INCOME TAX

Giridhar's

1

BASIC CONCEPTS

1. **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)

Facts of the case: 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.

Supreme Court's Decision: 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, is not in the ordinary course of business, hence it is a capital receipt in the hands of the assessee.

2. **Can waiver of loan or advance taken for the purpose of relocation of office premises be treated as a revenue receipt liable to tax?**

CIT v. Softworks Computers P. Ltd. (2013) 354 ITR 16 (Bom.)

Facts of the case: In the present case, the assessee-company worked as a dedicated software development centre for Speedwing British Airways (Speedwing BA). It provided transaction processing facilities and airline control system services to Speedwing BA. The assessee-company was located in the same premises as that of Speedwing BA. As a matter of arrangement, it was decided that the assessee-company should relocate itself to an independent location, for which purpose, Speedwing BA provided an advance of one lakh pounds to the assessee-company. Later, Amadeus Global Travel stepped into the shoes of Speedwing BA and assumed its rights and liabilities. Consequently, a new agreement was signed between the assessee-company and Amadeus Global Travel which, *inter alia,* relieved the assessee-company of its liability to repay the advance of one lakh pounds.

Assessee's view *vis-a-vis* Assessing Officer's view: The assessee-company claimed that such waiver, being capital in nature, was not taxable and hence, did not include the same while computing its taxable income. The Assessing Officer, however, opined that such waiver of loan was a revenue receipt, and so he added the same to the income of the assessee-company.

High Court's Decision: On appeal, the Bombay High Court held that since the advance taken by the assessee-company was utilized by it for the purpose of relocating its office premises i.e., for acquisition of a capital asset, namely, a new office, the waiver of the same cannot be said to be waiver or remission of trading liability to attract taxability under the Act. Waiver of such advance, being capital in nature, is not taxable under the Act.

3. What is the nature of grant received by a subsidiary company from its holding company to recoup the losses incurred year after year and to enable it to meet its liabilities - Capital or Revenue?

CIT v. Handicrafts and Handlooms Export Corporation of India Ltd. (2014) 360 ITR 0130 (Delhi)

Facts of the case: The assessee, a Government company, operates a channelising agency for sale of handicrafts and handlooms abroad. In the relevant previous year, it received a grant of ₹ 25 lakh from its holding company, the State Trading Corporation of India (STC). The Assessing Officer opined that the said amount was a revenue receipt chargeable to tax.

Tribunal's view: The Appellate Tribunal held that the grant received was not taxable as revenue receipt since the said grant was given to recoup the losses incurred by the assessee and was hence, in the nature of capital contribution.

High Court's Observations: The High Court examined the judgment of the Supreme Court in *Sahney Steel and Press Works Ltd. v. CIT (1997) 228 ITR 253,* which laid down the test for determining whether subsidy received by an assessee is taxable as capital or revenue receipt. As per the said test, if any subsidy is given, the character of the subsidy in the hands of the recipient - whether revenue or capital - will have to be determined by having regard to the purpose for which the subsidy is given. The point of time, the source and the form of subsidy are immaterial. The object for which the subsidy is given, would, thus determine the nature of subsidy. If it is given by way of assistance to the assessee in carrying on of his trade or business, it has to be treated as trading receipt.

The High Court observed that, in this case, ₹ 25 lakhs was not paid by a third party or by a public authority but by the holding company. It was not on account of any trade or commercial transaction between the subsidiary and holding company. The intention and purpose behind the said payment was to secure and protect the capital investment made by STC Ltd. The payment of grant by STC Ltd. and receipt thereof by the assessee was not during the course of trade or performance of trade, and thus, could not partake the character of a trading receipt. The same was in the nature of a capital grant.

The High Court observed the difference between Government Grant and payment made by STC, as pointed out by the Division Bench in *Handicrafts and Handlooms Corporation Ltd. v. CIT (1983) 140 ITR 532*. The grants given were specific amounts paid by STC to the assessee, in order to enable the assessee, which was its subsidiary and was incurring losses year after year, to recoup these losses and to enable it to meet its liabilities. These amounts, therefore, cannot form part of the trading receipts of the assessee since these were not in the nature of grants received from an outsider or the Government on general grounds such as for carrying on of trade.

> High Court's Decision: The High Court, in this case, observed that in all the years, it was the case of a 100% holding company coming to the rescue of its subsidiary. Applying the rationale of Apex Court decision in the case of *Sahney Steel [1997] 228 ITR 253 (SC)*, which requires the nature of subsidy to be decided on the basis for which the subsidy was given, the High Court held that grant given by the holding company in this case is in the nature of capital receipt since its purpose is to secure and protect the capital investment made in the subsidiary company.

4. Can power subsidy received by the assessee from the State Government, year after year, on the basis of actual power consumption be treated as a capital receipt?

CIT v. Rassi Cement Ltd. (2013) 351 ITR 169 (A.P.)

Facts of the case: In this case, the assessee received power subsidy from the State Government and treated it as a capital receipt. The Assessing Officer, however, denied the assessee's claim, contending that the power rebate given by the Electricity Department cannot be capitalized as the same is given as a rebate which is in the nature of revenue receipt.

High Court's Observations: The High Court observed the decision of the Supreme Court in *Sahney Steel & Press Works Ltd. v CIT (1997) 228 ITR 253,* where incentives (including power subsidy) granted year after year were treated as supplementary trade receipts. The power subsidy granted after commencement of production is based on actual power consumption and has nothing to do with the investment subsidy given for establishment of industries or expanding industries in the backward areas.

The power subsidy was given as a part of an incentive scheme after commencement of production, which is linked to production and therefore, has to be treated as a revenue receipt, since such assistance is given for the purpose of carrying on of the business of the assessee. The production incentive scheme is different from the scheme giving subsidy for setting up industries in the backward areas. This is, in fact, a basis of discrimination in deciding whether the subsidy has to be treated as a capital receipt or revenue receipt, i.e, the purpose for which the subsidy is given should determine the nature of the receipt.

> <u>High Court's Decision</u>: The High Court, accordingly, held that the power subsidy received by the assessee from the State Government on the basis of actual power consumption has to be treated as a trading receipt and not as a capital receipt.

5. 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)

<u>Assessee's contention *vis-à-vis* Tribunal's contention</u>: 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, the Tribunal contended that 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 would be treated as revenue receipt and would accordingly, be charged to tax.

> <u>High Court's Observations & Decision</u>: 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. The High Court, therefore, held that the entire gain has to be treated as capital receipt as the source of fund in this case is capital in nature.

6. 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.)

<u>Facts of the case</u>: In the present case, the assessee received 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.

High Court's Observations & Decision: 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.

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

7. 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.)

Assessee's contention *vis-à-vis* Assessing Officer's contention: 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.

High Court's Decision: 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 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.

The Kisan Sahkari Chini Mills Ltd.

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) 349 ITR 0618 (Delhi)

High Court of Delhi

<u>Facts of the case</u>: In the present case, the assessee is a co-operative society engaged in marketing of fertilizers and purchase and processing of seeds. The assessee had claimed 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.

<u>High Court's Observations</u>: 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.

<u>High Court's Decision</u>: The Delhi High Court, therefore, 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. In a case where the application for registration of a charitable trust is not disposed of within the period of 6 months as required under section 12AA(2), can the trust be deemed to have been registered as per provisions of section 12AA?

KOPSA LTD

Madras High Court

CIT v. Karimangalam Onriya Pengal Semipu Amaipu Ltd. (2013) 354 ITR 483 (Mad)

High Court's Observations: On this issue, the Madras High Court observed that as per the provisions of section 12AA(2), every order granting or refusing registration under section 12AA(1)(b), shall be passed by the registering authority before the expiry of six months from the end of the month in which the application was received under section 12A(1)(a) or section 12A(1)(aa).

The Madras High Court observed the decision of the Orissa High Court, in *Srikhetra, A.C. Bhakti-Vedanta Swami Charitable Trust v. ACIT (2006) (II) OLR 75,* wherein it was held that the period of six months as provided under section 12AA(2) is not mandatory. In that case, the Orissa High Court observed that in order to ascertain whether a provision is mandatory or not, the expression 'shall' is not always decisive. The nature of the statutory provision, whether mandatory or directory, has to be ascertained not only from the wording of the statute, but also from the nature and design of the statute and the purpose sought to be achieved. Further, since the consequence for non-adherence of the time limit of six months is not spelt out in the statute, it cannot be said that passing the order within such time limit is mandatory in nature. The Orissa High Court also opined that in the absence of any clear statutory intent to the contrary, when public duty is to be performed by the public authorities, the time-limit which is granted by the statute is normally directory and not mandatory. Hence, though the word 'shall' has been used in section 12AA(2), the period of six months provided thereunder is not mandatory but directory in nature.

High Court's Decision: Accordingly, in the present case, the Madras High Court held that the time frame mentioned in section 12AA(2) is only directory in nature and non-consideration of the registration application within the said time frame of six months would not amount to "deemed registration".

Note - Similar ruling was pronounced by the Madras High Court in the case of CIT v. Sheela Christian Charitable Trust (2013) 354 ITR 478, holding that there is no automatic or deemed registration if the application filed under section 12AA was not disposed of within the stipulated period of six months.

3. Where a charitable trust applied for issuance of registration under section 12A within a short time span (nine months, in this case) after its formation, can registration be denied by the concerned authority on the ground that no charitable activity has been commenced by the trust?

DIT (Exemptions) v. Meenakshi Amma Endowment Trust (2013) 354 ITR 219 (Kar.)

Facts of the case: In the present case, the assessee, being a trust, made an application under section 12A for issuance of registration within nine months of its formation. The registration authority issued a show cause notice to the assessee-trust to furnish its audited accounts as also material indicating the actual activities undertaken by the trust. In response to the said notice, the assessee-trust furnished the details, wherein it indicated that it has not yet commenced any charitable activity. The concerned registration authority, not being satisfied with the reply, refused to grant registration to the trust on the ground that it has not commenced any charitable activity.

Issue: The issue under consideration is whether registration under section 12AA can be denied on the ground of non-commencement of charitable activity, where an application for registration has been made within a short-time span after the formation of the trust.

High Court's Observations: On this issue, the Karnataka High Court opined that an application under section 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in case the registration is sought much later after formation of the trust.

The High Court further observed that, in this case, the corpus fund included contribution made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities. Also, it was not the Revenue's contention that the assessee-trust had collected lots of donations for the activities of the trust, by the time its application came up for consideration before them. When the application for registration was made, the trust, therefore, did not have sufficient funds for commencement of its activities.

High Court's Decision: The High Court observed that, with the money available with the trust, it cannot be expected to carry out activity of charity immediately. Consequently, in such a case, it cannot be concluded that the trust has not intended to do any activity of charity. In such a situation, the objects of the trust as mentioned in the trust deed have to be taken into consideration by the authorities for satisfying themselves about the genuineness of the trust and not the activities carried on by it. Later on, if it is found from the subsequent returns filed by the trust, that it is not carrying on any charitable activity, it would be open to the concerned authorities to withdraw the registration granted or cancel the registration as per the provisions of section 12AA(3).

4. 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)

Facts of the case: 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 that 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.

High Court's Observations: Considering the above mentioned issue, the Delhi High Court observed 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).

High Court's Decision: The *Explanation* to section 11(2), therefore, cannot be applied to the accumulations under section 11(1)(a) i.e. accumulations upto 15%, unless it is expressly mention in the Act for the same.

Consequently, 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

Shankar Krishnan

1. **Can notional interest on security deposit given to the landlord in respect of residential premises taken on rent by the employer and provided to the employee, be included in the perquisite value of rent-free accommodation given to the employee?**

CIT v. Shankar Krishnan (2012) 349 ITR 0685 (Bom.)

Facts of the case: The assessee, a salaried employee, was provided with rent-free accommodation, being a flat in Mumbai, by his employer company. The monthly rent paid by the employer in respect of the said flat was ₹ 10,000 per month. The employer had given an interest-free refundable security deposit of ₹ 30 lacs to the landlord for renting out the said premises. The assessee-employee computed the perquisite value on the basis of rent of ₹ 10,000 paid by his employer to the landlord, since the same was lower than 10% (now, 15%) of salary.

Assessing Officer's contention: The Assessing Officer, however, contended that since the employer had given interest-free deposit of ₹ 30,00,000 to the landlord, interest@12% on the said deposit is required to be taken into consideration for estimating the fair rental value of the flat given to the assessee and accordingly, he enhanced the perquisite value of the residential accommodation provided to the employee by such notional interest. The Commissioner (Appeals) upheld the decision of the Assessing Officer.

Tribunal's Observations: The Tribunal observed that, as per Rule 3 of the Income-tax Rules, 1962, the perquisite value of the residential accommodation provided by the employer shall be the actual amount of lease rent paid or payable by the employer or 10% (now, 15%) of salary, whichever is lower, as reduced by the rent, if any, actually paid by the employee. The Tribunal, therefore, held that there is no concept of determination of the fair rental value for the purpose of ascertaining the perquisite value of the rent-free accommodation provided to the employees.

High Court's Decision: On appeal by the Revenue, the Bombay High Court held that the Assessing Officer is not right in adding the notional interest on the security deposit given by the employer to the landlord in valuing the perquisite of rent-free accomodation, since the perquisite value has to be computed as per Rule 3 and Rule 3 does not require addition of such notional interest. Thus, the perquisite value of the residential accommodation provided by the employer would be the actual amount of lease rental paid or payable by the employer, since the same was lower than 10% (now 15%) of salary.

2. Can the limit of ₹ 1,000 per month per child be allowed as standard deduction, while computing the perquisite value of free or concessional education facility provided to the employee by the employer?

Director, Delhi Public School

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High Court of Punjab and Haryana

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 exceed ₹ 1,000 per month per child, the perquisite value shall be taken to be Nil.

Assessee's contention: 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.

High Court's Decision: 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

New Delhi Hotels Ltd

High Court of Delhi

1. Whether the rental income derived from the unsold flats which are shown as stock-in-trade in the books of the assessee would be taxable under the head 'Profits and gains from business or profession' or under the head 'Income from house property', in a case where the actual rent receipts formed the basis of computation of income?

New Delhi Hotels Ltd. v. ACIT (2014) 360 ITR 0187 (Delhi]

High Court's Observations: On this issue, in *CIT v. Ansal Housing Finance and Leasing Co. Ltd. (2013) 354 ITR 180*, where the deemed rent (i.e., Expected Rent) formed the basis of computation of income from unsold flats held as stock-in-trade, the Delhi High Court held that such rent was taxable under the head "Income from house property". Further, in *CIT v. Discovery Estates Pvt. Ltd.* and *CIT v. Discovery Holding Pvt. Ltd. (2013) 356 ITR 159*, the same issue emerged when the actual rent formed the basis of computation of income from unsold flats held as stock-in-trade. In that case also, the Delhi High Court held that the income was taxable under the head "Income from house property".

High Court's Decision: In this case, the Delhi High Court followed its own decision in the case of *CIT vs. Discovery Estates Pvt. Ltd / CIT vs. Discovery Holding Pvt. Ltd.*, wherein it was held that rental income derived from unsold flats which were shown as stock-in-trade in the books of the assessee should be assessed under the head "Income from house property" and not under the head "Profits and gains from business or profession".

