A.C. Bhuteria & Co.
Chartered Accountants

2, India Exchange Place,
2nd Floor, Room No 10,
Kolkata – 700001

Ph: 033-22306990
Email id: updates@acbhuteria.com

Tax Digest

- Recent case laws

March 22, 2022

- *CBDT issues circular on TDS from salaries for the Financial Year 2021-22*

Direct Tax Updates

1. Section 56:

Where shares of a company were allotted proportionately to assessee shareholder based on its existing shareholding, there was no scope for any property being received on said allotment of shares and, consequently, provisions of section 56(2)(vii)(c) did not apply to difference in book value and face value of such shares allotted.

In the instant case[1], the assessee was a director and a major shareholder in an entity namely, KFPL. During the year under consideration, KFPL offered rights issue and the assessee was allotted shares of KFPL of certain amount. The Assessing Officer (AO) alleged that the consideration of face value per share was less than fair market value (FMV) of shares and, therefore, difference between FMV and consideration paid by assessee would be taxable under section 56(2)(vii)(c)(ii) read with rules 11U & 11UA.

The assessee relied on the decision of Mumbai Tribunal in Sudhir Menon HUF wherein it was held that in case of proportionate allotment of shares, there would be no taxability u/s 56(2)(vii)(c)(ii). However, the said provisions might get attracted in case of disproportionate allotment of shares. So, the Ld. AO argued that there was disproportionate allotment of shares since the percentage of shareholding of the assessee in KFPL increased from 90.37% as on 31-3-2013 to 96.88% as on 31-3-2014, and therefore, the stated provisions would apply in the assessee's case. Accordingly, the Ld. AO worked out intrinsic value per share as on 31-3-2013 on the basis of formula laid down in Rules 11U and 11UA and the differential amount as calculated was added to the income of the assessee which resulted into an addition of Rs. 4285.75 Lacs in the hands of the assessee.

Aggrieved assessee went for an appeal before the CIT(A) wherein it was submitted that the shares were offered on right basis by KFPL on proportionate basis to all existing shareholders. The assessee subscribed to the right issue only to the extent of proportionate offer and no further. The attention was drawn to CBDT Circular No. 5 of 2010 dated 3-6-2010 which provided that the newly introduced provisions of sec. 56(2)(vii) were anti-abuse measures. Similarly, attention was drawn to CBDT Circular No. 1 of 2011 which provided that these provisions were introduced as a counter evasion mechanism to prevent laundering of unaccounted income. The provisions were intended to extend the tax net to such transactions in kind. The intent was not to tax the transactions entered into the normal course of business and trade, the profits of which are taxable under specific head of income. It was further argued that it was not a case of tax evasion or money laundering but a pure genuine commercial arrangement in the normal course of business. Also, the Gift tax Act was not applicable to issue of shares, therefore, the provisions of sec.56(2) would not apply to transaction of such nature as per the decision of Bangalore Tribunal in CIT v. Dr. Rajan Pai [IT Appeal No. 1290 (Bang.) of 2015, dated 29-4-2016]. Another argument was that that the provisions of sec.56(2)(vii) would be applicable to recipient of the property or money. Such property includes shares and securities being capital assets of the assessee. However, in the present case, the shares came into existence only on allotment. An allotment is not a transfer and does not attract section 4(1)(a) of the Gift Tax Act. It was, therefore, contended that the property must be in existence at the time when it

[1] **Income Tax Officer Vs Rajeev Ratanlal Tulshyan (ITAT Mumbai) [2021]**

was received from a person. In the present case the shares come into existence only after the shares have been allotted and therefore, the provisions of sec.56(2)(vii) could not be made applicable. However, at the same time, it was admitted by the assessee that similar argument was rejected by Mumbai Tribunal in Sudhir Menon HUF (supra) wherein the bench held that though allotment of shares was not to be regarded as transfer but since the assessee is receiving property in the form of shares, the provisions of sec. 56(2)(vii) would apply. It was further submitted by the assessee that the shares were offered to all the existing shareholders at the same price and in the same proportion in which they were entitled to. Each shareholder had the same right of entitlement to right issue. Thus, what the assessee had received, it was within his entitlement of rights and he has not received anything more over and above thereof. Accordingly, the provisions would have no application since no special benefit was offered to the assessee. Accordingly, Ld. CIT(A) partly allowed assessee's appeal.

Aggrieved, the revenue went for further appeal before the Tribunal in response of which the assessee filed cross objection. The Hon'ble Tribunal upon hearing both the parties was of the view that the impugned additions as made by Ld. AO in the assessment order were considered unsustainable in the eyes of law. In conclusion, the Tribunal deleted the said additions and dismissed the Revenue's appeal.

