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1. Classification of Income: Section 28 versus Section 45 (shares; immovable property sale/purchase etc); versus section 22 (lease income/rentals etc)

   - **Property Rentals**

   Goel Builders: Allahabad High Court : In the present case, from the very beginning, the plot purchased and building constructed by the assessee was for commercial use. That is why continuously since almost a decade, the rental income was assessed of his "business income" and not for "house property". Nothing has been brought on record to show that the assessee constructed the building as house property for own use...In the present case, the investment made by the assessee while constructing the commercial complex seems to be a business investment, hence the rental income earned from the building as a natural consequence shall be business income.. it may be safely inferred that the assessee constructed the 'Goel Complex' exclusively as the part of its commercial activity to earn income by letting it on rent. Accordingly, the income so drawn shall be business income. INCOME TAX APPEAL No. - 127 of 2005/24.5.2010

   (also see Guj HC in Neha Builders 296 ITR 661, DHC IN K.J.Business Centre; BHC in Nutan Warehousing INCOME TAX APPEAL NO.1269 OF 2007; Kar High Court Mysore Intercontinental Hotels ; Kar High Court East West Hotels (hotel lease- no intention to resume business- hence other sources taxation; otherwise business head eg if leased out for facing temporary lull ; All High Court Rawalpindi Flour Mills etc)

   - **Shares and Securities (Host of factors: no of scrips involved; no of total transactions; delivery versus non delivery transactions; primary market versus secondary market; earlier year treatment accepted; infrastructure employed if any etc)**

   ITAT Mumbai bench in Bharat Kunverji Kenia – 130 TTJ 86 (URO) Held (where assessee engaged in pulses business- carried shares transactions- mere frequency and volume not decisive – book treatment and no borrowings emphasized – cap gains)

ITAT Delhi Bench in Rajiv Anand 34 SOT Page 42 (capital gains held);

Mumbai ITAT bench in Smt. Sadhana Nabera vs. ACIT (ITAT Mumbai) (business income held); Management Structures and Systems (capital gains held)

In J. M. Share & Stock Brokers and Gopal Purohit 228 CTR 582 (Bom), the assessee had separate portfolios for trading and investment. See Also Sarnath Infrastructure 120 TTJ 216 (Luck) where the legal principles have been succinctly summarized

From Treaty Perspective; AAR in Royal Bank of Canada etc

(refer DHC in SMC Credit Ltd (for business head taxation);

- **Land Deals**

P&H High Court :Mohini Kulwant Ghai: Classification Gains from Property Sales: Held "We have heard the learned counsel for the appellant. It has been found as a fact that merely because the assessee was engaged in the business of buying and selling of property in the name of the company would not result into an inference that she would not held some property as investment in her own name by keeping in view the fact that most of the property had been held by the assessee for the last ten years and that there was no frequent purchase/ sale of the property made in her individual name. Therefore, the intention with regard to transaction of sale and purchase of property has been ascertained in accordance with law which is necessarily a finding of fact which cannot be gone into.."

P&H High Court ruling in Raj Bricks Industry on characterization of Land sale Gains vis a vis Capital Gains or Business Profits:

"2. The assessee is a partnership firm and carries on business of running brick kiln. It derived income from sale of land earlier purchased. The land was sold on winding up of the firm. The said income was claimed to be income from capital gain. The Assessing Officer, however, held the
said income to be not from capital gain but from business, by treating the sale to be adventure in the nature of trade. On appeal, the CIT(A) reversed the view taken

by the Assessing Officer and held that income was covered by the heading of capital gains. Reliance was also placed on the judgment of Hon'ble Suprme Court in ***Raja Bahadur Kamakhya Narain Singh*** *Vs.* ***CIT****, (1970) 77 ITR 253.*

There is no dispute to the fact that the assessee is running a brick kiln and the land acquired as a capital asset over a period and the same was shown by the assessee in the balance sheet. The part of the land was got refilled in the year 2001 with the sole intention of reusing the same but the character of the land was not changed. The assessee was forced to sell the land to pay off the tax liability. It is not the case that the assessee is in regular business of sale of land rather the assessee was doing its bricks business. In view of this fact we are in agreement with the impugned order that there was no adventure in the nature of trade…"

