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CASE BRIEF

National Co-Operative Development Corporation v. Commissioner of Income Tax, Delhi-V

Case No.	Civil Appeal Nos. 5105-5107 of 2009
Date	11 September 2020
Court	Supreme Court of India
Coram	Sanjay Kishan Kaul J., Indu Malhotra J.

1. FACTUAL BACKDROP

- 1.1 National Co-operative Development Corporation's ('Assessee') was engaged, *inter alia*, in the business of advancing loans or granting subsidies. The Assessee received interest, dividends and/or other realization.
- 1.2 For the Assessment Year 1976-77, the Assessee claimed deduction for non-refundable grants given by the Assessee but it was disallowed by the Assessing Officer ('AO') holding the same to be in the nature of capital expense and not a revenue expense and therefore, not deductible while computing taxable income. What also weighed with the AO was the fact that the grants received from the Central Government were in the nature of a capital receipt exempt from tax.

2. ISSUE

- 2.1 Whether the component of interest income earned on the funds received under section 13(1) National Co-operative Development Corporation Act, 1962 ('**NCDC Act**'), which were disbursed as grants to national or state level co-operative societies, is eligible for deduction for determining the "taxable income" of the Assessee.

3. SUPREME COURT'S DECISION

- 3.1 The income generated as interest income from investment of idle funds is necessarily interlinked to the business of the Assessee and is taxable as 'business income' and not as 'income from other sources'.
- 3.2 The disbursement of non-refundable grants is an integral part of business of the Assessee as contemplated under section 13(1) of NCDC Act, thus relating of its business. The purpose is direct, merely because the grants benefit a third party, it would not render the disbursement as 'application of income' and not expenditure. Application of the interest income towards disbursement of grants is as per business objective of the Assessee and therefore, business expenditure allowable as deduction under Section 37 of the Income Tax Act.
- 3.3 The contention of the Revenue that interest income received has merged with the common fund and therefore, lost its revenue character and becomes capital in nature is rejected. The interest, having been treated as revenue receipt on which taxes are paid, shall continue to retain the character of revenue receipt.

4. POSTSCRIPT

- 4.1 Interestingly, this judgment comes with two postscripts. The main reason of these postscripts seems to be that this case took 44 years to be finally decided. First

postscripts is on account of the backbreaking dockets which are ever increasing and second is as a move towards a trust between the tax department and the Assessee.

- 4.1.1 **First Postscript:** The court emphasized that the Indian legal system is reeling under a docket explosion. Both the government and public authorities are active contributors to this deluge and the question which essentially remains is ‘which pocket of the Government will be benefitted?’. The court also noted the sheer failure of existing out of court settlement mechanism for such cases. In order to make the system function effectively, court suggested that the mechanism for resolution of commercial disputes of Central Public Sector Enterprises (**‘CPSEs’**)/Port trusts *inter se*, as well as between CPSEs and other Government departments should be effectively implemented. The court stated that mediation has proved to be an efficacious remedy in most countries, therefore, India should take steps towards having a comprehensive legislation to institutionalize mediation.
- 4.1.2 **Second Postscript:** The court discussed the issue of matters pertaining to CPSEs and Government authorities insofar as taxation matters are concerned. One of the largest areas of litigation for the Government is taxation matters. Court was of the opinion that “*vibrant system of Advanced Ruling can go a long way in reducing taxation litigation*”. Court also referred the international scenario where there has been an incremental shift towards mature tax regimes adopting advance ruling mechanisms. Court recommended to the Central government to consider the efficacy of the advance ruling system and make it more comprehensive as a tool for settlement of disputes.

5. PSL COMMENT

- 5.1 In this case, the Supreme Court has not only resolved the issue pertaining to the matter but also made few strong observations on soaring tax litigation in India. The court has recommended to the Central Government to consider the efficacy of the advance ruling system and make it more comprehensive as a tool for settlement of disputes. However, it would be just over simplification of applicable laws on the part of Central Government if it solely rely on advance ruling system to settle international tax disputes.
- 5.2 As we are aware, that India has not opted for Mandatory Binding Treaty Arbitration (**‘MBTA’**) which is prescribed under Article 19 of Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (**‘MLI’**), which means that India’s covered tax agreements (**‘CTA’**) would not contain arbitration clause thus leading to litigation in Indian Courts. In view thereof, it would be advisable that India adopts the MBTA to promote use of alternative dispute resolution mechanism when it comes to international tax disputes and which may in turn may reduce the burden of international tax litigation from Indian Courts.