CASE STUDIES - SET 1 (5 Case Studies)

FINAL LEVEL - DT: EXAM IN YEAR 2021 & 2022

1. CASE STUDY

Where a leasehold property is purchased and subsequently converted into freehold property and then sold, should the period of holding be reckoned from the date of purchase or from the date of conversion for determining whether the resultant capital gains is short-term or long-term?

CIT v. Smt. Rama Rani Kalia (2013) 358 ITR 0499 (All.)

Facts of the case:	*The assessee purchased a leasehold property on July 7, 1984. Such leasehold rights in the property were converted into freehold rights on March 29, 2004. She sold the property on March 31, 2004 and declared long-term capital gains on the transfer. The Assessing Officer opined that since the property was acquired by converting the leasehold right into freehold right on March 29, 2004, and was sold within three days on March 31, 2004, the resultant capital gains would be short-term.*
Appellate Authorities' Views:	*The Commissioner (Appeals) opined that the conversion of leasehold property into freehold property was nothing but improvement of the title over the property, as the assessee was the owner prior to conversion. The Tribunal affirmed this view of the Commissioner (Appeals) and held that the gains were long-term capital gains, as the assessee was the owner of the property even prior to conversion*
High Court's Observations:	*The High Court observed that the difference between "short-term capital asset" and "long-term capital asset" is the period over which the property has been held by the assessee and not the nature of title over the property. The lessee of the property has rights as the owner of the property subject to the covenants of the lease deed. Accordingly, the lessee may, subject to covenants of the lease deed, transfer the leasehold rights of the property with the consent of the lessor.*
High Court's Decision:	*The High Court, therefore, concurred with the views of the Tribunal that conversion of the rights of the lessee from leasehold to freehold is only by way of improvement of her rights over the property, which she enjoyed. It would not have any effect on the taxability of gain from such property, which is related to the period over which the property is held. Since, in this case, the period of holding is more than 36 months, the resultant capital gains would be long-term.*

2. CASE STUDY - VERY IMP

X & Co., a partnership firm consisting of three partners, enhanced working partner salary from ₹ 25,000 per month for each partner to ₹ 50,000 per month for each partner. The increase in working partner salary was authorised by the deed of partnership.

The Assessing Officer during the course of assessment contended that the remuneration paid to working partners @ ₹50,000 per month for each partner as excessive and applied section 40A(2)(a) though the payment was within the statutory limit prescribed under section 40(b)(v). Decide the correctness of action of the Assessing Officer.

CIT v. Great City Manufacturing Co. (2013) 351 ITR 156 (All)

The issue under consideration is whether remuneration paid to working partners as per the partnership deed can be considered as unreasonable and excessive for attracting disallowance under section 40A(2)(a) of the Income-tax Act, 1961 even though the same is within the limit prescribed under section 40(b)(v).

The facts of the case are similar to the facts in CIT v. Great City Manufacturing Co. (2013) 351 ITR 156, wherein the above issue came up before the Allahabad High Court.

The High Court observed that section 40(b)(v) prescribes the limit of remuneration to working partners, and deduction is allowable up to such limit while computing the business income. ***If the remuneration paid is within the ceiling limit provided under section 40(b)(v), then, recourse to provisions of section 40A(2)(a) cannot be taken.***

The Assessing Officer is only required to ensure that the remuneration is paid to the working partners mentioned in the partnership deed, the terms and conditions of the partnership deed provide for payment of such remuneration to the working partners and the remuneration is within the limits prescribed under section 40(b)(v). ***If these conditions are complied with, then the Assessing Officer cannot disallow any part of the remuneration on the ground that it is excessive.***

Hence, applying the rationale of the Allahabad High Court ruling in Great City Manufacturing Co.'s case, the increased remuneration which is authorized by the partnership deed and is within the limits specified under section 40(b)(v) and paid to working partners, ***cannot be disallowed by invoking the provisions of section 40A(2)(a).***

The action of the Assessing Officer in this case is, therefore, not correct.