2. Method Of Accounting : Section 28 with Section 145

Tour Operator : Delhi High Court : Paradise Holidays: Books rejection

….The Tribunal which is the final fact finding authority has held that considering the nature of the business of the assessee, it was not obligatory to enter into a formal agreement with the foreign principal. Hence, non-production of formal agreements with the foreign principals would not render the accounts of the assessee incomplete and would not give justification to the Assessing Officer to reject them under Section 145(3) of the Act. Similarly, the explanation given by the assessee for the tour expenses not reconciling with tour itinerary having been accepted, both by Commissioner of Income Tax(Appeals) as well as by the Tribunal, the accounts of the assessee cannot be said to be defective on this ground and, therefore, could not have been rejected. If any particular expense claimed by the assessee remained unverified, the Assessing Officer could have disallowed that particular expense. But, that by itself cannot be a ground for rejection of accounts as a whole under Section 145(3) of the Act

Jas Jack Elegance Exports: Held

No provision either in the Act or in the rules requiring an assessee carrying business of this nature, to maintain a Stock Register, as a part of its accounts has been brought to our notice. ***As regards non-production of Stock Register, the assessee has given an explanation which has been accepted not only by the Commissioner of Income Tax(Appeals) but also by the Tribunal and both of them have given a concurrent finding of fact that maintaining Stock Register was not feasible considering the nature of the business being run by the assessee which was engaged in the business of manufacturing readymade garments by purchasing fabric which was then subjected to embroidery, dyeing and finishing and then converted into readymade garments by stitching. Section 145(3) of the Act therefore could not have been applied by the Assessing Officer to the present case***. &

Non Production of Fabricators/Job Workers etc: no ground for books rejection: 6. As regards failure of the assessee to produce the persons to whom payments were made by the assessee for fabrication, embroidery and dyeing & finishing, etc., the Assessing Officer was at liberty to summon any or all of them in case he wanted to verify the genuineness of the payments made to them. No such course of action was, however, adopted by him. Failure of the assessee to produce those persons could not have been a ground for rejecting the accounts under Section 145(3) of the Act.

SMT. POONAM RANI: 8. The fall in gross profit ratio, in the absence of any cogent reasons could not, by itself, have been a ground to hold that proper income of the assessee cannot be deduced from the accounts maintained by her and consequently, could not have been a ground to reject the accounts invoking Section 145(3) of the Act. …9. The fall in gross profit ratio could be for various reasons such as increase in

the cost of raw material, decrease in the market price of finished product, increase in the cost of processing by the assessee etc. There is no finding that the actual cost of the raw material purchased by the assessee was less than what was declared in the account books. There is no finding that the actual cost of processing carried out by the assessee was less than what had been declared in her account books. No particular expenditure shown in the account books has been disallowed by the Assessing Officer. There is no finding by the Assessing Officer that the actual quantity of finished product produced by the assessee was more than what it was shown in the accounts books. There is no finding that the assessee had made any such sale of the finished product which was not reflected in the accounts books. There is no finding by the Assessing Officer that the finished product was sold by the assessee at a price higher than what was declared in the accounts books. In these circumstances, the Commissioner of Income Tax (Appeals) and the Income Tax Appellate Tribunal, in our view, were justified in holding that the Assessing Officer could not have increased the gross profit ratio merely because it was low as compared to the gross profit ratio of the preceding year. …If stock register is not maintained by the assessee that may put the Assessing Officer on guard against the falsity of the return made by the assessee and persuade him to carefully scrutinize the account books of the assessee. But the absence of one register alone does not amount to such a material as would lead to the conclusion that the account books were incomplete or inaccurate ..

Delhi Bench of ITAT in Motia Rani Bhatia and Chettan Dass Laxman Dass Section 145 etc

P&H High Court: Crown Milk: Books rejection Section 145: Trading results comparison: Held "We have heard learned counsel for the Revenue at considerable length and find that in the absence of rejection of books of accounts, it would not be possible for the Assessing Officer to resort to some other formula by invoking the norms of Amrit Dairy and then make additions. No question of law much less a substantive question of law would arise for determination of this court. The appeal does not warrant admission and is thus liable to be dismissed"

3. Business Loss: Cases:

   - Advance Money forfeited (real estate developer): Allowable business loss: Delhi High Court Rose View Apartments

   - DHC has affirmed concurrent conclusion of ITAT and CIT-A as to loss on account of non recovery of advance made for purchase of shares on trading account. to stock broker, in course of trade, is allowable as trading loss under Income Tax Act, 1961. SMT. BALA KAUL

