INCOME TAX

1

BASIC CONCEPTS

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

   CIT v. Jagatjit Industries Ltd. (2011) 337 ITR 21 (Delhi)

   On this issue, the assessee contended that the entire gain arising from the fluctuation in foreign exchange on the balance sheet date, in respect of the share capital raised in foreign country, should be treated as capital receipt as the source of funds was capital in nature.

   However, as per the Tribunal's decision, gain due to fluctuation in foreign exchange arising on that part of share capital which is used for acquiring fixed assets should be treated as capital receipt and the remaining gain that arises on that part of share capital which is used as working capital will be treated as revenue receipt and accordingly, would be chargeable to tax.

   The Delhi High Court observed that in this case, the manner of utilization of such fund partly for acquiring fixed asset and partly as working capital was approved by the Ministry of Finance. The High Court held that the capital raised, whether in India or outside, can be utilized both for the purpose of acquiring fixed assets and to meet other expenses of the organization i.e. as working capital. For determining the nature of receipts, due consideration should be given to the source of funds and not to the ultimate use of the funds.

   Therefore, the entire gain has to be treated as capital receipt as the source of fund in this case is capital in nature.

2. **In case there is no possibility of recovery of loan given by a NBFC, which is an NPA as per RBI guidelines, can the interest on such loan be treated as income of the NBFC, following mercantile sytem of accounting?**

   DIT v. Brahamputra Capital Financial Services Ltd. (2011) 335 ITR 182 (Delhi)

   In the present case, the assessee, a non-banking financial company (NBFC), gave interest bearing loans to group concerns. The NBFC is bound by the NBFC Prudential

Norms (RBI) Directions, 1998 which states, *inter alia,* that the interest/discount or any other charges on non-performing assets (NPA) shall be recognised only when it is actually realized. Accordingly, the assessee did not credit the interest in the profit and loss account relating to certain loan amount which had become NPA as per the said norms. Even the recovery of principal amount of the said loan was doubtful.

The department did not dispute that the recovery of the said loan was doubtful but contended that since the assessee is following mercantile system of accounting, it is required to declare interest income on the above loan on accrual basis in the relevant assessment year, irrespective of the date of actual receipt of interest. It contended that such interest should be treated as income of the assessee as per the provisions of section 5 and taxed accordingly.

On the said issue, the Delhi High Court held that it was prudent decision on the part of the assessee that the interest on the non-performing asset, whose recovery was doubtful, was not accounted for in the books of account. Also, the assessee was bound by the RBI guidelines, which required the said treatment of the interest income.

Therefore, in this case, the High Court held that there was no real accrual of interest income in the hands of assessee and, hence, it would not be chargeable to tax under section 5.

3. **Would 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 state of Jammu and Kashmir be treated as a revenue receipt or a capital receipt?**

Shree Balaji Alloys v. CIT (2011) 333 ITR 335 (J&K)

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

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

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

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

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

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

(vi) the incentives were recurring in nature.

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

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

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

4. What is the nature of incentive received under the scheme formulated by the Central Government for recoupment of capital employed and repayment of loans taken for setting up/expansion of a sugar factory – Capital or Revenue?

CIT v. Kisan Sahkari Chini Mills Ltd. (2010) 328 ITR 27 (All.)

The assessee, engaged in the business of manufacture and sale of sugar, claimed that the incentive received under the Scheme formulated by the Central Government for recoupment of capital employed and repayment of loans taken from a financial institution for setting up/ expansion of a new sugar factory is a capital receipt. The Assessing Officer, however, treated it as a revenue receipt.

On this issue, the High Court followed the ruling of the Apex Court in *CIT v. Ponni Sugars and Chemicals Ltd. (2008) 306 ITR 392*, wherein a similar scheme was under consideration. In that case, the Apex Court had held that the main eligibility condition for the scheme was that the incentive had to be utilized for the repayment of loans taken by the assessee to set up a new unit or substantial expansion of an existing unit. The subsidy receipt by the assessee was, therefore, not in the course of a trade and hence, was of capital nature.

5. What is the nature of liquidated damages received by a company from the supplier of plant for failure to supply machinery to the company within the stipulated time – a capital receipt or a revenue receipt?

CIT v. Saurashtra Cement Ltd. (2010) 325 ITR 422 (SC)

The assessee, a cement manufacturing company, entered into an agreement with a supplier for purchase of additional cement plant. One of the conditions in the agreement was that if the supplier failed to supply the machinery within the stipulated time, the assessee would be compensated at 5% of the price of the respective portion of the machinery without proof of actual loss. The assessee received ₹ 8.50 lakhs from the supplier by way of liquidated damages on account of his failure to supply the machinery within the stipulated time. The Department assessed the amount of liquidated damages to income-tax. However, the Appellate Tribunal held that the amount was a capital receipt and the High Court concurred with this view.

The Apex Court affirmed the decision of the High Court holding that the damages were directly and intimately linked with the procurement of a capital asset i.e., the cement plant, which lead to delay in coming into existence of the profit-making apparatus. It was not a receipt in the course of profit earning process. Therefore, the amount received by the assessee towards compensation for sterilization of the profit earning source, not in the ordinary course of business, is a capital receipt in the hands of the assessee.

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

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

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

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

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

2

INCOME WHICH DO NOT FORM PART OF TOTAL INCOME

1. **Whether section 14A is applicable in respect of deductions, which are permissible and allowed under Chapter VI-A?**

   CIT v. Kribhco (2012) 209 Taxman 252 (Delhi)

   In the given case, the assessee is a co-operative society and is engaged in marketing of fertilizers and purchase and processing of seeds. The assessee had claim deduction under section 80P(2)(d) on dividend income received from NAFED and co-operative bank and also on interest on deposits made with co-operative banks.

   The Assessing Officer, relying upon section 14A, contended that the aforesaid income were not included in the total income of the assessee and therefore, expenditure with respect to such income should be disallowed.

   The High Court observed that section 14A is not applicable for deductions, which are permissible and allowed under Chapter VIA. Section 14A is applicable only if an income is not included in the total income as per the provisions of Chapter III of the Income-tax Act, 1961. Deductions under Chapter VIA are different from the exclusions/exemptions provided under Chapter III.

   The words "do not form part of the total income under this Act" used in section 14A are significant and important. Income which qualifies for deductions under section 80C to 80U has to be first included in the total income of the assessee and then allowed as a deduction. However, income referred to in Chapter III do not form part of the total income and therefore, as per section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income.

   Therefore, the Delhi High Court held that no disallowance can be made under section 14A in respect of income included in total income in respect of which deduction is allowable under section 80C to 80U.

2. **Can *Explanation* to section 11(2) be applied in respect of the accumulation up to 15% referred to in section 11(1)(a), to treat the donation made to another charitable trust from the permissible accumulation upto 15% as income of the trust?**

DIT (Exemption) v. Bagri Foundation (2012) 344 ITR 193 (Delhi)

The assessee is a charitable trust registered under section 12AA and recognized under section 80G. The assessee filed the return of income for the previous year declaring nil income. On perusal of the application of income made during the year, it was found that donation to the corpus of another trust was made which was much higher than the gross total income declared in the return of income. The source of the excess donation was the accumulation of income of the past made under section 11(1)(a) (i.e., out of permissible accumulation upto 15%) and encashment made out of these accumulations/funds.

The Assessing Officer added the donation made out of the accumulations or the set apart income, applying the *Explanation* to section 11(2) and accordingly, computed taxable income of the assessee.

Considering the above mentioned issue, the Delhi High Court held that, as per the provisions of section 11(1)(a), the accumulations upto 15% is permitted and no additional conditions are attached with such accumulation. It is an absolute exemption.

However, as per section 11(2) accumulations in excess of 15% is also allowed but subject to certain conditions mentioned therein and also subject to provisions of *Explanation* to section 11(2), which mentions that the amount accumulated in excess of 15% under section 11(2) cannot be donated to another trust. Such an explanation is not mentioned under section 11(1). Therefore, the *Explanation* to section 11(2) cannot be said to be applicable to the accumulations under section 11(1)(a) i.e. accumulations upto 15%, unless there is an express mention in the Act for the same.

Therefore, it follows that even if the donations by the assessee to another charitable trust were out of past accumulations under section 11(1)(a) i.e. upto 15%., the same would not be liable to be included in the total income as assessed by the Assessing Officer.

3

INCOME FROM SALARIES

1. **Is the limit of ₹ 1,000 per month per child to be mandatorily deducted, while computing the perquisite value of the free or concessional education facility provided to the employee by the employer?**

   CIT (TDS) v. Director, Delhi Public School (2011) 202 Taxman 318 (Punj. & Har.)

   As per the provisions of Rule 3(5) of the Income-tax Rules, 1962, in case an educational institution is maintained and owned by the employer and free or concessional education facility is provided to the employees' household in such institution, then, the cost of education in a similar institution in or near the locality shall be taken to be the value of perquisite in the hands of the employee. In case the cost of such education or the value of benefit does not exceeds ₹ 1,000 per month per child, the perquisite value shall be taken to be nil.

   In the present case, the cost of education was more than ₹ 1,000 per month per child, therefore, while determining the perquisite value on the above basis, the assessee claimed a deduction of ₹ 1,000 per month per child.

   The Punjab and Haryana High Court, in the above case, held that on a plain reading of Rule 3(5), it flows that, in case the value of perquisite for free/concessional educational facility arising to an employee exceeds ₹ 1,000 per month per child, the whole perquisite shall be taxable in the hands of the employee and no standard deduction of ₹ 1,000 per month per child can be provided from the same. It is only in case the perquisite value is less than ₹ 1,000 per month per child, the perquisite value shall be nil. Therefore, ₹ 1,000 per month per child is not a standard deduction to be provided while calculating such a perquisite.

4

INCOME FROM HOUSE PROPERTY

1. **Can the rental income from the unsold flats of a builder be treated as its business income merely because the assessee has, in its wealth tax return, claimed that the unsold flats were stock-in-trade of its business?**

   Azimganj Estate (P.) Ltd. v. CIT (2012) 206 Taxman 308 (Cal.)

   The assessee, a property developer and builder, in the course of its business activities constructed a building for sale, in which some flats were unsold. During the year, the assessee received rental income from letting out of unsold flats which is disclosed under the head "Income from house property" and claimed the permissible statutory deduction of 30% therefrom. The Assessing Officer contended that since the assessee had taken the plea that the unsold flats were stock-in-trade of its business and not assets for the purpose of Wealth-tax Act, 1961, therefore, the rental income from the said flats have to be treated as business income of the assessee. Consequently, he rejected the assessee's claim for statutory deduction of 30% of Net Annual Value.

   On this issue, the Calcutta High Court held that the rental income from the unsold flats of a builder shall be taxable as "income from house property" as provided under section 22 and since it specifically falls under this head, it cannot be taxed under the head "Profit and gains from business or profession". Therefore, the assessee would be entitled to claim statutory deduction of 30% from such rental income as per section 24. The fact that the said flats have been claimed as not chargeable to wealth-tax, treating the same as stock-in-trade, will not affect the computation of income under the Income-tax Act, 1961.

2. **Can benefit of self-occupation of house property under section 23(2) be denied to a HUF on the ground that it cannot occupy a house property, being a fictional entity?**

   CIT v. Hariprasad Bhojnagarwala (2012) 342 ITR 69 (Guj.) (Full Bench)

   The assessee, being a Hindu Undivided Family (HUF), claimed the benefit of self occupation of a house property under section 23(2). However, the Assessing Officer did not accept the said claim and denied the benefit of self occupation of house property to the HUF arguing that such benefit is available only to the owner who can reside in his own residence i.e., only an individual assessee, who is a natural person, and not to an imaginary assessable entity being HUF or a firm, etc.

On the above mentioned issue, the Gujarat High Court observed that a firm, which is a fictional entity, cannot physically reside in a house property and therefore a firm cannot claim the benefit of this provision, which is available to an assessable entity who can actually occupy the house. However, the HUF is a group of individuals related to each other i.e., a family comprising of a group of natural persons. The said family can reside in the house, which belongs to the HUF. Since a HUF cannot consist of artificial persons, it cannot be said to be a fictional entity. Also, it was observed that since singular includes plural, the word "owner" would include "owners" and the words "his own" used in section 23(2) would include "their own".

Therefore, the Court held that the HUF is entitled to claim benefit of self-occupation of house property under section 23(2).

3. Can an assessee engaged in letting out of rooms in a lodging house also treat the income from renting of a building to bank on long term lease as business income?

Joseph George and Co. v. ITO (2010) 328 ITR 161 (Kerala)

On the above issue, it was decided that while lodging is a business, however, letting out of building to the bank on long-term lease could not be treated as business. Therefore, the rental income from bank has to be assessed as income from house property.

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

CIT v. Asian Hotels Ltd. (2010) 323 ITR 490 (Del.)

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

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

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

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

5

PROFITS AND GAINS OF BUSINESS OR PROFESSION

1. **Can business contracts, business information, etc., acquired by the assessee as part of the slump sale be described as 'goodwill', be classified as an intangible asset to be entitled for depreciation under section 32(1)(ii)?**

   Areva T and D India Ltd. v. DCIT (2012) 345 ITR 421 (Delhi)

   In the present case, a transferor under a transfer by way of slump sale, transferred its ongoing business unit to the assessee company. On perusal of the sale consideration, it was found that some part of it was attributable to the tangible assets and the balance payment was made by the assessee company for acquisition of various business and commercial rights categorized under the separate head, namely, "goodwill" in the books of account of the assessee. These business and commercial rights comprised the following: business claims, business information, business records, contracts, skilled employees, know-how. The assessee company claimed depreciation under section 32 on the excess amount paid which was classified as “goodwill” under the category of intangible assets.

   The Assessing Officer accepted the allocation of the slump sale between tangible and intangible assets (described as Goodwill). However, he claimed that depreciation in terms of section 32(1)(ii) is not allowable on goodwill. He further contended that the assessee has failed to prove that such payment can be categorized under “other business or commercial right of similar nature” as mentioned in section 32(1)(ii) to qualify for depreciation.

   The assessee argued that any right which is obtained for carrying on the business effectively, is likely to come within the sweep of the meaning of intangible asset. Therefore, the present case shall qualify for claiming depreciation since business claims, business information, etc, are in the nature of “any other business or commercial rights”. However, the Revenue argued that, the business or commercial rights acquired by the assessee would not fall within the definition of intangible assets under section 32.

   The Delhi High Court observed that the principle of *ejusdem generis* provides that where there are general words following particular and specific words, the meaning of the latter words shall be confined to things of the same kind. The Court applied this principle for interpreting the expression "business or commercial rights of similar nature" specified in section 32(1)(ii). It is seen that such rights need not be the same as the description of "know-how, patents, trademarks, licenses or franchises" but must be of similar nature as the specified assets. The use of these general words after the specified intangible assets in section 32(1)(ii) clearly demonstrates that the Legislature did not intend to provide for depreciation only in respect of specified intangible assets but also to other categories of intangible assets, which were neither feasible nor possible to exhaustively enumerate.

Further, it was observed that the above mentioned intangible assets are invaluable assets, which are required for carrying on the business acquired by the assessee without any interruption. In the absence of the aforesaid intangible assets, the assessee would have had to commence business from scratch and go through the gestation period whereas by acquiring the aforesaid business rights along with the tangible assets, the assessee has got a running business. The aforesaid intangible assets are, therefore, comparable to a license to carry on the existing business of the transferor.

Therefore, the High Court held that the specified intangible assets acquired under the slump sale agreement by the assessee are in the nature of intangible asset under the category "other business or commercial rights of similar nature" specified in section 32(1)(ii) and are accordingly eligible for depreciation under section 32(1)(ii).

2. What would be the nature of expenditure incurred by the assessee by way of severance cost paid to the employees in respect of suspension of one of the activities, in a case where he continues to carry on other business activities – Capital or Revenue?

CIT v. KJS India P. Ltd. (2012) 340 ITR 380 (Delhi)

In the present case, the assessee was carrying more than one business activity, namely manufacturing powdered soft drink and trading in soft drinks. However, the manufacturing activity was not profitable and hence, was stopped. The employees who were directly connected with this manufacturing activity were laid off and severance cost was paid to those employees. The same was claimed by the assessee as revenue expenditure. The Assessing Officer disallowed the same treating it as a capital expenditure, on the argument that it was incurred as a result of closure of business of the assessee.

The Delhi High Court, on the above mentioned issue, held that though one of the business activities was suspended, it cannot be construed that the assessee has closed down its entire business. The assessee still continues to trade in soft drinks. Therefore, the said expenditure will be allowed as revenue expenditure though it was related to manufacturing activity which was suspended.

3. Is the income or expense of an asset management company liable to be assessed on the basis of the maximum limit mentioned in the SEBI regulations or should the assessment be made on the basis of the actual income or expenses charged?

CIT v. Templeton Asset Management (India) P. Ltd. (2012) 340 ITR 279 (Bom.)

The assessee is a private limited company engaged in the business of asset management of mutual funds. The Assessing Officer noticed and made additions in respect of the under mentioned items:

(i) The difference between the ceiling for investment advisory fees prescribed under the relevant regulation of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and the actual amount claimed as being charged from the mutual fund.

(ii) Certain expenses incurred by the assessee on behalf of the mutual funds. The assessee recovered only a part of those expenses from the mutual fund and the balance was borne by the assessee himself. In some cases, the whole expense was borne by the assessee. The Assessing Officer, relying on the relevant SEBI regulation, contended that since the SEBI regulation empowers the assessee to recover those expenses up to the ceiling prescribed therein, the assessee was not justified in charging those expenses to its own account, thereby reducing its taxable income. Accordingly, the Assessing Officer added the differential amount to the income of the assessee.

On the issue mentioned in (i) above, the Bombay High Court, confirming the decision of the Commissioner (Appeals) and the Income-tax Appellate Tribunal, held that the relevant SEBI regulation provides for the maximum limit towards the fees that could be charged by an asset management company from the mutual funds. In case due to business exigencies, if the assessee, an asset management company, collects lesser amount of fees than the ceiling prescribed, it is not open to the Assessing Officer to make additions on notional basis and assess the assessee at the maximum amount prescribed under the SEBI regulation.

Similarly, in respect of the issue mentioned in (ii) above, it was held that it is a bonafide decision of the assessee to claim part of the expenses or claim no expense from the mutual funds on the basis of commercial prudence. The ceiling on expenses mentioned in the SEBI regulation is the maximum amount that can be claimed from the mutual fund. The restrictions under the SEBI Regulations are imposed with a view to ensure that the mutual funds are not overcharged and the said Regulations are not intended to mandatorily burden the mutual funds with the liability set out in the Regulations. In case an asset management company does not charge the mutual funds part of the expenses actually incurred due to a bonafide commercial decision, then, no part of the expenditure can be disallowed unless it is established that there were no business exigencies or the claim was not genuine. Therefore, the disallowance made by the Assessing Officer in the present case is not justified since the transaction was genuine in nature.

