TAX FLASH NEWS

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The benefit of ‘indexed’ cost of acquisition is available on the sale of long-term capital asset while computing Minimum Alternate Tax

The Karnataka High Court in the case of Best Trading and Agencies Ltd.[1] (the taxpayer) dealt with the eligibility of indexed cost of acquisition on the sale of long term capital asset while computing Minimum Alternate Tax (MAT) liability under Section 115JB of the Income-tax Act, 1961 (the Act). The High Court held that the taxpayer is entitled to the benefit of indexed cost of acquisition on the sale of long-term capital asset while computing the MAT liability under Section 115JB.

The High Court also held that the taxpayer is entitled to the deduction of interest paid under Section 57(iii) against the interest earned on deposits. There was a nexus between the interest paid to the creditors and the interest earned on the deposits. The interest expenditure was incurred wholly and exclusively for the purpose of earning the interest income.

Facts of the case

The taxpayer was formed with the purpose of restructuring the Indian electricity supply company under a scheme approved by the Court. The taxpayer was utilised as a special purpose vehicle (SPV) for restructuring purpose whereby surplus of non-manufacturing and liquid assets (including real estate, capital asset, and land) together with certain liabilities were transferred to the taxpayer for disbursement of liabilities.

The lenders and banks were shareholders of the taxpayer and held 88 per cent of the equity. The taxpayer had taken over the loans of erstwhile company and the interest payable to the term lenders was a part and parcel of the loan, which was outstanding. During the Assessment Year 2005-06 and AY 2006-07, the taxpayer earned interest from fixed deposits against which interest paid to the creditors were claimed as deduction under Section 57 when the said deposit was made out of surplus from restructuring process. The taxpayer also declared a long term capital loss on sale of a capital asset.

The Assessing Officer (AO) disallowed the interest claimed as deduction under Section 57. The AO also invoked the MAT provisions under Section 115JB and assessed the taxpayer on the book profits without giving a benefit of indexation on the cost of capital asset sold during the year.

The Commissioner of Income-tax (Appeals) [CIT(A)] held that there was a close nexus between the interest earned on the fixed deposits and the interest paid to the lenders and the creditors. Accordingly, the claim of deduction under Section 57 was allowed. Further, the CIT(A) held that the taxpayer was eligible to claim indexed cost of acquisition on sale of capital asset while computing MAT liability under Section 115JB.

However, the Tribunal observed that there was no nexus between the interest income and interest expenditure claimed under Section 57. Therefore, such interest claimed under Section 57 should not be allowed. The Tribunal[3] observed that the taxpayer was not eligible to claim the benefit of indexation on the cost of capital asset sold during the year while computing the MAT liability.

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[1] Best Trading and Agencies Ltd. v. DCIT. (ITA.No.191/2011) (ITA.No.32/2012) – Taxsutra.com

[2] DCIT v. Best Trading and Agencies Ltd. (ITA No.36/Bang/2010)

[3] Apollo Tyres Ltd v. CIT [2002] 122 Taxman 562 (SC), Karnataka State Industrial Infrastructure Development Corporation Ltd. v. DCIT. [2017] 54 ITR(T) 425 (Bang), MSR & Sons Investment Ltd. v. DCIT (ITA.No.769/2000), CIT v. Metal & Chromium Plater P. Ltd [2019] 415 ITR 123 (Mad)

High Court's decision

Eligibility of indexed cost of acquisition while computing MAT liability

The High Court relied on various decisions1 where it was held that while computing capital gains the benefit of indexed cost of acquisition was to be considered for the purpose of computing MAT liability under Section 115JB. The High Court held that, on the invocation of Section 115JB(5), the application of other provisions of the Act are open, except if specifically barred by the Section itself. The indexed cost of acquisition is a claim allowed under Section 48 to arrive at the income from capital gains. The difference between the sale consideration and the indexed cost of acquisition represents the actual cost of the taxpayer. The taxpayer has to be given the benefit of indexed cost of acquisition. Denial of the benefit of indexed cost of acquisition will result in taxing the income other than actual/real income.

There is no provision in the Act to prevent the taxpayer from claiming indexed cost of acquisition on the sale of asset where the taxpayer is subjected to the provisions of MAT under Section 115JB. Therefore, the taxpayer was eligible to claim the benefit of indexed cost of acquisition.

Allowability of interest paid to the creditors

While referring to various decisions[4] and on perusal of Section of 57(iii), the High Court observed that the purpose of expenditure was relevant in determining the applicability of Section 57(iii) and the purpose must be 'making or earning of income'. The taxpayer in order to cover the cost of interest payable to the creditors for the unpaid period, invested the surplus in the fixed deposits and earned interest on such deposits. The amount earned by way of interest was paid to the lenders and creditors. Thus, there was a nexus between the interest paid to the creditors and interest earned on the deposits. The interest expenditure was incurred wholly and exclusively for the purpose of earning the interest income and therefore, the taxpayer was entitled to deduction from the interest income under Section 57(iii) of the Act.

Our comments

The issue with respect to the eligibility of indexation and other benefits available under the capital gains provisions while computing MAT has been a subject matter of debate before the Courts.

The Madras High Court in the case of Metal & Chromium Plater P. Ltd.[5] held that the allowance or otherwise of the claim under Section 54EC has to be seen in the context of the provisions of Section 115JB which is a self-contained code of assessment. The levy of tax is on the book profits after effecting various upward and downward adjustments as set out in terms of the Explanation thereto. The provisions of Section 115JB(5) open the assessment to the application of all other provisions contained in the Act except if specifically barred by that section itself.

Similarly, the Mumbai Tribunal in the case of Savannah Real Estate Pvt Ltd.[6] held that the benefit of indexation under Section 48 should be allowed while computing capital gains to be added to the book profits under the provisions of MAT.

However, the Mumbai Tribunal in the case of Dharmayug Investments Ltd.[7] held that only net amount on sale of shares will be taken into account while computing book profits under Section 115JB and not the amount of long-term capital gain computed after indexation under the normal provisions of the Act. The Tribunal held that the concept of indexation for computing the long-term capital gain cannot be imported while computing book profits under Section 115JB .

The High Court in the present case has held that the taxpayer is entitled to the benefit of indexed cost of acquisition on the sale of long term capital asset while computing MAT liability under Section 115JB

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[4] CIT v. Shoorji Vallabh Das and co. [1962] 46 ITR 144 (SC), CIT v. Lakshmi Machine Works. [2007] 290 ITR 667 (SC)

[5] CIT v. Metal & Chromium Plater P. Ltd [2019] 415 ITR 123 (Mad)

[6] ITO v. Savannah Real Estate Pvt Ltd (ITA No 6310/Mum/2017)

[7] Dharmayug Investments Ltd. v. ACIT (ITA No. 1284/Mum/2013)

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