment.	48 Hours of payment.
Study notes in softcopy provided for download. (*likely to be provided.)	No	Yes	No*

Membership expiry for May 2011 exam (Respective hours or this date whichever is earlier.)	No	18 th May	18 th May
New Batch for Nov 2011 Online lectures commence for May 2011 students of CA final.	20 th May	20 th May	20 th May
Copy right protected	Yes	Yes	Yes

Amount of fees can be deposited in HDFC bank account name : **“Education Unlimited A/c No. 04232000004324”** (Bank code if required : 400240056 – 004827 – 11, Novelty cinema branch, mumbai.) if you are paying by demand draft then it should be in favour of **“Education Unlimited A/c No. 04232000004324”** payable at Mumbai.

Part B

Various Legal issues
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SCOPE OF THE WORD PLANT

Scope of the word Plant from Income tax point of view.

Relevant Provision of the Law

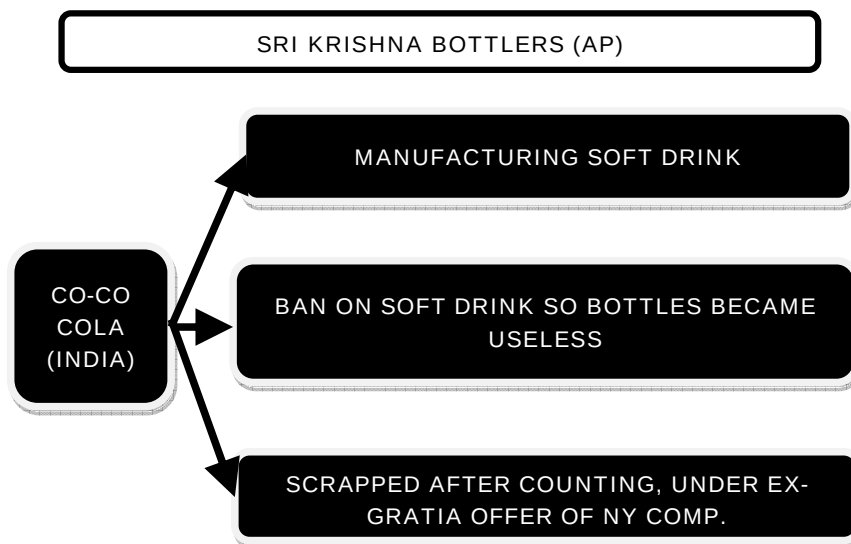
Section 43 (3) Defines the word "plant" that includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of the business or profession but does not include tea bushes or livestock.

Test and Following points is to be kept in mind in relation to the definition of Plant.

1. The word "plant" is to be given a "very wide" meaning. In its ordinary sense, it includes whatever "apparatus" is used by a businessman for carrying on his business but it does not include his stock-in-trade which the tradesman keeps for permanent employment in his business.
2. But the building or the "setting" in which the business is carried on cannot be plant.
3. The thing need not be part of the machine used in the manufacturing process but could be merely an "apparatus" used in carrying on the business but having a "degree of durability".
4. Merely because the asset has a passive function in the carrying on the business, it cannot be said that it is not plant. It may have a passive or an active role.
5. The subject must have a function in the trader's operation and if it has, it is prima facie a plant unless there was good reason to exclude it from that category. It must be a "tool in the trade" of the businessman.
6. Gross materiality or tangibility is not necessary and, in fact, intangible things like ideas and designs contained in a book could be "plant". They fall under the category of "intellectual storehouse".
7. The functional test is a decisive test.

Scientific Engineering House (SC) 157 ITR 86 [A land Mark case] [1986]

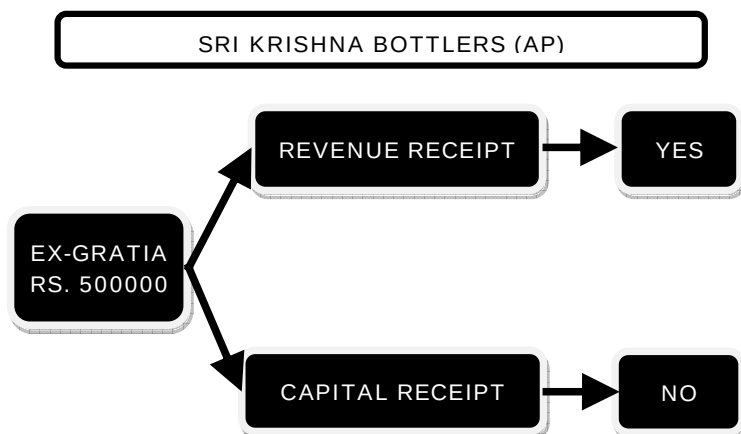
- "plant" was not necessarily confined to an apparatus which was used for mechanical operations or process or was employed in mechanical or industrial business. But in order to qualify as "plant", the particular article had to have some degree of durability. The test to be applied was: Did the article fulfill the function of a plant in the assessee's trading activity? Was it a tool of his trade with which he carried on his business? If the answer was in the affirmative, it would be a "plant".
- The drawings, designs, charts, plans, processing data and other literature comprised in the "documentation service" as specified in clause 3 constituted a "book" and fell within the definition of "plant" in section 43(3) of the Income-tax Act, 1961.
- The capital asset acquired by the appellant, viz., the technical know-how in the shape of drawings, designs, charts, plans, processing data and other literature, fell within the definition of "plant" and was, therefore, a depreciable asset.

Sri Krishna Bottlers (P) Limited (AP) 175 ITR 154 [1989]

The bottles were essential tools of the trade for it was through them that soft drink was passed on from the assessee to the customer. Without the bottles and shells, the soft drink could not be effectively transported. The bottles and their contents were totally interdependent. So were the shells. The bottles and shells also satisfied the durability test because it was nobody's case that their life was so transitory or negligible to warrant an inference that they

had no function to play in the assessee's trade. They were, therefore, "plant" for purposes of the Income-tax Act, and the assessee was entitled to depreciation in respect of them

Special Leave Petition was made by department on the point that, whether Bottles and crates are "plant" and Whether entitled to depreciation, Court dismissed a special leave petition to appeal against the order of the Andhra Pradesh High Court rejecting a reference application, following 175 ITR 154, on the question whether bottles and crates belonging to the assessee, a dealer in soft drinks, were "plant" and entitled to depreciation under section 32.

**Steel City Beverages (P) Limited (Pat) 222 ITR 0744 [1996]**

The assessee, a private limited company, which derived income from sale of cola, soda and ice boxes, claimed depreciation of Rs. 29,55,813 on bottles at 100 per cent under section 32(1)(ii) of the Income-tax Act, 1961, as the purchase price of each bottle was less than Rs. 750. The Income-tax Officer disallowed the depreciation on the ground that bottles could not be considered as plant. On appeal, the Commissioner of Income-tax (Appeals) held that the bottles purchased by the assessee constituted plant under section 43(3) and allowed 100 per cent. depreciation. Accepted by the court.

Saurashtra Bottling Pvt Ltd. (Guj) 232 ITR 270 [1998]

The expression "plant" has not been extensively defined and section 43(3) of the Income-tax Act, 1961, provides only an inclusive definition, which has the effect of adding items mentioned thereunder to the meaning of the word "plant" as understood in its ordinary sense. The assessee claimed that these bottles and crates were "plant" within the meaning of section 43(3) of the Act, and since the cost of each

individual item was below Rs. 750, depreciation at 100 per cent. should be allowed to the assessee-company. The Income-tax Officer allowed the claim of the assessee. The Commissioner of Income-tax, in exercise of his powers under section 263 of the Act, set aside the assessment order with a direction to the Income-tax Officer to reframe the assessment in which bottles and crates were not considered to be plant. The Tribunal held that the bottles and crates constituted plant and were entitled to 100 per cent. depreciation as the cost of each bottle and crate was less than Rs.750. **The Revenue contended that the bottles and crates should be treated as supplies or stock-in-trade:** Held, That the bottles and crates remained in the ownership of the assessee and they were not intended to be sold when the soft drinks were supplied to the purchasers who were required to return them to the assessee. Having regard to the wide import of the word “business” when these bottles and shells (crates) were used for bottling soft drinks so that they could be supplied to the purchasers, they were obviously used as tools for the purpose of business of the assessee. Bottles and crates were used for the purposes of his business as a tool of the assessee’s trade and were, therefore, plant and the assessee would be entitled to depreciation on them.

General Opinion of other courts :

Many other court have also held that bottles and shells could be regarded as Plant for the income tax purpose. However Recently SC has held that bottles and shells shall not be regarded as plant. The final words are as follows.

[1999] 235 ITR 0131[SC] State of Bihar v. Steel City Beverages Ltd.

Judgement is actually in relation to SSI unit but the concept is laid down. **In respect of an industry, manufacturing soft drinks and beverages, it can be said that plant would mean that apparatus which is used for manufacturing soft drinks or beverages and not articles like crates and bottles used for storing the manufactured product.** In calculating the value of plant and machinery, the cost of storage tanks which store raw materials/finished products only and which are not linked with the manufacturing process shall be excluded. The Government of India again issued a circular, after having received representations from the industry seeking clarification whether bottles and crates are to be taken into account for determining the SSI status of the units engaged in the manufacture of soft drinks/concentrates, clarifying that investment in bottles and crates in such units is in the nature of storage of finished products and, therefore, such investment has to be excluded while computing the value of plant and machinery.

[1979] 117 ITR 15 Commissioner of Income-tax Vs. Warner Hindustan Ltd. (AP)

The definition of "plant" in section 43(3) is of wide amplitude so as to take in even a well, provided that the well was dug for the purpose of carrying on the business of the assessee.

The assessee had to dig a well in the factory premises and install a pumping set for pumping water to the factory as there was no adequate supply of water by the Corporation to the factory. It is his case that without digging that well, it would have been well nigh impossible for the assessee to carry on its business of manufacturing pharmaceuticals. In other words, it is his case that the well is part and parcel of the plant without which it would not be possible for the assessee to manufacture pharmaceuticals.

The Supreme Court earlier construed in case of Taj Mahal Hotel's case [1971] 82 ITR 44 the expression "plant" as having a wider meaning. In that view, it held that the sanitary and pipeline fittings fell within

the definition of "plant". There can be no doubt that it was not the intention of the legislature to restrict the meaning of "plant".

[2000] 243 ITR 81 Commissioner of Income-tax Vs. Dr. B. Venkata Rao (SC)

Assessee's nursing home was equipped to enable the sterilisation of surgical instruments and bandages to be carried on. It was reasonable to assume in the circumstances, particularly having regard to the Tribunal's order which stated that the sterilisation room covered about 250 sq. ft. that the nursing home was also equipped with an operation theatre. In the circumstances, the assessee was entitled to depreciation on the nursing home building on the ground that it was a "plant".

[2000] 244 ITR 192 Commissioner of Income-tax Vs. Anand Theatres (SC)

The scheme of section 32 of the Income-tax Act, 1961 unequivocally leads to the conclusion that building and plant are treated separately for the purpose of grant of depreciation. A higher rate of depreciation is granted to machinery and plant as against buildings which have more durability. The word "plant" is given an inclusive meaning under section 43(3) which nowhere includes buildings. In the context of the legislative scheme under section 32, even though the word "plant" may include building or structure in certain set of circumstances as per the dictionary meaning, to say that a building used for running the business of hotel or a cinema would be "plant" under the Act would be inconsistent with the provisions of section 32 and the legislative intent. There is well established distinction, in general terms, between the premises in which the business is carried on and the plant with which the business is carried on. The premises are not plant. It is proper to consider the function of the item in dispute. If it functions as part of the premises it is not plant. The fact that the building in which a business is carried on is, by its construction particularly well suited to the business, or indeed was specially built for that business, does not make it plant. Its suitability is simply the reason why the business is carried on there. But it remains the place in which the business is carried on and is not something with which the business is carried on, except in some rare cases where it plays an essential part in the operations which take place. Hotel premises are not considered to be an apparatus or tool for running the hotel business but are merely a shelter or home or setting in which business is carried on. The same would be the position with regard to a theatre in which cinema business is carried on. Therefore, even the functional test is not satisfied.

A characteristic of plant is that it is an adjunct to the carrying on of a business and not the essential site or core of the business itself. Therefore, a hotel or cinema building cannot be stated to be an adjunct to the carrying on of the business, that is to say, something added to another, or which is in a subordinate, auxiliary or dependent position.

Dictionary meanings however helpful in understanding the general sense of the words cannot control where the scheme of the statute or the instrument considered as a whole clearly conveys a somewhat different shade of meaning. Words have to be so construed as to fit in with the idea which emerges on a consideration of the entire context. The meanings of the words "building" and "plant" have to be gathered in the context of the scheme of section 32 and it is not necessary to adopt a judge-made sense, which is artificial and imprecise in application.

TWO FIRMS WITH SAME PARTNERS

Two partnership firms with the same partners, and same profit sharing ratio, whether assessment to be clubbed ?

[1985] 155 ITR 0158A CST (Deputy) vs. Kelukutty (K.) (SC) (A land mark case)

For determining whether there is a firm, the officer assessing a tax has to apply the partnership law, subject, of course, to any specific provision in that regard in the tax law modifying the partnership law. If the tax law is silent, it is the partnership law only to which he will refer. It will all depend on the intention of the partners. The intention of the partners will have to be decided with reference to the terms of the agreement and all surrounding circumstances, including evidence as to the interlacing or interlocking of management, finance and other incidents of the respective businesses. The firm name is only a collective name for the individual partners. But each partnership is a distinct relationship.

[1976] 104 ITR 0028- CIT (Addl) vs. Venkata Narasimha Rao (M.) and Co. (Andhra Pradesh High Court) (Over Ruled)

Judicial Member of ITAT found that there is no legal bar for the existence of two firms with identical partners and there is no interlacing of finances between the two firms, the Accountant Member held that the businesses carried on by the two firms are different--held that the two firms were entitled to two separate assessments in respect of their incomes.

Held: If there are two firms consisting of exactly the same partners but carrying on separate businesses, the real position in law is that there is only one firm and the incomes in the hands of both the firms should be aggregated in one assessment. Partnership firm is treated as a distinct unit apart from its partners, for the purpose of the Income-tax Act, 1961, as in the case of Hindu undivided family, association of persons and body of individuals, this does not invest the partnership with a juristic personality.

[1999] 236 ITR 0350 - CIT vs. Parthasarathy Naidu (G.) and Sons (SC)

In the instant case, the two partnerships constituted by different partnership deeds carried on different businesses. Though they had the same partners their shares were different. It was clearly specified that the business of one partnership shall not be deemed to be part and parcel of the other. There was no interlacing or inter-locking between the two firms. As it is well-settled that it is open to any person to arrange his affairs by adopting legal device to reduce his tax liability to the minimum under the law, in the absence of prohibition in any law for creation or existence of two partnership firms with the same set of partners, the assessment of such firms cannot be clubbed and one assessment cannot be made merely because the partners are the same in both the firms. Though the question whether a firm is genuine or bogus or benami is a pure question of fact, that must be considered.

Conclusion: Assessment cannot be clubbed merely because Partners in both the firms are the same.

TAX TREATMENT OF REDUCTION IN SHARE CAPITAL

Whether scheme of reduction in share capital give rise to Capital Gains within the scope of section 45.
AND Whether section 2(22)(d) is attracted when the scheme of reduction is implemented.

Relevant Provision of Law, Definition of the word transfer u/s 2(47), in relation to a capital asset, includes,

- (i) The sale, exchange or relinquishment of the asset ; or
- (ii) The extinguishment of any rights therein ; or

(Relevant portion of definition is reproduced above)

Dividend U/s 2(22)(d)

any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April, 1933, whether such accumulated profits have been capitalised or not ;

[1997] 224 ITR 0422- Anarkali Sarabhai vs. CIT (S C)

Before the decision of Supreme court Bombay HC was of the opinion :

When a company redeems its preference shares what in effect and substance it does is to purchase back its shares. Reduction of share capital amounts to purchase of its own shares by the company. It may be that the redeemable preference shares have some features which are common with debentures but legally they are shares. Even if redemption of shares is not held to be a sale of shares to the company there is an extinguishment of the rights in the redeemed shares in that all the rights which the shareholder possessed in the preference shares come to an end as a result of the redemption of the shares.

A preference shareholder has three rights, namely, (i) right to receive dividend, (ii) right to attend the meetings and vote, where any decision affecting his right is taken, and (iii) right to receive back his capital. All these three rights come to an end. Hence when a company redeems the preference shares held by an assessee there is a "transfer" within the meaning of section 2(47) which would attract section 45.

Held in the SC that:

When a preference share is redeemed by a company, what the shareholder does in effect is to sell the share to the company. The company redeems its preference shares only by paying the preference shareholders the value of the shares and taking back the preference shares. In effect, the company buys back the preference shares from the shareholders. If redemption of preference shares did not amount to sale, it would not have been necessary, in section 77 of the Companies Act, 1956, to specifically provide that the restriction imposed upon a company in respect of buying its own shares will not apply to redemption of shares issued under section 80 of that Act. The redemption of preference shares by a

company, therefore, **is a sale** and squarely comes within the phrase "sale, exchange or relinquishment" of an asset in section 2(47)(i) of the Income-tax Act, 1961.

[1997] 228 ITR 0163A Kartikeya vs. Sarabhai v. CIT (S C)

When as a result of the reducing of the face value of the share, the share capital is reduced, the right of the preference shareholder to the dividend on his share capital and the right to share in the distribution of the net assets upon liquidation is extinguished proportionately to the extent of reduction in the capital. Such reduction of the right in the capital asset would clearly amount to a transfer within the meaning of that expression in section 2(47) of the Income-tax Act, 1961.

Sale is only one of the modes of transfer envisaged by section 2(47) of the Act. Relinquishment of the asset or extinguishment of any right in it, which may not amount to a sale, can also be considered as a transfer and any profit or gain which arises from the transfer of a capital asset is liable to be taxed under section 45. A company, under section 100(1)(c) of the Companies Act, 1956, has a right to reduce the share capital and one of the modes which can be adopted is to reduce the face value of the preference shares.

This court examined the question of capital gains in the context of an amount received by a shareholder from a company on reduction in the face value of shares on account of a reduction in the share capital of the company. This court said that it is not necessary for a capital gain to arise that there must be a sale of a capital asset. Relinquishment of the asset or extinguishment of any right in it, which may not amount to a sale, can also be considered as a transfer. Any profit or gain which arises from the transfer of a capital asset is liable to be taxed under section 45. As a result of a reduction in the face value of the share, the share capital is reduced, the right of the shareholder to the dividends and his right to share in the distribution of the net assets upon liquidation, is extinguished proportionately to the extent of reduction in the capital. Even though the shareholder remains a shareholder, his right as a holder of those shares stands reduced with the reduction in the share capital. Therefore, this extinguishment of right is a transfer. The amount received by the assessee for such reduction is liable to capital gains under section 45. The court followed an earlier decision of this court in *Anarkali Sarabhai Ltd. v. CIT* [1997] 224 ITR 422.

IN THE SAID CASE COURT DID NOT CONSIDER THE APPLICABILITY OF SECTION 2(22)(d) BECAUSE THAT WAS NOT THE QUESTION BEFORE IT, THIS WAS CONSIDER IN THE CASE BELOW OF CIT vs. Narasimhan (G.)(Decd.).

[1999] 236 ITR 0327 CIT vs. Narasimhan (G.)(Decd.) (Supreme Court of India)

However, in the case of *Kartikeya V. Sarabhai v. CIT* [1997] 228 ITR 163, this court did not consider the provisions of section 2(22)(d) in the context of capital gains arising on a reduction of the share capital. Under section 2(22)(d) any distribution to its shareholders by a company on the reduction of its capital, is deemed to be a distribution of dividend to the extent that the company possesses accumulated profits whether such profits have been capitalised or not. Therefore, any distribution which is made by a company on a reduction of its share capital which can be correlated with the company's accumulated profits (whether capitalised or not), will be dividend in the hands of the assessee. Therefore, it will have to be treated as income of the assessee and taxed accordingly.

Assessee in the present case had been paid not merely cash but had also been given a property for the reduction in the value of his shares from Rs. 1,000 to Rs. 210. Out of the total amounts so received including the value of the property so received, the portion attributable to accumulated profits had to be deleted. Only the balance amount could be treated as a capital receipt. Thereafter looking to the cost of acquisition of that portion of the share which had been diminished, capital gains would have to be determined.

CONCLUSION :

In the Reduction of capital by company face value of shares reduces, Amounts distributed to shareholders as a result of reduction has two components (i) distribution attributable to accumulated profits, and (ii) distribution attributable to capital Part attributable to accumulated profits is assessable as dividends and balance subject to capital gains tax.

EXPENDITURE ON ISSUE OF CONVERTIBLE DEBENTURES

Relevant Provision of Law : Section 37(1)

Any expenditure (not being expenditure of the nature described in sections 30 to 36 and **not being in the nature of capital expenditure** or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession”.
Explanation.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.]

Since there is no specific provision for such expenditure it has been claimed under section 37(1) as general deduction. Also related questions are expenditure on issue of share capital, additional share capital, discount on debentures, expenditure on issue of debentures and of course the most vital question expenditure on convertible debentures. All this is discussed here in brief based on the light of some decided cases. The general principles applicable in determining whether a particular expenditure is capital or revenue expenditure are as follows:

- Outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment;
- Expenditure may be treated as properly attributable to capital when it is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade. If what is got rid of by a lump sum payment is an annual business expense chargeable against revenue, the lump sum payment should equally be regarded as a business expense, but if the lump sum payment brings in a capital asset, then that puts the business on another footing altogether
- Whether for the purpose of the expenditure, any capital was withdrawn, or, in other words, whether the object of incurring the expenditure was to employ what was taken in as capital of the business. Again, it is to be seen whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital.