4. **Can the expense incurred by the assessee on the education and travelling of an employee, for acquiring knowledge relating to assessee's business, be disallowed**

merely on the ground that the employee is the son of an ex-director of the assessee company?

CIT v. Naidunia News and Networking (P.) Ltd. (2012) 210 Taxman 73 (MP)

In the present case, the assessee was engaged in the business of printing and distribution of newspapers and magazines. It incurred foreign travel and education expenditure on higher studies in printing technology for its employee, who was the son of the ex-director of the company. However, the said expense was disallowed by the Assessing Officer.

The Madhya Pradesh High Court held that the expenses incurred by the assessee on the foreign travel and education of a regular employee outside India for gaining advanced knowledge of the latest printing technology, which was directly related to the business of the assessee, is allowable under section 37(1). The expenditure cannot be disallowed merely because it was incurred in respect of an employee, who was son of ex-director of the assessee company.

5. Can advance given to employees and security deposit paid to the landlord by the amalgamating company, which became irrecoverable, be allowed as a business loss in the hands of the amalgamated company?

CIT v. Triveni Engg. & Industries Ltd. (2012) 343 ITR 245 (Delhi)

The amalgamating company had given certain advances to employees and had made a security deposit with the landlords for obtaining lease of premises for purposes of its business. Both the advance given and the security deposit paid by the amalgamating company became irrecoverable and were written off in the books of account of the assess-amalgamated company. The Assessing Officer disallowed the said claims on the ground that the same is not directly related to carrying on of the business of the assessee-amalgamated company nor is it incidental to the same.

On the above mentioned issue, the Delhi High Court held that advances to employees were given by the amalgamating company in the ordinary course of business by way of temporary financial accommodation to be recovered out of the salary paid to the employees. The giving of such advances was necessitated in order to share up the personal finances of the employees, to meet any emergency/financial commitment and keep the employees motivated, contended and happy. Therefore, such advances given to persons who had been employed by the assessee company which have become irrecoverable would be treated as business loss.

However, as regards the allowability of non-recoverable security deposit given to the landlord for obtaining lease of premises for purposes of business, the High Court observed that the security deposits were refundable and therefore, were not in the form of rent. They were given for securing the premises on rent. The assessee had obtained a right to use the property, *i.e.,* tenancy right, which is a capital asset. Therefore, it is not allowable as business loss.

6. **Can an assessee, engaged in money lending business, claim interest paid on money borrowed as business expenditure?**

   Rajendra Kumar Dabriwala v. CIT (2012) 347 ITR 353 (Cal.)

   In the present case, the assessee was engaged in the business of dealing in shares and money lending. He borrowed funds for lending purposes, paid interest on the funds borrowed and claimed the same as deduction while computing business income. The interest received was shown as income. The Assessing Officer did not allow the claim of interest paid as business expenditure on the contention that, substantial amount of loan was obtained by the assessee from various parties and substantial amount of loans were given to different parties. The Assessing Officer claimed that the loans were not given for the sake of business transactions but simply the loans taken from one party were transferred to the other parties by way of loan.

   The Calcutta High Court held that the Assessing Officer is not right in his contention, since the assessee is in the money lending business. He is entitled to receive interest from the loan advanced and is also entitled to take loan for running the money lending business. Therefore, the assessee is lawfully entitled to deduct interest paid on the funds borrowed as business expenditure, subject however to the provisions contained in section 14A. In other words, if any loan has been taken by the assessee in relation to the income which does not form part of his total income under the Act, the assessee will not get deduction of interest paid on that amount.

7. **Can subsidy received by the assessee from the Government of West Bengal under the scheme of industrial promotion for expansion of its capacities, modernization and improving its marketing capabilities be treated as a capital receipt?**

   CIT v. Rasoi Ltd. (2011) 335 ITR 438 (Cal.)

   In the present case, the assessee received the subsidy by way of financial assistance in the period of crisis for promotion of the industries mentioned in the scheme which had manufacturing units in West Bengal and which were in need of financial assistance for expansion of their capacities, modernization and improving their marketing capabilities. The subsidy was a one time receipt and was equivalent to 90% of the amount of sales tax paid.

   The Assessing Officer, relying on the decision of the Supreme Court in the case of "*Sahney Steel & Press Works Ltd. v CIT (1997) 228 ITR 253*", came to the conclusion that since the subsidy received from the Government was 90% of the sales tax paid, the same was in the form of refund of sales tax paid and hence, should be considered as a revenue receipt.

   The Calcutta High Court, applying the rationale of Supreme Court in *CIT v. Ponni Sugars & Chemicals Ltd. (2008) 306 ITR 392*, observed that if the object of the subsidy is to enable the assessee to run the business more profitably, the receipt is a revenue receipt. On the other hand, if the object of the assistance is to enable the assessee to set up a new unit or to expand an existing unit, the receipt would be a capital receipt. Therefore, the object for which subsidy is given determines the nature of the subsidy and not the form of the mechanism through which the subsidy is given. Further, it was observed that in "*Sahney Steel and Press Work Ltd*.", the subsidy was given by way of assistance in carrying the trade or business more profitably and hence, the receipt was a revenue receipt. However, in the instant case, the object of the subsidy was for expansion of their capacities, modernization and improvement of their marketing capabilities. It was further observed that merely because the subsidy was equivalent to 90% of the sales tax paid, it cannot be construed that the same was in the form of refund of sales tax paid.

Therefore, the High Court held that, in the present case, the subsidy received has to be treated as a capital receipt and not as a revenue receipt.

8. Can the assessee, being a charitable institution claim depreciation under section 32 in respect of an asset, where the cost of such asset has been treated as application of income for charitable purposes under section 11(1)(a)?

Lissie Medical Institutions v. CIT (2012) 348 ITR 344 (Ker.)

On the above issue, it was held that once the expenditure on acquisition of assets has been treated as application of income for charitable purposes under section 11(1)(a), the full value of the asset stands written off and if depreciation is further allowed, the same will result in double deduction of capital expenditure leading to violation of provision of section 11(1) and therefore, the trust is not eligible to claim depreciation on such capital expenditure, in the current year or in any subsequent year.

9. Is the assessee entitled to depreciation on value of goodwill considering it as an asset within the meaning of *Explanation 3(b)* to Section 32(1)?

CIT v. Smifs Securities Ltd. (2012) 348 ITR 302 (SC)

In this case, the assessee has paid an excess consideration over the value of net assets of the amalgamating company acquired by it, which is treated as goodwill, since the extra consideration was paid towards the reputation which the amalgamating company was enjoying in order to retain its existing clientele. The assessee had claimed depreciation on the said goodwill. However, the Assessing Officer contended that the goodwill is not an asset falling under *Explanation 3* to section 32(1) and therefore, is not eligible for depreciation.

On this issue, the Supreme Court observed that *Explanation 3* to section 32(1) states that the expression 'asset' shall mean an intangible asset, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature. A reading of the words 'any other business or commercial rights of similar nature' in *Explanation 3(b)* indicates that goodwill would fall under the said expression. In the process of amalgamation, the amalgamated company had acquired a capital right in the form of goodwill because of which the market worth of the amalgamated company stood increased.

Therefore, it was held that 'Goodwill' is an asset under *Explanation 3(b)* to section 32(1) and depreciation thereon is allowable under the said section.

10. **Is abkari licence covered under section 32(1)(ii) and eligible for depreciation @ 25% of written down value?**

S. Ambika v. DCIT (2011) 203 Taxman 2 (Ker.)

Relevant section: 32

On this issue, the High Court observed that abkari licence is treated as a transferable asset and the Excise Commissioner is authorised to approve transfers as per Foreign Liquor Rules. When licence is transferable according to the Rules under which it is issued, it is for consideration and the licence would be renewed every year unless a general policy decision is taken by the Government against it, and therefore, it is a business asset for long-term exploitation. Therefore, abkari licence is a business right given to the party to carry on liquor trade.

As per section 32(1)(ii), the assessee is entitled to claim depreciation on know-how, patents, copyright, trademarks, licenses, franchises or any other business or commercial rights of similar nature as being being intangible assets.

Therefore, the High Court held that the abkari licence squarely falls under section 32(1)(ii) on which the assessee is entitled to depreciation at 25% of the written down value as provided under Section 32(1).

11. **Is the commission paid to doctors by a diagnostic centre for referring patients for diagnosis be allowed as a business expenditure under section 37 or would it be treated as illegal and against public policy to attract disallowance?**

CIT v. Kap Scan and Diagnostic Centre P. Ltd. (2012) 344 ITR 476 (P&H)

On the above mentioned issue, the Punjab and Haryana High Court held that the argument of the assessee that giving commission to the private doctors for referring the patients for various medical tests was a trade practice which could not be termed to be illegal and therefore, the same cannot be disallowed under section 37(1), is not acceptable. Applying the rationale and considering the purpose of *Explanation* to section 37(1), the assessee would not be entitled to deduction of payments made in contravention of law. Similarly, payments which are opposed to public policy being in the nature of unlawful consideration cannot also be claimed as deduction. The assessee cannot take a plea that businessmen are entitled to conduct their business even contrary to law and claim deduction of certain payments as business expenditure, notwithstanding that such payments are illegal or opposed to public policy or have pernicious consequences to the society as a whole.

As per the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, no physician shall give, solicit, receive, or offer to give, solicit or receive, any gift, gratuity, commission or bonus in consideration of a return for referring any patient for medical treatment.

The demanding as well as paying of such commission is bad in law. It is not a fair practice and is opposed to public policy and should be discouraged. Thus, the High Court held that commission paid to doctors for referring patients for diagnosis is not allowable as a business expenditure.

12. **What would be the nature of the repair and reconditioning expenditure incurred on a machine which broke down years ago – Revenue or Capital?**

Bharat Gears Ltd. v. CIT (2011) 337 ITR 370 (Delhi)

In the present case, the assessee had machinery which broke down many years back and was not in use. In the current year the assessee got that machinery repaired and reconditioned and claimed that expenditure as "current repairs" i.e., revenue expenditure. The assessee contended that this was neither a case of replacement of asset nor acquisition of a new asset. The defects in the machinery were only being removed and therefore, the expenditure should be treated as current repairs. The Assessing Officer disallowed the claim since the expenditure incurred has given a benefit of enduring nature to the assessee by increasing the useful life of the machinery and therefore, has to be treated as a capital expenditure on which depreciation is allowable.

After considering the above mentioned arguments, the Delhi High Court held that the machinery which was repaired had outlived its utility and huge expenditure was incurred by replacing many vital parts in order to make the same functional. The expenditure was of such nature that it brought into existence a new machinery altogether and consequently, there was a benefit of enduring nature to the assessee even though technically no new asset came into existence. Therefore, the Delhi High Court observed that it is in the nature of capital expenditure on which depreciation can be claimed.

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

Catholic Syrian Bank Ltd. v. CIT (2012) 343 ITR 270 (SC)

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

On the above issue, the Supreme Court observed that the deduction on account of provision for bad and doubtful debts under section 36(1)(viia) relating to rural advances of a scheduled bank is distinct and independent of the provisions of section 36(1)(vii), where such bad debts are in respect of urban advances.

In effect, where the provision under section 36(1)(viia) is in respect of rural advances and the bad debts write off under section 36(1)(vii) is in respect of urban advances, the restriction contained in the proviso to section 36(1)(vii) would not apply. The Supreme Court held that in such a case, the benefit of deduction under section 36(1)(vii) in respect of urban advances would be available to the bank, subject to provisions of section 36(2).

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

CIT v. Modi Industries Ltd. (2011) 339 ITR 467 (Del.)

On the issue of allowability of expenditure on demolition and re-erection of a cell room, the High Court referred to the Supreme Court ruling in *CIT v. Saravana Spinning Mills P. Ltd. (2007) 293 ITR 201*, wherein it was observed that "current repairs" under section 31 refer to expenditure effected to preserve and maintain an already existing asset and the object of expenditure must not be to bring a new asset into existence or to obtain a new advantage. In that case, it was held that since the entire machine had been replaced, the expenditure incurred by the assessee did not fall within the meaning of "current repairs" in section 31(1).

Applying the rationale of the Apex Court ruling, the Delhi High Court observed that if a part of a structure becomes dilapidated and repairs/reinforcement of some parts of the structure is required, it would be treated as "current repairs". However, on the other hand, if a part of the building is demolished and a new structure is erected on that place, it has to be treated as capital expenditure, as in that case a totally new asset is created even if it may be a part of the building.

In this case, it was clear that after completely demolishing the old cell room, an entire new cell room was erected. The money spent was not merely on repairs of the cell room, but for constructing a new cell room. Even the nomenclature of the entry, as given by the assessee, was "fabrication and erection charges of cell room". Thus, it was nothing but a complete demolition of the old cell room and construction/erection of a new cell room in its place. The expenditure incurred on the cell room was capital expenditure.

However, so far as purchase of pumping set, mono block pump with HP motors and two transformers were concerned, they were not stand alone equipment, but were part of the bigger plant. Therefore, it would be treated as replacement of those parts and the expenditure would be eligible for deduction under section 37(1).

Note*: The Explanation in section 31 inserted by the Finance Act, 2003 w.e.f. 01.04.2004 clarifies that the amount paid on account of current repairs shall not include any* *expenditure in the nature of capital expenditure. Therefore, as per this clarification also, expenditure on demolition and re-erection of a cell room cannot be treated as current repairs.*

15. **Can the provisions 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?**

Rollatainers Ltd. v. CIT (2011) 339 ITR 54 (Del.)

The assessee, a sick company under the provisions of the Sick Industrial Companies (Special Provisions) Act, 1985, approached the Corporate Debt Restructuring Cell for settlement of outstanding dues of various financial institutions/banks. The Cell approved the reworked restructuring package, pursuant to which financial institutions and banks waived part of their respective dues, comprising principal and interest. The Commissioner (Appeals) held that the principal amount of loans waived by the banks, including the waiver of the principal amount against the working capital loans in the form of cash credit limits did not constitute taxable income. The Tribunal held that the waiver of the working capital loan utilized towards day-to-day business operations resulted in manifest in the revenue field and hence was taxable in the year of waiver.

The High Court observed that the Tribunal had found as a fact that the term loans were taken for the purchase of capital assets from time to time. Therefore, as regards term loans, the Tribunal had come to a conclusion that since the monies did not come into the possession of the assessee on account of any trading transaction, the receipts were capital in nature, being loan repayable over a period of time along with interest. Therefore, on writing off of the loans, no benefit or perquisite arose to the assessee in the revenue field. The liability in question, i.e. the term loan for purchase of capital assets, was not a trading liability. Therefore, the provisions of section 41(1) are also not attracted in this case since the waiver was in respect of a term loan taken for a capital asset and hence, cannot be treated as remission or cessation of a trading liability. Thus, the waiver of such term loans cannot be treated as income of the assessee.

However, in the case loan is written off in the cash credit account, the benefit is in the revenue field as the money had been borrowed for day-to-day affairs and not for the purchase of capital asset. These loans were for circulating capital and not fixed capital. Therefore, the writing off of these loans on the cash credit account which was received for carrying out the day-to-day operations of the assessee amounted to remission of a trading liability and hence, has to be treated as income in the hands of the assessee by virtue of section 41(1).

Note: *The crux of the High Court decision is that the provisions of section 41(1) are attracted in respect of waiver of the working capital loan utilized for day-to-day business operations, since it amounted to remission of a trading liability. However, in the case of waiver of term loan for purchasing capital assets, the provisions of section 41(1) are not attracted since it cannot be treated as remission or cessation of a trading liability.*

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

    CIT v. Tulip Star Hotels Ltd. (2011) 338 ITR 482 (Del.)

    The assessee-company was engaged in the business of owning, running and managing hotels. The assessee had borrowed certain funds which it had utilized to subscribe to the equity capital of the subsidiary company. The investment in the wholly owned subsidiary was for effective control of the hotels acquired by the assessee-company under its management and the subsidiary company also used the funds for the said purpose.

    The assessee paid interest on the borrowed money. This interest liability incurred by the assessee was claimed by it as deduction under section 36(1)(iii) on the ground that it was business expenditure. The Assessing Officer refused to allow the expenditure. However, the Commissioner (Appeals) reversed the decision of the Assessing Officer and this opinion was confirmed by the Tribunal.

    The High Court held that the assessee was in the business of owning, running and managing hotels. For the effective control of new hotels acquired by the assessee under its management it had invested in a wholly owned subsidiary company. The expenditure incurred was for business purposes and was thus allowable under section 36(1)(iii).

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

17. **Can "moneys payable" in respect of a building sold by the assessee (which has to be reduced from the opening written down value of the block of assets for calculating depreciation) be construed as the fair market value of the asset instead of the actual sale price?**

    CIT v. Cable Corporation of India Ltd. (2011) 336 ITR 56 (Bom.)

    On this issue, the Bombay High Court observed that the "moneys payable" to be reduced from the written down value of the block of assets as per section 43(6) is to be construted as per the meaning assigned to the same according to the *Explanation* below section 41(4) which states that the "moneys payable" in relation to the sale of a building, machinery, plant or furniture would be the price for which it is sold.

    Therefore, the written down value of the asset falling within that block of assets at the beginning of the previous year has to be adjusted by the amount for which the asset is actually sold and not by its fair market value.

It may, however, be noted that, in case of scrap, the amount of scrap value (i.e. the fair market value) has to be reduced as per the provisions of section 43(6), to arrive at the written down value at the end of the year.

18. **Can the expenditure incurred on the assessee-lawyer's heart surgery be allowed as business expenditure under section 31 by treating it as current repairs considering heart as plant and machinery or under section 37 by treating it as expenditure incurred wholly and exclusively for purposes of business or profession?**

Shanti Bhushan v. CIT (2011) 336 ITR 26 (Delhi)

In the present case, the assessee is a lawyer by profession. The assessee argued that the repair of vital organ (i.e. the heart) had directly impacted his professional competence. He contended that the heart should be treated as plant as it is used for the purpose of his professional work. He substantiated his contention by stating that after his heart surgery, his gross receipts from profession increased manifold. Hence, the expenditure on the heart surgery should be allowed as business expenditure either under section 31 as current repairs to plant and machinery or section 37 as an expense incurred wholly and exclusively for the purpose of profession. The department argued that the said expenditure was personal in nature and was not incurred wholly and exclusively for the purpose of business or profession, and therefore, the same should not be allowed as business expenditure.

