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DIRECT TAX REVIEW
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CBDT revises monetary limits for filing appeals; issues measures to reduce litigation

Reference is invited to Board's Instruction No. 3/2011, dated 09/02/2011 wherein monetary limits and other conditions for filing departmental appeals (in Income-tax matters) before Appellate Tribunal, High Courts and Supreme Court were specified. In supersession of the above instruction, it has been decided by the Board that departmental appeals may be filed on merits before Appellate Tribunal, High Courts and Supreme Court keeping in view the monetary limits and conditions specified below.

Henceforth appeals shall not be filed in cases where the tax effect does not exceed the monetary limits given hereunder:

Appeals in Income-tax matters Monetary Limit	Amount in Rs.
Before Appellate Tribunal	400,000
U/s 260A before High Court	1,000,000
Before Supreme Court	2,500,000

It is clarified that an appeal should not be filed merely because the tax effect in a case exceeds the monetary limits prescribed above. Filing of appeal in such cases is to be decided on merits of the case.

For this purpose, "tax effect" means the difference between the tax on the total income assessed and the tax that would have been chargeable had such total income been reduced by the amount of income in respect of the issues against which appeal is intended to be filed (hereinafter referred to as "disputed issues"). However the tax will not include any interest thereon, except where chargeability of interest itself is in dispute. In case the chargeability of interest is the issue under dispute, the amount of interest shall be the tax effect. In cases where returned loss is reduced or assessed as income, the tax effect would include notional tax on disputed additions. In case of penalty orders, the tax effect will mean quantum of penalty deleted or reduced in the order to be appealed against.

The Assessing Officer shall calculate the tax effect separately for every assessment year in respect of the disputed issues in the case of every assesse. If, in the case of an assessed, the disputed issues arise in more than one assessment year, appeal, can be filed in respect of such assessment year or years in which the tax effect in respect of the disputed issues exceeds the monetary limit specified in para 3. No appeal shall be filed in respect of an assessment year or years in which the tax effect is less than the monetary limit specified in para 3. In other words, henceforth, appeals can be filed only with reference to the tax effect in the relevant assessment year. However, in case of a composite order of any High Court or appellate authority, which involves more than one assessment year and common issues in more than one assessment year, appeal shall be filed in respect of all such assessment years even if the 'tax effect' is less than the prescribed monetary limits in any of the year(s), if it is decided to file appeal in respect of the year(s) in which 'tax effect' exceeds the monetary limit prescribed. In case where a composite order/judgment involves more than one assessee, each assessee shall be dealt with separately.

In a case where appeal before a Tribunal or a Court is not filed only on account of the tax effect being less than the monetary limit specified above, the Commissioner of Income-tax shall specifically record that "even though the decision is not acceptable, appeal is not being filed only on the consideration that the tax effect is less than the monetary limit specified in this instruction". Further, in such cases, there will be no presumption that the Income-tax Department has acquiesced in the decision on the disputed issues. The Income-tax Department shall not be precluded from filing an appeal against the disputed issues in the case of the same assessee for any other assessment year, or in the case of any other assessee for the same or any other assessment year, if the tax effect exceeds the specified monetary limits.

Delhi HC rules sale of CCDs is capital gains and exempt under India Mauritius DTAA

The Delhi High Court (HC) has set aside the ruling of the Authority for Advance Ruling (AAR) in the case of Zaheer Mauritius. The AAR had ruled that the gains arising on sales of equity shares and compulsorily convertible debentures (CCDs) were taxable as interest income. The HC has now held that these gains should be characterised as capital gains.

Zaheer Mauritius was a company incorporated in Mauritius and was a tax resident of Mauritius. It was engaged in investing in Indian companies undertaking construction and development activities in India. SH Tech Park Developers Private Limited (the JV Company), an Indian company, was incorporated as a wholly owned subsidiary of Vatika Limited (Vatika). Zaheer Mauritius entered into a Securities Subscription Agreement and a Shareholder's Agreement (SHA) with Vatika and the JV Company to invest in the JV Company by subscribing to equity shares and CCDs.

The SHA recorded the terms of the relationship between Zaheer Mauritius,Vatika and the JV Company and their inter se rights and obligations, including matters relating to transfer of equity shares and the management and operation of the JV Company. The SHA also ascribed a call option to Vatika to buy the securities from Zaheer Mauritius and a put option to Zaheer Mauritius to sell the securities to Vatika.