Note – In effect, irrespective of whether it is the deemed rent or actual rent which forms the basis of computing income from unsold flats held as stock-in-trade, the head under which the income is taxable would be "Income from house property".

2. 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 (2013) 352 ITR 82 (Cal.)

Azimganj Estate Private Limited

Calcutta High Court

Facts of the case: 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 at 30% of Net Annual Value.

High Court's Decision: 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.

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

Hariprasad Bhojnagarwala

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

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THE HIGH COURT OF GUJARAT

Facts of the case: 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 contending 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.

High Court's Observations & Decision: 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 individual owner 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).

4. 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

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

<u>High Court's Decision</u>: 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.

5. 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.)

<u>Facts of the case</u>: 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).

<u>High Court's Observations & Decision</u>: The High Court observed 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 otherwise than by way of 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) deals with the determination of the expected rent of a let out property for computing the income from house property. It provides that the expected rent is deemed to be the sum for which the property might reasonably be expected to be let out 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 neither assessable as business income nor as income from house property.

5

PROFITS AND GAINS OF BUSINESS OR PROFESSION

Industrial Credit and Development Syndicate Ltd

1. Can depreciation on leased vehicles be denied to the lessor on the ground that the vehicles are registered in the name of the lessee and that the lessor is not the actual user of the vehicles?

I.C.D.S. Ltd. v. CIT (2013) 350 ITR 527 (SC)

Facts of the case: The assessee is a non-banking finance company engaged, *inter alia,* in the business of leasing and hire purchase. The assessee purchased vehicles directly from the manufacturers and as a part of its business, leased out these vehicles to its customers, after which the physical possession of the vehicles was with the lessee. Further, the lessees were registered as the owners of the vehicles in the certificate of registration issued under the Motor Vehicles Act, 1988. The assessee-lessor claimed depreciation on such vehicles.

The Assessing Officer disallowed the depreciation claim on the ground that the assessee's use of these vehicles was only by way of leasing out the vehicles to others and not as actual user of the vehicles in the business of running them on hire and secondly, the vehicles were registered in the name of the lessee and not the assessee-lessor. Therefore, according to the Assessing Officer, the assessee had merely financed the purchase of these assets and was neither the owner nor the user of these assets.

High Court's view: The High Court was also of the view that the assessee could not be treated as the owner of the vehicles, since the vehicles were not registered in the name of the assessee and the assessee had only financed the transaction. Therefore, the High Court held that the assessee was not entitled to claim depreciation.

Supreme Court's Observations : The Supreme Court observed that section 32 imposes a twin requirement of "ownership" and "usage for business" as conditions for claim of depreciation thereunder. The Apex Court further observed that as far as usage of the asset is concerned, the section requires that the asset must be used in the course of business. It does not mandate actual usage by the assessee itself. In this case, the assessee did use the vehicles in the course of its leasing business. Hence, this requirement of section 32 has been fulfilled, notwithstanding the fact that the assessee was not the actual user of the vehicles.

The Supreme Court further noted that section 2(30) of the Motor Vehicle Act, 1988, is a deeming provision which creates a legal fiction of ownership in favour of the lessee only for that Act, not for the purpose of law in general. No inference could be drawn from the registration certificate as to ownership of the legal title of the vehicles, since registration in the name of the lessee during the period of lease is mandatory as per the Motor Vehicles Act, 1988. If the lessee was in fact the legal owner, he would have claimed depreciation on the vehicles which was not the case.

The Apex Court observed that as long as the assessee-lessor has a right to retain the legal title against the rest of the world, he would be the owner of the asset in the eyes of law. In this regard, the following provisions of the lease agreement are noteworthy –

- The assessee is the exclusive owner of the vehicle at all points of time;
- The assessee is empowered to repossess the vehicle, in case the lessee committed a default;
- At the end of the lease period, the lessee was obliged to return the vehicle to the assessee;
- The assessee had a right of inspection of the vehicle at all times.

It can be seen that the proof of ownership lies in the lease agreement itself, which clearly points in favour of the assessee.

<u>Supreme Court's Decision</u>: The Supreme Court, therefore, held that assessee was entitled to claim depreciation in respect of vehicles leased out since it has satisfied both the requirements of section 32, namely, ownership of the vehicles and its usage in the course of business.

2. **What is the eligible rate of depreciation in respect of computer accessories and peripherals under the Income-tax Act, 1961?**

CIT v. BSES Yamuna Powers Ltd (2013) 358 ITR 47 (Delhi)

<u>Assessee's contention *vis-a-vis* Department's contention</u>: The assessee claimed depreciation on computer accessories and peripherals at the rate of 60%, being the eligible rate of depreciation on computers including computer software. However, the Revenue contended that computer accessories and peripherals cannot be treated at par with computers and computer software, and hence were eligible for depreciation at the general rate applicable to plant and machinery, i.e., 15%.

<u>High Court's Decision</u>: The High Court observed that computer accessories and peripherals such as printers, scanners and server etc. form an integral part of the computer system and they cannot be used without the computer. Consequently, the High Court held that since they are part of the computer system, they would be eligible for depreciation at the higher rate of 60% applicable to computers including computer software.

BSES Yamuna Power Limited

High Court of Delhi

Note - The Delhi High Court, in CIT v. Orient Ceramics and Industries Ltd. [2013] 358 ITR 0049, following its own judgment in the above case, held that depreciation on UPS is allowable @ 60%, being the eligible rate of depreciation on computers including computer software, and not at the general rate of 15% applicable to plant and machinery.

3. Can waiver of loan given to the assessee by the Government of India from Steel Development Fund (SDF) to meet the capital cost of asset be reduced to arrive at the actual cost as per section 43(1) for computing depreciation under section 32?

Steel Authority of India Ltd. v. CIT (2012) 348 ITR 150 (Delhi)

Facts of the case: The assessee is a public sector undertaking engaged in the manufacture and sale, including export of iron and steel of various grades. It has several steel plants in India. The Government of India sanctioned huge loans to the assessee from the SDF to meet its requirements. On account of glut in the international steel market due to heavy production of steel in South East Asia and the meltdown in the USA, the price of steel fell rapidly and the assessee started incurring heavy losses. The assessee, therefore, approached the Government of India for waiver of loans granted from SDF. The Government of India, as a measure of providing relief to the steel industry in general and the assessee in particular, waived repayment of loans granted to the assessee from the SDF.

सेल SAIL

High Court of Delhi

The assessee reduced the cost of the assets by the amount of the loans waived by the Government of India in its books of account and accordingly calculated depreciation. However, in the returns filed for the years under consideration, the assessee took a contrary stand and claimed depreciation on the assets without reducing the loans waived by the Government. The assessee took a plea that *Explanation 10* to section 43(1) does not consider the waiver of a loan as a subsidy or a grant or reimbursement of the cost.

Assessing Officer's contention: The Assessing Officer, however, contended that depreciation ought to be allowed to the assessee in respect of assets purchased on the reduced cost, after reducing the loans waived by the Government, as per the provisions of section 43(1). The Commissioner (Appeals) and Tribunal upheld the view of the Assessing Officer.

High Court's Observations: The Delhi High Court observed that the case of the assessee may not fall under *Explanation 10* to section 43(1), since the *Explanation* covers only a case of subsidy, grant or reimbursement but not a case of waiver of loan. However, having regard to the facts of the case, the waiver of the loan would amount to the meeting of a portion of the cost of the assets under the main provision of section 43(1) which spells out the meaning of "actual cost". As per section 43(1), "actual cost" means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority. The intention of the parties, as reflected in the accounts of the assessee, appears to be that the loans have been granted towards a portion of the cost of the assets.

<u>High Court's Decision</u>: The waiver of the loan, in this case, is not a mere quantification of a subsidy granted generally for industrial growth. It was granted specifically to the assessee, who had reduced the amount waived from the cost of the assets in its books of account. This accounting treatment reflects the analogous understanding by the assessee regarding the purpose of the grant of loan. The High Court, therefore, held that, by applying the main provision of section 43(1), the amount of loan waived by the Government is to be reduced from the cost of assets to arrive at the "actual cost" for computing depreciation.

Madras High Court

4. **Can the second proviso to section 32(1) be applied to restrict the additional depreciation under section 32(1)(iia) to 50%, if the new plant and machinery was put to use for less than 180 days during the previous year?**

M.M. Forgings Ltd. v. ACIT (2012) 349 ITR 0673 (Mad.)

<u>Facts of the case</u>: In this case, the Assessing Officer, by applying the second proviso to section 32(1), restricted the allowability of depreciation to 50% of the amount of additional depreciation computed under section 32(1)(iia), since the new plant and machinery was put to use for less than 180 days during the previous year. The assessee argued that he has satisfied all the conditions stipulated under section 32(1)(iia), and therefore, the depreciation under section 32(1)(iia) should not be restricted to 50% by resorting to the second proviso to section 32(1). The Commissioner (Appeals) and Appellate Tribunal, however, affirmed the action of the Assessing Officer.

<u>High Court's Observations</u>: On appeal, the Madras High Court observed that clause (iia) was inserted by the Finance Act, 2002, with effect from April 1, 2003, in the second proviso to section 32(1). Therefore, it was imperative that on and after April 1, 2003, the claim of the assessee made under section 32(1)(iia) had to be necessarily allowable by applying the second proviso to section 32(1).

As per the second proviso to section 32(1), which specifically mentions that where an asset referred to in, *inter alia*, clause (iia) of section 32(1) is acquired by the assessee during the previous year and is put to use for the purpose of business or profession for a period of less than 180 days in that previous year, the deduction in respect of such asset shall be restricted to 50% of the amount calculated at the prescribed percentage under section 32(1)(iia).

<u>High Court's Decision</u>: The Madras High Court held that if an asset is acquired on or after 1.04.2003, it was mandatory that the claim of the assessee made under section 32(1)(iia) had to be necessarily assessed by applying the second proviso to section 32(1). Since there is a statutory stipulation restricting the allowability of depreciation to 50% of the amount computed under section 32(1)(iia), where the asset is put to use for less than 180 days, the amount of depreciation allowable has to be restricted to 50% of the amount computed under section 32(1)(iia). The High Court, accordingly, affirmed the order of the Tribunal.

5. Can business contracts, business information, etc., acquired by the assessee as part of the slump sale and 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)

Facts of the case: 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.

Assessing Officer’s contention *vis-a-vis* Assessee’s contention: 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.

High Court’s Observations: 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 that of 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.

<u>High Court's Decision</u>: The High Court, therefore, 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).

6. **Is the assessee entitled to depreciation on the 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)

<u>Facts of the case</u>: 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.

<u>Supreme Court's Observations</u>: 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.

<u>Supreme Court's Decision</u>: 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.

7. **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.

B.Raveendran Pillai

Facts of the case: 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.

> **High Court's Decision**: 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.

8. 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)

Issue: 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 had already been discarded and hence, was not put to use during the relevant previous year.

High Court of Delhi

High Court's Observations: 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.

> **High Court's Decision**: 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. Therefore, 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.

9. 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)

> **High Court's Decision**: 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%.

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

A.Sivakami and Another

Madras High Court

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

Facts of the case: 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.

High Court's Observations: 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.

High Court's Decision: 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, the High Court held that she was entitled to claim depreciation even though she was not the legal owner of the buses.

11. **What is the nature of expenditure incurred on glow-sign boards displayed at dealer outlets - capital or revenue?**

CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR 49 (Delhi)

High Court's Observations: On this issue, the Delhi High Court noted the following observations of the Punjab and Haryana High Court in *CIT v. Liberty Group Marketing Division [2009] 315 ITR 125,* while holding that such expenditure was revenue in nature -

(i) The expenditure incurred by the assessee on glow sign boards does not bring into existence an asset or advantage for the enduring benefit of the business, which is attributable to the capital.

(ii) The glow sign board is not an asset of permanent nature. It has a short life.

ORIENT
Ceramics and Industries Ltd

High Court of Delhi

(iii) The materials used in the glow sign boards decay with the effect of weather. Therefore, it requires frequent replacement. Consequently, the assessee has to incur expenditure on glow sign boards regularly in almost each year.

(iv) The assessee incurred expenditure on the glow sign boards with the object of facilitating the business operation and not with the object of acquiring asset of enduring nature.

> High Court's Decision: The Delhi High Court concurred with the above observations of the P & H High Court and held that such expenditure on glow sign boards displayed at dealer outlets was revenue in nature.

12. **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.)

High Court's Observations: 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.

> High Court's Decision: 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 to 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.

Mascon Technical Services Ltd

Madras High Court

13. Can share issue expenses incurred by a company be treated as capital in nature, if the public issue could not ultimately materialize on account of non-clearance by SEBI?

Mascon Technical Services Ltd. v. CIT (2013) 358 ITR 545 (Mad.)

Facts of the case : The assessee-company incurred share issue expenses of ` 35.39 lakh for its proposed public issue, which could not ultimately materialize due to non-clearance by the SEBI. It claimed such expenses as revenue in nature, on the ground that the same was incurred for augmenting its working capital. The claim of the assessee was, however, rejected by the Assessing Officer.

Assessee's contention *vis-à-vis* Tribunal's contention: On appeal to the Tribunal, the assessee contended that the expenditure incurred was only for the purpose of bettering the cash availability and the working capital of the company, and hence, the same should be allowed as a revenue expenditure. The assessee further contended that since incurring of share issue expenses did not result in increase in the share capital of the company on account of the reasons beyond its control, such expenditure should be allowed as revenue expenditure.

The Tribunal rejected the said contention of the assessee and took the view that the share issue expenditure was incurred *prima facie* for expansion of the capital base of the company and was, hence, in the nature of capital expenditure. The fact that the efforts had got frustrated later on would not alter the nature of the expenditure.

High Court's Decision: The High Court noted that the assessee-company had taken steps to go in for a public issue and incurred share issue expenses for the same. However, it could not go in for the public issue by reason of the orders issued by the SEBI just before the proposed issue. Though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts. The expenditure, therefore, constitutes a capital expenditure.

14. 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)

Facts of the case: 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

DCM

High Court of Delhi

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.

<u>Issue</u>: The issue under consideration was whether closure of one textile mill unit would amount to closure of the business as contended by the Revenue.

<u>Tribunal's Observations</u>: 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.

<u>High Court's Decision</u>: 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 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.*

15. 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 368 (Delhi)

<u>Facts of the case</u>: 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 the 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

BHARAT GEARS LIMITED

High Court of Delhi

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.

<u>High Court's Decision</u>: The Delhi High Court, after considering the above mentioned arguments, held that the machinery which was repaired had outlived its utility and huge expenditure was incurred in 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.

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

Karnataka High Court

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

<u>High Court's Decision</u>: 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.

17. **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)

PVR LIMITED

<u>Facts of the case</u>: 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.

High Court of Delhi

<u>High Court's Observations</u>: 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.

High Court's Decision: The High Court held that, 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.

18. **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.Aswanth N.Rao

Karnataka High Court

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

Facts of the case: 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.

Assessee's contention *vis-à-vis* Assessing Officer's contention: 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.

High Court's Decision: 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).

19. 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?

Sagar Talkies

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

Karnataka High Court

High Court's Observations and Decision: 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.

20. 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.)

Facts of the case: 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.

Tribunal view: 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.

High Court's Observations & Decision: 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.

