Rates of Tax, Surcharge and Education Cess

- **Exemption limit and rates of taxes**:

The exemption limit for Individuals, HUF, AOP and BOI has been increased w.e.f. A.Y. 2010-11. This limit is now increased for senior citizens from Rs. 2,25,000 to Rs. 2,40,000, for women (below 65 years) from Rs.1,80,000 to Rs.1,90,000, and for others from Rs.1,50,000 to Rs.1,60,000. The slabs for levy of tax have also been recast as under:

Slab (Rs. in lacs)	A.Y. 2009-10	Slab (Rs. in lacs)	A.Y. 2010-11
1.50 to 3.00	10%	1.60 to 3.00	10%
3.00 to 5.00	20%	3.00 to 5.00	20%
Above 5.00	30%	Above 5.00	30%

Rates in A.Y. 2010-11 (Account Year ending 31-3-2010)

Income slab (Rs. in lacs)	Rates for senior citizens	Rates for women below 65 years	Rates for others
Up to 1.60	Nil	Nil	Nil
1.60 to 1.90	Nil	Nil	10%
1.90 to 2.40	Nil	10%	10%
2.40 to 3.00	10%	10%	10%
3.00 to 5.00	20%	20%	20%
Above 5.00	30%	30%	30%

- **Surcharge on income-tax:**

In A.Y. 2009-10, surcharge at 10% of the income-tax was payable by a non-corporate as well as corporate body if their total income exceeded certain limits. In A.Y. 2010-11, no surcharge is leviable on non-corporate assessees. Surcharge will only be payable by companies if their total income exceeds specified limits. The following comparative position will explain the effect of this change:

Assessee	A.Y. 2009-10	A.Y. 2010-11
Individual, HUF, AOP, BOI - If total income exceeds Rs.10 lacs.	10%	Nil
Artificial Juridical Person	10%	Nil
Co-operative Society or Local Authority	Nil	Nil
Firm - If total income exceeds Rs.1 crore (Note : From: A.Y. 2010-11 Firm will include LLP)	10%	Nil
Company having total income exceeding Rs.1 crore		
- Domestic company	10%	10%
- Foreign Company	2.5%	2.5%

- **Education Cess:**

  As in A.Y. 2009-10, Education Cess of 3% (including 1% secondary and higher education cess) on I.T. and surcharge (where applicable) is payable by all assessees in A.Y. 2010-11.

Dividend Distribution Tax

As in A.Y. 200910, the rate of DDT u/s.1150 continues to be at 15%. This amount is to be increased by surcharge at 10% of tax and Education Cess at 3% of tax and surcharge. It may be noted that w.e.f. 1-4-2009, no DDT is payable on the amount of dividend distributed to New Pension Scheme Trust as defined in S. 10 (44).

Deduction of Tax at Source (TDS)

- **No surcharge and Education Cess on TDS**:
  While deducting TDS w.e.f. 1-4-2009, the tax deductor has not to add surcharge and Education Cess to the tax deducted under various provisions of the Income-tax Act. Similarly, while collecting tax at source u/s. 206 from certain income, no surcharge or education cess is to be collected. There are only two exceptions as under:

i) TDS from payment to a foreign company u/s. 195 or collection of tax from foreign company u/s.206C. In such cases, surcharge at 2.5% of tax and education cess at 3% of tax and surcharge is to be added to the amount of tax.

ii) TDS from payment to a Non-resident u/s.195, collection of tax from a Non-Resident u/s. 206 C and salary payment to an employee u/s.192. In such cases only Education cess at 3% of tax is to be added to the amount of tax.

- **TDS rates:**

Part II of the First Schedule to the Finance Act (No. 2) Act, 2009 prescribes different rates of taxes for TDS from certain payments u/s. 193, 194, 194A, 194B, 194BB, 194D and 195 of the Income-tax Act. It may be noted these rates are the same as in A.Y. 2009-10 except for the following:

(i) In the case of a domestic company, the rate of TDS from Interest Income and Other Income which was 20% is now reduced to 10% w.e.f. 1-4-2009.

(ii) In the case of other residents, the rate of TDS from other income which was 20% has been reduced to 10% w.e.f. 1-4-O9.

- **S. 206AA**:

This is a new Section which will come into force w.e.f. 1-4-2010. It is now provided that wherever tax is to be deducted at source under Chapter XVIIB (S. 192 to S. 196D), the deductor should obtain PAN of the deductee. If the deductee does no provide his/its PAN, the tax deductor will have to deduct tax at source at the higher of the following rates:

(i) Rate specified in the relevant Section in Chapter XVII B.
(ii) Rate or rates applicable to the deductee.
(iii) 20%.

It is also provided in this Section that in the application u/s.197 for lower deduction of tax and in the declaration u/s.197A (Forms 15G and 15H), the PAN of the deductee should be stated, otherwise this application /declaration will be invalid. Further, in all correspondence, bills, vouchers and other documents which are exchanged between the tax deductor and deductee, this PAN should be mentioned. If the PAN provided by the deductee is invalid for any reason, the tax deductor will be considered as having deducted tax at lower rate if he has deducted tax at a rate lower than 20%.

- **S. 194A: TDS from Interest**

W.e.f. 1-4-2009, this Section shall not apply to interest paid by a scheduled bank in relation to Zero Coupon Bonds issued on or after 1-6-2005 by such bank.

- **S. 194C**:

(i) This Section deals with TDS from payments to contractors for work. The existing S. 194C has been replaced by a new S. 194C w.e.f. 1-10-2009. Under the existing S. 194C, TDS at the rate 2% to be deducted on payment for a contract to a contractor. However, in the case of sub-contractor, the TDS rate is 1% of the amount paid or payable. Further, in the case of payment for an advertising contract, TDS rate is 1%.

(ii) In order to reduce the scope for disputes, the new S. 194C now removes the distinction between the contractor and sub-contractor. Uniform rates for TDS are now provided in this new Section for contractors and sub-contractors as under:

(a) 1% where payment for a contract is to an individual or HUF.

(b) 2% where payment for a contract is to any other entity (e.g., Firm. LLP, AOP, Company, Co-operative Society, etc.)

(c) 'Nil' rate where payment is to a contractor for plying, hiring or leasing goods carriage, as defined in Explanation to S. 44AE(7), if the contractor furnishes his PAN. If PAN is not given the rate for TDS will be 1% if the contractor is an individual/HUF and 2% in other cases up to 31-3-2010.

(d) New S. 206AA now provides that w.e.f. 1-4-2010, the rate for TDS will be 20% in all cases if the deductee does not provide his PAN. Hence, in the case of a transport contractor, the rate of TDS will be 20% if the contractor does not provide his/its PAN.

(iii) It is also provided in the Section that tax is to be deducted on invoice value, excluding value of the material used by the contractor if such value is separately stated in the invoice. Otherwise, TDS will be on the entire invoice value.