Vatika exercised the call option, and purchased all the CCDs and some of the equity shares from Zaheer Mauritius Zaheer Mauritius filed an application under section 197 of the Income-tax Act, 1961 (the Act) before the Tax Officer, requesting a nil withholding tax certificate in relation to the transfer of CCDs and shares. However, the TO held that the gains on the transfer of equity shares and CCDs would be treated as interest, and that tax at 20% (plus applicable surcharge and education cess) should be withheld.

Zaheer Mauritius filed an application before the AAR to obtain a ruling on whether the gains arising on the sale of equity shares and CCDs were exempt from capital gains tax in India under Article 13(4) of the India-Mauritius Double Taxation Avoidance Agreement (tax treaty). The AAR ruled that the gains were taxable as interest within the meaning of section 2(28A) of the Act and Article 11 of the tax treaty.

Issues before the High Court

Whether the gains arising on the transfer of equity shares and CCDs by Zaheer Mauritius to Vatika were taxable as capital gains or as interest income.

Zaheer Mauritius's contentions

There was no debtor and borrower relationship between Zaheer Mauritius and Vatika. The CCDs were held by Zaheer Mauritius as a capital asset and the transfer of these investments was liable to be treated as capital gains, and was accordingly exempt under Article 13(4) of the tax treaty. The transaction entered into between Zaheer Mauritius, Vatika and the JV Company was an investment in shares and CCDs, and not a loan transaction.

Revenue's contentions

The transaction entered into by Zaheer Mauritius and Vatika was essentially in the nature of external commercial borrowing (ECB). Under the terms of the agreement, Zaheer Mauritius was entitled to receive a fixed rate of return determined by the duration of the investment. Hence, the transaction should be viewed as a loan transaction and returns on the investment should be taxed as interest income.

High Court's ruling

The HC stated that under normal circumstances, gains arising on the transfer of a debenture held as a capital asset by the transferor would be taxable as capital gains and not interest.

The HC found that the AAR's conclusion (that returns on the investment should be taxed as interest income) had been based on the following findings:

- There was a fixed rate of return on the investment;
- The JV Company's affairs were controlled by Vatika/ its shareholders;
- The transaction was structured as an investment in equity shares and CCDs to avoid tax.

The HC observed that the clauses in the SHA relating to the call/ put options could not be read to mean that Zaheer Mauritius was entitled to a fixed return on its investments. Merely because an investment agreement provided an exit option to the investor, this would not change the nature of the investment made.The HC held that it was common in any joint venture agreement for the co- venturers to include covenants for buying each other's stakes. Although the SHA enabled Zaheer Mauritius to exit the investment by receiving a reasonable return on it, this could not be read to mean that the CCDs were fixed- return instruments. Zaheer Mauritius also had the option to continue with its investment as an equity shareholder in the JV Company (following the conversion of the CCDs into equity shares).

Based on the reading of the corporate governance and other related clauses in the SHA, the HC observed tha the affairs of the JV Company were managed separately and distinctly from those of Vatika. The HC acknowledged that in accordance with the foreign direct investment guidelines, CCDs were the most appropriate way of routing investments in the JV Company. In such circumstances, it ought not to be readily inferred that the entire structure of the transaction was designed solely for the purposes of avoiding tax.

The HC considered that if the gains were considered as interest paid by Vatika, they would also qualify a deductible expenditure in the hands of Vatika. In view of this, it would be an error to conclude that the transaction had been structured to avoid tax. The HC considered that if the gains were considered as interest paid by Vatika, they would also qualify as deductible expenditure in the hands of Vatika. In view of this, it would be an error to conclude that the transaction had been structured to avoid tax.

Therefore, the ruling of the HC reinforces the position that gains arising on the transfer of CCDs should be taxed as capital gains. By adopting a holistic view of the transaction, the HC has emphasized the importance of the "look at test" to ascertain the true nature of transactions. If there are sufficient commercial reasons for structuring a transaction in a particular way, the form of the transaction should be respected, and the legal nature of the transaction should not be ignored.