3. CASE STUDY [Can be ignored for exam]

Can unpaid electricity charges be treated as "fees" to attract disallowance under section 43B?

CIT v. Andhra Ferro Alloys P. Ltd. (2012) 349 ITR 255 (A.P)

Assessing Officer's view vis-a-vis Tribunal's view:	*On this issue, the Assessing Officer was of the view that electricity charges come within the ambit of section 43B and therefore, could be allowed as deduction only on payment basis. Therefore, he disallowed the unpaid electricity charges. The Tribunal, however, set aside the disallowance.*
High Court's Observations and Decision:	***The Andhra Pradesh High Court observed that the provisions of section 43B do not incorporate electricity charges.*** *Therefore, non-payment of electricity charges would not attract disallowance under section 43B since such charges cannot be termed as "fees".*

4. CASE STUDY - VERY IMP

Where the waiver is in respect of loan taken for purchase of plant and machinery and tooling equipment, would the same be subject to tax in the hands of the recipient by virtue of the provisions contained in either section 28(iv) or section 41(1)?

CIT v. Mahindra and Mahindra Ltd. [2018] 404 ITR 1 (SC)

Facts of the case:	*The assessee, Mahindra and Mahindra, decided to expand its jeep product line and entered into an agreement with K, an American company, which agreed to sell it dies, welding equipment and die models. The purchase consideration was agreed at $ 650,000 including cost, insurance and freight and K agreed to advance a loan to the assessee at 6% interest repayable after 10 years in instalments. The Reserve Bank of India and the concerned Ministry approved the loan agreement.* *Later on, AMC took over K and agreed to waive the principal amount of loan advanced by K to the assessee - company and to cancel the promissory notes as and when they matured. This was co mmunicated to the assessee-company which filed its return showing ₹ 57,74,064 as cessation of its liability towards AMC.* ***The Income-tax Officer concluded that the waiver of the loan amount represented income and held that the sum of ₹57,74,064 was taxable under section 28(iv) as a perquisite. The alternate argument of the revenue authorities was that the sum would be taxable under section 41(1) as a waiver of a trading liability.***
Issue:	*The issue under consideration is whether the sum due by the assessee-company to K, which has been waived off later on by AMC (which took over K), constitutes taxable income in the hands of the company.*
Supreme Court's Observations:	*The Supreme Court observed that for applicability of section 28(iv), income must arise from business or profession and the benefit received has to be in non - monetary form.* ***The amount of ₹57,74,064, being a cash receipt, therefore, does not fall under section 28(iv).*** *For being covered under section 41(1), the assessee-company should have claimed an allowance or deduction in any assessment for any year in respect of a trading liability incurred by the assessee. Subsequently, during any previous year, if the creditor waives such liability, the assessee-company would be liable to pay tax under section 41. In this case, the loan was taken for procurement of capital assets, namely, plant, machinery and tooling equipment. The purchase amount had not been debited to the trading account or to the profit and loss account in any of the assessment years.* ***Hence, waiver of such loan would not tantamount to cessation of a trading liability.***
Supreme Court's Decision:	*The Supreme Court, accordingly,* ***held that the amount of loan waived would not be taxable either under section 41(1) or under section 28(iv).***

Note – *As per section 2(24)(xviii), assistance in the form of waiver by the Central Government or State Government or any authority or body or agency in cash or kind to the assessee would be included in the definition of "income". In this case, the waiver is by a foreign company, and hence, is not included within the scope of definition of "income" under section 2(24).*

Further, it may be noted that as per Explanation 10 to section 43(1), deduction on account of, subsidy or grant or reimbursement, by whatever name called, received from any person has to be made while computing actual cost. Since waiver has not been expressly included in the said Explanation, it is possible to take a view that the same is not deductible while computing the actual cost. ***However, if a view is taken that "waiver" is included within the scope of the phrase "by whatever name called" in the said Explanation, then, the same has to be deducted while computing actual cost.***

5. CASE STUDY - VERY IMP

Is interest income from share application money deposited in bank eligible for set-off against public issue expenses or should such interest be subject to tax under the head 'Income from Other Sources'?