   - Karnataka High Court in the case of Bhartiya Reserve Bank Note Mudran (P) Ltd (a WHOLLY owned subsidiary of RBI engaged in printing of currency notes ultimately supplied to RBI): In this interesting case, assessee company ordered for certain machines intended to be used in the process of printing of currency notes, out of which a machine was damaged during transit, from which after reducing insurance compensation, assessee suffered loss of INR 25 lacs (app) which was claimed as business loss. This claim of assessee company was rejected by AO stating the loss to be in capital field, affirmed by CIT-Appeals. However, ITAT allowed assessee's claim which order in turn has been now approved by Kar HC

4. **Business Setting Up Section 3 vis a vis Section 28 TRIGGER POINT**

   BHC in Western Vegetable 26 ITR 151 In captioned case, BHC speaking through CJ Chagla (as his lordship then was) interalia held as under:

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"…It seems to us, that the expression "setting up" means, as is defined in the Oxford English Dictionary, "to place on foot" of "to established", and in contradistinction to "commence". The distinction is that when a business is established and is ready to commence business then it can be said of that business that it is set up. But before it is ready to commence business it is not set up. But there may be an interregnum, there may be an interval between a business which is set up and a business which is commenced and all expenses incurred after the setting up of the business and before the commencement of the business, all expenses during the interregnum, would be permissible deductions under Section 10 (2)(present section 37(1)) ….."

In aforesaid case, Assessee Company's object was to run *oil mill* and in this line of business operation, it was the case of Assessing Officer (AO) that assessee's business was set up only when it made *first purchase of groundnut oil*. Finally, BHC upheld ITAT's view wherein it was held that albeit first purchase of raw material in indicative of setting up of business, *but still some time would have been taken in making arrangements for purchase, therefore additional cushion of one month was allowed in computing "set up" date*. In this case, another interesting feature which came to light was three authorities viz. AO, Appellate Commissioner (AC), ITAT came to three different set up dates viz. AO took date of raw material purchase, AC took date of commencement of business certificate, and ITAT took one month date prior to raw material purchase.

This is how the issue becomes more complex and therefore it is advisable to minutely analyze/consider date of every event in initial phase of business operation so as to correctly decide the "date of set up" u/s 3 of the Act.

Further, it becomes manifest from aforesaid BHC ruling, that date of set up of business operations has to be necessarily and particularly analyzed in context of "objects" for which business is started which may be evident in company's case from Memorandum of Association, as different parameters will apply to different sets of business. ***Further relevant in this context is Guj HC ruling in Saurashtra Cement 91 ITR 170 wherein it is held that:*** *…the term business connotes a continuous course of activities. All the activities, which go to make up the business, need not be started simultaneously in order that the business may commence. The business would commence, when the activity which is first in point of time and which must necessarily precede all other activities, is started.* ***It was further held that in order to determine the question whether, the business of an assessee has commenced or not, it is necessary to consider, what constitutes the business of the assessee. It was also laid down that in determining this question arising under fiscal legislation, one must consider what are the activities which constituted such business without being misguided by the loose expressions of vague and indefinite import****…*

5. **Lull Business : Expenses to keep the business going : Madras High Court in L.Ve Chettiar 72 ITR 114 as relied by Delhi Bench of ITAT in Mokul Finance 110 TTJ 445**

In the case of L.VE. Vairavan Chettiar vs. CIT (1969) 72 ITR 114 (Mad), their Lordships of Hon'ble Madras High Court were in seisin of a situation where the assessee had obtained an import licence for doing arecanut business but due to adverse conditions in market, he temporarily suspended the arecanut business for the assessment year in question. Nevertheless, he was maintaining the establishment and was waiting for improved market conditions in arecanut. It was thus an admitted position that no activities were carried out so far as this part of the business was concerned. On these facts, their Lordships took note of the position that "There is nothing on record to show that he completely abandoned or closed the business forever. On the other hand, his books of account revealed that he was meeting the establishment charges and interest payments as detailed in the accounts in the year of accounts". It was then observed that the question whether the business is being carried on must depend in each case on its own facts and not on any general theory of law. Their Lordships then referred to, with approval, Lord •Summer's observation in IRC vs. South Behar Railway Co. Ltd. (1925) 12 Tax Cases 657 that business is not confined to being busy; in many businesses long intervals of inactivity occur. . . . "The concern is still a going concern though a very quiet one." After elaborate survey of judicial precedents on the issue, their Lordships concluded, in the light of, as noted above, the factual position that "there is nothing on record to show that he completely abandoned or closed the business forever. On the other hand, his books of account revealed that he was meeting the establishment charges and interest payments as detailed in the accounts in the year of account," that the loss in arecanut business, in which admittedly no activity was carried out during the relevant previous year, was to be set off against assessee's business income in the year. As the ratio of the aforesaid judgment is summed up in the ITR headnotes at p. 115 of the report, "as the assessee was maintaining the establishment and waiting for the improved market conditions in arecanuts and there was nothing to show that he completely abandoned or closed the business forever, the business must be deemed to be continuing". In the light of this legal position, it would follow that unless there is some material on record to show that the assessee has completely abandoned the share dealing business, merely because there are no business transactions in the relevant previous year cannot be reason enough to come to the conclusion the business has come to an end. It could not thus be said ; as was the case before the Hon'ble Madras High Court, that the assessee had "completely abandoned or closed the business forever".