HINDUSTAN ZINC LIMITED

RAJASTHAN HIGH COURT

21. Is *Circular No. 5/2012 dated 01.08.2012* disallowing the expenditure incurred on freebies provided by pharmaceutical companies to medical practitioners, in line with *Explanation* to section 37(1), which disallows expenditure which is prohibited by law?

Confederation of Indian Pharmaceutical Industry (SSI) v. CBDT (2013) 353 ITR 388 (H.P.)

<u>High Court's Observations</u>: On this issue, the Himachal Pradesh High Court observed that as per Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, every medical practitioner and his or her professional associate is prohibited from accepting any gift, travel facility, hospitality, cash or monetary grant from any pharmaceutical and allied health sector industries. This is a salutary regulation in the interest of the patients and the public, considering the increase in complaints against the medical practitioners prescribing branded medicines instead of generic medicines, solely in lieu of gifts and other freebies granted to them by some particular pharmaceutical industries.

The CBDT, considering the fact that the claim of any expense incurred in providing freebies to medical practitioners is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, has, *vide Circular No.5/2012 dated 1.8.2012*, clarified that the expenditure so incurred shall be inadmissible under section 37(1). The disallowance shall be made in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebies and claimed it as a deductible expense in its accounts against income.

<u>High Court's Decision</u>: The High Court opined that the contention of the assessee that the above mentioned Circular goes beyond section 37(1) was not acceptable. As per *Explanation* to section 37(1), it is clear that any expenditure incurred by an assessee for any purpose which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession. The sum and substance of the circular is also the same. Therefore, the circular is totally in line with the *Explanation* to section 37(1).

However, if the assessee satisfies the assessing authority that the expenditure incurred is not in violation of the regulations framed by the Medical Council then it may legitimately claim a deduction, but it is for the assessee to satisfy the Assessing Officer that the expense is not in violation of the Medical Council Regulations.

22. Can 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)

<u>High Court's Observations</u>: On the above mentioned issue, the Punjab and Haryana High Court observed 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

Kap Scan and
Diagnostic Centre
Private Ltd

High Court of
Punjab and Haryana

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.

<u>High Court's Decision</u>: 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.

23. 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.)

<u>High Court's Observations</u>: 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.

<u>High Court's Decision</u>: The High Court, thus, held that 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.

24. Can the expenditure incurred on heart surgery of an assessee, being a lawyer by profession, 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 the purpose of business or profession?

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

Shanti Bhushan

High Court of Delhi

Facts of the case: 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.

High Court's Observations: 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, such 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.

High Court's Decision: There is, therefore, 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.

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

Neelavathi & Others

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

Facts of the case: 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.

High Court's Observations: 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.

High Court's Decision: 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.

26. 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.)

Facts of the case: 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.

High Court's Observations and Decision: 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.

27. Can remuneration paid to working partners as per the partnership deed be considered as unreasonable and excessive for attracting disallowance under section 40A(2)(a) even though the same is within the statutory limit prescribed under section 40(b)(v)?

CIT v. Great City Manufacturing Co. (2013) 351 ITR 156 (All)

Facts of the case: In this case, the Assessing Officer contended that the remuneration paid by the firm to its working partners was highly excessive and unreasonable, on the ground that the remuneration to partners (₹ 39.31 lakh) was many times more than the total payment of salary to all the employees (₹ 4.87 lakh). Therefore, he disallowed the excessive portion of the remuneration to partners by invoking the provisions of section 40A(2)(a).

High Court's Observations: On this issue, the High Court observed that section 40(b)(v) prescribes the limit of remuneration to working partners, and deduction is allowable up to such limit while computing the business income. If the remuneration paid is within the ceiling limit provided under section 40(b)(v), then, recourse to provisions of section 40A(2)(a) cannot be taken.

The Assessing Officer is only required to ensure that the remuneration is paid to the working partners mentioned in the partnership deed, the terms and conditions of the partnership deed provide for payment of remuneration to the working partners and the remuneration is within the limits prescribed under section 40(b)(v). If these conditions are complied with, then the Assessing Officer cannot disallow any part of the remuneration on the ground that it is excessive.

High Court's Decision: The Allahabad High Court, therefore, held that the question of disallowance of remuneration under section 40A(2)(a) does not arise in this case, since the Tribunal has found that all the three conditions mentioned above have been satisfied. Hence, the remuneration paid to working partners within the limits specified under section 40(b)(v) cannot be disallowed by invoking the provisions of section 40A(2)(a).

28. 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.)

Facts of the Case: 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.

High Court's Observations and Decision: 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.

29. **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?**

High Court of Delhi

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

Facts of the case: 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.

High Court's Observations: 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.

High Court's Decision: The liability in question, i.e. the term loan for purchase of capital assets, is not a trading liability. Therefore, the provisions of section 41(1) are 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 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.*

High Court of Uttarakhand

30. Can the amount of employees' contribution towards provident fund, deducted and credited to the employee's PF account by the employer-assessee after the "due date" under the EPF & Miscellaneous Provisions Act, 1952, but before the due date of filing return of income under the Income-tax Act, 1961, be allowed as deduction while computing business income of the employer-assessee?

CIT v. Kichha Sugar Co. Ltd. (2013) 356 ITR 351 (Uttarakhand)

High Court's Observations: On this issue, the Uttarakhand High Court observed that the "due date" referred to in section 36(1)(va) must be read in conjunction with the "due date" referred to in the first proviso to section 43B. A combined reading of both the sections would make it clear that the due date referred to in section 36(1)(va) is the due date as mentioned in section 43B i.e., the due date of filing of return of income. Therefore, any amount of employees' contribution paid by the employer-assessee to the provident fund authorities after the due date under the Employees Provident Fund & Miscellaneous Provisions Act, 1952 (EPF & MP Act) but before the due date of filing the return for the previous year, shall be allowable as deduction in the hands of the employer-assessee.

The High Court opined that the Assessing Officer had committed an error in disallowing the said payment on account of delay in depositing the same to the credit of the account of the employee maintained with the provident fund authorities, taking a view that the due date mentioned in section 36(1)(va) is the due date fixed by the provident fund authorities under the EPF & MP Act, without considering the provisions of section 43B. The High Court concurred with the opinion of the previous appellate authority/ies that the amount paid was no longer in the hands of the employer and thus, cannot be taken as income in the hands of the employer-assessee.

High Court's Decision: Therefore, the employees' contribution to provident fund, deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer-assessee with the provident fund authority on or before the due date of filing the return for the previous year.

Note - *As per provisions of section 2(24)(x), any sum received by the assessee from his employees as a contribution towards, inter alia, any provident fund, shall be included in the income of the assessee.*

Section 36(1)(va) provides for deduction, while computing income under the head 'Profit and gains of business or profession', of any sum received by the assessee from any of its employees to which provisions of section 2(24)(x) apply, provided the same is credited by the assessee to the employee's account in the relevant fund on or before the due date. Explanation to section 36(1)(va) clarifies that the "due date" referred to therein is the date *by which the assessee is required as an employer to credit an employee's contribution to the employee's account in the relevant fund (i.e., Provident Fund, in this case) under any Act (i.e., EPF & MP Act, in this case).*

Section 43B provides for certain deductions only on actual payment. The first proviso to section 43B permits such payments to be made on or before the due date of filing of return under section 139(1), for the purpose of admissibility of deduction. The payments covered under section 43B include, inter alia, any sum payable by the assessee as an employer by way of contribution to any provident fund.

Thus, whereas section 43B permits payment of employer's contribution to PF on or before the due date of filing of return to qualify for deduction, section 36(1)(va) provides a time limit upto the due date specified under the EPF & MP Act for credit of employee's contribution to the employee's PF account, for claiming deduction under that section.

In this case, the High Court has concluded that the extended time limit upto the due date of filing of return under section 43B is also available for credit of employee's contribution to his PF Account, even though Explanation to section 36(1)(va) requires such payment to be made on or before the due date under the EPF & MP Act to qualify for deduction.[1]

31. Can unpaid electricity charges be treated as "fees" to attract disallowance under section 43B?

CIT v. Andhra Ferro Alloys P. Ltd. (2012) 349 ITR 255 (A.P)

Assessing Officer's view *vis-a-vis* Tribunal's view: On this issue, the Assessing Officer was of the view that electricity charges come within the ambit of section 43B and therefore, could be allowed as deduction only on payment basis. Therefore, he disallowed the unpaid electricity charges. The Tribunal, however, set aside the disallowance.

High Court's Observations and Decision: The Andhra Pradesh High Court observed that the provisions of section 43B do not incorporate electricity charges. Therefore, non-payment of electricity charges would not attract disallowance under section 43B since such charges cannot be termed as "fees".

[1] *The Gujarat High Court, in CIT v. Gujarat State Road Transport Corporation (2014) 366 ITR 170, held that employees contribution to provident fund, deposited by an employer after the due date under the EPF & MP Act but before the due date of filing of return for the relevant assessment year, is not allowable as deduction under section 36(1)(va).*

6

CAPITAL GAINS

1. **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

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

<u>High Court's Decision</u>: 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.

Note: 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.

2. **Where a leasehold property is purchased and subsequently converted into freehold property and then sold, should the period of holding be reckoned from the date of purchase or from the date of conversion for determining whether the resultant capital gains is short-term or long-term?**

Rama Rani Kalia

CIT v. Smt. Rama Rani Kalia (2013) 358 ITR 0499 (All.)

<u>Facts of the case</u>: The assessee purchased a leasehold property on July 7, 1984. Such leasehold rights in the property were converted into freehold rights on March 29, 2004. She sold the property on March 31, 2004 and declared long-term capital gains on the transfer. The Assessing Officer opined that since the property was acquired by converting the leasehold right into freehold right on March 29, 2004, and was sold within three days on March 31, 2004, the resultant capital gains would be short-term.

<u>Appellate Authorities' views</u>: The Commissioner (Appeals) opined that the conversion of leasehold property into freehold property was nothing but improvement of the title over the property, as the assessee was the owner prior to conversion. The Tribunal affirmed

this view of the Commissioner (Appeals) and held that the gains were long-term capital gains, as the assessee was the owner of the property even prior to conversion.

<u>High Court's Observations</u>: The High Court observed that the difference between "short-term capital asset" and "long-term capital asset" is the period over which the property has been held by the assessee and not the nature of title over the property. The lessee of the property has rights as the owner of the property subject to the covenants of the lease deed. Accordingly, the lessee may, subject to covenants of the lease deed, transfer the leasehold rights of the property with the consent of the lessor.

> <u>High Court's Decision</u>: The High Court, therefore, concurred with the views of the Tribunal that conversion of the rights of the lessee from leasehold to freehold is only by way of improvement of her rights over the property, which she enjoyed. It would not have any effect on the taxability of gain from such property, which is related to the period over which the property is held. Since, in this case, the period of holding is more than 36 months, the resultant capital gains would be long-term.

3. 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

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

<u>Facts of the case</u>: 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.

> <u>High Court's Decision</u>: 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, in this case, the period of holding of the asset received by the assessee-partner on dissolution of the firm has to be reckoned only from the date of dissolution of the firm. Since the assessee-partner has sold the property within three days of acquiring the same, the gains have to be treated as short-term capital gain.

4. 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) Navin Jindal

Supreme Court's Observations: 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.

Supreme Court's Decision: 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.

5. 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 in which the same was first acquired by the previous owner?

Manjula J.Shah

CIT v. Manjula J. Shah 355 ITR 474 (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.

Facts of the case: 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.

High Court's Observations: In the present case, the Bombay High Court observed 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.

<u>High Court's Decision</u>: 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 cases covered under 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.

6. Where a building, comprising of several floors, has been developed and re-constructed, would exemption under section 54/54F be available in respect of the cost of construction of -

   (i) the new residential house (i.e., all independent floors handed over to the assessee); or

   (ii) a single residential unit (i.e., only one independent floor)?

Gita Duggal

CIT v. Gita Duggal (2013) 357 ITR 153 (Delhi)

High Court of Delhi

<u>Facts of the case</u>: In the present case, the assessee was the owner of property comprising the basement, ground floor, first floor and second floor. In the year 2006, she entered into a collaboration agreement with a builder for developing the property. According to the terms of the agreement, the builder was to demolish the existing structure on the plot of land and develop, construct, and/or put up a building consisting of basement, ground floor, first floor, second floor and third floor with terrace at its own

costs and expenses. The assessee handed over to the builder, the physical possession of the entire property, along with 22.5% undivided interest over the land. The handing over of the entire property was, however, only for the limited purpose of development. The builder was to get the third floor plus the undivided interest in the land to the extent of 22.5% for his exclusive enjoyment. In addition to the cost of construction incurred by the builder on development of the property, a further amount of ₹ 4 crores was payable by the builder to the assessee as consideration against the rights of the assessee.

Assessee's contention *vis-à-vis* Assessing Officer's contention: The assessee, in her return of income, showed only ₹ 4 crores as sales consideration. The Assessing Officer, however, took the view that the sale consideration for the transfer should include not only the amount of ₹ 4 crores received by the assessee in cash, but also the cost of construction amounting to ₹ 3.44 crore incurred by the developer in respect of the other floors, which were handed over to the assessee.

The assessee contended that if the cost of construction incurred by the builder is to be added to the sale price, then, the same should also correspondingly be considered as re-investment in the residential house for exemption under section 54.

However, the Assessing Officer rejected the claim for exemption under section 54 on the ground that the floors obtained by the assessee contained separate residential units having separate entrances and cannot qualify as a single residential unit. He contended that deduction under section 54F was allowable, and that too only in respect of cost of construction incurred in respect of one unit i.e., one floor.

Appellate Authorities' views: The Commissioner (Appeals), on the basis of the judgment in *CIT v. D. Ananda Basappa [2009] 309 ITR 0329* (Kar.), took a contrary view. The Tribunal concurred with the view of the Commissioner (Appeals).

High Court's Observations: The High Court observed that sections 54 and 54F use the expression "residential house" and not "residential unit" and it is the Assessing Officer who has introduced a new concept of "residential unit" into these sections. Sections 54 and 54F require the assessee to acquire a "residential house" and so long as the assessee acquires a building, which may be constructed, for the sake of convenience, in such a manner as to consist of several units which can, if the need arises, be conveniently and independently used as an independent residence, the requirement of the section should be taken to have been satisfied. There is nothing in these sections which requires the residential house to be constructed in a particular manner. The only requirement is that it should be for residential use and not for commercial use. The physical structuring of the new building, whether lateral or vertical, should not come in the way of considering the building as a residential house.

High Court's Decision: The High Court held that the fact that the residential house consists of several independent units cannot be permitted to act as an impediment to the allowance of the deduction under section 54 or section 54F. It is neither expressly nor by necessary implication prohibited. Therefore, the assessee is entitled to exemption of capital gains in respect of investment in the residential house, comprising of independent residential units handed over to the assessee.

7. Would an assessee be entitled to exemption under section 54 in respect of purchase of two flats, adjacent to each other and having a common meeting point?

Syed Ali Adil

CIT v. Syed Ali Adil (2013) 352 ITR 0418 (A.P.)

Facts of the case: The assessee-individual had inherited an ancestral house property, which he sold during the relevant previous year. Out of the sale consideration, he purchased two adjacent residential flats. The assessee claimed exemption under section 54 in respect of investment in both the residential flats, in view of the decision of the Karnataka High Court in *CIT v. Ananda Basappa (2009) 309 ITR 329*, wherein investment in two adjacent flats were considered eligible for exemption under section 54.