[1966] 060 ITR 0052A India Cements Ltd. v/s. CIT (S C)

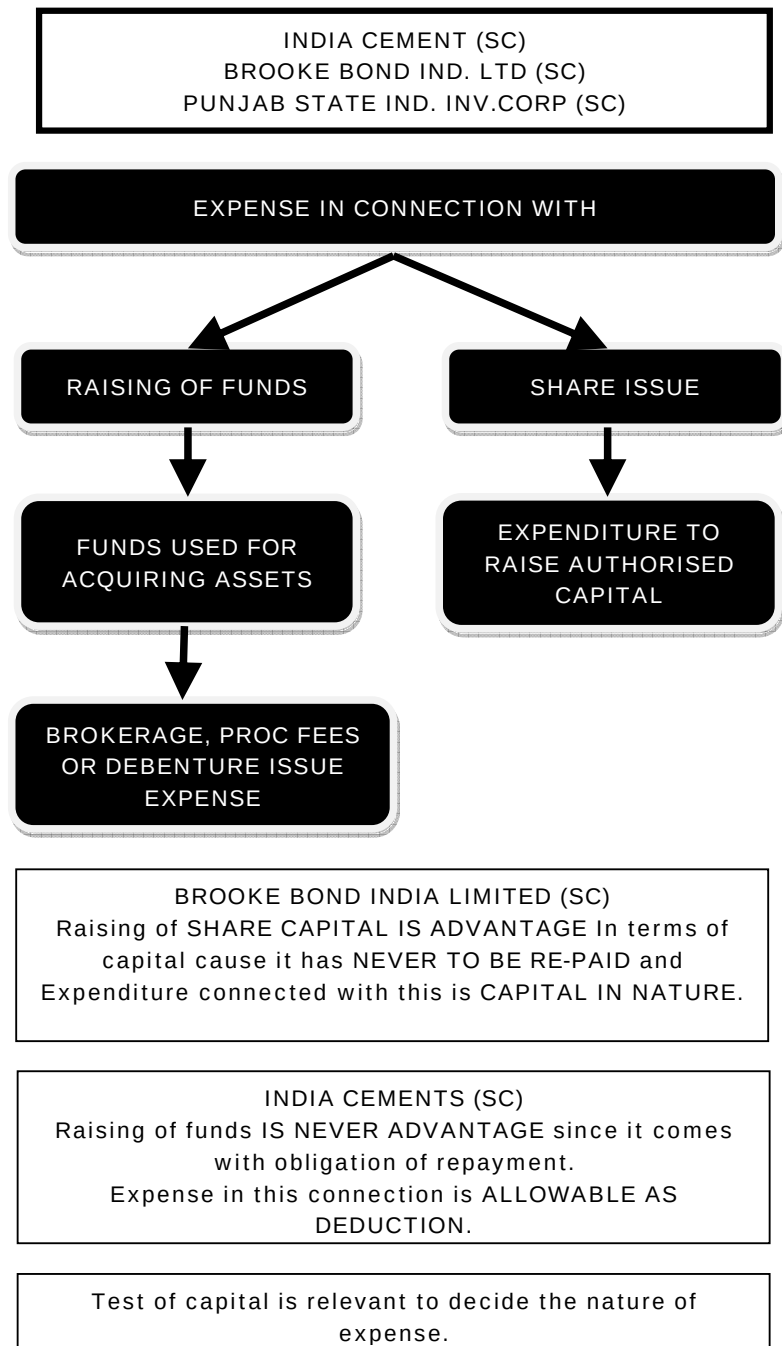
The act of borrowing money is incidental to the carrying on of business, the loan obtained is not an asset or an advantage of enduring nature, the expenditure made for securing the use of money for a certain period, and it was irrelevant to consider the object with which the loan was obtained. The appellant obtained a loan of Rs. 40 lakhs from the Industrial Finance Corporation secured by a charge on its fixed assets. In connection therewith it spent a sum of Rs. 84,633 towards stamp duty, registration fees, lawyer's fees, etc., and claimed this amount as business expenditure. Held that the amount spent was not in the nature of capital expenditure and was laid out or expended wholly and exclusively for the purpose of the assessee's business and was therefore allowable as a deduction.

In principle, apart from any statutory provisions, there is no distinction between interest in respect of a loan and an expenditure incurred for obtaining the loan. The nature of the expenditure incurred in raising a loan would not depend upon the nature and purpose of the loan. The purpose for which the loan was required is irrelevant to the consideration of the question whether the expenditure for obtaining the loan is revenue expenditure or capital expenditure

225 ITR 0798- BROOKE BOND INDIA LTD. VS. CIT (S C)

When an expenditure is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital. But this is not a strait-jacket formula and the question will have to be determined in the backdrop of the facts of each case. The test laid down can at best be a guide for determining whether a particular expenditure forms part of revenue expenditure or capital expenditure.

Where the object of incurring an expenditure is to affect the capital structure as a result of which certain incidental advantage flows, the expenditure will be of capital nature. Expenditure incurred by a company in connection with issue of shares, with a view to increase its share capital, is directly related to the expansion of the capital base of the company, and is capital expenditure, even though it may incidentally help in the business of the company and in the profit-making.



[1997] 225 ITR 0802B Madras Industrial Investment Corpn. Ltd. vs. CIT (S C)

The question whether a particular expenditure is revenue expenditure incurred for the purpose of business must be determined on a consideration of all the facts and circumstances, and by the application of principles of commercial trading. When a company issues debentures at a discount, it incurs a liability to pay a larger amount than what it has borrowed. The liability to pay the discounted amount over and above the amount received for the debentures, is a liability which has been incurred by the company for the purposes of its business in order to generate funds for its business activities. The amounts so obtained by issue of debentures are used by the company for the purposes of its business. This would, therefore, be expenditure. Section 37(1) further requires that the expenditure should not be of a capital nature.

The appellant-company issued debentures in December, 1966, at a discount. The total discount on the issue of Rs. 1.5 crores amounted to Rs. 3 lakhs. For the assessment year 1968-69, the appellant-company wrote off Rs. 12,500 out of the total discount of Rs. 3 lakhs being the proportionate amount of discount for the period of six months ending with June 30, 1967, taking into account the period of 12 years which was the period of redemption and dividing the discount of Rs. 3 lakhs over the period of 12 years.

In other words ordinarily, revenue expenditure which is incurred wholly and exclusively for the purpose of business must be allowed in its entirety in the year in which it is incurred. It cannot be spread over a number of years even if the assessee has written it off in his books over a period of years. However, the facts may justify an assessee who has incurred expenditure in a particular year to spread and claim it over a period of ensuing years. Issuing debentures at a discount is one such instance, where although the assessee has incurred the liability to pay the discount in the year of issue of debentures, the payment is to secure a benefit over number of years. There is a continuing benefit to the business of the company over the entire period. The liability should, therefore, be spread over the period of the debentures

[1997] 063 ITD 0370- Banco Products (India) Ltd. vs. Deputy Commissioner of Income-tax (ITAT)

The assessee company offered 3 lacs Equity Shares of Rs. 10 each and 1,00,000 15% Partly Convertible Debentures of Rs. 100 each to the Public during the year under appeal. The objects of the public issue specified in the Prospectus issued by the assessee company were as follows Finance the capital expenditure of the company; Supplement the company's long term resources for working capital; and obtain listing of the Equity Shares and Debentures of the company on the stock exchange.

Assessee submitted that :

It was true that part of the borrowed funds were going to be converted into equity shares at a future date. That by itself, however, cannot change the characteristics of the receipts. Borrowings continued to remain borrowings till the end of the year. If that be so, expenditure incurred by the assessee would certainly be regarded as expenditure incurred on borrowing the funds. What might happen at a future date is an issue which is not relevant for the purpose of deciding this controversy.

Following facts emerge from the case that was notified and officers point of view:

- The Debenture issued as per terms of issue itself was liable to be converted into Equity Shares automatically and compulsorily without any further act or application on the part of such debenture holder.

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- The debenture holder or any subsequent transferee, before the date of conversion, has to hold such shares with the aforesaid condition of automatic and compulsory conversion having no choice or option in the matter.
 - The date and manner of such conversion was pre-determined and final at the date of issue of such debentures itself.
 - Further, although the date of conversion was a subsequent date, such convertible portion had characteristics of Equity Shares which becomes further clear from stipulation regarding augmentation of number of such shares by conversion in the event of issue of bonus shares prior to such conversion.
 - The further restriction on repurchase of such debenture prior to conversion makes it abundantly clear as such restriction was obviously self-imposed in view of provisions of section 77 of the Companies Act, 1956 prohibiting repurchase of its share capital from open market.

According to the officer it was clear that funds so obtained through the issue of Convertible Debentures were clearly identifiable as Equity Capital and loan funds from the very beginning and for all the time thereafter. The mere fact that such funds, temporarily for a brief period of about 6 months from the time of completion of formalities of allotment, were treated as raised against debenture with a mandatory condition of convertibility will not bestow on the entire funds, the characteristics of loan funds.

Held that :

The conversion of such debentures on the stipulated date leads to augmentation of the equity base of the company. In the case before us convertible debentures were clearly identifiable as Equity capital and issue relates to the expenditure on issue of partly convertible debentures and for the reasons discussed above, we hold that the proportionate expenditure on the convertible part of the debentures is for the augmentation of equity base of the company and as such has to be treated as capital expenditure.

Conclusion:

Exactly opposite decision exist of the Mumbai ITAT, that is of the opinion that in present assessee has acquired the loan in form of debentures and thus it is an expenditure in connection with raising of finance and must be regarded as revenue expenditure. What is expected to happen at a future date is of no relevance for the previous year in question.

COMPANIES IN LIQUIDATION

Whether section 178 of the Income-tax Act affects or alters the existing law of priority or overrides the provision of preferential payment provided in section 530 of the Companies Act. ??

NOW THE POSITION SETTLES

Relevant Provision of the Law. Company in liquidation. Section 178 of Income tax Act

(1) Every person (a) who is the liquidator of any company which is being wound up, whether under the orders of a court or otherwise; or (b) who has been appointed the receiver of any assets of a company, (hereinafter referred to as the liquidator) shall, within thirty days after he has become such liquidator, give notice of his appointment as such to the Assessing Officer who is entitled to assess the income of the company.

(2) The Assessing Officer shall, after making such enquiries or calling for such information as he may deem fit, notify to the liquidator within three months from the date on which he receives notice of the appointment of the liquidator the amount which, in the opinion of the Assessing Officer, would be sufficient to provide for any tax which is then, or is likely thereafter to become, payable by the company.

(3) The liquidator-- (a) shall not, without the leave of the Chief Commissioner or Commissioner, part with any of the assets of the company or the properties in his hands until he has been notified by the Assessing Officer under sub-section (2); and (b) on being so notified, shall set aside an amount equal to the amount notified and, until he so sets aside such amount, shall not part with any of the assets of the company or the properties in his hands:

Provided that nothing contained in this sub-section shall debar the liquidator from parting with such assets or properties for the purpose of the payment of the tax payable by the company or for making any payment to secured creditors whose debts are entitled under law to priority of payment over debts due to Government on the date of liquidation or for meeting such costs and expenses of the winding up of the company as are in the opinion of the Chief Commissioner or Commissioner reasonable.

(4) If the liquidator fails to give the notice in accordance with sub-section (1) or fails to set aside the amount as required by sub-section (3) or parts with any of the assets of the company or the properties in his hands in contravention of the provisions of that sub-section, he shall be personally liable for the payment of the tax which the company would be liable to pay:

Provided that if the amount of any tax payable by the company is notified under sub-section (2), the personal liability of the liquidator under this sub-section shall be to the extent of such amount.

(5) Where there are more liquidators than one, the obligations and liabilities attached to the liquidator under this section shall attach to all the liquidators jointly and severally.

(6) The provisions of this section shall have effect notwithstanding any thing to the contrary contained in any other law for the time being in force.

Section 530 of Company Law

(1) In a winding up, subject to the provisions of section 529A, there shall be paid in priority to all other debts

(a) all revenues, taxes, cesses and rates due from the company to the Central or a State Government or to a local authority at the relevant date as defined in clause (c) of sub-section (8), and having become **due and payable** within the twelve months next before that date;

Question for consideration :

Income tax act provide that amount of monies must be provided, that in the opinion of the Assessing Officer, would be sufficient to provide for any tax which is then, or is likely thereafter to become, payable by the company. And company Law Provide to make provision of amount that has become due and payable within the twelve months next before that date. Thus there seems to be some conflict in the two provision of law on the point that what is the amount that liquidator must provide in the books of the company in liquidation. In other words: The sole question that arises for consideration in this case is, whether section 178 of the Income-tax Act affects or alters the existing law of priority or overrides the provision of preferential payment provided in section 530 of the Companies Act.

View of Kanga & Palkhiala's Law Practice of Income Tax.

One wishes that s. 178 of the I.T. Act, 1961, were more explicit, but, as I read that provision, I do not think that it affects the scheme of priority in s. 530 of the Companies Act although its effect no doubt is that the amount set aside under sub-s. (3) thereof has first to be applied to the satisfaction of the tax liability and in that sense the tax liability gets priority over the other debts of the company in the same way as a secured creditor who stands outside the winding up or whose security is redeemed, under sub-s. (4) of s. 47 of the Provincial Insolvency Act read with s. 529 of the Companies Act, gets priority to the extent of the value of his security. But, although sub-s. (3) of s. 178 of the I.T. Act, which speaks of the liquidator making 'payment to secured creditors whose debts are entitled under law to priority of payment over debts due to Government' --the only payment I can think of by the liquidator to a secured creditor who has not relinquished his security is a payment under sub-s. (4) of s. 47 of the Provincial Insolvency Act, or to a creditor who, although he has not relinquished his security, has agreed to the liquidator selling the property free of his incumbrance on condition of his being given the same charge over the sale proceeds--seems to regard these as cases of priority, they are really not so much cases of priority as of the particular asset not being available for distribution among the creditors in the winding up. They stand on the same footing as, for example, trust funds. What is really available for distribution are the assets which come into the hands of the liquidator minus the trust monies, or the incumbrance of a secured creditor, or, in a case falling under s. 178 of the I.T. Act, the amount set aside or earmarked for the payment of the tax. For, reading sub-ss. (2), (3) and (4) of that section together there can be no doubt that what the section does is to create a first charge on the amount set aside by sub-s. (3) thereof for payment of the tax that might be admitted to proof. " We see a blending of two strands of reasoning in the passage quoted above : (1) that the amount "set aside" is outside the scheme of winding up ; and (2) that the I.T. department is put practically in the same position as a secured creditor, and gets, so to say, a first charge on the amount due.

[1976] 102 ITR 0153- Baroda Board and Paper Mills Ltd. vs. ITO (Gujarat) (REVERSED)

Decided that under s. 530(1)(a) of the Companies Act, priority was extended only to taxes "due" and "payable" by the company. These expressions, it was held, meant that the amount must be presently payable. It was held that the income-tax for a particular assessment year becomes a debt due to the Crown only when the tax is calculated and assessed and thereafter a demand is made under the relevant provisions of the Act. It was only in this sense that the words in s. 530(1)(a) had to be interpreted. It was further ruled that s. 178 of the I.T. Act did not sanction any priority of payments, and that the same is provided only in the Companies Act. The provision in s. 178 of the I.T. Act only required the liquidator to intimate the ITO about his appointment, and the latter to give notice to the liquidator of the approximate amount that would suffice to meet the demand for any tax "then due, or likely to become due". It does require the liquidator not to part with any assets of the company, until he had been notified by the ITO under sub-s. (2), and on being so notified, he is to "set aside" the amount equal to what has been notified ; and until he thus sets aside, he is not to part with any of the assets of the company. The Gujarat High Court pointed out that the provision for setting aside did not require the liquidator to give priority to the income-tax liability different from the order of priority indicated by s. 530(1)(a) of the Companies Act ; and that the provisions of s. 178(6) did not interfere with s. 530(1)(a). It was pointed out that s. 17 of the CST Act, 1956, was in terms similar to, if not identical with, s. 178 of the I.T. Act, and that with respect to the same, the same principle had to be followed. In the result, it was held that all sales tax due in respect of which assessment orders were made within a period of twelve months, from the relevant date, would have priority ; but those beyond the said date would not qualify for any priority and it would not be open to the liquidator to pay up the liabilities under the demand unless the claims are scrutinised and ascertained and the dues paid under orders of the liquidation court. The liquidation court had to decide how far the amounts, of tax liability due by the department should be accepted as a lawful liability. It was held that the sales tax authorities were not entitled to recover the amount of sales tax or penalties. This, in substance, is the principle of the ruling of the Gujarat High Court. It emphasised the meaning of the expression "due and payable" as explained in judicial decisions. We have noticed the sense in which these words were explained. The decision noticed the passage in Sampath Iyengar's Income Tax, 6th edn., at page 1732, with respect to s. 178(6) of the I.T. Act. The learned author observed that under the provisions of the Act, a tax is payable only after notice of payment being served on the assessee under s. 156, and, therefore, the priority under the Companies Act is restricted only to cases where the notice has been served under s. 156 within the period of one year immediately preceding the relevant date under s. 530(8) of the Companies Act. Thus, in the view of the author though an order of assessment might have been made before the commencement of the winding up, still no priority would attach unless the notice of payment under s. 156 had been served on the assessee. The learned author noted that the section secured for revenue, priority of payment over all unsecured creditors, for taxes payable in respect of periods up to the date of commencement of liquidation or date of appointment of receiver. In regard to s. 178(6), the learned author observes that the section secures to the revenue, priority of payment over all unsecured creditors, of taxes payable in respect of all periods up to the date of commencement of liquidation or the date of appointment of receiver. In respect of taxes due for the years subsequent to the commencement of liquidation or the appointment of a receiver, according to the learned author, there was no provision made in the I.T. Act or the Companies Act. After noticing the above view of Shri Sampath Iyengar, the learned judges of the Gujarat High Court disagreed with the author's interpretation of s. 178(6) of the Act. The learned judges were of the view that s. 178 did not sanction any priority of payments which is provided in the Companies Act, and all that s. 178 requires is the giving of information by the liquidator about his appointment to the ITO and an intimation by the ITO within three months of the date of intimation, about the approximate amount needed to cover the

tax liability. The learned judges were of the view that there is nothing in s. 178 which provides for a rule of priority for the said tax liability, and, therefore, the non-obstante clause in s. 178(6) did not interfere with s. 530(1)(a) of the Companies Act.

[1974] 095 ITR 0488- CIT vs. Official Liquidator, Golcha Properties (Pvt.) Ltd. (Rajasthan) (REVERSED)

After a company, G, was ordered to be wound up, the Income-tax Officer sent a letter to the official liquidator notifying that Rs. 41 lakhs were payable or likely to be payable as income-tax by the company, and, therefore, the official liquidator was specifically directed to set apart this amount under section 178 of the Income-tax Act, 1961. The official liquidator wrote back to the Income-tax Officer that such a direction could be issued to him only after obtaining leave of the High Court under section 446 of the Companies Act, 1956, but the Income-tax Officer did not agree with this suggestion.

When the scheme of section 178 of the Income-tax Act is carefully examined in the light of the provisions of the Companies Act, the only harmonious construction that can be given to this provision is that in so far as the duty is cast on the Income-tax Officer to quantify the estimated amount of tax liability of the company and to notify the same to the liquidator is concerned, he cannot in any manner be subjected to the supervision of the company judge, but so far as the setting apart of the quantified amount of tax is concerned, the provisions of section 446 of the Companies Act are attracted, as the act of the liquidator is covered by the expression "legal proceeding" as used in section 446 of the Companies Act.

In view of this provision of law, it is necessary for the winding up court to exercise its supervisory jurisdiction under section 446 of the Companies Act in the matter of setting apart the company's funds or assets in pursuance of the instructions issued by the Income-tax Officer under section 178(2) of the Income-tax Act and it is the duty of the court to show light to the liquidator as to how he should proceed in the matter of setting apart the amount notified to him under section 178(2) of the Income-tax Act. If the proceedings taken by the liquidator under section 178(3) of the Income-tax Act are taken out of the control and overall supervision of the company judge under section 446 of the Companies Act, then it would defeat the entire scheme of the Companies Act about the disbursement of the company's assets during the winding up proceedings.

[1975] 101 ITR 0470- ITO vs. Official Liquidator (Andhra Pradesh) (APPROVED)

The income-tax liability includes not only the taxes that became due and payable within 12 months next before winding up, but also the entire income-tax liability of the company, which had become due earlier and also the taxes likely to become due thereafter.

Though section 530(1)(a) of the Companies Act, 1956, restricts the preferential claim of the Government to the extent of taxes which became due and payable within 12 months next before the winding up order is passed, still the official liquidator is under obligation to set apart the entire income-tax liability of the company, as notified by the Income-tax Officer, inasmuch as section 178(3) of the Income-tax Act enjoins the official liquidator to do so and under section 178(6) of the Income-tax Act, section 178(3) of the Income-tax Act has got overriding effect and will prevail over section 530 of the Companies Act.

Income-tax liability of the company, in liquidation, is entitled to preferential treatment. Even though section 178(3) does not speak about preferential payment, when once the amount is set aside, it cannot be distributed to the other creditors or put to some other use except towards the tax

liability. Hence, the official liquidator is liable to accord preferential treatment to the income-tax arrears, as notified by the Income-tax Officer, and effect payment of the same.

[1979] 116 ITR 0176- Imperial Chit Funds Ltd. vs. Income-tax Department (Kerala) (APPROVED)

There is a difference in the phraseology between section 530(1)(a) of the Companies Act and section 178(2) read with sub-section (3)(b) of the Income-tax Act, 1961. Under the former section, the priority extends to all taxes "due and payable" within twelve months before the relevant date which means only taxes which have crystallised into a liability as against the assessee. But, under section 178(4) of the Income-tax Act, 1961, the amount to be notified by the Income-tax Officer covers any tax "which is then, or is likely thereafter, to become, payable by the company". Thus, the range of liability is much wider in section 178(2).