Further, the said decision is rendered taking into consideration various clauses and terms of the SHA. Hence, it would be important to examine the actual documentation and facts of each case for deciding the applicability.

Penalty cannot be levied merely because an amount is not allowed or taxed as income

Hon'ble Supreme Court in the case of M/s Hindustan Steel Ltd. vs State of Orissa (1972) 83 ITR 26(SC) and decision of Hon'ble High Court of Delhi in Escorts Finance Ltd. (2009) 226 CTR (Del) 105 wherein it was held that where facts are clearly disclosed in the return, penalty cannot be levied merely because an amount is not allowed or taxed as income.

Turning to the facts and circumstances of the present case, admittedly, the assessee made claim of deduction u/s 80HHC of the Act which was reduced during the reassessment proceedings finalized u/s 263/143(3) of the Act and a substantial part of the claim of the assessee for deduction u/s 80HHC of the Act was reduced and the AO held that the assessee was entitled to claim deduction u/s 80HHC of the Act of ₹25,13,742 or against the deduction of ₹58,00,945 as claimed by the assessee in its return of income. In this factual matrix, while the AO passed an order of reassessment in pursuance to order of CIT u/s 263 of the Act and on recomputation of deduction, the AO allowed the claim of the assessee for deduction u/s 80HHC Act at a lower figure but even in this situation, it cannot be inferred that the assessee has concealed its particulars of income or has furnished inaccurate particulars of its income. Thus, we come to a conclusion that the CIT was right in following decision of Hon'ble Supreme Court in the case of CIT vs Reliance Petroproducts Pvt. Ltd. (supra) and the CIT deleted the penalty on just and cogent reason because penalty cannot be levied merely because the assessee's claim was not accepted or was not acceptable to the revenue, that by itself would not attract the penalty u/s 271(1)(c) of the Act. Accordingly, we are unable to see any ambiguity, perversity or any other valid reason to interfere with the impugned order and appeal of the revenue being devoid of merits is dismissed.

No disallowance U/s 14A if there is no exempt income

Counsel for the assessee submits that assessee has not received any exempt income and in the absence of the assessee receiving any exempt income, there is no justification in deriving expenses attributable for earning income which is not received by the assessee. He places reliance on the recent decision of the Hon'ble Allahabad High Court in the case of CIT Vs. M/s. Sivam Motors Pvt.Ltd. in I.T. Appeal No.88 of 2014 dated 5.5.2014 for the assessment year 2008-09, the decision of the Hon'ble Gujarat High Court in the case of CIT Vs. Corrtech Energy Pvt. Ltd. in Tax Appeal No.239 of 2014 dated 24.3.2014 for the assessment year 2009-10 and the decision of Hon'ble Bombay High Court in the case of CIT Vs. Delite Enterprises in Tax Appeal No.110 of 2009 dated 26.2.2009. Counsel for the assessee submits that even otherwise the Assessing Officer should have excluded share application money in various companies which will not produce any exempt income. He submits that if such share application money is excluded the disallowance under section 14A of the Act will works out to ₹5,61,125/- as against disallowance of ₹19,28,666/- made by the Assessing Officer. For the proposition that share application money is not investment for the purpose of section 14A, he places reliance on the decision of the Tribunal in the case of Rainy Investments Pvt. Ltd. Vs. ACIT in I.T. Appeal No.5491/Mum/2011 dated 16.1.2013.

Heard both sides. Perused orders of lower authorities and submissions made by the assessee and the decisions in relied on. No doubt in the decision of the Special Bench of Delhi Tribunal in the case of Cheminvest Ltd. Vs. ITO (supra), the Special Bench held that disallowance under section 14A can be made even in the year in which no exempt income has been earned or received by the assessee. This decision of Special Bench of the Tribunal has been impliedly overruled by the decisions of High Courts in the following cases:

- CIT Vs. M/s. Sivam Motors Pvt.Ltd. (Allahabad High Court) I.T. Appeal No.88 of 2014 dated 5.5.2014
- CIT Vs. Corrtech Energy Pvt. Ltd. (Gujarat High Court) Tax Appeal No.239 of 2014 dated 24.3.2014
- CIT Vs.Delite Enterprises (Bombay High Court) Tax Appeal No.110 of 2009 dated 26.2.2009

- CIT Vs. M/s. Lakhani Marketing (Punjab & Haryana High Court) ITA No.970 of 2008 dated 2.4.2014
- CIT Vs. Winsome Textiles Industries Ltd. (Punjab & Haryana High Court) (319 ITR 204)

In the case of CIT Vs. Winsome Textiles Industries Ltd. (319 ITR 204) the Hon'ble Punjab & Haryana High Court held that when there is no claim for exemption of income in such situation section 14A has no application. Respectfully following the above decisions, we delete the disallowance made under section 14A as the assessee has not earned / received for exempt income during the previous year relevant to the assessment year under appeal.