33 DTR 210: KNP Securities: Mum ITAT Held: SEBI has barred the assessee from doing business till further orders and thus not doing business activity was on account of forced Circumstances and not voluntarily and therefore Assessee was entitled to deduction for business Expense, interest etc

6. **Stock Valuation Principles**
   - *Principles for Closing Stock Valuation (Cost or Market Price whichever is less) Refer:*
   - *SC in Chainrup Sampatram 24 ITR 481 (misconception any profit can arise out of valuation of stock) applied latestly by Guj HC in 217 CTR 254*
   - *SC in Hindustan Zinc 291 ITR 391 (no local market of the commodity and valuation at foreign price)*
   - *Mad HC in 56 ITR 360 & 60 ITR 531 (Obsolete stock valuation) Latest DHC in Hotline and Reliance Electronics at 12 DTR 311 & 13 DTR 143*
   - *Principles laid by SC in 240 ITR 355*

7. **SC in TRF on Bad Debts u/s 36(1)(vii) (Write off is sufficient, no need to prove badness of debt) – DHC in Bonanza case on Stock Broker**

8. **Commission payment: Delhi Bench of ITAT in Shyam Sunder Jajodia (approved by DHC) and latest Delhi bench of ITAT in Mobile India 128 TTJ 666 (Detailed ruling covering host of issues)**

   As regards allowability of commission expense u/s 37 of the Act and onus probandi for the same : Held that considering the quantum of information available with the AO in the matter, the AO should have attempted to disprove contents of the agency agreement or that payments made through the banks were bogus or money had come back to the assessee by way of cash etc, and in the process the AO had not done his part of the duty in the matter, assessee has discharged his onus…also observed subject commission expense to procure orders from NTPC etc – not in violation of Prevention of Corruption Act- 30 SOT 495 Mum ITAT Dresser Value Reference may be further made to:

   a) DHC ruling in Smer Mal Nahata; b) DHC ruling in Printer House; c) DHC ruling in Tusker Dye Chem ITA 21/2008; d) DHC ruling in Fancy International 166 tAXMAN 183; e) Del ITAT ruling in Shyam Sunder Jajodia ; f) DHC ruling in Dr R.N.Goel; g) DHC ruling in J.M.D Computers; h) DHC ruling in Jindal Vegetable; i) DHC ruling in Gujarat Guardian; j) Raj HC in Laxmi Engg 298 ITR 203

9. Section 40A(2)(b) Related Party Payment:

1. On section 40A(2)(b): In case of Indo Saudi Services, BHC in relation to aforesaid subject, interalia placing reliance on CBDT Circluar No. 6-P of 1968 explaining scope of subject provision, has upheld ITAT's conclusion that unless there is evasion to tax (onus on revenue), no disallowance can be made on payments to relatives under subject provision. In this case, BHC took cognizance of the fact that payee relative (sister concern) is assessed to tax on subject payments by instant assessee.

