VERENDRA KALRA & CO
CHARTERED ACCOUNTANTS

Like always,
Like never before...

DIRECT TAX REVIEW
MAY 2018

Inside this edition

- ITAT deletes section 68 addition on account of share premium receipt
- Delay to invest in REC bonds for non-availability cannot deny section 54EC benefit
- No automatic denial of exemption u/s. 11 for violating Sec. 13(1) condition
- Issuing share capital at excess premium not taxable in hands of eligible start-ups, CBDT notifies

& more...

Supreme Court Rulings of the month

SC dismisses assessee's SLP, FD interest assessable as business income ineligible for 80IC deduction

SC dismisses assessee's SLP against Uttarakhand HC decison denying Sec.80-IC deduction on interest earned on fixed deposit with bank for AY 2009-10 as it is not 'dervied from' eligible business.

HC had observed that the Legislature has chosen to employ the word 'derived' in sec.80-IC as distinguished from 'attributable to'; HC remarked that "Had the Legislature used the words "attributable to", then it would have a much wider effect and it may have encompassed within itself, the income, which is the subject matter of controversy before us".HC further affirmed AO's order holding that interest income qualifies as business income u/s. 28 but no deduction can be allowed u/s 80-IC.

Source: SC of India in the case of Conventional Fastners Vs Commissioner of Income Tax, Dehradun

Special Leave Appeal nos. 12610 of 2018, date of publication May 18, 2018

***

High Court Rulings of the month

HC applying the Principle of Natural Justice, treats TDS default order u/s 201 as 'show-cause' notice to assessee

Madras HC directs the order u/s 201(1)/(1A) (for TDS default on payments to non-resident) **be treated as 'show-cause' notice to the assessee instead of remitting back the matter for a fresh consideration.** HC observes that 'principles of natural justice' have not been followed by the revenue while passing the order, notes that materials which have been referred to in the order passed by AO were never disclosed to the assessee. HC also notes that AO's order does not deal with all the factual objections raised by the assessee and HC concludes that "The respondent having referred to several materials and information not pertaining to the petitioner/assessee in the impugned order and arriving at a conclusion against the petitioner largely based on such information, the impunged proceedings can be directed to be treated as a show cause notice"; Directs the assessee to submit preliminary objections wherein it can also raise plea of limitation (initiation of TDS default proceedings beyond 6 years) and AO after affording opportunity of personal hearing to the assessee, pass fresh order in accordance with Law.

Source: HC of Judicature at Madras in the case of M/s International Seaport Dredging Pvt. Ltd Vs DCIT, International Taxation, Chennai W.P Nos. 10319 & 10320 of 2018, date of publication May 17, 2018

***

ITAT Rulings of the month

ITAT deletes section 68 addition on account of share premium receipt

Mumbai ITAT deletes sec. 68 addition on account of share premium received by assessee-company during AY 2012-13 from its Hong Kong based holding companie. Relied on Bombay HC ruling in case of

Vodafone India Services Private Limited wherein it was held that **issue of shares at premium is a capital account transaction and does not give rise to income chargeable to tax**, and also observes that this position is accepted by CBDT in its instruction No. 2 /2015. Rejects revenue's contention that Bombay HC ruling cannot be relied upon since it was rendered in context of TP proceedings and not in context of Sec. 68. Further rejects revenue's stand that the share premium charged was in excess of the intrinsic valuation of shares and therefore, addition u/s. 68 was warranted, observes that RBI has accepted the valuation of shares under DCF method (supported by CA Certificate). Moreover, ITAT notes that Sec 56(2)(viib) on excess share premium taxability was introduced by Finance Act, 2012 and it is not applicable to consideration received towards shares premium from non-resident entities.