On this issue, the Delhi High Court observed that a healthy and functional human heart is necessary for a human being irrespective of the vocation or profession he is attached with. Expenses incurred to repair an impaired heart would thus add to the longevity and efficiency of a human being which would be reflected in every activity he does, including professional activity. It cannot be said that the heart is used as an exclusive tool for the purpose of professional activity by the assessee. Further, the High Court held that:-

(i) To allow the heart surgery expenditure as repair expenses to plant, the heart should have been first included in the assessee's balance sheet as an asset in the previous year and in the earlier years. Also, a value needs to be assigned for the same. The assessee would face difficulty in arriving at the cost of acquisition of such an asset for showing in his books of account. Though the definition of plant as per the provisions of section 43(3) is inclusive in nature but the plant must have been used as a business tool which is not true in case of heart. Therefore, the heart cannot be said to be plant for the business or profession of the assessee. Therefore, the expenditure on heart surgery is not allowable as repairs to plant under section 31.

(ii) According to the provisions of section 37, *inter alia,* the said expenditure must be incurred **wholly and exclusively** for the purposes of the assessee's profession. As mentioned above, a healthy heart will increase the efficiency of human being in every field including its professional work. Therefore, there is no **direct nexus** between the expenses incurred by the assessee on the heart surgery and his efficiency in the professional field. Therefore, the claim for allowing the said expenditure under section 37 is also not tenable.

Hence, the heart surgery expenses shall not be allowed as a business expenditure of the assessee under the Income-tax Act, 1961.

19. **Would the expenditure incurred for issue and collection of convertible debentures be treated as revenue expenditure or capital expenditure?**

CIT v. ITC Hotels Ltd. (2011) 334 ITR 109 (Kar.)

On this issue, the Karnataka High Court held that the expenditure incurred on the issue and collection of debentures shall be treated as revenue expenditure even in case of convertible debentures, i.e. the debentures which had to be converted into shares at a later date.

Note: *However, it may be noted that Ahmedabad High Court in the case of Banco Products (India) Ltd. v. CIT (1999) 63 Taxman 370 held that since the convertible debentures have characterstics of equity shares, such debentures cannot be termed as debt and therefore proportionate issue expenses of such debentures that relates to the equity base of the company has to be treated as capital expenditure.*

20. **Can the Assessing Officer bring to tax the actual profits as per books of accounts, if the same is higher than 10% of receipts which are deemed to be the profits under section 44BBB in case of a foreign company engaged in turnkey projects?**

DIT v. DSD Noell GmbH (2011) 333 ITR 304 (Delhi)

In the present case, the assessee is a German company providing engineering and technical services for various projects eligible for presumptive taxation scheme under section 44BBB. The assessee filed its return declaring a sum equal to 10% of the amount paid or payable to the assessee under the projects undertaken by it as deemed profits and gains chargeable to tax under the head "Profits and gains of business or profession" as per the provisions of section 44BBB. The Assessing Officer contended that on the basis of books of account maintained by the assessee, the profits could be more than 10% and therefore, the actual profits should be brought to tax by invoking sub-section (2) of section 44BBB.

On the above issue, the Delhi High Court held that if an assessee fulfills all the conditions mentioned in section 44BBB(1), the provisions of sections 28 to 44AA of the Act would not be applicable for computation of its business income, and a sum equal to 10% of the amount paid or payable to such foreign company would be deemed as its business income. Further, under section 44BBB(2), the assessee has the benefit of declaring before the Assessing Officer that the actual profits earned by it were less than 10% but the Revenue cannot take recourse of this sub-section to claim that the profits earned by the assessee were more than 10%.

21. **Would expenditure incurred on feasibility study conducted for examining proposals for technological advancement relating to the existing business be classified as a revenue expenditure, where the project was abandoned without creating a new asset?**

    CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594 (Delhi)

    In this case, the assessee, engaged in the business of running cinemas, incurred expenditure towards architect fee for examining the technical viability of the proposal for takeover of cinema theatre for conversion into a multiplex/ four-screen cinema complexes. The project was, however, dropped due to lack of financial and technical viability. The issue under consideration is whether such expenses can be treated as revenue in nature, since no new asset has been created.

    On this issue, the High Court observed that, in such cases, whether or not a new business/asset comes into existence would become a relevant factor. If there is no creation of a new asset, then the expenditure incurred would be of revenue nature. In this case, since the feasibility studies were conducted by the assessee for the existing business with a common administration and common fund and the studies were abandoned without creating a new asset, the expenses were of revenue nature.

22. **Is the assessee entitled to depreciation on value of goodwill considering it as "other business or commercial rights of similar nature" within the meaning of an intangible asset?**

    B. Raveendran Pillai v. CIT (2011) 332 ITR 531 (Kerala)

    Under section 32(1)(ii), depreciation is allowable on intangible assets, being know-how, patents, copyrights, trade marks, license, franchise, or any other business or commercial rights of similar nature.

    In this case, a hospital was run in the same building, in the same town, in the same name for several years prior to purchase by the assessee. By transferring the right to use the name of the hospital itself, the previous owner had transferred the goodwill to the assessee and the benefit derived by the assessee was retention of continued trust of the patients, who were patients of the previous owners. When goodwill paid was for ensuring retention and continued business in the hospital, it was for acquiring a business and commercial right and it was comparable with trade mark, franchise, copyright etc., referred to in the first part of clause (ii) of section 32(1) and so, goodwill was covered by the above provision of the Act entitling the assessee for depreciation.

23. **Would the special provisions for computing profits under section 44BB be applicable to a non-resident carrying on business of seismic data acquisition and processing under contract with Indian concerns?**

Global Geophysical Services Ltd., In re (2011) 332 ITR 418 (AAR)

On an application made to the Authority of Advance Ruling by the non-resident on the above issue, the Authority observed that in an identical issue in *Geofizyka Torun SP. Z.O.O. (2010) 320 ITR 0268 (AAR),* it was observed that without seismic data acquisition and interpretation, it is impractical to carry out the activity of prospecting of mineral oil and gas which is a step in aid to its exploration. The seismic data (in processed form) is used to create highly accurate images of the earth's sub-surface which in turn are used by the exploration and production companies for locating potential oil and gas reserves based upon the geology observed.

Accordingly, in this case, the AAR ruled that the said activities and services of the applicant clearly fell within the description of section 44BB and the income derived by the applicant under the contracts with Indian concerns, namely ONGC and Cairn Energy, for seismic data acquisition and processing were to be computed under the provisions of section 44BB.

24. Can EPABX and mobile phones be treated as computers to be entitled to higher depreciation at 60%?

Federal Bank Ltd. v. ACIT (2011) 332 ITR 319 (Kerala)

On this issue, the High Court held that the rate of depreciation of 60% is available to computers and there is no ground to treat the communication equipment as computers. Hence, EPABX and mobile phones are not computers and therefore, are not entitled to higher depreciation at 60%.

25. Can the waiver of principal amount of loan taken for purchase of capital asset by the bank be treated as "benefit arising out of business" or "a remission of trading liability" for taxability as business income of the company?

Iskraemeco Regent Ltd. v. CIT (2011) 331 ITR 317 (Mad.)

The assessee company, engaged in the business of development, manufacturing and marketing of electro-mechanical and static energy meters, took a bank loan for purchase of capital assets. The grant of bank loan for purchase of a capital asset is a capital receipt and not a trading receipt. The provisions of section 41(1) are attracted only in case of remission of a trading liability. Since the loan was taken for purchase of capital assets, waiver of a portion of principal would not amount to remission of a trading liability to attract the provisions of section 41(1). Further, such waiver cannot be treated as a benefit arising out of business and consequently, section 28(iv) will not apply in respect of such loan transaction.

26. Would the phrase "used for purpose of business" in respect of discarded machine include use of such asset in the earlier years for claim of depreciation under section 32?

CIT v. Yamaha Motor India Pvt. Ltd. (2010) 328 ITR 297 (Delhi)

The issue under consideration in this case is whether depreciation is allowable on the written down value of the entire block, even though the block includes some machinery which has already been discarded and hence, cannot be put to use during the relevant previous year.

On the above issue, it was observed that the expression "used for the purposes of the business" in section 32 when used with respect to discarded machinery would mean the use in the business, not in the relevant financial year/previous year, but in the earlier financial years. The discarded machinery may not be actually used in the relevant previous year but depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year. So, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it is used in the earlier previous years for the business.

27. **Can expenditure incurred by a company on higher studies of the director's son abroad be claimed as business expenditure under section 37 on the contention that he was appointed as a trainee in the company under "apprentice training scheme", where there was no proof of existence of such scheme?**

Echjay Forgings Ltd. v. ACIT (2010) 328 ITR 286 (Bom.)

On this issue, it was observed that there was no evidence on record to show that any other person at any point of time was appointed as trainee or sent abroad for higher education. Further, the appointment letter to the director's son, neither had any reference number nor was it backed by any previous application by him. The appointment letter referred to "apprentice training scheme" with the company in respect of which no details were produced. There was no evidence that he was recruited as trainee by some open competitive exam or regular selection process. Hence, there was no nexus between the education expenditure incurred abroad for the director's son and the business of the assessee company. Therefore, the aforesaid expenditure was not deductible.

28. **Can the expenditure incurred for purchase of second hand medical equipment for use as spare parts for existing equipment be claimed as revenue expenditure?**

Dr. Aswath N. Rao v. ACIT (2010) 326 ITR 188 (Karn)

Relevant section: 37(1)

The assessee, a cardiologist, following cash system of accounting claimed deduction of expenditure incurred for purchase of second hand medical equipment from USA on 31st March of the relevant previous year. However, the said equipment reached India only in August (i.e., the next previous year). The second-hand machinery was purchased for the purpose of dismantling the same and using its parts as spare parts to the existing machinery.

The assessee contended that as the existing machines were old, they went out of order quite often, and spare parts were not readily available in India. Therefore, as and when he visited USA on professional work, he purchased second hand machinery which he brought to India and used the spare parts after dismantling the machinery. Therefore, he claimed deduction of expenditure incurred for purchase of such machinery.

The Department rejected the claim of the assessee on the ground that such expenditure was a capital expenditure. Further, since the machines had reached India only in the next year, any claim for deduction could be considered only in the next year.

On these issues, the High Court held that since the second hand machinery purchased by the assessee is for use as spare parts for the existing old machinery, the same had to be allowed as revenue expenditure. Since the entire sale consideration was paid on 31st March of the relevant previous year and the machinery was also dispatched by the vendor from USA, the sale transaction was complete on that date. The title to the goods had passed on to him on that date and he became the owner of the machinery even though the goods reached India only in August next year. Therefore, the assessee was eligible to claim deduction of expenditure in the relevant previous year ended 31st March.

Note – *In this case, since the machinery was purchased with the intention of using its parts as spare parts for existing machinery, the same has been allowed as revenue expenditure and the date of its purchase is material for determining the year in which the expenditure is allowable as deduction. However, if the intention was to use such machinery on a standalone basis, then the expenditure would be treated as a capital expenditure and the date on which it is put to use would determine its eligibility for depreciation in that year as also the quantum of depreciation (100% or 50%, depending on whether it is put to use for more than 180 days or less in that year).*

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

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

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

30. For claiming deduction of bad debts, is it necessary for the assessee to establish that the debt had, in fact, become irrecoverable?

T.R.F. Ltd. v. CIT (2010) 323 ITR 397 (SC)

Relevant section : 36(1)(vii)

On this issue, the Apex Court held that in order to obtain deduction in relation to bad debts under section 36(1)(vii), it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable. It is enough if the bad debts is written off as irrecoverable in the accounts of the assessee for the relevant previous year.

Note – *Prior to 1st April, 1989, the condition to be satisfied for claim of deduction under section 36(1)(vii) was that the debt should have been established to have become a bad debt in the relevant previous year. However, w.e.f. 1st April, 1989, the condition for claim of deduction under section 36(1)(vii) is that the bad debts should be written off as irrecoverable in the accounts of the assessee for the previous year. Therefore, there is presently no requirement to prove that the debt has actually become irrecoverable.*

31. Can payment to police personnel and gundas to keep away from the cinema theatres run by the assessee be allowed as deduction?

CIT v. Neelavathi & Others (2010) 322 ITR 643 (Karn)

Relevant section: 37(1)

The assessee running cinema theatres claimed deduction of the sum paid to the local police and local gundas towards maintenance of the theatre. The same was disallowed by the Assessing Officer.

On this issue, the High Court observed that if any payment is made towards the security of the business of the assessee, such amount is allowable as deduction, as the amount is spent for maintenance of peace and law and order in the business premises of the assessee i.e., cinema theatres in this case. However, the amount claimed by the assessee, in the instant case, was towards payment made to the police and gundas. Any payment made to the police illegally amounts to bribe and such illegal gratification cannot be considered as an allowable deduction. Similarly, any payment to a gunda as a precautionary measure so that he shall not cause any disturbance in the theatre run by the assessee is an illegal payment for which no deduction is allowable under the Act.

If the assessee had incurred expenditure for the purpose of security, the same would have been allowed as deduction. However, in the instant case, since the payment has been made to the police and gundas to keep them away from the business premises, such a payment is illegal and hence, not allowable as deduction.

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

CIT v. Hindustan Zinc Ltd. (2010) 322 ITR 478 (Raj.)

Relevant section: 37(1)

The assessee company owned a super smelter plant which requires large quantity of water for its day-to-day operation, in the absence of which it would not be able to function. The assessee, therefore, incurred expenditure for alteration of the dam (constructed by the State Government) to ensure sharing of the water with the State Government without having any right or ownership in the dam or water. The assessee's share of water is also determined by the State Government. The assessee claimed the expenditure as deduction under section 37, which was disallowed by the Assessing Officer on the ground that it was of capital nature. The Tribunal, however, was of the view that since the object and effect of the expenditure incurred by the assessee is to facilitate its trade operation and enable the management to conduct business more efficiently and profitably, the expenditure is revenue in nature and hence, allowable as deduction.

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

33. Is the amount paid by a construction company as regularization fee for violating building bye-laws allowable as deduction?

Millennia Developers (P) Ltd. v. DCIT (2010) 322 ITR 401 (Karn.)

Relevant section: 37(1)

The assessee, a private limited company carrying on business activity as a developer and builder, claimed the amount paid by way of regularization fee for the deviations made while constructing a structure and for violating the plan sanctioned in terms of the building bye-laws, approved by the municipal authorities as per the provisions of the Karnataka Municipal Corporations Act, 1976. The assessee's claim was disallowed by the Assessing Officer and the disallowance was confirmed by the Tribunal.

The High Court observed that as per the provisions of the Karnataka Municipal Corporations Act, 1976, the amount paid to compound an offence is obviously a penalty and hence, does not qualify for deduction under section 37. Merely describing the payment as a compounding fee would not alter the character of the payment.

Note – *In this case, it is the actual character of the payment and not its nomenclature that has determined the disallowance of such expenditure as deduction. The principle of substance over form has been applied in disallowing an expenditure in the nature of penalty, though the same has been described as regularization fee/compounding fee.*

34. Would beneficial ownership of assets suffice for claim of depreciation on such assets?

CIT v. Smt. A. Sivakami and Another (2010) 322 ITR 64

Relevant section: 32(1)

The assessee, running a proprietary concern, claimed depreciation on three buses, even though she was not the registered owner of the same. However, in order to establish that she was the beneficial owner, she furnished documents relating to loans obtained for the purchase of buses, repayment of such loans out of collections from the buses, road tax and insurance paid by her. She had also obtained an undertaking from the persons who hold the legal title to the vehicles as well as the permits, for plying buses in the name of her proprietary concern. Further, in the income and expenditure account of the proprietary concern, the entire collections and expenditure (by way of diesel, driver's salary, spares, R.T.O. tax etc.) from the buses was shown. The buses in dispute were also shown as assets in the balance sheet of the proprietary concern.

The assessee claimed depreciation on these buses. The Assessing Officer rejected the claim of the assessee on the ground that the assessee was not the owner of the three buses and the basic condition under section 32(1) to claim depreciation is that the assessee should be the owner of the asset. The Assessing Officer was of the view that mere admission of the income cannot *per se* permit the assessee to claim depreciation.

The High Court observed that in the context of the Income-tax Act, 1961, having regard to the ground realities and further having regard to the object of the Act i.e., to tax the income, the owner is a person who is entitled to receive income from the property in his own right. The Supreme Court, in *CIT v. Podar Cement P Ltd. (1997) 226 ITR 625*, observed that the owner need not necessarily be the lawful owner entitled to pass on the title of the property to another. Since, in this case, the assessee has made available all the documents relating to the business and also established before the authorities that she is the beneficial owner, she is entitled to claim depreciation even though she is not the legal owner of the buses.

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

CIT v. DCM Ltd. (2010) 320 ITR 307 (Delhi)

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

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

The Tribunal applied the tests laid down by the Apex Court in *CIT v. Prithvi Insurance Co. (1967) 63 ITR 632* and arrived at the conclusion that there was interconnection, interlacing and unity of control and management, common decision making mechanism and use of common funds in respect of all the four units.

The High Court concurred with these findings of the Tribunal and accordingly, held that deduction was allowable in respect of expenditure on payment of retrenchment compensation and interest on money borrowed for payment of retrenchment compensation.

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

6

CAPITAL GAINS

1. **Can non-cumulative preference shares carrying a fixed rate of dividend with a fixed holding period be said to be equated with bonds or debentures so as to deny the indexation benefit while computing capital gain on its transfer, applying the third proviso to section 48?**

   CIT v. Enam Securities P. Ltd. (2012) 345 ITR 64 (Bom.)

   As per the third proviso to section 48, benefit of indexation is not available on transfer of a long-term capital asset, being bond or debenture other than capital indexed bonds issued by the government.

   In the present case, the assessee had subscribed to non-cumulative preference shares of a private limited company carrying dividend@4% p.a. and redeemable after the expiry of 10 years from the date of allotment. On the redemption of a part of the aforesaid preference shares at par, the assessee computed the capital loss on the same after claiming the benefit of indexation. However, the Assessing Officer claimed that the above mentioned 4% non-cumulative redeemable preference shares have a fixed holding period and a fixed rate of return which are the principal characteristics of a bond and on this basis denied the benefit of cost indexation to the assessee, applying the third proviso to section 48.

   On this issue, the Bombay High Court, following the judgement of the Supreme Court in *Anarkali Sarabhai v. CIT (1997) 224 ITR 422,* observed that the redemption of preference shares by a company falls within the ambit of section 2(47) and amounts to transfer so as to attract capital gain tax.