   In aforesaid connection, further reference can be made to following rulings on subject:

   a) SC in 117 ITR 569
   b) KarHC in 160 Taxman 244 : unless there is no intention to evade tax and subject expense is not shocking, no disallowance u/s 40A(2)(b) is attracted.
   c) Mad HC in 285 ITR 84 : Legal test reasonability of an expense to be judged from businessman point of view applies to section 40A(2)(b) also.
   d) Del ITAT in Shar Lee Filtorties ITA 4621/Del/2005 (argued by undersigned)

e) Del ITAT (SMC) in Mittal Metals 21 SOT 186
f) Del ITAT in Gujarat Guardian 114 TTJ 565
g) Raj HC in Udaipur Distilleries: ***Raj HC after taking stock of number of precedents on the issue of disallowance u/s 40A(2) (payments to related parties), has upheld CIT-A & ITAT order holding that:***
a) Consistency needs to be adopted when facts flowing through different years are same that is when expense stands allowed in earlier assesments u/s 143(3) same cannot be departed unles facts are changed (Refer SC Larger Bench ruling in JK Charitable Trust and DHC ruling in Bhartesh Jain);
b) to invoke section 40A(2) of the Act, it is must on part of AO to prove by positive evidence on record, expense is not reasonable; AO cannot compel businessman to conduct its business in a manner suitable to him (AO) (that is AO cannot ask businessman to take loans on cheaper rate from banks instead of outside parties from which assessee took the loan); AO needs to bring comparable cases on record for invoking subject provision;
c) it is upto businessman how he conducts his business; d) By reference to SC ruling in 65 ITR 381, it is observed that to justify increased remuneration it is not necessary that profits increase in same proportion;
e) By reference to SC ruling in 72 ITR 612, it is observed that reasonableness of an expense needs to be judged from businessman point of view and it is not the function of courts/AO to state what expense assesse should incur; (also refer SC in 288 ITR 1 SA Builders)

10. Section 14A: SC in Wallfort Stock Brokers 6/7/2010

SECTION 14A CLASSICAL PROPOSITIONS: MUMBAI ITAT DAGA CAPITAL SPECI AL BENCH MAY BE IMPACTED (PRIMA FACIE) FROM SC RULING OF TODAY'S DATE IN WALLFORT CASE **INCL TAX AVOIDANCE**

HELD

The insertion of Section 14A with retrospective effect is the serious attempt on the part of the Parliament not to allow deduction in respect of any expenditure incurred by the assessee in relation to income, which does not form part of the total income under the Act against the taxable income (see Circular No. 14 of 2001 dated 22.11.2001).

….Therefore, one needs to read the words "expenditure incurred" in Section 14A in the context of the scheme of the Act and, if so read, it is clear that it disallows certain expenditures incurred to earn exempt income from being deducted from other income which is includible in the "total income" for the purpose of chargeability to tax…….

For attracting Section 14A, there has to be a proximate cause for disallowance, which is its relationship with the tax exempt income. Pay-back or return of investment is not such proximate cause, hence, Section 14A is not applicable in the present case. Thus, in the absence of such proximate cause for disallowance, Section 14A cannot be invoked….

Section 14A deals with disallowance of expenditure incurred in earning tax-free income against the profits of the accounting year under Sections 30 to 37 of the Act….. Section 14A comes in when there is claim for deduction of an expenditure…

…Even assuming that the transaction was pre-planned there is nothing to impeach the genuineness of the transaction. With regard to the ruling in McDowell & Co. Ltd. v. Commercial Tax Officer [154 ITR 148(SC)], it may be stated that in the later decision of this Court in Union of India v. Azadi Bachao Andolan [263 ITR 706(SC)] it has been held that a citizen is free to carry on its business within the four corners of the law. That, mere tax planning, without any motive to evade taxes through colourable devices is not frowned upon even by the judgment of this Court in McDowell & Co. Ltd.'s case (supra).

11. Liquidated Damages Saurashtra case 9/7/2010 SC views

SUPREME COURT IN SAURASHTRA CEMENT LIMITED ON CAPITAL RECEIPT HELD:

"....It is evident that the damages to the assessee was directly and intimately linked with the procurement of a capital asset i.e. the cement plant, which would obviously lead to delay in coming into existence of the profit making apparatus, rather than a receipt in the course of profit earning process. Compensation paid for the delay in procurement of capital asset amounted to sterilization of the capital asset of the assessee as supplier had failed to supply the plant within time as stipulated in the agreement and clause No.6 thereof came into play. The afore- stated amount received by the assessee towards compensation for sterilization of the profit earning source, not in the ordinary course of their business, in our opinion, was a capital receipt in the hands of the assessee. We are, therefore, in agreement with the opinion recorded by the High Court on question Nos. (i) and (ii) extracted in Para 1 (supra) and hold that the amount of Rs.8,50,000/- received by the assessee from the suppliers of the plant was in the nature of a capital receipt."

