

CASE STUDIES

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CRITICAL JUDICIAL RULINGS IN QUESTION – ANSWER FORMAT

Case Study 1

Honda Siel Cars India Ltd. (assessee), is a joint venture company between Honda Motors, a Japanese company and Siel Ltd., an Indian company. The assessee and Honda Motors entered into a technical collaboration agreement (TCA) on May 21, 1996 under which a technical fee of 30.5 million USD was payable by the assessee in five equal instalments on a yearly basis. Under the agreement, TCA Honda Motors had to provide manufacturing facilities, know-how, technical information, information regarding intellectual property rights to the assessee which the assessee was entitled to exploit only as a licensee, without any proprietary rights.

Whether the technical fee of 30.5 million USD payable by the assessee is in the nature of revenue expenditure or capital expenditure?

Solution

Honda Siel Cars India Ltd. v. CIT [2017] 395 ITR 713 (SC)

The Supreme Court observed that if a limited right to use technical know-how is obtained for a limited period for improvising existing business, the expenditure is revenue in nature.

However, if technical know-how is obtained for setting up a new business, the position may be different. (That means it would be of capital nature)

Supreme Court further observed that there is no single principle or test for determining the nature of expenditure; it is a question to be answered based on the circumstances in each case.

In the given facts, the very purpose of the TCA was to set up the Joint Venture. The collaboration included not only transfer of technical information, but, complete assistance, actual, factual and on the spot, for establishment of plant, machinery, etc. so as to set up a manufacturing unit. Upon termination of TCA, the joint venture itself would come to an end.

Though the TCA is framed in a manner to look like a licence for a limited period having no enduring nature but a close scrutiny into the said agreement shows otherwise.

The Supreme Court held that, in this case, technical fee is capital in nature since upon termination of TCA, the joint venture itself would come to an end.

Readers Note:

Case Study 2

There have been conflicting interpretations by judicial authorities regarding disallowance under section 40(a)(ia). In that one of the view in favour of assessee was that disallowance under section 40(a)(ia) would be invoked only in respect of the amount which remained payable at the end of relevant financial year and not in respect of the amount which had actually been paid during the previous year without deduction of tax at source. This conflict has been done away by Supreme Court. You are required to mention that in whose favour conflict has been resolved and what are the reasons awarded by Supreme Court for bringing down the conflict.

Solution

Supreme Court in case of Palam Gas Service vs. CIT dated 4th May, 2017 held that Section 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid. In this behalf, one has to keep in mind the purpose with which Section 40 was enacted and that has already been noted above. We have also to keep in mind the provisions of Sections 194C and 200. Once it is found that the aforesaid Sections mandate a person to deduct tax at source not only on the amounts payable but also when the sums are actually paid to the contractor, any person who does not adhere to this statutory obligation has to suffer the consequences which are stipulated in the Act itself. Certain consequences of failure to deduct tax at source from the payments made, where tax was to be deducted at source or failure to pay the same to the credit of the Central Government, are stipulated in Section 201 of the Act. This Section provides that in that contingency, such a person would be deemed to be an assessee in default in respect of such tax. While stipulating this consequence, Section 201 categorically states that the aforesaid Sections would be without prejudice to any other consequences which that defaulter may incur. Other consequences are provided under Section 40(a)(ia) of the Act, namely, payments made by such a person to a contractor shall not be treated as deductible expenditure. When read in this context, it is clear that Section 40(a)(ia) deals with the nature of default and the consequences thereof. Default is relatable to Chapter XVIIIB (in the instant case Sections 194C and 200, which provisions are in the aforesaid Chapter). When the entire scheme of obligation to deduct the tax at source and paying it over to the Central Government is read holistically, it cannot be held that the word 'payable' occurring in Section 40(a)(ia) refers to only those cases where the amount is yet to be paid and does not cover the cases where the amount is actually paid. If the provision is interpreted in the manner suggested by the appellant herein, then even when it is found that a person, like the appellant, has violated the provisions of Chapter XVIIIB (or specifically Sections 194C and 200 in the instant case), he would still go scot free, without suffering the consequences of such monetary default in spite of specific provisions laying down these consequences.

