Direct Tax case laws for Nov'12 Examination-CA Final

1 .MODI INDUSTRIES LIMITED (2011)

What is the nature of expenditure incurred on demolition and re-creation of a cell room and expenditure incurred on purchase of pumping set, mono block pump and two transformers, which were parts of bigger plant-capital or revenue?

It was nothing but a complete demolition of old cell room and construction of new cell room in its place. The expenditure incurred on cell room was capital expenditure.

However as far as the purchase of pumping set, mono block etc are concerned; they are not the stand alone equipment but were part of bigger plant hence it would be treated as replacement of those parts and be treated as expense allowable u/s 37(1).

Note that amount paid on account of current repairs shall not include any expense in the nature of capital expenditure. Therefore expenditure on demolition and re creation of cell room cannot be treated as current repairs. *(Explanation to sec-31, Finance Act'03)*

2. JAGATJIT INDUSTRIES LIMITED (2011)

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

In this case assessee contended that entire gain on fluctuation of foreign exchange is capital receipt as source of fund was capital in nature.

The Delhi High court held that, the capital raised, whether in India or outside India, can be utilized both for the purpose of acquiring fixed assets and to meet working capital requirement. For determining nature of receipt *due consideration should be given to the source of fund and not to the ultimate use of the funds.*

Therefore, entire gain has to be capital receipt as the source of fund was capital in nature.

3 .BRAHAMPUTRA CAPITAL FINANCIAL SERVICES LIMITED (2011)

In case there is no possibility of recovery of loan given by NBFC, which is a NPA as per RBI guidelines, Can the interest on such loan be treated as income of such NBFC, following mercantile system of accounting?

It was prudent decision on the part of assessee that the interest on NPA, whose recovery was doubtful, was not accounted for in the books of accounts. Also the assessee is bound by RBI guidelines for the same treatment of interest income.

Therefore, High court held that there is no real accrual of interest income in the hands of assessee and hence it would not be chargeable to tax u/s 5.

4 .SHREE BALAJI ALLOYS (2011)

Refund of excise duty and grant of interest subsidy under the incentive scheme formulated by central government for public interest, namely, to accelerate industrial development, generate employment and create opportunities for self employment in the state of Jammu and Kashmir shall be treated as capital receipt not taxable.

5. UDIPI BUILDERS PRIVATE LIMITED (2009)

Where the hotel industry was established based on subsidy announced by state government, can such subsidy be treated as revenue receipt solely due to the reason that same was received by the assessee after the completion of hotel project and commencement of the business?

Held that hotel industry was established based on subsidy announced by state government to encourage tourism and state government was in habits of releasing the budget of subsidy depending upon the budgetary allocation each year. In several cases state government has released the subsidy even after ten years of commencement of the project. *Therefore subsidy received has to be treated as capital receipt; not taxable*.

6. ROLLATAINERS LIMITED (2011)

Can the provision of section 41(1) be invoked both in respect of waiver of working capital loan utilized for day to day business operations and in respect of waiver of term loan taken for purchasing a capital asset?

Held that, provision of 41(1) is attracted in respect of waiver of working capital loan, utilized for day to day business operations, since, it amounted to remission of trading liability. However in case of waiver of term loan for purchase of capital assets, provision of section 41(1) is not attracted since it cannot be treated as remission or cessation of trading liability.

7. TULIP STAR HOTELS LIMITED (2011)

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

Held that, for effective controls of new hotels acquired by the assessee under its management it had invested in wholly owned subsidiary company. The expenditure incurred was for business purpose and was thus allowable u/s 36(1) (iii).

Note that under section 36(1) (iii), the amount of interest paid in respect of capital borrowed for business/profession purpose is allowable as deduction. In the given case the interest is allowed as deduction since subsidiary company was formed to carry on a business of the parent company in more effective manner.

8. ITC HOTELS LIMITED (2011)

Expenditure on issue and collection of convertible debenture be treated as revenue expenditure even in case of convertible debenture.

However in case of *Banco products (India) limited (1999)* it was held that since the convertible debentures have characters of the equity shares and hence proportionate expenses on issue and collection of such debenture that relates to the equity base of the company has to be treated as capital expenditure.

9. PRIYA VILLAGE ROADSHOWS LIMITED (2011).

Expenditure incurred on feasibility study conducted for examining proposals for technological advancement relating to the existing business is revenue expenditure where the project was abandoned without creating the new asset.

The high court held that, in such cases whether or not the new business or asset comes into existence is relevant factor for determining the nature of expenditure. If there is no creation of new asset the expenditure incurred would be of revenue nature.

10. FEDERAL BANK LIMITED (2011)

EPABX and mobile phones are not computers and therefore not entitled to higher depreciation of 60%. Held that higher rate of depreciation of 60% is available to computers and there is no ground to treat communication equipments as computers.

