

JUST IN...

- Once assessee is carrying on a speculation business and profits and gains have arisen from that business during course of assessment year, the assessee is entitled to set off losses carried forward from a speculation business arising out of a previous assessment year
- Right of carry forward u/s 74(1) in respect of long term capital loss is not hit by provisions of section 70(3)
- Profit derived from contract works does not qualify for relief u/s 80-IB
- Section 50C has no application for arriving at value of benefit u/s 2(24)(iv)
- Section 35 refers to 'capital expenditure' and does not require any further requirement

DIRECT TAX LAWS

FROM SC/HC

- » **ONCE ASSESSEE IS CARRYING ON A SPECULATION BUSINESS AND PROFITS AND GAINS HAVE ARISEN FROM THAT BUSINESS DURING COURSE OF ASSESSMENT YEAR, THE ASSESSEE IS ENTITLED TO SET OFF LOSSES CARRIED FORWARD FROM A SPECULATION BUSINESS ARISING OUT OF A PREVIOUS ASSESSMENT YEAR.**

The expression “any speculation business” in Explanation to section 73 means a speculation business of assessee in respect of which profits & gains for assessment year in question have arisen and there is no justification to restrict content of that speculation business where profits have arisen by excluding a business involving actual delivery of shares

HIGH COURT OF BOMBAY

CIT

v.

Lokmat Newspapers Pvt. Ltd.

ITA (L) No. 3005 of 2009

February 16, 2010

RELEVANT EXTRACTS:

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6. Sub section (1) of Section 73 provides that the loss in respect of a speculation business can be set off only against the profits and gains of another speculation business. Sub section (2) of Section 73 enables an assessee to carry forward the loss arising out of a speculation business which has not been set off either wholly or partly under the provisions of sub section (1). A loss from a speculation business which has not been set off either entirely or in part, can be carried forward to the following Assessment Year and can be set off against the profits and gains, if any, of a speculation business carried on by the assessee and assessable for that Assessment Year. If the loss cannot be wholly set off, the amount of loss which is not so set off, can be carried forward to the following Assessment Year. However, a loss cannot be carried forward for more than four Assessment Years immediately succeeding the Assessment Year in which the loss was first computed.

7. The explanation to Section 73 creates a deeming fiction. The explanation postulates a situation where the assessee is a Company and where any part of the business of the Company consists of the purchase and sale of shares of other Companies. In such a case, the assessee is for the purposes of Section 73 deemed to be carrying on a speculation business, to the extent to which the business consists of the purchase and sale of shares. The explanation carves out an exception in the case of a Company whose gross total income consists mainly of income under the heads of interest on securities, income from house property, capital gains and income from other sources, or a company the principal business of which is the business of banking or the granting of loans and advances. The exception carved out by the explanation, however, is not attracted to the facts of this case and its interpretation, therefore, does not call for consideration here. What is material for the purposes of this case is, that the explanation postulates a situation where any part of the business of a Company consists of the purchase and sale of shares of other Companies. Therefore, the explanation is attracted in a situation where something more than an isolated transaction involving sale and purchase of shares is involved. A business postulates a systematic course of activity or dealing. Unless the business of a Company consists of the sale and purchase of shares, the deeming fiction would not apply. However, once the requirements of the explanation are satisfied, namely, on where: (i) The assessee is a Company; (ii) Any part of the business of the Company consists in the purchase and sale of shares of other Companies, the consequence which is envisaged in the explanation, as a fiction of law, is brought into existence. The legal fiction is that the

assessee is deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

8. Section 28 of the Act deals with the profits and gains of a business or profession. Explanation (2) to Section 28 provides that where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business (which is to be referred to as a "speculation business") shall be deemed to be distinct and separate from any other business. Section 43 provides definitions of certain terms relevant to the head of income from profits and gains of business or profession. Sub section (5) of Section 43 defines the expression "speculative transaction" to mean a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scripts. The proviso to sub section (5) then describes certain categories of transactions which shall not be deemed to be speculative transactions. The proviso will not have a bearing on these proceedings.