Assessing Officer's contention: The Assessing Officer, however, restricted the exemption under section 54 only in respect of investment in one residential flat (including stamp duty paid for registration of the flat), contending that –

(i) the two residential units were separated by a strong wall;

(ii) the two flats were purchased from two different vendors under two separate sale deeds.

Appellate Authorities' views: The Commissioner (Appeals), however, observed that the assessee was entitled to exemption under section 54 in respect of investment in both the flats, since the two flats had adjacent kitchens and toilets and also had a common meeting point. The Tribunal concurred with the view of the Commissioner (Appeals).

High Court's Observations: On appeal by the Revenue, the High Court referred to the Karnataka High Court decision in *CIT v. Ananda Basappa (2009) 309 ITR 329,* wherein it was observed that where the flats are situated side by side and the builder had effected the necessary modification to make it as one unit, the assessee would be entitled to exemption under section 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds.

The above ruling was also followed by the Karnataka High Court in *CIT v. K.G. Rukminiamma (2011) 331 ITR 211*, wherein it was held that were a residential house was transferred and four flats in a single residential complex were purchased by the assessee, all the four residential flats constituted "a residential house" for the purpose of section 54.

High Court's Decision: The Andhra Pradesh High Court, on the basis of the above rulings of the Karnataka High Court, held that in this case, the assessee was entitled to investment in both the flats purchased by him, since they were adjacent to each other and had a common meeting point, thus, making it a single residential unit.

Note – Sections 54 and 54F have been amended by the Finance (No.2) Act, 2014 to clarify that the exemption available thereunder would be in respect of investment in one residential house in India. In this case as well as in Ananda Basappa's case, the assessee had invested in two adjacent flats and necessary modification was effected so that the flats can be used as a single residence. The respective High Courts had held that the assessees were entitled to exemption under section 54 in respect of investment in both the residential flats, since they were intended to be used as a single residence and necessary modification had also been effected so that the two flats located side by side can be used as a single residence. It appears that even after the amendment by the Finance (No.2) Act, 2014, the above rulings will continue to hold good, since the restriction is regarding investment being made in one residential house, and not in one unit of a residential house.

8. 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?

Gurnam Singh

High Court of Punjab and Haryana

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

Facts of the case: 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.

Tribunal's Observation: 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.

High Court's Decision: 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.

9. Can exemption under section 54F be denied solely on the ground that the new residential house is purchased by the assessee exclusively in the name of his wife?

Kamal Wahal

High Court of Delhi

CIT v. Kamal Wahal (2013) 351 ITR 4 (Delhi)

Facts of the case: The assessee sold a capital asset and invested the sale proceeds in purchase of a new house in the name of his wife. He claimed deduction under section 54F in respect of the new residential house purchased by him in the name of his wife.

However, the same was denied by the Assessing Officer on the ground that, in order to avail the benefit under section 54F, the investment in the residential house should be made by the assessee in his own name.

The Tribunal, however, accepted the assessee's contention observing that since section 54F is a beneficial provision enacted for encouraging investment in residential houses, the said provision has to be interpreted liberally.

<u>High Court's Observations</u>: The Delhi High Court concurred with the Tribunal's view and observed that, for the purpose of section 54F, a new residential house need not necessarily be purchased by the assessee in his own name nor is it necessary that it should be purchased exclusively in his name. A similar view was upheld by this Court in *CIT v. Ravinder Kumar Arora (2012) 342 ITR 38,* where the new residential house was acquired in the joint names of the assessee and his wife and the Court had held that the assessee was entitled for 100% exemption under section 54F. In that case, it was further observed that section 54F does not require purchase of new residential house property in the name of the assessee himself. It only requires the assessee to purchase or construct a residential house.

Further, in this case, the Delhi High Court observed that the assessee had not purchased the new house in the name of a stranger or somebody who is unconnected with him, but had purchased it in the name of his wife. The entire investment for purchase of new residential house had come out of the sale proceeds of the capital asset (of the assessee) and there was no contribution from his wife.

<u>High Court's Decision</u>: Hence, the Delhi High Court, having regard to the rule of purposive construction and the object of enactment of section 54F, held that the assessee is entitled to claim exemption under section 54F in respect of utilization of sale proceeds of capital asset for investment in residential house property in the name of his wife.

10. **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?**

Ravindra Kumar Arora

High Court of Delhi

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

<u>Facts of the case</u>: 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%.

High Court's Decision: 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) 203 Taxman 208, 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.

11. 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?

Sambandam Udaykumar

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

Karnataka High Court

Facts of the case: 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.

High Court's Observations: The Karnataka High Court observed 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 within the stipulated period. 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.

High Court's Decision: 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.

12. 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)

Facts of the case: 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.

Rajiv Shukla

High Court of Delhi

High Court's Decision: 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.

Gouli Mahadevappa

13. Where the stamp duty value under section 50C has been adopted as the full value of consideration, can the reinvestment made in acquiring a residential property, which is in excess of the actual net sale consideration, be considered for the purpose of computation of exemption under section 54F, irrespective of the source of funds for such reinvestment?

Gouli Mahadevappa v. ITO (2013) 356 ITR 90 (Kar.)

Facts of the case: In the present case, the assessee sold a plot of land for ₹ 20 lakhs and reinvested the sale consideration of ₹ 20 lakhs together with agricultural income of ₹ 4 lakhs, in construction of a residential house. The assessee claimed capital gains exemption under section 54F, taking into consideration the entire investment of ₹ 24 lakhs. The Assessing Officer, applying the provisions of section 50C, deemed the stamp duty value of ₹ 36 lakhs as the full value of consideration since the consideration received or accruing as a result of transfer of capital asset (i.e. ₹ 20 lakhs) was less than the value adopted by the stamp valuation authority (i.e., ₹ 36 lakhs). The same was not disputed by the assessee before the Assessing Officer.

Assessing Officer's contention *vis-a-vis* Assessee's contention: The Assessing Officer allowed exemption under section 54F, taking into consideration investment in construction of residential house, to the extent of actual net consideration of ₹ 20 lakhs. He did not consider the balance amount of ₹ 4 lakhs, invested in the construction of residential house, out of agricultural income, for computation of exemption under section 54F, even though the sale consideration adopted for the purpose of computation of capital gains i.e., stamp duty value of ₹ 36 lakhs, was more than the amount of ₹ 24 lakhs invested in the new house.

The assessee contended that the entire investment of ₹ 24 lakhs made in construction of the residential house should be considered for computation of exemption under section 54F, irrespective of the source of funds for such reinvestment. Further, the assessee also contended before the High Court that the registration value adopted under section 50C was excessive and disproportionate to the market value of the property.

High Court's Observations: On the issue of applicability of section 50C, the Karnataka High Court observed that section 50C(2) allows an opportunity to the assessee to contend, before the Assessing Officer, the correctness of the registration value fixed by the State Government. Had he done so, the assessing authority would have invoked the power of appointing a Valuation Officer for assessing the fair market value of the property. The High Court held that when the assessee had not disputed the registration value at that point of time, it is not permissible for the assessee to now contend, at this stage, that the registration value does not correspond to the market value. Hence, the value of ₹ 36 lakhs adopted under section 50C has to be deemed as the full value of consideration.

High Court's Decision: On the issue of exemption under section 54F, the High Court held that when capital gain is assessed on notional basis as per the provisions of section 50C, and the higher value i.e., the stamp duty value of ₹ 36 lakhs under section 50C has been adopted as the full value of consideration, the entire amount of ₹ 24 lakhs reinvested in the residential house within the prescribed period should be considered for the purpose of exemption under section 54F, irrespective of the source of funds for such reinvestment.

14. 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.)

High Court's Observations: 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.

High Court's Decision: 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.

15. In the case of an assessee, being a dealer in shares and securities, whose portfolio comprises of shares held as stock-in-trade as well as shares held as investment, is it permissible under law to convert a portion of his stock-in-trade into investment and if so, what would be the tax treatment on subsequent sale of such investment?

CIT v. Yatish Trading Co. Pvt. Ltd. (2013) 359 ITR 320 (Bom.)

Facts of the case: The assessee, being a dealer in shares and securities, has a trading as well as an investment portfolio of shares and securities. On 1st April 2002 and 1st

Yatish Trading Company Private Limited

October 2004, the assessee converted certain shares and securities held as stock-in-trade into investments and thereafter, in the A.Y.2006-07, it transferred such converted shares and securities and declared income arising on such transfer under the head "Profits and gains of business or profession" and "Capital gains". The profits and gains up to the date of conversion was offered as business income (i.e., fair market value on the date of conversion minus the cost of acquisition). The profits and gains arising after conversion up to the date of sale was offered as capital gains (i.e., sale price minus the fair market value on the date of conversion). The Assessing Officer, however, assessed the entire income arising on transfer of such converted shares and securities as business income.

Appellate Authorities' findings & views: The CIT (Appeals) opined that the view of the assessee was logical and reasonable. The Tribunal noted that the Department had accepted the conversion of stock-in-trade into investment while assessing the income of A.Y.2003-04 and A.Y.2005-06. Further, the books of account of the assessee showed such shares (on which the assessee offered income as capital gains) as investment. Also, the mere fact that the assessee-company was trading in the shares and securities cannot estop it from holding certain shares as investment and offering the gains on sale of such shares to tax under the head "Capital gains". It is open for a trader in shares to have a trading as well as an investment portfolio of shares and securities.

High Court's Decision: The High Court concurred with the Tribunal's ruling that the gains arising on sale of those shares held as investments by the dealer-assessee (i.e., the difference between the sale price and the fair market value on the date of conversion) were to be assessed under the head "Capital gains" and not under the head "Profits and gains of business or profession".

16. **Where transfer of shares in a company has been effected, fulfilling all the requirements for claim of exemption under section 10(38), can such exemption be denied on the ground that the transaction is a colorable device, since the underlying asset transferred is, in effect, land, which is a short-term capital asset, on sale of which capital gains tax liability would have been attracted?**

Bhoruka Engineering Inds. Ltd. v. DCIT (2013) 356 ITR 25 (Kar.)

Facts of the case: Bhoruka Steel Ltd. (BSL), a group company of the assessee, was incorporated in the year 1969. It had a mini steel plant at Bangalore. It commenced commercial production in 1972 and set up a refractory plant at Bangalore. BSL was declared as a sick industrial company in 1996 and IDBI was appointed as the Operating Agency. The rehabilitation scheme formulated envisaged sale of the surplus assets of BSL, which included 30 acres of land. A decision was taken in the meeting held on 29th July, 2002, to offer the land first to the promoters/sister companies jointly or severally with the reserve price of ₹ 25 lakhs per acre on the condition that the dues of the secured creditors and the others as per the rehabilitation scheme were cleared by 31st December, 2002. Bhoruka Financial Services Ltd. (BFSL), a public limited company and a group company engaged in financial services, offered to purchase the 30 acres of land at a price of ₹ 25 lakhs per acre. The Committee approved the sale of 15 acres of land to BFSL at ₹

3.75 crores. Accordingly, the land measuring 15 acres was sold to BFSL in June 2004 through registered sale deeds for ₹ 3.75 crores, the then prevailing market price which was accepted for the purpose of section 50C also.

The assessee-company is a limited company whose shares are quoted in the stock exchange. The assessee is holding shares in BFSL since October, 1984. The assessee, together with other promoter shareholders, held 98.73% shares in BFSL, the remaining being held by the public shareholders. In the financial year 2005-06, the assessee-company sold its shares to DLF Commercial Developers Ltd. (DLFCDL) for a net consideration of ₹ 20.29 crores. The other promoters also sold their shares to DLFCDL and the total net consideration, including that of the assessee, was ₹ 89.28 crores. The assessee claimed the capital gain arising on sale of such shares as exempt under section 10(38), since the shares, being a long-term capital asset, were sold in a recognized stock exchange and securities transaction tax has been paid on such sale.

<u>Revenue's contention</u>: The Revenue contended that the substance of the above transaction was the transfer of land, which would attract short-term capital gains tax in the hands of BFSL. BSL had sold its immovable property to its associate concern, BFSL, for a nominal value of ₹ 3.75 crores. BFSL, never before doing any business other than financial services, purchases the land for ₹ 3.75 crores and immediately thereafter, the assessee-company and its entire group, holding 98.73% of shares in BFSL, sell their entire shareholding of BFSL to DLFCDL for a consideration of ₹ 89.28 crores, without attracting corresponding tax liability. This is made possible by getting away from Bangalore Stock Exchange and going to Magadh Stock Exchange to carry out the sale transaction and by paying securities transaction tax for claiming exemption from long-term capital gains arising on sale of shares under section 10(38). The shares of BFSL were listed in Bangalore Stock Exchange, but hardly got traded. The last quoted value of the share was ₹ 5 in the year 1985. The promoters of BFSL sought permission from SEBI to exempt them from making public announcement in respect of sale of equity shares to DLFCDL.

Further, the promoters of BFSL had disposed of all the other assets held by BFSL except land, before the shares were sold to DLFCDL. BFSL was, in effect, reduced to a shell company, which was used to transfer a real asset and the promoters took the fruits of the transaction. The intention of the promoters was to transfer the underlying asset, being land to DLFCDL. The Revenue contended that DLFCDL could not have bought the shares of BFSL at a substantial rate of ₹ 4,490 per share. Since the area where the land was situated had high commercial value, DLFCDL had purchased the shares of BFSL keeping in mind the value of the underlying asset, being the land. The land had, in effect, been transferred to DLFCDL by way of the above circuitous transaction.

<u>Appellate Authorities' views</u>: The Commissioner (Appeals) concurred with the view of the assessing authority and held that the corporate veil had to be pierced and the substance of the transaction (i.e. sale of a short-term capital asset, being land, giving rise to taxable short-term capital gains), has to be considered. The Tribunal was of the view that the transaction in question was a colorable device to avoid payment of short-term

capital gains tax. This view was further substantiated by applying the rationale of case of *Vodafone International Holdings B. V. v. Union of India reported in (2012) 341 ITR 1 (SC)*.

High Court's Observations: The Karnataka High Court observed that in *Vodafone* case, it was also mentioned that 'Tax planning may be legitimate provided it is within the framework of law' and 'colorable devices cannot be a part of tax planning and it is wrong to encourage or entrain the belief that it is honorable to avoid the payment of tax by resorting to dubious methods'. Therefore, in that case, it was inferred that tax planning within the framework of law is legal. However, tax evasion through the use of colorable devices and by resorting to dubious methods and subterfuges is not allowed.

The High Court further observed that the assessee is entitled to manage its affairs within the four corners of law so as to attract minimum tax liability or no tax liability. However, the same should be real and genuine and not a sham or make-believe. He may legitimately claim the advantage of any express terms or of any omissions that he can find in his favour in taxing statutes in absence of any specific tax avoidance provision. Further, the intention of the legislature in a taxation statute is to be gathered from the language of the provisions particularly where the language is plain and unambiguous. In a taxing Act, it is not possible to assume any intention or governing purpose of the statute more than what is stated in the plain language.

If the transaction in question is sham or colorable and entered into with the sole intention of evading payment of tax, then such a transaction would not have any legitimacy. For determining whether a transaction is a valid transaction or a sham, each case should be seen on a standalone basis.