How to close Short TDS Payment Defaults using Online Correction facility?

CPC (TDS) -Advisory for closure of Short Payment Defaults using Online Correction facility before allowing Conso Files.

At the time of filing TDS statements, it is mandatory to quote the challan particulars through which TDS payments have been made. The TDS forms prescribe quoting of such challans and the underlying deductee transactions corresponding to such challans.

However, it is observed that:

- At times, data entry mistakes are committed, while reporting tax payments in the respective TDS statements.
- Though CPC (TDS) makes best efforts to match such challans, however, they may remain unmatched leading to "Short Payment" demand.
- The above results into issuance of notices by the field officers.

To make the resolution process non-intrusive, CPC (TDS) proposes a new change while submitting request for download of the Consolidated (Conso) file for a particular quarter. If there is a "Short Payment defaults" on account of unmatched challans for the relevant quarter, the deductor would be provided with online view of all available unconsumed challans, which can be tagged with deductees, to close the above default.
Following are key information to be noted in this regard:

- CPC (TDS) mandates to close the above default by tagging unconsumed challans, if available in CPC(TDS) system, through online correction (without digital signature).
- In case there is no available challan for consumption, the deductor is required to first deposit the due tax in the bank and then the same challan will be available for tagging in CPC (TDS) system after around 3-4 days of deposit.
- The Online Correction facility of TRACES needs to be used for closure of the Short Payment default.
- The user will not be able to download Conso file for the relevant TDS statement on closure of the above default.

- Once the challan is suitably tagged, CPC (TDS) shall suo moto reprocess the cases thereby reducing the Short Payment default by equivalent amount.

What Actions to be taken:

- During submission of request for Conso File, a message will be displayed, if there are Short Payment defaults in the TDS statement and instructions will be provided to submit Online Correction.
- Details of defaults will be provided during Online Correction process.
- In case of insufficient challans, please use Challan ITNS 281 to pay the demand or use any other Challan, which has adequate balance available.
- Submit an Online Correction using the functionality on TRACES to tag the challans with deductee rows. Login to TRACES and navigate to "Defaults" tab to locate "Request for Correction" from the drop-down list.

Online Challan Corrections:

- A list of all Matched and Unmatched challans can be viewed by clicking the appropriate tab.
- Unmatched challans can be corrected and tagged to Deductee rows in the statement.
- The corrections in TDS statements can be raised even without Digital Signature
- Correct KYC information needs to be submitted for the purpose of validation.
- All previous corrections pertaining to the statement should have been processed and the processing status can be verified from the Dashboard.

Interest Expense incurred to earn Interest Income is allowable – Section 57(iii)

Raj Kumari Agarwal vs. DCIT (ITAT Agra), I.T.A. No.: 176/Agra/2013, Date of pronouncing the order: July 18th, 2014

AO Must refer valuation to DVO if assessee claims that actual market value of the land or building is less than stamp duty valuation.

Once the assessee claims that the actual market value of the land or building is less than stamp duty valuation adopted by the authorities, it is incumbent upon the Assessing Officer to refer the valuation of said land or building to the departmental valuation officer. In the present case, the Assessing Officer has not done so. In view of this factual position, and in the light of the discussions above, we deem it fit and proper to remit the matter to the file of the Assessing Officer for adjudication de novo after making a reference to the DVO, and completing the assessment on the basis of the valuation so received from the DVO. While so deciding the matter afresh, the Assessing Officer will decide the matter in accordance with the law, by way of a speaking order and after giving a reasonable opportunity of hearing to the assessee. We direct so.

