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CHARTERED ACCOUNTANTS

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DIRECT TAX REVIEW
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SUPREME COURT RULINGS

Grants received for the benefit of the third party would not render disbursement as application of income. Thus, the expenditure incurred for the purposes of business shall be allowed as deduction u/s 37(1)

Facts

The assessee corporation was set up under National Development Corporation (NCDC) Act where the only business of the assessee-Corporation was to receive funds and then to advance them as loans or grants to co-operative societies. The funding of NCDC came by way of grants and loans received from Central Government where Interest income arose on account of fund so received and it may not have been utilized for a certain period of time, being put in FDs so that amount did not lie idle. Interest income generated from fixed deposits was again applied to disbursement of grants and loans. The issue had arisen as to whether the component of interest income earned on the funds received u/s 13(1) and disbursed by way of grants to national or state level co-operative societies, was eligible for a deduction for determining the taxable income of the Corporation. The AO opined that the non-refundable grants were not a revenue expense but they were a capital expense, and thus, the equivalent was not allowed for deduction.

The CIT (Appeals) opined that the grants made by the assessee-Corporation undisputedly fell within its authorized activities, which were interlinked and interconnected with its main business of advancing loans on interest to State Governments and cooperative societies. On second appeal, the Tribunal set aside the order of the CIT (Appeals) holding that all the grants, additional and other sum received by the assessee-Corporation from the Central Government u/s 12 of NCDC Act went to the single fund and the same could not be treated as its income, therefore, the disbursements made from such fund could not be treated as a revenue expense.

On further appeal, the High Court held that the main business of the assessee-Corporation was to receive funds from Central Government and then advance them as loans or grants to cooperative societies, therefore the interest earned from the loan would fall under the head D of section 14 of Chapter IV of the Income-tax Act, 1961 under the head of PGBP being a part of its normal business activity. It was also advanced by the High Court that to claim a deduction as an item of revenue expenditure, the assessee-Corporation had to first establish that it was incurred as an expenditure and, because the advancement of loans to the State Government and Cooperative Societies did not leave the hands of the Corporation irretrievably, it could not be claimed as an expenditure. Aggrieved by which the assessee filed an appeal to the Hon'ble Supreme Court.

Ruling

The Hon'ble Apex Court held that the generation of interest income from surplus or idle funds and its utilization for grant of loan or grants was a part of its finance business activity and was to taxed as business income. Mere circumstance that the assessee did not carry on business activity for profit motive was not material as profit making

was not an essential ingredient for the taxability of the income. Therefore, the disbursement of funds having been held to be a core business of assessee-corporation, expenditure incurred in course of business and for the purpose of business would naturally be an allowable deduction u/s 37(1). The source of funds from which expenditure was made was not relevant and it was also not relevant as to whether expenditure was incurred out of corpus funds or from interest income earned by the assessee-corporation. Further, merely because grants benefitted a third party, would not render disbursement as application of income and not expenditure and thus, every application of income towards business objective of assessee-corporation was a business expenditure and nothing else.

Source: SC in National Co-operative Development Corporation vs. CIT, Delhi; ITA No. 5105 to 5107 of 2009, dated Sept 11, 2020

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HIGH COURT RULINGS

Expenditure incurred wholly and exclusively for the purposes of earning the interest income will be allowed as deduction u/s 57(ii) of the Income Tax Act, 1961

Facts

The assessee filed its return of income for the AY 2006-07 where the AO by an order disallowed the interest expenses against interest income paid to the financial institutions. The CIT(A) by an order allowed the appeal preferred by the assessee. However, the Tribunal by an order by following its earlier order in case of the assessee for the AY 2005-06 allowed the appeal filed by the revenue. Therefore, the assessee filed an appeal before the Hon'ble High Court.

Ruling

It is decided that the purpose of expenditure is relevant in determining the applicability of Section 57(iii) of the Act and the

purpose must be making or earning of income. The assessee in order to cover the cost of interest payable to the creditors for the unpaid period, invested the surplus in fixed deposits and earned interest. The amount earned by way of interest was paid to the lenders and creditors. Thus, there is a nexus between the interest paid to the creditors on the unpaid balance and interest earned on the deposits. The interest expenditure was incurred wholly and exclusively for the purpose of earning the interest income and therefore, the assessee is entitled to deduction of the interest income u/s 57(iii) of the Act.

Therefore, the substantial question of law is answered in favour of the assessee and against the revenue.