A notice to pay the total of Rs. 1,027 (likely to become due and payable) was received from the Tax Recovery Officer whereupon the Official Liquidator filed a report seeking the direction of the court that the tax claimed was not payable at that stage as the Income-tax Officer would have to wait and prove his claim when the list of creditors was settled

[1996] 219 ITR 0498A Imperial Chit Funds (P.) Ltd. vs. ITO (Supreme Court of India)

High Courts fail to take note of the object and purpose with which section 178 of the Income-tax Act was put into the statute book ; and the significance and the implications of 'setting aside' of an approximate amount needed to meet the tax liability of the company. These have been noticed in the Kerala and the Andhra decisions to which we shall refer. Before we do so, we may briefly indicate that the effect of section 178(3)(b) is that the amount 'set aside' by the liquidator is marked off as outside the area of the winding-up proceedings and the jurisdiction of the winding-up court. This is the view taken by the Kerala High Court and we are in agreement with it. It should be remembered that section 178 of the Income-tax Act occurs in Chapter XV of the Act. The object sought to be achieved by the provisions in the said Chapter is "to fasten liability to pay the tax" on the income received and to catch the income at the earliest point of time and tax the same where it is found, instead of waiting for long.

The interpretation placed on section 178 of the Income-tax Act, should govern cases arising under section 17 of the Central Sales Tax Act, 1956, as well. But, a situation may arise where the authorities under both the Acts (Income-tax Act as well as the Central Sales Tax Act) send similar orders to the official liquidator, in which case the question of precedence may arise. In such cases, the priority shall be with respect to the date of receipt of the orders by the official liquidator.

Conclusion:

Under section 178(2) read with section 178(3) of the Income-tax Act, provision should be made for any tax which is then or is likely thereafter to become payable. Even the amounts which have not crystallised into a liability, but which are "likely to become due thereafter" should be taken note of. Moreover, there is a non obstante clause in section 178(6). On a total view of the relevant statutory provisions, the Income-tax Department is treated as a "secured creditor".

TAX TREATMENT OF PROFIT PRIOR TO INCORPORATION

Preface to the controversy:

It said that under the Income-tax Act an assessee meant a person by whom income-tax or any other sum of money was payable thereunder. Tax had to be paid by an assessee under the head 'Profits and loss of business, profession or vocation, in respect of the profits or gains of any business, profession or vocation carried on by him. Therefore, before a person could be assessed, it had to be shown that it was he who had carried on the business, profession or vocation. The Calcutta High Court could not see how a person could be said to have carried on a business during a period when he was not born or he could be assessable to tax in respect thereof. As in the case of a natural born person, so in the case of a legal entity like a company, the liability to pay tax could only arise after the date of birth or incorporation. The liability of a company to pay income-tax for the business carried on by its promoter could only be in respect of a period subsequent to its incorporation.

[1953] 023 ITR 0278 [All] Commissioner of Income-tax v Bijli Cotton Mills Ltd.

Respondent company was incorporated on December 11, 1943. Prior to that date, the firm that promoted it had entered into an agreement to purchase a mill for it and, on December 10, 1942, had obtained its possession. The sale deed of the mill was executed in favour of the respondent-company after it had been incorporated. The respondent-company chose to accept the profits of the mill made before its incorporation, but treated the promoters as accountable therefor.

Learned counsel for the Department has laid great stress on the language of Income-tax Act and has pointed out that tax is payable by an assessee in respect of the profits or gains of any business carried on by him. The argument is that the assessee cannot be said to have been carrying on a business prior to its incorporation when it did not exist and Messrs. Shyamlal Chimanlal, must be deemed to have been carrying on the business and they are, therefore, the persons who are liable to assessment.

The Allahabad High Court observed that it was true that under the law the respondent-company had come into existence only upon its incorporation and it was not possible to hold that the legal title in the business or its profits had vested in it before its incorporation. It was, however, well-settled that if the promoters of a company carried on business on behalf of a company which they intended to float, the company, on its incorporation, had a right to either accept what had been done on its behalf by the promoters or repudiate the same. If the company accepted what the promoters had done on its behalf it had a right to claim from them the entire income for the period during which the business was carried on for its benefit. And thus company would be assessable for the profits.

CIT v. Abubaker Abdul Rehman [1939] 7 ITR 139 [Bom]

Where it had been held that if the income of the trust property as it accrued was earmarked and had to be handed over by the trustee to the beneficiary, the beneficiary could be said to be in receipt of that income and could be taxed directly. If, on the other hand, the income came into the hands of the trustee and he had the right to dispose of it and it was only the balance left over that was payable to the beneficiary, then the income was taxable in the hands of the trustee.

These decision showed that under the Income-tax Act, it was not only legal ownership that had to be looked into, but the court could also go into the question of beneficial ownership and decide who should be held liable for tax after taking into account the question as to who, as a matter of fact, was in receipt of the income which was to be taxed. The assessment proceedings in respect of the respondent-company had been started at a time when it had already decided to accept what had been done on its behalf by the promoters and take over the business and income made therefrom. It was, therefore, in the same position as a beneficiary for whom the income was earmarked as payable to it and the same could be legally assessed in its hands.

[1963] 048 ITR 0200- [Cal] Commissioner of Income-tax v Tea Producing Co. of India Ltd.

Whatever may be the agreement between the vendor and the assessee, the income-tax authorities have to look to the person who is legally liable under the Act, i.e., the person who carried on the business, and, as the assessee came into existence only after its incorporation, and could not have carried on the business before that date even as an agent of the vendor, the assessee can only have the benefit of the loss, if any, incurred during the period commencing from the date of its incorporation

[1996] 219 ITR 0001- [SC] Commissioner of Income-tax v City Mills Distributors (P.) Ltd.

The relevant question was : what was the legal entity that had carried on the business before the assessee-company was incorporated and earned the income at the time of its accrual. A company becomes a legal entity in the eye of law only when it is incorporated. Prior to its incorporation, it simply does not exist. The assessee-company did not exist when the income with which we are here concerned was earned. It is, therefore, not the assessee-company which earned the income when it accrued and it is not liable to pay tax thereon. The same result is reached by a somewhat different process of reasoning. A company can enter into an agreement only after its incorporation. It is only after incorporation that a company may decide to accept that its promoters have carried on business on its behalf and appropriate the income thereof to itself. The question as to who is liable to pay tax on such income cannot depend upon whether or not the company after incorporation so decides. It is he who carried on the business and received the income when it accrued who is liable to bear the burden of tax thereon.

Conclusion :

The company chose to accept the profits made before its incorporation and treated the promoters as accountable for all profits made during the period prior to incorporation in the circumstances of the case, the income of the period prior to incorporation could be legally assessed in the hands of the company.

TAX TREATMENT OF THE GUARANTEE COMMISSION

Tax treatment of the guarantee commission on acquisition of capital asset.

[1971] 079 ITR 0048 Commissioner of Income-tax vs. Fort Gloster Industries Ltd. (Cal) [NOT APPLICABLE NOW]

The assessee had placed an order with a British concern for the purchase of machinery worth Rs. 48 lakhs. The British supplier required a guarantee to be given. The Allahabad Bank Ltd. agreed to be the guarantor for the sum of Rs. 48 lakhs for a consideration of Rs. 36,000 to be paid to the bank as guarantee commission. Held, that this sum of Rs. 36,000 should be treated as part of the "actual cost" to the assessee of the new machinery acquired by it.

[1982] 137 ITR 0389 Commissioner of Income-tax vs. Vallabh Glass Works Ltd. (Guj) [NOT APPLICABLE NOW]

The assessee company, which carried on the business of manufacturing various types of glass, purchased machineries on deferred payment basis from a foreign supplier. The assessee-company had to furnish bank guarantee for the payment of the purchase price of the machineries. The assessee paid Rs. 24,266, being the bank guarantee commission to the concerned banks, who had furnished the guarantee.

HELD THAT The payment of bank guarantee commission to the bank and the expenditure incurred in obtaining the letter of credit were necessary items of expenditure to bring the machineries, capital assets, into existence and to put them in working condition. These items of expenditure were incurred as an integral part of the payment of the cost price of the machineries and formed part of the cost of acquisition of the capital assets. Therefore, the expenditure must be regarded as capital expenditure irrespective of the time when the payment was made

[1966] 060 ITR 0052A India Cements Ltd. v/s. CIT (S C) [GENERAL CONCEPT FOR THE EXPENDITURE IN RAISING FINANCE]

The act of borrowing money is incidental to the carrying on of business, the loan obtained is not an asset or an advantage of enduring nature, the expenditure made for securing the use of money for a certain period, and it was irrelevant to consider the object with which the loan was obtained. The appellant obtained a loan of Rs. 40 lakhs from the Industrial Finance Corporation secured by a charge on its fixed assets. In connection therewith it spent a sum of Rs. 84,633 towards stamp duty, registration fees, lawyer's fees, etc., and claimed this amount as business expenditure Held that the amount spent was not in the nature of capital expenditure and was laid out or expended wholly and exclusively for the purpose of the assessee's business and was therefore allowable as a deduction.

In principle, apart from any statutory provisions, there is no distinction between interest in respect of a loan and an expenditure incurred for obtaining the loan. The nature of the expenditure incurred in raising a loan would not depend upon the nature and purpose of the loan. The purpose for which the loan was

required is irrelevant to the consideration of the question whether the expenditure for obtaining the loan is revenue expenditure or capital expenditure

[1997] 227 ITR 0464- Commissioner of Income-tax vs. Akkamba Textiles Ltd. (SC) [A LAND MARK CASE]

The question whether a particular expenditure is revenue expenditure incurred for the purpose of the business must be viewed in the larger context of business necessity or expediency. If the outgoing expenditure is so related to the carrying on or the conduct of business, that it may be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition to the carrying on of business, the expenditure may be regarded as revenue expenditure. The transaction of acquisition of assets can be said to be closely related to the commencement and carrying on of business by an assessee. Hence, any expenditure incurred by the assessee, which is a running concern, for ensuring use of money for a certain period or enabling the assessee to make deferred payment of cost of assets acquired, constitutes revenue expenditure and, therefore, the same is admissible as deduction from revenue income. Therefore, the commission paid by the assessee to the guarantor for enabling it (the assessee) to make deferred payment of the purchase consideration, constitutes revenue expenditure and not capital expenditure and, therefore, is admissible as deduction from the income.

[1997] 227 ITR 0465 Commissioner of Income-tax vs. Sivakami Mills Ltd. (SC) [TO BE FOLLOWED]

FACTS OF THE CASE :

The assessee-company purchased from abroad for the purpose of its business some items of machinery on deferred payment terms under which an immediate payment had to be made and the balance was to be paid in instalments. For assuring the due payment of the instalments, the assessee obtained a guarantee executed by a bank in favour of the sellers of the machinery and the bank charged a commission at a percentage of the amount guaranteed. The commission calculated at one per cent. on the outstanding balance and also of the commission guaranteed on the additional liability consequent on the devaluation of the Indian rupee.

CLAIM OF DEPARTMENT

The assessee's claim for deduction of this amount was negated by the Income-tax Officer on the ground that it was capital in nature. The Appellate Assistant Commissioner allowed the claim on the ground that though the expenditure for the purchase of the assets was undoubtedly capital, the expenditure for discharging the liability in instalments could not be regarded as capital expenditure.

VIEW OF TRIBUNAL

The Tribunal, however, held that the disallowance made by the Income-tax Officer was correct in the view that the payment of guarantee commission was concerned with an expenditure incurred by the assessee in connection with the purchase of the machinery and it went to increase the actual cost to the assessee of the machinery and hence was capital in nature.

VIEWS OF HIGH COURT

That the payment of guarantee commission was unrelated to the working out of the cost of acquisition of any depreciable machinery, plant or other asset but was an expenditure which was incurred in the course of carrying on the business and not prior to the commencement of the business. The payment was so closely related to the business that it could be viewed as an integral part of the conduct of the business and would be a revenue expenditure. It did not bring into existence any asset of an enduring nature nor did it bring in any other advantage of an enduring benefit. The acquisition of the machinery in instalment terms was only a business exigency. The very nature of the expenditure and the time at which it had been incurred would justify the claim of the expenditure as revenue expenditure.

DECISION OF SUPREME COURT

Affirming the decision of the High Court, that the guarantee commission paid to the bank was revenue expenditure and hence was an allowable deduction in computing the total income of the assessee.

MEANING OF OWNER

Meaning of the word Owned, Owner, and Ownership for the purpose of section 32.

Relevant Provision of Law section 32

In respect of depreciation of-- (i) buildings, machinery, plant or furniture being tangible assets ; (ii) know-how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after the 1st day of April, 1998, owned, wholly or partly, by the assessee and used for the purposes of the business or profession the following deductions shall be allowed

Relevant Provision of Law section 22

The annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the **owner**, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head "Income from house property.

[1997] 226 ITR 0625 Commissioner of Income-tax vs. Podar Cement Pvt. Ltd. (SC)

Though under the common law "owner" means a person who has got valid title legally conveyed to him after complying with the requirements of law such as the Transfer of Property Act, the Registration Act, etc., in the context of section 22 of the Income-tax Act, 1961, having regard to the ground realities and further having regard to the object of the Income-tax Act, namely, to tax the income, "owner" is a person who is entitled to receive income from the property in his own right. The requirement of registration of the sale deed in the context of section 22 is not warranted.

[1999] 235 ITR 0158- Commissioner of Income-tax vs. Navdurga Transport Co. (All)

That the expression "owned by the assessee" in section 32 of the Act had not been used in the sense of the property, complete title in which vested in the assessee. The assessee would be considered to be an owner under section 32 if he was in a position to exercise the rights of an owner not on behalf of the person in whom the title vested, but in his own right. Therefore, the Tribunal was right in holding that the assessee owned and used the three vehicles and was entitled to depreciation under section 32 of the Act.

[1998] 233 ITR 0453- A.P. Small Scale Industries Development Corporation vs. Commissioner of Income-tax (AP)

Meaning of "owner" building was purchased by assessee and full consideration was paid and building occupied but document of sale was not registered. Held assessee was owner for purposes of income-tax act and was entitled to depreciation.

[1997] 226 ITR 0733- Commissioner of Income-tax vs. A.B.C. India Ltd. (Gau)

In order to get the benefit of depreciation allowance in respect of a building or property, the assessee must be the owner of the property. Without a valid registered document, the right, title and interest in immovable property does not pass to the transferee. Therefore, even where the assessee has paid the full consideration and is in exclusive possession, in the absence of a registered deed of conveyance in the assessee's favour, the assessee is not entitled to get the benefit of depreciation under section 32. In other words assessee paying full consideration and put in exclusive possession but registered deed of conveyance not executed in assessee's favour than assessee is not entitled to depreciation.

[1995] 211 ITR 0593- Commissioner of Income-tax vs. Draupadi Pvt. Ltd. (Ori)
[1988] 169 ITR 0334B Parthas Trust vs. Commissioner of Income-tax (Ker)

Under section 32 of the Income-tax Act, 1961, depreciation can be claimed by an owner who uses the assets and, therefore, both the conditions of ownership as well as use has to be satisfied. The use of the expression "owned by the assessee and used for the purpose of business or profession" emphasises the fact that it is not mere user irrespective of ownership that is contemplated by section 32 for claiming depreciation. Ownership must necessarily mean legal title to the asset in the assessee and the user thereof by the assessee while being such owner in the course of the business.

In other words assessee must be the legal owner of building. Assessee entered in to agreement to transfer buildings to company and registered deed was not executed. Company not entitled to depreciation in respect of the building.

[1993] 202 ITR 0291 Commissioner of Income-tax vs. Mirza Ataullah Baig (Bom)

The law is well settled that in a case of sale in which the price is to be paid by installments, the property passes as soon as sale is made, even though the price has not been fully paid and may later be paid in installments. An assessee, who has purchased a motor vehicle for valuable consideration and used the same for his business, cannot be denied the benefit of depreciation thereon on the ground that the transfer was not recorded under the Motor Vehicles Act or that the vehicle stood in the name of the vendor in the records of the authorities under the Motor Vehicles Act.

[1981] 127 ITR 0097- Additional Commissioner of Income-tax vs. U.P. State Agro Industrial Corporation Ltd. (All)

The expression "building owned by the assessee" in section 32 of the 1961 Act has not been used in the sense of property, complete title in which vests in the assessee. The assessee will be considered to be an owner of the building under section 32 if he is in a position to exercise the rights of the owner not on behalf of the person in whom the title vests but in his own rights.

[1999] 239 ITR 0775 [Supreme Court of India] Mysore Minerals Ltd. v. Commissioner of Income-tax

Anyone in possession of property in his own title exercising such dominion over the property as would enable others being excluded therefrom and having the right to use and occupy the property and/or to enjoy its usufruct in his own right would be the owner of the building though a formal deed of title may not have been executed and registered as contemplated by the Transfer of Property Act, the Registration

Act, etc. “Build-ing owned by the assessee”, the expression as occurring in section 32(1) of the Income-tax Act, means the person who having acquired possession over the building in his own right uses the same for the purposes of the business or profession though a legal title has not been conveyed to him consistently with the requirements of laws such as the Transfer of Property Act and the Registration Act, etc.

1. Section 32 of the Act allows certain deductions, one of them being depreciation of buildings, etc., owned by the assessee and used for the purposes of the business or profession. The terms “own”, “ownership” and “owned” are generic and relative terms. They have a wide and also a narrow connotation.
2. Generally speaking depreciation is an allowance for the diminution in the value due to wear and tear of a capital asset employed by an assessee in his business.
3. The very concept of depreciation suggests that the tax benefit on account of depreciation legitimately belongs to one who has invested in the capital asset and is utilising the capital asset and thereby losing gradually the investment caused by wear and tear, and would need to replace the same by having lost its value fully over a period of time.
4. It is well-settled that there cannot be two owners of the property simultaneously and in the same sense of the term. The intention of the Legislature in enacting section 32 of the Act would be best fulfilled by allowing deduction in respect of depreciation to the person in whom for the time-being vests the dominion over the building and who is entitled to use it in his own right and is using the same for the purposes of his business or profession. Assigning any different meaning would not subserve the legislative intent.

[2002] 256 ITR 0357- Commissioner of Income-tax vs. Mohd. Bux Shokat Ali (No.2) (Rajasthan High Court)

The consideration for the purchase of vehicles had been met by the firm consisting of eight partners and debited to the books of account of the firm only. It was also a finding of fact arrived at by the Tribunal that the vehicles had been exclusively used for the purpose of the business of the firm. Merely because, the vehicles had been registered under the Motor Vehicles Act in the name of one of the partners only, it would not deprive the firm of the ownership of the vehicle which is not distinct from its Partners

Conclusion : WIDE MEANING MUST BE GIVEN TO THE WORD OWNER UNDER SECTION 32. IF ASSESSEE IS IN POSSESSION OF BUILDING ON PART PAYMENT OF PRICE AND BUILDING IS NOT REGISTERED IN NAME OF ASSESSEE. ASSESSEE IS TO BE REGARDED AS OWNER OF BUILDING FOR PURPOSES OF SECTION 32 AND IS ENTITLED TO DEPRECIATION ON IT.

TREATMENT OF DEFERRED REVENUE EXPENDITURE

Treatment of Deferred Revenue Expenditure – Development of law.

Business does not run on the definite lines. Some expenses make contribution to current profits and some does not. Namely they are revenue and capital expenditure. The revenue expenditure is specifically covered by section 37. Accountancy would also cover third category of expense namely deferred revenue expenditure. Like for research and development expense or expense on ad-campaign. Where expenditure is incurred by an out lay its deferment for tax purpose is considered not permissible. Its accounting and permissibility under the tax law has their own purpose and justification from different angle. In light of this some of the decided cases are discussed here. However the issue seems to be now settling with the decision of supreme court in case of 225 ITR 802 as discussed below.

21 ITR 353 Hindustan Commercial Bank Ltd. Vs. In re [All]

The assessee, a bank, incurred during the relevant account year certain expenses in opening forty six new branches, sub-branches and pay offices. A sum of Rs. 24,675 represented charges for advertisement, entertainment, photos and invitation cards and a sum of Rs. 89,870 represented salary, dearness and other allowances, tax on salaries, postage, telegrams, telephone, rent, lighting, travelling expenses and conveyance. Held, that there was no legal justification for spreading out the sum of Rs. 89,870 over a period of twenty years and the whole amount was deductible in the year in which it was incurred if it was not in the nature of a capital expenditure and assuming that the sums of Rs. 89,870 and Rs. 24,675 were expenses incurred wholly and exclusively for the purpose of the business, they were in the nature of revenue expenditure and were admissible deductions.

50 ITR 211 Bank of Cochin Ltd. Vs. Commissioner of Income-tax [Ker]

The memorandum of articles of association of the assessee-bank permitted it to carry on kuri business. The assessee claimed to deduct the amounts expended by it in connection with the commencement of kuries. The amounts had been spent on commission for canvassing, advertisement, registration, travelling expenses, etc. The Income-tax Officer disallowed the expenses on the ground that they were preliminary expenses for starting new businesses. The business of the kuries was not a new business and as such the expenses were not in the nature of preliminary expenses; the expenses were not also of a capital nature. Hence, they were allowable.

20 ITR 475 Commissioner of Income-tax Vs. Finlay Mills Ltd. [SC]

The expenditure incurred by a company carrying on business of manufacturing and selling textile goods in registering for the first time its trade marks is revenue expenditure and an allowable deduction. [although the benefit there from would last for number of years]

[1959] 37 ITR 1 Calcutta Co. Ltd. v. CIT (SC)

Where the outstanding obligation undertaken in the sale document, it was found, was deductible in ascertaining the profit on the sale.

[1987] 165 ITR 765 M. P. Financial Corporation v. CIT [MP]

In the case of issue of bonds at a discount, the same principles as are applicable in the case of issue of debentures at discount would be attracted. The amount of discount in effect represents deferred interest. Looked at as a loss, a proportionate amount of discount can be written off out of revenue every year during the period the bonds would remain outstanding. Therefore, though an assessee would not be justified in claiming deduction of the entire amount of discount in the accounting year in question, it would be entitled to proportionate deduction spread over the period for which the bonds remain outstanding.