Interest Expense incurred to earn Interest Income is allowable – Section 57(iii)

During the course of the assessment proceedings, the Assessing Officer noticed that the assessee had made a fixed deposit of ₹1,00,00,000 with ICICI Bank and earned interest of ₹11, 77,574 on these deposits. However, while computing the income from other sources, the assessee claimed a deduction of ₹4,36,705 on account of interest paid on loan of ₹75,00,000 taken, on the security of deposits. When asked to justify this deduction, the assessee submitted that the assessee needed her funds, as she had to give money to her son and with a view to avoid premature encashment of the fixed deposits, for that purpose, which would have resulted in net loss to her, she took a loan against fixed deposit so as to keep the fixed deposit intact and earn the interest income thereon. It was contended that the interest of ₹4, 36,705 thus paid on the borrowings from ICICI Bank, against security of fixed deposit, was thus made for the purpose of earning FDR interest income of ₹11,77,574. The Assessing Officer was, however, not impressed with this plea. He rejected the claim of deduction for ₹4,36,705 with rather cryptic observations that, "since the expenditure of ₹4,36,705 being accrued interest on loan has not been laid out or expended wholly and exclusively for the purpose of making or earning income from FDRs, claim of the assessee is not correct and not admissible in view of the provisions of Section 57 (iii) of the Act". Aggrieved by the stand so taken by the Assessing Officer, assessee carried the matter in appeal before the CIT (A) but without any success.

There is no dispute that interest income in this case is to be taxed as an 'income from other sources'. Section 57(iii) of the Act clearly provides that "the income chargeable under the head 'income from other sources' is to be computer making the deduction, namely.. (inter alia)… any…expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income". It is thus clear that as long as expenditure is incurred wholly or exclusively for the purpose earning an income, such expenditure constitutes an admissible deduction in computation of the income.

The question that we really need to adjudicate on is, therefore, whether or not income paid on interest against the fixed deposits can be said to have been incurred "wholly and exclusively" for the purpose of earning interest income from fixed deposits.

As long as the expense is incurred wholly and exclusively for the purpose of earning an income, even if it is not necessarily for earning that income, it will still be deductible in computation of income. What thus logically follows is that even in a situation in which proximate or immediate cause of an expenditure was an event unconnected to earning of the income, in the sense that the expenditure was not triggered by the objective to earn that income, but the expenditure was, nonetheless, wholly and exclusively to earn or protect that income, it will not cease to be deductible in nature. It is also important to bear in mind the fact that a borrowing against fixed deposit cannot be considered in isolation of a fixed deposit itself inasmuch as, going by the admitted facts of this case, the interest chargeable on the fixed deposit itself is linked to the interest accruing and arising from the fixed deposit. On these facts, in order to protect the interest earnings from fixed deposits and to meet her financial needs, when an assessee raises a loan against the fixed deposits, so as to keep the source of earning intact, the expenditure so incurred in wholly and exclusively to earn the fixed deposit interest income. The authorities below were apparently swayed by the fact that the borrowings were triggered by assessee's financial needs for personal purposes and, by that logic, the borrowing cannot be said to be wholly and exclusively for the purposes of earning interest income, but what this approach overlooks is whether the expenditure is incurred for directly contributing to the beginning of or triggering the source of income or whether the expenditure is for protecting, and thus keeping alive, that source of income, in either case it is expenditure incurred wholly and exclusively for the purpose of earning that income. The assessee indeed required that money, so raised by borrowing against the fixed deposits, for her personal purposes but that is not relevant for the present purposes. The assessee could have gone for premature encashment of bank deposits, and thus ended the source of income itself, as well, but instead of doing so, she resorted to borrowings against the fixed deposit and thus preserved the source of earning. The expenditure so incurred, in our considered view, is an expenditure incurred wholly and exclusively for earning from interest on fixed deposits. We are alive to the fact that in the case of a business assessee, and in a situation in which the borrowings against fixed deposits were resorted to for use in business, consideration for end use of funds so borrowed would be relevant because the interest deduction is claimed as a business deduction under section 36(1)(iii). That aspect of the matter, however, is academic in the present context as the limited issue for our consideration is whether or not, on the facts before us, the interest on borrowings against the fixed deposits could be said to protect the interest income from fixed deposit interest and thus, incurred wholly and exclusively for the purposes of earning such incom

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