9. The contention of the Revenue in the present case, in essence is that the definition of the expression "speculative transaction" in Section 43(5) must be read into the provisions of Section 73, because a business cannot be a speculation business unless there is a speculative transaction and a speculative transaction is defined by the former as one, not involving an actual delivery of shares. Hence, it was submitted that a transaction which involves an actual delivery of shares would not constitute a speculative transaction and the assessee who is engaged in a business involving the actual delivery of shares, cannot be regarded as being engaged in speculation business.

10. The submission which has been urged on behalf of the Revenue, cannot be accepted, having regard to the plain meaning of the explanation to Section 73. The submission of the Revenue is that a loss which arises on account of a transaction of the sale and purchase of shares would constitute a loss from a speculation business for the purposes of the explanation. But, that the profit which arises from a transaction involving the actual delivery of shares would not constitute a profit for the purposes of sub sections (1) and (2) of Section 73 in respect of which a set off can be granted. To accept the submission of the Revenue would be to introduce a restriction into the scope and ambit of the deeming fiction which is created by the explanation to Section 73, which is not contemplated by Parliament. Once a deeming fiction is created by law, it must be given full and free effect, of course, in relation to the ambit within which it is intended to operate. The deeming fiction created by the explanation to Section 73 defines when an assessee is to be deemed to be carrying on a speculation business for the purposes of the Section. The deeming fiction is, therefore, one which arises specifically in the context of the provisions of Section 73 and is confined to that purpose alone. The explanation stipulates that where an assessee is a company whose business consists in any part of the purchase and sale of shares of other Companies, it shall be deemed to be carrying on a speculation business to the extent to which the business

consists of purchase and sale of such shares. Whether or not it is a profit or loss that has resulted from carrying on such business, is a consideration which is alie to the meaning of what constitutes a speculation business by the explanation to Section 73. Once an assessee is deemed to be carrying on a speculation business for the purpose of Section 73, any loss computed in respect of that speculation business, can be set off only against the profits and gains of an other speculation business. Similarly, for the purposes of sub section (2), the loss in respect of a speculation business which has not been set off either in whole or in part, can be carried forward and can be set off against profits and gains “of any speculation business ”. The expression “any speculation business ” means a speculation business of the assessee in respect of which profits and gains for the Assessment Year in question have arisen and there is no justification to restrict the content of that speculation business where profits have arisen by excluding a business involving actual delivery of shares. No such restriction is found in the explanation. To impose one is a legislative function. In other words, once the assessee is carrying on a speculation business and the profits and gains have arisen from that business during the course of the Assessment Year, the assessee is entitled to set off the losses carried forward from a speculation business arising out of a previous Assessment Year.

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FROM ITAT

» **RIGHT OF CARRY FORWARD U/S 74(1) IN RESPECT OF LONG TERM CAPITAL LOSS IS NOT HIT BY PROVISIONS OF SECTION 70(3)**

The case of the revenue that “the long term capital gain is income notwithstanding the fact that it is exempt under section 10(38)” is fallacious.

ITAT, MUMBAI BENCH ‘G’, MUMBAI

G. K. Ramamurthy

v.

JCIT

ITA No. 1367/Mum/ 2009

February 9, 2010

RELEVANT EXTRACTS:

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5.4 Now we shall examine the provisions with regard to claim of carry forward and set off. The assessee in the present case has claimed carry forward of long term capital loss. Such claim has to be tested in terms of Sec. 74 of the Act, which confers such right on the assessee. The relevant portion of Sec. 74 of the Act, reads as follows:

"Losses under the head 'capital gains' (1) Where in respect of any assessment year, the net result of the computation under the head 'capital gains' is a loss to the assessee, the whole loss shall, subject to the other provisions of this Chapter, be earned forward to the following assessment year,

The section says "subject to other provisions of this Chapter i.e., chapter VI containing Sec.66 to 80. The other provisions which will be relevant in this regard are Sec. 70(3)

Section 70: Set off of loss from one source against income from another source under the same head of income.

