RECENT IN JUDICIARY (NOVEMBER, 2019 EXAMINATION)

1. **Can an assessee who has set up a new industrial undertaking and availed deduction@100% of profits under section 80-IC for the five years, once again claim deduction@100% of profits on the basis of having undertaken substantial expansion thereafter?**

CLASSIC BINDING INDUSTRIES [2018] (SUPREME COURT)

Facts of the case: The assessee-firm stated its business on July 11, 2005 and its initial assessment year for the purpose of deduction under 80-IC was A.Y. 2006-07. The assessee claimed deduction under section 80-IC to the extent of 100% of eligible profits for five assessment years from A.Y. 2006-07 to A.Y. 2010-11. Thereafter, the assessee once again claimed 100% deduction of eligible profits in the A.Y. 2012-13 on the ground that it had carried out substantial expansion in the F.Y. 2011-12.

The Assessing Officer restricted the deduction to 25% of the eligible profits for the assessment year under consideration, namely, A.Y. 2012-13 (i.e., the seventh assessment year) on the ground that the assessee had already claimed deduction@100% of the eligible profits under section 80-IC for assessment years 2006-07 to 2010-11.

Relevant provision of the Income-tax Act, 1961: Section 80-IC applies to an undertaking which has begun to manufacture any article or thing therein by setting up a new factory *inter alia,* in the State of Himachal Pradesh. As per section 80-IC the assessee is entitled to deduction@100% of profits and gains for five assessment years commencing from the initial assessment year and, thereafter, deduction@25% of profits and gains for the next five years. The period of deduction is, thus, 10 years, namely, deduction@100% for the first five years and @25% for the remaining five years.

Issue: The issue under consideration is whether an assessee who has set up a new industrial undertaking and availed deduction@100% of profits under section 80-IC(3) for the first five years, can once again claim deduction@100% of profits on the basis of having undertaken substantial expansion thereafter in a subsequent year.

Supreme Court's Observations: The Supreme Court observed that upon a reasonable interpretation, once the assessee satisfies the eligibility conditions under section 80-IC and the initial assessment year commences from a certain assessment year for claim of deduction@100% of profits for a certain period, five years in this case, there cannot be another "initial assessment year", commencing after the expiry of the said period on the basis of substantial expansion.

2. **Is the assessee-company engaged in refining, distribution and sale of petroleum products, liable to deduct tax under section 194C or under section 194-I, in respect of payment made to the carrier engaged for road transport of bulk petroleum products?**

INDIAN OIL CORPORATION [2019] (UTTARAKHAND)

Facts of the Case: The assessee-company was engaged in refining crude oil and storing, distributing and selling the petroleum products. The assessee-company required trucks for road transportation of bulk petroleum products from its various storage points to customers or other storage points. It entered into an agreement with another company for the said purpose.

Upon scrutinizing the contract, the Assessing Officer came to the conclusion that the assessee was liable to deduct tax under section 194-I as the carrier is being hired and being paid for full time unlike in the case of a works contract.

Relevant provision of the Income-tax Act, 1961: Section 194-I provides for deduction of tax at source on payment of rent. As per section 194-I, "rent" means payment, by whatever name called, for inter alia, use of any plant. Section 194C deals with deduction of tax at source in respect of payment made to a contractor for carrying out any work. Section 194C defines "work" to include carriage of goods or passengers by any mode of transport other than by railways.

Issue: The issue under consideration is whether the assessee-company is liable to deduct tax under section 194C or under section 194-I on payment made to the carrier engaged for road transport of bulk petroleum products.

High Court's Observation: Upon perusing the terms of the contract, the High Court observed that the parties understood the agreement as one where the carrier would be paid transport charges, and that too, **for the shortest route travelled by it in the course of transporting the goods of the assessee**. The contract **did not require payment of idle charges and it was clear that there was no entitlement to any payment other than the actual transportation of the goods. Hence, the carrier was not being hired for full time.**

The carrier under the contract was undoubtedly obliged to maintain the requisite number of trucks of a particular type subject to various restriction and conditions. However, the carrier was under the obligation to operate the trucks for the specific purpose of transporting the goods belonging to the assessee.