[1997] 225 ITR 802 Madras Industrial Investment Corporation Ltd. v. CIT [SC]

The Supreme Court in this case had occasion to deal with the issue of deduction of discount on debentures issued by the company. For accounting purposes, the discount was spread over the period of debentures with the result that only a proportionate part was charged to the accounts of the year. What was charged to accounts was alone claimed in the assessment as well. Hence an important issue as to whether discount on the issue of debentures could be treated as revenue expenditure had arisen in this case. The further question was the year of allowability in case it is to be treated as revenue expenditure. In fact, after a review of a number of cases, it felt that, while discount on debentures is a revenue expenditure, it could be allowed only on a proportionate basis as there is a continuing benefit.

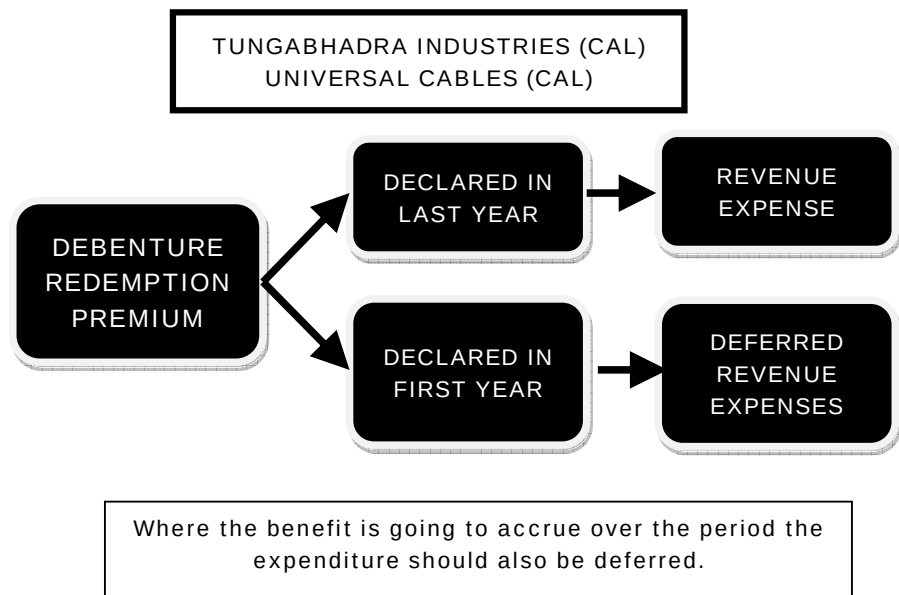
The Supreme Court has made observations to the effect that when a debenture carries a payment clause, say in the nature of a discount, that payment clause is to be spread over as a liability of the issuing assessee-company over the years ranging from issue to redemption.

236 ITR 577 National Engineering Industries Ltd. Vs. Commissioner of Income-tax [Cal]

There is no distinction between a discount and a premium. The result in both is that something over and above the face value and the specified interest is paid, the accounting procedure in one case being by way of a preliminary deduction from the mentioned amount, and the accounting procedure in the other case being an addition at the end over the prescribed and mentioned face value amount. The extra premium is to be spread over all the years which are occupied between the date of issue and the date of ultimate redemption.

207 ITR 553 TUNGABHADRA INDUSTRIES LTD. VS. COMMISSIONER OF INCOME-TAX [CAL]

That the expenditure incurred in respect of the premium on debentures was revenue expenditure. Where the liability to pay premium arose at the expiry of the seventh year from the date of allotment and there was no liability to pay the premium at all if the debentures were repurchased under the buy-back clause and there was no further issue of debentures. The payment of premium was clearly a contingent liability and the liability to pay the premium would arise only if the debentures were not repurchased by the company and were redeemed only at the end of seven years. The entire amount of the premium in respect of the said debentures should be allowed as a deduction in its entirety in one year, i.e., in the year in which such liability was incurred. This case is to be understood in light of the special facts before the court.



243 ITR 371 Universal Cables Ltd. Vs. Commissioner of Income-tax [Cal]

There is a continuing benefit to the business of the company over the entire period and therefore premium payable on redemption of loan convertible secured debentures issued during the year should be spread over the period of the debentures.

TAXATION OF BUSINESS OF RENTING PROPERTY

Section 22 of Income Tax act provide that the annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head "Income from house property".

BUSINESS OF LETTING OF PROPERTY

The appellant company, which was incorporated with the objects of buying and developing landed properties and promoting and developing markets, purchased 10 bighas of land in the town of Calcutta and set up a market therein. The question was whether the income realised from the tenants of the shops and stalls was liable to be taxed as "business income" or as "income from property" **[[1961] 042 ITR 0049- East India Housing and Land Development Trust Ltd. vs. Commissioner of Income-tax (Supreme Court of India)]** Where it was Held that the income derived by the company from shops and stalls was income received from property and fell under the specific head of House Property. The character of that income was not altered because it was received by a company formed with the object of developing and setting up markets. Nor because of the fact that the company was required to obtain a licence from the Calcutta Municipality to maintain sanitary and other services and for that purpose had to maintain a staff and to incur expenditure did the income become "profits or gains" from business 10. Nor was the character of the income altered merely because some stalls were occupied by the same occupants and the remaining stalls were occupied by a shifting class of occupants. The primary source of income from the stalls was the occupation of the stalls, and it was a matter of little moment that the occupation which was the source of the income was temporary.

BUSINESS OF SUB-LETTING OF PROPERTY

The appellant-company was incorporated with the objects specified in its memorandum of association was to take on lease or otherwise acquire and to hold, improve, lease or otherwise dispose of land, houses and other real and personal property and to deal with the same commercially. Within less than two weeks of its incorporation the company took on lease a market place for an initial term of 50 years, undertaking to spend Rs. 5 lakhs for the purpose of remodelling and repairing the structure on the site. It was also given the right to sublet the different portions. The question was whether the appellant's income from subletting the stalls was assessable as business income, or as income from other sources or under the head house property. **[1972] 083 ITR 0700 S.G. Mercantile Corporation P. Ltd. vs. Commissioner of Income-tax (SC)** Held (i) that since the appellant-company was not the owner of the property or any part thereof, no question of making the assessment under the head house property arose; (ii) that the definition of "business" is of wide amplitude and it could embrace within itself dealing in real property as also the activity of taking a property on lease, setting up a market thereon and letting out shops and stalls in the market (iii) that, on the facts, the taking of the property on lease and subletting portions thereof was part of the business and trading activity of the appellant and the income of the appellant fell under the head business and profession and (iv) that where, the income could appropriately fall under the head business income, no resort could be made to other sources.

INCOME FROM LETTING OF GODOWNS

The assessee-company, which was doing rice-milling business, had previously been running an oil mill and soap manufacturing business which were discounted. It let out to the Government for storing grains

certain godowns which it was previously using in its discontinued business. **[1971] 082 ITR 0023-** Rampur Industries Ltd. vs. Commissioner of Income-tax (Allahabad High Court) Held that the rental income was chargeable as income from property. The assessee-company was not established for earning profit from godowns. Godowns were let out incidentally. Rent from godowns was clearly income from property. If an item is covered by a specific head, it cannot be covered by a head which touches the item only incidentally.

TAXATION OF COMPOSITE RENT

Where a lodging house is let out along with furniture and fixtures with two separate agreements, one for bare property and the other for furniture and fixtures, the mere fact that there are two agreements would not mean that part of the income would be assessable under the head "Income from house property" and the other as income from "Other sources". The transaction was a single one and the consideration should, therefore, be treated as a composite one. **[1964] 051 ITR 0353-** Sultan Brothers Pvt. Ltd. vs. Commissioner of Income-tax (SC). The High Court in CIT v. Smt. P. Andal Ammal [2000] 243 ITR 715 (Mad) decided that the entire income in such a case will be assessable only as income from other sources / Business Income.

CONCLUSION

Where there is a Business of letting the property or there is incidental letting of property it shall be taxable as income under the head House Property. Where there is specific head provided for it one can not tax the income under the other head. However if there is composite letting of the property it can not be assessed under the head house property since it contemplates only the property income to be assessed there in.

MEANING OF : CURRENT REPAIRS

MEANING OF CURRENT REPAIRS

The law allows current repairs specifically under section 31 of the Income-tax Act. Current repairs do not rule out accumulated repairs undertaken during the year. Where a restaurant is renovated involving large outlay in replacement of airconditioning plants and parts of electric motors, etc., to renovate the same after a fire, the entire amount is allowable. [2002] 253 ITR 0405 VOLGA RESTAURANT (DELHI HIGH COURT) Various items of expenditure were incurred by the assessee by way of replacement and repairs of the damaged parts of the air-conditioning plant of its restaurant where some of the parts of the air-conditioning plant, such as electric motors, pumping sets, etc., were completely damaged, and the assessee had to remove them and replace them. But that did not mean that what the assessee put up was an entirely new air-conditioning plant after scrapping the old plant which was damaged in the fire as a total loss and that the assessee had tried to retain as much as possible of the existing air-conditioning plant which was not damaged by the fire and tried to restore the same by replacing the damaged parts of the plant with new parts. Hence, the expenditure of Rs. 1,21,752 incurred by the assessee in replacement of the air-conditioning plant was a revenue expenditure being in the nature of current repairs.

RATIO OF SOME OF OTHER DECIDED CASES

1. The expression “current repairs” in section 31 of the Income-tax Act, 1961, means expenditure on building, machinery, plant which is not for renewal or restoration.
2. It is only for preserving or maintaining an already existing asset which does not bring a new asset into existence or does not give to the assessee a new or different advantage and they must be such repairs as are attended to as and when the need for them arises and the question as to when a building, machinery, plant or furniture requires repairs and when the need arises must be decided not by any academic or theoretical test but must be decided by the test of commercial expediency.
3. But if the amount spent was for the purpose of bringing into existence a new asset or obtaining a new advantage, then such an expenditure would not be an expenditure of a revenue nature but it would be a capital expenditure.
4. “Repair” implies the existence of a thing which has malfunctioned and can be set right by effecting repairs which may involve replacement of some parts, thereby making the thing as efficient as it was before or as close to it as possible.
5. After repair the thing to which the repair was carried out continues to be available for use.
6. Replacement is different from repair. Replacement implies the removal or discarding of the thing that was in use, by a different or new thing capable of performing the same function with the same or greater efficiency. The replacement of a section in a series of machines which are interconnected, in a segment of the production process which together form an integrated whole may in some circumstances, be regarded as amounting to repair when without such replacement that unit in that segment will not function. That logic cannot be extended to the entire manufacturing facility from the stage of raw material to the delivery of the final finished product.
7. In CIT v. Sri Rama Sugar Mills Ltd., a decision reported in [1952] 21 ITR 191 (Mad). It was held therein that renewal is a repair if it is only restoration by renewal or replacement of subsidiary parts of a whole, and that if the reconstruction is of the entirety or of substantially the whole of the subject-matter, it is not a repair but a reconstruction.
- 8.

**[2002] 255 ITR 0243- COMMISSIONER OF INCOME-TAX VS. MADRAS CEMENTS LTD.
(MADRAS HIGH COURT)**

The assessee, a cement company invested a sum of Rs. 5,31,55,319 in installing a new cement mill known as “Combidan Cement Mill” during the year, which mill was technologically superior to the four cement mills which it had installed in the earlier years and which four old mills were subsequently sold. The assessee claimed that the sum invested was deductible as current repairs. The claim for deduction made under the head “Repairs” was made by the assessee despite the fact that it had in its own books of account, treated this investment as “investment on capital equipment” and the amount had been capitalised in its accounts. Held, that the Combidan Cement Mill which the assessee had installed and which replaced four old cement mills, was a new cement mill, installed at a different location, was technologically superior, was far more efficient than the four mills together and was capable of delivering a recognizably superior product. The acquisition and installation of that mill, could not by any stretch of imagination be regarded as “repair” to the four cement mills which were discarded and subsequently sold.

INTEREST ON CAPITAL BORROWED

INTEREST ON CAPITAL BORROWED FOR THE PURPOSE OF BUSINESS AND PROFESSION.

Expenditure associated with raising funds or borrowing money.

The appellant obtained a loan of Rs. 40 lakhs from the Industrial Finance Corporation secured by a charge on its fixed assets. In connection therewith it spent a sum of Rs. 84,633 towards stamp duty, registration fees, lawyer's fees, etc., and claimed this amount as business expenditure. Held, that the amount spent was not in the nature of capital expenditure and was laid out or expended wholly and exclusively for the purpose of the assessee's business and was therefore allowable as a deduction. The act of borrowing money was incidental to the carrying on of business, the loan obtained was not an asset or an advantage of enduring nature, the expenditure was made for securing the use of money for a certain period, and it was irrelevant to consider the object with which the loan was obtained. Obtaining capital by issue by shares is different from obtaining loan by debentures. A loan obtained cannot be treated as an asset or advantage for the enduring benefit of the business of the assessee. [1966] 060 ITR 0052A India Cements Ltd. vs. CIT (Supreme Court of India)

Interest paid in the pre-commencement period

As the expression "actual cost" has not been defined, it should be construed in the sense which no commercial man would misunderstand. For this purpose it would be necessary to ascertain the connotation of the expression in accordance with the normal rules of accountancy prevailing in commerce and industry. The accepted accountancy rule for determining cost of fixed assets is to include all expenditure necessary to bring such assets into existence and to put them in working condition. In case money is borrowed by a newly started company which is in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalised and added to the cost of the fixed assets created as a result of such expenditure. Interest paid before the commencement of production on amounts borrowed by the assessee for the acquisition and installation of plant and machinery forms part of the "actual cost" of the assets to the assessee and the assessee will be entitled to depreciation allowances with reference to such interest also. [1975] 098 ITR 0167W Challapalli Sugars Ltd. vs. Commissioner of Income-tax (Supreme Court of India)

Interest on un-paid consideration

Interest on unpaid consideration could not be treated as borrowal and would not, therefore, be allowable as a deduction under section 36(1)(iii), but all the same found that what does not fall under any of the sub-clauses would have to be considered for deduction and allowed, if warranted, under section 37. Such a view was taken in Bombay Steam Navigation Co. (1953) Pvt. Ltd. v. CIT [1965] 56 ITR 52.

Interest on amount received towards charity

In CIT v. Nanalal Mansukhram [2002] 253 ITR 50 (Guj), it was held that interest on amounts received towards charity is deductible because such funds pending disbursement for charity were put to business

use, so that it is allowable under section 36(1)(iii) as interest on borrowed capital. Such amounts received towards charity often described as dharmada or mahimai are treated as amounts not belonging to the assessee as they are bound to be spent for the purpose for which they are collected even as held in CIT v. Bijli Cotton Mills (P.) Ltd. [1979] 116 ITR 60 (SC) in the view that the amount so received is held in trust or legal obligation for charity. It follows that interest on the same should be allowable, so that there could be no reasonable controversy on this matter.

Successor's right to deduction of interest

Interest on borrowing for purposes of business of the subsidiary carrying on the same business, after amalgamation of subsidiary by the holding company, would be deductible in the hands of the holding company after amalgamation. It was so held in CIT v. Tata Chemicals Ltd. [2002] 256 ITR 395 (Bom). The business being one, it was found that there could be no disallowance. Where the assets and liabilities of a business are taken over as a going concern and such liabilities are continued to be treated as those of the business which has been taken over, such liability including bad debt should be deductible as held in CIT v. T. Veerabhadra Rao, K. Koteswara Rao and Co. [1985] 155 ITR 152 (SC), even in the context of the claim by the successor.

Diversion of borrowed funds for non-business purposes cannot be allowed:

While interest on borrowings for business is allowable as a deduction under section 36(1)(iii), such borrowing, if diverted would cease to be a borrowing for purposes of business, so that the proportionate interest is liable for disallowance. It was so held in K. Somasundaram and Brothers [1999] 238 ITR 939 (Mad) in the context of the borrowings being diverted for interest-free advances to relatives of parties. It was found that the fact that it was initially borrowed for the purposes of business cannot justify the deduction. It is expected that the capital borrowed for the purpose of the business continues to remain in business in the sense that it is used for business.

Dividends on preference shares is not deductible

A novel claim to treat preference shares as borrowings, so that dividend thereon could be claimed as a deduction under section 36(1)(iii) as interest on borrowed capital was not found acceptable in Kirloskar Electric Co. Ltd. v. CIT (No. 1) [1997] 228 ITR 674 and 676 (Kar). The argument in favour of the claim was that there is an assured return on such investment, but the High Court found that such dividend can be paid only out of profits and that the shares themselves are part of the capital of the company and cannot, therefore, be treated as borrowing. The claim was, therefore, considered "to be devoid of any merit and needs to be rejected outright".

Interest on borrowed capital for setting up a new factory, Expansion and Diversification.

Interest on borrowed capital for setting up a new undertaking even before it has started commercial production is allowable as a deduction under section 36(1)(iii). In view of settled law that borrowing for purposes of expanding an existing business would entitle deduction even if the new unit constitutes a separate and distinct undertaking as long as it is an expansion of an existing one. It was so held in CIT v. Malwa Vanaspati and Chemical Co. Ltd. [1997] 226 ITR 253 (MP) following, inter alia, the decision in CIT v. Alembic Glass Industries Ltd. [1976] 103 ITR 715 (Guj).

In case of [1976] 103 ITR 0715- CIT vs. Alembic Glass Industries Ltd. (Gujarat High Court) The assessee was a company manufacturing glass at Baroda from 1947. The company incurred expenditure for establishing a new glass manufacturing unit at Bangalore. The said unit did not go into production during the assessment years in question, and, therefore, during the course of assessment, the Income-tax Officer disallowed the payment of interest. Officer further held that the Bangalore unit was not a branch of the assessee's factory and was, therefore, a new business and since this new business had not started production, the payment of interest could not be taken as revenue expenditure. It was contended for the revenue that, since during the relevant account years, the unit at Bangalore had not started production, the payment of interest on the borrowing which was utilised for the purpose of establishing that new unit should go towards the cost of the new unit and this interest should be treated as a capital expenditure and not as a revenue expenditure.

Held,

1. That it could not be disputed that the business organisation, administration and fund of both the units of the assessee, namely, the unit at Baroda and the unit at Bangalore, were common.
2. There was one company which controlled the administration of both the units, which supplied the staff to both the units and which managed the whole of the business organisation of both the units. The production of both the units was considered the production of the assessee-company itself.
3. It was stated that the new unit at Bangalore was nothing but an expansion of the existing business. Thus, there was complete inter-connection, inter-lacing and inter-dependence of both the units, which is the test laid down for determining whether two lines of businesses constitute the "same business".
4. Where the borrowing is for the purpose of a business, the interest paid on such a borrowing becomes eligible for deduction. This would be so, whether the capital is invested in order to acquire a revenue asset or a capital asset, because the act of borrowing capital is distinct from the act of investment of the capital to acquire an asset;
5. The business for which an asset of enduring nature is purchased with the borrowed capital should not be separate or distinct from the business for the purpose of which the capital is borrowed,
6. If there is no existing business with reference to which the capital is borrowed and the borrowed capital is invested to purchase a new asset of enduring nature, then the interest paid on such borrowing till the asset so purchased goes into production, increases the cost of installation of the said asset, and hence should be treated as capital expenditure
7. Applying the above principles the interest incurred by the assessee on the borrowing utilised for the purpose of establishing the Bangalore unit is for the purposes of the assessee's business and as such allowable as revenue expenditure.

Interest paid for acquiring a capital asset in a running business was held allowable as revenue expenditure in CIT v. Kasthuri and Sons [2000] 241 ITR 412 (Mad), a point well-established in India Cements Ltd. v. CIT [196] 60 ITR 52 (SC).

In respect of a running business, interest on borrowing for purchase of a capital asset cannot be disallowed merely because the asset was never used, where the borrowing is for business. It was so held by the Supreme Court in CIT v. Associated Fibre and Rubber Industries Pvt. Ltd. [1999] 236 ITR 471.

Where it is a new industrial undertaking constituting expansion, such interest would be allowable as a deduction even in the year in which such liability has accrued. Though it is established law, such issues do come up on departmental objection. The law that has long since been established was followed in CIT v. Bhilai Iron Foundry P. Ltd. [1998] 234 ITR 661 (MP) following two earlier precedents of the same

High Court. However, it is necessary for the assessee to establish that though the product is a new one, the line is not independent of the existing business whether by way of expansion, diversification or otherwise. This has been the view that has been consistently taken in a number of cases, though the dispute often arises as to whether the new line of business constitutes a new activity or altogether a new business. But the conclusion in such a case is essentially one of inference from the facts and not one of law.

Capital Borrowed for Payment of Dividends

In case of **[1986] 161 ITR 0516A** CIT vs. Belapur Co. Ltd. (Bom) The interest paid on monies borrowed, which are utilised for payment of dividends to the shareholders of a company, is entitled to deduction under section 36(1)(iii) of the Income-tax Act, 1961, as the payment of dividend is part of the business of a company and one of its purposes and must be regarded as included in the connotation of the expression " for the purpose of the business " within the meaning 36(1)(iii). Further, the expression " for the purpose of the business " may take into account not only the day to day running of the business but several other matters.

Capital Borrowed for Payment of Income Tax

In case of **[1997] 224 ITR 0627B** East India Pharmaceutical Works Ltd. vs. CIT (Supreme Court of India) The appellant company had an overdraft account with a bank. During the year company claimed deduction of a sum of rupees 28,488 as expenditure under section 37(1), the said amount representing the interest which it had to pay on the overdraft amount, the said overdraft having been made for the payment of income-tax. The Income-tax Officer disallowed the deduction. The appellant contended, that the liability being to the tune of a couple of lakhs of rupees, if it had not been discharged, the entire business would have been crippled. Department is right in holding that the interest of Rs. 28,488 on money borrowed for payment of income-tax was not an expenditure laid out wholly and exclusively for the purpose of business as contemplated by section 37(1).

