Nangia Andersen LLP

Tax Rulings Compendium

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01

Deemed dividend provisions under section 2(22)(e) inapplicable when advance granted to a shareholder for Company's own benefit- Karnataka High Court[1]

Section 2(22)(e) prescribes that "dividend" shall include any payment by a closely held company by way of an advance or loan to a shareholder holding at least 10% of the voting power, wherefore the AO held that the amounts received by the assessee were taxable as deemed dividends. However, as the advance granted by the company to the shareholder conferred an advantage upon the company itself and not on the share-holder, the Karnataka High Court held that the advance could not be deemed as dividend. The ruling lays down an important principle that only gratuitous loan would come under the purview of deemed dividend.

02

ESOP expenses allowable as deduction when rights are vested in the hands of the employees- Bangalore Tribunal[2]

The question of admissibility of expense pertaining to ESOPS as deduction was often contested. However, the Karnataka High Court, in a pronouncement of the recent past[1], has established that discount (i.e. the difference between market price of the shares, as at the date of grant of the options and the issue price) is a deductible business expense. Further, the assessee would be liable to deduct TDS when discount becomes perquisite in the hands of the concerned employee. The ITAT, in the instant case has accorded genuine relief to the assessee on the basis of the decision rendered by the Karnataka High Court.

03

Amount received by a relative towards share capital, subsequently treated as gift due to non-compliance with the provisions of FEMA, not taxable under the Income Tax Act- Mumbai Tribunal[3]

Tribunal after thoroughly analysing various provisions of Income Tax Act to determine taxability of amount received towards share capital but subsequently treated as gift on account of failure to comply with the provisions of FEMA. The Tribunal explicated that the sum in question was not covered by section 56(2)(viia) as the provisions apply only to receipt of shares without consideration or for inadequate consideration. Provisions of 56(2)(viib) were also found inapplicable as the same are attracted only for consideration for issue of shares received from any person who is a *resident.* Further, the provisions of section 28(iv) were also not fitting, as the monies were not received by the assessee in its ordinary course of business. Relying on Supreme Court ruling in the case of G.S.Homes & Hotels (P) Ltd.[4], it was concluded that the amount received towards share capital cannot to be treated as business income.

[1] CIT V N.S. Narendra [2021] 129 taxmann.com 335 (Karnataka)
[2] Northern Operating Services Pvt. Ltd [TS-818-ITAT-2021(Bang)]
[3] Crescent Payments Pvt. Ltd [TS-834-ITAT-2021(Mum)]
[4] [TS-5111-SC-2016-O]

04

A discrepancy in income reflected in Form 26AS and those credited in P&L account is a tangible material for initiating reassessment proceedings - Madras Tribunal[5]

The assessee had not made full and true disclosure of all material facts during original assessment and there was a huge mismatch in receipts appearing in Form 26AS vis-a-vis receipts credited in P&L account. These facts sprang up after rectification application was filed by assessee. The ITAT therefore concluded that reopening of assessment was justified. The ruling lays down the important principle that mismatch in income reflected in Form 26AS and receipts credited in P&L account is a tangible material to conclude that the income has escaped assessment warranting reassessment proceedings.

05

Amounts expended as "prepayment premium" pursuant to a debt restructuring agreement allowable as interest under section 36 of the Income Tax Act- Madras Tribunal[6]

The ruling reiterates an important principle that prepayment premium paid pursuant to a debt restructuring agreement, to reduce the interest rates is in essence the present value of differential interest amount that would have been due on the loan if no restructuring of the debt had taken place. Such expenditure qualifies for deduction as interest under the provisions of section 36 of the Income Tax Act. The ruling is in line with the Supreme Court verdict[7] in this regard and accords a legitimate benefit to the assessee.

06

Plain 'possibility' of filing an appeal shall suffice for determining eligibility of claiming benefit under the DTVSV Act- Telangana High Court[8]

In view of the fact that the DTVSV Act is a beneficial piece of legislation, the High Court has resorted to liberal interpretation rather than literal interpretation, to make the Scheme operable. The court remarked that extending benefit to an assessee who has filed objections to the draft assessment order and denying it to one who chooses not to file such objections for various reasons, would result in creating separate class of assesses artificially, resulting in discrimination. The Court was mindful of the intent of the legislation and thus allowed the assessee to settle dispute under VsV. Judgements like these strengthen the faith of the taxpayers in the judiciary.