Source: HC in karnataka, M/s Best Trading and Agencies Ltd vs. DCIT, Circle 11; ITA No. 191 of 2011, dated August 26, 2020

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ITAT RULINGS

Only the part of income which had violated the sections 13(1)(c) or 13(1)(d) by a trust registered u/s 12AA would suffer MMR as per proviso to section 164(2)

Facts

The assessee is a society registered under Rajasthan Societies Registration Act,1958 and is also registered u/s 12AA of the Act. The assessee society filed its return of income declaring Nil income after claiming exemption u/s 11 of the Act. During the course of

assessment proceeding, the AO observed that the society has violated the provisions of Section 11A of the Act. Therefore, interest @ 12% was considered to be diversion of income of the society and accordingly exemption u/s 11 and 12 of the Act was denied and surplus as per income and expenditure account along with various additions made in the assessment order were assessed u/h Income from Business & Profession and charged to tax u/s 164(2) of the Act at Maximum Margin Rate (MMR). Aggrieved by the order of the AO, the assessee preferred appeal before the ld. CIT(A) who after considering the case of both the parties deleted the disallowances of salary but confirmed the addition in respect of notional interest on advances given against the purchase of immovable properties. The ld. CIT(A) also directed the AO to reduce this amount from the application of income and directed that where there is a violation of Section 13(1)(c) or 13(1)(d) of the Act only the relevant part of income was not exempt u/s 11 and 12 of the Act, shall be charged to tax at MMR.

However, aggrieved by the order of the ld. CIT(A), the Revenue filed the appeal before the Hon'ble ITAT.

Ruling

It was decided by the Hon'ble ITAT that where the whole or any part

of the relevant income is not exempt u/s 11 or 12 because of the violation of provisions of section 13(1)(c) or 13(1)(d), tax is chargeable on the relevant income or part of the relevant income at the maximum marginal rate (MMR). Therefore, in case where there is violation of section 13 of the Act then the entire income of the trust is not liable to tax at MMR, but only the relevant part of the income which violates section 13 attracts the MMR. In the present case, even if it is held that there is violation of section 13, then only the amount of benefit given to the persons specified u/s 13(3) out of the income of the trust is chargeable to tax at MMR. Hence, the action of AO in taxing the surplus at maximum marginal rate without considering the provisions of section 11 & 12 is bad in law.

Accordingly, the appeal of the revenue is dismissed.

Source: ITAT in Jaipur, DCIT(Exemptions) Circle vs. Central Academy Jodhpur Education Society; ITA No. 790, 793 & 794 of 2019, dated September 9, 2020

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Capital gain on sale of transfer of Agriculture land is not required to be disclosed in the return of income as it is not a Capital asset and sale of agriculture land is not exigible to tax

Facts

The assessee is an individual, consequent to search u/s. 132 of the Income-tax Act, 1961 in the case of assessee, proceedings u/s. 153A of the Act were initiated for AY 2013-14. The assessee in response to the said notice filed return of income. In the course of assessment proceedings, the AO noticed that assessee received an amount on sale of land at Agarsure Village, Alibaug Taluk, Raigad Dist., Maharashtra. Since capital gain on sale of the property had not been disclosed in the return of income, the AO called upon the assessee to explain why the same was not declared. The assessee took a stand that the property was an agricultural land and therefore was not a capital asset and capital gain on sale of agricultural land was not exigible to tax. The AO accepted the fact that the assessee was an agriculturist and the land in question was an agricultural land as per

the revenue records. He was, however, of the view that the main business of assessee was trading in areca nut. The decision of the Hon'ble Supreme Court in the case of *Sarif Abibi Ibrahim 204 ITR 631 (SC) (1993)* was relied upon and the AO concluded that the land at Agarsure was non-agricultural. Consequently, the same was brought to tax as LTCG. On appeal by the assessee, the CIT(A) concurred with the view of the AO. Hence, the the assessee filed an appeal before the Tribunal.