Source: ITAT Mumbai Bench in the case of M/s Finproject India Private Ltd Vs DCIT, Mumbai

IT. Appeal no. 4860/Mum/2016, date of publication May 10, 2018

***

Taxation on Income in the A.Y. of its receipt instead of accrual does not cause loss to the Revenue where there is no difference in the tax rates

The expenses to earn the disputed income were made in previous AY, however, the assessee has accounted for the income in the assessment year, wherein, the bills were raised and income was received. Moreover, as held by **the Hon'ble Supreme Court in case of CIT v/s Excel Industries Ltd., when the tax rate applicable in both the years is same there is no loss to the revenue if the income is assessed in the subsequent assessment year.**

Source: ITAT Mumbai Bench in the case of M/s Deloitte Touche Tohmatsu Vs DCIT, Mumbai

IT. Appeal no. 3017/Mum/2016, date of publication May 17, 2018

***

Delay to invest in REC bonds for non-availability cannot deny section 54EC benefit

Tribunal held that, the issue that arises in the present appeal is regarding the benefit of deduction u/s 54EC on account of purchase of Rural Electrification Bonds after the specified time. In the present case, the assessee had sold the capital asset on Oct 25, 2006 and, therefore, for claiming deduction u/s 54EC, he should have made the investment on or before Apr 25, 2007 i.e. within six months from the date of earning of the capital gain. However, in the instant case, the assessee has invested in Rural Electrification Bonds on July 23, 2007. The submission of AR that the Rural Electrification Bonds were not available between Mar 31, 2007 to July 02, 2007 could not be controverted by the DR. Under these circumstances, it has to be adjudicated as to whether the assessee is entitled to deduction u/s 54EC when such bonds were not purchased during the time limit as prescribed u/s 54EC but were purchased subsequent to the date when such bonds were made available in the market.

It is found that the Pune Bench of the Tribunal in the case of Phansalkar Suman Jaikrishna, under identical facts and circumstances has allowed the claim of deduction u/s 54EC by observing that: *"....Lex not cogit impossibila (law does not compel a man to do that which he cannot possibly perform) and impossibilum nulla oblignto est (law does not expect a party to do the impossible) are well known*

maxims in law and would squarely apply to the present case. The statue viz. Section 54EC provides for exemption from tax to long term capital gain provided the same is invested in bonds of Rural Electrification Corporation Limited or National Highway Authority of India. However, as the bonds were not available, it was impossible for the assessee to invest in them within six months of the sale of their factory building. Therefore, in the circumstance, one would have to interpret Section 54EC to ensure that it does not lead to injustice. Therefore, the six months provided for investing in bonds may be reasonably extended in view of the non-availability of bonds...." Since in the instant case, the facts are identical to the facts decided by the Pune Bench, therefore, following the said decision, the assessee is entitled to deduction u/s 54EC.

Source: ITAT Delhi Bench in the case of Lt. Col Virender Singh, Gurgaon Vs ITO, Haryana

IT. Appeal no. 4436/Del/2017, date of publication May 16, 2018

***

No automatic denial of exemption u/s. 11 for violating Sec. 13(1) condition

Delhi ITAT deletes disallowance of loan advanced by assessee-trust to other charitable institution u/s 10(23C) and u/s 11 during AY 2007-08, rules that only the loan amount advanced by assessee-trust in violation of sec.11(5) is liable to be taxed and that violation u/s 13(1)(d) and sec.13(1)(c) does not automatically result in the denial of benefit u/s 10(23C) or Sec.11. During relevant AY, revenue treated the amount of loan advanced out of corpus fund to other charitable trust as ineligible for deduction and subsequently denied exemption u/s 11 and Sec.10(23C) and states that assessee has not received any

securities or interest by advancement of loan to other trust, further notes that the said sum was returned by other trust during FY 2007-08. On Revenue's allegation that there are common trustees involved due to which sec.13(1)(d) comes into play, ITAT remarks that, " .. *nothing has been brought on record to establish that the common trustees have substantial interest in the other trust.";* Relies on plethora of rulings including Karnataka HC ruling in Fr.Mullers Charitable Institutions, Bombay HC ruling in Sheth Mafatlal Gagalbhai Foundation Trust and Allahabad HC ruling in Red Rose School.