   The Court held that, since shares, debentures and bonds are not defined in the Income-tax Act, 1961, the terms have to be understood from the meaning given in the Companies Act, 1956. As per the Companies Act, 1956, the share capital of a company limited by shares can be of two kinds only, namely, equity share capital and preference share capital. Further, as per section 2(12) of the Companies Act, 1956, debenture is defined to include debenture stock, bonds and any other securities of a company, whether or not they constitute a charge on the assets of the company. A debenture is a certificate of a loan or a bond evidencing the fact that the company is liable to pay an amount specified with interest. Though the amount which is raised by a company through debentures becomes a part of its capital structure, it does not become part of share capital. Hence, the 4% non-cumulative preference shares cannot be said to be in the nature of bonds or debentures.

Therefore, the indexation benefit on the transfer of long-term capital asset, being 4% non-cumulative preference shares cannot be denied applying the provisions of the third proviso to section 48.

2. In case of a house property registered in joint names, whether the exemption under section 54F can be allowed fully to the co-owner who has paid whole of the purchase consideration of the house property or will it be restricted to his share in the house property?

CIT v. Ravinder Kumar Arora (2012) 342 ITR 38 (Delhi)

In the present case, the assessee filed the return of income showing long-term capital gain on sale of plot of land. The assessee claimed exemption under section 54F from such long-term capital gain on account of purchase of new residential house property within the stipulated time period as mentioned in the aforesaid section. He claimed exemption under section 54F taking into consideration the whole of purchase price of the residential house property. However, after going through the purchase deed of the house property, the Assessing Officer found that the said house property was purchased in joint names of assessee and his wife. Therefore, the Assessing Officer allowed 50% of the exemption claimed under section 54F, being the share of the assessee in the property purchased in joint names.

The assessee submitted that the inclusion of his wife's name in the sale deed was just to avoid any litigation after his death. He further explained that all the funds invested in the said house were provided by him, including the stamp duty and corporation tax paid at the time of the registration of the sale deed of the said house. This fact was also clearly evident from the bank statement of the assessee. The assessee claimed that the exemption under section 54F is to be allowed with reference to the full amount of purchase consideration paid by him for the aforesaid residential house and is not to be restricted to 50%. The Assessing Officer did not deny the fact that the whole amount of purchases of the house was contributed by the assessee and nothing was contributed by his wife. However, the Assessing Officer opined that exemption under section 54F shall be allowed only to the extent of assessee's right in the new residential house property purchased jointly with his wife, i.e. 50%.

Considering the above mentioned facts, the Delhi High Court held that the assessee was the real owner of the residential house in question and mere inclusion of his wife's name in the sale deed would not make any difference. The High Court also observed that section 54F mandates that the house should be purchased by the assessee but it does not stipulate that the house should be purchased only in the name of the assessee. In this case, the house was purchased by the assessee in his name and his wife's name was also included additionally. Therefore, the conditions stipulated in section 54F stand fulfilled and the entire exemption claimed in respect of the purchase price of the house property shall be allowed to the assessee.

Note: A similar view was taken by the Karnataka High Court in the case of DIT (IT) v. Mrs. Jennifer Bhide (2011) 15 taxmann.com 82, in the context of deductions under section 54 and 54EC, wherein the assessee had sold a residential house property. The assessee, in order to claim exemption of the long-term capital gain, made the investment in the residential house property and bonds jointly in her name and in the name of her husband. The Karnataka High Court, in this case, observed that it was clear from the facts of this case that the entire investment was done by the assessee and no contribution was made by her husband. Therefore, in the present case, it was, held that section 54 and 54EC only stipulate that the capital gain arising on a sale of property is to be invested in a residential house property or in the long-term specified asset i.e., bonds. It is not mandatory in those sections that the investment is to be made in the name of the assessee only. The name of the assessee's husband is shown in the sale deed as well as in the bonds, as a joint owner. However, since the consideration for acquisition flows entirely from the assessee's funds, the assessee is entitled to claim deduction under section 54 and 54EC in respect of the full amount invested. Therefore, in the present case, the exemption under section 54 and 54EC shall not be restricted to 50%, being the share of the assessee in the ownership of the house property and the bonds. The assessee is entitled to 100% exemption of the long-term capital gain so invested in the residential house property and in the bonds.

3. Can the scheme of arrangement approved under section 391 to 394 of Companies Act, 1956 be treated as slump sale to attract capital gains provisions?

   SREI Infrastructure Finance Ltd. v. Income-tax Settlement Commission (2012) 207 Taxman 74 (Delhi)

   In this case, assessee had received certain amount from its subsidiary (under a scheme of arrangement) which was sanctioned by the High Court under sections 391 to 394 of the Companies Act, 1956. The Settlement Commission brought to tax such amount by applying the provisions of section 50B treating such arrangement as slump sale. However, the assessee contended that the transfer of assets between the assessee and its subsidiary was under the "scheme of arrangement", and the same cannot be treated as slump sale as contemplated under section 2(42C).

   Considering the above, the Delhi High Court held that it would be wrong to infer that section 50B is applicable only in case actual "sale" of assets takes place. It shall apply in case of all types of "transfer" mentioned in section 2(47). When a scheme under sections 391 to 394 of the Companies Act, 1956 is sanctioned by the Court, it is treated as a binding statutory scheme because the scheme has to be implemented and enforced. However, this cannot be a ground for the assessee to escape tax on 'transfer'of a capital asset under the provisions of the Income-tax Act, 1961. The taxability of the said transaction is to be decided as per the provisions of the Income-tax Act, 1961.

Therefore, the scheme approved by the court under sections 391 to 394 of the Companies Act, 1956 shall be treated as slump sale and capital gains provisions would be attracted. The cost of acquisition of the arrangement shall, therefore be determined as per the provisions of section 50B.

4. **Will an agricultural land be treated as capital asset, in case it is located within 8 kilometers from the local limits of a City Municipal Corporation, even though the same is not notified by the Central Government under section 2(14)(iii)(b)?**

CIT v. Madhukumar N. (HUF) (2012) 208 Taxman 394 (Kar.)

On this issue, the Karnataka High Court observed that, as per section 2(14), an agricultural land is not a capital asset except in the following cases -

(a) when it is located within the jurisdiction of a municipality, etc, which has a population not less than 10,000 or

(b) when it is located within 8 kilometers from the local limit of a municipality, etc, mentioned in (a) above, which is notified by the Central Government in this regard.

For an agricultural land to become a capital asset by virtue of (b) above, two conditions have to be satisfied namely, the population of the municipality etc, should not be less than 10,000 and the same should be notified by the Central Government.

Therefore, in case an agricultural land is situated within 8 kilometers from the local limit of a municipality, etc. whose population is more than 10,000 but the same is not notified by the Central Government, the said land would not be a capital asset and no capital gain tax would be attracted on its sale.

5. **What are the factors determining the nature of income arising on sale of shares i.e. whether the income is taxable as capital gains or business income?**

PVS Raju v. ACIT (2012) 340 ITR 75 (AP.)

On the said issue, the Andhra Pradesh High Court held that the question whether the shares were held as an investment to give rise to capital gain on its sale or as a trading asset to give rise to business income is not a pure question of law but essentially one of fact. The character of a transaction cannot be determined solely on the application of any abstract rule, principle or test but must depend upon all the facts and circumstances of the case. The facts that may be considered while determining the same are the magnitude and frequency of buying and selling of shares by the assessee; the period of holding of shares, ratio of sales to purchases and the total holdings, etc. Mere classification of shares in the books of accounts of the assessee is not relevant for determining the nature of income for income-tax purposes.

6. **Can an assessee be deprived of claiming exemption under section 54EC, if bonds of assessee's choice are not available or are available only for a broken period within the period of six months after the date of transfer of capital asset and the**

bonds are purchased shortly after it became available next time after the expiry of the said six months?

CIT V. Cello Plast (2012) 209 Taxman 617 (Bom.)

In the present case, the assessee sold its building on 22.03.2006. To avail exemption under section 54EC, the assessee was required to invest the sale proceeds either in the bonds of Rural Electrification Corporation Ltd. (REC bonds) or in the bonds of National Highway Authority (NHA bonds) within six months from the date of sale of building i.e. on or before 21.09.2006. However, during this period of six months, REC bonds were available only between 1.07.2006 to 3.08.2006. Thereafter, it became available only on 22.01.2007 to 31.01.2007. The assessee purchased the REC bonds on 31.01.2007 and claimed the exemption under section 54EC.

However, the Assessing Officer disallowed the benefit of section 54EC to the assessee and taxed the entire capital gain on the contention that bonds were purchased beyond the period of six months from the date of transfer of capital asset. The Assessing Officer contended that since the REC bonds were available during the period from 1.07.2006 to 3.08.2006, the same could have been purchased before 3.08.2006. The Assessing Officer further argued that the assessee could have purchased NHA bonds, if REC bonds were not available throughout the period of said six months.

On the above mentioned issue, the Bombay High Court observed that though REC bonds were available for limited period between 1.07.2006 to 3.08.2006, but assessee had time till 21.09.2006 to invest in these bonds to avail the benefit under section 54EC. The availability of the bonds only for a limited time during the period of six months from the date of sale of the asset as provided in section 54EC, cannot restrict the assessee's right to exercise the same upto last date. The contention of the Revenue that since the REC bonds were available upto 3.08.2006, the assessee should have purchased the bonds before this date, is not sustainable as the time given by the statute is till 21.09.2006.

Hence, reasonable extension ought to be granted after the bonds are made available, at least to the extent of the number of days between 4.08.2006 (being the last date the bonds were available) and 21.09.2006 (being the expiry of 6 months from the date of transfer)

Therefore, the High Court held that since the assessee invested in the bonds on 31.01.2007 i.e within 9 days of their being available once again from 22.01.2007, he cannot be deprived of exemption under section 54EC.

The High Court further held that since section 54EC gives the choice to the assessee either to invest in REC bonds or in NHA bonds, in case the bonds of the assessee's choice are not available, the time to invest in the bonds get automatically extended till the bonds are available in the market.

7. **Would sale of a plot of land held as stock-in-trade by an assessee engaged in the business of real estate and construction of plots, be treated as sale of capital assets, to attract the provisions of section 50C?**

   CIT v. Kan Construction and Colonizers (P) Ltd (2012) 208 Taxman 478 (All.)

   On this issue, the High Court observed that for applicability of section 50C, the essential requirement is that the building and land transferred should be a capital asset. Further, as per section 2(14), capital asset does not include stock-in-trade held for the purpose of an assessee's business or profession.

   The Assessing Officer treated the sale of plot of land held by the assessee as sale of capital asset and accordingly, applied the provisions of section 50C.

   The High Court held that since the assessee is a builder and construction of buildings is its business, investment in purchase and sale of plots by it is ancillary and incidental to its business activity. Therefore, it was held that the assessee has held the land as stock-in-trade and not as a capital asset. Hence, section 50C will not apply in this case and the profit on sale of land will be treated a business income.

8. **Can exemption under section 54F be denied to an assessee in respect of investment made in construction of a residential house, on the ground that the construction was not completed within three years after the date on which transfer took place, on account of pendency of certain finishing work like flooring, electrical fittings, fittings of door shutter, etc?**

   CIT v. Sambandam Udaykumar (2012) 345 ITR 389 (Kar.)

   In this case, the assessee has claimed benefit of exemption under section 54F in respect of capital gain arising on sale of shares of a company by investing the amount in construction of a house property. However, the Assessing Officer contended that no exemption under section 54F would be available in this case, as the construction of a residential house was not completed on account of pendency of certain work like flooring, electrical fittings, fittings of door shutter, etc., even after lapse of three years from the date of transfer of the shares.

   The Karnataka High Court held that the condition precedent for claiming the benefit under section 54F is that capital gains realized from sale of capital asset should have been invested either in purchasing a residential house or in constructing a residential house. If he has invested the money in the construction of a residential house, merely because the construction was not completed in all respects and possession could not be taken within the stipulated period, would not disentitle the assessee from claiming exemption under section 54F. In fact, in this case, the assessee has taken the possession of the residential building and is living in the said premises despite the pendency of flooring work, electricity work, fitting of door and window shutters. The condition precedent for claiming exemption under section 54F is that the capital gain realized from sale of capital asset should have been parted by the assessee and invested either in purchasing a residential house or in constructing a residential house within the stipulated period.

Therefore, the Court held that in this case the assessee would be entitled to exemption under section 54F in respect of the amount invested in construction within the prescribed period.

9. **Whether indexation benefit in respect of the gifted asset shall apply from the year in which the asset was first held by the assessee or from the year the same was first acquired by the previous owner?**

CIT v. Manjula J. Shah 16 Taxman 42 (Bom.)

As per *Explanation* 1 to section 2(42A), in case the capital asset becomes the property of the assessee in the circumstances mentioned in section 49(1), *inter alia*, by way of gift by the previous owner, then for determining the nature of the capital asset, the aggregate period for which the capital asset is held by the assessee and the previous owner shall be considered.

As per the provisions of section 48, the profit and gains arising on transfer of a long-term capital asset shall be computed by reducing the indexed cost of acquisition from the net sale consideration. The indexed cost of acquisition meant the amount which bears to the cost of acquisition the same proportion as Cost Inflation Index (CII) for the year in which the asset is transferred bears to the CII for the year in which the asset was first held by the assessee transferring it i.e., the year in which the asset was gifted to the assessee in case of transfer by the previous owner by way of gift.

In the present case, the assessee had acquired a capital asset by way of gift from the previous owner. The said asset when transferred was a long-term capital asset considering the period of holding by the assessee as well as the previous owner. The assessee computed the long-term capital gain considering the CII of the year in which the asset was first held by the previous owner. The Assessing Officer raised an objection mentioning that as per meaning assigned to the Indexed cost of acquisition, the CII of the year in which the asset is first held by the assessee need to be considered and not the CII of the year in which the asset was first held by the previous owner.

In the present case, the Bombay High Court held that by way of 'deemed holding period fiction' created by the statute, the assessee is deemed to have held the capital asset from the year the asset was held by the previous owner and accordingly the asset is a long term capital asset in the hands of the assessee. Therefore, for determining the indexed cost of acquisition under Section 48, the assessee must be treated to have held the asset from the year the asset was first held by the previous owner and accordingly the CII for the year the asset was first held by the previous owner would be considered for determining the indexed cost of acquisition.

Hence, the indexed cost of acquisition in case of gifted asset has to be computed with reference to the year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset.

Note- The Delhi High Court, in the case of ***Arun Shungloo Trust v. CIT(2012) 205 Taxman 456 (Delhi)*** *has also given the similar view on the said issue. The court observed that as per Explanation (iii) to section 48, the expression 'asset held by the assessee' is not defined and therefore, in the absence of any intention to the contrary, it has to be construed in consonance with the meaning given in section 2(42A). However, the Assessing Officer contended that in section 49, the benefit of indexed cost of acquisition will be available only from the date the capital asset was transferred and not from the date on which the asset was held by the previous owner.*

The High Court observed that this will result in inconsistency because as per the provisions of Explanation to section 48, the holding of predecessor has to be accounted for the purpose of computing the cost of acquisition, the cost of improvement and indexed cost of improvement, but not for the purpose of indexed cost of acquisition.

In the present case, the Bombay High Court held that by way of 'deemed holding period fiction' created by the Statute, the assessee is deemed to have held the capital asset from the year the asset was held by the previous owner and accordingly, the asset is a long term capital asset in the hands of the assessee. Therefore, for determining the indexed cost of acquisition under section 48, the assessee must be treated to have held the asset from the year in which the asset was first held by the previous owner and accordingly the cost inflation index for the year the asset was first held by the previous owner would be considered for determining the indexed cost of acquisition.

10. **Would an asset which is sold the very next day after the period of 12/36 months is over, be treated as long-term capital asset by including both the date on which the asset is acquired and the date on which the asset is transferred for computing period of holding?**

Bharti Gupta Ramola v. CIT [2012] 207 Taxman 178 (Delhi)

As per section 2(29A), long-term capital asset means a capital asset which is not a short-term capital asset. Further, section 2(42A) defines "short-term capital asset" to mean a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer. However, in case of a share held in a company or any other security listed in a recognized stock exchange in India or a unit of the Unit Trust of India, or a unit of a Mutual Fund specified under section 10(23D) or a zero coupon bond, "twelve months" would be considered instead of "thirty-six months" for the purpose of section 2(42A).

In the present case, the assessee had sold two mutual fund instruments on 29.9.2005 and 14.10.2005 and had shown the income earned as long-term capital gains. The aforesaid mutual fund instruments were purchased by the assessee on 29.9.2004 and 14.10.2004. The Assessing Officer treated the two gains as short-term capital gains on the ground that the instruments had not been held for a period of more than 12 months immediately preceding the date of transfer. The contention of the Revenue was that the asset must be held for a period of more than 36/12 months plus one day before the date when the transfer is made, to be treated as a long-term capital asset. In effect, the date on which the transfer is made has to be excluded.

The High Court observed that the expression "immediately preceding the date of transfer" is a cut off point for determining and deciding the period during which the asset was held by an assessee. The said expression should not be interpreted to mean that the date of transfer itself should be added or excluded.

Section 2(42A) stipulates that if an asset is held for 36/12 months, or less, it will be a short term capital asset. The term "month" would mean "calendar month". In normal course, period of 12 calendar months would begin on the specified day when the asset was transferred and the assessee became the holder of the asset and end one day before in the relevant calendar month, next year. The expression used in section 2(42A) is "for not more than 36/12 months". The requirement prescribed is that the assessee should not hold the asset for more than 36/12 months. The moment an assessee exceeds this period and the holding continues beyond 36/12 months, the asset is treated as a long term asset and accordingly the gains are computed. For computing the period of 12/36 months, neither the date on which the asset is acquired, nor the date of sale/transfer is to be excluded. Thus, if an asset is held for 12/36 months and is sold the very next day after the period of 12/36 months is over, the asset would be treated as a long term capital asset. There is nothing in the said section to show and hold that the time period would not include fraction of a day. Thus, an asset acquired on the 1st January would complete 12 months at the end of the said year, i.e. on 31st December and if it is sold on 1st January next year and if the proviso to section 2(42A) applies, it would be treated as a long term capital gains.

11. **Can the assessee claim exemption under section 54F, on account of capital gain arising on transfer of depreciable assets held for more than 36 months i.e. a long-term capital asset, though the same is deemed as capital gain arising on transfer of short-term capital asset by virtue of section 50?**

CIT v. Rajiv Shukla (2011) 334 ITR 138 (Delhi)

In the above mentioned case, the assessee had claimed benefit of exemption under section 54F in respect of capital gain arising on the sale of property, being a depreciable asset held for more than 36 months i.e. long-term capital asset. However, the department contended that no exemption under section 54F is available in this case, as the said exemption is granted in respect of the capital gain arising from the transfer of a long-term capital asset whereas the capital gain arising on transfer of depreciable asset is deemed to be capital gain arising from transfer of short-term capital asset by virtue of provisions of section 50.