Ruling

The Tribunal upheld that the AO in the order of assessment are

sufficient to come to a conclusion that the property is not Agricultural land. He firstly pointed out that the classification of the property in the revenue records is agricultural land and the assessee has been paying land revenue charges levied by the Government. According to him this factor was a very vital factor in favour of the assessee. He pointed out that the potential use of the property for non-residential purpose due to presence of amusement and recreational activities in the vicinity of the property was an irrelevant consideration. Yet other reason given by the Tribunal is that the adjacent lands are put to commercial use by way of plots and therefore, the very character of the lands of the assessees is doubted as agricultural in nature. The manner in which the adjacent lands are used by the owner therein is not a ground for the Tribunal to come to a conclusion that the assessees' lands are not agricultural in nature. The reason given by the Tribunal said that the adjacent lands have been divided into plots for sale would not mean that the lands sold by the assessees were for the purpose of development of plots. Also the reasoning given by the Tribunal that "No agriculturists would have purchased the land sold by the assessee for pursuing any agricultural activity" is based on mere conjectures and surmises. However, though circumstance that land was classified as Agricultural in revenue records was in favour of the assessee, however, in view of other circumstances pointed out that land was too small for carrying out agricultural operations, land was sold at a price comparable to price fetched by building sites, price was such that no bona fide agriculturist would purchase same for genuine agricultural operations and no evidence of agricultural operations carried out had been placed on record it was to be concluded that property was not an agricultural land. Therefore, the appeal of the assessee was dismissed.

Source: ITAT, Bangalore in Jairam G Kimmane vs. DCIT, Central Circle ITA No. 2026 of 2019, dated September 4, 2020

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Part disallowance of Interest cannot be made where all the conditions for allowance are fulfilled unless amount borrowed Is not used for the purposes of business

Facts

The assessee challenged the disallowance of interest u/s 36(1)(iii) of the Act. The AO has calculated the interest on interest free advances on notional basis and disallowed the same from interest expenses without considering the actual basics of some availability of interest free funds, unsecured loans, capital and background of the advances given. The assessee has made some interest free advances to various person for business purposes. The same was not accepted by the AO and treating the same as diversion of borrowed funds, proportionate interest was disallowed from interest expenditure

Ruling

As per the facts of the case, the appellant company has huge surplus funds at its disposal. The company had given interest free loans and advances out of interest free funds which consists of capital fund, free reserve, interest free unsecured loans, provisions for deferred tax liabilities created out of surplus and accumulated depreciation reserve created out of profit and trade payable. Details of the same was already provided to the Ld. AO. Since the interest on borrowed fund is allowable as business expenditure by virtue of income tax provision u/s 36(1)(iii) hence payment made for interest on borrowed fund should be allowed as interest expenses in its totality and interest free loans and advances granted out of the interest free own funds even not used for business and no actual interest is received by the assessee therefore, notional interest on such fund cannot be disallowed as interest expenses. The reasonableness of the expenditure would be covered into only for the purpose of the determining whether, in fact, the amount was spent. Once it is established that the nexus between the expenditure and the purpose of business, the revenue cannot justifiably claim to put itself in the arm chair of a businessman or in the position of the board of directors and assume the said role to decide how much is a reasonable expenditure. In support of the contention the Hon'ble ITAT relied upon the judgment passed by the *Hon'ble Delhi High Court* in the case of *Dalmia Cement (B) Ltd. (2002) 254 ITR 377.*

Therefore, the addition on account of interest disallowance is deleted and the assesse's appeal was allowed.

Source: ITAT, Ahmedabad in Balji Electrical Insulators Pvt. Ltd. vs. DCIT; ITA No. 1538, 1539 of 2018, dated September 11, 2020

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Mere debit balance on account of share application money in the books of the assessee company will not fall within the ambit of deemed dividend under the provisions of section 2(22)(e) of the Act

Facts

The assessee company is a shareholder in M/s Pink city Jewel house

Pvt. Ltd. having more than 10% voting power and had applied for allotment of shares of the said company. The assessee accepted the offer and applied for allotment of shares and paid the value of shares through various cheques. The cheque was handed over to the company along with the share applications. The assessee was also having a running account in the company in which he had a credit balance. The Company allotted the shares without presenting the cheque for clearance before allotment and made credit entry for these cheques in her ledger account as well as debited the value of shares to her running account and therefore the account never represented a debit balance. However, two cheques which were credited in the books but were presented by the company after some time however during the current FY, in the books of the assessee there was a credit balance even after debit of for Share Application money but the ld. ACIT has treated the same as deemed dividend u/s 2(22)(e) of the Income tax Act and made the addition.

Further, the CIT(A) deleted the addition, aggrieved by which the department filed an appeal before the Hon'ble ITAT.

