

MVDCO Advisory Services

News Letter

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Direct Tax

Rajmoti Industries – Gujarat High Court

Section 40A(3) – Disallowance of expenditure

Section 40A(3) states “Where assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds Rs. 20,000/-, no deduction shall be allowed in respect of such expenditure.”

The Gujarat High Court has held that there is a difference between “Crossed cheque” and “Account Payee cheque”. What is referred to in Section 40A(3) is “Account Payee cheque”. Therefore any payment made by crossed cheque does not satisfy the condition specified in Section 40A(3) and will be subject to disallowance.

Dholgiri Industries Pvt. Ltd.

Section 41(1) – Waiver of Principal is not income

The assessee Company never claimed as expenditure in any of the past years, the principal amount of bank loan as a deduction against their taxable income. Therefore in the event of waiver of principal amount of such loan by the bank, such amount cannot be treated as income of the assessee Company and therefore no tax can be levied against such amount of waiver.

Alkaben Patel – Ahmedabad Tribunal, Special Bench

Section 54EC – The meaning of term “Month”

To be able to claim exemption from Long Term Capital Gain Tax on transfer of an asset, Section 54EC requires investment in specified bonds to be made within 6 months after the date of such transfer. Since the term “month” is not defined under the Income Tax Act, the issue arises whether the term month referred to in this section shall be regarded as a period of 30 days or a month only.

The Ahmedabad Special Bench held that since the term month is not defined specifically under the Income Tax Act, the meaning of the term month has to be understood as stated under the General Clauses Act which defines the word “month” to mean a month reckoned according to the British Calendar.

Hindustan Lever Limited – Delhi court

Godown Maintenance Charges – TDS under Section 194C

The assessee Company had hired godown on rent. It also engaged C & F to maintain the godown. The question was whether the Tax was deductible under section 194-I (Rent) or under section 194-C (Contract) with regards to the payment made to the C & F agent.

The Delhi High Court confirming the decision of the Tribunal held that with respect to the payment made to the C & F agent, the payment was in the nature of contract and therefore the Tax was deductible under section 194C of The IT Act.

Wizcraft International – Bombay High court

Commission paid to an agent for services rendered abroad and payment by way of reimbursement of expenses are not taxable in India

The assessee paid remuneration to the artists, to the agent and reimbursed the expenses in connection with the visit and performance of the artists in India. The assessee deducted tax at source on fees paid to the international artists in India. Tax was deducted at source on the payment made to artists for performance in India but it was not deducted at source on the commission paid to Mr. Colin Davie who acted as an agent between the assessee and the artists performed in India.

Under Article 18 of the India-UK DTAA, the payment made to the agent as payment of commission is not covered by Article 18. The agent never took part in the event organised. He did not exercise any personal activities in India. He did not act as a performing artist or an entertainer. All that he was concerned are the services which were rendered outside India. He contacted the artists and negotiated with them for performance in India in terms of the authority given by the assessee. The CIT(A) and Tribunal rightly arrived at the conclusion that the agent did not perform any services in India, but they were rendered outside India. Therefore, commission income to the agent is not liable to tax in India and there was no obligation on the part of the assessee to deduct the tax at source at the time of making of payment.

In so far as payment or reimbursement of expenses in connection with the visit and performance of the artists in India, the amount reimbursed to them was towards air travel so long as they are supported by documents, the tax need not be deducted.

Aditya Medisales – Ahmedabad Tribunal

Investment in specified bonds under Section 54EC eligible for exemption on transfer of Long Term assets in spite of Section 50.

It is generally understood that when any asset forming part of the block of assets on which depreciation has been claimed by the assessee in the past is transferred, the gain arising out of such transfer is taxable as Short Term Capital Gain and tax is accordingly calculated on it.

The Tribunal has held that this restriction is limited to the calculation of capital gain and it does not apply to exemption provisions. The benefit of section 54E will be available to the assessee regardless of the fact that the computation of capital gain is made under section 49 or 49 or 50. The legal fiction created under section 50 is to deem capital gain as short term capital gain and not to deem the asset as short term asset. Therefore it is incorrect to state that Section 50 converts Long Term Capital Asset into Short Term Capital Asset.

