# Direct Tax Vista

**Your weekly Direct Tax recap**

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1. **Test for treating Export Incentives/ State Incentive as being "derived from" the business of an undertaking or not**

As per Sections 28(iiid) and (iiie) any profit on the transfer of the Duty Drawback and on transfer of DEPB Schemes, etc., shall be chargeable to income tax under the head "Profits and gains of business or profession". The question is whether income from DEPB / Duty Drawback/RoDTEP/MEIS/SEIS or other such Schemes are incentives which flow from the schemes or are they a part of profits "derived from" the business eligible under Section 80-IB or any other such scheme. Similarly, whether electricity or interest subvention or transportation subsidies provided by The State Government would be considered as "derived from" the said business or not.

In these cases it has to be seen whether the income has a direct nexus / close connection with the business of the assessee or not. The words used are "derived from" and not "attributable to". The words "attributable to" in the given clause have been given a wider connotation as opposed to the words "derived from" which have been interpreted to be confined to "first degree sources". The words "derived from" will be given a restrictive interpretation.

Hence it was held by The Hon'ble Apex Court in the case of M/s SARAF EXPORTS Vs COMMISSIONER OF INCOME TAX, JAIPUR-III [2023-VIL-08-SC-DT] that the profit from DEPB and Duty Drawback claims, the assessee shall not be entitled to the deductions under Section 80-IB as such income cannot be said to be an income "derived from" industrial undertaking and even otherwise as per Section 28(iiid) and (iiie), such an income is chargeable to tax. However, as far as electricity or interest subvention or transportation subsidies provided by The State Government are concerned and where they impact the manufacture directly, they would continue to be considered as "derived from" the said business.

2. **Circulars adverse to The IT Dept. are also binding on officers**

A circular can be adverse to the Income Tax Department, but still are binding on the authorities of the IT Department, but cannot be binding on the assessee if they are adverse to the assessee. This is a settled position after the judgement of The Hon'ble the Supreme Court in the case of UCO Bank vs. CIT (1999) 154 CTR (SC) 88. Hence, the authorities cannot select any case for detailed scrutiny against the circulars issued by the Board. The CBDT's Instruction NO. 1935/1996 dated: March 12, 1996, It was decided that the norms of exclusion from sample scrutiny could be extended for the assessment year 1996-97 in the cases where the following criteria are satisfied:-

Those assessees who declared a total income for the assessment year 1995-96 that was more by 30 per cent of the total income returned for the assessment year 1994-95 subject to the conditions that:

(i) the total income for the assessment years 1995-96 and 1996-97 exceed the basic exemption limit.
(ii) the total income for the assessment year 1995-96 does not exceed Rs. 5 lakhs; and
(iii) taxes for the assessment year 1996-97 are fully paid before the return is filed for that year.

If, however, the case falls under the compulsory scrutiny basket, the above norms of exclusion from scrutiny would not apply.

If the above requirements were fulfilled by the assesse, the case could not be taken up for sample scrutiny even incase the other balance sheet items were of high financial value and where the revenue would have doubts.

If these criteria were fulfilled, then even if genuineness of Share application money, loans and advances taken or made, etc are prevalent, the case cannot be taken up for sample scrutiny as was held in the case of COMMISSIONER OF INCOME TAX, ROHTAK Vs M/s CRYSTAL PHOSPHATES LTD. [2023-VIL-50-P&H-DT].

The CBDT, could issue such orders, instructions and directions to other IT authorities as it may deem fit for the proper administration of the Act and such authorities and all other persons employed in the execution of this Act shall observe and follow such orders, instructions and directions of the Board. The power is given to the Board for the purpose of proper and efficient management of the work of assessment. It is a beneficial power given to the Board for proper administration of fiscal law so that undue hardship may not be caused to the assessee and the fiscal laws may be correctly applied. Hard cases which can be properly categorized as belonging to a class can thus be given the benefit of relaxation of law by issuing circulars binding on the taxing authorities.