(3) Where the result of the computation made for any assessment year under sections 48 to 55 in respect of any capital asset (other than a short term capital asset) is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in respect of any other capital asset not being a short-term capital asset"

5.5 The case of the Revenue is that the long term capital gain which was exempt u/s 10(38) of the Act, is income arrived at under similar computation made as the long term capital loss was arrived at and therefore the long term capital loss has to be set off against long term capital gain. In other words the case of the Revenue is that the long term capital gain is income notwithstanding the fact that it is exempt u/s (38) of the Act. This reasoning in our view is fallacious. We have already pointed out that income which do not form part of the total income do not enter the computation of total income at all i.e., under any of the heads of income mentioned in Sec. 14 of the Act. Therefore the question of aggregating them under Chapter VI at all does not arise. Therefore the question of set off of the same under Sec. 70(3) of the Act also does not arise for consideration. Therefore the right of carry forward u/s 74(1) of the Act in respect of the long term capital loss suffered by the assessee is not hit by the provisions of Sec. 70(3) of the Act.

5.7. One more angle of examination of matter is to see The purpose and intention of insertion of clause (38) of the section 10 of the Act of the legislature. Before insertion of clause (38) of the section 10 of the Act, the existing provisions of the Income-tax Act, profits and gains arising to an investor from the transfer of securities were charged to tax either as long term capital gains or short term capital gains depending on the period of holding of the said securities. Short term capital gains arising from transfer of securities are taxed at the applicable rates. Long term capital gains are taxed at 20%, after adjusting for inflation by indexing the cost of acquisition. For listed securities, the taxpayer has an option to pay tax on long-term capital gains at 10% but without indexation. For foreign institutional investors (FIIs), the long term capital gains and short term capital gains are taxed at the rate of 10% (without indexation) and 30% respectively. In case of a trader in securities, however, the gains are taxed as any other normal business income. With a view to simplify the tax

regime on securities transactions; it was proposed to levy a tax at the rate of 0.15 per cent on the value of all the transactions of purchase of securities that take place in a recognized stock exchange in India. This tax was to be collected by the stock exchange from the purchaser of such securities and paid to the exchequer. The above provisions relating to the proposed tax were contained in Chapter VI of the Finance (No.2) Bill, 2004, and took effect from 01.10.2004. Further, it was proposed to insert clause (38) in section 10 of the Income Tax Act, so as to provide exemption from long term capital gains arising out of securities sold on the stock exchange. Thus section 10(38) has been inserted with a particular object to grant exemption to such income as tax has already been levied on some different footings. If we accept the contention of the revenue to adjust long term capital loss against exempt income (long term capital gain) that will be contrary to law and contrary to the intention, object and purpose of the legislature in introducing clause (38) to section 10 of the Act. Further, on acceptance of revenue's view on the issue, there is absurd outcome of interpretation if the facts are reversed, then, long term capital loss from taxable assets will have to be adjusted against the long term capital gains exempt u/s 10(38) of the Act. Suppose in the case on hand if there is taxable long term capital gain before 01.10.2004 of Rs. 33,01,57,200/- and long term capital loss of Rs. 9,23,55,945/-, which may be exempt u/s 10(38) after 01.10.2004 then the loss from exempt source would be set off against taxable gain, such set off is contrary to law.

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» **PROFIT DERIVED FROM CONTRACT WORKS DOES NOT QUALIFY FOR RELIEF U/S 80-IB**

The word 'derived from' in Section 80-IB must be understood as something which has direct or immediate nexus with the assessee's industrial undertaking.