TAX TREATMENT OF BAD DEBTS

[1962] 046 ITR 0649- CIT vs. Mysore Sugar Co. Ltd. (Supreme Court of India)

The assessee who carried on the manufacture of sugar used to advance seedlings, fertilisers and money to sugarcane growers under an agreement by which the growers agreed to sell the next crop of the sugarcane grown by them exclusively to the assessee at current market rates and to have the advances adjusted towards the price of the sugarcane to be delivered to the company. In a certain year owing to drought the sugarcane growers could not grow sugarcane and the advances remained unrecovered. A Committee appointed by the Government recommended that the assessee should ex gratia forgo some of its dues. The assessee accordingly waived its right in respect of Rs. 2,87,422 and claimed this amount as a deduction. So far as the assessee-company was concerned it was merely making a forward arrangement for the next year's crops and paying an amount in advance out of the price and there was no element of a capital investment in making the advance and the loss incurred by the assessee was, therefore, a loss on the revenue side and was deductible.

[1970] 077 ITR 0751- CIT vs. Birla Bros. Pvt. Ltd. (Supreme Court of India)

The respondent, a private company, carried on the business of banking and financing and also of managing agency. Starch Products Ltd., was one of the various companies managed by the respondent. Starch Products Ltd., had appointed a selling agent and the respondent stood guarantee for a loan of Rs. 6 lakhs which was advanced by a bank to the selling agent of the managed company. The selling agent failed to pay the loan which at the relevant time stood at Rs. 5,60,199. This amount was paid by the respondent pursuant to the guarantee and, thereafter, the respondent treated the selling agent as its debtor for the amount. The selling agent went into liquidation and the respondent, not being able to recover any part of that amount, wrote off the sum of Rs. 5,60,199 in its accounts and claimed deduction thereof as a bad debt.

Neither the memorandum of association of the respondent, nor the managing agency agreement contained any provision whereby it could be said that the guaranteeing of the loan to the selling agent was done in the course of the managing agency business. Nor was there even material to show that the managed-company was under any legal obligation to finance the selling agent or to guarantee any loans to the selling agent. Held on the facts, that the sum of Rs. 5,60,199 was not allowable as a bad debt. The guaranteeing of the loan could not be said to have indirectly facilitated the carrying on of the respondent's business. Nor could it be said that it was in the larger interests of the respondent's business that the guarantee was given.

[1971] 079 ITR 0514- Indian Aluminium Co. Ltd. vs. CIT (Supreme Court of India)

A company in Montreal (Canada) provided the assessee with technical know-how, engineering services, etc. The agreement between the two companies provided for an annual retainer fees. There was no condition or stipulation that the fee would be payable by the assessee without TDS. The assessee had credited a total fee of Rs. 2,50,808 in favour of the Montreal company for a period of seven years. The Income-tax Officer treated the assessee as being in default in respect of the amount of tax liable to be deducted from the payments made to the Montreal company. The assessee paid the sum of Rs. 1,24,199 towards such tax and asked the Montreal company for reimbursement. The Montreal company refused to

reimburse the amount on the ground that it was bound neither morally nor contractually to meet the obligation of the Indian tax liability. The assessee wrote off the amount and the question was whether the sum was deductible either as a bad debt or as business expenditure. The amount which the assessee was bound to deduct from the payment made to the Montreal company and which it failed to recover from that company could not be regarded as a bad debt and the payment made under a statutory obligation because the assessee was in default could not constitute expenditure laid out for the purpose of the assessee's business.

[1967] 065 ITR 0403- Bharucha (B.D.) vs. CIT (Supreme Court of India)

Assessee was in the business of financing film producers and distributors had entered in to contract for share of profits in exploitation and exhibition of a particular picture. Provided that if picture not exhibited within stipulated time distributor to return all moneys advanced with interest. There was failure on part of distributor and moneys advanced was irrecoverable. The debt was in respect of and incidental to the business which was carried on by the appellant in the relevant year, it was found that it had become irrecoverable in the relevant accounting year, and the amount had actually been written off as irrecoverable in the books of the appellant. Therefore, all the conditions for the grant of the allowance were satisfied.

Bad Debts in case of succession of Business

A issue was decided by the Supreme Court in CIT v. T. Veerabhadra Rao, K. Koteswara Rao & Co. [1985] 155 ITR 152 in respect of a bad debt claim of an asset taken over by the transferee as successor to a running business. The Supreme Court found that the successor in such cases steps into the shoes of his predecessor. In this case the suit for recovery had already been instituted by the predecessor firm. It was held that when a debt was taken into account in computing the income of the assessee in earlier years even after transfer, there can be no difference in character of the asset in the hands of the transferee.

Loss in hire purchase business.

Where hire purchasers of vehicles default in paying stipulated instalments and the assessee, a financier, claimed loss, on sale of such repossessed vehicles with reference to the value of the asset as on the date of repossession, the Tribunal had taken the view that the vehicles not being stock-in-trade, the loss, if any, can be allowed only on sale of such seized vehicles. This was upheld by the High Court in Motor and General Sales (P.) Ltd. v. CIT [1997] 226 ITR 137 (All). In cases of financiers, such losses can be considered only as bad debts under section 36(1)(vii) read with section 36(2).

Bad debt-when can it be claimed as deduction ?

The present law effective from assessment year 1989-90 allows any debt "which is written off as irrecoverable in the accounts of the assessee for the previous year". This welcome reform in law relating to direct taxes would avoid the type of controversy that had arisen in Kamla Cotton Co. v. CIT [1997] 226 ITR 605 (Guj), where the amount available was not sufficient to recover debts of secured creditors with company meanwhile having been declared as a sick undertaking. The High Court found that there was no basis for disallowance as the duty to prove that it is bad or irrecoverable under the then law did not mean that the Department should insist upon infallible proof, when it was clear that the prospect of recovery was bleak. In coming to the conclusion the High Court followed its own decision in Sarangpur

Cotton Mfg. Co. Ltd. [1983] 143 ITR 166 (Guj) where it was pointed out that the write off itself is prima facie evidence that it had gone bad with the result that the burden of rebuttal was with the Income-tax Department to justify the disallowance. A similar view was taken in the cases of CIT v. Bombay Samachar Pvt. Ltd. [1969] 74 ITR 723 (Bom). In Jethabhai Hirji and Jethabhai Ramdas [1979] 120 ITR 792 (Bom) it was held that a bad debt could be allowed even when legal proceedings are still pending. Under the present law such issues should not arise as long as the write off is not mala fide.

Written off in the books of accounts – Scope of

Under section 36 it is clear that before any claim for allowance for a bad debt is held established by the Income-tax Officer it must appear that the concerned bad debt was written off as irrecoverable in the account books of the assessee for the relevant previous years. This requirement has become a condition for the grant of claim for bad debt allowance. The requirement of section 36(2) is that the concerned bad debt must have been written off as irrecoverable in the accounts of the assessee. If the debit entries posted by the assessee indicate the said fact the requisite statutory condition has got to be treated as fully complied with. Once the assessee has posted entries in the profit and loss account and corresponding entries are posted in the bad debt reserve account that would be sufficient compliance with the provisions of the statutory requirement for writing off as irrecoverable the concerned debt in the books of the assessee. No further requirement can be spelt out from the express language used by the Legislature. It is not necessary that the assessee must also post corresponding entries in the ledger account of the concerned parties and should close those accounts. **[1981] 130 ITR 0095-** Vithaldas H. Dhanjibhai Bardanwala vs. CIT (Gujarat High Court)

There is even an earlier decision of the Bombay High Court in CIT v. Jwala Prasad Tiwari [1953] 24 ITR 537, where the Revenue contended that unless the accounts of the parties are credited, there is no write off and that mere debit to the profit and loss account was not sufficient. Chagla C.J. did not accept such an argument in following words "What the section requires is that the amount should be written off in the books of the assessee and there could not be the slightest doubt that looking to the books of the assessee the amount has been written off. There is no more striking or significant way of writing off the amount than by debiting the amount to the profit and loss account". In another decision from the Gujarat High Court in Vithaldas H. Dhanjibhai Bardanwala v. CIT [1981] 130 ITR 95 (Guj), it was held that a debit entry to the profit and loss account, by itself, would constitute write off following the meaning assigned to "write off" in E. L. Kohler's Dictionary for Accountants as follows : "To transfer the balance of an account previously regarded as an asset to an expense account or to profit and loss account".

Section 36(1)(vii) requires that a bad debt should be "written off as irrecoverable in the accounts of the assessee in the previous year". Where it is clear that the debt has become bad, though the decision to write off was taken subsequent to the accounting year, the bad debt is admissible as a deduction as was found in Turner Morrison and Co. Ltd. v. CIT [2000] 245 ITR 724 (Cal), where it was pointed out that such decisions are ordinarily taken by the board of directors at the time when the accounts are being finalised, so that the fact that the resolution accepting such adjustments was passed subsequent to the accounting year need not stand in the way of deduction.

CASH EXPENSE / PAYMENT

CASH PAYMENT EXCEEDING RS. 20000

Section 40A(3) provide that, where the assessee incurs any expenditure in respect of which payment is made, in a sum exceeding twenty thousand rupees otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, twenty per cent. of such expenditure shall not be allowed as a deduction. Provided that no disallowance under this section shall be made where any payment in a sum exceeding twenty thousand rupees is made otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, in such cases and under such circumstances as may be prescribed having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

Cheque transactions carry conviction Entries in the accounts, whether by way of cash borrowings or other credits in the books classed as cash credits, or any payment which is chargeable in trading or PAL Account made in cash are to be proved. The same amount if received by cheque or paid by cheque carries greater conviction. The preference for cheque transactions as better proof of transactions has found its way in the statute as well in section 40A(3), section 269SS and 269T. It is very unfortunate that there should be so much faith in bank transactions as proof of genuineness since it is as easy to disguise cheque payments with reference to cheque transactions as in cash. Notwithstanding the fact that there could be tax evasion by adoption of cheque as a mode of payment, statutes as well as practice place greater faith in cheque transactions. Trade practice or the exigencies of business requiring cash payment in certain urgent circumstances, or where it is prompted by other considerations like lack of faith in the other party, a taxpayer may find himself in difficulties when he has to accept cash. The fact that banks take an unduly long time for cashing cheques, especially when they are out-station instruments is also a circumstance which is not taken into consideration when explanation is given for preference of cash to cheque.

Section 40A(3) of the Income-tax Act, 1961, says that the assessee should not incur any expenditure in a sum exceeding Rs. 20,000 otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft. Such expenditure shall not be allowed as deduction. Therefore, the law only says that the amount exceeding Rs. 20,000 should not be paid except by way of cheque drawn on a bank or by a crossed bank draft and if it exceeds this amount, then such expenditure shall not be allowed as deduction. It does not say that the aggregate of the amount should not exceed Rs. 20,000. The words used are "in a sum", i.e., single sum has been used. Therefore, irrespective of any number of transactions, where the amount does not exceed Rs. 20,000 the rigours of section 40A(3) will not apply. Commissioner of Income-tax Vs. Triveniprasad Pannalal (MP)

Section 40A(3) of the Income-tax Act, 1961, begins with a non obstante clause. It is an overriding provision which operates in spite of anything to the contrary contained in any other provision of the Act relating to the computation of income under the head "Profits and gains of business or profession". The Legislature has thus made it clear that the provisions of section 40A will apply in supersession of other contrary provisions of the Act relating to the computation of income. The word "expenditure" has not been defined in the Act. It is a word of wide import. Section 40A(3) refers to the expenditure incurred by the assessee in respect of which payment is made. It means that all outgoings are brought under the word "expenditure" for the purpose of the section. The expenditure for purchasing stock-in-trade is one of such outgoings. The value of the stock-in-trade has to be taken into account while determining the gross profits

under section 28 on principles of commercial accounting. The payments made for purchases would also be covered by the word "expenditure" and such payments can be disallowed if they are made in cash in sums exceeding the amount specified under section 40A(3). Rule 6DD of the Income-tax Rules, 1962, has to be read along with section 40A(3). Section 40A(3) is, therefore, attracted to payments made for acquiring stock-in-trade and other materials. *Attar Singh Gurmukh Singh v. ITO* [1991] 191 ITR 667 (SC), *Nathalal Jethalal Vs. Commissioner of Income-tax (Guj)* The provisions of section 40A(3) requiring that expenditure in excess of the stated amount would be allowed to be deducted only if made by a crossed cheque or crossed bank draft is not arbitrary and does not amount to a restriction on the fundamental right to carry on business. The terms of the section are not absolute consideration of business expediency and other relevant factors are not excluded. *Attar Singh Gurmukh Singh v. CIT* [1991] 191 ITR 667.

The Income-tax Act has not defined the word "expenditure". In the absence of a statutory definition, the court will have to consider the meaning of a word in the manner it is understood generally by those who deal with the subject in question. The assessee was a distributor of films. He paid an amount of Rs. 50,000 in cash for sole distributorship of a picture. Since the picture was a failure, the assessee did not release the film and wrote off this sum of Rs. 50,000. The amounts in question were paid by the assessee in the course of its business to acquire the assessee's stock-in-trade. In other words, the assessee was actually incurring a business expenditure while making the payments. The payments would fall within the concept of expenditure. Section 40A(3) applied. *Akash Films Vs. Commissioner of Income-tax (Kar)* Even if the payments were made by way of advances and were ultimately treated as discharging the liability to pay the price of the goods purchased, the payments so made must be considered to fall within the expression 'expenditure' incurred for payment of the price of the goods - *Kejriwal Iron Stores v. CIT* [1988] 169 ITR 12 (Raj.).

Where there are three parties, A, B and C, where A owes money to B, and B owes money to C, it is possible for B to ask A to take over the responsibility of repayment to C as long as C is agreeable to it. In such an event B would be repaying the money owed to C by a book entry crediting A and debiting C. In the case of A he would debit B and credit C, while C would credit B and debit A. There has been both borrowing and repayment as between the different parties with no cash passing between them. It cannot be said that this should have been done only by account-payee cheque as between the parties.

Conclusion

Provision of section 40A(3) shall apply only for actual cash payment. Any amount written off in the books of accounts or adjusted against other account shall not attract the provision. The expenditure for this purpose shall include any payment in form of trading advance or payment for acquisition of stock in trade. However any capital transaction shall not attract the provisions.

DEEMED INCOME / TRADING RECEIPT

Section 41(1) is intended to deem a receipt as income, where a trading liability ceases or is remitted. The application of section 41(1) is confined to the assessee who had been allowed the deduction for any provision or liability, so that only such person was liable to tax on the deemed income under section 41(1). The law was amended to make the successor liable, if such liability was taken over by the successor.

CIT v. Thirumalaiswamy Naidu and Sons [1998] 230 ITR 534, where the Supreme Court had held that any refund of amount, which was allowed as a deduction in computation of income in any earlier year, was covered by section 41(1) and that sales tax collected being a trading receipt as held in Chowringhee Sales Bureau P. Ltd. v. CIT [1973] 87 ITR 542 (SC), the refund received would have revenue character covered under section 41(1) of the Act. This decision was sought to be distinguished by the assessee on the ground that it was a case where refund was not disputed. It was pointed out by the Supreme Court in Thirumalaiswamy's case that the refund was taxable in the facts of the case, but it was only incidentally observed "the position has been placed beyond doubt by express provision of section 41(1) of the Income-tax Act".

Sales tax whether accounted under a separate head or as part of sales in accounting has to be treated as part of turnover, according to the Revenue, in view of the decision of the Supreme Court in Chowringhee Sales Bureau Pvt. Ltd. v. CIT [1973] 87 ITR 542 and Sinclair Murray and Co. Pvt. Ltd. v. CIT [1974] 97 ITR 615. It is only sales tax paid, which would be allowable as a deduction after section 43B.

In case of Jagdish Prasad Nigam v. CIT [1997] 228 ITR 112, the Allahabad High Court pointed out that excise duty collected from the customers as part of the price of goods will have to be treated as trading receipt and brought to tax following the decision in the sales tax case in Chowringhee Sales Bureau P. Ltd. v. CIT [1973] 87 ITR 542 (SC). The case for treating excise duty as a trading receipt is probably stronger because excise duty is part of production cost and more integrated as a component of price even where it is separately charged.

Commissioner of Income-tax Vs. State Trading Corporation of India Ltd. (Del) An assessee engaged in business of selling cars and collects deposits from buyers described as security deposits and forfeits the same with reference to the conditions for the deposit, where the booked cars are not purchased, such forfeited deposits relate to trading activity and, therefore, liable to be treated as trading profits. The argument was that the damages for breach of contract do not become a capital receipt in every case.

TDS ON WORK CONTRACT 194C

According to the provisions of section 194C, any person responsible for paying any sum to any resident for carrying out any work in pursuance of a contract between the contractor and the bodies specified therein shall, at the time of credit of such sum to the account of the contractor or payment thereof, in cash, etc., deduct an amount equal to 2% of such sum as income-tax on income comprised therein. Similarly, when a contractor makes payment to a resident sub-contractor in pursuance of a contract for carrying out the whole or any part of the work undertaken by him, he is required to deduct an amount equal to 1% of such sum as income-tax on income comprised therein. However, no such deduction is required to be made from any sum credited or paid in pursuance of a contract the consideration of which does not exceed Rs.20,000.

The provisions of that section would apply only in relation to "works contracts" and "labour contracts" and would not cover a contract for the sale of goods. (Circular No. 86,1 dated May 29, 1972)

The question of tax deduction under section 194C with reference to the gross payment due to the contractor or the net payment was essentially to be decided in the light of the terms of the particular contract and the conduct of the parties thereto. It was also stated that where the contractor had undertaken to construct a building or a dam, e.g., a composite works contract, and the Government or the other specified person had undertaken to supply all or any of the materials necessary for the work at stipulated price, the deduction would have to be related to the gross payment without excluding the cost of the materials. Circular No. 295

In the bidi manufacturing industry, generally there are three parties, the manufacturer, the munshis and the workers. The manufacturer provides the raw material, i.e., leaves, tobacco thread, etc., to the munshis who distribute the same to the workers who work at home. At regular intervals, the munshis collect the bidis prepared by the workers and hand over the same to the manufacturer. For this work, the manufacturer pays to the munshis, who in turn, make the payment to the workers. The workers as well as munshis get their payment at the rates agreed to. The Board have had occasion to examine the question whether a munshi engaged by the bidi manufacturers is a contractor or an agent and whether the provisions of section 194C would apply to the payments made to him. The Board advised the provisions of section 194C would apply in respect of payments made to munshis. It may be clarified that the provisions of section 194C are wide enough to cover oral contracts also. By the very nature of the functions performed by the munshis, there is an implied contract between the manufacturer and the munshis and, consequently, the munshis are contractors even though there is no written contractor agreement. As such, the provisions of section 194C would apply in respect of payments made to them. Circular 433 Where home workers are employed through the medium of agency such as Munshis but the workers bring bidi to the factory for quality check and for getting their payments then the deductions under section 194C to be made from the payments to Munshis need not include payments to such home workers. Circular 487

A question has arisen whether the provisions of section 194C are applicable to the payments made by a State Road Transport Corporation to private bus owners, from whom buses are hired for plying on specified routes. On the basis of terms and conditions, the Board have been advised that although the contract may appear to be a simple hire contract, it is actually a service contract (for carrying out any work) entered into between the State Road Transport Corporation and the owner of the bus for plying

certain buses on certain routes and subject to certain conditions. In such cases, the provisions of section 194C are applicable and tax will have to be deducted at source from the payment made to the private bus owners. Circular 558

The Finance Act, 1995*, has enlarged the scope of income-tax deduction at source by making various amendments. In regard to the changes introduced through the Finance Act, 1995, a number of queries have been received from the various associations and professional bodies on the scope of tax deduction at source. It would be desirable to clarify the doubts by issuing a public circular in the form of question answer as under : _

The term "advertising" has not been defined in the Act. The provisions of tax deduction at source would apply when a client makes payment to an advertising agency and not when an advertising agency makes payment to the media, which includes both print and electronic media. The deduction is required to be made at the rate of 1 per cent. It was further clarified that when an advertising agency makes payments to their models, artistes, photographers, etc., the tax shall be deducted at the rate of 5 per cent. as applicable to fees for professional and technical services under section 194J of the Act. Circular 715

At what rate is tax to be deducted if the advertising agencies give a consolidated bill including charges for art work and other related jobs as well as payments made by them to media ? The deduction will have to be made under section 194C at the rate of 1 per cent. The advertising agencies shall have to deduct tax at source at the rate of 5 per cent. under section 194J while making payments to artistes, actors, models, etc. Circular 715

Whether tax is required to be deducted at source on payments made directly to the print media/Doordarshan for release of advertisements ? The payments made directly to print and electronic media would be covered under section 194C as these are in the nature of payments for purposes of advertising. Deduction will have to be made at the rate of 1 per cent. It may, however, be clarified that the payments made directly to Doordarshan may not be subjected to TDS as Doordarshan, being a Government agency, is not liable to income-tax. Circular 715

Whether a contract for putting up a hoarding would be covered under section 194C or 194-I of the Act ? The contract for putting up a hoarding is in the nature of advertising contract and provisions of section 194C would be applicable. It may, however, be clarified that if a person has taken a particular space on rent and thereafter sublets the same fully or in part for putting up a hoarding, he would be liable to TDS under section 194-I and not under section 194C of the Act. Circular 715

The payments made to a travel agent or an airline for purchase of a ticket for travel would not be subjected to tax deduction at source as the privity of the contract is between the individual passenger and the airline/travel agent, notwithstanding the fact that the payment is made by an entity mentioned in section 194C(1). The provisions of section 194C shall, however, apply when a plane or a bus or any other mode of transport is chartered by one of the entities mentioned in section 194C of the Act. As regards payments made to clearing and forwarding agents for carriage of goods, the same shall be subjected to tax deduction at source under section 194C of the Act. Circular 715

Whether a travel agent/clearing and forwarding agent would be required to deduct tax at source from the sum payable by the agent to an airline or other carrier of goods or passengers ? The travel agent, issuing

tickets on behalf of the airlines for travel of individual passengers, would not be required to deduct tax at source as he acts on behalf of the airlines. Circular 715

Whether section 194C would be attracted in respect of payments made to couriers for carrying documents, letters etc. ? The carriage of documents, letters etc., is in the nature of carriage of goods and, therefore, provisions of section 194C would be attracted in respect of payments made to the couriers. Circular 715

In the case of payments to transporters, can each GR be said to be a separate contract, even though payments for several GRs are made under one bill ? Normally, each GR can be said to be a separate contract, if the goods are transported at one time. But if the goods are transported continuously in pursuance of a contract for a specific period or quantity, each GR will not be a separate contract and all GRs relating to that period or quantity will be aggregated for the purpose of the TDS. Circular 715

Whether a contract for catering would include serving food in a restaurant/sale of eatables ? TDS is not required to be made when payment is made for serving food in a restaurant in the normal course of running of the restaurant/cafe. Circular 715

Whether payment to a recruitment agency can be covered by section 194C ? Provisions of section 194C apply to a contract for carrying out any work including supply of labour for carrying out any work. Payment to recruitment agencies are in the nature of payments for services rendered. Accordingly, provisions of section 194C shall not apply. The payment will, however, be subject to TDS under section 194J of the Act. Circular 715

Whether section 194C would cover payments made by a company to a share registrar ? In view of the answer to the earlier question, such payments will not be liable for tax deduction at source under section 194C. But these will be liable to tax deduction at source under section 194J. Circular 715

Whether advertisement contracts are covered under section 194C only to the extent of payment of commission to the person who arranges release of advertisement, etc., or whether deduction is to be made on the gross amount including bill of media ? Tax is to be deducted at the rate of 1 per cent. of the gross amount of the bill. Circular 715

Whether deduction of tax is required to be made under section 194C for sponsorship of debates, seminars and other functions held in colleges, schools and associations with a view to earn publicity through display of banners, etc., put up by the organisers? The agreement of sponsorship is, in essence, an agreement for carrying out a work of advertisement. Therefore, provisions of section 194C shall apply. Circular 715

ASSOCIATION OF PERSONS

ISSUES / CLARIFICATION RELATING TO : ASSOCIATION OF PERSONS

Section 4 of the Act of 1961 says that income-tax shall be charged on the total income "of every person" and the expression "person" is defined in clause (31) of section 2. The definition merely says that the expression "person" includes, inter alia, a firm and an association of persons or a body of individuals whether incorporated or not. There are no words in the present Act which empower the Income-tax Officer or give him an option to tax either the association of persons or its members individually or for that matter to tax the firm or its partners individually. If it is the income of the association of persons in law, the association of persons alone has to be taxed; the members of the association of persons cannot be taxed individually in respect of the income of the association of persons. Consideration of the interests of the Revenue has no place in this scheme. **[1996] 218 ITR 0239-** Income-tax Officer vs. Atchaiah (Ch.) (Supreme Court of India) Under the present Act, the Income-tax Officer has no option He can, and he must, tax the right person and the right person alone.