High Court's Decision: The Karnataka High Court observed that, in this case, the assessee-company was holding shares in BFSL from 1st October, 1984. Therefore, the shares represent a long-term capital asset. The transaction had taken place subsequent to 28th September, 2004. Hence, the second condition for claim of exemption is fulfilled. The transaction had taken place through the Magadh Stock Exchange and securities transaction tax has been paid on such sale. Where all the three conditions have been fulfilled, the assessee is entitled to exemption under section 10(38) in respect of long-term capital gains arising from such transfer. Merely because capital gains tax liability would have been attracted had a registered sale deed been executed by BFSL for selling land to DLFCDL, it cannot be concluded that the shareholders of BFSL transferring their shares after complying with the legal requirements would not be entitled to the benefit of exemption.

The High Court further noted that the companies involved in the transaction were existing companies. Thus, neither of the companies came into existence as a part of the scheme for purchase of immovable property or transfer of shares for the purpose of evading payment of tax. The event of transfer of shares happened in ordinary course of business and is legal. The transaction is, therefore, real, valuable consideration is paid, all legal formalities are complied with, and what is transferred is shares and not immovable property. Hence, it is a valid legal transaction and cannot be termed as a colorable device or sham transaction or an unreal transaction.

7

INCOME FROM OTHER SOURCES

Parle Plastics limited

1. **What are the tests for determining "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.)

High Court's Observations: 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.

High Court's Decision: 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).

2. **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

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

Facts of the case: 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.

Issue: 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).

High Court's Observations: 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.

High Court's Decision: In the present case, the advance given to the assessee by the company was not in the nature of a gratuitous advance; 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).

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

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

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

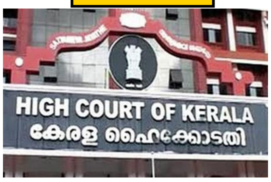
The assessee, a travel agency, has regular business dealings with two concerns in the tourism industry dealing with holiday resorts.

<u>High Court's Observations & Decision</u>: 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, therefore, 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).

4. 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?

Manjoo and co.



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

<u>High Court's Observations</u>: 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.

<u>High Court's Decision</u>: The High Court, therefore, held that the rate of 30% prescribed under section 115BB is applicable in respect of winnings from lottery received by the distributor.

8

Set-Off And Carry Forward Of Losses

Pramod Mittal

High Court of Delhi

1. Can the loss suffered by an erstwhile partnership firm, which was dissolved, be carried forward for set-off by the individual partner who took over the business of the firm as a sole proprietor, considering the succession as a succession by inheritance?

Pramod Mittal v. CIT (2013) 356 ITR 456 (Delhi)

Facts of the case: In the present case, the assessee was previously a partner in a firm. As per the dissolution deed of the partnership firm, with effect from 18th September, 2004, he took over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partner was paid his dues. He then ran the business as a sole proprietor with effect from that date. The assessee, relying upon section 78(2) and the decisions of the Supreme Court in *CIT v. Madhukant M. Mehta (2001) 247 ITR 805 (SC)* and *Saroj Aggarwal v. CIT (1985) 156 ITR 497 (SC),* claimed the set-off of the losses suffered by the erstwhile partnership firm against his income earned as an individual proprietor, considering the case as inheritance of business.

However, considering that only the person who has suffered the loss is entitled to carry forward and set-off the same, the claim of the assessee was disallowed by the Assessing Officer. The Tribunal concurred with the Assessing Officer's view.

High Court's Observations: The High Court observed that upon dissolution, the partnership firm ceased to exist. Also, the partnership firm and the proprietorship concern are two separate and distinct units for the purpose of assessment. As per section 170(1), the partnership firm shall be assessed as such from 1st April of the previous year till the date of dissolution (i.e., 18th September, 2004). Thereafter, the income of the sole- proprietorship shall be taxable in the hands of the assessee as an individual. Thus, section 170(1) provides as to who will be assessable in respect of the income of the previous year from business, when there is a change in the person carrying on business by succession.

Section 78(2), however, deals with carry forward of losses in case of succession of business. It provides that only the person who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. An exception provided thereunder is in the case of succession by inheritance.

Therefore, section 170(1) providing the person in whose hands income is assessable in case of succession and section 78(2) providing for carry forward of losses in case of succession of business, deal with different situations and resultantly, there is no contradiction between these sections.

The income earned by the sole proprietor would include his share of loss as an individual but not the loss suffered by the erstwhile partnership firm in which he was a partner. The exception given in section 78(2), permitting carry forward of losses by the successor in case of inheritance, is not applicable in the present case since the partnership firm was dissolved and ceased to continue. Taking over of business by a partner cannot be considered as a case of inheritance due to death as per the law of succession. The High Court opined that the decision in *Madhukant M. Mehta's case* and *Saroj Aggarwal's case* cannot be applied since this is not a case of succession by inheritance.

High Court's Decision: Therefore, the loss suffered by the erstwhile partnership firm before dissolution of the firm cannot be carried forward by the successor sole-proprietor, since it is not a case of succession by inheritance. The assessee sole-proprietor is, therefore, not entitled to set-off the loss of the erstwhile partnership firm against his income.

Note - *In Madhukant M. Mehta's case, the sole proprietor had expired and after his death the heirs succeeded the business as a partnership concern. Therefore, the losses suffered by the deceased proprietor was allowed to be set-off by the partnership firm since the case falls within the exception mentioned under section 78(2), i.e., a case of succession by inheritance.*

Also, in Saroj Aggarwal's case, upon death of a partner, his legal heirs were inducted as partners in the partnership firm. The partnership firm was not dissolved on the death of the partner. The partnership firm which suffered the losses continued with induction of the legal heirs of the deceased partner. This, being a case of succession by inheritance, the benefit of carry forward of losses was given to the re-constituted partnership firm.

In the present case, however, the partnership firm was dissolved and the take over of the running business of the firm by the erstwhile partner as a sole proprietor was not a case of succession by inheritance. Hence, the carry forward of losses of the firm by the sole proprietor was not allowed in this case.

9

DEDUCTIONS FROM GROSS TOTAL INCOME

1. **Can unabsorbed depreciation of a business of an industrial undertaking eligible for deduction under section 80-IA be set off against income of another non-eligible business of the assessee?**

CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245 (Kar.)

Facts of the case: The assessee was in the business of manufacture of wires. It installed a windmill for power generation. The assessee claimed depreciation on windmill against income from power generation, which was eligible for deduction under section 80-IA. The balance depreciation was set off against the profits from manufacturing of wires, being a non-eligible business.

Assessing Officer's contention: The Assessing Officer contended that depreciation relating to a business eligible for deduction under section 80-IA cannot be set off against non-eligible business income. Therefore, unabsorbed depreciation was to be carried forward to the subsequent year to be set off against the eligible business income of the assessee of that year.

Tribunal's Observations: The Tribunal observed that the balance depreciation of the eligible business is required to be carried forward for set-off against eligible business income of the next year while determining the profits eligible for deduction under section 80-IA in that year. However, the Tribunal noted that section 80-IA is a beneficial section permitting certain deduction in respect of certain income under Chapter VI-A. A provision granting tax incentive for economic growth should be construed liberally and any restriction placed should also be construed in a reasonable and purposive manner to advance the objects of the provision.

High Court's Observations and Decision: The High Court observed that it is a generally accepted principle that deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1). The assessee had incurred loss in eligible business after claiming depreciation. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed. It is thereafter that section 70(1) comes into play, whereby the assessee is entitled to set off the losses from one source against income from another source under the same head of income. The Court, therefore, held that the assessee was entitled to the benefit of set off of loss of eligible business against the profits of non-eligible business. However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year.

Note – *The crux of the above decision can be explained with a simple example. Let us consider a company, X Ltd., having two units, Unit A and Unit B. If Unit A engaged in eligible business (say, power generation) has a profit of ₹ 100 lacs in A.Y.2015-16, before claiming depreciation of ₹ 120 lacs and Unit B engaged in non-eligible business (say, manufacture of wires) has a profit of ₹ 70 lacs, then, as per the above decision, the loss of ₹ 20 lacs (representing balance depreciation not set-off) pertaining to Unit A can be set-off against profit of ₹ 70 lacs of Unit B carrying on non-eligible business. Therefore, the net profit of ₹ 50 lacs would be taxable in the A.Y.2015-16. If in the next year, i.e. A.Y.2016-17, the net profits of Unit A and Unit B are ₹ 200 lacs and ₹ 80 lacs, respectively, then the eligible deduction under section 80-IA for that year would be ₹ 180 lacs (i.e., ₹ 200 lacs minus ₹ 20 lacs, being loss (representing balance depreciation) set-off in the A.Y.2015-16 against other income).*

2. 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?

Kiran Enterprises

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

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

Issue: 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.

High Court's Decision: 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.

3. Can Duty Drawback be treated as profit derived from the business of the industrial undertaking to be eligible for deduction under section 80-IB?

CIT v. Orchev Pharma P. Ltd. (2013) 354 ITR 227 (SC)

Supreme Court's Decision : On this issue, the Supreme Court, following the decision in case of *Liberty India v. CIT (2009) 317 ITR 218 (SC)* held that Duty Drawback receipts cannot be said to be profits derived from the business of industrial undertaking for the purpose of computation of deduction under section 80-IB.

Note - In the case of Liberty India v. CIT (2009) 317 ITR 218 (SC), 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.*

4. 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.

High Court's Observations: 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.

High Court's Decision: 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.

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

Jaswand Sons

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

High Court's Decision: 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.

6. Whether the process of bottling of gas into gas cylinders amounts to production of gas cylinders for the purpose of deduction under section 80-IB?

Puttur Petro Products Private Limited

Puttur Petro Products P. Ltd. v. ACIT [2014] 361 ITR 290 (Kar.)

High Court's Decision: Applying the rationale of the Apex Court decision in the case of *CIT v. Vinbros and Co. [2012] 349 ITR 697*, the High Court held that the process of bottling of gas into gas cylinders, which requires a very specialised process and independent plant and machinery, amounts to production of "gas cylinders" containing gas for the purpose of claiming deduction under section 80-IB.

7. Would the procurements of parts and assembling them to make windmill fall within the meaning of "manufacture" and "production" to be entitled to 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.

<u>High Court's Observations and Decision</u>: 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.

8. 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.)

<u>Issue</u>: 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.

<u>Assessing Officer's contention</u>: 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).

<u>High Court's Observations</u>: 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). Therefore, it would be reasonable to hold that the expression "worker" in section 80-IB(2)(iv) 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.

<u>High Court's Decision</u>: 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.

9. 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)

NESTOR

High Court of Delhi

<u>Facts of the case</u>: 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.

<u>Tribunal's Observations</u>: 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.

<u>High Court's Observations & Decision</u>: 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.

10. Can an assessee who has not claimed deduction under section 80-IB in the initial years, start claiming deduction thereunder for the remaining years during the period of eligibility, if the conditions are satisfied?

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

<u>High Court's Decision</u>: 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.

Praveen soni

High Court of Delhi

10

ASSESSMENT OF VARIOUS ENTITIES

1. **Would the ancestral property received by the assessee after the death of his father, be considered as HUF property or as his individual property, where the assessee's father had received such property as his share when he went out of the joint family under a release deed?**

   Commissioner of Income-tax v. D. L. Nandagopala Reddy (Individual) (2014) 360 ITR 0377 (Kar)

   Facts of the case: In the present case, Laxmaiah Reddy had no sons and therefore, he adopted the assessee vide a registered adoption deed dated June 25, 1956. The property, which is the subject matter of the suit, originally belonged to Venkateshwaraiah (assessee's grandfather). The assessee's father (Laxmaiah Reddy), took his share in the joint family property and executed a release deed in favour of the remaining members of the joint family *vide* a registered release deed dated November 23, 1927 and bequeathed all his properties in favour of the assessee. The assessee, in turn, distributed the property in favour of his wife and children. This was done by oral partition which was evidenced by a memorandum of partition dated August 6, 1998.

   Thereafter, a transaction was entered into by the assessee with the builder for development of the property. The Assessing Officer treated the consideration received from the builder by the assessee and his wife as their individual income and assessed the same to tax in their individual hands.

   Assessing Officer's contention: The Revenue contended that when assessee's father got the property under a release deed, it ceased to be the joint family property. Since that property was bequeathed in favour of the assessee, he became its owner after the death of his father. Therefore, it was a separate property and, consequently, the income derived therefrom is assessed to tax in the hands of the assessee as separate property.

   High Court's Observations: The High Court observed that the property originally belonged to Hindu Undivided Family (HUF). One of the members of the family (i.e., the assessee's father) went out of the joint family under a release deed and the remaining members continued to be the members of joint family. After the death of assessee's father and mother, the assessee, being the adopted son, became the sole surviving co-parcener. When such property came to the hands of the assessee it was not his individual property; it was the property of his Hindu Undivided Family.

High Court's Decision: The High Court held that that when the property came to the hands of the assessee, it was not his self-acquired property; it was property belonging to his HUF. The assessee had given a portion of the property to his wife without a registered document, which is possible only if the property is a HUF property. If such property is treated as a self-acquired property, then assessee would have been able to give the portion of the property to his wife only by registered document.

2. **Under which head of income is rental income from plinths inherited by individual co-owners from their ancestors taxable - "Income from house property" or "Income from other sources"? Further, would such income be assessable in the hands of the individual co-owners or in the hands of the Association of Persons?**

Sudhir Nagpal v. Income-tax Officer (2012) 349 ITR 0636 (P & H)

First Issue: The first issue relates to the head of income under which rental income from plinths, inherited by individual co-owners from their ancestors, is taxable – whether "Income from house property" or "Income from other sources"?.

High Court's Observations: As regards the head of income under which rental income from plinths is assessable, the High Court referred to the Division Bench judgment in *Gowardhan Das and Sons v. CIT (2007) 288 ITR 481,* wherein it was observed that it is the income from property consisting of any building or land appurtenant thereto which is assessed under section 22 and not the income from renting out of open land or some kutcha plinth only.

High Court's Decision: Therefore, the Court held that the income from letting out the plinths is assessable under section 56 as "Income from other sources" and not under the head "Income from house property".

Second Issue: The second issue relates to whether such rental income is assessable in the hands of the individual co-owners or in the hands of the Association of Persons. To appreciate this issue, it is necessary to understand the complete facts of the case.

Facts of the case: In the present case, five persons of the Nagpal family were co-owners of the agricultural land "Nagpal farms" inherited from their forefathers. The co-owners executed a power of attorney in favour of Mr. Sudhir Nagpal, one of the co-owners, appointing him to construct plinths on the agricultural land and to further lease out such open plinths to any party on their behalf. The co-owners had, therefore, not purchased the land for the said purpose but had inherited the land. They were owners not in their joint capacity but in their individual capacity with a definite/defined proportion of share. The co-owners filed their individual returns of income disclosing their rental income and also paid tax on such income.

The Assessing Officer, however, issued notice under section 148 to all the co-owners of the property in the name of Mr. Sudhir Nagpal on the ground that there is an association of persons formed by the co-owners and therefore, income had escaped assessment in the hands of association of persons.

The assessee contended that since no land was purchased, therefore, the status of the co-owners cannot be treated as association of persons.

