SNR & COMPANY
CHARTERED ACCOUNTANTS

INCOME TAX BULLETIN

MARCH 2024

Delhi, Pune, Bangalore

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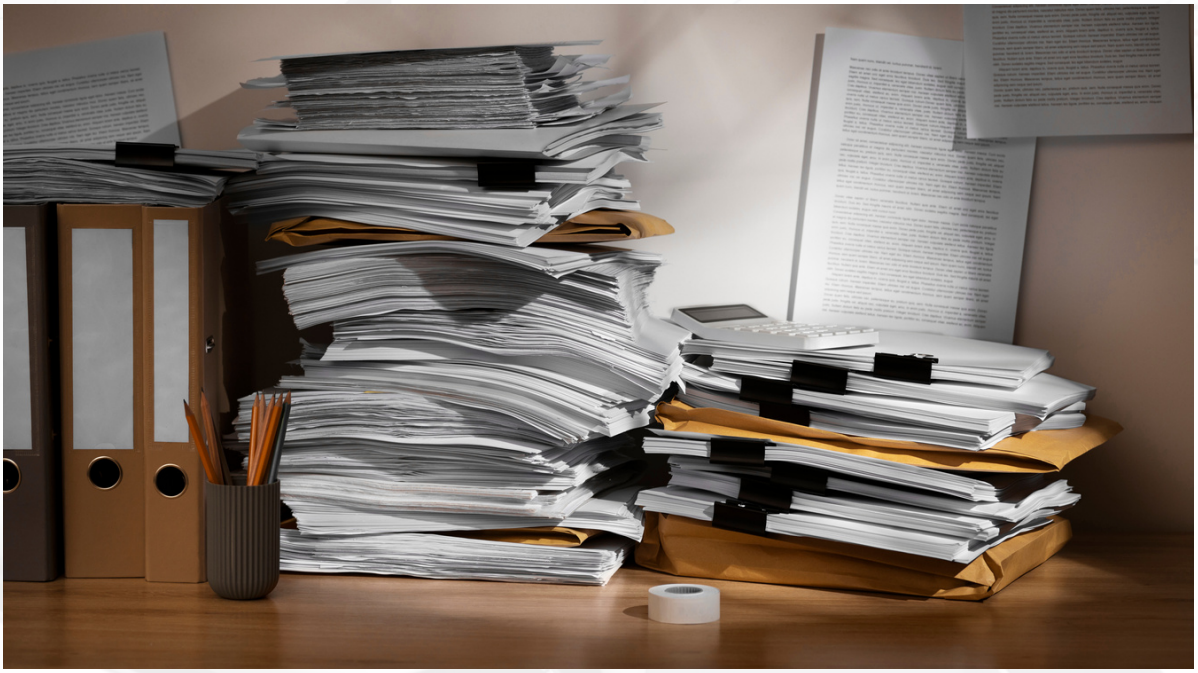
1. Loose sheets cannot be constituted as books of account for the purpose of section 153C and 127:

Case of : DCIT Vs Sunil Kumar Sharma
Decision by : High Court Karnataka
In favour of : Assessee
Date of Judgement : 2024-01-22

- Search proceedings were conducted against D.K. Shivakumar. During the course of such search of Mr. D.K. Shivakumar, certain diaries and entries related to the appellant were found. The case of the appellant was centralised under Section 127.
- Meanwhile the appellant preferred a writ petition wherein before the Single Judge Bench, the main contention raised by the assessee was that notice under Section 153C can be issued only on "other person". In the present case, the appellant being "searched person", hence notice under Section 153C issued to the appellant is not maintainable.
- The Single Judge quashed the impugned notices and remanded the matter to Revenue to consider the issue afresh. Aggrieved, Revenue preferred the instant writ appeal.
- The Division Bench of HC noted that the entire allegation against the petitioner has been made based on loose sheets of documents, which does not come under the ambit and scope of 'books of entry' or as 'evidence' under the Indian Evidence Act.
- Against the judgement of Single Judge Bench, the Revenue went in appeal wherein the court opined that applicability of Section 69A arises only when the principles laid down under Section 68 are satisfied which states that that there must be books of accounts or any books with credit entry.
- Further, the court observed that, "searched person in the instant case is the assessee, as the search was conducted in his premises, which is evident from the Panchanama. The distinction between 'searched person' and 'other person' is misinterpreted in the case advanced by the Revenue-appellant, as the premises of the Respondent was searched and documents pertaining to him were seized, thereby making him the searched person".