Meaning of “associate”

The word "associate" means "to join in common purpose, or to join in an action". Therefore, "association of persons", as used in section 3 means an association in which two or more persons join in a common purpose or common action, and as the words occur in a section which imposes a tax on income, the association must be one the object of which is to produce income, profits or gains. The co-widows of a Hindu governed by the Mitakshara law inherited his estate which consisted of immovable properties, shares, money lying in deposit and a share in a registered firm. That, as there was no finding that the three widows had combined in a joint enterprise to produce income, and as they had done no act which had helped to produce the income, it could not be held that they had the status of an association of persons. **[1960] 039 ITR 0546-** Commissioner of Income-tax vs. Indira Balkrishna (Supreme Court of India)

The concepts of AOP or BOI may often be overlapping. But some distinctions between AOP and BOI are sometimes attempted. In AOP, all the members are competent to contract, while in the case of BOI it may not be so. Again another distinction made is that an AOP can contain persons other than individuals as members while BOI can have only individuals as members. The concept of BOI is sought to be relied upon by the Revenue, where the volition necessary for an AOP cannot be established. In Meera & Co's case, [1997] 224 ITR 635 it is clarified that mere co-trustees or co-executors do not always constitute a BOI, where they cannot constitute an AOP. In this elaborate judgement, the court has referred to a number of precedents as to the tests for constituting an AOP and more or less treated them as equally applicable for a BOI. [The view of the Revenue that in all cases where more than one person jointly receive income, the group has to be assessed as a BOI does not find support in these cases as in both cases the group of persons had active interest in business. If incomes of different individuals are combined as a matter of course merely because of the concept of BOI, income-tax will no longer be a personal tax and progressive rate of taxation based upon ability to pay would also have no meaning, if collective assessments are routinely made.]

Inherited Business

An individual who was carrying on business under the name of M and Co died intestate, and was survived by his mother, widow and three minor children. The mother of the deceased relinquished her interest in the assets of the deceased against a lump sum payment. The business, M and Co., was continued as a single unit in the same name by the widow, on her behalf and on behalf of the three minor children. When the minors along with their mother formed a body to generate income, the levy of tax under section 4 was on that body. The mother could not insist that the income of the joint venture must be assessed separately on the minors and her, even when a joint business was carried on. **[1997] 224 ITR 0635B** Meera and Company vs. Commissioner of Income-tax (Supreme Court of India) There is another decision in Bhupindra Food and Malt Industries v. CIT [1998] 229 ITR 496 (HP), where the Assessing Officer presumed an association of persons between an adult guardian and a minor. The assessee had claimed a partnership of four persons of which two were found to be not real partners, with the remaining two being an adult and a minor. The High Court found that there was no evidence of the guardian having given consent to the association on behalf of the minor for business with the result that there was no association of persons, which implied an agreement between two persons competent to contract. But the argument that in such a case a collective assessment is still possible as a body of individuals was not raised on behalf of the Revenue, though such an assessment was upheld by the Supreme Court in Meera & Co. v. CIT [1997] 224 ITR 635 in a respect of a business carried on by a mother along with her minor children.

Joint letting of Properties

D and G purchased a land jointly and jointly constructed a cinema theatre on it. There was an agreement for lease of the cinema theatre. The material on record showed that there had been a joint purchase of the land and the construction of the theatre had been jointly undertaken. Subsequently, in the lease deeds also there was no specification of shares nor specification of shares of the investment or expenditure. There had been a common venture for producing income and the assessee were assessable as an association of persons. **[1982] 138 ITR 0801A** Dar (M.K.) vs. Commissioner of Income-tax (Allahabad High Court)

Joint Investment

Assessee who worked in a cycle shop on daily wages of Rs. 2, purchased a lottery ticket for Rs. 2. He agreed to share 25 per cent. of the prize money with the second respondent as he was in need of 50 paise for the next meal. The agreement was reduced into writing. The ticket earned a prize of Rs. 17,85,000. That there was no agreement between the two respondents prior to the purchase of the lottery ticket to form an entity for the purpose of producing income by purchasing the lottery ticket. There was no consensus ad idem between these two persons to purchase the ticket for the purpose of producing the income. Hence, the ingredients for considering both of them as forming an association of persons were lacking. There was no association of persons between the two respondents and hence they could not be assessed in the status of association of persons. **[1997] 224 ITR 0391-** Commissioner of Income-tax vs. Arumugham Chettiar (O.K.) (Madras High Court)

Treatment of co-owned property

Where the property was co-owned by 65 co-owners deriving income from the lease rent, the Revenue took the matter to the Supreme Court against a decision of the High Court disputing the finding of the Tribunal that the assessment has to be made on the respective shares and not as an association of persons (AOP). The Supreme Court in CIT v. Shivsagar Estate [2002] 257 ITR 59 upheld the order of the High

Court solely on the ground that no appeal had been filed by the Revenue on an identical assessment in the previous year. Incidentally, it may be pointed out that even in respect of capital gains on sale of joint property, which was acquired jointly, the Madras High Court in CIT v. Deghamwala Estates [1977] 109 ITR 416 and [1980] 121 ITR 684 respectively held that capital gains on sale of such joint property cannot be clubbed together for assessments either as AOP or BOI (body of individuals), since the latter also would require the same condition that there should be a common purpose or common action with the object of producing income, profits or gains.

In CIT v. Smt. Vimla Lal [1983] 143 ITR 16 (All), it was pointed out that where the shares of the co-owners are definite, capital gains have to be assessed only in their respective hands and that the concept of BOI cannot be brought in.

SALARY & REMUNERATION, CLUBBING OF SPOUSE

SALARY, REMUNERATION TO SPOUSE FROM A CONCERN IN WHICH INDIVIDUAL HAS SUBSTANTIAL INTEREST.

64(1)(ii) provide that in computing the total income of any individual, there shall be included all such income as arises directly or indirectly to the spouse of such individual by way of salary, commission, fees or any other form of remuneration whether in cash or in kind from a concern in which such individual has a substantial interest. Provided that nothing in this clause shall apply in relation to any income arising to the spouse where the spouse possesses technical or professional qualifications and the income is solely attributable to the application of his or her technical or professional knowledge and experience.

The law would tackle any attempt to divert the income of a person to others to avoid proper tax liability at the progressive rate of taxation by disallowing any payment which is excessive or unreasonable, if paid to a relative or a related concern under section 40A(2). This provision should itself be sufficient for tackling tax avoidance. However, there are many redundant provisions in our law with the result that section 64(1)(ii) would club any payment of salary, commission, fees or any other form of remuneration to a spouse of an individual by himself or from a concern in which he has substantial interest, in such individual's hands, unless such spouse has technical or professional knowledge and experience.

Section 64(1)(ii) would require salary paid to a spouse to be included in the hands of the husband, if the spouse does not have technical or professional qualification. In a number of cases, courts have held that the expertise acquired during past experience would have to be treated as such qualification as would make the clubbing provision inapplicable. It has been so held in *Batta Kalyani v. CIT* [1985] 154 ITR 59 (AP); *Dr. J.M. Mokashi v. CIT* [1994] 207 ITR 252 (Bom) and *CIT v. Smt. R. Bharathi* [1999] 240 ITR 697 (Mad). There is a decision to the same effect in *CIT v. R. Jaya-lakshmi* [1999] 240 ITR 773 (Mad), where the husband had several decades of experience in managing the business though he did not have any academic qualification. In most of these decisions, it would appear that the provision is being applied without considering the purpose for which it was enacted.

In one such instance in *CIT v. Smt. Pratima Saha* [1999] 239 ITR 570 (Gauhati), salary paid by a medical practitioner to his wife, who was serving as a nurse in her husband's clinic, was clubbed in the hands of the husband on the ground that she did not have formal professional qualification by way of a degree or a diploma from a university or any other recognised institute as required under the Indian Nursing Council Act, 1947, overlooking the fact that trained and competent nurses in many private nursing homes are not having any such qualification, but all the same function as staff nurses and get paid for the same. In this case also, it was not that the Assessing officer found that she was not working as a nurse or that the reward was excessive. Because of such disallowances in such cases the taxpayer is worse off by engaging his wife for his business or profession.

In *R. S. Kini v. CIT* [1993] 71 Taxman 71 (Bom), the assessee's wife was a matriculate who attended to the business of the firm in which her husband was having substantial interest by looking after the correspondence and bank matters. All the same it was found that she did not have technical or professional qualification so that it had to be taxed in her husband's hands. It is necessary that the test that

should be substituted should be one of genuineness and reasonableness of payment with reference to services rendered; a test, which is already a part of our law in section 40A(2) of the Act.

In case of 168 ITR 598 Commissioner of Income-tax Vs. Sorabji Dorabji, court noted that “We find considerable force in the submission of the learned counsel for the assessee that the words 'technical or professional qualifications', occurring in the first part of the proviso do not necessarily relate to the technical or professional qualifications acquired by obtaining a certificate, diploma or a degree or in any other form from a recognised body like a university or an institute. That this was not the intention of the Legislature is clear from the use of the expression 'knowledge and experience' in the latter part of the proviso, as otherwise it would have been perfectly permissible for the Legislature to use the same expression as occurring in the first part. The harmonious construction of the two parts of the proviso, in our opinion, would be that if a person possesses technical or professional knowledge and the income is solely attributable to the application of such technical or professional knowledge and experience, the requirement for the application of the proviso is satisfied, although the person concerned may not possess any qualification issued by a recognised body. In our opinion, the Tribunal erred in coming to the conclusion that unless a recognised body conferred a qualification, it should not be considered that a person possessed technical or professional qualifications. It is enough, in our opinion, for the purpose of the proviso, if the recipient of the salary possesses the attributes of technical or professional qualifications, in the sense that he has got expertise in such profession or technique. If by the use of that expertise in the profession or technique, the person concerned earns salary, then the latter part of the proviso is also satisfied.”

[1999] 238 ITR 1044 COMMISSIONER OF INCOME-TAX VS. SHRI OM PRAKASH (SC) When the karta of a Hindu undivided family is a partner in a partnership firm, he has a dual capacity; qua the partnership, he functions in his personal capacity and qua third parties, in his representative capacity. Under the Income-tax Act, 1961, when he is assessed in respect of the income derived by him from the partnership firm as a partner, it is in his representative capacity as karta of the Hindu undivided family and not as an individual as such. That is because his capacity vis-a-vis his spouse/minor children who are members of the Hindu undivided family is that of karta and not as individual though vis-a-vis other partners of the partnership firm he functions in his personal capacity. This being the position, the income of a karta's spouse/minor child cannot be included in the computation of his total income for that is the income of the Hindu undivided family and, not his individual income. Section 64 of the Income-tax Act, 1961, will be attracted only when an assessee's own income is being assessed and not that of a Hindu undivided family. If a karta is brought within the ambit of "individual" in section 64(1), the share income of the spouse of the karta and his minor children will, in effect, be included in the income of the Hindu undivided family which is not what is contemplated by section 64(1)(i) and (ii) which is impermissible.

SCOPE OF BUILDING

SCOPE OF "BUILDING" FROM DEPRECIATION POINT OF VIEW.

Building generally would mean **walled roofed structure**: a structure with walls and a roof, for example, a house or factory or **making large structures** the business or task of constructing houses, factories, bridges, and other large structures.

[1967] 065 ITR 0377- CIT vs. Alps Theatre (Supreme Court of India)

Depreciation is not allowable on the cost of the land on which a building is erected but only on the cost of the superstructure. The word "building" means structures and does not include the site.

[1996] 218 ITR 0511- Commissioner of Income-tax vs. Indian Oil Corporation Ltd. (Bombay High Court)

The assessee included the premium paid by it on the leasehold land in the cost of the building constructed thereon for the purpose of allowance of depreciation under section 32 of the Income-tax Act, 1961. The Tribunal allowed the depreciation claimed by the assessee. Held, that no depreciation was allowable in respect of premium paid by the assessee for the lease-hold land because the premium was not includible in the cost of the superstructure constructed thereon. CIT v. Alps Theatre [1967] 65 ITR 377 (SC) followed.

[1992] 196 ITR 0149A CIT vs. Gwalior Rayon Silk Manufacturing Co. Ltd. (Supreme Court of India)

The word "building" in its connotation is referable to something that is a constructed one as a structure or super-structure on land with walls and roof. Since the Act did not give a definition of its own, the dictionary meaning of "building", which means "a house or anything which is built, a structure", is to be adopted.

The roads laid within the factory premises as links or providing approach to the buildings are necessary adjuncts to the factory buildings to carry on the business activity of the assessee and would be building within the meaning of section 32 of the Act. The capital expenditure incurred thereon is admissible to depreciation on written down value. Equally, the drains also would be an integral part of building for the convenient enjoyment of the factory.

In other words Roads laid within factory premises as links or providing approach to the buildings to carry on the business activity of the assessee are "buildings" within the meaning of section 32. Depreciation is admissible on the capital expenditure incurred thereon as "building". Equally, drains also would be an integral part of the building for convenient enjoyment of the factory. Depreciation would be available in the same manner on expenditure incurred in laying drains.

[1980] 126 ITR 0347- CIT vs. Engine Valves Ltd. (Madras High Court)

The proper view-point from which one must approach the question of interpretation of the term "factory building", with respect to depreciation allowable under the Income-tax Act and Rules, would be to look at

the operative words functionally as intending to provide for wear and tear of depreciable assets. Therefore, one must exclude from consideration judicial interpretation of the term "factory", occurring in other enactments such as the Factories Act, 1948. A canteen, by virtue of its purpose and function, is susceptible to a higher rate of wear and tear than ordinary buildings, although the wear and tear may not approach the high rate which would affect parts of a building where plant and machinery and other moving parts engaged in the process of manufacture are fixed. This is because, a canteen as such is a place, which a large assemblage of people who might be described as a floating population, constantly put to use. It is also subject to recurrent cleaning, washing and other processes which inevitably bring about a higher rate of wear and tear. The second reason is that a canteen where cooking and other preparations are carried on either in the kitchen or elsewhere, can be regarded in the strictest sense of the term, as a place where manufacture is carried on, although, in normal parlance, we do not refer to the process of cooking as a process of manufacture. But, whatever expression we might employ to describe the culinary process, there is no doubt whatever that the use of fuel and other reforms of energy in that part of the canteen, would have the same damaging effect on the life of the building as a regular manufacturing process would by the use of plant or machinery. In cases where modern mechanical processes are adopted in a kitchen or canteen for the purpose of cooking meals and making other preparations, the analogy of a manufacturing process would be more apparent. Moreover, it is common knowledge and also part of the statute law governing the running of factories, that every factory has within its precincts a canteen run for the benefit of the workers employed therein. In this respect, the canteen must be considered as a part and parcel of the factory premises and the canteen building must be regarded as a factory building. A canteen building is, therefore, in the proper sense of the term, a "factory building" for the purpose of depreciation allowance.

[1996] 221 ITR 0123B CIT vs. Associated Flour Mills P. Ltd. (Gauhati High Court)

Depreciation was allowable in respect of the temple building constructed within the premises of the assessee.

[2001] 247 ITR 0803- INDORE MUNICIPAL CORPORATION VS. CIT (SC)

Question before the court was, Whether, the expenditure incurred by the assessee towards construction of the metal roads on trenching grounds was an item of revenue deduction ? and Whether, the assessee was entitled to depreciation on the amount of the cost of construction of metal roads on the trenching grounds ?

Learned counsel for the assessee has invited attention to the decision of this SC in CIT v. Gwalior Rayon Silk Manufacturing Co. Ltd. Where the roads were constructed to approach about 500 trenches for dumping waste and night soil in the trenches and transporting the processed manure. The High Court while answering the said question has said that the roads could not be treated as "building". In CIT v. Gwalior Rayon Silk Manufacturing Co. Ltd. (SC), while construing the expression "building" in section 32, has observed that the roads and roadways are adjuncts of the building lying within the factory area linking them together and are being used for carrying on its business by the assessee. And thus qualifies for the purpose of depreciation.

However Held in this case that the expenditure incurred by the assessee towards construction of the metal roads on trenching grounds was not revenue expenditure. That the roads were not buildings. As there was no other construction except the roads, the roads by themselves could not constitute buildings, and the assessee was not entitled to depreciation on the cost of construction of the roads.

USED FOR THE PURPOSE OF BUSINESS & PROFESSION

SCOPE OF “USED FOR THE PURPOSE OF BUSINESS AND PROFESSION”

Sections 30, 31 and 32 uniformly use the expression “used for the purposes of the business or profession”. The emphasis here is on the user for business or profession and it excludes user for purposes other than the business or profession. To the extent of such user for non-business or non-professional purposes, the benefit allowed under sections 30, 31 and 32 is required to be reduced proportionately. If payment or expenditure is incurred for the purpose of the trade of the assessee it does not matter that the payment may benefit a third party. The fact that a benefit is obtained by a third party by reason of an expenditure incurred by an assessee does not ipso facto result in the assessee not being regarded as having incurred the expenditure solely and exclusively for its business. What is important is the intention of the assessee and the user by the assessee of the machinery in relation to his business.

The words “used for the purpose of business” are capable of a larger and narrower interpretation. If the expression “used” is construed strictly it could be taken as connoting or requiring the active employment or the actual working of the machinery, plant or building in the business. On the other hand the wider meaning would include not only cases where the machinery or plant are actively employed but also cases where there is passive user of the same in business. An asset could be said to be in use when it is kept ready for use.

[1996] 221 ITR 0857- CIT VS. INDIA TEA AND TIMBER TRADING CO. (GAUHATI HIGH COURT)

The assessee owned a sugar mill. The Assessing Officer denied depreciation in respect of the factory, plant and machinery as there was no production and no user of machinery during the year. The Tribunal upheld the claim of the assessee on the basis of passive user by keeping the machinery in readiness. On a reference held, that the expression "used" should have a wider meaning so as to include not only actual but also passive user and depreciation was allowable.

[1971] 079 ITR 0613- WHITTLE ANDERSON LTD. VS. CIT (BOMBAY HIGH COURT)

The assessee-company which owned two cotton ginning and pressing factories and two other concerns, owning in all four presses, entered into a pooling agreement. As the agreement clearly provided that, although two out of the four presses which were directly in the pooling arrangement were to remain idle while the two presses worked, the owners of those presses which were idle had to keep them ready for use at any time and the contingency for their use could also, upon the terms of the agreement, arise at any time and having regard to the above meaning of the word "used", it is clear that even these presses which remained under forced idleness were in use during the entire period of the year.

[1994] 206 ITR 0682- CIT VS. ORIENTAL COAL CO. LTD. (CALCUTTA HIGH COURT)

Section 32(1) lays down two conditions to be satisfied by an assessee before claiming any depreciation.