Ruling

The provisions of section 2(22)(e) of the Act comes to play only if the company makes any payment to a shareholder, by way of advance or loan and that too to the extent the company possesses accumulated

profits, provided that his/her holding is not less than 10% of the voting power. From the provisions of section 2(22)(e) it is clearly evident that the provisions of this section come to play only if the company makes any payment of advance or loan to a shareholder holding not less than 10% of the voting power. In the case of assessee, the company has not paid any sum and in fact amount is being debited by way of Journal Entry and no amount or money has been given as loan or advance to the shareholder. The debit balance has been notionally worked out by the AO by working out the balance in ledger account of shareholder on the basis of clearing date of cheque received (not paid) in the bank account, which is not correct. As per the accounting principles entries in the books of accounts are required to be made on the basis of transactions entered which is the receipt of cheque, hence the entries appearing in the ledger account is correct and same cannot be ignored and balance cannot be worked out on notional basis and even if he wants to do the same, then also the amount was never paid to the shareholder but in fact was received from the shareholder and the date of debit should also be transferred to the date on which the amount was cleared. There is no way this company has paid any amount to the shareholder and thus provisions of section 2(22)(e) are not applicable. Going on the substance of section 2(22)(e) that is "any payment made by a company that too by way of advance or loan" which shows that for invoking the provisions of section 2(2)(e), there must be a payment by way of advance or loan. This vital aspect is missing in the case of the assessee as neither there is any payment nor the company made any advance or loan to the assessee, thus debit balance worked out by the assessee company will not fall within the ambit of the provisions of section 2(22)(e) and thus are not applicable in the case of the assessee. Therefore, the decision of the CIT(A) in deleting the aforesaid addition has been upheld.

Source: ITAT, in Jaipur DCIT, Circlre-2 vs. Veena Goyal
ITA No. 75, 76 of 2020, dated September 15, 2020

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CIRCULARS & NOTIFICATIONS

CBDT issues guidelines for the deduction of TDS/TCS u/s 194O & section 206C(1H) of the Income Tax Act, 1961

In order to remove difficulties for the deduction of TDS/TCS u/s 194O and 206(1H) of the Income Tax Act, 1961 (newly inserted by the Finance Act, 2020), CBDT with the approval of the Central Government issues the guidelines.

Source: Circular No. 17/2020 dated September 29, 2020.

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Central Government notifies the Faceless Appeal Scheme, 2020

In accordance with the "Transparent Taxation-Honoring the honest" platform launched by our Hon'ble Prime Minister, a faceless appeal platform called the "Faceless Appeal Scheme, 2020", is notified by the Central government for conducting appeal proceedings in a faceless manner before the Commissioner of Income Tax (Appeals) under the Income Tax Laws. The said scheme is intended to impart greater efficiency, transparency and accountability by eliminating the interface between taxpayers, the Tax Authority and CIT(A) and making optimal utilization of the administrative resources with dynamic jurisdiction. The Faceless Appeal Scheme, 2020 involves a step-wise process to

conduct appeal proceedings. It harnesses the use of technology to allow communication between taxpayers, the Tax Authority and CIT(A) and a team-based appeal process in lieu of the existing manual interface and single officer-based proceedings.

Source: Notification No. 76 & 77/2020 dated September 25, 2020.

(PFL to Notification 76 & Notification 77 for the detailed information on the Faceless Assessment Scheme, 2020)

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CBDT issued Income tax (22nd Amendment) Rules, 2020 to notify changes in Form 3CD, Form No 3CEB and ITR6. Further, amended Rule 5 of Income Tax Rules, 1962 and inserted new Rules and Forms

The following proviso shall be substituted by the Income Tax (22nd Amendment Rules, 2020 and shall come into force on the date of their publication in the Official Gazette:

1. Depreciation allowance u/s 32(1)(ii) of the Act for any block of asset entitled to more than 40%. shall be restricted to 40% on the WDV of such block of assets in case of:
    a. a domestic company which has exercised option u/s 115BA(4), or u/s 115BAA(5), or u/s 115BAB(7); or
    b. an individual or HUF which has exercised option u/s 115BAC(5); or
    c. a co-operative society resident in India which has exercised option u/s 115BAD(5)
2. After rule 21AF, the following rules shall be inserted:

    Rule 21AF: Exercise of option u/s 115BAC(5)

    The option to be exercised in accordance with the provisions of section 115BAC(5) by a person, being an individual or HUF, for any PY relevant to the AY beginning on or after April 1, 2021, shall be in **Form No. 10-IE**.

    Form No. 10-IE shall be furnished electronically either under digital signature or electronic verification code.

    Rule 21AH: Exercise of option u/s 115BAD(5)

    The option to be exercised in accordance with the provisions of section 115BAD(5) by a person, being a cooperative society resident in India, for any PY relevant to the AY beginning on or after April 1, 2021, shall be in **Form No. 10-IF**.

    Form No. 10-IF shall be furnished electronically either under digital signature or electronic verification code.

Source: Notification No. 82/2020 dated October 1, 2020.

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