07

No disallowance u/s 36(i)(iii) if interest-free loans advanced to a subsidiary purely out of commercial expediency- Bombay High Court[9]

The ruling lays down an interesting position- where a holding company advances interest-free loans to its subsidiary purely out of commercial expediency, no such expenditure can be disallowed under section 36(1)(iii) and no notional interest income can be brought to tax, provided such loans are not utilized for personal benefits of directors of subsidiary and, the holding company has sufficient interest-free funds to cover such loans given to its subsidiary.

[5] Thiru Arooran Sugar Ltd. [2021] 130 taxmann.com 113 (Madras)
[6] Civil Appeal Nos.7615 of 2009 and 2414 of 2010 [CIT v. Gujarat Guardian Ltd.]
[7] Dongfang Electric Corporation Ltd [TS-856-HC-2021(TEL)]
[8] Thiru Arooran Sugar Ltd. [2021] 130 taxmann.com 113 (Madras)
[9] Civil Appeal Nos.7615 of 2009 and 2414 of 2010 [CIT v. Gujarat Guardian Ltd.]

08

Asset forming part of a block of assets on which depreciation was allowable shall retain the character of a depreciable asset - Supreme Court[10]

The Income Tax Act has prescribed different method for computation of capital gains on transfer of a depreciable asset forming part of block of assets. It is required that capital gains computed in respect of depreciable assets, be classified as STCG, even when the asset qualifies as a long-term asset on the basis of its period of holding. In the instant case, the Supreme Court has established that once an asset forms part of a block of assets on which depreciation has been allowed, it would retain its character of being a depreciable asset for taxation purposes, even if its non-use disentitles an assessee to depreciation for a few years prior to date of sale. The court recognised that the assessee in the instant case had reclassified the asset as investment only to avoid taxation as short-term capital gain, which would entail a higher tax outgo as compared to tax on long term gains.

09

Taxpayers entitled to arrange transactions in a way that results in minimum tax liability as long as it is through legitimate tax planning- Mumbai Tribunal[11]

There is no doubt about a taxpayer's right to arrange his affairs such that his taxes are as low as possible. No person is bound to choose that pattern which will best pay the Treasury. However, certain types of legal tax planning, with even the most benign and commercially legitimate practices might be deemed as egregious. Accordingly, genuine transactions undertaken in a tax efficient manner need to be distinguished from sham transactions or colourable devices used for evading taxes. Legitimacy of a particular transaction depends upon factual matrix of each case and shall be assessed in view of all material factors.

10

Finance costs of funds utilised for providing interest-free loan to a subsidiary engaged in a different line of business not allowable as there can be no commercial expediency between entities engaged in different lines of business- Bangalore Tribunal[12]

In past, the Supreme Court[13] had deciphered the connotations of the term 'commercial expediency' to mean something that creates opportunities for business advancement or lessens incidence of some business expenditure. The purpose for which the loan has been granted is a material consideration for establishing commercial expediency.

In the present case, the Bangalore Tribunal has asseverated that there cannot be any commercial expediency between two entities engaged in different lines of business. The finance cost of funds utilised for providing interest-free loan to a subsidiary engaged in a different line of business shall not be allowable under the provisions of the Act.

[10] Sakthi Metal Depot [2021] 130 taxmann.com 238 (SC)
[11] Michael E Desa [TS-874-ITAT-2021(Mum)]
[12] Davanam Constructions Private Limited [TS-851-ITAT-2021(Bang)]
[13] S.A. Builders v. CIT, 288 ITR 1 (SC)

11

Revision u/s 263 originates from regular assessment, not reassessment; Tribunal holds revisionary order time-barred- Mumbai Tribunal[14]

Section 263 of the Income Tax Act prescribes that Commissioner of Income-tax (CIT) can request for revision of AO's order, if he is of the opinion that the AO's order is erroneous and prejudicial to the revenues' interest. However, as per section 263(2), no such request can be made after expiry of two years from the end of financial year in which the order sought to be revised was passed.

In the instant case, the PCIT exercised its revisionary jurisdiction and reopened the order of assessment for matters which were not the subject of the reassessment proceedings. Accordingly, the period of limitation provided for u/s 263(2) would begin to run from the date of the order of assessment and not from the order of reassessment. Thus, the decision passed by the Tribunal is in line with the provisions of the Act.

12

No disallowance of interest on borrowed capital when assessee had sufficient funds to make investment in foreign subsidiaries – Karnataka High Court[15]

The ruling of the High Court highlights the importance of commercial expediency while incurring business expenses. The High Court noted that the assessee had sufficient funds to make investment in foreign subsidiaries and therefore acted on the presumption that investments were made from interest free funds available to assessee, deleting the impugned disallowance of interest on borrowed capital. Separately, the High Court analysed the facts of the case to reasonably hold that proviso to section 36(1)(iii) can be attracted in case of "expansion" of business only with effect from 1-4-2016 (prospectively).