Readers Note:

Case Study 3

Raj Dadarkar and Associates(assessee) acquired the right to conduct a market on certain land from Municipal Corporation, Greater Bombay under an auction on May 28, 1993. The premises allotted to it was a bare structure and it was for the assessee. The appellant spent substantial sums to construct 95 shops and 30 stalls. From the years 1999 to 2004, the assessee treated income from sub-letting of such shops and stalls as business income. The return of the assessee for assessment year 2000-2001 was reopened by Assessing Officer by issuing notice under section 148 treating the same as income under the under the head 'Income from house property'. Whether the action of assessing officer is justified?

Solution

Raj Dadarkar and Associates v. Assistant Commissioner of Income Tax [2017] 394 ITR 592 (SC)

The Supreme Court held that wherever there is an income from leasing out of premises, it is to be treated as income from house property. However, it can be treated as business income if letting out of

the premises itself is the business of the assessee. The question has to be decided based on the facts of each case as was held in *Sultan Brothers Pvt Ltd. v. CIT* [1964] 51 ITR 353 (SC).

In the given facts, it was an undisputed fact that the assessee **would be considered to be a deemed owner under section 27(iiiib)** read with section 269UA(f) as it had a leasehold right for more than 12 years.

The only evidence adduced for proving that letting out and earning rents is the main business activity of the appellant was the object clause of the partnership deed. The clause provided that "The Partnership shall take the premises on rent to sub-let or do any other business as may be mutually agreed by the parties from time to time."

The Supreme Court held the clause to be inconclusive and observed that the assessee had failed to produce sufficient material to show that its entire or substantial income was from letting out of the property.

The Supreme Court, accordingly, held that, in this case, the income is to be assessed as "Income from house property" and not as business income, on account of lack of sufficient material to prove that the substantial income of the assessee was from letting out of the property. Therefore, the contention of the assessing officer is justified in this case.

Readers Note:

Case Study 4

Berger Paints India Ltd (assessee) is a company engaged in the manufacture of paints. For the relevant assessment years, the assessee claimed deduction under section 35D of a sum representing share premium as being a part of the capital employed. However, the assessing officer stick to the definition of capital employed given under section 35D of the Act and therefore, not included share premium under "capital employed". Whether the action of assessing officer is justified?

Solution

Berger Paints India Ltd v. CIT [2017] 393 ITR 113 (SC)

The Supreme Court observed that the share premium collected by the assessee on its subscribed issued share capital could not be part of "capital employed in the business of the company" for the purpose of section 35D(3)(b). If it were the intention of the legislature to treat share premium as being "capital employed in the business of the company", it would have been explicitly mentioned.

Moreover, column III of the form of the annual return in Part II of Schedule V to the Companies Act, 1956 under Section 159 dealing with capital structure of the company provides the break-up of "issued share capital" which does not include share premium at the time of subscription.

Hence, in the absence of the reference in section 35D, share premium is not a part of the capital employed. Also, section 78 of the Companies Act, 1956 requires a company to transfer the premium amount to be kept in a separate account called "securities premium account".

Considering the above, the action of assessing officer not treating share premium as a part of "capital employed" is justified.

Readers Note:

Case Study 5

The assessee was a foreign company engaged in shipping business and was a tax resident of Denmark. The assessee had agents working for it across the globe, who booked cargo and acted as clearing agents. In India, the assessee had three agents. The assessee had set up and maintained a vertically integrated communication system called Maersk net system in order to help all its agents. The agents paid for the system on a pro rata basis. The Assessing Officer contended that the amounts paid by the Indian agents were fees for technical services taxable under Article 13(4) of the India and Denmark DTAA. The assessee argued that the arrangement was merely a cost sharing system and the payments were only a reimbursement of expenses. Whether the contention of assessee is correct?

Solution**Director of Income-Tax (International Taxation) v. A.P. Moller Maersk [2017] 392 ITR 186 (SC)**

The Supreme Court observed that, for the sake of convenience of its agents, the assessee had set up a centralised communication system which was an integral part of the international shipping business of the assessee. The expenditure incurred for running this system was shared by all the agents and payments to assessee were merely as reimbursement of expenses incurred. The payments could not be treated as fees for technical services.

Moreover, the Revenue authorities had accepted that assessee's freight income in the relevant assessment years was not chargeable to tax as it arose from the operation of ships in international waters in terms of Article 9 of the India and Denmark DTAA.

Once that was accepted and it was found that the communication system was an integral part of the shipping business, payments received from agents could not be treated as in lieu of any technical services.