The Delhi High Court in the present case relying on the decision of the Bombay High Court in the case of *CIT v. Ace Builders P. Ltd. (2006) 281 ITR 210* and the decision pronounced by

Gauhati High Court in *CIT v. Assam Petroleum Industries P. Ltd. [2003] 262 ITR 587,* in relation to erstwhile section 54E, held that the deeming fiction created by section 50 that the capital gain arising on transfer of a depreciable asset shall be treated as capital gain arising on transfer of short-term capital asset is only for the purpose of sections 48 and 49 and not for the purpose of any other section. Section 54F being an independent section will not be bound by the provisions of section 50. The depreciable asset if held for more than 36 months shall be a long-term capital asset as per the provisions of section 2(29A).

Therefore, the exemption under section 54F on transfer of depreciable asset held for more than 36 months cannot be denied on account of fiction created by section 50.

12. Can exemption under section 54 be claimed in respect of more than one residential flat acquired by the assessee under a joint development agreement with a builder, wherein the property owned by the assessee was developed by the builder who constructed eight residential flats in the said property, four of which were given to the assessee?

CIT v. Smt. K. G. Rukminiamma (2011) 331 ITR 211 (Kar.)

The assessee, being the owner of a property, entered into a joint development agreement with a builder to develop the property. Under the agreement, the builder constructed eight residential flats and handed over four residential flats to the assessee. The entire cost of construction and other expenses were borne by the builder.

The issue under consideration is whether capital gains exemption under section 54 can be claimed in respect of the four residential flats treating them as “a residential house”. In the present case, the Revenue contended that the benefit of deduction under section 54 could be availed only in respect of one residential flat and in respect of the remaining three residential flats, the assessee was not entitled to deduction under section 54.

The Karnataka High Court, applying the decision in *Anand Basappa (2009) 309 ITR 329 (Kar.)* to the present case, held that all the four flats are situated in the same residential building and hence, will constitute "a residential house" for the purpose of section 54. Therefore, the assessee would be entitled to deduction under section 54 in respect of all four flats.

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

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

Relevant section : 54B

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

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

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

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

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

Relevant sections : 2(42A) & 49(1)(iii)(b)

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

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

15. Can exemption under section 54EC be denied on account of the bonds being issued after six months of the date of transfer even though the payment for the bonds was made by the assessee within the six month period?

Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)

Relevant section: 54EC

In this case, the Bombay High Court observed that in order to avail the exemption under section 54EC, the capital gains have to be invested in a long-term specified asset within a period of six months from the date of transfer. Where the assessee has made the payment within the six month period, and the same is reflected in the bank account and a receipt has been issued as on that date, the exemption under section 54EC cannot be denied merely because the bond was issued after the expiry of the six month period or the date of allotment specified therein was after the expiry of the six month period. For the purpose of the provisions of section 54EC, the date of investment by the assessee must be regarded as the date on which payment is made. The High Court, therefore, held that if such payment is within a period of six months from the date of transfer, the assessee would be eligible to claim exemption under section 54EC.

16. What would be the period of holding to determine whether the capital gains on renunciation of right to subscribe for additional shares is short-term or long-term?

Navin Jindal v. ACIT (2010) 320 ITR 708 (SC)

On this issue, the Apex Court observed that the right to subscribe for additional offer of shares on rights basis, on the strength of existing shareholding in a company, comes into existence when the company decides to come out with the rights offer. Prior to that date, the right, though embedded in the original shareholding, remains inchoate. It crystallizes only when the rights offer is announced by the company. Therefore, for determining whether the capital gains on renunciation of 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 upto the date of renunciation of such right.

7

INCOME FROM OTHER SOURCES

1. **Can the loan or advance given to a shareholder by the company, in return of an advantage conferred on the company by the shareholder, be deemed as dividend under section 2(22)(e) in the hands of the shareholder?**

   Pradip Kumar Malhotra v. CIT (2011) 338 ITR 538 (Cal.)

   In the present case, the assessee, a shareholder holding substantial voting power in the company, permitted his property to be mortgaged to the bank for enabling the company to take the benefit of loan. The shareholder requested the company to release the property from the mortgage. On failing to do so and for retaining the benefit of loan availed from Bank, the company gave advance to the assessee, which was authorized by a resolution passed by its Board of Directors.

   The issue under consideration is whether the advance given by the company to the assessee shareholder by way of security deposit for keeping his property as mortgage on behalf of company to reap the benefit of loan, can be treated as deemed dividend within the meaning of section 2(22)(e).

   In the above case, the Calcutta High Court observed that, the phrase "by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans which a share holder enjoys simply on account of being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power. In case such loan or advance is given to such shareholder as a consequence of any further consideration which is beneficial to the company received from such a shareholder, such advance or loan cannot be said to a deemed dividend within the meaning of the Act. Thus, gratuitous loan or advance given by a company to a share holder, who is the beneficial owner of shares holding not less than 10% of the voting power, would come within the purview of section 2(22)(e) but not to the cases where the loan or advance is given in return to an advantage conferred upon the company by such shareholder.

   Therefore, in the present case, the advance given to the assessee by the company was not in the nature of a gratuitous advance given, instead it was given to protect the interest of the company. Therefore, the said advance cannot be treated as deemed dividend in the hands of the shareholder under section 2(22)(e).

2. **Can winnings of prize money on unsold lottery tickets held by the distributor of lottery tickets be assessed as business income and be subject to normal rates of tax instead of the rates prescribed under section 115BB?**

CIT v. Manjoo and Co. (2011) 335 ITR 527 (Kerala)

On the above issue, the Kerala High Court observed that winnings from lottery is included in the definition of income by virtue of section 2(24)(ix). Further, in practice, all prizes from unsold tickets of the lotteries shall be the property of the organising agent. Similarly, all unclaimed prizes shall also be the property of the organising agent and shall be refunded to the organising agent.

The High Court contended that the receipt of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be "income earned" by him in business. The said view was taken on the basis that the unsold lottery tickets cease to be stock-in-trade of the distributor because, after the draw, those tickets are unsaleable and have no value except waste paper value and the distributor will get nothing on sale of the same except any prize winning ticket if held by him, which, if produced will entitle him for the prize money. Hence, the receipt of the prize money is not in his capacity as a lottery distributor but as a holder of the lottery ticket which won the prize. The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which tax is deducted at source.

Further, winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls. Therefore, even if the argument of the assessee is accepted and the winnings from lottery is taken to be received by him in the course of his business and as such assessable as business income, the specific provision contained in section 115BB, namely, the special rate of tax i.e. 30% would apply.

Therefore, the High Court held that the rate of 30% prescribed under section 115BB is applicable in respect of winnings from lottery received by the distributor.

3. **What can be the tests to determine "substantial part of business" of lending company for the purpose of application of exclusion provision under section 2(22)?**

CIT v. Parle Plastics Ltd. (2011) 332 ITR 63 (Bom.)

Under section 2(22), dividend does not include*, inter alia,* any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company. The expression used in the exclusion provision of section 2(22) is "substantial part of the business". Sometimes a portion which contributes a substantial part of the turnover, though it contributes a relatively small portion of the profit, would be termed as a substantial part of the business. Similarly, a portion which is relatively small as compared to the total turnover, but generates a large portion, say more than 50% of the total profit of the company would also be a substantial part of its business. Percentage of turnover in relation to the whole as also the percentage of the profit in relation to the whole and sometimes even percentage of manpower used for a particular part of the business in relation to the total manpower or work force of the company would be required to be taken into consideration for determining the substantial part of business. The capital employed for a specific division of a company in comparison to total capital employed would also be relevant to determine whether the part of the business constitutes a substantial part.

In this case, 42% of the total assets of the lending company were deployed by it by way of loans and advances. Further, if the income earned by way of interest is excluded, the other business had resulted in a net loss. These factors were considered in concluding that lending of money was a substantial part of the business of the company. Since lending of money was a substantial part of the business of the lending company, the money given by it by way of advance or loan to the assessee could not be regarded as a dividend, as it had to be excluded from the definition of "dividend" by virtue of the specific exclusion in section 2(22).

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

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

Relevant section: 2(22)(e)

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

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

8

SET-OFF AND CARRY FORWARD OF LOSSES

1. **In order to determine whether *Explanation* to section 73 is applicable in a particular case, is it necessary to first determine the gross total income of the assessee computed as per normal provisions of the Act?**

   CIT v. Darshan Securities (P.) Ltd. (2012) 341 ITR 556 (Bom.)

   On this issue, the Bombay High Court observed that, in order to apply the exemption carved out in the bracketed portion of the *Explanation* to section 73, the gross total income (GTI) of a company is to be first computed as per the normal provisions of the Act and thereafter, it needs to be determined whether the GTI of the assessee consists of mainly income under the head interest on securities, income from house property, capital gains and income from other sources. The words "consists mainly" are indicative of the fact that the legislature had in its contemplation that the GTI consists predominantly of income from the four heads that are referred to therein.

   In case the gross total income of an assessee consists of loss in share trading and service charges taxable under the head "Profit and gains of business or profession", then such loss would be first set-off against such income as given in section 70 and then the composition of GTI has to be determined. In case such loss is completely set-off against the income, and the assessee has income predominantly under heads mentioned in the exception carved out in the bracketed portion of the said *Explanation*, such loss will not be treated as speculation loss for applicability of section 73(1).

9

DEDUCTIONS FROM GROSS TOTAL INCOME

1. Can an assessee, engaged in the business of developing a housing project, be denied deduction under section 80-IB(10) on the ground that the ownership of land has not yet been transferred to the assessee and the approval to build the housing project has been taken in the name of the land owner, though the assessee assumes the entire risks and rewards of the project?

   CIT v. Radhe Developers (2012) 341 ITR 403 (Guj.)

   The assessee is a land developer and derives its income from the business of developing and building of housing project. To execute a housing project, the assessee entered into a development agreement with the owner of a land. On the same day, the land owner entered into an "agreement to sell" the said land to the assessee. The assessee claimed deduction under section 80-IB(10) contending that the income derived was by an undertaking developing and building a housing project approved by the local authority.

   However, the Assessing Officer rejected the assessee's claim for deduction under section 80-IB(10) on the ground that the assessee was not the owner of the land on which the housing project was developed and also the approval by the local authority to commence such housing project was not in the name of the assessee. The Department was of the view that the assessee had merely acted as an agent or contractor for the land owner for development of housing project and therefore, it would be taken as a works contractor and hence, would not be eligible for the deduction applying *Explanation* to section 80-IB(10).

   The assessee contended that the ownership of land is not a pre-requisite to claim deduction under section 80-IB(10). The assessee further argued that the execution of a housing project cannot be taken to be a works contract in this case since the assessee had the full authority to take all the decisions and had assumed the full risk of the failure or success of the housing project. The profit or loss derived from the project was of the assessee and the owner of the land would only receive a part of sale consideration in lieu of which he had granted development permission to the assessee. The land owner was not exposed to any risk in respect of the housing project. Therefore, *Explanation* to section 80-IB(10) is not applicable and deduction cannot be denied on that basis.

   Considering the above, the Gujarat High Court held that, on perusal of the provisions of section 80-IB(10), it is clear that deduction of 100% of profit is provided to an undertaking deriving profit from the business of developing and building housing projects which is approved by the local authority before the specified date, subject to certain other conditions mentioned therein. The said provisions nowhere require that only those developers who themselves own the land would be entitled to deduction under section 80-IB(10). This condition cannot be read for the applicability of section 80-IB(10). The issue is whether the contract is a contract of work or a contract of sale. As the land owner entered into an agreement to sell the land to the assessee, it would constitute a contract for sale and not a works contract. The owner of the land had, in part performance of the agreement to sell, given the possession thereof to the assessee and the assessee had carried out the construction work for development of the housing project. Therefore, as per provisions of section 2(47) read with section 53A of the Transfer of Property Act, 1882, it can be construed that the land, for the purpose of the Income-tax Act, 1961, is deemed to have been transferred to the assessee, though the title of the land has not yet been transferred to the assessee. The ownership has been understood differently in different contexts. Hence, for the purpose of deduction under section 80-IB(10), the assessee had satisfied the condition of ownership, even if it was necessary. Therefore, the assessee shall be deemed to be the owner of the land.

Hence, in the present case, as per the provisions of section 80-IB(10), deduction shall be provided to the assessee engaged in the business of developing and building housing projects, in case it satisfies the conditions mentioned therein even if the ownership of the land has not yet been transferred to the assessee and the approval for such housing project is obtained in the name of the original land owner.

2. Does standing charges paid by the client for failure to purchase the minimum agreed quantity, qualify for deduction under section 80-IC?

Pine Packaging (P.) Ltd. v. CIT (2012) 209 Taxman 74 (Delhi)

On this issue, the Delhi High Court held that the standing charges received by an assessee from a client on failure to place the minimum amount of purchase order as per the agreement, cannot be said to be profit or gains derived by an eligible enterprise from its manufacturing or production activities. The said standing charges are in the nature of compensation for non-utilization or under utilization of plant and machinery due to lack of orders. The said charges were paid to compensate the assessee for failure to produce and market its products. Therefore, such standing charges are not eligible for deduction under section 80-IC.

3. In a case where an additional building was constructed on a plot of land and approval for the same is obtained in the year 2002, can deduction under section 80-IB(10) be denied in respect of the said building on the contention that it was an extension of an earlier project for construction of four buildings, in respect of which approval was obtained before 1.10.98?

CIT v. Vandana Properties (2012) 206 Taxman 584 (Bom.)

In this case, the assessee-firm, engaged in business of construction and development of housing projects, constructed buildings A, B, C and D prior to 1.10.1998 on a plot measuring 2.36 acres, in respect of which approval was obtained prior to 1.10.1998. After taking permission of the State Government in the year 2001, the assessee-firm has constructed an additional building 'E' with other residential units, in respect of which approval was obtained in the year 2002. The assessee claimed deduction under section 80-IB in respect of building 'E'.

However, the Assessing Officer disallowed the claim for deduction on the ground that approval for building 'E', granted in the year 2002, was an extension of approvals granted earlier for other buildings and, hence, the project commenced prior to 1.10.1998 which disentitled the project from claiming deduction under section 80-IB. The Assessing Officer, further, making reference to the conditions laid down under section 80-IB(10)(b), contended that project should be on the size of a plot of land of minimum one acre. However, in this case, even if the plot is proportionately divided between five buildings, the land pertaining to building 'E' would be less than one acre, thus, violating the condition mentioned above for claiming deduction under section 80-IB(10).

The Bombay High Court observed that construction of building 'E' constitutes an independent housing project and therefore, the date prior to 1.10.1998 applicable to the other buildings in the housing project could not be applied to building 'E'. It is only in the year 2001 that the status of the land was converted from surplus vacant land by the State Government and consequently, the building plan for construction of building 'E' was submitted and the same was approved by the local authority in the year 2002. Further, It was observed that section 80-IB specifies the size of the plot of land of minimum 1 acre but not the size of the housing project. It is immaterial as to whether any other housing projects are existing on the said plot of land or not. Hence, the objection raised by the Assessing Officer that if plot was proportionately divided between 5 buildings, the land pertaining to building 'E' would be less than 1 acre was not correct.

Therefore, the High Court held that the assessee was entitled to deduction under section 80-IB(10) in respect of building E.

4. Can an industrial undertaking engaged in manufacturing or producing articles or things treat the persons employed by it through agency (including contractors) as "workers" to qualify for claim of deduction under section 80-IB?

CIT v. Jyoti Plastic Works Private Limited (2011) 339 ITR 491 (Bom.)

One of the conditions to be fulfilled by an industrial undertaking engaged in manufacturing or producing articles or things to qualify for claim of deduction under section 80-IB is that it should employ ten or more workers in a manufacturing process carried on with the aid of power or twenty or more workers in a manufacturing process carried on without the aid of power. The issue under consideration in this case is whether the persons employed by such industrial undertaking through agency (including contractors) can be treated as "workers" for fulfillment of the above condition.

In this case, the Assessing Officer rejected the assessee's claim for deduction under section 80-IB on the grounds that -

(1) the assessee was not a manufacturer as the goods were not manufactured at the factory premises of the assessee but at the factory premises of the job workers; and

(2) the total number of permanent employees employed in the factory being less than ten, the assessee had not fulfilled the condition stipulated in section 80-IB(2)(iv).

The Commissioner (Appeals) allowed the claim of the assessee and the Tribunal upheld the order of the Commissioner (Appeals).

The High Court observed that the Tribunal had found on the basis of the material on record that manufacturing activity was carried out at the factory premises of the assessee. Though the workers employed by the assessee directly were less than ten, it was not in dispute that the total number of workers employed by the assessee directly or hired through a contractor for carrying on the manufacturing activity exceeded ten.

The expression "worker" is neither defined under section 2 of the Income-tax Act, 1961, nor under section 80-IB(2)(iv) of the Act. Therefore, it would be reasonable to hold that the expression "worker" in section 80-IB(2)(iv) of the Act is referable to the persons employed by the assessee directly or by or through any agency (including a contractor) in the manufacturing activity carried on by the assessee. The employment of ten or more workers is what is relevant and not the mode and the manner in which the workers are employed by the assessee.

The High Court, therefore, held that the Tribunal was justified in holding that the condition of section 80-IB(2)(iv) had been fulfilled and therefore, the deduction under section 80-IB is allowable.

5. **Can an assessee not claiming deduction under section 80-IB in the initial years claim the said deduction for the remaining years during the period of eligibility, if the conditions are satisfied?**

Praveen Soni v. CIT (2011) 333 ITR 324 (Delhi)

On the above issue, the Delhi High Court held that the provisions of section 80-IB nowhere stipulated a condition that the claim for deduction under this section had to be made from the first year of qualification of deduction failing which the claim will not be allowed in the remaining years of eligibility. Therefore, the deduction under section 80-IB should be allowed to the assessee for the remaining years up to the period for which his entitlement would accrue, provided the conditions mentioned under section 80-IB are fulfilled.

6. **Would the procurements of parts and assembling them to make windmill fall within the meaning of "manufacture" and "production" to be entitled for deduction under section 80-IB?**

CIT v. Chiranjjeevi Wind Energy Ltd. (2011) 333 ITR 192 (Mad.)