Therefore in a case where the asset, though forming part of the block of asset on which depreciation has been claimed by the assessee in past, which is a Long Term Capital Asset is transferred and the sale proceeds were invested in bonds specified under Section 54EC, the asset still remains a Long Term Asset and the assessee will be eligible to claim exemption under Section 54EC.

Compiled by: CA Malay Damania, Partner

Additional Rebate under the Income Tax Act

Income Tax Rebate under Section 87A was introduced in the budget 2013 and is made applicable from the F. Y. 2013 - 14, i.e. A. Y. 2014 - 15.

Section 87A reads as follows:

“An assessee, being an individual resident in India, whose total income does not, exceeds five lakh rupees, shall be entitled to a deduction, from the amount of income- tax on his total income with which he is chargeable for any assessment year, of an amount equal to 100% of such income tax or an amount of 2,000 Rs. whichever is less.”

Salient Features:

Eligibility

- Rebate under Section 87A is **available only to Individuals**. All categories of Individuals whether Male, Female or Senior Citizens are eligible to claim Income Tax Rebate under Section 87A. Other assesses will not be eligible to claim this relief.

Please note however that the benefit of this Rebate to **Super-Senior Citizens** i.e. Individuals above 80 years of age is not available since their Income up to Rs 5 Lakh is already exempt from the levy of Income Tax.

- Income Tax Rebate under Section 87A is only available to **Resident Individuals** and not to Non-Resident Individuals.

Basic Exemption Limit

- Rebate is allowed only when the Total Income does not exceed Rs. 500,000/-
- This section is not inserted to increase basic exemption limit from Rs. 2,00,000/- to Rs. 2,20,000/-

Note:

To clarify Resident Individuals of the age of:

60 ≤ but < 80	-	eligible	(since the senior citizen has BEL of Rs. 2.5L)
80 ≤	-	not eligible	(since the super senior citizen has BEL of Rs. 5L)

Relief in terms of tax

- The total rebate allowed under section 87A would be Rs. 2,000 or the total tax payable, **whichever is less.**
- Income Tax Rebate of Rs. 2,000 is **allowed before the levy of Education Cess.**
- There will not be any entitlement of any refund in case tax liability is less than Rs. 2,000
- The rebate of Rs. 2,000 would be given from the **Tax Payable and not from Taxable Income** of an individual

➤ **Illustration:**

Assessee Name: **Mr. Rahul Jain**
 DOB: **01.03.1994**
 Assessment Year: **2014 - 15**

Statement of Total Income

<u>Particulars</u>	<u>Amount(Rs.)</u>
Income under the Head "Salary"	6,00,000
(+) Income under the Head "House Property"	-50,000
(+) Income under the Head "Profit from Business and Profession"	Nil
(+) Income under the Head "Capital gains"	Nil
(+) Income under the Head "other Sources"	<u>Nil</u>
Gross Total Income	5,50,000
(-) Deduction u/c VIA	<u>(1,00,000)</u>
Total income	4,50,000
Tax payable on Total Income as per Slab Rate	
Upto Rs. 200,000/-	0
From Rs. 200,000/- to Rs. 450,000/- @ 10%	<u>25,000</u> 25,000
(-) Income Tax Rebate u/s 87A subject to max Rs. 2,000	(2,000)
Total tax Payable	23,000
(+) E.C. @ 2% and S.H.E.C. @ 1%	<u>690</u>
Balance Tax Payable	23,690

Compiled by: Tarang Doshi, Article student

Section 40(A)3: Distinction between Crossed Cheque and Account Payee Cheque. Payment by crossed cheque disallowed u/s. 40A(3).

Rajmoti Industries v/s ACIT (Gujarat High Court)

Tax Appeal No. 105 of 2014 with Tax Appeal No. 106 of 2014

➤ Synopsis of the Case

In the immediate case the assessee had made the payment through crossed cheque instead of account payee cheque and contented that there was no distinction between a crossed cheque and an account payee cheque. However, the AO held that the above payment was subject to disallowance u/s 40A(3). Withstanding the decision of the AO the Gujarat High Court observed that a crossed cheque can be endorsed in favour of a person other than the drawee making it difficult to trace the constituent of the money. To remove this loophole, an amendment w.e.f. July 13, 2006 was made in section 40A(3) replacing the term “crossed cheque or a crossed bank draft” with “an account payee cheque or account payee bank draft”. Therefore, **crossed cheque and account payee cheque cannot be considered same**. Accordingly, payment by a crossed cheque is subject to disallowance u/s 40A(3).