The Assessing Officer did not agree with the contention of the assessee and assessed the entire rental income from the plinths as income from other sources in the hands of the association of persons and determined the tax payable by applying section 167B(2). The Commissioner (Appeals) and the Tribunal confirmed the action of the Assessing Officer.

High Court's Observations: On appeal, the High Court observed that in order to assess individuals as "association of persons", the individual co-owners should have joined their resources and thereafter, acquired property in the name of association of persons and the property should have been commonly managed. It is only in such a case that income could be assessed in the hands of "association of persons". Mere accruing of income jointly to more persons than one would not constitute them an association of persons in respect of such income. In other words, unless the associates have done some acts or performed some operations together, which have helped to produce the income in question, they cannot be termed as an association of persons. Unless the members combine or join in a common purpose, it cannot be held that they have formed themselves into an association of persons.

High Court's Decision: In this case, the co-owners had inherited the property from their ancestors and there was nothing to show that they had acted as an association of persons. Thus, the High Court held that the rental income from the plinths has to be assessed in the status of individual and not association of persons and consequently, section 167B would not be attracted in this case.

3. **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 Since 1884

Madras High Court

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

Facts of the case: 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.

High Court's Decision: 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.

4. **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)

Sind Co-operative Housing Society

High Court's Observations: 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.

High Court's Decision: 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.

5. 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

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

High Court's Observations: On this issue, the Calcutta High Court observed that, in order to attract 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.

High Court's Decision: 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.*

6. 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?

Anil Hardware Store

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

Facts of the case: 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% of the book profits, whichever is more. In respect of the next ₹ 75,000, it is 60% and for the balance book profits, it is 40%. 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.

> High Court's Decision: 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 ventures 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).

Notes:

(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).

7. 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)

Supreme Court's Observations: 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.

Supreme Court's Decision: The Supreme Court, therefore, held that interest under sections 234B and 234C shall be payable on failure of the company 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.*

8. Can long-term capital gain exempted by virtue of section 54EC be included in the book profit computed under section 115JB?

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

Facts of the case: 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.

High Court's Decision: 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 (*now, Statement of Profit and Loss prepared in accordance with Part II of Schedule III to the Companies Act, 2013*), 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 18.5% 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.*

11

INCOME-TAX AUTHORITIES

Kathiroor Service Co-operative Bank Limited

1. **Where no proceeding is pending against a person, can the Assessing Officer call for information under section 133(6), which is useful or relevant to any enquiry, with the permission of Director or Commissioner?**

Kathiroor Service Co-operative Bank Ltd. v. CIT (CIB) (2014) 360 ITR 0243 (SC)

Facts of the case: The Assessing Officer, with the prior approval of the Commissioner, issued notice under section 133(6) to the assessee, a co-operative society engaged in banking business, calling for general information regarding details of all persons (whether resident or non-resident) who had made (a) cash transactions of ₹ 1 lakh and above in any account, and/or (b) time deposits of ₹ 1 lakh or above, for the period of three years between April 1, 2005, and March 31, 2008, expressly stating therein that failure to furnish the information would attract penal consequences.

The assessee objected to the said notice, *inter alia*, on the ground that such notice seeking for information which is unrelated to any existing or pending proceeding against the assessee could not be issued under the provisions of the Act.

Supreme Court's Observations: The Supreme Court observed that the Assessing Officer has been empowered to requisition information which will be useful for or relevant to **any enquiry** or proceeding under the Income-tax Act, 1961 in the case of any person. However, an income-tax authority below the rank of the Director or Commissioner can exercise this power in respect of an **enquiry** in a case where no proceeding is pending, only with the prior approval of the Director or the Commissioner.

Supreme Court's Decision: The Supreme Court held that information of general nature could be called for from banks. In this case, since notices have been issued after obtaining approval of the Commissioner, the assessing authority had not erred in issuing the notices to assessees requiring them to furnish information regarding account holders with cash transactions or deposits of more than ₹ 1 lakh. The Supreme Court, therefore, held that for such enquiry under section 133(6), the notices could be validly issued by the assessing authority.

2. Is the requirement to grant a reasonable opportunity of being heard, stipulated under section 127(1), mandatory in nature?

Sahara Hospitality Ltd. v. CIT (2013) 352 ITR 38 (Bom.)

High Court's Observations: On this issue, the Bombay High Court observed that the provisions of section 127(1) stipulate, *inter alia,* that the income tax authority mentioned therein may give an opportunity of being heard to the assessee, wherever it is possible to do so, and after recording his reasons for doing so, transfer any case from one or more Assessing Officers subordinate to him to any other Assessing Officer or officers subordinate to him.

High Court's Decision: The Bombay High Court held that the word "may" used in this section should be read as "shall" and such income-tax authority has to mandatorily give a reasonable opportunity of being heard to the assessee, wherever possible to do so, and thereafter, record the reasons for taking any action under the said section. "Reasonable opportunity" can only be dispensed with in a case where it is not possible to provide such opportunity. In such a case also, the authority should record its reasons for making the transfer, even though no opportunity was given to the assessee. The discretion of the authority is only to consider as to what is a reasonable opportunity in a given case and whether it is possible to give such an opportunity to the assessee or not. The authority cannot deny a reasonable opportunity of being heard to the assessee, wherever it is possible to do so.

3. 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.)

Facts of the case: 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.

Issue: 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.

High Court's Decision: 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

Govind Nagar Sugar Limited

High Court of Delhi

1. **Can 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)

High Court's Observations: 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.

High Court's Decision: 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.

Orissa Rural Housing Development Corporation Limited

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)

High Court's Decision: 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 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.

High Court's Decision: 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.

4. **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.)

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.

High Court's Observations and Decision: 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.

5. **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)

Facts of the case: 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.

Supreme Court's Decision: 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.

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)

Facts of the case: 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.

Issue: 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.

High Court's Observations: 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.

High Court's Decision: 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. 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 framed the original assessment had already applied his mind and come to a conclusion?

H.K.Buildcon Limited

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

सत्यमेव जयते
THE HIGH COURT OF GUJARAT

High Court's Observations: 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.

<u>High Court's Decision</u>: 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.

8. **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)?**

HSHHCL

High Court of Punjab and Haryana

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

<u>High Court's Observations</u>: 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 permitted 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)

<u>High Court's Decision</u>: 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 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.

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

TEL

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

Issue : 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.

High Court of Delhi

High Court's Decision: 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. **Can an assessee, objecting to the reassessment notice issued under section 148, directly approach the High Court in the normal course contending that such reassessment proceedings are apparently unjustified and illegal?**

   Samsung India Electronics P. Ltd. v. DCIT (2014) 362 ITR 460 (Del.)

   Facts of the case: In the present case, Samsung Electronics Co. Ltd., the Korean Company was subjected to regular assessment for the assessment year 2006-07. The assessment order was passed, pursuant to the directions under section 144C(5) made by the Disputes Resolution Panel. For the same assessment year, i.e., A.Y.2006-07, assessee was issued a reassessment notice dated March 30, 2013 under section 148. Against this reassessment notice, assessee filed a writ petition before the High Court.

   High Court's Observations: The High Court observed the Apex court ruling in the case of *GKN Driveshafts (India) Ltd. v. ITO [2003] 259 ITR 19 (SC)*, wherein, it was laid down that **when a notice under section 148 is issued, the proper course of action for the noticee is to file a return and if he so desires, to seek reasons for issuing notices. The Assessing Officer is bound to furnish reasons within a reasonable time. On receipt of the reasons, the noticee is entitled to file objections to issuance of notice and the Assessing Officer is bound to dispose of the objections by passing a speaking order.**

   The High Court noted that the assessee has not filed objections before the Assessing Officer and has directly approached the court by way of the writ petition. On this issue, the assessee contended that they were justified in approaching the High Court directly as the reassessment proceedings *ex facie* were unjustified and illegal. The assessee relied upon the decision of the Delhi High Court in *Techspan India P. Ltd. v. ITO [2006] 283 ITR 212 (Delhi)* in which reference was made to the decision of the Gujarat High Court in *Garden Finance Ltd. v. Asst. CIT [2004] 268 ITR 48 (Guj),* wherein it was observed that the exercise of the powers under section 148 may be so arbitrary or *mala fide* that the court may entertain the petition without requiring the assessee to approach the Assessing Officer, but such a case was an exception and not a rule. In *Techspan India P. Ltd.'s* case, the High Court had given concurrent reasons and made observations when a writ court should interfere. However, there is no need to go into the said question and controversy in the present case, since it does not occasion or require a different treatment from the procedure followed in other cases in which re-assessment proceedings were/are initiated.

High Court's Decision: The High Court, thus, held that it will not be appropriate and proper in the facts of the present case to permit and allow the petitioner to bypass and forgo the procedure laid down by the Supreme Court in *GKN Driveshafts (India) Ltd. (supra),* since the said procedure has been almost universally followed and has helped cut down litigation and crystallise the issues, if and when the question comes up before the Court.

2. 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.)

Facts of the case: 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).

Assessee's contention *vis-à-vis* Revenue's contention: 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).

High Court's Decision: 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, the period of limitation in respect of the order of the Commissioner under section 263 with regard to 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.

3. **Can an assessee file a revision petition under section 264, if the revised return to correct an inadvertent error apparent from record in the original return, is filed after the time limit specified under section 139(5) on account of the error coming to the notice of the assessee after the specified time limit?**

Sanchit Software and Solutions Pvt. Ltd. v. CIT (2012) 349 ITR 404 (Bom.)

Facts of the case: The assessee-company had electronically filed its return of income. It committed a mistake by including dividend income [exempt under section 10(34)] and long term capital gains on sale of shares [exempt under section 10(38)] in its return of income, though the same was correctly disclosed in the Schedule containing details of exempt income. The return was processed under section 143(1) denying the exemptions under section 10(38) and 10(34) and therefore, intimation under section 143(1) was served on the assessee raising a demand of tax. The assessee, on receiving the intimation, noticed the error committed and filed a revised return rectifying the error. However, the revised return was not sustainable as the same was filed beyond the period of limitation as provided under section 139(5). Later, the assessee filed an application for rectification under section 154 and also a revision petition under section 264.

Commissioner's contention: The Commissioner of income-tax, while considering the revision petition, contended that the intimation under section 143(1) was based on the return of the assessee, in which the claims under section 10(34) and under section 10(38) were not made by the assessee. Hence, it cannot be said that the intimation under section 143(1) was erroneous, since the same was squarely based on the return filed by the assessee. Secondly, the power of Commissioner under section 264 is only restricted to the record available before the Assessing Officer which can be examined by the Commissioner. In the circumstances, the other evidence sought to be brought on record to establish the mistake committed by the assessee cannot be considered by the Commissioner under section 264. The revision petition under section 264 was rejected by the Commissioner on the above grounds.

High Court's Observations: The High Court observed that the entire object of administration of tax is to secure the revenue for the development of the country and not to charge the assessee more tax than which is due and payable by the assessee. In this context, the High Court referred to the CBDT Circular issued as far back as 11th April, 1955 directing the Assessing Officer not to take advantage of the assessee's mistake. The High Court opined that the said Circular should always be borne in mind by the officers of the Revenue while administering the Act.

The High Court observed that, in this case, the Commissioner of income-tax had committed a fundamental error in proceeding on the basis that no deduction on account of dividend income and long-term capital gains under section 10 was claimed from the total income, without considering that the assessee had specifically sought to exclude the same as is evident from the entries in the relevant Schedule. Therefore, this was an error on the face of the order and hence, the same was not sustainable.

<u>High Court's Decision</u>: The High Court, accordingly, set aside the order of Commissioner and remanded the matter for fresh consideration.

The High Court further directed the Assessing Officer to consider the rectification application filed by the assessee under section 154 as a fresh application received on the date of service of this order and dispose of the rectification application on its own merits, without awaiting the result of the revision proceedings before the Commissioner of Income-tax on remand, at the earliest.

Pruthvi Brokers & Shareholders

4. 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) 349 ITR 336 (Bom.)

<u>High Court's Observations:</u> 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.

High Court's Decision: 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.

Earnest Exports Limited

5. 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.)

High Court's Observations: 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.

High Court's Decision: 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).

Lachman Dass Bhatia Hingwala Private Limited

6. 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)

High Court's Observations: 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.

High Court's Decision: 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.

HIGH COURT OF MADHYA PRADESH

Deepak Kumar Garg

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

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

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

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

14

PENALTIES

MAK Data Private Limited

1. **Can an assessee who has surrendered his income in response to the specific information sought by the Assessing Officer in the course of survey, be absolved from the penal provisions under section 271(1)(c) for concealment of income?**

MAK Data P. Ltd. v. CIT (2013) 358 ITR 593 (SC)

Facts of the case: The assessee-company filed its return of income for the A.Y. 2004-05 declaring an income of ₹ 16.17 lakh along with tax audit report. The assessee's case was selected for scrutiny and notices were issued under section 143(2) and section 142(1). During the course of assessment proceedings, it was noticed by the Assessing Officer that certain documents, namely, share application forms, bank statements, memorandum of association of companies, affidavits, copies of income-tax returns and assessment orders and blank share transfer deeds duly signed, had been found in the course of survey proceedings under section 133A conducted on December 16, 2003, in the case of a sister concern of the assessee, and the same were impounded.

The Assessing Officer issued a show cause notice dated October 26, 2006 to the assessee seeking specific information regarding the documents pertaining to share applications found in the course of survey, particularly, blank transfer deeds signed by persons who had applied for the shares.

In its reply to the show cause notice, the assessee made an offer to surrender a sum of ₹ 40.74 lakhs by way of voluntary disclosure without admitting any concealment or any intention to conceal and subject to non-initiation of penalty proceedings and prosecution. The Assessing Officer, however, completed the assessment bringing the sum of ₹ 40.74 lakhs to tax and levied penalty under section 271(1)(c) for concealment of income and not furnishing true particulars.

Assessee's contention: The assessee contended that the penalty proceedings were not maintainable since the Assessing Officer had not recorded his satisfaction to the effect that there has been concealment of income/furnishing of inaccurate particulars of income. Further, it also contended that the surrender of income was a conditional surrender before any investigation in the matter.

Appellate Authorities' view: The Commissioner (Appeals) did not accept the assessee's contention. The Tribunal, however, was of the view that the amount of ₹ 40.74 lakhs was surrendered by the assessee to settle the dispute with the Department. It opined that since the assessee, for one reason or the other, agreed or surrendered certain amounts for assessment, the imposition of penalty solely on the basis of the assessee's surrender could not be sustained. The Tribunal, therefore, allowed the appeal and set aside the penalty order.

The High Court, however, accepted the plea of the Revenue that there was absolutely no explanation by the assessee for the concealed income of ₹ 40.74 lakhs. The High Court took the view that in the absence of any explanation in respect of surrendered income, the first part of *Clause (A) of Explanation 1 to section 271(1)(c)* would be attracted.

Apex Court's Observations: The Apex Court observed that the assessee had stated that the surrender of the additional sum was with a view to avoid litigation, to buy peace and to channelize the energy and resources towards productive work and to make amicable settlement with the Income-tax Department. The Court observed that these types of defenses are, however, not recognized under the statute. It further observed that the survey was conducted and documents were impounded ten months before the assessee filed its return of income. The Court opined that had it been the intention of the assessee to make full and true disclosure of its income, it would have filed the return declaring an income inclusive of the amount which was surrendered later during the course of the assessment proceedings. It is the statutory duty of the assessee to record all its transactions in the books of account, to explain the source of payments made by it and to declare its true income in the return of income filed by it from year to year.