13

Interest on loan borrowed for acquisition of land allowable when there was material on record to establish that land had been put to use- Madras High Court[16]

The proviso to Section 36(1)(iii) specifically disallows the interest paid in respect of capital borrowed for acquisition of an asset for any period beginning from the date on which the capital was borrowed till the date on which such asset was first "put to use".

In the instant case, the assessee was able to substantiate that the land was put to use in the AY under consideration by furnishing ledger accounts of expenses incurred towards architect fees, CMDA charges, etc. Further, it was evident from material on record that the assessee had carried out demolition of structure built by the previous owner in order to use land for its hotel business. The High Court noted that there can be justifiable circumstances where a capital asset requires preparation after acquisition to facilitate the business activity. As the assessee was able to establish that substantial activities had been undertaken, no interest expenditure was to be disallowed in view of proviso to Section 36(1)(iii).

[14] Royal Western India Turf Club [TS-952-ITAT-2021(Mum)]
[15] Coffeeday Global Ltd [2021] 130 taxmann.com 277 (Karnataka)
[16] Ceebros Hotels P Ltd [TS-991-HC-2021(MAD)]

14

In view of no Business Connection and Permanent Establishment(PE) in India, no profits can be attributed- Delhi Tribunal[17]

It is a well- accepted principle that there must exist a fixed place of business in India for constitution of a fixed place Permanent Establishment (PE) in India. Further, such fixed place shall be at the disposal of the foreign entity through which it can carry on its business.

In the present case, the assessee was engaged in the business of selling advertisement time and programme sponsorship from Mauritius. An Indian company "ESPN Software India" acquired Ad time from assessee for allotting it to various advertising agencies in India. The Delhi Tribunal noted that the assessee did not have any office, agency, or operations in India. The sale of ad time by assessee to ESPN India was effected outside India and the sale consideration was also discharged outside India. As the assessee had no business connection in India as per the Income Tax Act or PE under India-Mauritius tax treaty, no attribution of profit was to be made.

15

The revision proceedings undertaken by CIT u/s 263 based on AO's recommendation bad in law, jurisdictionally deficient- Pune Tribunal[18]

Under the Income Tax Law, the process of revision u/s 263 shall initiate only when the CIT calls for and examines the record of any proceeding and considers that order passed by the AO is erroneous and prejudicial to the interests of the revenue.

In the case under consideration, the Tribunal noted that the CIT had carried out revision based on AO's proposal. The Tribunal asseverated that a communication from the AO is not "the record of any proceedings". Further, a power which vests exclusively in one authority can't be invoked or cause to be invoked by another. Therefore, the AO recommending a revision to the CIT has no statutory sanction. If AO, after passing an assessment order, finds something erroneous in it, he can either reassess the earlier assessment u/s 147 or carry out rectification u/s 154 of the Act. He can't usurp the power of the CIT and recommend a revision. Therefore, the Tribunal held that it was a case of jurisdiction deficit.

16

Provisions of section 269SS and 271D not applicable in respect of sum received from husband with no intention to repay as the sum does not qualify as a loan- Jaipur Tribunal[19]

Section 269SS states that a person shall not accept a loan/deposit of INR 20,000 or more from another person otherwise than by the prescribed banking channels, i.e. a/c payee cheque or account payee bank draft or by use of an electronic clearing system. In the event of failure to comply with the foregoing provisions, penalty under section 271D is attracted.

The Tribunal accorded relief to the assessee by not triggering provisions of Section 269SS and 271D in respect of sum received from husband with no intention to repay as the same did not qualify as a loan. Further, the assessee had compelling reasons for accepting cash from her husband. The assessee had explained that *funds were accepted from husband for paying consideration in cash for purchase of land* as the seller of the property had insisted for the same. Further, the payment against purchase of construction material and payment to labourers was also required to be incurred in cash.

The Tribunal found the explanation furnished by assessee to be reasonable and accordingly directed that no levy of penalty u/s 271D was to be imposed.

[17] ESPN Star Sports Mauritius- TS-982-ITAT-2021(DEL)
[18] Alfa Laval Lund AB- TS-1024-ITAT-2021(PUN)
[19] Smt. Meera Devi Kumawat vs JCIT, Jaipur [2021] - 132 taxmann.com 21 (Jaipur - Trib.)

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