ITAT, HYDERABAD BENCH 'A', HYDERABAD

Maruti Tubes (P.) Ltd.

v.

DCIT

ITA No. 500/Hyd/2009

February 11, 2010

RELEVANT EXTRACTS:

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The word 'derived from' in Section 80IB must be understood as something which has direct or immediate nexus with the assessee's industrial undertaking. Although, the assessee earned income by executing contract work, it is not from the manufacturing activity of the Industrial undertaking. It cannot be said to flow directly from industrial undertaking itself. Where the words unequivocal, there is no scope for importing any rule of interpretation as argued by the assessee counsel. In our opinion, profit derived from contract works does not qualify for relief u/s 80IB of the Act. The laying pipes by the assessee could not be said to be engaged in the manufacture or production of articles process of laying the pipes was a works contract, it was no different from any other works contract which were done on the spot. The laying of pipes does not leads to generation or manufacture of any new article or product. There was no production of any new article or articles, v place reliance on the judgement of Hon'ble Supreme Court in the case CIT Vs. N.C. Bhudharaja & Co. and Another (204 ITR 412). Also we place reliance on the judgement in the case of CIT Vs. Sterling Foods (Goa) (213 ITR 851) (SC) wherein held that unless the new or article emerges as a result of processing it cannot be said that manufacturing or production of articles. In our, opinion the laying of pipes cannot be considered as an integral part of the activity of industrial undertaking of the assessee and having no nexus with industrial activity of the assessee. The manufacturing activity could be carried on by the assessee independently without carrying on activity of laying pipes and in our opinion, laying of pipes have no nexus with the manufacturing activity of the assessee. Accordingly, tin assessee is not entitle for relief u/s 80IB on income earned from laying of pipes.

7.1 Further the assessee counsel argued to re-compute the allocation of expenses between manufacturing activity and non manufacturing activity and file a statement of allocation of expenses on activity with. We have carefully considered this argument. The argument of the assessee counsel is not based on any evidence on record. The assessee has filed division wise profitability statement before the lower authorities. Now the assessee wants to revise the same by saying that on earlier occasion, at the time of the assessment the assessee was ignorant about the consequences and the assessing officer cannot take benefit of assessee's ignorance. This argument of the assessee counsel is devoid of merits. The assessee filed the division wise profitability statement on its own based on books of accounts of the relevant assessment year which have been audited by the competent Chartered Accountant and also represented by CA before the Assessing Officer and it was also noticed by the lower authorities that expenses are properly allocated between the two division. Before us the assessee is not able to point out the specific mistake erupt in the statement filed before the assessing officer and without pointing out the specific error the assessee wants to revise the statement reallocating the expenses. In our opinion, this is after thought. The authority when they given a finding that there is no profit earned by the manufacturing activity of the assessee and the profit earned from the non manufacturing activity is not

entitled for the deduction u/s 8011 then the assessee wants to find out new alternative to avail deduction u/s 80IB for which the Tribunal cannot be party. Accordingly, we are the opinion at this stage, we cannot allow the assessee to reallocate the expenses and thereby recompute the profit of the manufacturing activity and non manufacturing activity.

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» **SECTION 50C HAS NO APPLICATION FOR ARRIVING AT VALUE OF BENEFIT U/S 2(24)(IV)**

The valuation to be considered under section 50C cannot be taken as value for the purpose of section 2(24)(iv)

ITAT, 'A' BENCH, MUMBAI

Ashok W. Phansalkar

v.