2. Section-54 – "Exemption for Capital Gains":

Source of funds is irrelevant where there is purchase of a new residential property within the specified period from sale of old residential property to avail benefit under Section 54.

In the instant case[2], the assessee was a salaried employee and had booked a residential flat in an under construction building along with his wife. The assessee had made payments for the new property by availing a housing loan. Further, the assessee sold a residential property which was jointly owned by him and his wife and the sale proceeds from the said property were utilized for repayment of the aforementioned housing loan taken for the purpose of purchasing the new residential property. Furthermore, the assessee claimed deduction under Section 54 of the Act and offered to tax 'Nil' long term capital gains in his income tax return for the A.Y. 2015-16 relevant to the Financial Year 2014-15 during which the sale took place, which was rejected by the AO.

The AO denied benefit of deduction under Section 54 of the Act to the assessee on the ground that he had not purchased the new residential house within period specified in Section 54 of the Act which is one year before or two years after the sale of the existing residential house. According to the AO, the New Residential House was purchased on 15.02.2012, i.e., the date on which the Agreement for Sale, dated 07.02.2012 was registered. Since this was 2 years and 3 months prior to the date of transfer/sale of the Original Asset (i.e. 21.05.2014), the assessee could not be granted the benefit of Section 54 of the Act. The AO was also of the view that the Assessee had utilized his regular income to repay the loan installments and not the consideration received from the same of the property.

[2] **Reji Easow Vs Income Tax Officer, Thane (ITAT Mumbai) [2022]**

Aggrieved by AO's order, the assessee preferred an appeal to the CIT(A), who confirmed the order passed by AO.

Aggrieved, the assessee appealed before the Tribunal wherein the assessee contented that the property purchased was under construction, so, the benefit of Section-54 of the Act could be extended to it by treating the transaction as a case of 'construction' and not 'purchase' since the construction was completed and possession of the New Residential House was taken within a period of 3 years from the date of sale of Original Asset. The assessee further contended that the date of actual physical possession should be taken as date of purchase of the New Residential House. In addition, it was contended that the case of the assessee could be viewed as a case of 'construction'. Whereas, the Ld. DR relied upon the order of the AO as well as CIT(A) & contended that the date of registration of Agreement for Sale must be taken as date of purchase. He further submitted that the assessee had purchased the property and therefore, it could not be contended that this was a case of 'construction'. However, the Tribunal was of the view that the agreement to sell was not a sale/conveyance deed but mere an agreement for sale of a flat in a multi-storeyed building entered into between the parties. When the Agreement for Sale was registered, the multi-storeyed building was not fully constructed and the obligation of the assessee to make payment was linked to construction. It also added that the date of possession by the assessee should be taken as the date of purchase. As per the requirement of the Section 54, the assessee should have purchased a residential house within the specified period and source of funds was quite irrelevant. Nowhere, it had been mentioned that the funds received as consideration from sale of original asset must be utilized for the purchase of the new residential house. Since the date of purchase fell within a period of 2 years from the sale of Original Asset, the assessee was entitled to benefit under Section 54 of the Act. Therefore, the appeal of the assessee was allowed in the conclusion.

3. Section 68:

Where there was no evidence to show that commodity profit was a bogus transaction and motive behind the arrangement of such a transaction, section 68 of the Act could not be applied.

In the instant case[3], the assessee had shown a commodity profit of Rs. 2,18,346/- in its return of income.However, on scrutiny, the AO held that the said commodity profit shown by the assessee was ingenuine and bogus and treated the said amount of Rs. 2,18,346/- as unaccounted income of the assessee u/s 68 of the Act.

He further estimated the expenditure at the rate of 3% of the said profit at Rs.6,550/- and treated the same as unexplained expenditure of the assessee and added the same to the income of the assessee. The ld. CIT(A) also confirmed the addition so made by the AO.

The ld. Counsel for the assessee has submitted that in this case the AO had relied upon certain report of Investigation Wing wherein it was noted that 85 entities were identified who had booked contrived losses in excess of Rs.10 crores which were used to set off any income/profit available in the books. The assessee was found to be one of the parties to whom bogus profit was given, so as to give the benefit of equal loss to some other parties. The AO,

[3] **Aditya Pugalia HUF Vs Income Tax Officer, Kolkata (ITAT Kolkata) [2022]**

therefore, treated the income of commodity profit shown by the assessee as unexplained income of the assessee. The ld. Counsel for the assessee has submitted that the assessee has never indulged in such bogus profit, as alleged by the Department. He has, further, submitted that there was no evidence that the assessee had done any bogus transaction. He has, further, submitted that the income earned from commodity profit was offered to taxation as income from 'other sources'. He further, submitted that even if the said income is treated as unexplained income u/s 68 of the Act, still there was no tax effect. He further, submitted that the AO has wrongly made the addition of Rs.6,550/- on account of unexplained expenditure in respect of arranging the ingenuine commodity trade.