(iv) This Section applies to a contract for any 'work'. The definition of this term is now widened to include '<u>Manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased by such customer, but does not include such contract where the material used is purchased from a person other than such customer</u>'.

<u>Question:</u>

Explain whether the following contracts fall within the meaning of "work" under section 194C –

(i) Manufacturing a product for A as per A's requirement using raw material purchased from B.

(ii) Manufacturing a product for A as per A's requirement using raw material purchased from A himself.

If yes, what would be the value on which tax should be deducted at source under section 194C?

Answer:

The definition of "work" under section 194C has been amended to resolve the issue as to whether outsourcing constitutes work or not. Accordingly, as per the new definition, "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer, as such a contract is a contract for 'sale'. Therefore, if a product is manufactured for A using the raw material purchased from B, it would be a contract from 'sale' and not a works contract.

It may be noted that the term "work" would include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. Therefore, if a product is manufactured for A using the raw material purchased from A himself, it would fall within the definition of work under section 194C.

In such a case, tax shall be deducted on the invoice value excluding the value of material purchased from A if such value is mentioned separately in the invoice. Where the material component has not been separately mentioned in the invoice, tax shall be deducted on the whole of the invoice value.

- **S.194I**:

This Section deals with TDS from payment of rent. The rates for TDS are reduced w.e.f. 1-10-2009 as under.

Type of payment	**Existing rate up to 30.0.09**	**Revised w.e.f. 1-10-2009**
(i) Rent for hire of machinery, plant or equipment	10%	2%
(ii) Rent for land, building (including factory building) or furniture/fitting		
(a) If payee is Individual/HUF	15%	10%
(b) If payee is any other person	20%	10%

If the payee does not furnish PAN, the rate will be 20% in all cases w.e.f. 1-4-2010.

- **S. 197A**:

This Section provides that TDS provisions do not apply to Individuals who file declarations (Form 15G/15H) with the tax deductor and to certain specified persons. By amendment of this Section w.e.f. 1-4-2009, it is now provided that the tax is not to be deducted from payment to New Pension System Trust as defined in S. 10(44).

- **S. 200:**

At present the tax deductor has to file quarterly returns of TDS. It is now provided that the tax deductor shall prepare such statements for such period as may be prescribed by the CBDT. Thus new procedure will be effective from 1-10-2009. Similar amendments are made in S. 201(1A), 203A, 206A, 206C, etc.

- **S. 200A**:

This is a new Section which comes into effect from 1-4-2010. The Section provides that TDS returns filed u/s.200 shall be processed and TDS amount worked out by the assessee under Chapter XVIIB shall be computed after making adjustments of arithmetical errors or apparent incorrect claims made by the tax deductor. The method of processing of TDS returns is now provided in this new Section. The provisions are as follows:

Where a statement of tax deduction at source has been made by a person deducting any sum under section 200, such statement shall be processed in the following manner, namely:—

(a) the sums deductible under this Chapter shall be computed after making the following adjustments, namely:—
    (i) any arithmetical error in the statement; or
    (ii) an incorrect claim, apparent from any information in the statement;
(b) the interest, if any, shall be computed on the basis of the sums deductible as computed in the statement;
(c) the sum payable by, or the amount of refund due to, the deductor shall be determined after adjustment of amount computed under clause (b) against any amount paid under section 200 and section 201, and any amount paid otherwise by way of tax or interest;

(d) an intimation shall be prepared or generated and sent to the deductor specifying the sum determined to be payable by, or the amount of refund due to, him under clause (c); and
(e) the amount of refund due to the deductor in pursuance of the determination under clause (c) shall be granted to the deductor :

Provided that no intimation under this sub-section shall be sent after the expiry of <u>one year from the end of the financial year</u> in which the statement is filed.

Explanation.—For the purposes of this sub-section, "an incorrect claim apparent from any information in the statement" shall mean a claim, on the basis of an entry, in the statement—

(i) of an item, which is inconsistent with another entry of the same or some other item in such statement;

(ii) in respect of rate of deduction of tax at source, where such rate is not in accordance with the provisions of this Act.

- **S. 201:**

This Section deals with levy of penalty and interest for defaults in not deducting TDS or having deducted the tax there is default in not depositing the same with the Government. There is no time limit for passing order for levy of penalty, or interest. This Section is amended w.e.f. 1-4-2010 to provide that no order u/s.201(1), deeming the tax deductor who is Resident as an assessee in default, shall be made after the expiry of:

(i) 2 years from the end of the financial year in which the TDS return is filed.

(ii) 4 years from the end of the financial year in which the payment is made or credit is given, in any other case.

Exemptions and deductions:

- **S. 10(10C)**:

Under this Section it is provided that lumpsum amount received for VRS or on retirement of an employee is not liable to tax up to the specified amount. The Section is amended effective from A.Y. 2010-11 to provide that if the relief u/s. 89 is allowed, no relief in rate of tax will be allowed to such employee under this Section. Corresponding amendment is made in S. 89.

<u>Question:</u>

Mr. Ravi, working in a public sector company, opted for voluntary retirement scheme andreceived Rs.8 lakh as VRS compensation. He claimed Rs.5 lakh as exemption under section 10(10C). Further, in respect of the balance amount of Rs.3 lakh, he claimed relief under section 89(1). Mr.Ravi seeks your opinion on the correctness of the above tax treatment.

Answer:
An employee opting for voluntary retirement scheme receives a lump-sum amount in respect of his balance period of service. This amount is in the nature of advance salary. Under section 10(10C), an exemption of Rs.5 lakh is provided in respect of such amount to mitigate the hardship on account of the employee going into the higher tax bracketconsequent to receipt of the amount in lump-sum upon voluntary retirement.

However, some tax payers have resorted to claiming both the exemption under section 10(10C) (upto Rs.5 lakh) and relief under section 89 (in respect of the amount received in excess of Rs.5 lakh). This tax treatment has been supported by many court judgementsalso, for example, the Madras High Court ruling in *CIT v. G.V. Venugopal (2005) 273 ITR 0307* and *CIT v. M. Abdul Kareem (2009) 311 ITR 162* and the Bombay High Court ruling in *CIT v. Koodathil Kallyatan Ambujakshan (2009) 309 ITR 113* and *CIT v. Nagesh Devidas Kulkarni (2007) 291 ITR 0407.* However, this does not reflect the correct intention of the statute.

Therefore, in order to convey the true legislative intention, section 89 has been amended to provide that no relief shall be granted in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or a scheme of voluntary separation (in the case of a public sector company), if exemption under section 10(10C) in respect of such compensation received on voluntary retirement or termination of his service or voluntary separation has been claimed by the assessee in respect of the same assessment year or any other assessment year.

Correspondingly, section 10(10C) has been amended to provide that where any relief has been allowed to any assessee under section 89 for any assessment year in respect of any amount received or receivable on his voluntary retirement or termination of service or voluntary separation, no exemption under section 10(10C) shall be allowed to him in relation to that assessment year or any other assessment year.

