Tax Wire

Bollywood Badshah's tryst with the tax department!

07th April, 2017

adwith CONSULTING

Bollywood Badshah's tryst with the tax department!

Background

Mr. Shahrukh Khan (hereinafter referred to as Mr. Khan/the assessee for brevity) is a well-known name in the film industry and also referred to as Badshah of Bollywood. The Badshah had a tryst with the tax department, when his contract relating to KBC ran into some tax dispute. In a recently pronounced verdict[1] of the Mumbai tax tribunal things have turned out in his favour.

Flashback

There were 3 incomes of Mr. Khan that were disputed:

1. Mr. Khan had entered into an agreement with Star India Pvt. Ltd. (**SIPL**) to act as a host and anchor of the show **"Kaun Banega Crorepati" (KBC)** for a total of 2 seasons comprising of 52 episodes each on 30.03.2007. Pursuant to this agreement, he had received an amount of Rs.72 Crores which was also offered to tax in a previous year. Due to commercial reasons, SIPL chose to discontinue the programme. Mr. Khan as a moral liability and in a gesture to ensure continuance of cordial professional relationships intended to return the amounts received for the non-shooting of the 52 episodes by entering into a mutual agreement with SIPL agreeing to pay on their behalf to M/s Kolkata Knight Riders Sports Pvt. Ltd. (**KKR**), a sum of Rs.10 Crores in order to get them the sponsorship of the KKR Team for the 2nd Season of IPL.

2. Mr. Khan also agreed, as a part of the agreement, to make appearances at press conferences one each at London and Dubai to promote SIPL as a sponsor of KKR at no further cost or fees. The press conferences however did not happen. However, the tax officer brought to tax an amount of Rs.7 Crores as notional income on the appearances that were agreed to be done by Mr. Khan.

3. Mr. Khan had a villa in Dubai which was received by him as a gift. The tax officer wanted to tax notional rental income on this.

The Conflict

The following are the 3 grounds on which the assessee had challenged the order of the AO:

1. The assessee had claimed a deduction for the Rs.10 Crores paid by him to KKR during the year as an expense against his professional income. The tax officer rejected this deduction stating that nothing in the agreement entered into with SIPL obligated the assessee to pay any amount unless in the case of a breach of contract. Accordingly, when the reason for discontinuance of the programme KBC was not attributable to the assessee, the AO stated that the expenditure of Rs.10 Crores claimed as a deduction was not payable and had no nexus with the profession or the receipts of the assessee and made an addition to the income declared by the assessee.

2. Another addition of Rs.7 crores towards the agreed appearance was made by the tax officer on a notional basis.

3. Regarding the Dubai villa, tax officer treated this as deemed to be let out and an annual letting value estimated at Rs.67.2 Lakhs after providing the standard deduction of 30% [Rs.96-28.8 lakhs], was added to the income of the assessee.

[1] **Shah Rukh Khan vs. ACIT [2017] 79 taxmann.com 227 (Mumbai Trib.)**

Mr. Khan disputed the above before the first appellate authority in vain. He carried the dispute further to the tax tribunal - Mumbai.

The Climax

1. **On the matter of disallowance of Rs. 10 crores**

The tax tribunal while holding that such payment was a deductible expenditure owing to commercial expediency highlighted certain key principles of section 37(1) of the Income Tax Act.

Section 37(1) of the Act provides inter alia deduction for an expense if it is incurred "**wholly and exclusively**" for the purpose of the business.

Mr. Khan's counsel argued that payment of Rs.10 Crores to obtain the sponsorship for Star India was a part of the business strategy of the assessee in maintaining his goodwill with Star India. They also highlighted that the lower tax officer had not appreciated the practice of having to maintain good relationship. It was also argued that the Hon'ble Supreme Court in the case of ***S.A Builders v. CIT, 288 ITR 1(SC),*** had held that *"it is not the legal necessity to incur the expense which is determinative of its allowability, rather, it is the existence or otherwise of commercial expediency which guides the allowability of expenditure under Section 37(1) of the Act",*

The Mumbai ITAT analyzed the facts and submissions and relying on the above mentioned decision held that the assessee had a long standing relationship with Star India Pvt. Ltd. and the payment made to maintain such relationship indicates a nexus between the impugned expenditure and the business of the assessee and was therefore deductible. It also agreed that it was not for the Revenue to prescribe what expenditure an assessee should incur and under what circumstances and ruled in favour of the assessee reversing the addition of Rs.10 Crores.