- Regarding centralisation of the Assessee's case, HC remarked, “as per section 127, before transferring the cases, a reasonable opportunity must be provided to the Assessee.”

Full Judgement: Sunil Kumar Sharma

SNR's Take

The Karnatka HC relied on ***Supreme Court's judgement in V.C. Shukla case*** *and rightly emphasized the importance of evidence and proper substantiation by the revenue department by clarifying that loose sheets or scraps of paper cannot be termed as books of accounts.* ***The HC has accentuated the required conditions post adherence to which Section 153C can be invoked.***

2. ITAT: Exorbitant interest rate charged by Trust with profit making intention, not charitable activity; Rejects Sec.11 exemption.

Case of : Sanghamitra Rural Financial Services Vs ACIT (Exemptions)
Decision by : Income tax Appellate Tribunal Bangalore
In favour of : Assessee
Date of Judgement : 2024-01-03

- The Assessee-Trust, registered under Section 12A & 80G, is engaged in the activity of providing loans to the persons who are otherwise ineligible to apply for the loan from other financial institution, through the self-help groups (SHGs), charging interest.
- Assessee submitted that it has been undertaking charitable activity in pursuance to its objectives and it borrows money from banks and financial institutions and lends the same to the poor and destitute people through the assistance of SHGs. Revenue noted that he Assessee while providing microfinance services through SHGs, is charging exorbitant rate of interest (@ 18-20%) from its borrowers, thus held that the Assessee was engaged in the commercial activity and Assessee's activity cannot be considered as charitable activities under Section 2(15). Accordingly, Revenue disallowed Assessee's claim for exemption under Section 11, for AYs 2016-17 and 2018-19, which was confirmed by the CIT(A). Aggrieved, Assessee preferred the appeal before the Tribunal.
- ITAT determined the microfinance activity constituted a commercial endeavor due to the following factors:

  a) Excessive Interest Rates: The trust charged interest rates (18-20%) significantly exceeding bank rates, resulting in substantial profits.

  b) Absence of Additional Charitable Services: The trust exclusively focused on microfinance, lacking any free services or other charitable programs.

  c) Profit as Primary Motive: ITAT concluded that profit generation, not charitable aims, was the trust's dominant objective.

- ITAT analyzed the definition of "charitable institution" under Section 2(15), emphasizing that the proviso disallows exemption for activities resembling trade, commerce, or business. Since the microfinance activity lacked a genuine charitable element and aimed primarily for profit, it fell outside the scope of Section 11 exemption.
- ITAT considered Section 11(4A), which restricts exemption for trusts engaged in profit-making businesses unless such businesses are incidental to their charitable objectives. Here, microfinance constituted the trust's core activity, not an incidental one.
- The tribunal distinguished past cases where trusts received tax exemptions for microfinance activities by highlighting the following key differences:

  a) Reasonable Interest Rates: In those cases, trusts charged reasonable interest rates alongside demonstrably charitable activities.

  b) Microfinance as Incidental Activity: The microfinance function served as a secondary activity supporting the trust's primary charitable purpose.

Full Judgement: Sanghamitra Rural Financial Services

SNR's Take

This ITAT ruling underscores the importance for trusts to demonstrate a genuine charitable purpose exceeding mere microfinance operations to qualify for tax exemption under Section 11. The tribunal emphasized the "dominant or primary purpose" test to differentiate charitable endeavours from commercial activities. While microfinance can serve a social purpose, exorbitant interest rates and a profit-driven focus can negate the charitable character for tax exemption purposes.