Therefore, in view of the above amendment, Mr. Ravi's tax treatment is incorrect. He has to either opt for exemption of upto Rs.5 lakh under section 10(10C) or relief under section 89(1), but not both.

- **S. 10(23C)**:

Under this Section application for exemption or renewal of exemption is to be made to the prescribed authority by a university, educational institution, hospital, etc.

before the end of the accounting year. It is now provided w.e.f. 1-4-2009 that such application can now be made before 30th September of the following year.

Question:

An educational institution having annual receipts of Rs.1.20 crore during the P.Y.2009- 10, has to make an application to the prescribed authority before 31.3.2010 for claiming tax exemption under section 10(23C) for A.Y. 2010-11 - Discuss the correctness or otherwise of this statement.

Answer:

This statement is not correct.

This position has changed consequent to an amendment in section 10(23C) by the Finance (No.2) Act, 2009. Prior to such amendment, an educational institution having annual receipts of more than rupees one crore, had to make an application for seeking exemption at any time during the financial year for which the exemption is sought.

Therefore, an eligible educational institution is required to estimate its annual receipts for deciding whether or not to file an application for exemption. This resulted in genuine hardship, for alleviating which, the time limit for filing such application has been extended from 31st March to 30th September of the succeeding financial year.

Therefore, in the given case, the educational institution (having annual receipts of Rs.1.20 crore during the P.Y.2009-10) can make an application for grant of exemption in the prescribed form to the prescribed authority on or before 30th September, 2010.

- **S. 10(44)**:

This is a new clause inserted w.e.f. 1-4-2009 to provide that the income of the New Pension System Trust established on 27-2-2008 shall be exempt from A.Y. 2009-10 onwards.

- **S. 1OA and S. 1OB**:

Both these Sections are amended w.e.f. 1-4-2009 and it is now provided that such deductions will be available in A.Y. 2011-12 also.

- **S. 10AA**:

This Section grants exemption to income-of a unit established in the SEZ. Up to now, the formula for working out proportion of the profit exempt under this Section was as under:

$$\frac{\text{Profits of the business of the unit} \times \text{Export turnover of the unit}}{\text{Total turnover of the business carried on by the assessee}}$$

It is now clarified by amendment of this Section, effective from A.Y. 2010-11 that this will be worked out with reference to Total turnover of the SEZ unit only. Thus, the denominator in the above example will be 'Total turnover of SEZ unit'.

Recently, it has been proposed by Finance Minister in Finance Bill, 2010 that this amendment shall be applied retrospectively from assessment year beginning on the 1st day of April, 2006

- **Donations to 'Electoral Trust:**

(i) New S. 13B has been inserted effective from A.Y. 2010-11. It may be noted that u/s.13A, the income of recognised political party is exempt. S. 13B now provides that voluntary contributions received by 'Electoral Trust' shall not be included in the total income of the trust if the following conditions are complied with:
   a) Such trust distributes 95% of the aggregate donations received by it during the accounting year, along with surplus brought forward from earlier years, to recognised political parties. This distribution is to be made in the same accounting year.
   b) Such trust functions in accordance with the rules made by the Central Government.

(ii) The expression 'Electoral Trust' is defined in S. 2(22 AAA) to mean a trust approved by the CBDT in accordance with the scheme made by the Central Government.

(iii) S. 80GGB and S. 80GGC provide that any donation by an assessee (including a company) to a recognised political party is allowable as deduction in computing total income. These two Sections are also amended effective from A.Y. 2010-11 to provide that such deduction will be allowed in respect of donations to such an 'Electoral Trust'.

- **Charitable trusts:**

S. 2(15): This Section defines the expression Charitable Purpose as (i) relief of the poor, (ii) education, (iii) medical relief and (iv) advancement of any other objects of general public utility. The last object No (iv) will not be considered as charitable if it involves the carrying on of any activity in the nature of trade, commerce or business, etc. This Section is now amended, effective from A.Y. 2009-10, to provide that the trust engaged in the preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest will not fall in object No. (iv). Therefore, if such trust is carrying on activity of trade, commerce, business etc. it will still be considered as charitable, trust u/s. 2(15).

Finance Minister has proposed to introduce another proviso w.e.f 1.4.09 as follows under the Finance Bill, 2010:

"Provided further that the first proviso shall not apply if the aggregate value of the receipts from the activities referred to therein is ten lakh rupees or less in the previous year;";

That means that if profit from the activities of carrying on any activity in the nature of trade, commerce or business does not exceed Rs.10 lacs, then the same will be eligible for deduction as being for charitable purpose.

- **S. 115 BBC**:

This Section was inserted by the Finance Act, 2006, w.e.f. 1-4-2007 to provide that anonymous donations received by a public trust claiming exemption u/s 10(23C)- University, educational institutions, hospital, etc. and u/s 11 —Public Charitable Trusts will be taxable at the rate of 30% of such donations. The Section is now amended effective from A.Y. 2010-11 to provide as under:

(i) Tax at 30% will be payable on the aggregate of anonymous donations received in excess of the higher of the following:

(a) 5% of total donations received by the trust or institution, or

(b) Rs.1,00,000

(ii)The amount on which the above tax is payable will be excluded from the total income of the trust.

Question:

A charitable trust received anonymous donation of Rs.10 lakh during the P.Y.2009-10. It seeks your opinion on the taxability of such anonymous donation. The total donations received by the trust during the P.Y.2009-10 is Rs.25 lakh.

Answer:

Anonymous donations received by wholly charitable trusts and institutions are subject to tax at a flat rate of 30% under section 115BBC. In order to provide relief to these trusts and institutions and to reduce their compliance burden, an exemption limit has been introduced, and only the anonymous donations in excess of this limit would be subject to tax@30% under section 115BBC.

The exemption limit is the higher of the following –
(1) 5% of the total donations received by the assessee; or
(2) Rs.1 lakh.

The total tax payable by such institutions would be –
(1) tax@30% on anonymous donations exceeding the exemption limit as calculated above; and
(2) tax on the balance income i.e. total income as reduced by the aggregate of anonymous donations received.
Therefore, in this case, the charitable trust would be eligible for an exemption of Rs.1,25,000 [the higher of Rs.1,00,000 and Rs.1,25,000 (i.e., 5% of Rs.25 lakh)]. The balance anonymous donation of Rs.8,75,000 (i.e. Rs.10,00,000 minus Rs.1,25,000) would be taxable at 30%. The tax liability under section 115BBC on anonymous donations would be Rs.2,62,500 (being 30% of Rs.8,75,000).