➤ Facts of the Case

- i. Appeal involves assessment year 2007-08. For the said assessment year, assessee filed return of income declaring total income of Rs.83.28 lakhs. The return was taken in scrutiny. The assessing officer in the order of assessment disallowed a sum of Rs.26,72,198/- being 20% of the total payment of Rs.1,33,60,988/- made by the assessee during the year under consideration otherwise than by account payee cheque in violation of provisions of section 40A(3)(a) of the Income Tax Act, 1961.
- ii. The factual matrix established that the cheques were otherwise than Account Payee Cheques. There were “& Co.” cheques, and was found during the course of investigation, one of the partners of Shree Swaraj Oil Mill, JamKhambhalia in his statement on oath, has also admitted that they have encashed the entire payment received from M/s. Shree Rajmoti Industries through different Shroffs, vis. Pari Pankajkumar Jasubhai, Kishan Enterprise and others.
- iii. On the basis of these facts and the investigation made during the course of remand, it clearly proves that the continuance claim of the appellant during the course of assessment proceedings and appellate proceedings that the payments to M/s.Shree Swaraj Oil Mill, JamKhambhalia have been made through an Account Payee cheque is false.

➤ **Question of Law**

“Whether, in the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in law in confirming the action of the CIT(A) of disallowing Rs.26,72,198/- under the provisions of Section 40A(3)(a) of the Act?”

➤ **Order of the Court**

- i. A crossed cheque or crossed bank draft is not a non-negotiable instrument. This has, at times, resulted in crossed cheques being endorsed making it difficult to trace final payee and thus defeating the provisions of section 40A(3). However, as per the RBI's instructions to commercial banks, an account payee cheque or account payee bank draft cannot be credited to any account other than the account of the payee. “Account Payee Cheques” cannot be transferred or encashed. The credit for that cheque is to be given into the account of drawee only, in whose name the cheque is drawn.
- ii. The Act has accordingly amended the aforementioned sub-section (3) and sub-section (4) to substitute the expression “a crossed cheque drawn on a bank or by a crossed bank draft”, in both the sub-sections, by “an account payee cheque drawn on a bank or account payee bank draft”.
These amendments take effect from 13th July, 2006.
- iii. On the basis of all above facts and in the circumstances, there is enough evidence to point out that there is violation of provisions of section 40A(3)(a) of the Act and the Assessing Officer has rightly considered that payments made to M/s. Shree Swaraj Oil Mill, Jamkhambhalia after 13-07-2006 amounting to Rs.13360988/- are otherwise than by Account Payee Cheques, and thereby, there is violation of provision of section 40A(3)(a) of the Act. The Assessing Officer, therefore, rightly disallowed 20% of above payment of Rs.13360988/-, which comes to Rs.2672198/- and added the same to the total income of the appellant.
- iv. It is also noticed that the legislature in terms has removed the provisions of Rule 6DD(j) keeping in view the intention that main purpose of introducing provisions of section 40A(3) was to curb proliferation of black money. The payment for the purchase of goods is covered by section 40A(3) of the Act as has been held by the Hon'ble Punjab & Haryana High Court in the case of Hari Chand Virendra Paul vs. CIT 140 ITR 148. The provisions section 40A(3) are construed strictly as has been held by various courts.
- v. As we have noted, previously the expression used in section 40A(3)(a) was a crossed cheque or a crossed bank draft. With specific purpose in mind, the same was amended by the legislature to be replaced by the expression “an account payee cheque or account payee bank draft”. This was done in the background of the experience that even crossed cheques were being endorsed in favour of a person other than the drawee making it difficult to trace the constituent of the money. To plug this possible loophole the requirement of section 40A(3) was made more stringent. If we accept the contention of the counsel for the assessee that

there was no distinction between a crossed cheque and an account payee cheque, we would be obliterating this amendment brought in the statute with specific purpose in mind.

- vi. Therefore, the appeal was dismissed by the High court, withholding the order made by the AO as well as ITAT.

Abbreviations

AO- Assessing Officer

ACIT- Assistant Commissioner of Income Tax

ITAT- Income Tax Appellate Tribunal

Compiled by: Akshat Hariya, Article student.