The Supreme Court, in *India Cine Agencies v. CIT(2009) 308 ITR 98,* laid down that the test to determine whether a particular activity amounts to "manufacture" or not is whether new and different goods emerge having distinctive name, use and character. Further, the Supreme Court, in *CIT v. Sesa Goa Ltd. (2004) 271 ITR 331,* observed that the word "production" or "produce" when used in comparison with the word "manufacture" means bringing into existence new goods by a process, which may or may not amount to manufacture. It also takes in all the by-products, intermediate products and residual products, which emerge in the course of manufacture of goods.

In this case, Madras High Court, applying the above rulings of the Apex Court, observed that the different parts procured by the assessee could not be treated as a windmill individually. Those different parts had distinctive names and only when assembled together, they got transformed into an ultimate product which was commercially known as a "windmill". Thus, such an activity carried on by the assessee would amount to "manufacture" as well as "production" of a thing or article to qualify for deduction under section 80-IB.

Note: *The definition of manufacture has been incorporated in section 2(29BA) by the Finance (No. 2) Act, 2009 w.e.f. from 01.04.2009, and it means, inter alia, a change in a non-living physical object or article or thing resulting in transformation of the object or article or thing in to a new and distinct object or article or thing having a different name, character and use. Assembling of windmill at factory and putting them at site of customer apparently satisfies this definition of manufacture also.*

7. Would grant of transport subsidy, interest subsidy and refund of excise duty qualify for deduction under section 80-IB?

CIT v. Meghalaya Steels Ltd. (2011) 332 ITR 91 (Gauhati)

The Supreme Court, in *Liberty India v. CIT [2009] 317 ITR 218*, observed that section 80-IB provides for deduction in respect of profits and gains “derived from the business” of the assessee and accordingly, the Parliament intended to cover sources of profits and gains not beyond the first degree. There should be a direct nexus between the generation of profits and gains and the source of profits and gains, the latter being directly relatable to the business of the assessee. Any other source, not falling within the first degree, can only be considered as ancillary to the business of the assessee.

In this case, the High Court observed that the transport and interest subsidies were revenue receipts which were granted after setting up of the new industries and after commencement of production. The transport subsidy would have the effect of reducing the inward and outward transport costs for the purposes of determining the cost of production as well as for sales. However, the subsidy had no direct nexus with the profits or gains derived by the assessee from its industrial activity and the benefit to the assessee was only ancillary to its industrial activity. The subsidies were not directly relatable to the industrial activity of the assessee, and hence they did not fall within the first degree contemplated by the Act. Therefore, the subsidies could not be taken into account for purposes of deduction under section 80-IB.

However, the payment of Central excise duty had a direct nexus with the manufacturing activity and similarly, the refund of the Central excise duty also had a direct nexus with the manufacturing activity, being a profit-linked incentive, since payment of the Central excise duty would not arise in the absence of any industrial activity. Therefore, the refund of excise duty had to be taken into account for purposes of section 80-IB.

Note: *Similar ruling was pronounced by the Himachal Pradesh High Court in CIT v. Gheria Oil Gramudyog Workers Welfare Association (2011) 330 ITR 117, wherein it was held that interest subsidy received from the State Government cannot be treated as "profit derived from industrial undertaking" and hence was not eligible for deduction under section 80-IB.*

8. **Does income derived from sale of export incentive qualify for deduction under section 80-IB?**

CIT v. Jaswand Sons (2010) 328 ITR 442 (P&H)

On this issue, the High Court held that income derived from sale of export incentive cannot be said to be income "derived from" the industrial undertaking and therefore, such income is not eligible for deduction under section 80-IB.

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

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

Relevant section: 80-IA

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

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

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

10. **Does the period of exemption under section 80-IB commence from the year of trial production or year of commercial production? Would it make a difference if sale was effected from out of the trial production?**

    CIT v. Nestor Pharmaceuticals Ltd. / Sidwal Refrigerations Ind Ltd. v. DCIT (2010) 322 ITR 631 (Delhi)

    In this case, the assessee had started trial production in March 1998 whereas commercial production started only in April, 1998. Therefore, the assessee claimed deduction under section 80-IB for the assessment years 1999-2000 to 2003-04, whereas the Assessing Officer denied deduction for A.Y.2003-04 on the ground that the five year period would be reckoned from A.Y.1998-99, since the trial production began in March, 1998.

    The Tribunal observed that not only the trial production had started in March 1998 but there was in fact sale of one water cooler and air-conditioner in the month of March 1998. The explanation of the assessee was that this was done to file the registration under the Excise Act and Sales-tax Act.

    The High Court observed that with mere trial production, the manufacture for the purpose of marketing the goods had not started which starts only with commercial production, namely, when the final product to the satisfaction of the manufacturer has been brought into existence and is fit for marketing. However, in this case, since the assessee had effected sale in March 1998, it had crossed the stage of trial production and the final saleable product had been manufactured and sold. The quantum of commercial sale and the purpose of sale (namely, to obtain registration of excise / sales-tax) is not material. With the sale of those articles, marketable quality was established. Therefore, the conditions stipulated in section 80-IB were fulfilled with the commercial sale of the two items in that assessment year, and hence the five year period has to be reckoned from A.Y.1998-99.

    Note – *Though this decision was in relation to deduction under section 80-IA, as it stood prior to its substitution by the Finance Act, 1999 w.e.f. 1.4.2000, presently, it is relevant in the context of section 80-IB.*

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

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

    Relevant section: 80-IB

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

10

ASSESSMENT OF VARIOUS ENTITIES

1. **Would interest earned on fixed deposits made by a social club with its corporate members satisfy the principle of mutuality to escape taxability?**

   CIT v. Secunderabad Club Picket (2012) 340 ITR 121 (A.P.)

   The assessee is a social and recreational club. It is a mutual association and a non-profit making concern. The assessee was in receipt of monthly subscriptions, admission/entrance fee and payments made by its members for use of club facilities. It earned interest from the fixed deposit made by it with certain banks and financial institutions, which were also its corporate members. The assessee filed its return claiming this interest to be exempt on the contention that the interest was earned from its members and, therefore, the same was not taxable. The assessee further contended that if a person carries on an activity, which is also trade, in such a way that they and the customers are the same persons, no profits are yielded by such trade for tax purpose and therefore, principle of mutuality would apply.

   However, in this case, the Assessing Officer denied such exemption on the ground that neither the assessee deposited the amounts with the banks and financial institutions, treating them as corporate members, nor the banks and financial institutions accepted the same in the capacity of members of the club. The banks and the financial institutions treated the club at par with their other customers and offered them the same interest as offered to the general public.

   In the present case, the Andhra Pradesh High Court following the judgement of the Supreme Court in *Bankipur Club Ltd (1997) 226 ITR 97*, concluded that certain factors need to be considered to arrive at a conclusion as to what point the relationship of mutuality ends and that of trading begins. If the object of the assessee claiming to be a 'mutual concern' is to carry on a business and the same consideration is realized both from the members and from non members by giving similar facilities to them, then, the resultant surplus would be an income liable to tax.

   The High Court, considering*, inter alia,* the above mentioned facts, held that the principle of mutuality ends the moment the club deposits the amount with its corporate members, being banks and financial institutions, with the sole aim of earning interest on the deposits. Also, the corporate members, i.e the banks and financial institutions, have treated the club as a regular customer, accepting deposits in the normal course of business. There is nothing to show that the interest on fixed deposits have been provided as a facility to the club. The social relationship and social activities of the club have nothing to do with its deposits with corporate members.

Therefore, the said interest income is not exempt on the principle of mutuality.

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

Indcom v. Commissioner of Income-tax (TDS) (2011) 335 ITR 485 (Calcutta)

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

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

Therefore, although the payments made to non-resident umpires and the match referees are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the assessee is not liable to deduct tax under section 194E.

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

3. **Can interest under sections 234B and 234C be levied where a company is assessed on the basis of book profits under section 115JB?**

Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470 (SC)

On this issue, the Supreme Court observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted. Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C. Therefore, interest under sections 234B and 234C shall be payable on failure to pay advance tax in respect of tax payable under section 115JB.

Note – *According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year. Under section 115JB(1), where the tax payable on total income is less than 18.5% of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at the rate of 18.5%. Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.*

4. Would the interest earned on surplus funds of a club deposited with institutional members satisfy the principle of mutuality to escape taxability?

Madras Gymkhana Club v. DCIT (2010) 328 ITR 348 (Mad.)

The assessee, club providing facilities like gym, library, etc, to its members earned interest from fixed deposits which it had made by investment of its surplus funds with its corporate members.

The High Court held that interest earned from investment of surplus funds in the form of fixed deposits with institutional members does not satisfy the principle of mutuality and hence cannot be claimed as exempt on this ground. The interest earned is, therefore, taxable.

Note: *It may be noted that the Delhi High Court in the case of Delhi Gymkhana Club Ltd. v. CIT (2011) 339 ITR 525 held that, income from fixed deposit in bank satisfies the doctrine of mutuality and would be exempt in the hands of the club.*

Rationale of the judgment in the case of Madras Gymkhana Club was that the club had invested the surplus fund as fixed deposit with its own institutional member which had an effect of providing benefit to the said member of utilizing the funds in any manner it desired and depriving other members of such benefit. Therefore, the same cannot be said to satisfy the doctrine of mutuality and shall be chargeable to tax.

In case of Delhi Gymkhana Club Ltd, the rationale of the ruling was that the fixed deposit was made with a bank i.e., an outside body and therefore, the income on deposit with bank satisfies the doctrine of mutuality and the same would be exempt.

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

CIT v. Anil Hardware Store (2010) 323 ITR 368 (HP)

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

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

Note -

(1) Payment of remuneration to working partners is allowed as deduction if it is authorized by the partnership deed and is subject to the overall ceiling limits specified in section 40(b)(v). The limits for partners' remuneration under section 40(b)(v) has revised upwards and the differential limits for partners' remuneration paid by professional firms and non-professional firms have been removed. On the first ₹ 3 lakh of book profit or in case of loss, the limit would be the higher of ₹ 1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

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

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

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

N. J. Jose and Co. (P.) Ltd. v. ACIT (2010) 321 ITR 132 (Ker.)

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

The High Court held that once the Assessing Officer found that total income as computed under the provisions of the Act was less than 30 per cent of the book profit, he had to make the assessment under section 115J which does not provide for any deduction in terms of section 54E. As long as long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956, capital gains cannot be excluded unless provided under the Explanation to section 115J(1A).

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

7. Can transfer fees received by a co-operative housing society from its incoming and outgoing members be exempt on the ground of principle of mutuality?

Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47 (Bom)

On this issue, the High Court observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class. The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

11

INCOME-TAX AUTHORITIES

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

   Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 441 (Del.)

   Relevant section: 119(2)(b)

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

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

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

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

12

ASSESSMENT PROCEDURE

1. Is a person having income below taxable limit, required to furnish his PAN to the deductor as per the provisions of section 206AA, even though he is not required to hold a PAN as per the provisions of section 139A?

Smt. A. Kowsalya Bai v. UOI (2012) 346 ITR 156 (Kar.)

As per the provisions of section 139A, *inter alia,* a person whose total income does not exceed the maximum amount not chargeable to income-tax is not required to apply to the Assessing Officer for the allotment of a permanent account number (PAN).

However, as per the provisions of section 206AA, notwithstanding anything contained in any other provision of this Act, any person who is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, i.e., the deductee shall furnish his PAN to the deductor, otherwise tax shall be deducted as per the provisions section 206AA, which is normally higher. It is mandatory for an assessee to furnish his PAN, despite filing Form 15G as required under section 197A, to seek exemption from deduction of tax.

The provisions of section 139A are contradictory to section 197A, due to the fact that assessees whose income was less than the maximum amount not chargeable to income-tax, were not required to hold PAN, whereas their declaration furnished under section 197A was not accepted by the bank or financial institution unless PAN was communicated as per the provisions of section 206AA. The provisions of section 206AA creates inconvenience to small investors, who invest their savings from earnings as security for their future, since, in the absence of PAN, tax was deducted at source at a higher rate.

In order to avoid undue hardship caused to such persons, the Karnataka High Court, in the present case, held that it may not be necessary for such persons whose income is below the maximum amount not chargeable to income-tax to obtain PAN and in view of the specific provision of section 139A, section 206AA is not applicable to such persons. Therefore, the banking and financial institutions shall not insist upon such persons to furnish PAN while filing declaration under section 197A. However, section 206AA would continue to be applicable to persons whose income is above the maximum amount not chargeable to income-tax.

2. **Can an assessee revise the particulars filed in the original return of income by filing a revised statement of income?**

Orissa Rural Housing Development Corpn. Ltd. v. ACIT (2012) 343 ITR 316 (Orissa)

On this issue, the Orissa High Court held that the assessee can make a fresh claim before the Assessing Officer or make a change in the originally filed return of income only by filing revised return of income under section 139(5). There is no provision under the Income-tax Act, 1961 to enable an assessee to revise his income by filling a revised statement of income. Therefore, filling of revised statement of income is of no value and will not be considered by the Assessing Officer for assessment purposes.

The High Court, relying on the judgement of the Supreme Court in *Goetze (India) Ltd. v. CIT (2006) ITR 323,* held that the Assessing Officer has no power to entertain a fresh claim made by the assessee after filing of the original return except by way of filing a revised return.

3. **Is it permissible under section 147 to reopen the assessment of the assessee on the ground that income has escaped assessment, after a change of opinion as to a loss being a speculative loss and not a normal business loss, consequent to a mere re-look of accounts which were earlier furnished by the assessee during assessment under section 143(3)?**

ACIT v. ICICI Securities Primary Dealership Ltd.(2012) 348 ITR 299 (SC)

Relevant section: 147

In the above case, the Assessing Officer had completed the assessment of assessee under section 143(3) after taking into consideration the accounts furnished by assessee. After the lapse of four years from relevant assessment year, the Assessing Officer had reopened the assessment of assessee under section 147 on the ground that after re-look of the accounts of the relevant previous year, it was noticed that the assessee company had incurred a loss in trading in share, which was a speculative one. Therefore, such loss can only be set off against speculative income. Consequently, the loss represents income which has escaped assessment. Accordingly, the Assessing Officer came to a conclusion that income had escaped assessment and passed an order under section 147.

The Supreme Court observed that the assessee had disclosed full details in the return of income in the matter of its dealing in stocks and shares. There was no failure on the part of assessee to disclose material facts as mentioned in proviso to section 147. Further, there is nothing new which has come to the notice of the Assessing Officer. The accounts had been furnished by the assessee when called upon. Therefore, re-opening of the assessment by the Assessing Officer is clearly a change of opinion and therefore, the order of re-opening the assessment is not valid.

4. **In case of change of incumbent of an office, can the successor Assessing Officer initiate reassessment proceedings on the ground of change of opinion in relation**

to an issue which the predecessor Assessing Officer, who had framed the original assessment, had already applied his mind and come to a conclusion?

H. K. Buildcon Ltd. v. Income-tax Officer (2011) 339 ITR 535 (Guj.)

On this issue, the Gujarat High Court referred to the ruling of the Apex Court in *CIT v. Kelvinator of India Ltd. (2010) 320 ITR 561*, wherein it was held that the Assessing Officer has the power only to reassess and not to review. Reassessment has to be based on fulfillment of certain precondition and if the concept of change of opinion is removed, then, in the garb of reopening the assessment, review would take place. The Apex Court further laid down that one must treat the concept of change of opinion as an in-built test to check abuse of power by the Assessing Officer. The Apex Court referred to *Circular No.549 dated 31.10.1989* explaining the amendment made by the Direct Tax Laws (Amendment) Act, 1989 with effect from 1.4.1989 to reintroduce the expression "reason to believe", and concluded that if the phrase "reason to believe" is omitted, the same would give arbitrary powers to the Assessing Officer to reopen the past assessment on mere change of opinion and this is not permissible even as per legislative intent.

The Gujarat High Court, applying the rationale of the Apex Court ruling, observed that in the entire reasons recorded in this case, there was nothing on record to show that income had escaped assessment in respect of which the successor Assessing Officer received information subsequently, from an external source. The reasons recorded themselves indicated that the successor Assessing Officer had merely recorded a different opinion in relation to an issue to which the Assessing Officer, who had framed the original assessment, had already applied his mind and come to a conclusion. The notice of reassessment was, therefore, not valid.

5. **Can the Assessing Officer issue notice under section 154 to rectify a mistake apparent from record in the intimation under section 143(1), after issue of a valid notice under section 143(2)?**

CIT v. Haryana State Handloom and Handicrafts Corporation Ltd. (2011) 336 ITR 699 (P&H)

On this issue, the Punjab and Haryana High Court referred to the Delhi High Court ruling in *CIT v. Punjab National Bank (2001) 249 ITR 763,* where it was held that rectification of an intimation cannot be made after issuance of notice under section 143(2) and during the pendency of proceedings under section 143(3). It was held that if any change was permissible to be effected, the same can be done in the assessment under section 143(3) and not by exercising the power under section 154 to rectify the intimation issued under section 143(1)

In the present case, the Punjab and Haryana High Court relying, *inter alia,* on the said decision held that the scope of proceedings under section 143(2) is wider than the power of rectification of mistake apparent from record under section 154. The notice under section 143(2) is issued to ensure that the assessee has not understated the income or has not computed excessive loss or underpaid the tax. 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). Therefore, the the Assessing Officer has to proceed under section 143(3) and issue an assessment order. If issue of notice under section 154 is permitted to rectify the intimation issued under section 143(1), then it would lead to duplication of work and wastage of time.

Therefore, it was concluded that proceedings under section 154 for rectification of intimation under section 143(1) cannot be initiated after issuance of notice under section 143(2) by the Assessing Officer to the assessee.

6. **Can the Assessing Officer reassess issues other than the issues in respect of which proceedings were initiated under section 147 when the original "reason to believe" on basis of which the notice was issued ceased to exist?**

Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136 (Delhi)

In the present case, the assessee company was engaged in the business of manufacture and trading of pharmaceutical products. The Assessing Officer accepted the returned income filed by the assessee but initiated reassessment proceedings under section 147 in respect of the addition to be made on account of club fees, gifts and presents and provision for leave encashment. It was observed that the Assessing Officer had reason to believe that income has escaped assessment due to claim and allowance of such expenses and accordingly, he issued notice under section 148. However, after sufficient enquiries were made during reassessment proceedings, the Assessing Officer came to the conclusion that no additions are required to be made on account of these expenses. Therefore, while completing the reassessment he did not make additions on account of these items but instead made additions on the basis of other issues which were not the original "reason to believe" for the issue of notice under section 148. The Assessing Officer made such additions on the basis of *Explanation 3* to section 147 as per which the Assessing Officer may assess the income which has escaped assessment and which comes to his notice subsequently in the course of proceedings under section 147 even though the said issue did not find mention in the reasons recorded in the notice issued under section 148.