CIT v. Sree Rama Multi Tech Ltd. [2018] 403 ITR 426 (SC)

Facts of the case:	*The assessee-company is engaged in the manufacture of multi-layer tubes and other speciality packaging and plastic products. It came out with an initial public issue of shares during the relevant assessment years and deposited the share application money received in banks. The interest of ₹ 1,71,30,202 earned on the deposits was shown in the return of income originally filed under the head 'Income from Other Sources'.* ***Subsequently, the assessee-company raised an additional ground before the Tribunal for allowing the set off of such interest against the public issue expenses.***
Issue:	*The* ***issue under consideration is*** *whether the interest income from share application money is taxable under the head 'Income from Other Sources', or can the same be set-off against public issue expenses.*
Supreme Court's Observations:	*The Supreme Court observed that the assessee-company was statutorily required to keep share application money in a separate account till the allotment of shares was completed. Part of the share application money would normally have to be returned to unsuccessful applicants, and therefore, the entire share application money would not ultimately be appropriated by the company.* ***The interest earned was inextricably linked with the requirement of raising share capital .*** *Any surplus money deposited in the bank for the purpose of earning interest is liable to be taxed as "Income from Other Sources".* ***Here, the share application money was deposited with the bank not to make additional income but to comply with the statute.*** *The interest accrued on such deposit is merely incidental. Moreover, the issue of shares relates to capital structure of the company and hence, expenses incurred in connection with the issue of shares are to be capitalized.* ***Accordingly, the accrued interest is not liable to be taxed as "Income from Other Sources"; the same is eligible to be set-off against public issue expenses.***
Supreme Court's Decision:	***The Supreme Court concurred with the High Court's view*** *that the interest accrued on deposit of share application money with bank is eligible for set off against the public issue expenses;* ***such interest is, hence, not taxable as "Income from Other Sources".***

Question based on Case Study 5:

PQR Ltd. is engaged in the manufacture of multi-layer tubes and other speciality packaging and plastic products. It came out with an initial public issue of shares during the year 2020-21 and deposited the share application money received in banks till the allotment of shares was completed. The company earned interest of ₹75 lakhs on such deposits, which it set off against the public issue expenses, while computing total income for A.Y. 2021-22. Accordingly, the company paid the tax on total income, after adjusting tax deducted at source and advance tax paid, and filed its return of income in September, 2021. On scrutiny, the Assessing Officer contended that interest of ₹75 lakhs is not eligible for set-off against public issue expenses but is taxable under the head 'Income from Other Sources'. Examine the correctness of contention of the Assessing Officer.

Solution:

This issue came up before the ***Supreme Court in CIT v. Sree Rama Multi Tech Ltd. [2018] 403 ITR 426****. The Supreme Court observed that the assessee-company was statutorily required to keep share application money in a separate account till the allotment of shares was completed. Part of the share application money would normally have to be returned to unsuccessful applicants, and therefore, the entire share application money would not ultimately be appropriated by the company. The interest earned was inextricably linked with the requirement of raising share capital.*

The Supreme Court further observed that any surplus money deposited in the bank for the purpose of earning interest is liable to be taxed as "Income from Other Sources"; ***however, in this case, the share application money was deposited with the bank not to make additional income by earning interest but to comply with the statute.*** *The interest accrued on such deposit is merely incidental. Moreover, the issue of shares relates to capital structure of the company and hence, expenses incurred in connection with the issue of shares are to be capitalized.* ***Accordingly, the Supreme Court held that the accrued interest on deposit of share application money is eligible to be set-off against public issue expenses.***

Applying the rationale of the Supreme Court ruling to the case on hand, the ***contention of the Assessing Officer that interest income is taxable under the head "Income from Other Sources" is not correct.***