Apex Court's Decision: The Apex Court was, therefore, of the view that surrender of income in this case is not voluntary, in the sense, that the offer of surrender was made in view of detection made by the Assessing Officer in the survey conducted in the sister concern of the assessee. The Apex Court, therefore, concurred with the view of the High Court that levy of penalty is correct in law.

Note: *According to Explanation 1 to section 271(1)(c), where in respect of any facts material to the computation of the total income of any person under this Act,-*

(A) such person fails to offer an explanation or offers an explanation which is found by the Assessing Officer or the Commissioner (Appeals) or the Commissioner to be false, or

(B) such person offers an explanation which he is not able to substantiate and fails to prove that such explanation is bona fide and that all the facts relating to the same and material to the computation of his total income have been disclosed by him,

then, the amount added or disallowed in computing the total income of such person as a result thereof shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed.

In this case, since the assessee has failed to offer an explanation regarding surrendered income, the amount of income surrendered is deemed to represent the income in respect of which particulars have been concealed, thereby attracting penal provisions under section 271(1)(c).

Triumph International Finance India Limited

2. **Where an assessee repays a loan merely by passing adjustment entries in its books of account, can such repayment of loan by the assessee be taken as a contravention of the provisions of section 269T to attract penalty under section 271E?**

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

Facts of the case: 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.

Assessing Officer's contentions: 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.

Assessee's contentions: 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.

High Court's Observations: Considering the above mentioned facts and arguments, the Bombay High Court observed 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.

<u>High Court's Decision</u>: 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.*

Reliance Petro Products Private Limited

3. **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)

<u>Supreme Court's Observations</u>: 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.

Supreme Court's Decision: 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.

4. Can reporting of income under a different head tantamount to furnishing of inaccurate particulars or suppression of facts to attract penalty under section 271(1)(c)?

Amit Jain

High Court of Delhi

CIT v. Amit Jain (2013) 351 ITR 74 (Delhi)

Facts of the case: In this case, the assessee declared a particular income as short-term capital gains in his return. The Assessing Officer, on an interpretation of the relevant provisions and having regard to the nature of transactions, assessed such income as income from business. He further levied penalty under section 271(1)(c) on the ground that the assessee had furnished inaccurate particulars of his income.

The Commissioner (Appeals), however, cancelled the penalty. The Tribunal upheld the order of the Commissioner (Appeals), observing that the record reveals that the amount in question, which formed the basis of levy of penalty by the Assessing Officer, was honestly reported in the return. Therefore, merely because the Assessing Officer was of the opinion that the income fell under some other head cannot be reason enough to treat the particulars reported in the return as "inaccurate particulars" or as suppression of facts.

High Court's Decision: The High Court, after considering the above observations of the Tribunal and the decision of the Supreme Court in *CIT v. Reliance Petro Products Pvt. Ltd. (2010) 322 ITR 158*, held that mere reporting of income under a different head would not characterize the particulars reported as "inaccurate" to attract levy of penalty under section 271(1)(c).

5. Can penalty under section 271(1)(c) be imposed on the ground of disallowance of a certain deduction under Chapter VI-A owing to the subsequent decision of the Supreme Court?

CIT v. Celetronix Power India P. Ltd. (2013) 352 ITR 70 (Bom.)

Facts of the case: In this case, the assessee had claimed deduction a particular section under Chapter VI-A relying on a judgment of the Bombay High Court. Subsequent to filing of its return, the above judgment was reversed by the Supreme Court and accordingly, the deduction was not allowed at the time of assessment. Consequent to additions made on account of such disallowance, penalty was also imposed.

Tribunal's observations: The Tribunal observed that for imposing penalty under section 271(1)(c), there should be concealment of income or furnishing of inaccurate particulars of income, which were missing in this case. The assessee had disclosed all material facts relevant for assessment and there was no concealment.

High Court's Decision: The Bombay High Court affirmed the decision of Appellate Tribunal deleting the penalty under section 271(1)(c) on the ground that the additions made on account of disallowance were neither due to the failure on the part of the assessee to furnish accurate particulars nor on account of furnishing inaccurate particulars.

Indersons Leather Private Limited

6. 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)

High Court of Punjab and Haryana

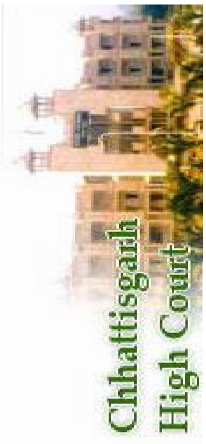
Facts of the case: The assessee company, after discontinuing its manufacturing business, leased out its shed along with fittings and disclosed the income as income from business, whereas the Revenue contended that the same be assessed as "Income from house property. The issue under consideration is whether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

High Court's Decision: 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.

Vijay Kumar Jain

7. 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)

Facts of the case: 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.

High Court's Decision: 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.

15

OFFENCES AND PROSECUTION

Bhavecha Machinery and Others

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)

   High Court's Observation and Decision: 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.

HIGH COURT OF MADHYA PRADESH

16

MISCELLANEOUS PROVISIONS

SivaKumar.v

Madras High Court

1. **Can loan, exceeding the specified limit, advanced by a partnership firm to the sole-proprietorship concern of its partner be viewed as a violation of section 269SS to attract levy of penalty?**

CIT v. V. Sivakumar (2013) 354 ITR 9 (Mad.)

Facts of the case: In the present case, the assessee was a partner in four firms and also had a sole-proprietary business. In the relevant previous year, the partnership firms had advanced loan to the assessee in cash exceeding the specified amount mentioned in section 269SS. The Assessing Officer initiated penalty proceedings under section 271D in view of violation of section 269SS. The Assessing Officer recorded a factual finding that the said money had been advanced by the partnership firm as a loan and were debited to the accounts of the proprietary concern; therefore, it was evident that the assessee had taken loan from the firms in cash in the capacity of the proprietor and not as a partner. Consequently, the provisions of section 269SS had been violated.

Assessee's contention: The assessee contended that the amount is taken in the capacity of the partner and it cannot be taken as an independent transaction and therefore, there is no violation of section 269SS. Also, the assessee contended that the partnership firm has no separate legal entity and there is no separate identification between the firm and the partner.

Tribunal's view: The Tribunal, relying upon the various court decisions, confirmed the finding of the Commissioner (Appeals) that partnership firm is not a juristic person and there is no separate identity for the firm and the partners; Being a partner, the assessee had withdrawn amounts from the firms and there were no reasons to doubt the genuineness of the transactions. Consequently, the transactions between the firm and the partner cannot be brought within the meaning of section 269SS.

High Court's Decision: The High Court, relying upon the various court decisions, upheld the decision of the Tribunal holding that there is no separate identity for the partnership firm and that the partner is entitled to use the funds of the firm. In the present case, the assessee has acted *bona fide* and that there was a reasonable cause within the meaning of section 273B. Therefore, the transaction cannot be said to be in violation of section 269SS and no penalty is attracted in this case.

17

DEDUCTION, COLLECTION AND RECOVERY OF TAX

ITC Limited

High Court of Delhi

1. **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.)

<u>Facts of the case</u>: 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% 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.

<u>High Court's Decision</u>: 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.

2. Where the assessee fails to deduct tax at source under section 194B in respect of the winnings, which are wholly in kind, can he be deemed as an assessee-in-default under section 201?

CIT v. Hindustan Lever Ltd. (2014) 361 ITR 0001 (Kar.)

Facts of the case: In the present case, the assessee is a company engaged in the business of manufacture and sale of various consumer goods/products. During the previous years relevant to A.Y.2001-02 and A.Y.2002-03, it had conducted certain sales promotion schemes. The assessee advertised the schemes wherein coupons were inserted in packs/containers of their products. Some of those coupons indicated that on purchase of the packs/ containers, they would get prizes, as indicated in coupons. The prizes that were offered were Santro car, Maruti car, gold chains, gold coins, gold tablas, silver coins, emblems, etc. The total amount of prizes distributed valued ₹ 6,51,238 for the A.Y.2001-02 and ₹ 54,73,643 for the A.Y.2002-03.

The Assessing Officer, having received the information about the schemes, sought clarification and also conducted survey of the assessee's business premises under section 133A. The Assessing Officer, thereafter, passed an order dated 3.1.2002, under sections 201(1) and 201(1A) for the A.Y.2001-02 and treated the assessee as an assessee-in-default of its obligation in terms of section 194B. Similar order was passed for the A.Y.2002-03. According to the Assessing Officer, the assessee was obliged to ensure that the tax in respect of the winnings, wholly in kind, was remitted before the winnings were released. Having failed to do so, the proceedings under section 201(1) were initiated. The Assessing Officer held that although the customers did not pay anything extra to receive the prize, nevertheless, they had participated in the scheme by purchasing the products advertised to take a chance at winning the prize. It was further held that what has been paid as prize-in-kind in various schemes conducted by the assessee is a lottery on which the tax was deductible under section 194B. As the assessee neither deducted the tax nor ensured payment thereof before the winnings were released, he treated the assessee as an assessee-in-default. He passed similar order dated 28.3.2002 for the A.Y.2002-03.

Appellate Tribunal's view: The Tribunal held that the schemes conducted by the assessee were not a lottery, as the said expression was understood up to the A.Y.2001-02. The Tribunal observed that the customers did not pay any excess amount for getting coupons indicating winnings in the packs/containers of products they purchased, and, therefore, nothing was paid by them for participating in the scheme. Accordingly, the Tribunal concluded that although there was an element of chance but as no consideration or payment was made by the customers for the purpose of participation in the lottery with the object of winning the prizes, the schemes conducted by the assessee would not fall within the ambit of section 194B.

The Tribunal further held that having regard to the insertion of *Explanation* below section 2(24)(ix), the scheme conducted by the assessee would be a lottery for the A.Y.2002-03 but nevertheless they accepted the alternate contention that having regard to *Circular No. 390, dated August 8, 1984 [See (1984) 149 ITR (St.) 5]*, there was no obligation on the respondent to deduct tax at source in respect of prizes paid in kind and in the absence of any such obligation, no proceedings under section 201 could be taken against the respondent.

<u>High Court's view</u>: From a bare perusal of section 194B, it is clear that the person responsible for paying to any person any income by way of winnings from any lottery in an amount exceeding ten thousand rupees shall, at the time of payment thereof, deduct income-tax thereon at the rates in force. A combined reading of sections 194B and 201 shows that if any such person fails to "deduct" the whole or any part of the tax or after deducting, fails to pay the tax as required by or under the Act, then such person shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax. The provisions contained in these sections do not cast any duty to deduct tax at source where the winnings are wholly in kind. If the winnings are wholly in kind, as a matter of fact, there cannot be any deduction of tax at source. The word "deduction" employed in this provision postulates a reduction or subtraction of an amount from a gross sum to be paid and payment of the net amount thereafter. Where the winnings are wholly in kind the question of deduction of any sum therefrom does not arise and in that eventuality, the only responsibility, as cast under section 194B, is to ensure that tax is paid by the winner of the prize before the prize or winnings is or are released in his favour.

<u>High Court's Decision</u>: The High Court observed that if the assessee fails to ensure that tax is paid before the winnings are released in favour of the winner, then, section 271C empowers the Joint Commissioner to levy penalty equivalent to the amount of tax not paid, and under section 276B, such non-payment of tax is an offence attracting rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine. However, the High Court held that proceedings under section 201 cannot be initiated against the assessee.

3. Can the transmission, wheeling and SLDC charges paid by a company engaged in distribution and supply of electricity, under a service contract, to the transmission company be treated as fees for technical services so as to attract TDS provisions under section 194J or in the alternative, under 194C?

AVVNL *Ajmer Vidyut Vitran Nigam Ltd., In re (2013) 353 ITR 640 (AAR)*

Ajmer Vidyut Vitran Nigam Ltd.

Authority for Advance Rulings
Ministry of Finance, Goverment of India

Facts of the case: In the present case, the applicant is a government company engaged in the business of distribution and supply of electricity to customers in various districts of Rajasthan. The activity of distribution is preceded by the production of electricity and its transmission from the point of production to the point of distribution. The production is by the generating company, which is another entity and transmission to the applicant is through the transmission system network of the transmission company. The transmission company carries the electrical energy to the applicant at the distribution system network of the applicant. The applicant then distributes the energy to the end customers.

The transmission of electricity from the point of generation to the point of distribution of the applicant is termed as "wheeling". The applicant pays transmission and wheeling charges for this wheeling, which it contends are statutory charges. The transmission company also functions as a State Load Dispatch Centre (SLDC), which is responsible for the general co-ordination of production and transmission of electricity to ensure uniform distribution in the State. The applicant pays to the transmission company, SLDC charges, which it claims as statutory in nature, since the levy is in terms of the Electricity Act, 2003.

Applicant's contention: The applicant contended that the above charges were not in the nature of fees for technical services to attract TDS provisions under section 194J, on the following grounds –

(i) The transmission does not involve rendering of any technical services nor were technically qualified staff of the transmission company involved in the transmission of electrical energy;

(ii) The SLDC charges were also mere statutory charges and does not involve rendering of technical services;

(iii) The payment of transmission, wheeling and SLDC charges were in the nature of reimbursement of actual cost and hence, do not generate any income in the hands of the transmission company.

Revenue's contention: The Revenue, on the other hand, was of the view that the transmission of electrical energy from the point of generation to the point of distribution of the applicant involves rendering of technical services and consequently, the applicant was bound to withhold tax. The Revenue supported its view on the basis of the following contentions –

(i) Transmission of electrical energy is a technical service and requires constant involvement of a technical system consisting of sophisticated instruments, constant monitoring and supervision by persons with a technical ability and knowledge to operate and manage the system so as to ensure regular and consistent supply of electricity at the grid voltage at the distribution point of the applicant.

(ii) As regards SLDC charges, the services rendered require the technical support and services of technically qualified staff and therefore they were technical services within the meaning of section 194J.

(iii) The fact that the contract between both the parties is backed by a statutory obligation cannot alter the nature of services rendered.

AAR's Observations: The AAR did not agree with the applicant's contention regarding transmission and wheeling charges not constituting fees for technical services on the ground that no rendering of technical services was involved for maintaining proper and regular transmission of electrical energy. It was also not in agreement with the applicant's argument that the services of technical personnel were not needed for ensuring due and proper transmission of electrical energy from the generation point to the distribution point. The AAR concurred with the Revenue's view that the personnel of the transmission company had to ensure regular and consistent transmission of electrical energy at the grid voltage at the distribution point of the applicant.

AAR's Decision: The AAR, considering the definition of fees for technical services under section 9(1)(vii) and the process involved in proper transmission of electrical energy, held that transmission and wheeling charges paid by the applicant to the transmission company are in the nature of fees for technical services, in respect of which the applicant has to withhold tax thereon under section 194J.

As regards SLDC charges, the AAR opined that the main duty of the SLDC is to ensure integrated operation of the power system in the State for optimum scheduling and dispatch of electricity within the State. The SLDC charges paid appeared to be more of a supervisory charge with a duty to ensure just and proper generation and distribution in the State as a whole. Therefore, such services were not in the nature of technical service to the applicant; Resultantly, it does not attract TDS provisions under section 194J or under section 194C.

