CASE STUDIES - SET 4 (5 Case Studies)

FINAL LEVEL - DT: EXAM IN YEAR 2021 & 2022

16. Tulsi Private Ltd., a company engaged in ship breaking activity, sold some old and used plates, wood etc., in respect of which it did not collect tax from the buyer. The company claimed that such items are usable as such. Hence these are not 'scrap' to attract the provisions for collection of tax at source. The Assessing Officer treated such items in the nature of 'scrap' and raised a demand under section 201(1) and interest under section 201(1A).

Is the action of the Assessing Officer in treating such items as 'scrap' tenable in law? Discuss.

Solution:

The issue under consideration in the present case is, can items which are usable as such be treated as "Scrap" to attract provisions for tax collection at source under section 206C.

The waste and scrap must be from manufacture or mechanical working of material which is definitely not usable as such because of breakage, cutting up, wear and other reasons.

Any material which is usable as such would not fall within the ambit of the expression scrap. In case of a company engaged in ship breaking activity, the old and used plates, wood etc. are usable as such. ***Since the items in question were usable as such, therefore, they do not fall within the definition of "scrap"***

Thus, in the present case, the action of Assessing Officer in treating such items in the nature of scrap and raising a demand under section 201(1) and interest under section 201(1A), ***is not tenable in law.***

Note – *The facts of the case given are similar to the facts in* ***CIT v. Priya Blue Industries (P) Ltd (2016) 381 ITR 210****, wherein the above issue came up before the Gujarat High Court. The answer is based on the rationale of the Gujarat High Court in the said case.*

17. Bose & Co. is a partnership firm consisting of 4 partners with equal shares. The partnership firm is engaged in execution of civil construction contracts with State Government authorities. The partnership firm deposited ₹ 50 lakhs in State Bank of India (SBI) for the purpose of obtaining guarantee as and when the tenders were applied by the firm. It also kept ₹ 10 lakhs in fixed deposit with Canara Bank, being the surplus funds of the firm. The firm credited interest on bank deposits of ₹ 4,00,000 from SBI and ₹ 80,000 from Canara Bank in Profit and Loss account and computed working partners' salary based on the resultant book profit.

The Assessing Officer wants to tax interest incomes as income under the head 'other sources' and accordingly reduced the amount allowable by way of working partners' salary. Is the action of the Assessing Officer tenable in law?

Solution:

Issue Involved: *The issue under consideration is whether the following interest income would be taxable under the head 'Profits and Gains from Business or Profession' or under the head 'Income from Other Sources':*

(1) *interest income of ₹4 lakhs on deposit made with bank for obtaining bank guarantee to carry on business; and*

(2) *interest income of ₹80,000 on fixed deposits made out of surplus funds with the firm*

Provision applicable: *As per the provisions of section 40(b)(v), salary to a working partner is deductible based on the book profits of the firm. In computing the book profits, only items chargeable as business income alone can be included, and not those chargeable under the head "Income from Other Sources".*

Income which is chargeable to tax under the Income-tax Act, 1961 would be chargeable under the residuary head "Income from Other Sources", only if such income is not chargeable to tax under any of the other four heads of income.

Analysis: *The interest income from the deposits made by the firm for the purpose of obtaining guarantee, as and when tenders were applied by it,* ***is inextricably linked to the business of the firm****. Making deposits is an essential requirement for obtaining the bank guarantee which was necessary to apply for tenders. If the firm had not furnished bank guarantee, it would not be eligible for applying for the tenders. Such interest income would, therefore, be taxable under the head "Profits and gains of business or profession". It was so held by* ***the Delhi High Court in CIT v. K and Co. (2014) 364 ITR 93.***

However, the interest amount on fixed deposits made out of surplus funds available with the firm would be chargeable to tax under the head "Income from Other Sources", since the firm had deposited the amount of surplus funds with the bank solely for the purpose of earning interest. Such interest is taxable under the Income-tax Act, 1961, but does not fall within the scope of income chargeable under any of the other four heads of income. Accordingly, such interest would be chargeable to tax under the head "Income from Other Sources". It was so held by the ***Supreme Court in Tuticorin Alkali Chemicals & Fertilizers Ltd. v. CIT [1997] 227 ITR 172.***

Conclusion: *Applying the rationale of the above court rulings to the facts of the present case, the action of the Assessing Officer in taxing the interest of ₹4 lakhs on deposit made with the bank, for obtaining guarantee for applying for tenders, under the head "Income from Other Sources" and accordingly, reducing the amount allowable by way of working partners' salary,* ***is not tenable in law.***

However, similar action relating to interest income of ₹ 80,000 on fixed deposits made out of surplus funds with the firm, ***is correct/tenable in law.***

18. Shri Chandok is running a factory in Nagpur for the past 10 years. He sold the factory building for ₹ 80 lakhs and the consideration was appropriated as ₹ 20 lakhs for the building and ₹ 50 lakhs for the land underneath the building. The factory building is the only asset of the block on which depreciation was claimed and whose WDV was ₹ 1,80,000. The indexed cost of acquisition of land amounts to ₹ 22 lakhs. He deposited ₹ 48 lakhs in capital gain bonds of NHAI within 2 months after the sale of the factory building. The Assessing Officer disallowed the claim of exemption on the reasoning that capital gain on transfer of depreciable asset being short -term is not eligible for exemption under section 54EC. Is the action of the Assessing Officer valid in law?

Solution:

Issue Involved: *Where a depreciable asset held for more than 36 months is transferred, can the claim of exemption under section 54EC be denied on the reasoning that capital gain on transfer of depreciable asset is deemed as short -term.*

Provision applicable: *As per section 54EC, where the capital gain arising from the transfer of a long-term capital asset is invested in the long-term specified asset, [being the bonds issued by the National Highways Authority of India (NHAI) or the Rural Electrification Corporation Limited (RECL) or any other bond notified by the Central Government in this behalf], at any time within a period of six months after the date of such transfer, the amount of such capital gain shall not be charged to tax, to the extent of ₹50 lakhs. The maximum permissible investment in such bonds, in respect of capital gains arising in a financial year, is ₹50 lakhs, whether such investment is made in the same financial year or in the next financial year within the six month period .*

Analysis: *Section 50 is a special provision for computation of capital gains in the case of depreciable asset, and has limited application in the context of computation of capital gains to the extent that the provisions of sections 48 and 49 would apply with the modifications stated thereunder.*

It does not deal with exemption which is provided in a totally different provision i.e. section 54EC. Section 54EC does not make any distinction between depreciable and non-depreciable asset for the purpose of re-investment of capital gains in long term specified assets for availing the exemption thereunder.

Further, section 54EC specifically provides that when the capital gain arising on the transfer a long-term capital asset is invested or deposited in bonds issued by NHAI, the assessee shall not be subject to capital gains to that extent [i.e., lower of capital gains or investment in bonds Up-to a maximum of ₹ 50 lakhs]. Therefore, the exemption under section 54EC cannot be denied to the assessee on account of the fiction created in section 50.

It was so held by the ***Apex Court in CIT v. V.S. Dempo Company Ltd (2016) 387 ITR 354.***

Conclusion: *Applying the rationale of the Apex Court ruling to the facts of the present case, the action of the Assessing Officer disallowing the claim for exemption under section 54EC on the reasoning that capital gain on transfer of depreciable asset is a short-term capital gain, even though held for more than 36 months, is not valid.*

19. Govind Charitable Trust registered under section 12AA is engaged in imparting Yoga to the public. Its aggregate annual receipt was ₹ 60 lakhs and it spent only ₹ 40 lakhs by way of remuneration to Yoga teachers and by way of administration expenses. The trust applied for approval under section 80G to the Commissioner of Income -tax. The application was rejected on the ground that it had not spent 85% of its income for charitable purposes. Decide the validity of the rival contentions.

Solution:

Issue Involved: *Can an application for grant of approval under section 80G(5) be rejected on the ground that the trust has failed to apply 85% of its income for charitable purposes?*

Provision applicable: *Section 80G provides that donation to any institution or fund would qualify for deduction thereunder only if it is established in India for a charitable purpose and derives such income which would not be liable to inclusion in its total income under the provisions of, inter alia, sections 11 and 12.*

Analysis: *While considering the application for the purpose of section 80G,* ***the authority cannot act as an assessing authority*** *and the enquiry should be confined to finding out if the institution satisfies the prescribed conditions.*

Section 80G does not relate to assessment of the trust or the institution whose income is not liable to be included in the computation of taxable income under various provisions of the Act. ***Primarily, section 80G is related to giving deduction in respect of donations made by a person to such trusts and institutions.***

Once a trust is registered under section 12AA, its income from property includes donations received. Such donations are deemed to be income from property, which are not to be included in the total *income under section 11 or section 12. The enquiry under section 80G, hence, cannot go beyond that.*

The scope of enquiry cannot include an enquiry as to whether, at the close of the previous year, the donee-trust will actually be able to apply 85% of its income. This is because non-fulfillment of some conditions by the donee-trust as regards application or accumulation cannot be ascertained initially, when the donation is made. The question of whether the trust will be able to apply 85% of its income can be determined only from the facts existing at the close of the assessment year.

*It was so held by the **Gujarat High Court in CIT v. Shree Govindbhai Jethalal Nathavani Charitable Trust (2015) 373 ITR 619.***

Conclusion: *Applying the rationale of the Gujarat High Court ruling to the facts of the present case, the rejection by the Commissioner, of the application made by Govind Charitable Trust for approval under section 80G, on the ground that it had not spent 85% of its income for charitable purposes, **is not valid.***

20. Syed & Co., a dealer in motor cycles conducted motor cycle race on the occasion of its' 25th year anniversary. The prize was given to first 3 winners by way of a luxury motor cycle which was worth ₹ 2 lakhs each. The assessee did not deduct tax at source on the prize given to the winners. The Assessing Officer treated the assessee as an assessee in default and passed order under sections 201(1) and 201(1A). The as sessee seeks your advice on the validity of the order and other legal consequences. Advise.

Solution:

Issue Involved: *Where the assessee fails to deduct tax at source in respect of the winnings, which are wholly in kind, can he be deemed as an assessee-in-default under section 201(1) and 201(1A).*

Provision applicable: *The person responsible for paying to any person any income by way of winnings from any lottery or crossword puzzle, card game and any other game of any sort in an amount exceeding ₹10,000 shall deduct tax at source @ 30%.*

*However, **where the winnings are wholly in kind,** the person responsible for paying shall, **before releasing the winnings, ensure that tax has been paid in respect of the winnings.***

Where any person, who is required to deduct any sum in accordance with the provisions of this Act, does not deduct, or does not pay, or after so deducting fails to pay such tax, then, such person would be deemed to be an assessee in default.

Analysis: *On a combined reading of the above provisions, it is possible to infer that, if any such person fails to "deduct" the whole or any part of the tax, or, after deducting, fails to pay the tax as required by or under the Act, then, such person shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee-in-default in respect of such tax.*

The provisions, however, do not cast any duty on any person to deduct tax at source where the winnings are wholly in kind. If the winnings are wholly in kind, as a matter of fact, there cannot be any deduction of tax at source. *The word "deduction" employed in this provision postulates a reduction or subtraction of an amount from a gross sum to be paid and payment of the net amount thereafter.*

Where the winnings are wholly in kind the question of deduction of any sum therefrom does not arise and in that eventuality, ***the only responsibility, as cast under the provisions of the Act, is to ensure that tax is paid by the winner of the prize before the prize or winnings is or are released in his favour .***

It was so held by the Karnataka High Court in ***CIT v. Hindustan Lever Ltd. (2014) 361 ITR 1****.*

Conclusion: *Applying the rationale of the Karnataka High Court to the facts of the present case, order under sections 201(1) and 201(1A) passed treating the dealer* ***as an assessee-in-default is not tenable in law.***

However, for this default, the dealer would be ***liable for penalty*** *equal to the sum of tax deductible and* ***prosecution by way of imprisonment and fine*** *for failing to ensure that tax is paid by the winner of the prize before the winnings are released in his favour.*