3. ITAT: Ownership not essential. Possession of transport vehicles sufficient for Sec.194C-TDS exception.

Case of : Adhunik Khanan VA Parivahan Theka Sahakari Samiti Limited Vs ITO
Decision by : Income tax Appellate Tribunal JODHPUR
In favour of : Assessee
Date of Judgement : 2024-02-12

- Assessee is engaged in the business of transportation and logistics services. During the survey proceedings, it was found that, in some cases, Assessee had made payment of transportation charges to persons other than owner of the vehicle, based on power of attorney whereby they were duly authorized by the truck owners to receive the transportation charges.
- Tax authorities contended that valid declarations for TDS exemption under Section 194C(6) required them to be from the registered owners of the trucks. Consequently, the assessee was deemed non-compliant and subject to interest penalties. The assessee preferred appeal before the NFAC which was dismissed. Aggrieved, the assessee appealed before the tribunal.
- The Tribunal interpreted the term "owner" in Section 194C(6) to encompass anyone in physical possession of the truck, aligning with the definition used in the presumptive taxation scheme (Section 44AE).
- ITAT cited Supreme Court precedents where "ownership" was determined based on the legislature's intended outcome - either to impose tax or confer a benefit. In this case, focusing on possession aligns with the purpose of taxing income earned from operating the trucks.
- Thus, ITAT allowed the assessee's appeal. Since declarations were obtained from those demonstrably possessing the trucks, and payments were made directly to them, the conditions for mandatory TDS under Section 194C(6) were not met. The assessee was not considered to be in default.

Full Judgement: [Adhunik Khanan VA Parivahan]

SNR's Take

The tribunal has provided a major relief to the taxpayers while reiterating the concepts of ownership through citing reference to the observations made by the Apex court in the cases of Podar Cement and Mysore Minerals.

4. Share premium is a non-taxable 'capital receipt' irrespective of the alleged violation of Companies Act conditions:

Case of : Shendra Advisory Services P. Ltd Vs The Deputy Commissioner of Income Tax
Decision by : Bombay High Court
In favour of : Assessee
Date of Judgement : 2024-02-09

- Assessee-Company is a joint venture between Indian and Netherlands Promoters. As a part of the joint venture arrangement and agreed business strategy, Indian group was to be issued shares at par at Rs. 10 each, while Netherlands promoters was to infuse funds at a premium of Rs. 2490 per share.
- Revenue held that the entire share premium receipts were unexplained cash credit under Section 68 and made addition of the same in Assessee's hand on the grounds that, there was no justification for charging share premium and that there was violation of the provisions of Section 78(2) of the Companies Act, 1956, which was upheld by CIT(A). ITAT dismissed Assessee's appeal, with a direction to the Revenue to examine in detail the aspect as to whether there was violation of the provision of Section 78(2) of the Companies Act, 1956 with respect to the utilization of the share premium account. Aggrieved, Assessee preferred the present appeal.
- The High Court overturned the lower court rulings and sided with the company, emphasizing the following key legal principles:

  a) Characterization of Share Premium: Share premium receipt is considered a capital receipt, not income chargeable under the Act. The court relied on established precedents from the Bombay High Court and coordinate benches of the ITAT.

  b) Taxability under the Income Tax Act: The Act lacks specific provisions to tax share premium income. Revenue cannot unilaterally expand the definition of income to encompass capital receipts.

  c) Violation of Companies Act and Tax Treatment: Even if the company violated the Companies Act regarding share premium utilization, such a violation would not convert a capital receipt into taxable income under the Act. These are distinct legal spheres with separate consequences.

  d) Evidence of Proper Utilization: The company's balance sheet did not indicate any misuse of the premium funds, further bolstering their case.

Full Judgement: Shendra Advisory Services P. Ltd

SNR's Take

The High Court's decision quashed the ITAT order and allowed the company's appeal. This ruling reaffirms the principle that share premium receipts generally constitute non-taxable capital inflows, provided they are issued in accordance with relevant company law and not subsequently misused. It is pertinent to note that Finance Act 2012 has added Section 56(viib) to tax share premium received in excess of Fair Market Value (FMV).