The Hon'ble Tribunal held that there was no motive for the assessee to arrange such a transaction, since there is no difference in the rate of tax which the assessee had already offered to in its return of income, and under section 68 of the Act.

Also, there is no mention as to whom/which party the assessee has given the benefit of bogus losses by booking the aforesaid profits. There is nothing on record that the assessee was involved in such a transaction. Even otherwise, there is nothing on record to show that the assessee has incurred expenditure at the rate of 3% at Rs.6,550/- to enter into alleged bogus transaction from which the assessee did not get any benefit of taxation. Hence, the appeal of the assessee stood allowed and the addition was deleted.

4. **Section-263 :**

Revision u/s 263 of the Act cannot be initiated where the entity ceased to exist by virtue of amalgamation

In the instant case[4], the facts in brief were that Sri Ram Financial Consultants Pvt. Ltd. was merged with the assessee-company M/s. Bbigplas Poly Pvt. Ltd. w.e.f. 01.04.2018 vide order dated 23.01.2019 passed by NCLT and consequently Shri Ram Financial Consultants Pvt. Ltd. ceased to exist w.e.f. 1.4.2018. The said entity Sri Ram Financial Consultants Pvt. Ltd. filed its return of income for A.Y. 2017-18 on 26.10.2017 declaring a total income of Rs. 8,41,600/. The case of the said company was selected for limited scrutiny through CASS and assessment u/s 143(3) of the Act dated 12.07.2019 was framed by the AO in the name of Sri Ram Financial Consultants Pvt. Ltd. Pertinent to state that the assessee intimated the AO vide letter dated 25.10.2019 filed on 06.11.2019 that M/s. Sri Ram Financial Consultants Pvt. Ltd. was merged with it i.e. M/s. Bbigplas Ploy Pvt. Ltd. vide order dated 23.01.2019 which was effective from 01.04.2018 and also surrendering the PAN of the ceased company and also requesting the AO to make all correspondences in future at the address of amalgamating company i.e. Bbigplast Poly Pvt. Ltd. The Ld. PCIT upon perusal of the assessment records came to the conclusion that the rental income received by M/s. Sri Ram Financial Consultants Pvt. Ltd. of Rs. 76,55,761/- has not been fully offered to tax as it has only shown Rs. 4,50,000/- as gross annual value of the let out property resulting into underassessment and thus the assessment framed by the AO is erroneous in so far as prejudicial to the interest of the revenue. Accordingly, a show cause notice u/s 263 of the Act dated 08.09.2021 was issued in the name of Sri Ram Financial Consultants Pvt. Ltd. which has ceased to exist w.e.f. 01.04.2018 vide NCLT order and thereafter order u/s 263 of the Act dated 29.10.2021 was passed by the ld. PCIT setting aside the assessment framed vide order dated 12.07.2019.

The assessee submitted that the exercise of revisionary jurisdiction u/s 263 of the Act is not valid since the ld. PCIT has issued show cause notice u/s

[4] **Bbigplas Poly Pvt. Ltd. Vs PCIT, Kolkata (ITAT Kolkata) [2021]**

263 of the Act in the name of the non-existent company which has already merged with the assessee company. The Ld. AR submitted that the revisionary proceedings initiated in the name of non-existent company are invalid and void ab-initio and so is the order passed by the PCIT u/s 263 of the Act.

Considering the facts as placed before the Hon'ble Tribunal, it held that the proceedings initiated u/s 263 of the Act in the name of non-existent company issued u/s 263 of the Act by the ld PCIT is nullity and void ab initio on the ground that M/s Sri Ram Financial Consultants Pvt. Ltd was non existing at the time when the show cause notice was issued. The jurisdiction assumed by ld PCIT by issuing show cause notice u/s 263 of the Act in the name of non-existent entity suffers from the substantive illegality and consequently the revisionary proceedings as well as order passed u/s 263 of the Act will not survive and have to be set aside as the very initiation of proceedings is invalid and nullity in the eyes of law. It placed reliance on the decision of the Hon'ble Supreme Court in the case of PCIT vs Maruti Suzuki India Limited (supra) wherein it has been held that the jurisdictional notice issued in the name of non-existent company and consequent assessment order are to be set aside as the issue of jurisdictional notice on non entity is a substantive illegality and not procedural irregularity of the nature as referred to in section 292B of the Act. Thus, the revisionary proceeding initiated the Ld. PCIT and also the revisionary order framed u/s 263 of the Act was quashed.