12. **Delhi High Court in Indian Oil Panipat Power Consortium ITA No.1156/2007 – 26/02/2009: In context of taxability of interest earned on fixed deposits/FD's,** on temporary parking of money inducted/infused as share capital for acquisition of land by the assessee company to set up its power plant, awaiting acquisition of land due to legal battle, DHC while allowing assessee's appeal and reversing ITAT order, has interalia held that:

a) If funds are surplus and same are invested in FD's, interest earned thereon is taxable under the head Income from Other Sources (Section 56) – vide SC ruling in Tutikorin 227 ITR 172

b) If income is earned in the form of interest or otherwise on funds which are inextricable linked to setting of the plant, such income is required to be capitalized – that is set off against pre operative expenses – vide SC ruling in Bokaro 236 ITR 315

c) For an income to be classified under the head business/profession (section 28), it would have to be an activity which is in some manner or form connected with business.

d) Further, drawing parity of reasoning from SC ruling in Challapali Sugar Mills, DHC has alternatively analyzed and held in aforesaid fact situation, when interest paid on funds brought in for specific purpose viz setting up of plant is held to be capitalized, similarly interest earned on temporary parking of funds/being share capital funded by share holders to acquire land needs to be capitalized that is set off against preoperative expenses.

Further reference in aforesaid connection may be made to : **Pench Power:** In this case DHC, in context of section 57(iii) of the Act (dealing with allowability of expenses against "other sources income" taxable u/s 56) has concluded that interest paid by assessee to **GE Capital Service** on loan taken to make deposit with Madhya Pradesh Electricity Board (Board) is allowable to be set off against interest income earned on said deposit (taxed under the head "other sources"). In this ruling, ***DHC has distinguished SC ruling in Tutikorin case and its ruling in Shri Ram Honda case***, on the reasoning that since instant loan has been take for specific purpose to make deposit with Board and there is direct nexus between the two, therefore, interest earned on deposit is to be reduced by interest paid on loan. ***Further reference in this connection may be made to Raj HC ruling in Neha Proteins case 217 CTR 180 & Ahd ITAT in 95 TTJ 14, wherein also similar ratio is concluded.***

13. ***Director Remuneration:***

ITAT TM in ITAT, Nagpur Bench, Nagpur (Third Member) **In The case of:** Jagdamba Rollers Flour Mills Ltd. v. ACIT

: Undisputedly, the payment to the director falls under clause (b) of section 40A of the Act and, therefore, the Assessing Officer was duty bound to make enquiry whether such expenditure was excessive or unreasonable having regard to the fair market value of the services rendered. To that extent, I am in agreement with the observations of the learned Accountant Member. However, no enquiry was made by the Assessing Officer to ascertain whether the payment was excessive or unreasonable having regard to the fair market value of the services: On the other hand, the Assessing Officer made the enquiry in a different direction i.e. whether the increase in the salary as compared to the salary paid to last year was justified on facts or not Such enquiry, in my view, is not required to be made as per the provisions of section 40A(2)(a). The scope of enquiry under the above provision is with reference to the fair market value of the services rendered. In the absence of enquiry as contemplated by the provisions of section 40A(2)(a), no disallowance could have been made or sustained. The onus was on the Assessing Officer to bring the material on record to prove that the payment made by the assessee was excessive or unreasonable having regard to the fair market value of the services rendered. If some material/evidence is brought on record to indicate that payment appeared to be excessive or unreasonable then the onus would shift to the assessee to prove that the payment was not excessive or unreasonable. Since no enquiry as contemplated by the aforesaid provisions was made on this account, it cannot be said that the payment was excessive or unreasonable. Therefore, I find myself in agreement with the conclusions arrived at by the Learned Judicial Member though for different reasons.