The issue under consideration is whether the Assessing Officer can make an assessment on the basis of an issue which came to his notice during the course of assessment, where the issues, which originally formed the basis of issue of notice under section 148, were dropped in its entirety.

As per section 147, the Assessing Officer may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice in the course of proceedings under this section. The Delhi High Court observed that the words "and also" used in section 147 are of wide amplitude.

The correct interpretation of the Parliament would be to regard the words 'and also' as being "conjunctive and cumulative with" and not "in alternative to" the first part of the sentence, namely, "the Assessing Officer may assess and reassess *such income*". It is significant to note that Parliament has not used the word 'or' but has used the word 'and' together and in conjuction with the word 'also'. The words *'such income*' in the first part of the sentence refer to the income chargeable to tax which has escaped assessment and in respect of which the Assessing Officer has formed a reason to believe for issue of the notice under section 148. Hence, the language used by the Parliament is indicative of the position that the assessment or reassessment must be in respect of the income, in respect of which the Assessing Officer has formed a reason to believe that the same has escaped assessment and also in respect of any other income which comes to his notice subsequently during the course of the proceedings as having escaped assessment. If the income, the escapement of which was the basis of the formation of the "reason to believe" is not assessed or reassessed, it would not be open to the Assessing Officer to independently assess only that income which comes to his notice subsequently in the course of the proceedings under the section as having escaped assessment. If he intends to do so, a fresh notice under section 148 would be necessary.

7. **Would the words "shall be issued" used in section 149 mean 'mere signing of notice by the Assessing Officer' or 'handing over of the said notice in the hands of the proper officer for serving it to the assessee' to constitute a valid notice issued within the prescribed time limit?**

Kanubhai M. Patel (HUF) v. Hiren Bhatt or his successors to Office (2011) 334 ITR 25 (Guj.)

In the present case, the assessee filed a return of income for the assessment year 2003-04. The assessee did not receive any notice under section 143(2). On 8th April, 2010, the assessee received a notice under section 148 dated 31st March, 2010 for the assessment of income relating to assessment year 2003-04 under section 147. The assessee, on inquiry from the post office, found out that the department had sent the covers for issuing notice to the speed post centre (for booking) only on 7th April, 2010 and not on 31st March, 2010 and the Revenue also did not challenge this finding of the assessee.

The assessee, therefore, challenged the legality and validity of the notices dated 31st March, 2010 issued by the department under section 148 as being time barred contending that the impugned notices have been issued beyond the time limit prescribed under the provisions of section 149 i.e. after a period of six years from the end of the relevant assessment year. The assessee contended that the date of issue of the notices under section 148 would be the date on which the same have been dispatched by registered post i.e. 7th April, 2010 and not the date of signing of the notice by the Assessing Officer i.e. 31st March, 2010.

The Gujarat High Court observed that the core issue which arises for consideration is the date when the notice under section 148 can be said to have been issued. For this purpose, it is necessary to examine the true meaning of the phrase **'shall be issued'** as employed in section 149(1) according to which no notice under section 148 'shall be issued' for the relevant assessment year, if the specified time period (i.e. 4 years/6 years, as the case may be) has elapsed from the end of the relevant assessment year.

The Gujarat High Court observed that according to Black's Law Dictionary, the term 'issue' when used with reference to writs, process, and the like, would mean as importing delivery to the proper person, or to the proper officer for service etc. Therefore, any notice may be considered to be issued if made out and placed in the hands of a person authorised to serve it, and with a bona fide intent to have it served. The expression **'shall be issued'** in section 149 would, therefore, have to be read in the above mentioned context.

In the present case, the notice has been signed on 31st March, 2010, whereas the same were sent to the speed post centre for booking only on 7th April, 2010. From the above definition of the word "issue", it is apparent that mere signing of notices on 31st March, 2010 cannot tantamount to issuance of notice as contemplated under section 149. The date of issue would be the date on which the same were handed over for service to the proper officer, which, in the facts of the present case, would be the date on which the said notices were actually handed over to the post office for the purpose of effecting service on the assessee.

Hence, the date of issue of the said notice would be 7th April, 2010 and not 31st March, 2010. Therefore, the aforesaid notice under section 148 in relation to the assessment year 2003-04, having been issued on 7th April, 2010, is beyond the period of six years from the end of the relevant assessment year and clearly barred by limitation.

8. **Can the unabsorbed depreciation be allowed to be carried forward in case the return of income is not filed within the due date?**

CIT v. Govind Nagar Sugar Ltd. (2011) 334 ITR 13 (Delhi)

On this issue, the Delhi High Court observed that, the provisions of section 80 and section 139(3), requiring the return of income claiming loss to be filed within the due date, applies to, *inter alia,* carry forward of business loss and not for the carrying forward of unabsorbed depreciation. As per the provisions of section 32(2), the unabsorbed depreciation becomes part of next year's depreciation allowance and is allowed to be set-off as per the provisions of the Income-tax Act, 1961, irrespective of whether the return of earlier year was filed within due date or not.

Therefore, in the present case, the High Court held that the unabsorbed depreciation will be allowed to be carried forward to subsequent year even though the return of income of the current assessment year was not filed within the due date.

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

Aventis Pharma Ltd. v. ACIT (2010) 323 ITR 570 (Bom.)

Relevant section: 147

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

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

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

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

Relevant section: 154(7)

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

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

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

13

APPEALS AND REVISION

1. **Would the period of limitation for an order passed under section 263 be reckoned from the original order passed by the Assessing Officer under section 143(3) or from the order of reassessment passed under section 147, where the subject matter of revision is different from the subject matter of reassessment under section 147?**

   CIT v. ICICI Bank Ltd. (2012) 343 ITR 74 (Bom.)

   In the present case, an order of assessment was passed under section 143(3) allowing the deduction under section 36(1)(vii), 36(1)(viia) and foreign exchange rate difference. Further, two notices of reassessment were issued under section 148 and an order of reassessment was passed under section 147 which did not deal with the above deductions.

   Later, the Commissioner passed an order under section 263 for disallowing the deduction under section 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference which have not been taken up in the reassessment proceedings under section 147 but which was decided in the original order of assessment passed under section 143(3).

   The assessee claimed that the order passed by the Commissioner under section 263 is barred by limitation since the period of 2 years from the end of the financial year in which the order sought to be revised was passed, had lapsed. However, the Revenue gave a plea that period of limitation shall be reckoned from the date of order under section 147 and not from the date of the original assessment order under section 143(3), applying the doctrine of merger.

   The Revenue pointed out that as per the provisions of *Explanation 3* to section 147, the Assessing Officer is entitled to assess or reassess the income in respect of any issue which has escaped assessment though the reasons in respect of such issue have not been included in the reasons recorded under section 148(2).

   Considering the above mentioned facts, the Bombay High Court held that the order of assessment under section 143(3) allowed deduction under section 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference. The order of reassessment, however, had not dealt with these issues. Therefore, the doctrine of merger cannot be applied in this case. The order under section 143(3) cannot stand merged with the order of reassessment in respect of those issues which did not form the subject matter of the reassessment. Therefore, period of limitation in respect of the order of Commissioner under section 263 in respect of a matter which does not form the subject matter of reassessment shall be reckoned from the date of the original order under section 143(3) and not from the date of the reassessment order under section 147.

2. Can an assessee make an additional/new claim before an appellate authority, which was not claimed by the assessee in the return of income (though he was legally entitled to), otherwise than by way of filing a revised return of income?

CIT v. Pruthvi Brokers & Shareholders (2012) 208 Taxman 498 (Bom.)

While considering the above mentioned issue, the Bombay High Court observed the decision of the Supreme Court, in the case of *Jute Corporation of India Ltd. v. CIT (1991) 187 ITR 688* and *National Thermal Power Corporation. Ltd v. CIT (1998) 229 ITR 383*, that an assessee is entitled to raise additional claims before the appellate authorities. The appellate authorities have jurisdiction to permit additional claims before them, however, the exercise of such jurisdiction is entirely the authorities' discretion.

Also, the High Court considered the decision of the Apex Court in the case of *Addl. CIT v. Gurjargravures (P.) Ltd.(1978) 111 ITR 1,* wherein it was held that in case an additional ground was raised before the appellate authority which could not have been raised at the stage when the return was filed or when the assessment order was made, or the ground became available on account of change of circumstances or law, the appellate authority can allow the same.

The Supreme Court, in the case of *Goetze (India) Ltd v. CIT (2006) 157 Taxmann 1,* held that the assessee cannot make a claim before the Assessing Officer otherwise than by filing an application for the same. The additional claim before the Assessing Officer can be made only by way of filing revised return of income.

The decision in the above mentioned case, however, does not apply in this case, since the Assessing Officer is not an Appellate Authority.

Therefore, in the present case, the Bombay High Court, considering the above mentioned decisions, held that additional grounds can be raised before the Appellate Authority even otherwise than by way of filing return of income. However, in case the claim has to be made before the Assessing Officer, the same can only be made by way of filing a revised return of income.

3. Can the Commissioner initiate revision proceedings under section 263 on the ground that the Assessing Officer's order not initiating penal proceedings was erroneous and prejudicial to the interest of the Revenue, in a case where non-initiation of penal proceedings was a pre-condition for surrender of income by the assessee?

CIT v. Subhash Kumar Jain (2011) 335 ITR 364 (P&H)

In the present case, an addition of ` 9,91,090 was made in the assessment of the assessee under section 143(3) on account of agricultural income, since the assessee failed to explain the source of agricultural income as declared by him in the return of income. The said addition was made on the basis of the report submitted by the Inspector pointing out the defects in the documents furnished by the assessee. As a result, the assessee made an offer to surrender ` 9,91,090 subject to a condition that no penal action under section 271(1)(c) would be initiated. The Assessing Officer accepted the same as the department did not have any documentary evidence against the assessee and the assessment was made only on the basis of the report by the Inspector. Accordingly, the assessment was framed by the Assessing Officer without initiating the penalty proceedings under section 271(1)(c). The Commissioner of Income-tax, exercising his power under section 263, directed the Assessing Officer to frame a fresh assessment order after taking into account the facts attracting the penal action under section 271(1)(c), considering the original order erroneous and prejudicial to the interest of the Revenue.

The issue under consideration in this case is whether, when the Assessing Officer, while passing the assessment order under section 143(3), had given effect to the office note that the surrender of the agricultural income which was made by the assessee would not be subject to penal action under section 271(1)(c) and accordingly not levied penalty, can the Commissioner of Income-tax, in exercise of his power under section 263, hold the order of the Assessing Officer to be erroneous and prejudicial to the interest of the Revenue.

On this issue, the Punjab and Haryana High Court observed that, on perusal of the office note issued by the Assessing Officer, it was clear that the assessee had made surrender of income with a clear condition that no penal action under section 271(1)(c) would be initiated. The office note further depicts that the offer of the assessee was accepted by the Department. Once that was so, the Commissioner cannot take a different view and levy penalty. The High Court relied on the decision of the Bombay High Court in *Jivatlal Purtapshi v. CIT (1967) 65 ITR 261*, where it was observed that an order based on an agreement cannot give rise to grievances and the same cannot be agitated.

4. **Does the Appellate Tribunal have the power to review or re-appreciate the correctness of its earlier decision under section 254(2)?**

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

Relevant section: 254(2)

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

taken in the first instance. Section 254(2) is not a mandate to unsettle decisions taken after due reflection.

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

5. **Can the Tribunal exercise its power of rectification under section 254(2) to recall its order in entirety, where there is a mistake apparent from record?**

Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243 (Delhi)(FB)

On this issue, the Delhi High Court observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in *Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466,* dealing with the Tribunal's power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.

The Apex Court, while dealing with the power of the Tribunal under section 254(2) in *Honda Siel Power Products Ltd.,* observed that one of the important reasons for giving the power of rectification to the Tribunal is to see that no prejudice is caused to either of the parties appearing before it by its decision based on a mistake apparent from the record. When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then it is the duty of the Tribunal to set it right. In that case, the Tribunal had not considered the material which was already on record while passing the judgment. The Apex Court took note of the fact that the Tribunal committed a mistake in not considering material which was already on record and the Tribunal acknowledged its mistake and accordingly, rectified its order.

The above decision of the Apex Court is an authority for the proposition that the Tribunal, in certain circumstances can recall its own order and section 254(2) does not totally prohibit so. In view of the law laid down by the Apex Court in that case, the decisions rendered by the High Courts in certain cases to the effect that the Tribunal under no circumstances can recall its order in entirety do not lay down the correct statement of law.

Applying the above-mentioned decision of the Apex Court to this case, the Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.

Note - *In deciding whether the power under section 254(2) can be exercised to recall an order in entirety, it is necessary to understand the true principle laid down in the Apex Court decision. A decision should not be mechanically applied treating the same as a precedent without appreciating the underlying principle contained therein. In this case, the Apex Court decision was applied since prejudice had resulted to the party on account of the mistake of the Tribunal apparent from record.*

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

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

Relevant section: 260A(7)

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

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

14

PENALTIES

1. **Can the repayment of loan by passing mere adjusting book entries by the asseessee be taken to be in contravention of provisions of section 269T to attract penalty under section 271E?**

   CIT v. Triumph International Finance (I.) Ltd. (2012) 345 ITR 270 (Bom.)

   In the present case, the assessee is a public limited company, registered as category-I merchant banker with SEBI, engaged in the business of stock broking, investment and trading in shares and securities. The assessee had taken a loan from the Investment Trust of India. During the previous year in question, the assessee had transferred shares of a company held by it to the Investment Trust of India. Therefore, in the current assessment year, the assessee was liable to pay the loan amount to the Investment Trust of India and had a right to receive the sale price of the shares transferred to Investment Trust of India. In order to avoid the unnecessary circular transfer of shares, both the parties agreed to set-off the amount payable and receivable by way of passing journal entries and the balance loan amount was paid by the assessee by way of an account payee cheque. The amount of loan settled by way of passing journal entries exceeds ₹ 20,000.

   The Assessing Officer passed the assessment order levying penalty under section 271E for the contravention of the provisions of section 269T on the argument that since section 269T put an obligation on the assessee to pay loan only by way of an account payee cheque or an account payee draft, the settlement of a portion of the loan by passing journal entry would be a mode otherwise than by way of an account payee cheque or an account payee draft and therefore, the penal provisions under section 271E shall be attracted.

   The assessee argued that the transaction of repayment of loan or deposit by way of adjustment through book entries was carried out in the ordinary course of business and the genuineness of the assessee's transaction with the Investment Trust of India was also accepted by the Tribunal. It is a bonafide transaction. The assessee further contended that section 269T mentions that in a case where the loan or deposit is repaid by an outflow of funds, the same has to be by an account payee cheque or an account payee demand draft. However, in case the discharge of loan or deposit is in a manner otherwise than by an outflow of funds, as is the situation in the present case, the provisions of section 269T would not apply.

Considering the above mentioned facts and arguments, the Bombay High Court held that, the obligation to repay the loan or deposit by account payee cheque/bank draft as specified in section 269T is mandatory in nature. The contravention of the said section will attract penalty under section 271E.

The argument of the assessee cannot be accepted since section 269T does not make a distinction between a bonafide or a non-bonafide transaction neither does it require the fulfillment of the condition mentioned therein only in case where there is outflow of funds. It merely puts a condition that in case a loan or deposit is repaid, it should be by way of an account payee cheque/ draft. Therefore, in the present case the assessee has repaid a portion of loan in contravention of provisions of section 269T.

However, the cause shown by the assessee for repayment of the loan otherwise than by account payee cheque/bank draft was on account of the fact that the assessee was liable to receive amount towards the sale price of the shares sold by the assessee to the person from whom loan was received by the assessee. It would have been mere formality to repay the loan amount by account payee cheque/draft and receive back almost the same amount towards the sale price of the shares. Also, neither the genuineness of the receipt of loan nor the transaction of repayment of loan by way of adjustment through book entries carried out in the ordinary course of business has been doubted in the regular assessment. Therefore, there is nothing on record to suggest that the amounts advanced by Investment Trust of India to the assessee represented the unaccounted money of the Investment Trust of India or the assessee and also it cannot be said that the whole transaction was entered into to avoid tax. This is accepted as a reasonable cause under section 273B.

In effect, the assessee has violated the provisions of section 269T by repaying the loan amount by way of passing book entries and therefore, penalty under section 271E is applicable. However, since the transaction is bona fide in nature being a normal business transaction and has not been made with a view to avoid tax, it was held that the assessee has shown reasonable cause for the failure under section 269T, and therefore, as per the provisions of section 273B, no penalty under section 271E could be imposed on the assessee for contravening the provisions of section 269T.

Note: In order to mitigate the hardship caused by certain penalty provisions in case of genuine business transactions, section 273B provides that no penalty under, inter alia, section 271E shall be imposed on a person for any failure referred to in the said section, if such person proves that there was **reasonable cause** *for such failure.*

2. **Can penalty under section 271(1)(c) for concealment of income be imposed in a case where the assessee has raised a debatable issue?**

CIT v. Indersons Leather P. Ltd. (2010) 328 ITR 167 (P&H)

The assessee company, after discontinuing its manufacturing business, leased out its shed along with fittings and disclosed the income as income from business, whereas the Revenue contended that the same be assessed as "Income from house property. The issue under consideration is whether penalty under section 271(1)(c) can be imposed in such a case.

On this issue, the High Court observed that, mere raising of a debatable issue would not amount to concealment of income or furnishing inaccurate particulars and therefore, penalty under section 271(1)(c) cannot be imposed.

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

CIT v. Vijay Kumar Jain (2010) 325 ITR 378 (Chhattisgarh)

Relevant section: 271(1)(c)

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

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

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

4. Would making an incorrect claim in the return of income *per se* amount to concealment of particulars or furnishing inaccurate particulars for attracting the penal provisions under section 271(1)(c), when no information given in the return is found to be incorrect?

CIT v. Reliance Petro Products Pvt. Ltd. (2010) 322 ITR 158 (SC)

Relevant section: 271(1)(c)

In this case, the Supreme Court observed that in order to attract the penal provisions of section 271(1)(c), there has to be concealment of the particulars of income or furnishing inaccurate particulars of income. Where no information given in the return is found to be incorrect or inaccurate, the assessee cannot be held guilty of furnishing inaccurate particulars. Making an incorrect claim (i.e. a claim which has been disallowed) would not, by itself, tantamount to furnishing inaccurate particulars.