- **S. 80G:**

This Section deals with approval of charitable trusts to enable the donors to claim deduction for donations made by them. The following amendments are made:

(i) Since many trusts may have lost their exemption u/s.11 by virtue of amendment to the definition of 'Charitable Purpose' u/s.2(15) effective from A.Y. 2009-10, in order that donors do not lose the benefit of deduction, in the first year of loss of exemption, such trusts as were eligible for benefit u/s.80G for A.Y. 2007-08 will be deemed to have continued to be eligible u/s.80 G for the F.Y. 2008-09.
(ii) W.e.f. 1-10-2009, the requirement of periodic renewal of approval u/s.80G has been done away with. All trusts whose approval u/s. 80G expires on or after 1-10-2009, will not have to apply for such approval or renewal again. Their approval will continue to be valid perpetuity unless withdrawn. Those trusts whose approval u/s.80G expire prior to 1-10-2009, will have to apply once for renewal their approval.

Business income

- **Definition of the word 'Manufacture'**:

S. 2(29BA) has been inserted effective from A.Y. 2009-10 to define the term “Manufacture”. Accordingly, the word 'Manufacture' means a change in a non living physical object or article or thing (i) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use, or (ii) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

- **S. 35**:

At present u/s.35 (2AB) weighted deduction of 150% of the expenditure on in-house scientific research incurred by a company engaged in the business of bio-technology or in manufacture or production of drugs, pharmaceuticals, electronic equipments, computers, telecommunication equipments, chemicals or any article or thing notified by the CBDT is allowed. The Section is now amended effective from A.Y. 2010-11 to provide that the weighted deduction will be available to any company engaged in any business of manufacture or production of any article or thing, other than the article or thing specified in the Eleventh Schedule.

- **New S. 35AD**:

This Section comes into effect from A.Y. 2010-11 and provides for deduction in respect of expenditure on specified business.

The deduction under this Section is available to an assessee carrying on any specified business viz, one or more of the following businesses:
(a) Setting up and operating a cold chain facility,
(b) Setting up and operating a warehousing facility for storage of agricultural produce,
(c) Laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being, an integral part of such network.

Some of the important conditions are:
(a) The business should be new and not set up, by splitting-up, or reconstruction of existing business.
(b) The business, stated in items (a) and (b) of (ii) above, should have been started on or after 1-4-2009.
(c) As regards business of laying and operating oil pipelines as stated in Para (ii) (c) above:
    - It should have started on or after 1-4-2007,
    - It should have been started by a company or by a consortium of companies or by a public sector undertaking,
    - It should have been approved by the prescribed authority,
    - It should comply with the conditions prescribed by the CBDT.

(d) The assessees will have to submit the return of income certificate from a chartered accountant in the prescribed form.

The deduction allowable under this Section as under:

(a) Whole of the expenditure of capital nature incurred, wholly and exclusively, for the purposes of above specified business, excluding expenditure incurred on acquisition of any land, goodwill or financial instrument.
(b) If any expenditure is incurred during any year prior to commencement of operations of the specified business, if the expenditure is capitalized in the books on commencement of the operations.
(c) No deduction for such expenses will be allowed under any other Sections of the Income tax Act.
(d) No deduction for the income of this business will be allowed under Chapter VIA. Consequential amendment is made in S. 80IA.

S. 28, S. 43, and S. 50B are also amended and new S. 73A is inserted effective from A.Y. 2010-11. By these amendments it is provided as under:

(a) Any sum received or receivable on account of capital asset, in respect of which the above 100% deduction is allowed, when such asset is demolished, destroyed, discarded or transferred shall be treated as income of the assessee and chargeable to income-tax as business income.
(b) Any loss computed in respect of the specified business shall be set off only against profits and gains of any other specified business. Unabsorbed loss of any year shall be carried forward and set off against profits and gains of any other specified business in subsequent year. No time limit is fixed for carry forward of such loss.

Question:

XYZ Ltd. commenced operations of the business of laying and operating a cross country natural gas pipeline network for distribution on 1st April, 2009. The company incurred capital expenditure of Rs.32 lakh during the period January to March, 2009 exclusively for the above business, and capitalized the same in its books of account as on 1st April, 2009. Further, during the financial year 2009-10, it incurred capital expenditure of Rs.95 lakh (out of which Rs.60 lakh was for acquisition of land) exclusively for the above business. Compute the deduction under section 35AD for the A.Y.2010-11, assuming that XYZ Ltd. has fulfilled all the conditions specified in section 35AD.

Answer:

The amount of deduction allowable under section 35AD for A.Y.2010-11 would be –

Particulars	Rs.

Capital expenditure incurred during the P.Y.2009-10 (excluding the expenditure incurred on acquisition of land) = Rs.95 lakh – Rs.60 lakh	35 lakh
Capital expenditure incurred prior to 1.4.2009 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2009	32 lakh
Total deduction under section 35AD for A.Y.2010-11	**67 lakh**

- **S. 36(1)(viii)**:

Under this Section deduction in respect of any specified reserve up to 20% of the profits is created and maintained by specified entities carrying on eligible business is allowed. At present, eligible business includes, amongst others, provision of long-term finance for 'Construction or Purchase of houses in India for residential purposes'. This is now replaced by provision of long-term finance for 'Development of housing in India'. This amendment is effective from A.Y. 2010-11. This amendment is made with a view to give the benefit of this Section to the National Housing Bank.

- **S. 40(b)**:

This Section provides for limit of deduction from income from business or profession for remuneration paid to working partners of a firm (including LLP). This limit is revised upwards effective from A.Y. 2010-11 (accounting year 2009-10) as under:

Book profit of business or profession	**Limit for remuneration to all working partners**
(i) On the first Rs.3 lacs or in case of loss	Rs.1,50,000 or at the rate of 90% of book profit whichever is more
(ii) On the balance of book profit	At the rate of 60% of book profit

- **S. 40A(3A)**:

S. 40A(3) and S. 40A(3A) provide for disallowance of expenditure if the payment for Rs.20,000 is made by any mode other than an A/c payee cheque. By amendment of S. 40A(3A) w.e.f. 1-10-2009, it is now provided that this limit in S. 40A(3) and

(3A) shall be increased to Rs.35,000 in the case of payment made for plying, hiring or leasing goods carriages. Therefore, goods transport operators can now be paid up to Rs.35,000 in cash.

- **S. 43(6):**

This Section provides for determination of WDV of block of assets. A new explanation (7) is now added effective from A.Y. 2010-11 to provide that where the income of an assessee is derived in part from agriculture and part from the taxable business (e.g., tea company, sugar company etc.) for computing the WDV of the assets acquired before the accounting year, the total amount of depreciation shall be computed as if the entire income is taxable and the said depreciation shall be deducted from the WDV of block of assets as if it has been actually allowed. This is in spite of the fact that only a proportionate part of the entire income is taxable. The balance of the income is considered as agricultural income.

- **Presumptive taxation of business profits**:

S. 44AA, S. 44AB, S. 44AF and S. 44AE have been amended and S. 44AD is substituted by new Section. These amendments are effective from A.Y. 2011-12. Scope of presumptive taxation of business profits is extended to all businesses where turnover or gross receipts do not exceed Rs.40 lacs.