ITAT in Bony Polymers: **[2010] 1 taxmann.com 70 (Delhi – ITAT: Held**

"…We do not agree with this. Section 36(1)(ii) provides that commission will not be allowed as deduction if, had it not been paid so, it would be paid as profits or dividend. There is no basis or material or evidence brought on record by AG to support this contention that the commission would have been paid as dividend to the shareholders. Companies Act 1956 contains the limitations and restriction in the matter of payment of dividend and such discretion of the company either to pay or not to pay dividend can not be assumed. A() can not presume that had this commission not been paid, this would have necessarily been paid as dividend to the share holders. There is no basis for this assumption. It can not be ignored that the assessee company had substantial profits out of winch dividend could be declared if assessee company so wanted. Thus, there is no basis for applicability of section 36(1)(ii). CBDT circular no. 551 relied upon by Ld. AR clearly states that after amendment of 1989, fact of commission payment alone is essential and its excess tvencss can be seen u/s 40 A(2) only. We-find that applicability of section 40 A (2) is not the case of AG. *liven* other wise, commission paid to the directors was part of remuneration of the directors as Supreme Court has held in the case reported at Gestetner Duplicators (P.) Ltd. v. CIT [1979] 117 ITR 1 that commission paid as fixed percentage of turnover is nothing but assessable as salary. Thus, section 36(l)(ii) has got no application. Further the contention of the assessee is also duly supported by the decision of Supreme Court in the case of Shahjada Nand & Sons v. CIT [1997] 108 ITR 358 in which the apex court held that commission paid to the employees is allowable and there is no need for any contractual obligation or extra services performed by the assesses…"

14. **Prior Period Expenses: SRF Ltd Delhi ITAT 34 SOT 1: Held** 13. We have considered the rival submissions. We find that the assessee is a body corporate. It has a set system for approving the payment of expenditure. The assessee therefore, accounts for the expenses when same is approved by prescribed authority within the organization. The fact being admitted by the learned CIT(A) is that the expenses pertaining to business for day-to-day running. Since the bills or claims were made during the year, it can be said that the liability became known for the first, time when such claim was made. Accordingly, the same is allowable in the year in which the liability got crystallized. Similar view has been adopted by the Hon'ble Gujarat High Court in the case of Saurashtra Cement and Chemical Industries Ltd. 213 ITR 523. (supra). We therefore, direct the Assessing Officer to examine whether such expenses are incurred wholly and exclusively for the purpose of business and if so found, allow the same irrespective of the year in which it pertains as the liability in regard to these expenses got crystallized during the relevant previous year.

Some ITAT/HC rulings on Prior Period for ur reference;

a) Mum ITAT in Toyo 100 TTJ 373
b) Cuttack ITAT in National Aluminium 101 TTJ 948
c) Mum ITAT Sterlite 102 TTJ 53

d) Guj HC in 213 ITR 523
e) Del ITAT in 106 TTJ 1153
f) Mum ITAT in 107 TTJ 522
g) Delhi ITAT in 95 TTJ 71 Annamaria Travels

SHRI RAM PISTONS and RINGS DHC 174 Taxman 147; Vishnu Industrial Gases ITR 229/1988 Order date: 6 May 2008: Held We have often wondered why the Income tax authorities, in a matter such as this where the deduction is obviously a permissible deduction under the Income tax Act, raise disputes as to the year in which the deduction should be allowed. The question as to the year in which a deduction is allowable may be material when the rate of tax chargeable on the assessee in two different years is different; but in the case of income of a company, tax is attracted at a uniform rate, and whether the deduction in respect of bonus was granted in the assessment year 1952-53 or in the assessment year corresponding to the accounting year 1952, that is in the assessment year 1953-54, should be a matter of no consequence to the Department; and one should have thought that the Department would not fritter away its energies in fighting matters of this kind

15. Apex court in Eimco K.C.P. Ltd v. CIT [2000] 242 ITR 659. It was held that where a foreign company gives a technical know-how and obtains equity shares in the new company, the amount attributable to technical know-how was not revenue expenditure under section 37 of the Act. However, it was treated to be of capital nature. It is clearly borne out from the various orders that the assessee was a new company. That being the position, the Tribunal was not justified in holding that the expenditure in question was revenue in character."

Applied by Delhi ITAT in SRF Ltd (supra) As per scheme of the BIFR, it paid interest to lenders of 'F' by issuing share to lenders. Thus no expenditure was incurred. The interest payment made by issue of shares was not deductible. and Ranbaxy cases :

2009-TIOL-632-ITAT-DEL.pdf

M/s Ranbaxy Laboratories Ltd Vs ACIT, New Delhi (Dated: June 12, 2009)

*Income tax - Sec 37(1) - Assessee is a pharma manufacturer - offers stock options to employees under ESOP Scheme at a price lesser than the market price - claims the difference between the market price and the offered price under ESOP as deductible loss - AO disallows and CIT(A) agrees with him - held, the difference between the premium price of shares in the market and the price at which the same were offered to the employees were only notional loss. The assessee is not to discharge any liability by making any sort of payment. The assessee merely grants stock option, though at a concessional rate but thereafter was not to discharge any liability in this regard. The loss if any, is notional and not actual liability incurred. Assessee's appeal rejected: **DELHI ITAT***