5. Registration u/s 12AA cannot be denied on the issue of application of income. It requires only requires examination of charitable objects:

Case of : Movement Against Diabetes and Endocrine Disorders Vs CIT (Exemption)
Decision by : ITAT, Delhi
In favour of : Assessee
Date of Judgement : 2024-02-16

- Assessee-Society filed an application in Form No. 10A seeking registration under Section 12AA. CIT(E) rejected Assessee's application on the ground that the Assessee would be promoting business of manufacturing and marketing of pharmaceutical drugs of the entities who had sponsored the research work. Aggrieved, Assessee preferred the present appeal.
- ITAT emphasized that the CIT(E)'s primary function during registration is to assess the charitable nature of the applicant's objectives, not the specific application of income. The tribunal focused on the following:

  a) Charitable Objectives: Raising public awareness about diabetes and endocrine disorders is a well-established charitable activity.

  b) Verification at Later Stage: The Revenue authorities retain the right to scrutinize the Society's activities at a later stage. If the Society deviates from its charitable objectives and engages in business promotion, the authorities can revoke its registration.
- ITAT cited the Allahabad High Court decision in "Fifth Generation Education Society" [1990]185ITR634(ALL) to support its position. The High Court ruling clarified that registration scrutiny concentrates on the applicant's objectives and adherence to proper form submission, not the specific use of income.

Full Judgement: Movement Against Diabetes & Endocrine Disorders

SNR's Take

ITAT has set aside the CIT(E)'s decision and remanded the application back for re-evaluation based on the Society's charitable objectives. This ruling underscores the distinction between the initial registration stage, which focuses on objectives, and the subsequent verification stage, which ensures adherence to charitable activities.

6. ITAT Rules on Software Payment to Chinese Company: Not Royalty:

Case of : SAIC Motor Overseas Intelligent Mobility Technology Co. Ltd.
Decision by : ITAT, Delhi
In favour of : Assessee
Date of Judgement : 2024-02-23

- The appellant supplied standardized car software to MG India under a license agreement, but the tax authorities contended the payment constituted taxable royalty under the India-China Double Taxation Avoidance Agreement (DTAA).
- On appeal, ITAT held that the appellant merely supplied pre-developed software, not "know-how" – confidential technical information enabling perpetual product replication. MG India received a non-exclusive license, not a transfer of intellectual property rights. Further, the payment was deemed compensation for the software itself, distinct from any copyright use or transfer of industrial expertise.
- The DTAA defines royalty as "imparting of information concerning industrial, commercial or scientific experience," which ITAT interpreted in line with judicial precedent as synonymous with "know-how." Since the appellant retained source code and copyright control, no knowledge transfer occurred.
- ITAT concluded that the payment constituted as business income and not royalty. As the appellant lacked a permanent establishment (PE) in India, the income was not taxable in India.

Full Judgement: SAIC Motor Overseas Intelligent Mobility Technology Co. Ltd.

SNR's Take

This ITAT ruling clarifies that under the India-China DTAA, software payments qualify as royalty only if they involve the transfer of technical knowledge or "know-how" enabling the recipient to reproduce the software perpetually. The mere supply of pre-developed software with a non-exclusive license does not constitute royalty.

Circulars/ Notifications:

1. CBDT notifies ITRs 2,3 & 5 for AY 2024-25

CBDT notified ITR-2, ITR-3 and ITR-5 for AY 2024-25. Further, it amended Rule 12 to provide that Individual or HUF required to be audited under Section 44AB can also opt for transmitting the data electronically in the return under electronic verification code for furnishing the ITR.

Read Circular: 19/2024

2. CBDT issues Instruction for work allocation to CIT(Judicial), effective immediately

CBDT issues Instruction No. 1/2024 dt. Feb 9, 2024 for expansion of the work allocation to Commissioner of Income-tax (Judicial) [CIT(J)] in supersession of Instruction No. 6/2015 dt. Jul 3, 2015; The Instruction comes into effect immediately and defines the structure, work jurisdiction and domain of CIT(J) consequent to the progressive increase in workload due to roll out of the faceless assessment and appeals; As per the Instruction, CIT(J) shall be the nodal officer for all matters relating to the jurisdictional High Court as also coordination with counterparts for other High Courts; CIT(J) shall also be responsible for ensuring that the Departmental view on legal interpretation is enforced uniformly and coherently within the jurisdiction of the respective Pr.CCIT.

Read Circular: Instruction No. 1/2024

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