The salient features of these amendments are as under:

(i) The presumptive taxation scheme applies to an eligible resident assessee being an Individual, HUF or a **Firm other than limited liability partnership**.

(ii) The presumptive scheme shall not apply to eligible assessees claiming deduction u/s.10A — (undertaking in Free Trade Zone), 10AA — (Unit in Special Economic Zone), 10B — (100% Export-Oriented Undertaking) and 10BA — (Export of handmade articles or things) and deductions in respect of income covered under Part C of Chapter VI-A such as S. 80-IA, S. 80-IB, etc.

(iii) Presumptive income shall be 8% of the total turnover or gross receipts or the income claimed to have been earned from such business, whichever is higher.

(iv) Eligible assessee will not be required to pay advance tax on presumptive income from such business, and, therefore tax is payable only on self assessment.

(v) Eligible partnership firm can claim deduction of salary and interest to partners within the ceiling prescribed u/s.40(b) of the Act.

(vi) Eligible assessee is not required to maintain books of account as required u/s.44AA.

(vii) Eligible assessee is required to maintain books of account and also get them audited if he declares income below 8% of gross turnover/ receipts and if his total income exceeds the basic exemption limit.

- **S. 44AE**:

This Section provides for presumptive income for truck owners. The Section applies to an assessee who owns not more than ten goods carriages and who is engaged in the business of plying, hiring or leasing of such goods carriages. At present, Rs.3,500 p.m. (for each heavy vehicle) and Rs.3,150 p.m. (for each other vehicle) or such higher amount as shown by the assessee is considered as his business income. By amendment of this Section, effective from A.Y. 2011-12, the above limits are increased to Rs.5,000 p.m. (for each heavy vehicle) and Rs.4,500 p.m. (for each other vehicle) or such higher amount as shown by the assessee.

Transfer pricing

- **S. 92C**:

This Section deals with determination of arm's-length price (ALP) in cases of international transactions with associated enterprises (AE). The proviso to S. 92C(2) has been amended. The existing proviso provides that where the most appropriate method results in more than one price, the arithmetical mean of such price or, at the option of the assessee, the price which differs from the arithmetical mean by an amount not exceeding 5% of such mean may be taken to be the arm's-length price in relation to the international transaction.

There were different interpretations of this proviso. Therefore, the proviso is modified w.e.f. 1-10-2009. This amendment can be explained by the following illustration:

	Assessee's interpretation of old proviso	**Provision in the amended proviso**
(i) Arithmetical mean of ALPs	Rs.1000	Rs.1000
(ii) If the assessee pays Rs.1050 (within 5%)	No adjustment	No adjustment

(iii) If the assessee has paid Rs.1200		
Adjustment will be 1200 – 1050	150	
Adjustment as per amendment (1200 – 1000)		200

S. 92CB:Safe Harbour Rules

This is a new Section inserted w.e.f. 1-4-2009. Transfer pricing is a very subjective exercise. There can be many bona fide reasons for the difference between ALP and actual price. To reduce the adjustments leading to avoidable disputes, it is now provided in this Section that the computation of ALP will be subject to safe harbour rules. These rules will now be made by the CBDT. ‘Safe Harbour Rules’ mean the circumstances under which the prices at which associated enterprises can enter into international transactions which will be considered as acceptable.

New S. 144C: Dispute Resolution Panel

This is a new Section which provides for reference to ‘Dispute Resolution Panel’ (DRP). The Section comes into force on 1-10-2009. At present, tax disputes relating to international transactions take a long time to resolve. To avoid such time-consuming process, an attempt is made to resolve such disputes through the dispute resolution mechanism provided in this Section. The salient features of this provision are as under:

Draft order of Assessment: Sec. 144C (1)

Notwithstanding anything to the contrary contained in this Act, the Assessing Officer shall, in the first instance, forward a draft of the proposed order of assessment (hereafter in this section referred to as the draft order) to the eligible assessee if he proposes to make, on or after the 1st day of October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.

Alternatives for Assessee: Sec. 144C (2)

On receipt of the draft order, the eligible assessee shall, within thirty days of the receipt by him of the draft order,—

(a) file his acceptance of the variations to the Assessing Officer; or
(b) file his objections, if any, to such variation with,—
    (i) the Dispute Resolution Panel; and
    (ii) the Assessing Officer.

Completion of Assessment by AO: Sec. 144C (3)

The Assessing Officer shall complete the assessment on the basis of the draft order, if—

(a) the assessee intimates to the Assessing Officer the acceptance of the variation; or
(b) no objections are received within the period specified in sub-section (2).

Time Limit: Sec. 144C (4)

Notwithstanding anything contained in section 153 the Assessing Officer shall pass the assessment order under sub-section (3) within one month from the end of the month in which,—

(a) the acceptance is received; or
(b) the period of filing of objections under sub-section (2) expires.

Issue of Directions by DRP

In a case where any objection is received under sub-section (2), the Dispute Resolution Panel shall issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

The Dispute Resolution Panel shall issue the directions after considering the following, namely:—

(a) draft order;
(b) objections filed by the assessee;
(c) evidence furnished by the assessee;
(d) report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority;
(e) records relating to the draft order;
(f) evidence collected by, or caused to be collected by, it; and
(g) result of any enquiry made by, or caused to be made by, it.

The Dispute Resolution Panel may, before issuing any directions-

(a) make such further enquiry, as it thinks fit; or

(b) cause any further enquiry to be made by any income-tax authority and report the result of the same to it.

Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.

No such direction shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interest of the revenue, respectively.

No such direction shall be issued after nine months from the end of the month in which the draft order is forwarded to the eligible assessee.

Upon receipt of the directions issued, the Assessing Officer shall, in conformity with the directions, complete, notwithstanding anything to the contrary contained in section 153, the assessment without providing any further opportunity of being heard to the assessee, within one month from the end of the month in which such direction is received.

Action by DRP – Sec. 144C (8)

The Dispute Resolution Panel may confirm, reduce or **enhance** the variations proposed in the draft order so, however, that it **shall not set aside** any proposed variation or issue any direction for further enquiry and passing of the assessment order.

Decision by Majority – Sec. 144C (9)

If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.

Power of Board to make rules

The Board may make rules for the purposes of the efficient functioning of the Dispute Resolution Panel and expeditious disposal of the objections filed under sub-section (2) by the eligible assessee.

For the purposes of this section,—

(a) "Dispute Resolution Panel" means a collegium comprising of three Commissioners of Income-tax constituted by the Board for this purpose;

(b) "eligible assessee" means,—

(i) any person in whose case the variation referred to in sub-section (1) arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 92CA; and

(ii) any foreign company.

Clarification regarding filing of Objections before Dispute Resolution Panel (DRP)

A query has been raised as to whether it is compulsory for an assessee to file an objection before the DRP or whether he can choose to file an appeal through the normal appellate channel of CIT (Appeals).