11. ISKRAEMECO REGENT LIMITED (2011)

Can the waiver of principal amount of loan taken for the purpose of purchase of capital assets by the bank be treated as "benefit arising out of business" as said in 28(iv) or a "remission of trading liability" for taxability??-NOPE

The grant of bank loan for purchase of capital asset is capital receipt and not the trading receipts. The provision of sec 41(1) is attracted only in case of remission of trading liability. Since loan is taken for purchase of capital asset hence the waiver cannot be treated as remission of trading liability to attract section 41(1). Further such waiver cannot be treated as benefits arising out of business and consequently section 28(iv) is not attracted in respect of such loan or transaction.

12. SAGAR TALKIES (2010)

The amount incurred by the assessee for replacing the old mono sound system in its cinema theatre with a new Dolby stereo system is treated as revenue expenditure? Since, this had not benefited the assessee in any way with regard to the total income since there was no change in seating capacity of the theatre or increase in tariff rate of the ticket. In such a case expenditure in such change in sound system cannot be treated as capital expenditure and is revenue expenditure.

13. HINDUSTAN ZINK LIMITED (2010)

Expenditure incurred on alteration of a dam to ensure adequate supply of the water for the smelter plant owned by the assessee can be allowed as revenue expenditure.

Expenditure incurred by the assessee for commercial expediency relates to carrying on of business. The expenditure is of such a nature that a prudent business man may incur for the purpose of his business. The operational expenses incurred by the assessee solely intended for furtherance of the enterprise can by no means be treated as capital expenditure.

14. DCM LIMITED (2010)

Is the expenditure incurred on payment of retrenchment compensation and interest on money borrowed for payment of retrenchment compensation on closure on one of the textile manufacturing units of the assessee company –revenue in nature??

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

15. TRF LIMITED (2010)

For claiming the deduction of bad debt, it is not necessary for the assessee to establish that, the debt had, in fact, became irrecoverable.

Note that Prior to 1-4-89 there was the condition that assessee had to prove that the debt; in fact had became irrecoverable, but after 1.4.89 there is no requirement to establish such proof.

16. DR. ASWATH N. RAO (2010)

The expenditure incurred on purchase of second hand medical equipment for use as spare parts in existing equipment is revenue in nature to be allowable u/s 37(1).

However if the intention was to use such machinery as standalone basis then, the expenses would be treated as capital expenditure and the date on which it is put to use would determine the eligibility and quantum of depreciation (i,e. 50% or 100% as the case may be).

17. NEELAVATHI & OTHERS (2010)

Payments made to police personnel and gundas to keep away from the cinema theaters run by assessee is not an allowable deduction u/s 37(1).

Any payments illegally made to police amounts bribe resulting to a disallowed expenses and any payments made to gundas so that he shall not cause any disturbance to the theatre of the assessee is illegal payment and not allowed as deduction.

Note that, had he incurred the expenditure for the purpose of security, the same would have been allowed u/s 37(1)

18. MILLENNIA DEVELOPERS (P) LIMITED (2010)-Karnataka

Is the amount paid by Construction Company as regularization fee for violating building by-laws allowable as deduction?-nope

In this case, it is the actual character of the payment and not its nomenclature that has determined the disallowance of such expense as deduction. The principle of substance over form has been applied in disallowing expenditure in the nature of penalty, though the same has been described as compounding fee/ regularization fee. *Note that as per the provision of Karnataka Municipal Corporation Act1976, the amount paid to compound an offence is absolutely a penalty.*

19. MANJULA J. SHAH (BOMBAY)

Indexation benefit in respect of the gifted assets shall apply from the year the same was first acquired by previous owner

20. P P MENON (2010)

In determining the period of holding of a capital assets received by the assessee on the dissolution of the firm the period of holding to be considered from the date of the dissolution and period of holding of capital assets by the firm should not be taken into account.

Note that the benefit of including of the period of holding of the previous owner u/s 2(42A) read with section 49(1) (iii) (b) can be availed only if the dissolution of the firm had taken place at any time before 01.04.1987.

21. NAVIN JINDAL (2010)

To determine whether the capital gain on renunciation of the right to subscribe for additional shares is short term or long term, the period of holding would be from the date on which such right to subscribe for additional shares comes into existence up to the date of such renunciation.

22. MANJOO & CO (2011)

Winnings of prize money on unsold lottery tickets held by distributors of lottery tickets shall be assessed u/s 115BB.

Winnings from lotteries are assessable under the specific provision of 115BB, irrespective of the head under which such income falls. Therefore specific tax rate of 30% prescribed u/s 115BB is applicable in respect of winning from lottery received by the distributor.

23. PARVEEN SONI (2011) (DELHI)

The assessee not claiming the deduction u/s 80IB in the initial years can claim said deduction for the remaining years during the period of eligibility, if the conditions are satisfied.

Note that, provisions of section 80 IB nowhere stipulated the condition that the claim for deduction under this section had to be made from first year of qualification of deduction failing which the claim will not be allowed in the remaining years of eligibility.