High Court's Decision: The High Court held that, the contract is one for transportation of goods and, therefore, is a contract of work within the meaning of section 194C and not section 194-I.

3. **Can an assessee setting up a hotel claim deduction under section 35AD for the relevant previous year, on the basis that it had commenced its operations and made an application for three-star category classification in beginning of the said previous year, even though the same was granted by the authority only in the next year due to the requirement of completion of inspection?**

CEEBROS HOTELS PRIVATE LIMITED [2008] (MAD)

Facts of the Case: The assessee commenced operation of hotel business in the relevant previous year 2018-19 and filed an application for classification of hotel on 10-04-2018 and claimed deduction under section 35AD for the previous year 2018-19. While completing the assessment under section 143(3) for the assessment year relevant to the said previous year 2018-19 the Assessing Officer denied the benefit of deduction under section 35AD on the ground that the assessee obtained three –star category hotel classification only during the subsequent previous year 2019-20.

__Issue:__ The issue under consideration is whether an assessee setting up a hotel can claim deduction under section 35AD for the relevant previous year 2018-19 on the basis that it had commenced its operations and made an application for three-star category classification in the said year, even though the same was granted by the authority only in the next year due to the requirement of completion of inspection.

__High Court's Decision:__ The High Court observed that the assessee had made an application for classification as early as in the month of April of the relevant previous year. Thereafter, an inspection was required to be conducted for such purpose. **The manner in which the inspection was conducted and the time frame taken by the competent authority were factors beyond the control of the assessee.**

The Department had not disputed the operation of the new hotel from the relevant previous year as it had accepted the income, which was offered to tax. Under section 35AD, deduction is available from the previous year in which the assessee commences operation of the specified business i.e., hotel business, in this case. **Section 35AD does not mandate that the date of the certificate has to be** with **effect from a particular date**.

The High held that the assessee is entitled to claim the deduction under section 35AD for the relevant previous year 2018-19.

4. Can part of the interest paid by the assessee on unsecured loans taken be disallowed due to the reason that, out of the said loans, the assessee had advanced certain sum of money to third parties without charging any interest?

REEBOK INDIA COMPANY [2018] (DEL)

__Facts of the Case:__ The assessee-company had taken unsecured loans of ₹502.69 crores. Out of the said sum, it had advanced ₹172.59 crores to third parties on which no interest was charged. Pursuant to this, for the relevant assessment year, the Assessing Officer proportionately disallowed, under section 36(1)(iii) an amount of ₹68.75 crores paid by the assessee.

__Issue:__ The issue under consideration is whether part of the interest paid by assessee on unsecured loans can be disallowed due to the reason that, out of the said loan, the assessee had advanced certain sum of money to third parties without charging any interest.

__High Court's Decision:__ The High Court relied upon **the Supreme Court ruling in S. A. Builders Ltd.** v., which interpreted the expression "for purposes of business or profession" in section 36(1)(iii) as being wider in scope than the expression "for the purpose of earning income, profits or gains". Accordingly, expenditure voluntarily incurred and meeting the "commercial expediency" test is to be allowed as a deduction. The expression "commercial expediency" is of wide import and is satisfied once it is established that there was a connection and nexus between the interest paid (claimed as expenditure) and the assessee's business.

The High Court observed that merely because non-interest bearing advances were given to third parties, that would not justify a finding that the test of "commercial expediency" was not satisfied. Interest-free advances were advanced to the parties connected with the business of the assessee. Money taken on loan was not diverted for non-business purpose. The unsecured loans were not used for personal purpose. Therefore, according to section 36(1)(iii), interest paid on capital borrowed for the purpose of business had to be allowed as a deduction.