The provisions of sub-section (2) to sub-section (5) of section 144C are quite clear that a choice has been given to the assessee either to go before the DRP or to prefer the normal appellate channel. It is again clarified that it is the choice of the assessee whether to file an objection before the Dispute Resolution panel against the draft assessment order or not to exercise this option and file an appeal later before CIT (Appeals) against the assessment order passed by the Assessing Officer.

Income Tax (Dispute Resolution Panel) Rules, 2009 - Notification No. 84/2009 dated 20-11-2009

In exercise of the powers conferred by sub-section (14) of section 144C of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes makes the following rules to regulate the procedure of the Dispute Resolution Panel, namely:-

1. **Short title and commencement.**

(1) These rules may be called the Income- tax (Dispute Resolution Panel) Rules, 2009.

(2) They shall come into force on the date of their publication in the Official Gazette

2. Definitions.

In these rules, unless the context otherwise requires,—

(i) "Act" means the Income-tax Act, 1961 (43 of 1961);

(ii) "panel" means the Dispute Resolution Panel;

(iii) "Form" means a form appended to these rules;

(iv) "Secretariat", in relation to panel, means the designated office for filing of objections by the eligible assessee under section 144C;

(v) "section" means a section of the Act.

(vi) words and expressions used herein but not defined and defined in the Act shall have the meanings respectively assigned to them in the Act.

3. Constitution of the Panel.

(1) The Board may, on the basis of workload and for efficient functioning, constitute panel.

(2) The Board shall assign by name three Commissioners of Income-tax to each panel as Members who, in addition to their regular duties as Commissioners, shall also carry on the functions of the panel.

(3) Where any Member of the panel is transferred, the Board shall assign, by name, another Commissioner of Income-tax in the place of the outgoing Member of the panel to carry out the functions of the panel.

(4) Each panel shall have a secretariat for receiving objections, correspondence and other documents to be filed by the eligible assessee and shall also be responsible for issuing notices, correspondence and direction if any, on behalf of the panel.

(5) The Chief Commissioner of Income-tax (CCA) shall, for the purposes of sub-rule (4), constitute the secretariat for the panel.

4. Procedure for filing objections.

(1) The objections if any, of the eligible assessee to the draft order may be filed in person or <u>through his agent</u> within the specified period in Form No. 35A.

(2) The objections referred to in sub-rule (1) shall be in English and presented to the Secretariat of the panel.

(3) The objections shall be filed in paper book form in quadruplicate duly accompanied by -

(a) four copies of the draft order duly authenticated by the eligible assessee or his authorised representative:

Provided that in the case of draft assessment under sub- section (3) of section 143 read with section 144A, the objections shall also be accompanied by four copies of the directions issued by the Joint Commissioner or Additional Commissioner under section 144A and in the case of draft assessment under sub-section (3) of section 143 read with section 147, the objections shall also be accompanied by four copies of the original assessment order, if any;

Provided further that the Panel may, in its discretion, either accept the objections which are not accompanied by all or any of the documents referred to above or reject it.

(b) the evidence, if any, the eligible assessee intends to rely upon including any document or statement or paper submitted to the assessing officer:

Provided that where the eligible assessee intends to rely upon any additional evidence other than those submitted to the assessing officer, such additional evidence shall not form part of the paper book but may be filed along with a separate application stating the reasons for filing such additional evidence.

5. Notice for hearing

The panel shall issue notice to the eligible assessee and the concerned assessing officer specifying the date and place of hearing of the objection.

6. Call for records.

The panel shall also call for records relating the draft order and permit the assessing officer to file report, if any, to the objections filed by eligible assessee.

7. Hearing of objections.

(1) For the purpose of hearing of objections, the panel may hold its sittings at its headquarters or at such other place or places as it may deem proper.

(2) On the date fixed for hearing, if an authorised representative appears on behalf of eligible assessee, he shall file the authorisation letter before the commencement of the hearing.

(3) The panel may consider the application for filing additional affidavit and may either allow such application or reject it.

(4) The eligible assessee may, with the permission of the panel, urge any additional ground which has not been set forth in the objections.

8. No abatement of proceedings.

After filing objections, if the eligible assessee, being an individual, dies or is adjudicated insolvent, or being a company, is wound up, the proceedings before the panel shall not abate and shall be continued by the executor, administrator or other legal representative of such individual assessee or by the assignee, receiver or liquidator of such assessee being a company, as the case may be.

9. Power to call for or permit additional evidence

Where the panel deems it necessary, it may call upon or, as the case may be, permit the eligible assessee to produce any document or examine any witness or file any affidavit to enable it to issue proper directions:

Provided that the panel shall, while so permitting the eligible assessee record its reasons for such permission.

10. Issue of directions.

(1) On the date fixed for hearing or on any other date to which the hearing may be adjourned, if the eligible assessee or his authorized representative do not appear, or when they appear, upon hearing the objections, the panel may, within the specified time, issue such directions as it deems proper.

(2) While hearing the objections, the panel shall not be confined to the grounds set forth in the objections but shall have power to consider any matter or grounds arising out of the proceedings.

(3) On conclusion of hearing, the panel shall issue directions within the specified period.

11. Directions to be communicated to parties.

The panel shall, after the directions are issued, communicate the same to the eligible assessee and to the assessing officer.

12. Passing of Assessment Order.

Upon receipt of directions from the panel, the Assessing Officer shall pass the Assessment Order in accordance with the procedure prescribed in sub-section (13) of section 144C.

13. Rectification of mistake or error.

After the issue of directions under rule 10, if nay mistake or error is apparent in such direction, the panel may, suo motu, or on an application from the eligible assessee or the assessing officer, rectify such mistake or error, and also direct the assessing officer to modify the assessment order accordingly.

14. Appeal against Assessment Order

Any appeal against the Assessment Order passed in pursuance of the directions of the panel shall be filed before the Appellate Tribunal in Form No. 36B.

Capital gains

S. 50C dealing with procedure for determination of full value of consideration in cases of transfer of immovable properties has been amended w.e.f. 1-10-2009. At present, for the purpose of computing capital gains on transfer of land or building or both, the amount adopted or assessed by the stamp duty authority is considered as full value of consideration. If such transfer is not registered and no stamp duty authority has adopted or assessed any valuation for the transfer, the provisions of S. 50C were not applicable as held in some judicial pronouncements. By this amendment, it is provided that if an immovable property is transferred without registration, the amount assessable as per stamp duty valuation will be considered as the full value of the consideration. The term 'Assessable' is defined to mean the price which the stamp valuation authority would have adopted or assessed, if it were referred to such authority for payment of stamp duty. Example: Contribution of Land as capital contribution in to Firm.

Question

"Section 50C can be invoked only in the case of registration of property pursuant to transfer.

In a case where only an agreement for sale is entered into and no registration has taken place, the provisions of section 50C cannot be made applicable."