Source: ITAT New Delhi in the case of Puran Chand Dharmarth Vs ITO, Gurgaon

IT. Appeal no. 1994/Del/2011, date of publication March 09, 2018

***

Capital Contributed by the partner does not amount to loan or deposit u/s 269SS

Assessee had received an amount of INR 12,00,000 on various dates from its partner towards capital contribution made by the said partner in the assessee firm. ITAT held that "*We find that the capital contributed by the partner in the partnership firm does not tantamount to loan or deposit within the meaning of section 269SS of the Act and accordingly the appeal raise by the revenue for sustaining penalty levied on the assessee is dimissed"*

Source: ITAT, Kolkata in the case of M/s Dayamayee Marble & Granite Vs ITO, Kolkata

IT. Appeal no. 162/Koll/2017, date of publication May 15, 2018

***

Rejects 'receipts-basis' taxation for advances received by land-owner under development agreement

A residential land was owned by several owners along the assessee. Assessee converted his share of capital asset into stock in trade in Jan 2006 and entered into agreement with J.K developers according to which only physical possession of the said property was to be handed over to the developer at the time of execution of impugned agreement i.e., Feb.24, 2006. The registration value of property was shown at INR 2.83 crores. Assessee agreed to entrust the land and developer had agreed to develop all the said land for consideration of 18% amount on gross sales, excluding certain charges.

During the course of assessment proceedings for AY 2006-07, AO took stand that the transfer of immovable property was completed only when the conveyance deed was registered and for the purpose of capital gains, the transfer was treated as complete with the delivery of possession, when the agreement to sell / buy immovable property was entered into. The AO thus, observed that capital gain was attracted in AY 2006-07 i.e. the year under appeal. Further, as per the AO, the assessee had received INR 2.78 crores over and above the registration value during the year under assessment. AO held that sum of INR 2.78 crores was to be assessed as business income of the assessee. CIT(A) partly ruled in favour of the assessee.

With regard to the issue of year of taxability of such capital gains, ITAT observed that Sec. 45(2) very clearly provided for taxability of such capital gains in the hands of assessee in the previous year in which such stock-in-trade was sold or otherwise transferred by him. ITAT observed that the assessee gave the land for development and was entitled to receive 18% of total sale consideration as his share of business profits. Thus, there was no dispute between the assessee and the revenue authorities that the business income arose to the assessee. However, ITAT highlighted that the dispute arose only to the year of taxability of such business profits. Pune ITAT accepts assessee's (land owner) plea that advance received from developer towards flat booking shall **not be taxable in subject AY 2009-10 on receipt basis, but in subsequent AY when the project was completed and tenements / flats were handed over to the prospective buyers**. With respect to advance booking amount received in subject AY, ITAT remarks that *"The said amount received by the assessee is an advance receipt because the right to collect the said amount would crystallize on the day when the tenants or portion of land is sold by the developer to the prospective buyers.";*

Moreover, observes that the developer recognized the completion and sale of developed portion in subsequent AY 2011-12, consequently, holds that the business profits arising to assessee were taxable in such year. Lastly, ITAT also held that since the amount was not assessable to tax as his business profits in the year under consideration, the capital gains arising on conversion of capital asset into stock-in-trade was also not to be taxed in the hands of assessee in the year under consideration but in the year in which the business profits were to be taxed

Source: ITAT, Pune in the case of Shri Vilas Babanrao Rukari (HUF) Vs ITO, Pune

IT. Appeal no. 1645/PUN/2014, date of pronouncement May 25, 2018

***

Land-sale with staff quarters, LTCG despite depreciation claimed, Cites Buyer's land-development intent

Assessee entered into agreement with different builders for selling the immovable property of the closed textile mill. In PY 2009-10, the assessee had executed a sale deed with a builder for sale of the property and offered long term capital gain from sale of property by treating it as sale of land.

The AO was of the view that the properties sold comprise of mill workers quarters against which the assessee has claimed depreciation earlier and therefore, the computation of capital gain will have to be made in terms of Sec. 50(1). Referring to the recitals of development agreement, ITAT observes that the **intention of the parties was to sell the land, notes that the terms of the deed required the assessee to vacate the employees from the staff quarters and handover the vacant possession of the property to the buyer.**

CIT (A) further noted that since, the assessee could not get the staff quarters vacated, finally the developer had to step in to get the staff quarters vacated by paying an amount of Rs. 1.04 Cr. to various employees of the assessee. Therefore, CIT (A) held that the intention of the parties was to transfer the land only as the developer was not interested in buying staff quarters, which were occupied by the employees of the assessee and, in fact, the staff quarters were creating a hindrance in the transfer of the land.