To the same effect is the judgment passed by the Calcutta High Court in Amal Kumar Ghosh vs. Assistant Commissioner of Income Tax & others, (2014) 105 DTR 351 (Cal), wherein it has been held that during the financial year 2004-05, the selection of case for scrutiny had to be completed within 3 months of the date of filing of return. In that case, return was filed on 29.10.2004 and selection of case for scrutiny was done on 06.07.2005 i.e. the beyond the period of three months. It was held that instructions of CBDT were violated, as the circulars were binding upon the department. The Department was bound by that standard and could not act with discrimination. Finally, the appeal was allowed.

3. **No Capital Gains on Agricultural Land u/s 2(14) even incase the land is not used for earning agricultural income and is sold after purchasing**

Section 2(14)(iii) of The Income tax Act provides that “Agricultural Land” would not be considered as a capital asset and states as under –

> “.. *(iii) agricultural land in India, not being land situated-*
> *(a) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board and which has a population of not less than ten thousand [***] ; or*
> *(b) in any area within the distance, measured aerially,-*

*(I) not being more than two kilometres, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten thousand but not exceeding one lakh; or*

*(II) not being more than six kilometres, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than one lakh but not exceeding ten lakh; or*

*(III) not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten lakh.*

***Explanation**.-For the purposes of this sub-clause, "population" means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year"*

No criterion has been mentioned that for holding a land to be "agricultural land", agricultural produce must be done on such land and agricultural income should have been derived from such land. Where the land had been shown as agricultural land in Revenue records, there was no application made for conversion of aforesaid agricultural land to non-agricultural land, the agriculture land under consideration was situated beyond 8 km from the municipal limits and other conditions for claiming the said land as agricultural land are satisfied, then the claim u/s 2(14)(iii) cannot be denied on the grounds that the assessee had not performed any agricultural activity on the said land or that the assessee had purchased the said property with the sole intention to sell the same for profit. The same was held in the case of THE ITO, WARD-2(1)(4), AHMEDABAD Vs M/s MEGHDEEP FARMS PVT. LTD [2023-VIL-477-ITAT-AHM].

A question may be asked that when agricultural land is not a 'capital asset' itself, can the profit on sale of the land be taxed under any other head. It is to be noted that that there is difference between a receipt not being an income and the same being an exempt income under the tax laws. So any profits made on sale of agricultural land, which is not a capital asset, is not an income at all for tax purpose.

Such profit made on sale of such agricultural land is not required to be disclosed in the ITR.

4. **Benefit of tolerance limit of +/- 5% as contained in Section 92C(2) available even when one comparable remains in comparable set**

Section 92C(2) of Income Tax Act states as follows -

> *"92C(2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed :*
>
> ***Provided** that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:*
>
> ***Provided further** that if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not exceeding three per cent of the latter, as may be notified by the Central Government in the Official Gazette in this behalf] the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price…"*

As per the first proviso where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices. Per contra, if there is only one price which is determined by the most appropriate method, then as per the main subsection (2) without the aid of proviso, that price shall constitute the ALP. The second proviso comes into play to deem the actual transacted price as the ALP. It provides that where the variation between the ALP "so determined" does not exceed the specified percentage, the price at which the international transaction has actually been undertaken 'shall be deemed to be the arm's length price'. The words 'so determined' as employed in the second proviso assume significance. As these have been used in the second proviso distinct from the subject matter of the first proviso, these will apply to the ALP

determined under sub-section (2) consisting of the main provision and also the first proviso. Resultantly, the option of 'deemed' ALP shall extend not only to a situation where more than one price is determined as ALP by the most appropriate method but also where only one price is determined as ALP. The net result is that the option to the assessee shall be available in both the situations, covered under main sub-section (2) and also the first proviso.

Hence in the case of PHILIPS INDIA LIMITED Vs ASSISTANT COMMISSIONER OF INCOME TAX, CIRCLE-12(2), KOLKATA [2023-VIL-478-ITAT-KOL], where TPO had rejected six out of seven comparable companies identified by assessee and only one comparable remained in comparable set, and that comparable fell within tolerance limit of +/- 5% as contained in Section 92C(2) of the Act, Benefit of tolerance limit under 2nd proviso to Section 92(C)(2) of the Act was considered to be available to assessee.

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