Discuss the correctness or otherwise of this statement.

Answer

This statement is not correct.

So far, the scope of section 50C did not include within its ambit, transactions which were not registered with stamp duty valuation authority, and executed through an agreement to sell or power of attorney. Therefore, in order to prevent tax evasion on this account, section 50C has been amended by the Finance (No.2) Act, 2009, to provide that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed **or assessable** by an authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed **or assessable** shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain. **The term "assessable" has been added to cover transfers executed through an agreement to sell or power of attorney.**

Explanation 2 has been inserted after section 50C(2) to define the term 'assessable' to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

Income from other sources:

- **S. 56(2)(vii)**:

  At present, only the sum of money received by an individual or HUF, if aggregate amount exceeds Rs.50,000 from non-relatives is taxable as income from other sources u/s.56(2)(vi) with certain exceptions. This provision is now replaced by S. 56(2)(vii) w.e.f. 1-10-2009 to cover cases of gifts received by an individual or HUF from non-relatives in cash or kind.

  In brief, the position after 1-10-2009 will be as under:

  (i) The following properties received by an assessee, without consideration, from a person (non-relative) will be considered as income from other sources:

    (a) A sum of money received from a non-relative, if the aggregate amount exceeds Rs.50,000.

    (b) Any immovable property (land or building or both) received, without consideration, if the stamp duty value of the property exceeds Rs.50,000. If the assessee has paid consideration for the same, but the difference between the stamp duty valuation and actual consideration paid, is more than Rs.50,000, the entire difference will be liable to tax under this Section.

(c) Any movable property viz. (i) Shares and securities, (ii) Jewellery, (iii) Archaeological collections, (iv) Drawings, paintings, sculptures or any work of art, received, without consideration, if the fair value of the property exceeds Rs.50,000. If the assessee has paid consideration for the same, but the difference between the fair value and the actual consideration paid is more than Rs.50,000, such difference will be considered as income under this Section.

(ii) For this purpose, stamp duty valuation of the immovable property will be considered as provided in S. 50C. For the determination of the fair value of movable property, the CBDT will prescribe rules.

(iii)S. 49(4) now provides that when the assessee is charged to tax u/s.56(2)(vii) on the difference between the stamp duty valuation/fair value of a property and the actual consideration, this difference will be added to the cost of acquisition of that property for computing capital gains u/s.48.

(iv)It may be noted that the Section does not apply to gifts received, as stated above, from relatives and gifts received on the occasion of marriage, under a will, gifts in contemplation of death, from local authority or from public charitable trusts. The term relatives is defined, as in S. 56(2)(vi). In other words, these exceptions are the same as provided in S. 56(2)(vi).

However recently, Finance Minister has proposed to amend this provision with effect from the date when it came in to operation. It has been proposed that w.e.f. 1.10.09, the provision of sub clause (b) of clause (vii) shall be applicable only if any immovable property has been received without consideration, stamp duty value of which exceeds Rs. 50,000. Besides, it has been proposed that the definition of property is to be restricted to Capital Asset only. Therefore it shall not be applicable to stock in trade.

Question:

Mr. Ganesh received the following gifts during the P.Y.2009-10 from his friend Mr.Sundar, -

(1) Cash gift of Rs.51,000 on his birthday, 19th June, 2009.

(2) 50 shares of Beta Ltd., the fair market value of which was Rs.60,000, on his birthday, 19th June, 2009.

(3) 100 shares of Alpha Ltd., the fair market value of which was Rs.70,000 on the date of transfer. This gift was received on the occasion of Diwali. Mr. Sundar had originally purchased the shares on 10-8-2009 at a cost of Rs.50,000.

Further, on 20th November, 2009, Mr. Ganesh purchased land from his sister's mother-inlaw
for Rs.5,00,000. The stamp value of land was Rs.7,00,000.

On 15th February, 2010, he sold the 100 shares of Alpha Ltd. for Rs.1 lakh.

Compute the income of Mr. Ganesh chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2010-11.

Answer:

Computation of "Income from other sources" of Mr.Ganesh for the A.Y.10-11

Particulars	**Rs.**
(1)Cash gift received before 1.10.2009 is taxable under section 56(2)(vi) since it exceeds Rs.50,000	51,000
(2) Value of shares of Beta Ltd. gifted by Mr.Sundar on 19th June, 2009 is not taxable since only gift of property after 1st October, 2009 is chargeable to tax under section 56(2)(vii).	-
(3) Fair market value of shares of Alpha Ltd. is taxable since the gift was made after 1st October, 2009 and the aggregate fair market value exceeds Rs.50,000.	70,000
(4) Purchase of land for inadequate consideration on 20.11.2009 would attract the provisions of section 56(2)(vii), since the difference between the stamp value and consideration exceeds Rs.50,000. Sister's mother-in-law does not fall within the definition of "relative" under section 56(2).	
Stamp Value 7,00,000 *Less:* Consideration 5,00,000	2,00,000
Income from Other Sources	**3,21,000**

Computation of "Capital Gains" of Mr. Ganesh for the A.Y.2010-11

Sale Consideration 1,00,000
Less: Cost of acquisition [deemed to be the fair market value

charged to tax under section 56(2)(vii)]	70,000
Short-term capital gains	**30,000**

- **S.56(2)(viii) r.w.s 145A - Interest on compensation**:

By amendment of S. 145A, effective from A.Y. 2010-11, it is now provided that interest received by an assessee on compensation or on enhancement of compensation shall be deemed to be income of the year in which it is received. Amendment in S. 56(2)(vii) states that this interest is taxable under the head 'Income from Other Sources' w.e.f. A.Y. 2010-11.

By amendment of S. 57, w.e.f. A.Y. 2010 -11, it is now provided that deduction of 50% of such interest will be allowed. Therefore, effectively, only 50% of such interest will be taxed as income.

Question:

Mr. Rajesh received interest of Rs.3 lakh on enhanced compensation on 17.8.2009. Out of
this interest, Rs.75,000 relates to the previous year 2006-07, Rs.1,00,000 relates to previous year 2007-08 and Rs.1,25,000 relates to previous year 2008-09. Discuss the tax implication, if any, of such interest income for A.Y.2010-11.

Answer:

(i) As per section 145(1), income chargeable under the head "Profits and gains of business or profession" or "Income from other sources", shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(ii) Further, the Hon'ble Supreme Court has, in *Rama Bai v. CIT (1990) 181 ITR 400*, held that arrears of interest computed on delayed or on enhanced compensation shall be taxable on accrual basis. The tax payers faced genuine difficulty on account of this ruling, since the interest would have accrued over a number of years, and consequently the income of all the years would undergo a change.

(iii) Therefore, to remove this difficulty, clause (b) has been inserted in section 145A to provide that the interest received by an assessee on compensation or on enhanced compensation shall be deemed to be his income for the year in which it is received,irrespective of the method of accounting followed by the assessee.