4. Can discount given to stamp vendors on purchase of stamp papers be treated as 'commission or brokerage' to attract the provisions for tax deduction under section 194H?

ASVA

CIT v. Ahmedabad Stamp Vendors Association (2012) 348 ITR 378 (SC)

Issue: The principal issue in this case is whether stamp vendors are agents of the State Government who are being paid commission or brokerage or whether the sale of stamp papers by the Government to the licensed vendors is on "principal-to-principal" basis involving a "contract of sale".

High Court's Observations: On this issue, the Gujarat High Court had in, *Ahmedabad Stamp Vendors Association v. Union of India (2012) 348 ITR 378*, observed that the crucial question is whether the ownership in the stamp papers passes to the stamp vendor when the treasury officer delivers stamp papers on payment of price less discount. The Gujarat Stamp Supply and Sales Rules, 1987 contemplates that the licensed vendor, while taking delivery of the stamp papers from the Government offices, is purchasing the stamp papers. The Rules also indicate that the discount which the licensed vendor has obtained from the Government is on purchase of the stamp papers.

If the licensed stamp vendors were mere agents of the State Government, no sales tax would have been leviable when the stamp vendors sell the stamp papers to the customers, because it would have been sale by the Government "through" stamp vendors. However, entry 84 in Schedule I to the Gujarat Sales Tax Act, 1969 specifically exempts sale of stamp papers by the licensed vendors from sales-tax. The very basis of the State Legislature enacting such exemption provision in respect of sale of stamp papers by the licensed vendors makes it clear that the sale of stamp papers by the licensed vendors to the customers would have, but for such exemption, been subject to sales tax levy. The question of levy of sales tax arises only because the licensed vendors themselves sell the stamp papers on their own and not as agents of the State Government. Had they been treated as agents of the State Government, there would be no question of levy of sales tax on sale of stamp papers by them, and consequently, there would have been no necessity for any exemption provision in this regard.

Therefore, although the Government has imposed a number of restrictions on the licensed stamp vendors regarding the manner of carrying on the business, the stamp vendors are required to purchase the stamp papers on payment of price less discount on "principal to principal" basis and there is no "contract of agency" at any point of time. The definition of "commission or brokerage" under clause (i) of the *Explanation* to section 194H indicates that the payment should be received, directly or indirectly, by a person acting on behalf of another person, *inter alia,* for services in the course of buying or selling goods. Therefore, the element of agency is required in case of all services and transactions contemplated by the definition of "commission or brokerage" under *Explanation (i)* to section 194H. When the licensed stamp vendors take delivery of stamp papers on payment of full price less discount and they sell such stamp papers to the retail customers, neither of the two activities (namely, buying from the Government and selling to the customers) can be termed as service in the course of buying and selling of goods. The High Court, therefore, held that discount on purchase of stamp papers does not fall within the expression "commission or brokerage" to attract the provisions of tax deduction at source under section 194H.

Supreme Court's Decision: The Supreme Court affirmed the above decision of the High Court holding that the given transaction is a sale and the discount given to stamp vendors for purchasing stamps in bulk quantity is in the nature of cash discount and consequently, section 194H has no application in this case.

5. **Can discount given on supply of SIM cards and pre-paid cards by a telecom company to its franchisee be treated as commission to attract the TDS provisions under section 194H?**

Bharti Cellular Ltd. v. ACIT (2013) 354 ITR 507 (Cal.)

High Court's Observations: On this issue, the Calcutta High Court observed the Supreme Court ruling in *Bhopal Sugar Mills' case (1977) 40 STC 42*, wherein it was held that the true relationship between the parties has to be gathered from the nature of the contract, its terms and conditions. The terminology used by the parties is not decisive of the said relationship.

The High Court, on perusal of the agreement between the assessee-telecom company and the franchisees, observed that –

(1) the property in the start-up pack and pre-paid coupons, even after transfer and delivery to the franchisee, remained with the assessee-telecom company;

(2) the franchisee really acted as a facilitator and/or instrument of providing services by the assessee-telecom company to the ultimate subscriber;

(3) the franchisee had no free choice to sell the pre-paid coupons and sim cards and everything including the selling price was regulated by the assessee-telecom company;

(4) the rate at which the franchisee sells to the retailers is also regulated and fixed by the assessee-telecom company.

In the real sense, the franchisee acted on behalf of the assessee-telecom company for selling start-up pack, prepaid recharge coupons to the customer. Therefore, the relationship between the assessee and the franchisee is essentially that of principal and agent, though the nomenclature used is "franchisee". The franchisees were, thus, agents of the assessee, getting a fixed percentage of commission, in the form of discount.

> High Court's Decision: Considering the above, the High Court held that there is an indirect payment of commission, in the form of discount, by the assessee-telecom company to the franchisee. Therefore, the assessee is liable to deduct tax at source on such commission as per the provisions of section 194H.

> Note - *Similar ruling was pronounced by the Kerala High Court in Vodafone Essar Cellular Ltd. v. ACIT (TDS) (2011) 332 ITR 255, wherein it was held that there was no sale of goods involved as claimed by the assessee-telecom company 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 consequently, the discount given to him was within the meaning of commission on which tax was deductible under section 194H.*

6. Are TDS provisions under section 194H attracted in a case where an assessee, a dairy, makes an outright sale of milk to its concessionaires at a certain price (which is lower than the MRP fixed by the assessee-dairy) and the concessionaires make full payment for the purchases on delivery and bear all the risks of loss, damage, pilferage and wastage?

CIT v. Mother Dairy India Ltd. (2013) 358 ITR 218 (Delhi)

High Court of Delhi

Facts of the case: The assessee-dairy undertook activities in connection with procurement, processing, storage and marketing including retail sale of milk and other products. The Dairy was called upon to explain why orders should not be passed under section 201(1)/(1A) treating it as an assessee in default, for failure on its part to deduct tax at source on the difference between the payments made by concessionaires to the assessee-dairy and the MRP at which the concessionaires had to sell the milk to the ultimate consumer, by the treating such difference as “commission” within the meaning of *Explanation (i)* to section 194H.

Assessee’s contention: In reply to the show cause notice, the assessee-dairy explained that it had sold the products to the concessionaires on a principal to principal basis, and the same can be evidenced from the following facts:

- the concessionaires bought the products at a given price after making full payment for the purchases on delivery;
- the milk and other products once sold to the concessionaires became their property and could not be taken back; and
- any loss on account of damage, pilferage and wastage was to the account of the concessionaires.

Owing to these facts, the assessee contended that the difference between payment made by the concessionaires and the MRP could not be treated as "commission" for services rendered and consequently, there was no liability on the part of the assessee to deduct tax at source.

Assessing Officer’s view: The Assessing Officer, however, contended that the relationship existing between the assesse-dairy and the concessionaires was not that of principal to principal but it was a relationship of a principal and an agent, due to the following reasons –

(i) The booths from which the concessionaires sold milk and other products of the assessee, were owned by the Dairy; and

(ii) Even after sale to the concessionaires, the assessee-dairy had a right to inspect the booths and check the milk and other products stored in the booth at any time.

Accordingly, he treated the difference between the bill value and the MRP fixed by the assessee-dairy as commission paid to the concessionaires on which the assessee-dairy ought to have deducted tax at source under section 194H.

Appellate Authorities’ view: The Commissioner (Appeals) concurred with the opinion of the Assessing Officer and passed an order affirming the Assessing Officer’s view.

The Tribunal, however, on a perusal of the agreement entered into between the assessee-dairy and the concessionaires as well as the other relevant facts of the case, observed that there was an actual sale of milk by the assessee to the concessionaires on delivery and that the assessee was not under any obligation to take back any portion of the unsold milk in any condition whatsoever. The Tribunal was of the view that the other conditions imposed on the concessionaires by the assessee such as the right to inspect the booths at any time, right to check the registers and ensure the proper usage of the equipment, furniture, machinery by the concessionaires did not affect the relationship of principal to principal between the assessee and the concessionaires. The Tribunal opined that such terms were included in the agreement only for the purpose of safeguarding the booths, the equipment, furniture etc. which were owned by the assessee. The Tribunal concluded that since the real test was whether the property in the milk and the products passed to the concessionaires at the time of delivery, and this test was satisfied, the difference between the price at which the assessee sold the milk and the other products to the concessionaires and the MRP at which the concessionaires were to sell them to the consumers was not liable to be treated as commission within the meaning of section 194H.

High Court's Observations: The High Court concurred with the Tribunal's ruling holding that the terms of the agreement clearly indicated that the relationship between the assessee and the concessionaire was on a principal to principal basis. The Dairy having given space, machinery and equipment to the concessionaire would naturally like to incorporate clauses in the agreement to ensure that its property is properly maintained by the concessionaire, especially because milk and other products are consumed in large quantities by the general public and any unattended defect in the storage facilities can cause serious health hazards. These terms are included in the agreement only to ensure the smooth operation of the system. Therefore, merely due to the existence of these clauses, it cannot be inferred that the relationship between the assessee and the concessionaire is that of principal and an agent.

High Court's Decision: The High Court opined that the issue had to be decided on the basis of the fact as to when and what point of time the property in the goods passed to the concessionaire. In this case, the concessionaire became the owner of the milk and products on taking delivery of the same from the assessee-dairy. Therefore the relationship between the assessee and the concessionaire is a Principal to Principal relationship. The High Court, therefore, held that the difference between the purchase price (price paid to the Dairy) and the MRP is the concessionaire's income from business and cannot be categorized as commission to attract the provisions of section 194H.

7. Can the difference between the published price and the 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.)

Facts of the case: 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.

High Court's Observations: 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.

High Court's Decision: 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, in that case, the Delhi High Court, 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.*

8. **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.)

Facts of the case: 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 (now, ₹ 1,80,000) 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.

Revenue's contentions: 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.

High Court's Decision: 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.

9. 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.)

High Court's Observations: 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.

High Court's Decision: 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.

10. Can the payment made by an assessee engaged in transportation of building material and transportation of goods to contractors for hiring dumpers, 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.)

Facts of the case: 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.

High Court's Observations: 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.

High Court's Decision: 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.

11. **Are the provisions of section 234D levying interest on excess refund attracted in a case where the refund granted to the assessee in pursuance of the order of Commissioner (Appeals) was reversed on account of setting aside of such order by the Tribunal?**

DIT (International Taxation) v. Delta Air Lines Inc. (2013) 358 ITR 0367 (Bom.)

Facts of the case: In the present case, the Assessing Officer disallowed the benefit of article 8 of the Double Taxation Avoidance Agreement between India and the U.S.A. (DTAA) to the assessee. The Commissioner (Appeals), on the other hand, held that the assessee was entitled to the benefit of article 8 of the DTAA. The Tribunal, however, set aside the order of the Commissioner (Appeals) and restored the order passed by the Assessing Officer. While giving effect to the order of the Tribunal, the Assessing Officer apart from levying interest under sections 234A and 234B, also levied interest under section 234D on the refund granted to the assessee pursuant to the order of Commissioner (Appeals).

Appellate Authorities' contention: The assessee challenged the order of the Assessing Officer levying interest under section 234D by filing an appeal before the Commissioner (Appeals). The Commissioner (Appeals) opined that since the refund was not granted under section 143(1), section 234D was not attracted. The Tribunal concurred with the view of the Commissioner (Appeals).

High Court's Decision: The High Court observed that interest under section 234D is chargeable only where the refund has been granted to the assessee while processing the return of income under section 143(1) and thereafter, such refund is found to be excessive under the regular assessment.

In the present case, the refund was not granted under section 143(1). The refund was not granted even by way of an assessment order passed under section 143(3) read with section 147. The same was granted pursuant to the order passed by the Commissioner (Appeals). Consequently, the High Court concurred with the Tribunal's view that the provisions of section 234D were not attracted in this case.

Note: Section 234D(1) provides that where any refund is granted to the assessee under section 143(1) and -

(a) no refund is due on regular assessment; or

(b) the amount refunded under section 143(1) exceeds the amount refundable on regular assessment,

the assessee shall be liable to pay simple interest @1½% on the whole or the excess amount refunded, for every month or part of a month comprised in the period from the date of grant of refund to the date of such regular assessment.

Explanation 1 to section 234D provides that where, in relation to an assessment year, the assessment is made for the first time under section 147 or section 153A, the assessment so made shall be regarded as regular assessment for the purpose of this section.

Therefore, the above provisions of section 234D(1) read with Explanation 1 thereto makes it clear that interest thereunder is attracted only in a case where refund is granted to the assessee under section 143(1), which becomes refundable on account of the order passed under section 143(3) or section 147 or section 153A.

12. Can refund of tax due to the assessee for a particular assessment year be adjusted, against sums due from the assessee in respect of another assessment year, under section 245, without giving prior intimation to the assessee of the proposed adjustment?

Jeans Knit P. Ltd. v. DCIT (2013) 358 ITR 0505 (Kar.)

Facts of the case: In the present case, the company is an export oriented unit. A certain deduction was disallowed for A.Y.2007-08 by the Assessing Officer, but subsequently, on appeal by the assessee, the same was allowed by the Commissioner (Appeals). Consequent to the order of Commissioner (Appeals), the assessee became entitled to a refund of ₹ 14.25 crores. While giving effect to the order of Commissioner (Appeals), the Assessing Officer adjusted the refund towards the tax demand for the A.Y. 2008-09.

High Court's Observations: On the issue of whether refund can be adjusted against demand for the subsequent year without prior intimation, the Karnataka High Court referred to the following High Court rulings–

(i) The Karnataka High Court's ruling in *Fosroc Chemicals (India) Ltd. v. CIT (2001) 248 ITR 607*, wherein it was observed that for the purpose of any adjustment of the amount due to the assessee by way of refund against an outstanding demand due from the assessee to the Revenue, an intimation in writing is required to be given to the concerned person of the action proposed. Proposed action would mean a notice before making the adjustments and not an intimation of making the adjustment. An order passed purporting to adjust the refund due to the assessee without prior intimation would be against the express provisions of law and is hence, bad in law. The provisions of section 245 are mandatory in nature.

(ii) The Delhi High Court's ruling *in Vijay Kumar Bhati v. CIT (1994) 205 ITR 110*, wherein it was held that any order of set-off of refund purporting to be made without prior intimation is neither fair, nor just, nor reasonable and has to be ignored.

(iii) The Calcutta High Court's ruling in *J.K. Industries Ltd. v. CIT (1999) 238 ITR 820*, wherein it was held that the Revenue has no jurisdiction to make an adjustment of a refund without following the provisions section 245 and without giving prior intimation to the assessee as required by that section.

High Court's Decision: In view of the above rulings, the Karnataka High Court, in this case, held that the communication informing the adjustment of refund, without prior intimation to the assessee, is illegal and contrary to law. Therefore, the High Court set aside the order in so far as it relates to adjustment of refund against tax due.

WEALTH TAX

17
WEALTH TAX

1. **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)

   <u>Revenue's Contentions</u>: 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.

   <u>High Court's Observations</u>: 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.

   <u>High Court's Decision</u>: 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.

2. **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)

   <u>Facts of the case</u>: 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 judgement without issue of any further notice under section 16(5). The assessee questioned 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.

High Court's Decision: 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 –

(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 being heard 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.