The Apex Court, therefore, held that where there is no finding that any details supplied by the assessee in its return are incorrect or erroneous or false, there is no question of imposing penalty under section 271(1)(c). A mere making of a claim, which is not sustainable in law, by itself, will not amount to furnishing inaccurate particulars regarding the income of the assessee.

15

OFFENCES AND PROSECUTION

1. **Would prosecution proceedings under section 276CC be attracted where the failure to furnish return in time was not willful?**

   Union of India v. Bhavecha Machinery and Others (2010) 320 ITR 263 (MP)

   Relevant section: 276CC

   In this case, the High Court observed that for the provisions of section 276CC to get attracted, there should be a willful delay in filing return and not merely a failure to file return in time. There should be clear, cogent and reliable evidence that the failure to file return in time was 'willful' and there should be no possible doubt of its being 'wilful'. The failure must be intentional, deliberate, calculated and conscious with complete knowledge of legal consequences flowing from them.

   In this case, it was observed that there were sufficient grounds for delay in filing the return of income and such delay was not willful. Therefore, prosecution proceedings under section 276CC are not attracted in such a case.

16

DEDUCTION, COLLECTION AND RECOVERY OF TAX

1. **In respect of a co-owned property, would the threshold limit mentioned in section 194-I for non-deduction of tax at source apply for each co-owner separately or is it to be considered for the complete amount of rent paid to attract liability to deduct tax at source?**

   CIT v. Senior Manager, SBI (2012) 206 Taxman 607 (All.)

   In the present case, the assessee was paying rent for the leased premises occupied. The said premise was co-owned and the share of each co-owner was definite and ascertainable. Also, the assessee made payment to each co-owner separately by way of cheque. The assessee did not deduct tax at source under section 194-I stipulating that the payment made to each co-owner was less than the minimum threshold mentioned in the said section and therefore, no liability to deduct tax at source on the rent so paid is attracted, though the whole rent taken together exceeds the said threshold limit.

   The Revenue contended that since the premises let out to the assessee had not been divided/partitioned by metes and bounds, it cannot be said that any specified portion let out to the assessee was owned by a particular person. Therefore, the assessee had to deduct tax at source on the rent so paid assessing the co-owners as association of persons and the threshold limit mentioned in section 194-I was to be seen in respect of the entire rent amount. Hence, the Revenue was of the view that assessee was liable to deduct tax on the payment of rent and interest would be leviable on failure to deduct such tax under section 201.

   Considering the above mentioned facts, the Allahabad High Court held that, since the share of each co-owner is definite and ascertainable, they cannot be assessed as an association of persons as per section 26. The income from such property is to be assessed in the individual hands of the co-owners. Therefore, it is not necessary that there should be a physical division of the property by metes and bounds to attract the provisions of section 26.

   Therefore, in the present case, since the payment of rent is made to each co-owner by way of separate cheque and their share is definite, the threshold limit mentioned in section 194-I has to be seen separately for each co-owner. Hence, the assessee would not be liable to deduct tax on the same and no interest under section 201 is leviable.

2. **Can the payment made to contractors for hiring dumpers, by an assessee engaged in transportation of building material, be treated as rent for machinery or equipment to attract provisions of tax deduction at source under section 194-I?**

CIT (TDS) v. Shree Mahalaxmi Transport Co. (2011) 339 ITR 484 (Guj.)

In this case, the assessee was engaged in the business of transportation of building material, salt, black trap, iron, etc. During the relevant previous year, the assessee made payment for hiring of dumpers and deducted tax at source at the rate under section 194C applicable for sub-contracts which, according to the Assessing Officer, was not correct as the assessee had taken dumpers on hire and such payments were governed under section 194-I. The Assessing Officer, accordingly, held that the assessee had short deducted tax at source and passed an order under section 201(1) holding the assessee to be an assessee-in-default.

The High Court observed that the assessee had given contracts to the parties for the transportation of goods and had not taken machinery and equipment on rent. The Court observed that the transactions being in the nature of contracts for shifting of goods from one place to another would be covered as works contracts, thereby attracting the provisions of section 194C. Since the assessee had given sub-contracts for transportation of goods and not for the renting out of machinery or equipment, such payments could not be termed as rent paid for the use of machinery and the provisions of section 194-I would, therefore, not be applicable.

Note*: Similar ruling was pronounced by the Gujarat High Court on an identical issue in CIT (TDS) v. Swayam Shipping Services P. Ltd. (2011) 339 ITR 647.*

3. **Do the tips collected by hotel and disbursed to employees constitute salary to attract the provisions for tax deduction at source under section 192?**

CIT (TDS) v. ITC Ltd [2011] 338 ITR 598 (Del.)

The assessee-company was engaged in the business of owning, operating and managing hotels. The assessee-company allowed the employees to receive tips from the customers, by virtue of the employment, and in case the employer himself collected tips, those were also disbursed by the employer to the employees. Once the tips were paid by the customers either in cash directly to the employees or by way of charge to the credit cards in the bills, the employees gained additional income, which was by virtue of their employment. When the tips were received by the employees directly in cash, the employer hardly had any role and it may not even know the amounts of tips collected by the employees. That would be out of the purview of responsibility of the employer under section 192.

However, when the tips were charged to the bill either by way of a fixed percentage, say 10 per cent. or so on the total bill, or where no percentage was specified and the amount was indicated by the customer on the bill as a tip, the tip went into the receipt of the employer and was subsequently disbursed to the employees. As soon as such amounts were received by the employer, there was an obligation on the part of the employer to disburse them to the rightful persons, namely, the employees. Simultaneously, a right accrued to the employees to claim the tips from the employer. By virtue of the employer-employee relationship, a vested right accrued to the employee to claim the tips. The High Court, therefore, held that the tips would constitute income within the meaning of section 2(24) and thus, taxable under section 15. It was obligatory upon the company to deduct tax at source from such payments under section 192.

In this case, the assessee-company had not deducted tax at source on tips under a bona fide belief that tax was not deductible. This practice had been accepted by the Revenue by accepting the assessments in the form of annual returns of the assessees in the past. The High Court held that since no dishonest intention could be attributed to the assessees, they could not be made liable for levy of penalty as envisaged under section 201.

The High Court, however, observed that payment of interest under section 201(1A) is mandatory. The payment of interest under that provision is not penal. There was, therefore, no question of waiver of such interest on the basis that the default was not intentional or on any other basis.

4. Can discount given on supply of SIM cards and recharge coupons by a telecom company to its distributors under a prepaid scheme be treated as commission to attract the TDS provisions under section 194H?

Vodafone Essar Cellular Ltd. v. ACIT (TDS) (2011) 332 ITR 255 (Kerala)

On this issue, the Kerala High Court observed that it was the SIM card which linked the mobile subscriber to the assessee`s network. Therefore, supply of SIM card by the assessee-telecom company was only for the purpose of rendering continued services to the subscriber of the mobile phone. The position was the same so far as recharge coupons or e-topups were concerned which were only air time charges collected from the subscribers in advance under a prepaid scheme.

There was no sale of any goods involved as claimed by the assessee and the entire charges collected by the assessee from the distributors at the time of delivery of SIM cards or recharge coupons were only for rendering services to ultimate subscribers. The assessee was accountable to the subscribers for failure to render prompt services pursuant to connections given by the distributor. Therefore, the distributor only acted as a middleman on behalf of the assessee for procuring and retaining customers and therefore, the discount given to him was within the meaning of commission under section 194H on which tax was deductible.

5. **Can difference between published price and minimum fixed commercial price be treated as additional special commission in the hands of the agents of an airline company to attract TDS provisions under section 194H, where the airline company has no information about the exact rate at which tickets are ultimately sold by the agents?**

   CIT v. Qatar Airways (2011) 332 ITR 253 (Bom.)

   In this case, the airline company sold tickets to the agents at a minimum fixed commercial price. The agents were permitted to sell the tickets at a higher price, however, up to the maximum of published price. Commission at the rate of 9% of published price was payable to the agents of the airline company, on which tax was deducted under section 194H. The issue under consideration is whether the difference between the published price and the minimum fixed commercial price amounts to additional special commission in the hands of the agents to attract the provisions of section 194H.

   On this issue, the Bombay High Court observed that the difference between the published price and minimum fixed commercial price cannot be taken as additional special commission in the hands of the agents, since the published price was the maximum price and airline company had granted permission to the agents to sell the tickets at a price lower than the published price. In order to deduct tax at source, the exact income in the hands of the agents must necessarily be ascertainable by the airline company. However, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents, since the agents had been given discretion to sell the tickets at any rate between the minimum fixed commercial price and the published price. It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of each ticket sold.

   Thus, tax at source was not deductible on the difference between the actual sale price and the minimum fixed commercial price, even though the amount earned by the agent over and above minimum fixed commercial price would be taxable as income in his hands.

   Note: *It may be noted that in the case of CIT v. Singapore Airlines Ltd. (2009) 319 ITR 29, the billing analysis statement clearly indicated the extra commission in the form of special or supplementary commission that was paid to the travel agent with reference to the deal code. Therefore, the Delhi High Court in the case of Singapore Airlines Ltd, held that the supplementary commission in the hands of the agent was ascertainable by the airline company and hence the airline company was liable to deduct tax at source on the same under section 194H.*

6. **What is the nature of landing and parking charges paid by an airline company to the Airports Authority of India and is tax required to be deducted at source in respect thereof?**

CIT v. Japan Airlines Co. Ltd. (2010) 325 ITR 298 (Del.)

Relevant section: 194-I

On this issue, the Delhi High Court referred to the case of *United Airlines v. CIT (2006) 287 ITR 281*, wherein the issue arose as to whether landing and parking charges could be deemed as rent under section 194-I. The Court observed that rent as defined in the said provision had a wider meaning than "rent" in common parlance. It included any agreement or arrangement for use of land. The Court further observed that when the wheels of the 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. Therefore, the landing and parking fee were definitely "rent" within the meaning of the provisions of section 194-I as they were payments for the use of the land of the airport.

Note- The Madras High Court in CIT v. Singapore Airlines Ltd. (2012) 209 Taxman 581 (Mad.), expressed a contrary view on the said issue. The Court has observed that payment made for the use of any land or building and the land appurtenant thereto under a lease or sub-lease or tenancy or under any agreement or arrangement with reference to the use of the land, would be "rent" as per Explanation to section 194-I. Therefore, only if the agreement or arrangement has the characteristics of lease or sub-lease or tenancy for systematic use of the land, the charges levied would fall for consideration under the definition of 'rent' for the purpose of section 194-I.

The principles guiding the charges on landing and take-off show that the charges are with reference to the number of facilities provided by the Airport Authority of India in compliance with the international protocols and the charges are not made for any specified land usage or area allotted. The charges are governed by various considerations on offering facilities to meet the requirement of passengers safety and on safe landing and parking of the aircraft. Depending on the traffic, there is a shared use of the airfield by the airlines. Thus, the charges levied are, at the best, in the nature of fee for the services offered rather than in the nature of rent for the use of the land.

Therefore, mere use of the land for landing and the payment charged, which is not only for the use of the land, but for maintenance of the various services, including the technical services involving navigation, would not automatically bring the transaction and the charges within the meaning of either lease or sub-lease or tenancy or any other agreement or arrangement of the nature of lease or tenancy so that the charges would fall within the meaning of 'rent' as appearing in Explanation to section 194-I.

The High Court observed that use of the runway by an aircraft cannot be different from the analogy of a road used by any vehicle or any other form of transport. If the use of tarmac of airport could be characterized as use of land, the use of a road too would be a use of land. Thus, going by the nature of services offered by the Airport Authority in respect of landing and parking charges, collected from the assessee, there is no ground to accept that the payment would fit in with the definition of "rent" as given under section

194-I. Therefore, the charges would get attracted under the provisions of section 194C.

7. **Whether retention of a percentage of advertising charges collected from customers by the advertising agencies for payment to Doordarshan for telecasting advertisements would attract the provisions of tax deduction at source under section 194H?**

   CIT v. Director, Prasar Bharti (2010) 325 ITR 205 (Ker)

   Relevant section: 194H

   Prasar Bharti is a fully owned Government of India undertaking engaged in telecast of news, sports, entertainment, cinema and other programmes. The major source of its revenue is from advertisements, which were canvassed through agents appointed by Doordarshan under the agreement with them. The advertisement charges were recovered from the customers by the advertisement agencies in accordance with the tariff prescribed by Doordarshan and incorporated in the agreement between the parties. There was a provision in the agreement permitting advertising agencies to retain 15% of the advertising charges payable by them to Doordarshan towards commission from out of the charges received for advertising services from customers.

   The issue under consideration is whether retention of 15% of advertising charges by the advertising agency is in the nature of commission to attract the provisions of tax deduction at source under section 194H. It was contended that the agreement between Prasar Bharti and the advertising agency is not an agency but is a "principal to principal" agreement of sharing advertisement charges and therefore, the provisions for deduction of tax at source under section 194H would not get attracted in this case.

   In this context attention was invited to a clause of the agreement between the parties which reads as follows –

   "Agency agrees to pay the TDS/income-tax liability as applicable under the income-tax law on the discount retained by him. For this purpose, the agency agrees to make payment to Doordarshan Commercial Service by means of cheque/demand draft for the TDS on 15% discount retained by them. This cheque/demand draft will be drawn separately and should not be included in the telecast fees/advertisement charges".

   The above provision makes it clear that the advertising agency clearly understood the agreement as an agency agreement and the commission payable by Prasar Bharati to such agency is subject to tax deduction at source under the Income-tax Act, 1961. The permission granted by Doordarshan under the agreement to the agencies to retain 15% out of the advertisement charges collected by them from the customers amounts to payment of commission by Doordarshan to agents, which is subject to deduction of tax at source under section 194H.

   It is clear from section 194H that tax has to be deducted at the time of credit of such sum to the account of the payee or at the time of payment of such income in cash or by the issue of cheque or draft or any other mode, whichever is earlier. When the agent pays 85% of the advertisement charges collected from the customer, the agent simultaneously gets paid commission of 15%, which he is free to appropriate as his income. TDS on commission charges of 15% has to be paid to the Income-tax Department with reference to the date on which 85% of the advertisement charges are received from the agent.

8. Can services rendered by a hotel to its customers in providing hotel room with various facilities / amenities (like house keeping, bank counter, beauty saloon, car rental, health club etc.) amount to "carrying out any work" to attract the provisions of section 194C?

   East India Hotels Ltd. v. CBDT (2010) 320 ITR 526 (Bom.)

   Relevant section: 194C

   On this issue, the High Court observed that the words "carrying out any work" in section 194C are limited to any work which on being carried out culminates in a product or result. "Work" in the context of this section, has to be understood in a limited sense and would extend only to the service contracts specifically included in section 194C by way of clause (iv) of the Explanation below sub-section(7).

   The provisions of tax deduction at source under section 194C would be attracted in respect of payments for carrying out the work like construction of dams, laying of roads and air fields, erection or installation of plant and machinery etc. In these contracts, the execution of the contract by a contractor or sub-contractor results in production of the desired object or accomplishing the task under the contract.

   However, facilities or amenities made available by a hotel to its customers do not fall within the meaning of work under section 194C, and therefore provisions of TDS under this section are not attracted.

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

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

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

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

WEALTH TAX

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WEALTH TAX

1. **Whether the best judgment assessment order passed without giving the assessee an opportunity of being heard is valid in a case where the notice under section 16(4) has already been given?**

   CWT v. Motor and General Finance Limited (2011) 332 ITR 1 (Delhi)

   In the present case, the assessee did not file the wealth-tax return under section 14(1). The Assessing Officer issued a notice to the assessee under section 16(4), calling upon it to furnish the return. On the failure of the assessee to comply with the terms of the notice issued, the Assessing Officer proceeded to make the assessment to the best of his judgment without issue of any further notice under section 16(5). The assessee questioned upon the validity of the assessment done on the ground that the mandatory notice under section 16(5), giving opportunity of being heard to the assessee, was not issued by the Assessing Officer.

   On the above issue the Delhi High Court held that, as per section 16(5) the Assessing Officer can resort to making best judgment assessment, after giving an opportunity of being heard to the assessee by issue of notice, in case where:

   (a) where a person fails to make the return under section 14(1) or under section 15, or

   (b) where he fails to comply with all the terms of notice issued under section 16(2) or section 16(4).

   Further, according to the second proviso to section 16(5), no notice or opportunity of hearing is required where a notice under section 16(4) has been issued prior to the making of the best judgment assessment.

   In the present case, since the Assessing Officer has duly served the notice under section 16(4) on the assessee upon failure of the assessee to file the wealth-tax return, no separate notice under section 16(5) giving opportunity of being heard is required to be issued before making a best judgment assessment.

   Note: *As per section 16(5), notice giving opportunity of being heard has to be mandatorily to be issued before making the best judgment assessment by the Assessing Officer in a case where the assessee has not filed the wealth-tax return under section 14(1) or section 15.*

However, in the case discussed above, though the assessee has not filed the return under section 14(1), it was not necessary for the Assessing Officer to issue the notice under section 16(5), for assessing the wealth of the assessee to the best of his judgment, since he has already issued notice under section 16(4) requiring the assessee to furnish the wealth-tax return. Therefore in this case, the second proviso to section 16(5) comes into operation and no further notice or opportunity to be heard is required to be given to the assessee.

2. **Is wealth-tax leviable on the value of house under construction, where the construction was still incomplete on the relevant valuation date?**

CIT v. Smt. Neena Jain (2011) 330 ITR 157 (P & H)

On this issue, the Revenue contended that the incomplete house of the assessee fell within the purview of assets in section 2(ea) of the Wealth-tax Act, 1957 and it was liable to wealth-tax. Consequently, the value of the plot and investment of assessee's share in construction of the residential house was added and tax was, accordingly assessed.

The High Court opined that the words "any building" could not be read in isolation and had to be harmoniously construed with the remaining portion of section 2(ea) i.e., whether the building was used for residential or commercial purposes or for the purpose of maintaining a guest house, because an incomplete building could not possibly either be used for residential or commercial purposes or for the purposes of maintaining a guest house. Therefore, the word "building" has to be interpreted to mean a completely built structure having a roof, dwelling place, walls, doors, windows, electric and sanitary fittings etc.

In this case, the assessee was constructing the building after obtaining sanction from the appropriate authorities. Explanation 1(b) under section 2(ea) defining "urban land" for levy of wealth-tax, specifically excludes from its scope, the land occupied by any building which has been constructed with the approval of the appropriate authority. Therefore, the incomplete building of the assessee neither fell within the meaning of a building nor within the purview of "urban land" under section 2(ea). Consequently, the incomplete building is not an asset chargeable to wealth-tax.