ITO

ITA No. 6373/Mum/2007

January 19, 2010

RELEVANT EXTRACTS:

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9. In the present case the assessee was a Promoter Director of company by name M/s. Semcon Electronics Pvt. Ltd. (SEPL). The SEPL purchased the property, flat 242-A admeasuring 1350 sq.ft. in 24th Floor, Maker Towers, Prakash Pethe Marg, Cuffe Parade, Mumbai in 1990 for a price of Rs.62,78,850/-. SEPL had made improvements to the property and the book value as at the beginning of the year was Rs. 1,14,44,394/-. After claiming depreciation upto the year 31.03.2002 of Rs.38,53,982/- the book value at the beginning of the year was at Rs.75,90,412/-. During the previous year SEPL sold the said flat to the assessee for Rs.10 lakhs. SEPL claimed a loss on the sale of the flat in its computation for the A.Y. 2003-04 of Rs.67,16,731/-. The same has been accepted by the Revenue.

10. Before us the dispute is as to whether the provisions of section 2(24)(iv) applies to the

transaction of purchase of flat by the assessee from SEPL and with regard to the quantification of the value of the benefit.

13. There is direct evidence in the form of loss incurred by the company which in turn can be considered as the benefit obtained by the assessee. We have already referred to the fact that SEPL suffered a loss of Rs. 67,16,731 on sale of the property to the assessee. The same was claimed as loss by SEPL and also was allowed by the AO in its IT proceedings for AY 2003-04. We are of the view that there is no need to consider any other factor in determining the value of the benefit. Even though the CIT(A) has gone on a different concept to arrive at the value of the benefit which he determined at Rs.80,00,000/-, we are of the opinion that it would be just and proper to go by the book value as per the books of the company in determining the value of the benefit. Since the company has suffered a loss to the extent of selling the property at a lesser price than the book value, this loss can be directly considered as a benefit received by the assessee under section 2(24)(iv).

14. The argument that the company's loss was accepted by the A.O. cannot come in the way of determining the benefit as under the provisions of the Act. Section 50C restricts the Assessing Officer's powers to the value as determined by the Stamp duty Authorities. Provisions of section 50C have limited application to the extent of determining the sale value of consideration while working out the capital gains or loss thereon in the hands of transferor and not in the hands of the buyer. While determining the capital gain or loss in the hands of the seller the sale value of consideration is to be determined by virtue of the provisions of section 50C. This has no application for arriving at the value of benefit under section 2(24)(iv). We have also considered that provisions of section 17(2) for valuation of perquisites has no application and the assessee also contested the same before the A.O. that the valuation for the purpose of perquisites cannot be determined for valuing the benefit under section 2(24)(iv). Likewise each provision has a significance in computation of total income and provisions of section 50C have to be invoked while determining the loss or gains after the sale of the property in the case of seller's computation. In view of the provisions of section 50C the A.O. assessing the company had no option than to accept the claim by the assessee company. This does indicate that the assessee company has certainly suffered loss and passed on the benefit in the form of an offer given by the assessee who is an interested person being the Promoter Director of the company. Accordingly we are of the view that the valuation to be considered under section 50C cannot be taken as value for the purpose of section 2(24)(iv).

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» **SECTION 35 REFERS TO 'CAPITAL EXPENDITURE' AND DOES NOT REQUIRE ANY FURTHER REQUIREMENT**

Any expenditure of a capital nature on scientific research is allowable deduction u/s 35(1)(iv) read with section 35(2)(ia).

ITAT, MUMBAI BENCH 'A', MUMBAI

Ayushakti Ayurved Pvt. Ltd.

v

ACIT

ITA No. 6541/M/20008

February 9, 2010

RELEVANT EXTRACTS:

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14. We have heard the learned representatives of the parties and perused the record. The crux of the matter in the case under consideration is whether capital expenditure incurred for scientific research expenses are allowable u/s 35 or not. The original claim of the assessee was u/s 37 of the Act. The AO rejected the assessee's claim u/s 37 of the Act as the expenses/analytical charges incurred, which were paid to M/s SCI Molecules India Pvt. Ltd., was no! a revenue expenditure. The AO treated the said expenditure is capital in nature and allowed 1/5" of the expenditure subject to amortization of balance in subsequent years. The CIT(A) was of the view that deduction u/s 35(1)(iv) r.w.s. 35(2)(ia) of the Act. cannot be allowed for the reason that certificate with regard to M/s SCI Molecules India Pvt. Ltd. was not certified by the prescribed authority as specified in rule 6(1) and that the approval was accorded to M/s SCI Molecules India Pvt. Ltd., Pune as R&D company issued for the purpose of section u/s 801B(5A) of the Act. The CIT(A) disallowed the assessee's claim treating the expenditure as capital in nature and enhanced the addition accordingly. We find force in the submission of the learned AK that the CIT (A) has not properly appreciated the provisions of section 35 of the Act. To examine the issue the relevant portion of section 35 reads as under:

"35. Expenditure on scientific research.— (1) In respect of expenditure on scientific research, the following deductions shall be allowed—

(i) to (Hi) ** ** *

(iv) in respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee, such deduction as may be admissible under the

provisions of sub section (2) :

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(2) For the purposes of clause (iv) of sub-section (1), —

dl ** ** *

(ia) in a case where such capital expenditure is incurred after the 31st day of March, 1967, the whole of such capital expenditure incurred in any previous year shall be deducted for that previous year :

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Explanation. — Where any capital expenditure has been incurred before the commencement of the business, the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced."

14.1 From the plain reading of section 35 of the Act, we find

that the scope of this section is limited to only the following sums incurred or paid by the assessee:

1) Revenue expenditure on scientific research related to his business [s. 35(1)(1)]

2) Amount paid to an approved scientific research association or institution or university, etc. to be used for scientific research [35(1) (n)] not deprive the assessee of the benefit of deduction under the provisions of section 35 of the Act.

3) Amount paid to an approved company registered in India with the main object of scientific research and development to be used for scientific research [s.35(1)(ia)].

4) Amount paid to approved university, college or institution to be used for research in social science or statistical research related to the class of business carried on by the assessee. [section 35(1)(iii) | The condition that such research should relate to the class of the business carried on by the assessee is waived with effect from the ay 1992 93i

5) Capital expenditure on the scientific research related to the assessee's business [section 35(1)(iv)].

6) Amount paid to an approved association or institution or to a public sector company to be used for scientific research undertaken under an approved programme; not to be used for acquiring land or building [section 35(2A) | This deduction is not available from 1st March, 1984 onwards].

7) Amount paid to National Laboratory or university or college to be used for scientific research undertaken under an approved programme [s.35(2AA)].

8) Any expenditure not being in the nature of capital expenditure incurred on the acquisition of land or building or construction of any building incurred by the assessee himself on scientific research undertaken under an approved programme [s.35 (213)] [This deduction is not available from 1st March, 1984 onwards].

14.2 The object behind the enactment of section 35 of the Act is to encourage research and development activities by the assessee. As an incentive, the Legislature has given this

benefit by way of deduction in respect, of the capital expenditure incurred by the assessee. This is a provision for the benefit of the assessee and if the assessee incurs capital expenditure for the purpose of research and development during the relevant previous year, in our opinion, the Revenue should

14.3 In the light of the above discussion, if we consider the admitted facts of the case under consideration, we find that the assessee has incurred research expenses, which are capital in nature and these facts are not in dispute. As per section 35(1)(iv), in respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee, such deduction as may be admissible under the provisions of sub-section (2) shall be allowed. Section 35(2)(ia) provides that in a case where such capital expenditure is incurred after 31-3-1967, the whole of such capital expenditure incurred in any previous year shall be deducted for that previous year. The section refers to 'capital expenditure' and does not require any further requirement. As stated above that the expenditure incurred is capital in nature and the same is allowable u/s deduction u/s 35(1)(iv) r.w.s. 35(2)(ia) of the Act. We accordingly set aside the order of CIT (A) and allow the claim of the assessee. The assessee taken ground No 9 for weighted deduction 125 % under section 35 of the Act but this was not argued before us therefore same is rejected.

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