These two conditions are, firstly, that the plant and machinery must be owned by the assessee and, secondly, the plant and machinery must be used for the purposes of business of the assessee. In certain cases of a pooling arrangement or where plant and/or machinery is kept as standby to provide against breakdown, even a passive user may entitle the assessee to claim depreciation under section 32 because in both these cases, the machinery is kept ready for use in the factory. Where the factory of the assessee remained under lock-out throughout the two previous years during the lock-out period, the plant and machinery had not been actually used for the purposes of the business. Held, that depreciation under section 32 of the Act was not allowable on such plant and machinery.

[2002] 253 ITR 0303- COMMISSIONER OF INCOME-TAX VS. PEPSU ROAD TRANSPORT CORPORATION (PUNJAB AND HARYANA HIGH COURT)

The assessee was a transport corporation. It had a large fleet of buses. These can normally be seen standing by the road side. Thus, it had to keep spare engines in store. The engines are meant to be used in case of need. There is a normal depreciation of value even when a machine or equipment is merely kept in a store. Secondly, keeping in view the nature of the assessee's business, it had to necessarily keep certain spare engines in store to meet an emergent situation. There was nothing on record to indicate that an engine, which was purchased a year or two earlier, would fetch the same price in the open market. The Tribunal was right in law in allowing depreciation on the spare engines lying in the stock of the assessee.

[2002] 255 ITR 0068- COMMISSIONER OF INCOME-TAX VS. INDIAN EXPRESS (MADURAI) PVT. LTD. (MADRAS HIGH COURT)

Is it necessary that the assessee should use the plant and machinery on which depreciation is claimed exclusively by it ? In CIT v. Indian Express (Madurai) Pvt. Ltd. [2002] 255 ITR 68 (Mad), it was held that the fact that the product of the machinery is used by a sister concern should not stand in the way of the claim being allowed.

If the investment is made by the assessee and ownership vests in the assessee, expense is incurred by the assessee, the machine is used for the business of the assessee, and the machine has not been used by the assessee for any non-business or non-professional use, the expenditure incurred on the machinery is commercially expedient from the point of view of the business of the assessee, and if the business of the assessee is benefited from the user of the machine, then the identical sharing of the benefits obtained from the user of the machine with an associate would not render the user of the machine non-exclusive for the purpose of section 38(2).

DISSOLUTION OF FIRM

SCOPE OF 45(4) FOR THE DISTRIBUTION OF ASSETS ON DISSOLUTION OR OTHER WISE.

Section 45(4) provides that profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and, for the purposes of section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of the consideration received or accruing as a result of the transfer. Section 2 (47) (vi) provides that "transfer", in relation to a capital asset, includes, any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

The assessee firm was holding two properties Prop G and K. The cost of both the properties were Rs. 3,90,230 and Rs. 1,36,867 respectively. These two properties were claimed to have been transferred to the respective occupant partners. Also observed that originally the firm was consisting of these two partners. Sri N.R. Kapur retired from the firm but before that the wife of Sri. N.R. Kapur, namely, Mrs. Sunita was introduced as partner. Referring to the partnership deed, the Assessing Officer noted that to retire, a partner was to give three months' notice. Sri. N.R. Kapur retired which, according to him, showed that all these persons knew that Sri. N.R. Kapur was retiring and Mrs. Sunita was introduced to avoid legal dissolution. This, according to officer, showed that she was introduced only to avoid the application of the provision of section 45(4) of the Act.

The assessee submitted that this section applies only when there is a dissolution of partnership and in the present case, there was neither dissolution nor transfer, inasmuch as the properties stood in the respective names of the two partners and it was a case of simple withdrawal. Assessee narrated that there was no transfer either on dissolution or otherwise as the flats were merely withdrawn from the firm and there was no transfer on dissolution on retirements. Even if section 45(4) of the Act applies, there being no transfer or deemed transfer, the distribution of assets or even extinguishment of a right on dissolution or retirement, if any, would not be liable to capital gains tax. In this connection, he relied on the decision of the Supreme Court in the case of *Malabar Fisheries Co. v. CIT* [1979] 120 ITR 49 wherein it was held that on dissolution of firm, there is no transfer of assets to the partners and another decision of the Supreme Court in the case of *Addl. CIT v. Mohanbhai Pamabhai* [1987] 165 ITR 166 upholding the decision of the Gujarat High Court wherein it was held that on retirement, there is no transfer of assets by the firm to the partners.

The Assessing Officer held that the transaction was covered by the words "or otherwise" appearing in section 45(4) of the Act, even if there was no dissolution of the firm. Assessing Officer determined the market value of the two properties at Rs. 1,53,07,500 and reducing therefrom the written down value of the two flats at Rs. 5,27,097, he determined the capital gains assessable under section 45(4) of the Act, at Rs. 1,47,80,403. The learned Departmental Representative, submitted that section 45(4) of the Act is clearly applicable in the instant case. Section 45(4) of the Act, according to him, covers not only the transfers "by way of distribution of assets on dissolution of firm" but transfers "otherwise" as well.

Withdrawal of assets, by whatever name called, from the firm was a transfer even under section 2(47)(vi). The firm has allowed the possession of the assets to the partners as is evident from a letter by the firm addressed to the Society, to change the name of ownership. He further submitted that section 45(4) of the Act is a specific mode of transfer and the words "or otherwise" includes every such distribution not necessarily on dissolution or retirement alone.

Decided in *Burlingtons' Exports vs. Assistant Commissioner of Income-tax* 45 ITD 424 that there is force in the contention of the counsel for the assessee, that there should be a distribution of assets by the firm to the partners so as to invoke the provisions of section 45(4) of the Act. The words "or otherwise" are used as an alternate to the words "on dissolution" and, therefore, in both the situations, i.e. on dissolution or otherwise, the distribution of a capital asset is a must. What is distribution of capital asset is not defined in the Act. Generally, it is the allocation of the assets by the firm given to the partners or the legal heirs on dissolution, retirement, death or exclusion of one or more of the partners of the firm and in cases of mere change in the constitution of a firm. However, if such withdrawal is for consideration, it would be a case of sale by the firm to the partners and not distribution. In distribution, no consideration is involved and the partners have to share the withdrawal in their prescribed sharing ratio, agreed to in the partnership deed. Court agreed with the assessee that the withdrawal of these properties by the two occupant-partners was not a distribution of capital asset. It was not without any consideration. Partners' accounts were debited by the respective consideration agreed. In our opinion, therefore, section 45(4) of the Act has no application to the facts of the case.

CIT v. A.N. Naik Associates [2004] 136 Taxman 107/265 ITR 346

Section 45(4) of the Income-tax Act, 1961 treats the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm, or otherwise, as a taxable capital gain. The expression 'or otherwise' has been the subject-matter of judicial scrutiny, especially in situations where there was only retirement of a partner without there being any dissolution of the firm. In this article, the author analyses this issue, with particular reference to the recent judgment of the Mumbai High Court holding that the term 'otherwise' covers a case of retirement also. *CIT v. A.N. Naik Associates* [2004] 136 Taxman 107/265 ITR 346

The question then arises is what meaning and significance is to be attributed to the expression 'otherwise' in section 45(4). In our opinion, it should cover cases akin to dissolution, e.g., if partnership consists of two partners and one of the partner dies, there is a deemed dissolution. The decision of the Mumbai High Court requires reconsideration since it unsettles the previously accepted position that there was no transfer in case of retirement in a continuing business. The recent liberalization and reform process initiated under the Act has indicated the mind of the Legislature that there should be no gains on bona fide business reorganisation, if that holds good for the Corporate Sector there is no reason why the same analogy cannot be applied to the firms which are a large constituent of the business in India. Nevertheless, the decision of the Mumbai High Court has indeed thrown up a controversy which would need an urgent resolution by the Apex Court.

CAPITAL OR REVENUE EXPENDITURE

1. Capital expenditure cannot be attributed to revenue and vice versa.
2. It is equally clear that a payment in a lump sum does not necessarily make the payment a capital one. It may still possess revenue character in the same way as a series of payments.
3. If there is a lump sum payment but there is no possibility of a recurrence, it is probably of a capital nature, though this is by no means a decisive test.
4. If the payment of a lump sum closes the liability to make repeated and periodic payments in the future, it may generally be regarded as a payment of a revenue character.
5. If the ownership of the money, whether in point of fact or by a resulting trust, be still in the taxpayer, then there is acquisition of a capital asset and not an expenditure of a revenue character - Indian Molasses Co. (P) Ltd. V/s. CIT [1959] 37 ITR 66 (SC).
6. When expenditure is incurred not only once and for all, and with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, ordinarily such expenditure is on capital account;
7. Where the expenditure is incurred in the field of fixed capital, it is on capital account, but if it is a part of the circulating capital, it is on revenue account;
8. If the expenditure is a part of the working expenses in ordinary commercial trading, it is not capital but revenue expenditure;
9. If the expenditure is incurred for the initial outlay or for extension of business or substantial replacement of equipment, it is capital expenditure but if it is incurred for running the business or is laid out as part of the process of profit making, it is revenue in character; and
10. If expenditure is incurred for ensuring the regular supply of raw material, maybe for period extending over several years, it is on revenue account - Gujarat Mineral Development Corp. Ltd. v. CIT [1983] 143 ITR 822 (Guj.).
11. Outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment;
12. Expenditure may be treated as properly attributable to capital when it is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade. If what is got rid of by a lump sum payment is an annual business expense chargeable against revenue, the lump sum payment should equally be regarded as a business expense, but if the lump sum payment brings in a capital asset, then that puts the business on another footing altogether
13. Whether for the purpose of the expenditure, any capital was withdrawn, or, in other words, whether the object of incurring the expenditure was to employ what was taken in as capital of the business. Again, it is to be seen whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital.
14. If the expenditure is for the initial outlay or for acquiring or bringing into existence an asset or advantage of an enduring benefit to the business that is being carried on, or for extension of the business that is going on, or for a substantial replacement of an existing business asset, it would be capital expenditure.
15. If, on the other hand, the expenditure, although for the purpose of acquiring an asset or advantage, is for running of the business or for working out that asset with a view to produce profit, it would be revenue expenditure.
16. If the outgoing is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit earning process or operations, and not for the acquisition of an asset of

a permanent character, the possession of which is a condition precedent for the running of the business, then it would be expenditure of a revenue nature.

17. Special knowledge, or technical knowledge, or a patent, or a trade mark, is an asset and if it is acquired by payment for use and exploitation for a limited period, and what is acquired is not an asset or advantage of an enduring nature and at the end of the agreed period that advantage or asset reverts back intact to the giver of that special knowledge or the owner of the patents or trade marks, it would be expenditure of a revenue nature.
18. If it is intrinsically a capital asset, it is immaterial whether the price for it is paid once and for all, or periodically, or whether it is paid out of capital or income, or linked up with the net sales. The outgoing, in such a case, would be of the nature of capital expenditure.
19. If the amount paid for the acquisition of an asset of an enduring nature is settled, the mere fact that the amount so settled is chalked out into various small amounts or periodic installments, the capital nature of expenditure would not cease to be so or alter into the nature of a revenue expenditure.
20. A lump sum amount for liquidating recurring claims would not cease to be revenue expenditure or get converted into capital expenditure merely because its payment is spread over a number of years. It is the intention and object with which the asset is acquired, that determines the nature of the expenditure incurred over it, and not the method or the manner in which the payment is made, or the source of such payment. If the expenditure is recurring and is incurred during the course of business or manufacture, it would be revenue expenditure.
21. An asset or advantage of an enduring nature does not mean that it should last for ever. If the capital asset is, in its nature, a short-lived one, the expenditure incurred over it does not, for that reason, cease to be a capital expenditure.
22. It is not the law that if an enduring advantage is obtained, the expenditure for securing it must always be treated as capital expenditure. If the advantage acquired is to get the stock-in-trade of the business, then it would be revenue expenditure. But if what is acquired is not the advantage of getting the stock-in-trade directly, but of something which has to be dressed up or processed before it is converted into stock-in-trade, the expenditure incurred over it would be capital expenditure.

If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If, on the other hand, it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits, it is a revenue expenditure .

. . The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure. In *Assam Bengal Cement Co. Ltd. v. CIT* [1955] 27 ITR 34,

Lakshmiji Sugar Mills Co. P. Ltd. v. CIT [1971] 82 ITR 376 (SC), wherein the assessee-company was carrying on the business of manufacture and sale of sugar. It paid to the Cane Development Council certain amounts by way of contribution for the construction and development of roads between the various sugarcane producing centres and the sugar factories of the assessee. The roads remained the property of the Government. The apex court held that the expenditure was not of capital nature and had to be allowed as an admissible deduction in computing the profits of the assessee's business. The expenditure was incurred for the purpose of facilitating the running of the assessee's motor vehicles and other means employed for transportation of sugarcane to its factories.

In the case of *L. H. Sugar Factory and Oil Mills (P.) Ltd. v. CIT* [1980] 125 ITR 293 (SC), the assessee was carrying on the business of manufacture and sale of sugar. It had its factory in U. P. The assessee

paid a contribution towards meeting the cost of construction of roads in the area around its factory under a sugarcane development scheme. The question was whether this amount was deductible in computing the assessee's profits. The apex court held that it was, because although the advantage secured was of long duration, it was not an advantage in the capital field because no tangible or intangible asset was acquired by the assessee nor was there any profit to or expansion of the profit-making apparatus of the assessee. The amount was contributed for the purpose of facilitating the business of the assessee and making it more efficient and profitable. It was, therefore, held to be expenditure of revenue nature.

In case CIT v. Associated Cement Companies Ltd. [1988] 172 ITR 257 (SC), the respondent-company entered into an agreement to supply water to the municipality and provide water pipelines as also to supply electricity for street lighting and put up a transmission line for that purpose. The assessee also agreed to concrete the main road from the factory to the railway station. The amounts expended for these purposes were held to be revenue expenditure since the installation and accessories were the assets of the municipality and not of the assessee. The expenditure, therefore, was held to be not of capital nature. The advantage secured by the respondent was immunity from liability to pay municipal rates and taxes for a period of 15 years. The apex court said that had these liabilities been paid the payment would have been on revenue account. Therefore, the advantage secured was in the field of revenue and not capital.

In case of CIT v. Bombay Dyeing and Manufacturing Co. Ltd. [1996] 219 ITR 521 (SC), the company contributed to the State Housing Board certain amounts for construction of tenements for its workers. The tenements remained the property of the Housing Board. It was held that the expenditure was incurred wholly and exclusively on the welfare of the employees and, therefore, constituted legitimate business expenditure. As the assessee-company acquired no ownership rights in the tenements, the apex court said that the expenditure was incurred merely with a view to carry on the business of the company more efficiently by having a contented labour force. All these cases have looked upon expenditure which did bring about some kind of an enduring benefit to the company as a revenue expenditure when the expenditure did not bring into existence any capital asset for the company. The asset which was created belonged to somebody else and the company derived an enduring business advantage by expending the amount. In all these cases, the expenses have been looked upon as having been made for the purpose of conducting the business of the assessee more profitably or more successfully.

The apex court in the case of CIT v. Madras Auto Service (P.) Ltd. [1998] 233 ITR 468 had an occasion to deal with an question on similar facts. In that case, the assessee was a company carrying on the business of sale of motor parts. Its head office was at Madras. It had a branch at Bangalore. Under the agreement of lease the assessee obtained certain premises for a period of thirty nine years at Bangalore. Under the terms and conditions of the lease, the lessee (that is to say the assessee), had the right to demolish at its own expense the existing premises and appropriate to itself all the material, thereof, without paying to the lessors any compensation and construct a new building thereon to suit the purpose of their business as per the plan approved by the lessors. Under clause 2 of the lease deed, the lessee was required to pay a rent of Rs. 1,000 per month for the first fifteen years, Rs. 1,500 per month for the next ten years, Rs. 1,650 per month for the next ten years and Rs. 2,000 per month for the remaining years. The lease deed further provided that the new construction shall, right from the commencement of the work, be the property of the lessors and upon completion of the work of construction the lessee would have only the right to be a tenant for a period of 39 years under the existing lease, subject to the payment of rent and observation of other terms and conditions of the lease. The lessee would not be entitled under any circumstances to any compensation whatsoever on account of its putting up the new construction in place of the old. Acting under the lease agreement, the assessee invested a sum of Rs. 1,62,835 in the

previous year and Rs. 50,937 during the succeeding year in constructing a new building on the said land. The assessee claimed before the Income-tax Officer the expenditure of the said sums of Rs. 1,62,835 and Rs. 50,937 in the relevant assessment years as capital loss. In the alternative, the assessee claimed deduction of the payments as business expenditure or as extra rent for the lease. Ultimately, the Income-tax Appellate Tribunal held that the expenditure of the said two amounts for the construction of a new building was in the nature of business expenditure for proper carrying on of the business of the assessee. The Tribunal had, therefore, treated these amounts as revenue expenditure. This was upheld by the High Court. On appeal to the Supreme Court, while dismissing the appeal, the apex court held that right from inception, the building was of the ownership of the lessor. By spending this money, the assessee did not acquire any capital asset. The only advantage which the assessee derived by spending the money was that it got the lease of a new building at a low rent. From the business point of view, therefore, the assessee got the benefit of reduced rent. The expenditure was, therefore, treated as revenue expenditure.

EXEMPTIONS FROM CAPITAL GAINS

EXEMPTION FROM CAPITAL GAINS IN RESPECT OF HOUSE AN OVERVIEW

Section 54 basically provide that where, in the case of an assessee being an individual or a Hindu undivided family the capital gain arises from the transfer of a long-term capital asset being buildings or lands appurtenant thereto, and being a residential house, the income of which is chargeable under the head "Income from house property" (hereafter in this section referred to as the original asset), and the assessee has within a period of one year before or two years after the date on which the transfer took place purchased, or has within a period of three years after that date constructed, a residential house, then instead of the capital gain being charged to income-tax as income of the previous year in which the transfer took place, it shall qualify for the exemption.

Section 54F basically provide that where, in the case of an assessee being an individual or a Hindu undivided family, the capital gain arises from the transfer of any long-term capital asset, not being a residential house (hereafter in this section referred to as the original asset), and the assessee has, within a period of one year before two years after the date on which the transfer took place purchased, or has within a period of three years after that date constructed, a residential house (hereafter in this section referred to as the new asset), the capital gain shall qualify for exemption. Where by both the section investment is required to be made in residential house. However 54F also restricts the exemption if investment is made in another house within stipulated time. 54F is not available if assessee owns more than one house at the time of transfer of original asset.

Section 54 of the Income-tax Act, 1961, provides for exemption in respect of capital gain arising from the transfer of a long-term capital asset, being a residential house, the income of which is chargeable under the head "Income from house property", if the conditions laid down in the said provision are fulfilled. Under house property chapter the annual value of one house in the occupation of the owner for purposes of his own residence is taken as nil. A question has been raised whether capital gain arising from the transfer of such a house property would be entitled to exemption under section 54 of the Act. Income from a self-occupied residential house is chargeable under the head "Income from house property", even though in certain circumstances such income may be computed at nil or at a negative. [1989] 179 ITR (Stat) 0023- Circular Number: 538

Under the Self-financing Scheme of the Delhi Development Authority, the allotment letter is issued on payment of the first instalment of the cost of construction. The allotment is final unless it is cancelled or the allottee withdraws from the scheme. The allotment is cancelled only under exceptional circumstances. The allottee gets title to the property on the issuance of the allotment letter and the payment of instalments is only a follow-up action and taking the delivery of possession is only a formality. If there is a failure on the part of the D.D.A. to deliver the possession of the flat after completing the construction, the remedy for the allottee is to file a suit for recovery of possession. The Board have been advised that under the above circumstances, the inference that can be drawn is that the D.D.A. takes up the construction work on behalf of the allottee and that the transaction involved is not a sale. Under the scheme, the tentative cost of construction is already determined and the D.D.A. facilitates the payment of the cost of construction in instalments subject to the condition that the allottee has to bear the increase, if any, in the cost of construction. Therefore, for the purpose of capital gains tax, the cost of the new asset is the tentative cost of construction and the fact that the amount was allowed to be paid in instalments does

not affect the legal position stated above. In view of these facts, it has been decided that cases of allotment of flats under the Self-financing Scheme of the Delhi Development Authority shall be treated as cases of construction for the purpose of capital gains. [1986] 162 ITR (Stat) 0041- Circular Number: 471

It was clarified in circular 471 that cases of allotment of flats under the self-financing scheme of the Delhi Development Authority (DDA) should be treated as cases of construction for the purposes of sections 54 and 54F of the Income-tax Act, 1961. If the terms of the schemes of allotment and construction of flats/houses by the co-operative societies or other institutions are similar to those mentioned in Board's Circular No. 471, such cases may also be treated as cases of construction for the purposes of sections 54 and 54F of the Income-tax Act. [1994] 205 ITR (Stat) 0047A Circular Number: 672

Four brothers, members of a Hindu undivided family, partitioned the joint family properties, leaving undivided a common house. The assessee, the eldest of them, had sold his own house incurring capital gains tax. Each of his three brothers executed a release deed valuing his share in the common house at 30,000 in favour of the assessee towards the extra share (jeshtabhagam) agreed to be given. The question was whether this would amount to a "purchase" of the house by the assessee attracting section 54(1) and the assessee would be entitled to the relief thereunder on the ground that he had "purchased" a house property. The word "purchase" in section 54(1) had to be given its common meaning, viz., buy for a price or equivalent of price by payment in kind or adjustment towards a debt or for other monetary consideration. Each release in this case was a transfer of the releasor's share for consideration to the releasee and the transferee, the assessee, "purchased" the share of each of his brothers and the assessee was, therefore, entitled to the relief under section 54(1). [1979] 120 ITR 0046- Commissioner of Income-tax vs. Arvinda Reddy (T.N.) (Supreme Court of India)

COMMENCEMENT OF CONSTRUCTION IS NOT RELEVANT

The assessee sold the building in February, 1977. In March, 1975, he had commenced construction of a new house which was completed in March, 1977. The assessee claimed exemption from tax on capital gains under section 54 of the Income-tax Act, 1961. The Income-tax Officer rejected the claim of the assessee on the ground that the construction of the new building had commenced much earlier to the sale of the old building and the major portion of the building was let out by the assessee. The building was used mainly for the residential purpose of the assessee and found that the major portion of the building was under the occupation of the assessee. Therefore the first condition prescribed under section 54 was satisfied. It was immaterial that the construction of the new building was started way back. The construction was completed in March, 1977, which was within three years from the date of sale of the old building. Therefore, the assessee was entitled to exemption under section 54 of the Act. [1987] 165 ITR 0571- Commissioner of Income-tax vs. Subramanya Bhat (J.R.) (Karnataka High Court)

REGISTRATION OF HOUSE IS NOT A CONDITION PRECEDENT

Section 54 of the Income-tax Act, 1961, has to be construed in the context of the manner in which residential properties are now being constructed in a city like Bombay where, looking to the cost of the land, co-operative housing societies are being formed for constructing a building in which flats are allotted to members. This must also be viewed as a method of constructing residential tenements. What we have to see is whether the assessee has acquired a right to a specific flat in such a building which is being constructed by the society and whether he has made a substantial investment within the prescribed period which will entitle him to obtain possession of the flat so constructed and in which he intends to

reside. [1995] 216 ITR 0376- Commissioner of Income-tax vs. Hilla J.B. Wadia (Mrs.) (Bombay High Court). Registration of the house in not a condition under section 54.