16. Leasehold Improvements: Expl to section 32: Depends upon case to case

Repairs Business Expense: Current in Nature not CAPEX: DELHI Press Samachar Case: Held:

"We find that the Tribunal has adequately and in great detail dealt with the entire issue… The assessee incurred a sum of Rs 35,51,245/- in the year in question on the following works:-
"(i) Water proofing of roofs with stones. (ii) Reinforcement of old beams in which steel bars and plasters were corroded. (iii) Relaying of worn out flooring of print shop/ process rooms etc. (iv) Repairing and relaying / carpeting of roads running inside the press compound. (v) Repairing and replacement of workers wash rooms, hand wash areas, damaged glass, wood work. (vi) Repairing and relaying boundary walls and gates. (vii) Repairing and reconstructions of cooling towers area. (viii) Repairing of cement sheets and laying of fiber coated sheets to prevent seepage, water and air. (ix) Repairing of AC Chiller rooms and plants…
The Tribunal also noticed that the contention of the assessee that it had undertaken major repairs to put the dilapidated columns, beams, roofs etc. in its original position, which had become dangerous and unsafe for the workmen and hindered the normal operation of the business, was not controverted by the departmental representative nor had any evidence to the contrary been produced before the Tribunal or the authorities below. It was ultimately concluded that employing the test indicated in ***Saravana Spinning Mills*** *(supra),* the assessee had incurred the said expenditure only to preserve and maintain the existing asset and that the expenditure was not of a nature which brought into being a new asset or created a new advantage of an enduring nature. Consequently, the Tribunal deleted the disallowance.

CIT, DCIT vs Sagar TalkieskAR High Court: In this background, we have to consider whether the expenditure incurred by the assessee for replacing the sound system to its theatre amounts to revenue or capital in nature. This Court has to consider whether the change of (sic) system has increased the revenue or not Admittedly, the old sound system was in existence for several years and due to use of the very sound system for several years, the old system was worn out If the assessee has provided certain amenities to its customers by replacing the old system with a better sound system and by introducing such system if the assessee has not increased its income in any way, we cannot consider such change of sound system as capital in nature. According to us, instead of repairing the existing old stereo system, the assessee has installed Dolby stereo system. This has not benefited the assessee in

any way with regard to its total income since there is no change in the seating capacity of the theatre or increase in the tariff rate of the ticket. Saravana SC considered and distinguished 293 ITR 201

All High Court Sara Engg: *Held However, he referred the Commissioner of Income Tax Vs. Sri Mangayarkarasi Mills P. Ltd. : (2009) 315 ITR 114 (SC) in support of his contention that repairs amounts capital expenditure. The relied upon decision in our considered view is not applicable to the facts of the present case. The relied upon decision is in respect of replacement of a machinery by a new machinery. It was the case of a spinning mill. In this case, the Supreme Court has observed that each machine in a spinning mill does a different function and the product from one machine is taken and manually fed into another machine and the output is taken, all the machines are, thus, not integrally connected. It may be noted that it was a case of replacement of machine as a whole. In this very case, the Supreme Court has relied upon its earlier judgment in the case of Commissioner of Income Tax Vs. Saravana Spinning Mills P. Ltd. : JT. (2007) (10) S.C. 111. In theApplying the above test to the facts of the present case, it has been found that the assessee has replaced the worn out G. C. sheets in the relevant assessment years. By replacing the G.C. sheets, the assessee has carried on the repairs as are necessitated by the day to day wear and tear. The repairs may be small or major. If it is major repair, it may involve considerable amount of money. But the amount of money spent alone cannot be a factor to determine whether the expenditure falls under "Current Repairs" or not. As held by the Andhra Pradesh High Court in Nathmal Venkatlal Parik and Co. Vs. CIT (1980) 122 ITR 168, it is nature of the repairs carried out by the assessee that matters for grant of deduction*

ALSO REFER ON AFORESAID ISSUE FOLLOWING DECISIONS WHERE SARAVANA SC IS CONSIDERED:

A) DELHI ITAT IN COSMAT MAX 29 SOT 436
B) WHIRLPOOL 22 SOT 103
C) CHENNAI ITAT IN PRABHU SPINNING MILLS

17. Forfeiture of Share Application Money Capital Receipt: not revenue in character (ITAT in 118 ITD 546)