2. **Real income vs. notional income on agreed appearances:**

The Honourable Supreme Court had held in the case of ***Godhra Electricity Co. Ltd., 225 ITR 746 (SC)***, that in case of accrual of income or receipt of income, what is of relevance is to assess an income which materializes. The assessee relied on this judgment in support of his proposition that only real income can be taxed. Accordingly, since the conferences at London and Dubai never happened, no real income accrued to him in substance and the addition proposed by the officer was a notional assessment.

The tax officer also had claimed that the appearances agreed to be made by the assessee, who enjoyed brand equity on account of his professional standing would add to the brand equity of KKR and SIPL and claimed that a benefit as referred to in Section 2(24)(iv) of the Act would accrue to the assessee, who purchased the shares in M/s. Kolkata Knight Riders Sports Pvt. Ltd. in the future years.

The tax tribunal disapproved such arguments and stated that the tax officer had failed to establish what benefit has been received by Mr. Khan to tax a notional income and thereby directed to delete such addition to income.

3. **Property situated outside India:**

In respect of the Dubai Villa, the assessee contended that he had not offered any income to tax relying on Article 6 of the DTAA between India and UAE according to which the income derived by a resident of a contracting State from immovable property situated in the other contracting State **may be taxed** in that other State.

Accordingly, the assessee claimed that the income from deemed letting out was

taxable in Dubai only. The department however had placed reliance on the Notifications 90 and 91 dated 28.08.2008 issued by Income Tax Board to the effect that where the DTAA entered into by India with any of the other country provides that any income of a resident of India "**may be taxed**" in the other country, such income is to be included in the total income of the assessee chargeable to tax in India in accordance with the provisions of the Income Tax Act, 1961 and relief should be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

In this matter, the Tribunal relying on the notifications and the interpretation given by the Board in them, held that income from the Dubai Villa is liable to be taxed in India in accordance with the provisions of Section 23(1) to tax the income from a deemed to be let-out property and the credit of whatever taxes that may have been levied in the other contracting State, was to be allowed as per law. The addition of Rs.67.2 Lakhs was therefore confirmed by the Tribunal. In holding so, the tax tribunal heavily relied on the judgement of Mumbai tax tribunal in the case of **Essar Oil Ltd. vs. ACIT. ITA No.2428/Mum/2007.**

Advith Comments

Commercial expediency principle under 37(1) is a very important and matured piece of legislation. The legislature has very clearly understood while enacting this provision that not all expenditure that a businessman incurs can be captured in a taxation statute and hence it has been left to the tax payer with a test of wholly & exclusively incurred for the purpose of business. The principle laid down by the Hon'ble Supreme Court ruling in SA Builders case, which has been followed in this ruling that '*it is not legal necessity that determines whether it is allowable or not but the commercial expediency*' is an ultimate test that needs to be considered while allowing an expenditure. It is appreciable that the tax tribunal considered that maintaining good relationship as a key factor to conclude on commercial expediency.

There is no debate that only real income should be taxed and not notional income, unless, the Act itself provides for it. However, what is real income and what is notional income has been a constant debate. This is a matter of fact and will remain so, as was in this case. It can only be expected that tax authorities would make necessary efforts to gather those facts in detail.

Usage of terms like 'may be taxed' in tax treaties is a big let down on certainty in cross border taxation. The spirit of the agreement should be kept in view while interpreting agreements. The finding of the tax tribunal in Essar Oil case that since the notification brought out by the Government specifies such intent seems to be the only acceptable argument by the tribunal at the moment. If this was to be the intent, why weren't terms like 'shall be taxed' as normally used for other provisions not used in all the treaties is something that needs to be answered. Until such time, this gets answered, the dispute on this matter may continue.

<<This space has been intentionally left blank>>

About Advith Consulting

Advith Consulting is a multi disciplinary consulting Firm offering range of services to cater clients with their professional needs. What makes Advith Consulting, a class apart is:

- Energetic, experienced and vibrant professionals driven by knowledge-centric client servicing practices.
- Fluidic organisation helping clients achieve their business goals by providing solutions to various requirements by seamlessly integrating all professional services.
- Belief in upholding the highest standards of business ethics with a total commitment to quality.
- Adequately backed by a committed team of employees, talent and expertise in multiple areas, which is the key for timely deliverables.

Reach us at:

Advith Consulting LLP

No. 72/1, 1st Floor, Jnanodaya School Road
Shankarapark, Shankarpuram, Bangalore 560 004
Contact: 080 22426484;
e-mail: info@advithconsulting.in
Visit us at: www.advithconsulting.in