The time limit as set out under section 54 for reinvestment benefit would be treated as complied with if substantial payment for the flat is made, though registration had been obtained beyond the time limit. On a decision to this effect by the Tribunal, no referable question of law would arise as was held in CIT v. R. L. Sood [2000] 245 ITR 727 (Delhi).

THE COMPLETION OF CONSTRUCTION IS RELEVANT

The construction of the flat was finally completed in July, 1988. The assessee paid the consideration on July 29, 1988, and she was put in possession of the flat on July 30, 1988. The assessee claimed the benefit of exemption under section 54F. According to the Department, the agreement for the purchase of the new flat was entered into more than one year prior to the sale and, therefore, the assessee was not entitled to exemption under section 54F. Held that she was entitled to the benefit of exemption under section 54F as the relevant date in this connection was July 29, 1988, when the assessee paid the full consideration on the flat becoming ready for occupation and obtained possession of the flat. [1996] 217 ITR 0363- Commissioner of Income-tax vs. Beena K. Jain (Smt.) (Bombay High Court).

REPURCHASE OF HOUSE IS ALSO ALLOWED

Sale of house used for residence and purchase of another house for residence within two years. There was a clause in deed for repurchase of house and assessee was paying rent for house after its sale. There was subsequent repurchase of house within one year of sale in accordance with clause in original deed the transaction was not bogus. Assessee entitled to exemption under section 54 in relation to the repurchase of the same house. [1994] 205 ITR 0377A Commissioner of Income-tax vs. Phiroze H. Patch (Bombay High Court)

REASONABLE REPAIRS EXPENSE ON NEW HOUSE IS ALSO ALLOWED

The words used about the amount spent on purchase of new asset are “cost thereto” and not “price thereto”. The cost includes purchase as well. Consequently, we are of the view that the word used signifies that the amount of purchase will include other necessary expenditure in this behalf to make a residential house habitable and taken together will be the cost of the new asset. We have perused the items of the report of the architect. The residential house was in a state of general disrepair and was uninhabitable. Consequently, the necessary repairs carried out to make the same habitable will constitute part of the cost of new house which qualifies for the exemption. Mrs. Gulshanbanoo R. Mukhi vs. Joint Commissioner of Income-tax 83 ITD 649 (Bom)

REINVESTMENT BENEFIT FOR RESIDENCE-PERMANENT OR TEMPORARY ?

Where an assessee sold a property, which was used for residential purposes for acquiring another property, but during the intervening period, before he could construct a permanent residence for himself, he used the funds for construction of a flat by way of temporary residence, which he had sold within three years of acquisition, he claimed exemption on sale of first house in view of such reinvestment in the second house within the permissible period. The High Court pointed out that original capital gains cannot be taxable, since the construction of permanent residence within a period of three years has satisfied the condition for exemption. Intermediate acquisition and use of temporary residence cannot nullify such right. The word “residence” in the present context refers to a place of permanent and not merely temporary abode. The word permanent here, is a relative term and is not synonymous with everlasting. A stop gap arrangement for stay in a house property not intended to be purchased or constructed for

permanent residence, that is as an abode where the assessee would ordinarily dwell, cannot deny the entitlement to the benefit of the provisions of section 54. Therefore, if an asset purchased or constructed not for residential purpose, but only for temporary accommodation is transferred within three years, that will not affect the benefit that attaches to the purchase or construction of the new asset for residential purposes and no question of reduction of cost by the amount of capital gain will arise qua the transfer of the asset which was not purchased or constructed for residential purpose. Harsutra J. Raval Vs. Commissioner of Income-tax 255 ITR 315

WHETHER INVESTMENT IS TO BE MADE ON ONE HOUSE ? (WHETHER A HOUSE IS ONE HOUSE OR NOT)

The expression used in a statute should ordinarily be understood in the sense in which it is best harmonious with the object of the statute and which effectuates the object of the legislature. It is, therefore, necessary to read section 54 of the Income-tax Act, 1961, in the context of the subject-matter and its setting in the scheme of capital gains and the object of the exemption and to ascertain its true import. The main purpose of section 54 is to give relief in respect of profit on the sale of a residential house. If an assessee is entitled to relief on the fulfilment of either of the two conditions, that is to say, either purchasing a house property within one year or constructing the house within two years, it would be improper to hold that on fulfilment of both the conditions he would be disentitled to that relief. It is the fulfilment of two alternative conditions that is contemplated by section 54. But, where both the conditions are fulfilled within the time stipulated, the assessee will be entitled to the relief under the section. [1981] 132 ITR 0150A Sarkar (B.B.) vs. Commissioner of Income-tax (Calcutta High Court)

In Shiv Narain Chaudhari's case the Allahabad High Court had held that several self-contained dwelling units which are contiguous and situate in the same compound and within common boundaries and having unity of structure could be regarded as one house of the purpose of granting exemption under wealth tax. The High Court granted exemption under wealth tax in respect of four different independent residential units, which were connected by a common passage in a building owned by the assessee-HUF and bearing Municipal Door Nos. 92, 92A, Darbhanga Castle. Their Lordships held as follows "The aforesaid decision also support the view we have taken, namely, that a house may consist of more than one self contained dwelling unit and that if there is unity of structure, the mere fact that such self contained dwelling units are occupied by different persons, will not make that house into several houses." 108 ITR 104 Shiv Narain Chaudhari Vs. Commissioner of Wealth-tax

"A house property" would include house properties also. Wherever the Parliament intended to restrict the allowance to one property, the Parliament had taken care to specify the same in express terms. There is no such restriction in section 54(1). In the decision of the Supreme Court in Trustees of Gordhandas Govindram Family Charity Trust v. CIT (1973) 88 ITR 47, wherein it was held that singular includes plural. Court also also relied on the provisions of section 13 of the General Clauses Act, 1897. Finally, the decision of the Allahabad High Court in Shiv Narain Chaudhari v. CWT (1977) 108 ITR 104 directly supported contentions for deduction, though it was a case under section 5(1) of wealth tax. The court also relied on the decision of the Calcutta High Court in B.B. Sarkar v. CIT (1981) 132 ITR 150. Thus the departmental authorities erred in denying the relief claimed by the assessee under section 54. 16 ITD 195 (Bom) K.G. Vyas

In case the assessee has purchased more than one house/flat within the period prescribed in section 54, it is for the assessee to claim relief against the purchase of any one of the house/flat provided the other

conditions mentioned in the section are satisfied [1990] 185 ITR 0499- Kaushik (K.C.) vs. Rane (P.B.), Fifth ITO (Bombay High Court).

If we take the ordinary and grammatical connotations, then “a residential house” means a dwelling unit. In Bombay one flat will mean one residential house. The assessee’s requirements may be many. But what we are concerned is with the plain reading of the provisions of the Act. The decisive factor is not the perception of the assessee but the clear intent of the law. Pitted against each other, the intent of law has to prevail. According to us section 54(1), 54(1)(i) and 54(1)(ii) uses the words “a residential house” and “the residential house” for the same thing. Similarly, “the residential house” is purported to be referred to as “the new asset” for rest of the provisions. It has to be presumed that Legislature is oblivious of the selection of words. If the Legislature had an intention to exempt more than one unit it could have been done by simple words like “residential house or houses”. Thus exemption under section 54 shall be available for one house only. Mrs. Gulshanbanoo R. Mukhi vs. Joint Commissioner of Income-tax 83 ITD 649 (Bom)

CONCLUSION :

In the scheme of section it is not very clear whether exemption is to be allowed for one house or for more than one house. This question is subject matter of debate and various courts have presented divergent opinion. It is judicial process that will decide the matter. It is strongly suggested that law in near future must be amended to set at rest the controversy.

CLUBBIN OF SPOUSE

SALARY, REMUNERATION TO SPOUSE FROM A CONCERN IN WHICH INDIVIDUAL HAS SUBSTANTIAL INTEREST.

64(1)(ii) provide that in computing the total income of any individual, there shall be included all such income as arises directly or indirectly to the spouse of such individual by way of salary, commission, fees or any other form of remuneration whether in cash or in kind from a concern in which such individual has a substantial interest. Provided that nothing in this clause shall apply in relation to any income arising to the spouse where the spouse possesses technical or professional qualifications and the income is solely attributable to the application of his or her technical or professional knowledge and experience.

The law would tackle any attempt to divert the income of a person to others to avoid proper tax liability at the progressive rate of taxation by disallowing any payment which is excessive or unreasonable, if paid to a relative or a related concern under section 40A(2). This provision should itself be sufficient for tackling tax avoidance. However, there are many redundant provisions in our law with the result that section 64(1)(ii) would club any payment of salary, commission, fees or any other form of remuneration to a spouse of an individual by himself or from a concern in which he has substantial interest, in such individual's hands, unless such spouse has technical or professional knowledge and experience.

Section 64(1)(ii) would require salary paid to a spouse to be included in the hands of the husband, if the spouse does not have technical or professional qualification. In a number of cases, courts have held that the expertise acquired during past experience would have to be treated as such qualification as would make the clubbing provision inapplicable. It has been so held in *Batta Kalyani v. CIT* [1985] 154 ITR 59 (AP); *Dr. J.M. Mokashi v. CIT* [1994] 207 ITR 252 (Bom) and *CIT v. Smt. R. Bharathi* [1999] 240 ITR 697 (Mad). There is a decision to the same effect in *CIT v. R.Jaya-lakshmi* [1999] 240 ITR 773 (Mad), where the husband had several decades of experience in managing the business though he did not have any academic qualification. In most of these decisions, it would appear that the provision is being applied without considering the purpose for which it was enacted.

In one such instance in *CIT v. Smt. Pratima Saha* [1999] 239 ITR 570 (Gauhati), salary paid by a medical practitioner to his wife, who was serving as a nurse in her husband's clinic, was clubbed in the hands of the husband on the ground that she did not have formal professional qualification by way of a degree or a diploma from a university or any other recognised institute as required under the Indian Nursing Council Act, 1947, overlooking the fact that trained and competent nurses in many private nursing homes are not having any such qualification, but all the same function as staff nurses and get paid for the same. In this case also, it was not that the Assessing officer found that she was not working as a nurse or that the reward was excessive. Because of such disallowances in such cases the taxpayer is worse off by engaging his wife for his business or profession.

In *R. S. Kini v. CIT* [1993] 71 Taxman 71 (Bom), the assessee's wife was a matriculate who attended to the business of the firm in which her husband was having substantial interest by looking after the correspondence and bank matters. All the same it was found that she did not have technical or professional qualification so that it had to be taxed in her husband's hands. It is necessary that the test that should be substituted should be one of genuineness and reasonableness of payment with reference to services rendered; a test, which is already a part of our law in section 40A(2) of the Act.

In case of 168 ITR 598 Commissioner of Income-tax Vs. Sorabji Dorabji, court noted that “We find considerable force in the submission of the learned counsel for the assessee that the words 'technical or professional qualifications', occurring in the first part of the proviso do not necessarily relate to the technical or professional qualifications acquired by obtaining a certificate, diploma or a degree or in any other form from a recognised body like a university or an institute. That this was not the intention of the Legislature is clear from the use of the expression 'knowledge and experience' in the latter part of the proviso, as otherwise it would have been perfectly permissible for the Legislature to use the same expression as occurring in the first part. The harmonious construction of the two parts of the proviso, in our opinion, would be that if a person possesses technical or professional knowledge and the income is solely attributable to the application of such technical or professional knowledge and experience, the requirement for the application of the proviso is satisfied, although the person concerned may not possess any qualification issued by a recognised body. In our opinion, the Tribunal erred in coming to the conclusion that unless a recognised body conferred a qualification, it should not be considered that a person possessed technical or professional qualifications. It is enough, in our opinion, for the purpose of the proviso, if the recipient of the salary possesses the attributes of technical or professional qualifications, in the sense that he has got expertise in such profession or technique. If by the use of that expertise in the profession or technique, the person concerned earns salary, then the latter part of the proviso is also satisfied.”

[1999] 238 ITR 1044 COMMISSIONER OF INCOME-TAX VS. SHRI OM PRAKASH (SC) When the karta of a Hindu undivided family is a partner in a partnership firm, he has a dual capacity; qua the partnership, he functions in his personal capacity and qua third parties, in his representative capacity. Under the Income-tax Act, 1961, when he is assessed in respect of the income derived by him from the partnership firm as a partner, it is in his representative capacity as karta of the Hindu undivided family and not as an individual as such. That is because his capacity vis-a-vis his spouse/minor children who are members of the Hindu undivided family is that of karta and not as individual though vis-a-vis other partners of the partnership firm he functions in his personal capacity. This being the position, the income of a karta's spouse/minor child cannot be included in the computation of his total income for that is the income of the Hindu undivided family and, not his individual income. Section 64 of the Income-tax Act, 1961, will be attracted only when an assessee's own income is being assessed and not that of a Hindu undivided family. If a karta is brought within the ambit of "individual" in section 64(1), the share income of the spouse of the karta and his minor children will, in effect, be included in the income of the Hindu undivided family which is not what is contemplated by section 64(1)(i) and (ii) which is impermissible.

ASSESSMENT OF MUTUAL CONCERN

CONCEPT OF MUTUAL CONCERN

Under the Income-tax Act what is taxed is, the “income, profits or gains earned or “arising”, “accruing” to a “person”. The question is whether in the case of a members’ club a species of mutual undertaking in rendering various services to its members which result in a surplus, the club can be said to “have earned income or profits”. In order to answer the question, it is necessary to have a background of the law relating to “mutual trading” or “mutual undertaking” and a “members’ club”.

In Halsbury’s Laws of England, Fourth edition, Reissue Volume 23, paragraphs 161 and 162 (pages 130 and 132), the relevant law is stated thus: “Where a number of persons combine together and contribute to a common fund for the financing of some venture or object and will in this respect have no dealings or relations with any outside body, then any surplus returned to those persons cannot be regarded in any sense as profit. There must be complete identity between the contributors and the participators. If these requirements are fulfilled, it is immaterial what particular form the association takes. Trading between persons associating together in this way does not give rise to profits which are chargeable to tax. Where the trade or activity is mutual, the fact that, as regards certain activities, certain members only of the association take advantage of the facilities which it offers does not affect the mutuality of the enterprise. Members’ clubs are an example of a mutual undertaking; but, where a club extends facilities to non-members, to that extent the element of mutuality is wanting. . . .”.

Simon’s Taxes, Volume B, Third edition, paragraphs B1.218 and B1.222 (pages 159 and 167), formulate the law on the point, thus: “. . . it is settled law that if the persons carrying on a trade do so in such a way that they and the customers are the same persons, no profits or gains are yielded by the trade for tax purposes and therefore, no assessment in respect of the trade can be made. Any surplus resulting from this form of trading represents only the extent to which the contributions of the participators have proved to be in excess of requirements. Such a surplus is regarded as their own money and returnable to them. In order that this exempting element of mutuality should exist it is essential that the profits should be capable of coming back at some time and in some form to the persons to whom the goods were sold or the services rendered. . . .”

The said principle which has been laid down in the leading decisions and emphasised in the leading English text books mentioned above, has been explained with reference to Indian decisions in “The Law and Practice of Income-tax” (Eighth edition, Volume I, 1990) by Kanga and Palkhivala at page 113, thus: “. . . ‘The contributors to the common fund and the participators in the surplus must be an identical body. That does not mean that each member should contribute to the common fund or that each member should participate in the surplus or get back from the surplus precisely what he has paid. The Madras, Andhra Pradesh and the Kerala High Courts have held that the test of mutuality does not require that the contributors to the common fund should willy-nilly distribute the surplus amongst themselves: it is enough if they have a right of disposal over the surplus, and in exercise of that right they may agree that on winding up the surplus will be transferred to a similar association or used for some charitable objects. . . .”

INCOME OUT OF SALE OF SOFT DRINK

The main question canvassed by the Revenue for the assessee being Bankipur Club Ltd., Ranchi Club Ltd., Cricket Club of India and Northern India Motion Pictures Association, was whether the assessee-mutual clubs, were entitled to exemption for the receipts or surplus arising from the sales of drinks, refreshments, etc., or amounts received by way of rent for letting out the buildings or amounts received by way of admission fees, periodical subscriptions and receipts of similar nature from its members. In all these cases, the Tribunal as also the High Court had found that the amounts received by the clubs were for supply of drinks, refreshments or other goods as also the letting out of building for rent or by way of admission fees, periodical subscription, etc., from the members of the clubs were only for/towards charges for the privileges, conveniences and amenities provided to the members, which they were entitled to, as per the rules and regulations of the respective clubs. It had also been found that different clubs realised various sums on the above counts only to afford to their members, the usual privileges, advantages, conveniences and accommodation. In other words, the services offered on the above counts were not done with any profit motive, and were not tainted with commerciality. The facilities were offered only as a matter of convenience for the use of the members (and their friends, if any, availing of the facilities occasionally). Held, in CIT v. Bankipur Club Ltd. [1997] 226 ITR 97, that in the light of the findings of fact the receipts for the various facilities extended by the clubs to its members, as part of the usual privileges, advantages and conveniences, attached to the membership of the club, could not be said to be "a trading activity." The surplus-excess of receipts over the expenditure-as a result of mutual arrangement, could not be said to be "income" for the purpose of the Act.

RENTAL INCOME OUT OF THE PROPERTY

The assessee, a members' club, provided recreational and refreshment facilities exclusively to its members and their guests. Its facilities were not available to non-members. The club was run on "no profit no loss" basis in that the members paid for all their expenses and were not entitled to any share in the profits. Surplus, if any, was used for maintenance and development of the club. The club house was owned by the assessee. The assessee claimed that it was a mutual concern and so the annual letting value of the club house was not assessable. Held that the assessee's business was governed by the doctrine of mutuality. It was an admitted fact that the business of the assessee did not come within the scope of business. It was not only the surplus from the activities of the business of the club that was excluded from the levy of income-tax, even the annual value of the club house, as contemplated in section 22 of the Act, would be outside the purview of the levy of income-tax. [2000] 243 ITR 0089- Chelmsford Club vs. Commissioner of Income-tax (SC)

CONTRIBUTORY AND PARTICIPATORY MUST BE THE SAME

Company was doing stock exchange business. Admission fees received from members and their authorised assistants and profits were distributed to shareholders. Mutuality was lacking and the fees were assessable to tax. Since as the body of trading members who paid the entrance fees and the shareholders among whom the profits of the company were distributed were not identical and the element of mutuality was lacking, the company carried on a business whose profits were taxable and, therefore, the admission fees received from members were taxable in its hands. [1961] 041 ITR 0495- Delhi Stock Exchange Association Ltd. vs. CIT (Supreme Court of India)

MUTUAL CONCERN V/S CO.OP. SOCIETY

In the case of a housing society, the Calcutta High Court in CIT v. Apsara Co-operative Housing Society Ltd. [1993] 204 ITR 662 had found that the transfer fees charged by the members, who formed themselves as a co-operative society without any profit element for the society itself is eligible for

treatment as a mutual concern. However, a similar claim failed in Haryana State Co-operative Labour and Construction Federation Ltd. v. CIT [2001] 252 ITR 265 (P&H), since the High Court found that the contributors to the federation had no control over the funds, so collected and that there was no obligation on the part of the Federation to return the funds to the contributors, so that no exemption was available on the principle of mutuality.

MUTUAL CONCERN V/S INSURANCE BUSINESS

A company which carries on a form of insurance business under which the policy money payable on the happening of the contingency insured against is not fixed but depends either partly or wholly on the results of the division of any portion of the premium income or funds among the policies which have become due for payment in proportion to the premiums received under each class in the specified period. Where the shareholders and the policy holders are not the same, a company carrying on such business is not a mutual society and its income is not exempt from tax on that account. The fact that the subscribed capital is very small compared with the premium income does not make any difference. [1939] 007 ITR 0333- Commissioner of Income-tax vs. Sind Central Provident Fund Society Ltd. (Sind High Court)

CONCLUSION

Under the Income-tax Act, what is taxed is, the "income, profits or gains" earned or "arising", "accruing" to a "person". Where a number of persons combine together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to those persons cannot be regarded in any sense as profit. There must be complete identity between the contributors and the participators. If these requirements are fulfilled, it is immaterial what particular form the association takes. Trading between persons associating together in this way does not give rise to profits which are chargeable to tax. Where the trade or activity is mutual, the fact that, as regards certain activities, certain members only of the association take advantage of the facilities which it offers does not affect the mutuality of the enterprise.