The SC, accordingly, held that amounts paid by Indian agents to the non-resident company would not be liable to tax as fee for technical services under Article 13(4) of the India and Denmark DTAA.

Readers Note:**Case Study 6**

Whether payment of sums due, after the deadline stipulated by the Settlement Commission, would save the petitioner from withdrawal of immunity from prosecution?

Solution**Sandeep Singh v Union of India [2017] 393 ITR 77 (SC)**

The Supreme Court explained that in case payments are not made within the time granted by the Settlement Commission or in case the person fails to comply with any other condition, subject to which the immunity was granted, the immunity shall stand withdrawn.

It is not in dispute that all payments were made by the assessee on January 20, 2016 before approaching the Supreme Court. Though the time originally granted was only up to July 31, 2015, all sums having been paid now, there is no need to relegate the assessee to the Settlement Commission. Settlement Commission has the power to extend the timelines. Hence, in the instant case, it shall be taken that the assessee has made the payments within the time granted under section 245H(1A).

The Supreme Court held that the assessee having cleared all taxes due vide order of Settlement Commission, albeit after stipulated deadline, is immune from prosecution.

Readers Note:

Case Study 7

Is loan to HUF who is a shareholder in a closely held company chargeable to tax as deemed dividend?

Solution**Gopal & Sons (HUF) v. CIT (2017) 391 ITR 1 (SC)****Facts of the case:**

The assessee is a HUF which holds 37.12% shares in M/s. G.S. Fertilizers (P.) Ltd., a closely held company. During the relevant previous year, it received loans and advances from the company. Its return was scrutinized by the Assessing Officer who treated the loans and advances as deemed dividend under section 2(22)(e). The company declared in its annual return that the advances were given to the HUF but the share certificates were issued in the name of the HUF's Karta, Shri Gopal Kumar Sanei. The assessing officer treated such advance as deemed dividend under section 2(22)(e) of the Act. Whether action of assessing officer is correct?

Supreme Court's Observations:

When a loan is given by a closely held company, it is chargeable to tax as deemed dividend if the loan was given to a shareholder (having more than 10% shares in the company) or to a concern in which the shareholder has substantial interest (having more than 20% share in the concern). 'Concern' includes HUF.

In the instant case, loans were given to the HUF. There was some dispute as to who was the shareholder - the Karta or the HUF as share certificates were issued in the name of the former but the annual return mentioned the latter. The Court observed that in either scenario, section 2(22)(e) would be attracted. If the HUF was the shareholder, as it held more than 10% shares, situation was covered. If the Karta was the shareholder, the HUF would be the concern in which the Karta has substantial interest.

Further, on the issue whether a HUF can be a shareholder or not, it was observed that on account of Explanation 3 to section 2(22)(e), a concern includes a HUF.

The Supreme Court, accordingly, held that the loan amount is to be assessed as deemed dividend under section 2(22)(e).

Therefore, the action of assessing officer treating this advance as deemed dividend is in accordance with law.

Readers Note:**Case Study 8**

The assessee owned vast area of agricultural land. The State Government acquired the property for development of a techno park. The assessee was awarded compensation of Rs.14.37 lakhs. Aggrieved by the amount, the assessee initiated negotiations with the Collector, further to which compensation was increased to Rs.38.42 lakhs. The assessee claimed exemption from capital gains under section 10(37)(iii) stating that the transfer of agricultural land was on account of compulsory acquisition. The Revenue authorities contended that the exemption should be denied as it was not a compulsory acquisition but a voluntary sale. Whether contention of revenue is correct?

Solution**Balakrishnan v. Union of India & Others (2017) 391 ITR 178 (SC)**

The Supreme Court observed that the acquisition process was initiated under the Land Acquisition Act, 1894. The assessee entered into negotiations only for securing the market value of the land without having to go to the Court.

Merely because the compensation amount is agreed upon, the character of acquisition will not change from compulsory acquisition to a voluntary sale.

The Court also drew attention to a recently enacted legislation titled, Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013, which empowers the Collector to pass an award with the consent of the parties. Despite the provision for consent, the acquisition would continue to be compulsory.

The Supreme Court held that when proceedings were initiated under the Land Acquisition Act, 1894, even if the compensation is negotiated and fixed, it would continue to remain as compulsory acquisition. The claim of exemption from capital gains u/s 10(37)(iii) is, therefore, tenable in law.