ITAT remarked that "*if one looks at the consideration paid by the buyer to the assessee, in no stretch of imagination it can be said that the consideration paid was for staff quarters as the value of the staff quarters, as per the Schedule of fixed assets, is only Rs.12, 36,193/-, whereas, the consideration paid to the assessee as per the development agreement is Rs. 2, 92, 50,000/-. Thus, it becomes clear from the registered development agreement, what the parties intended to transact is the land and the consideration paid was also for the land.*"

Therefore, ITAT held that Sec. 50(1) would not apply and the capital gains on sale of land would be long term capital gain.

Source: ITAT, Mumbai in the case of M/s Seth Industries Pvt. Ltd Vs ACIT, Mumbai

IT. Appeal no. 4094/Mum/2013, date of publication May 28, 2018

***

Press release/Notifications/Instructions/Letters of the month

CBDT releases draft rule for computation of FMV of inventory converted into capital asset

Finance Act, 2018 has inserted clause (via) to section 28 of the Income-tax Act, 1961 ('the Act') so as to provide that **any profit and gains from conversion of inventory into capital asset or its treatment as capital asset shall be charged to tax as business income**. It has also been provided that for this purpose the fair market value of inventory on the date of conversion or treatment determined in prescribed manner shall be deemed to be the full value of consideration.

In view of the above, **it is proposed to insert a new rule 11UAB in the Income-tax Rules, 1962 for prescribing the manner of determination**

of fair market value of the inventory which has been converted into, or treated as, capital asset.

Rule 11UAB. Determination of fair market value for inventory. (1) For the purposes of clause (via) of section 28 of the Act, the fair market value of the inventory:

- being an immovable property, being land or building or both, shall be the value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of such immovable property on the date on which the inventory is converted into, or treated, as a capital asset.
- being jewellery, archaeological collections, drawings, paintings, sculptures, any work of art, shares or securities referred to in rule 11UA, shall be the value determined in the manner provided in sub-rule (1) of rule 11UA and for this purpose the reference to the valuation date in the rule 11U and rule 11UA shall mean the date on which the inventory is converted into, or treated, as a capital asset.
- being the property, other than specified in clause (i) and clause (ii), the price that such property would ordinarily fetch on sale in the open market on the date on which the inventory is converted into, or treated, as a capital asset."

Source: CBDT Press Release , Dated 03-05-2018

***

Issuing share capital at excess premium not taxable in hands of eligible start-ups, CBDT notifies

As per Section 56(2) (viib), a closely held company is liable to pay tax if it issues shares at a price which exceeds its fair value. The CBDT notifies that the provision is not applicable if issuing co. is a registered start-up in view of Notification No. GSR 364(E), dated April 11, 2018. CBDT also amends Rule 11 UA (2)(b), makes merchant banker valuation compulsory for the purpose of determining fair market value of unquoted equity shares, omits the word 'accountant.'

Source: CBDT Notification No.23/2018/F.No.370142/5/2018-TPL and Notification No. 24/2018/F.No.370142/5/2018-TPL (Pt)], Dated 03-05-2018

***

VERENDRA KALRA & CO

CHARTERED ACCOUNTANTS

CONTACT DETAILS:

Head Office
75/7 Rajpur Road, Dehradun
T +91.135.2743283, 2747084, 2742026
F +91.135.2740186
E info@vkalra.com
W www.vkalra.com

Branch Office
80/28 Malviya Nagar, New Delhi
E info@vkalra.com
W www.vkalra.com

For any further assistance contact our team at
kmt@vkalra.com

This publication contains information in summary form and is therefore intended for general guidance only. It is not a substitute for detailed research or the exercise of professional judgment. Neither VKC nor any member can accept any responsibility for loss occasioned to any person acting or refraining from actions as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.