5. Would sale of fertilizer bonds (issued in lieu of government subsidy) at loss be treated as a business loss or a loss under the head "Capital gains"?

GUJARAT STATE FERTILIZERS AND CHEMICALS LIMITED [2018] (GUJ)

<u>Facts of the Case:</u> The assessee is engaged in manufacturing of fertilizers. The sale price of fertilizers is fixed by the Government of India and many a times, such price is even lower than the cost of production. Therefore, to compensate the manufacturer for the difference between the retention price of individual unit and sale price, fertilizer subsidy is given by the Government. Due to cash crunch, sometimes the Government of India discharges its dues of paying the subsidy by issue of fertilizer bonds. These bonds are saleable in the open market and the prices of such bonds are varying.

In this case, when such bonds were sold in the open market, the assessee incurred a loss of ₹ 91,45,000 which it treated as a business loss. The Assessing Officer disallowed the same treating it as a loss under the head "Capital Gains". The Tribunal, however, allowed the same.

<u>Issue:</u> The issue under consideration is whether sale of fertilizer bonds (issued in lieu of government subsidy) at a loss should be treated as a treated as a business loss or a loss under the head "Capital gains".

<u>High Court's Decision:</u> The High Court observed that there is no dispute that fertilizer subsidy given to an assessee to compensate the loss on sale of fertilizers should be treated as business income of the assessee. Due to cash crunch, the Government of India had discharged its dues of paying the subsidy by issue of fertilizer bonds. These bonds are saleable in the open market and the prices of such bonds are varying. In this case also, the assessee received fertilizer bonds (in lieu of subsidy) which were sold at a loss in the open market.

The High Court, accordingly, held that since the subsidy would have been treated as business income, loss on sale of fertilizer bonds issued is to be allowed as business loss.

6. Would an assessee who enters into an agreement with the Gujarat State Development Corporation for an infrastructure development project be entitled to deduction under section 80-IA, even though as per the requirement contained therein, the agreement has to be entered into with the Central Government or State Government or a local authority or any other statutory body?

RANJIT PROJECTS PRIVATE LIMITED [2018] (GUJ)

Facts of the Case: The assessee is a private limited company engaged in implementing infrastructure development projects. For the relevant assessment year, it claimed deduction of ₹ 4.97 crores under section 80-IA. The assessee contended that it had undertaken a road development project, for which, it had entered into an agreement with the Gujarat State Road Development Corporation (GSRDC) which was set up by the Government for the special purpose.

The Assessing Officer doubted whether such agreement would satisfy the requirements of section 80-IA. The assessee, however, contended that the GSRDC was performing all the function of the State Government and therefore, the concession agreement executed by GSRDC should be treated to have been entered into by the State Government. The Assessing Officer, however, did not accept the assessee's contention and rejected the assessee's claim of deduction under section 80-IA.

Relevant provision of the Income-tax Act, 1961: Section 80-IA provides for a certain deduction in respect of profits and gains from undertakings or enterprises engaged in infrastructure development. Section 80-IA provides that such section would, *inter alia,* apply to any enterprise carrying on the business of developing or operating and maintaining or developing, operating and maintaining any infrastructure facility. One of the conditions to be fulfilled for claiming deduction is that the assessee should have entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for developing or operating and maintaining or developing, operating and maintaining a new infrastructure facility.

Issue: the issue under consideration is whether an assessee who enters into an agreement with Gujarat State Road Development Corporation for an infrastructure development project would be entitled to deduction under section 80-IA, even though as per the requirement contained therein, the agreement has to be entered into with the Central Government or State government or a local authority or any other statutory body.

High Court's Decision: The High Court observed that GSRDC is a wholly Government owned company incorporated pursuant to the State Government's resolution. The memorandum of association shows that the Government enjoys total control over GSRDC. GSRDC was constituted by the State Government as a nodal agency for the purpose of executing road development projects through private participation. Hence, GSRDC is a Government agency.

The High Court held that since the assessee has entered into an agreement with GSRDC, a government agency constituted by the State Government for the purposes of executing road development projects, it is entitled to deduction under Section 80-IA.

7. Can the amount incurred by the assessee towards perfecting title of property acquired through will, for making further sale, be included in the cost of acquisition for computing capital gains?

ADITYA KUMAR JAJODIA [2018] (CAL)

Facts of the Case: The assessee obtained a leasehold property under a will which gave some interest to a trust and, thus, the assessee's acquisition of the perpetual lease was subject to rights of the trust as flowing from the will. The testator of the trust had also entered into an agreement to sell with a third party. The assessee had to, thus, perfect the ownership title before he transferred the property. For this purpose, he made payment to the Delhi Development Authority (DDA) for conversion of leasehold rights to freehold rights. He also made payments to the trust and to the third party to give up his right under the agreement.

Issue: The issue under consideration is whether the amount incurred by thee assesse towards perfecting title of property acquired through will, for making further sale, can be included in the cost of acquisition for computing capital gains.

High Court's Decision: The High Court observed that the assessee had inherited the immovable property under a will and the costs incurred by him for perfection of the title from perpetual leasehold rights to the complete ownership had to be regarded as a cost of acquisition, as the assessee was transferring the complete ownership rights to the transferee, and not the leasehold rights.

Further, the High Court took note of the Supreme Court's ruling in *RM. Arunachalam* v. CIT [1997} 227 ITR 222 holding that the amount incurred in discharging the mortgage created by the predessor-in interest of the assessee has to be regarded as cost of acquisition of the assessee.

The High Court, accordingly, observed that, in this case, the encumbrances were got rid of the assessee by making certain payment, consequent to which a better title to the property was acquired by the assessee and transferred to the assessee's transferee. The cost of getting rid of such encumbrances in any immovable property had to be accepted as a part of the cost of acquisition of the property, subject, however, to the assessment as to the genuineness and validity of such encumbrances.

The High Court, accordingly, held that, the assessee is entitled to deduction of amount incurred towards perfecting title of property acquired under will and the amount incurred towards making payments to the trust and the third party in whose favour rights were created, as cost of acquisition under section 55.

8. Would the cost of purchase of land and cost of construction of residential house thereon incurred by the assessee prior to transfer of previously owned residential house property, qualify for exemption under section 54?

C ARYAMA SUNDARAM [2018] (MAD)

Facts of the Case: The assessee sold a residential house property for a consideration of ₹ 12.5 crores on January 15th, 2010. Long-term capital gains arising to the assessee on sale of such property was ₹ 10.48 crores. In May, 2007, the assessee had purchased a property with a superstructure thereon for a total consideration of ₹ 15.96 crores and after demolishing the existing superstructure, the assessee constructed a residential house at a cost of ₹ 18.74 crores. For the A.Y. 2010-11, the assessee had claimed exemption of the entire long-term capital gains of ₹ 10.48 crores under section 54, since it was lower than the cost of construction of ₹ 34.70 crores.

Assessing Officer's view: The Assessing Officer opined that only that part of the construction expenditure incurred after the sale of the original asset was eligible for exemption under section 54. Based on records, the Assessing Officer calculated the cost of construction incurred after the sale of the original asset, amounting to ₹ 1.15 crores and accordingly, allowed exemption only to that extent.

Issue: The issue under consideration is whether the cost of purchase of land and cost of construction of residential house thereon incurred by the assessee prior to transfer of previously owned residential house property would qualify for exemption under section 54.

High Court's Decision: According to section 54, capital gains exemption is available in respect of the cost of new residential house purchased or constructed, Section 54 is specific and clear in that it mentions cost of new residential house and not just the cost construction of the new residential house. The cost of the new residential house would necessarily include the cost of the land, materials used in the construction, labour and any other cost relatable to the acquisition or construction of the residential house. Also, in this case, the assessee's construction of new house is within the timeline stipulated in section 54(1).

Section 54 does not lay down that construction could not have commenced prior to the date of transfer of the asset that resulted in capital gains. Also, section 54 does not contemplate that the same money received from the sale of a residential house should be used in the acquisition of new residential house. This is apparent as section 54 also provides exemption in respect of property purchased one year prior to the transfer of residential house property, which give rise to the capital gains.

The High Court, accordingly, held that, in this case, the cost of land and cost of construction incurred thereon prior to transfer of residential house property also have to be considered for all purpose of capital gains exemption under section 54. As capital gains arising on transfer of previously owned house property of the assessee is less than the cost of the new residential house in this case, the entire capital gains would be exempt under section 54.

9. Can payments made by an assessee to an non-resident agent who does not have any income assessable in India be disallowed under section 40(a)(i) for non-deduction of tax at source on the ground that no application was made by the assessee under section 195 for making deduction of tax at source at nil rate?

MARUTI SUZUKI INDIA LIMITED [2018] (DEL)

Fact of the Case: The issue relates to payments made by the assessee to its agents based and operating abroad. The agent had no assessable income in India. The Assessing Officer disallowed the payment invoking section 40(a)(i) on the ground that no application was made by the assessee under section 195(2) for making deduction of tax at source at nil rate or lower rate.

High Court's Decision: The High Court observed that the non-resident agent who operated outside India did not have any income arising in India. The High Court held that there was no obligation to deduct tax under section 195 from commission paid to a non-resident recipient who was not liable to tax in India. The commission earned by a non-resident agent who was in the business of selling

Indian goods abroad, did not accrue or arise in India, and hence no tax was deductible on such commission payment to a non-resident agent.

The High Court, accordingly, held that where the assessee has made payment to a non-resident agent where such income is not chargeable to tax in India, section 40(a)(i) could not be invoked to disallow deduction of such payment for non-deduction of tax at source, while computing the business income of the assessee.

10. Is interest under section 201(1A) attracted even in a case where non-deduction of tax at source was under a bona fide belief that tax was not deductible and the default was not willful?

SUN OUTSOURCING SOLUTIONS PRIVATE LIMITED V. [2018] (T & AP)

Facts of the Case: The assessee is a private limited company engaged in the business of software development with its office in Hyderabad and branch office in London. In the course of executing software projects in the U.K., the assessee had deputed some employees from Hyderabad to London and it had also employed local personnel (NRIs) in the U.K. The assessee did not deduct tax at source on the allowances paid to the staff deputed to the U.K. and the salary payments made to the local personnel engaged in the U.K.

The Assessing Officer charged interest on payments made to staff deputed to the U.K. and on salaries paid to the personnel engaged in the U.K. under section 201(1A). The assessee contended that since it was under a *bona fide* impression that the amounts paid to its employees were not taxable, it did not deduct tax on such payment.

Issue: The issue under consideration is whether interest under section 201(1A) is attracted even in a case where non-deduction of tax at source was under a *bona fide* belief that tax was not deductible and the default was not willful.

High Court's Decision: The High Court observed that section 201(1A) was automatically attracted for failure to deduct tax at source on the payments made. Only in case of penalty under section 221, there is a provision for non-levy where the assessee proves that the default was for good and sufficient reasons. Unlike section 221, section 201(1A) does not require proof of willful default. Even if the assessee was *bona fide* in not making such deduction, interest was nevertheless payable. Therefore, interest under section 201(1A), was rightly levied.

The High court, accordingly, held that since the company had failed to deduct tax on the payments made to its employees, being Indian residents deputed to work in the U.K., section 201(1A) is automatically attracted; even if such non-deduction was due to the *bona fide* belief that tax is not deductible in such case, the company is, nevertheless, liable to pay interest under section 201(1A).