Considering the above, the action of revenue authority is not justified

Readers Note:

Case Study 9

The assessee had a diagnostic laboratory in Kollam and a branch at Kottarakara. A survey under Section 133A was conducted, consequent to which the assessee filed its return of income. On the basis of certain incriminating documents and materials unearthed during the survey, a notice under section 148 was issued. Subsequently, the incomes were assessed for assessment years 2009-10 and 2010-11 under section 143(3) read with section 147.

The assessee raised additional jurisdictional grounds before the Appellate Tribunal. The assessee contended that for the assessment year 2009-10, the assessment was completed under section 143(3) read with section 147. However, a notice under section 143(2) was not issued. The assessee participated in re-assessment proceedings. Whether failure to issue notice under section 143(2) would vitiate the assessment notwithstanding the assessee's participation in the proceedings? Would section 292BB come to the rescue of the Revenue authority if they omit to issue notice under section 143(2)?

Solution**Travancore Diagnostics (P) Ltd v. Asstt. CIT (2017) 390 ITR 167 (Ker)**

High Court observed that the Apex Court had, in Asstt. CIT v. Hotel Blue Moon (2010) 321 ITR 362, held that without the statutory notice under section 143(2), the Assessing Officer could not assume jurisdiction. Here, Assessing Officer recorded his inability to generate a notice as the return was not filed electronically. Such defect cannot be cured subsequently, since it is not procedural but one that goes to the root of the jurisdiction.

Even though the assessee had participated in the proceedings, in the absence of mandatory notice, section 292BB cannot help the Revenue officers who have no jurisdiction, to begin with. Section 292BB helps Revenue in countering claims of assessee who have participated in proceedings once a due notice has been issued.

Readers Note:

Case Study 10

Is interest on enhanced compensation under section 28 of the Land Acquisition Act, 1894 assessable as capital gains or as income from other sources?

Solution**Movaliya Bhikhubhai Balabhai v. ITO (TDS) (2016) 388 ITR 343 (Guj)**

The High Court observed that the assessee has received interest under section 28 of the Land Acquisition Act, 1894 which represents enhanced value of land and thus, partakes the character of compensation and not interest. Hence, the interest under section 28 is liable to be taxed under the head of 'Capital Gains' and not under 'Income from Other Sources'.

On the other hand, interest under section 34 of the Land Acquisition Act, 1894 is for the delay in making payment after the compensation amount is determined. Such amount is liable to be taxed under the head 'Income from Other Sources'.

High Court's Decision: The High Court held that the interest awarded under section 28 of the Land Acquisition Act, 1894 was not liable to tax under the head of 'Income from other sources' and thus, was not deductible at source. The Revenue authority had erred in refusing to grant a certificate under section 197 to the petitioner for non-deduction of tax at source.

Readers Note:

Case Study 11

Whether the Assessing Officer is bound to consider the report of Departmental Valuation Officer (DVO) when it is available on record for the purpose section 50C of the Act?

Solution**Principal CIT v. Ravjibhai Nagjibhai Thesia (2016) 388 ITR 358 (Guj)**

The High Court observed that when the Assessing Officer has referred the matter to DVO, the assessment has to be completed in conformity with the estimate given by the DVO.

As the DVO has estimated the value of the capital asset at an amount lower than the value assessed by the stamp valuation authority, as per 50C(2), it is such valuation which is required to be taken into consideration for the purposes of assessment.

Readers Note:

Case Study 12

Does the CIT (Appeals) have the power to change the status of assessee?

Solution

High court in case of Mega Trends Inc. v. CIT (2016) 388 ITR 16 (Mad) observed that, under section 251(1), the powers of the first appellate authority are coterminous with those of the Assessing Officer and the appellate authority can do what the Assessing Officer ought to have done and also direct him to do what he had failed to do. If the Assessing Officer had erred in concluding the status of the assessee as a firm, it could not be said that the Commissioner (Appeals) had no jurisdiction to go into the issue. The appeal was in continuation of the original proceedings and unless fetters were placed upon the powers of the appellate authority by express words, the appellate authority could exercise all the powers of the original authority.

The High Court therefore held that the power to change the status of the assessee is available to the assessing authority and when it is not used by him, the appellate authority is empowered to use such power and change the status. For this purpose, the Court relied on a full bench decision of the Madras High Court in *State of Tamil Nadu v. Arulmurugan and Co.* reported in [1982] 51 STC 381 to come to such conclusion.

Readers Note:
