Legal Decisions: Direct Taxes

Whether the liability towards unsuccessful members of a vehicle draw scheme is deductible under the provisions of Income-tax Act?

Kanakateegala Enterprises v. CIT [2005] 274 ITR 448 (A.P - HC)

Decision: The liability towards unsuccessful members of the vehicle draw scheme is a contingent liability. It is not a case where liability is accrued and payment is pending and thus not deductible.

A vehicle draw scheme known as "own your vehicle scheme" was floated by the assessee being a registered firm carrying on business of conducting various schemes for the supply of different types of vehicles. Under the abovementioned scheme there were three types of schemes namely Luna scheme, Scooter scheme and Car scheme. In each scheme 250 members were enrolled and the duration of the scheme was 40 months. Different instalments were prescribed for different types of vehicle scheme. However, the common feature among all the schemes was that a draw was to be conducted every month and, the lucky member would get the vehicle and will not be required to pay further instalments. This will continue for 40 months and 40 lucky members would get the prize. The remaining members who have paid monthly subscription without default would get back the actual amount subscribed by them for 40 months with some extra amount. For the relevant assessment year, the assessee claimed a loss of Rs. 9,33,085, which included the amount of Rs. 7,85,725 kept as a provision for future scheme loss. The claim was disallowed by the Assessing Officer and the order was confirmed by the Commissioner (Appeals) and the Tribunal.

On a reference from the High Court it was held that the liability undertaken by the assessee at the time of entering the contract was subject to the condition that the member should pay all the 40 instalments without default. There was no guarantee as to how many members would continue to be subscribers to the scheme and how many members would remain in the scheme till the end. There was no liability, which accrued in the previous year relevant to the assessment year in question. As no liability had accrued the same was a contingent liability and thus, Rs. 7,85,725 were not deductible.

Note: There is a distinction between a contingent liability and a payment depending upon contingency. The liability towards the unsuccessful members arise only after the payment of the last instalment. In the above case the payment does not depend on contingency, but is a contingent liability.

2. Whether the acceptance of share application money in cash amounting to Rs. 20,000 or more violates the provisions of section 269SS?

Bhalotia Engineering Works Pvt. Ltd. v.CIT [2005] 275 ITR 399 (Jharkhand)

Relevant sections: 269SS, 271D

Decision: Share application money partakes the character of a "deposit" since it is repayable in specie on refusal to allot shares and is repayable if recalled by the applicant, before the allotment of shares and the conclusion of the contract.

The assessee being a private limited company accepted the amounts of Rs. 20,000 and more in cash from 10 persons and this was recorded in the books. During the course of assessment proceedings the Assessing Officer initiated a penalty proceeding under section 271D of the Income-tax Act, 1961.

Section 271D (1) clearly specifies that if a person takes or accepts a loan in contravention of the provisions of section 269SS, he shall be liable to pay by way of penalty, a sum equal to the amount of the loan or deposit so taken or accepted. The assessee sought to explain that these amounts were received by it as application money from 10 persons and subsequently shares were allotted to them. Thus, the amounts received from them in cash were not loans or deposits in view of Explanation to section 271D according to which loan or deposit means loan or deposit of money. The order of Assessing Officer was challenged by the assessee before the Commissioner (Appeals) who accepted the contention of the assessee.

On reference to the Jharkhand High Court it was held that the amounts were certainly not loans repayable without demand by the lenders but they partake the character of deposit, as the amounts were liable to be refunded to the applicants if it was decided that shares were not to be allotted to them. The provisions of section 269SS were violated when the assessee accepted the share application money in cash amounting to Rs. 20,000 or more.

Note: As per the Explanation to section 269T of the Act deposit means deposit of money which is repayable after notice or repayable after a period.

3. Whether:

a) there are special provisions under section 115AD for computing capital gains from investment in securities that apply to computation of capital loss also?

b) FII has an option to opt for general provisions for computing capital gains to get the benefit of Indexation?

c) provisions in the agreement for avoidance of double taxation between India and U.K., which provides different tax treatment on the basis of nationality?

Universities Superannuation Scheme Ltd. In re. [2005] 275 ITR 434 (A.A.R)

Relevant sections: 115AD of Income- tax Act 1961, Article 26 of DTAA between U.K. and India.

Decision:

a) The provisions of section 115AD would apply in respect of capital loss on the transfer of securities.

b) Special provision under section 115AD overrides general provisions. Absence of any provision in the section 115AD indicates that no option is available to FII for availing the benefit of indexation.

c) Article 26 of Double Taxation Avoidance Agreement forbids discrimination on the ground of nationality or residential status.

The applicant was a tax resident of U.K. and was registered in India as a Foreign Institutional Investor (FII) with SEBI. The Universities of U.K. established the applicant to discharge the office of the trustee of a superannuation scheme for providing pension and other benefits to the academic and senior staff. The applicant invested in securities in India and suffered a long term capital loss in the accounting year relevant to the assessment year 2003-04. The applicant being a FII was governed by the provisions of section 115AD of the Income-tax Act, 1961. The loss computed in accordance with the provisions of section 115AD was Rs. 12,94,46,340. The loss worked out under the second proviso to section 48 was more than the abovementioned loss. Loss calculated as per the provisions of section 115AD(3) was even more. On these facts the applicant sought the ruling of the Authority on the following questions:

a) Could the applicant opt out of the provisions of section 115AD and seek the benefit of indexation under section 48 and 112?

b) If the option was exercised would the applicant be precluded from taking a different position in later years?

c) Whether the provisions under section 115AD would apply to an assessee who has suffered a capital loss on the transfer of securities?

On the basis of facts stated the authority ruled that:

a) The special provisions relating to FIIs are contained in section 115AD. Special provisions override general provisions. Nothing contained in section 115AD gives an option to an assessee to opt for general provisions. For the reason that the applicant suffered a loss in an assessment year, it cannot claim to opt out of section 115AD.

b) Section 115AD(3) is a self-contained code. It is an inclusive provision containing, *inter alia*, the mode of computation of capital gains and concessional rate of tax. Its application does not depend upon the result of computation. Gain and loss are two sides of the same coin.

c) As Article 26 of the DTAA between India and U.K. is not discriminative no option is provided to FIIs on

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the basis of their residential status or nationality.

4. Whether loss in respect of heroin seized from the laboratory of a doctor is allowable as a deduction?

CIT v. Dr. T.A. Qureshi [2005] 275 ITR 352 (M.P.)

Relevant section: Explanation to section 37

Decision: A doctor has nothing to do with contraband articles like heroin. Any expenditure for any purpose, which is an offence or prohibited under any law shall not be deemed to have been incurred for business purposes.

The assessee was a doctor. In the year 1985, a raid was conducted at his premises wherein a clandestine laboratory to manufacture heroin powder along with several contraband drugs were recovered. All these contraband articles were seized. The assessee claimed that since heroin seized formed part of his stock-in–trade, its loss from seizure should be allowed as a deduction while computing profits and gains of his profession. The Assessing Officer rejected the doctors claim, but the tribunal allowed it.

On reference the High Court held that the assessee was a doctor by profession and had nothing to do with the contraband articles i.e heroin for carrying on his business. The possession of heroin was an offence under the Narcotic Drugs and Psychotropic Substances Act, 1985. The loss was not deductible.

Note: Explanation to section 37 of the Income-tax Act, 1961 was inserted by Finance Act (No.2) 1998, retrospectively from April 1, 1962. It clarifies that any expenditure for an illegal purpose shall not be deemed to have been incurred for the purposes of business or profession and thus, no deduction on that account shall be allowed.

5. Whether income from the property in occupation of the employees of sister concerns of the assessee be treated as income from house property under section 22 or charged under section 28(i)?

CIT v. T.V. Sundaram Iyengar &Sons Ltd. [2005] 145 Taxman 380 (Mad.)

Relevant sections: 22, 28(i)

Decision: Occupation of properties by employees of sister concern could not be construed as occupation by the employees of the assessee itself and therefore income from such property will be treated as income from house property under section 22.

The assessee let out certain properties to the employees of its subsidiary company. The assessee assessed the said properties as commercial assets and charged the same under section 28(i). However, the revenue assessed the income of the property under section 22 as income from house property. The Commissioner (Appeals) upheld the order of the Assessing Officer. On further appeal the Tribunal held that the residential properties let out to the employees of the sister concern were to be treated as commercial assets and depreciation was to be allowed on it and rental income should be treated as business income in the hands of the assessee.

As per the provisions of section 22 for claiming the exemption the assessee is required to satisfy two conditions i.e the property must be in occupation of the assessee for the purpose of business or profession and the profits should be chargeable to income tax. The term 'occupy' appearing in section 22 had been judicially interpreted as occupation directly by the assessee himself or through his employee or agent but such occupation must be subservient and necessary for the business of the assessee.

Taking into consideration the above interpretation the Court held that the assessee had let out the property to the employees of sister concern, which is a separate and independent assessee. Therefore occupation by the employees of sister concern cannot be construed to be occupation by the employees of the assessee. It is contrary to all rules of construction to read words into the Act unless it is absolutely necessary to do so. Rules of interpretation do not permit Courts to do so, unless the provision as it stands is meaningless or of a doubtful meaning. It was held that the income from the property let out to the employees of the subsidiary company should be treated as income from house property under section 22 instead of assessing the property as commercial assets and charging the same under section 28(i).

Note: In *CIT v. Delhi Cloth & General Mills Co. Ltd [1966] 59 ITR 152 (Punj.)* it was held that it is very much common for the assessees carrying on business of manufacturing and selling etc. to have constructed residential quarters and let them out to their employees, as incidental to their main business. In such cases, the letting out of residential quarters is sub-servient and incidental to the main business and section 22 does not apply to rent, if any, charged for such property. However, section 28 would apply. The case discussed above is distinguishable because such rent has been realised from the employees of the subsidiary company and not from the employer company itself.

6. Whether documents other than the books of account can be considered for ordering special audit under section 142(2A)?

Rajesh Kumar, Proprietor, Surya Trading v. Deputy Commissioner of Income tax [2005] 275 ITR 641 (Delhi)

Relevant sections: 142 (2A), 142 (1)

Decision: While directing special audit the Assessing Officer is not required to confine himself to the books of account submitted by the assessee. He can also consider such other documents related thereto and forming part of the assessment proceedings.

Search and seizure was carried out upon the petitioners under the provisions of section 132(1) during which various documents and books of account were seized. A notice under section 158BC was issued by the department, in response of which the petitioners filed the return of undisclosed income. After examination of the return the Assessing Officer issued a notice-cum-questionnaire to the petitioners under section 142(1) of the Act. The petitioner submitted the reply but the department was not satisfied by such reply due to which directions for audit under section 142(2A) were issued by the Assessing Officer. The petitioners filed a writ petition against the order.

It was held that before giving such direction the Assessing Officer had issued a detailed questionnaire under section 142(1) to the petitioner requiring them to furnish details, answer to which was not found satisfactory. This led to the direction for special audit. The Assessing Officer has applied his mind, which is essential before issuing such a direction. The provisions of section 142(2A) contemplates that at any stage of the proceedings if the Assessing Officer, having regard to the nature and complexity of the accounts of the assessee and interest of revenue, is of the opinion that it is necessary to do so, may get the accounts audited. The Assessing Officer while applying his mind need not confine himself only to the books of account submitted by the assessee but can also consider such other documents, which would be part of assessment proceedings. The Writ was dismissed and the order under section 142(2A) was held to be valid.

Note: This case establishes the principle that while ordering audit under section 142(2A) the power of the Assessing Officer is quite extensive and he can even go beyond the books of account for the purpose of arriving at a decision.❐