(iv) Clause (viii) has been inserted in section 56(2) to provide that income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A shall be assessed as "Income from other sources" in the year in which it is received.

(v) Clause (iv) has been inserted in section 57 to allow a deduction of 50% of such income. It is further clarified that no deduction would be allowable under any other clause of section 57 in respect of such income.

Therefore, in this case, the entire interest of Rs.3,00,000 would be taxable in the year of receipt, namely, P.Y.2009-10, under the head "Income from Other Sources".

Particulars	**Rs.**
Interest on enhanced compensation taxable u/s 56(2)(viii)	3,00,000
Less: Deduction under section 57(iv) @50%	1,50,000
Interest chargeable under the head "Income from other sources"	**1,50,000**

Taxation of Limited Liability Partnerships

The Limited Liability Partnership Act, 2008 (LLP Act) was passed by the Parliament in December, 2008. In the Income-tax Act, S. 2(23) and S. 140 have been amended w.e.f. A.Y. 2010-11. New S. 167C is also added effective from A.Y. 2010-11. The effect of these amendments is that the LLP will be taxed in the same manner as a partnership firm.

In the definition of the term 'Firm' and 'Partnership' in S. 2(23) of the Income-tax Act, it is stated that the term 'Firm' or 'Partnership' will include any LLP w.e.f. 1-4-2009. Further, the definition of a 'Partner' will include a partner of LLP. Therefore, all the provisions for taxation of 'Firm' and its partners will apply to LLP and its partners. Tax will be payable by the LLP at 30% plus Education Cess. No surcharge will be payable by the LLP from A.Y. 2010 -11.

Question:

Explain the tax treatment of Limited Liability Partnership under the Income-tax Act, 1961.

Answer:

Tax treatment for Limited Liability Partnership (LLP)

(a) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 has incorporated the taxation scheme of LLPs in the Income-tax Act on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

(b) Consequently, the following definitions in section 2(23) have been amended -
   (1) The definition of 'partner' to include within its meaning, a partner of a limited liability partnership;
   (2) The definition of 'firm' to include within its meaning, a limited liability partnership; and
   (3) The definition of 'partnership' to include within its meaning, a limitedliability partnership.

   The definition of these terms under the Income-tax Act would, in effect, also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. Section 2(q) of the LLP Act, 2008 defines a 'partner' as any person who becomes a partner in the LLP in accordance with the LLP agreement. An LLP agreement has been defined under section 2(o) to mean any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to the LLP.

(c) The LLP Act provides for nomination of "designated partners" who have been given greater responsibility. Therefore, clause (cd) has been inserted in section 140, which lays down the "Authorised signatories to the return of income", to provide that the designated partner shall sign the return of income of an LLP. However, where, for any unavoidable reason such designated partner is not able to sign and verify the return or where there is no designated partner as such, any partner can sign the return.

(d) New section 167C provides for the liability of partners of LLP in liquidation. In case of liquidation of an LLP, where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP. This provision would also apply where tax is due from any other person in respect of any income of any previous year during which such other person was a LLP.

(e) Since the tax treatment accorded to a LLP and a general partnership is the same, the conversion from a general partnership firm to an LLP will have no tax implications if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. However, if there is a change in rights and obligations of partners or there is a transfer of asset or liability after conversion, then the provisions of section 45 would get attracted.

(f) The LLP shall be entitled to deduction of remuneration paid to working partners, if the same is authorized by the partnership deed, subject to the limits specified in section 40(b)(v), i.e., -

(a) On the first Rs.3,00,000 of book profit or in case of a loss

Rs.1,50,000 or 90% of book profit, whichever is higher

(b) On balance book profit 60% of book profit

(g) The LLP shall be entitled to deduction of interest paid to partners if such payment is authorized by the partnership deed and the rate of interest does not exceed 12% simple interest per annum.

(h) The LLP shall comply with section 184, which requires that -
(1) the partnership is evidenced by an instrument;

(2) the individual shares of the partnership are specified in that instrument;

(3) a certified copy of the LLP agreement shall accompany the return of income of the LLP of the previous year relevant to the assessment year in which assessment as a firm is first sought.

(i) If the LLP does not comply with section 184, it shall not be entitled to deduction of payments of interest or remuneration made by it to any partner in computing the income under the head "Profits and gains of business or Profession".

Salary income

- **S. 17(2)(vi) & (vii):**

With the abolition of Fringe Benefit Tax (FBT), from A.Y. 2010-11 (A/c. year 1-4-2009 to 31-3-2010) certain perquisites, on which FBT was payable by the employer, will now be considered as part of salary income of the employee. For this purpose, S. 17(2)(vi) and (vii) have been amended effective from A.Y. 2010-11. This amendment provides that <u>perquisite will include the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee</u>. The value of the specified security or sweat equity shares shall be the fair market value on the date on which the option is exercised by the assessee as reduced by the amount actually paid by the assessee. For this purpose, the fair market value will be determined in accordance with the method prescribed by the CBDT. Similarly, <u>perquisite will include the amount of any contribution to an approved superannuation fund by the employer in respect of assessees, to the extent it exceeds Rs.1,00,000</u>. Further, perquisite will also include any other fringe benefit or amenity as may be prescribed.

- **S. 49(2AA)**:

This Section is also amended effective from A.Y. 2010-11 to provide that when capital gain arises on the transfer of the above-specified security or sweat equity shares allotted u/s.17(2) (vi), the cost of acquisition of such security or shares shall be the fair market value which has been taken into account for the purpose of levy of tax under that Section.

Chapter VIA deductions

- **S. 80A:**

This Section deals with deductions to be made in computing total income. Two sub-sections (4) and (5) have been inserted in this Section with retrospective effect from 1-4-2003 (A.Y. 2003-04) probably with a view to prevent abuse of tax incentives. Ss.(6) has been added w.e.f. 1-4-2009 (A.Y. 2009-10). Briefly stated these sub-sections provide as under:

(i) Ss. (4) effective from 1-4-2003, provides that if an assessee has claimed and has been allowed deduction of any amount of profit u/s.10A or u/s.10AA or u/s.10B or u/s.10BA or under Chapter VIA, the assessee shall not be allowed deduction under any other Section of the Act in respect of, and to the extent of, such profits and the total deduction shall not exceed the profits of the undertaking.

(ii) Ss.(5), effective from 1-4-2003, provides that if the assessee does not claim deduction u/s.10A or u/s.10AA or u/s.10B or u/s.10BA or under Chapter VIA in the return of income, he shall not be allowed deduction under those Sections.

(iii) Ss.(6), effective from 1-4-2009, provides that in the case of an undertaking, unit, business or enterprise (for sake of brevity, unit), the profits of which are eligible for deduction u/s.10A or u/s.10AA or u/s.10B or u/s.10BA or under Chapter VIA, where the unit transfers any goods or services to other business of the assessee or the unit acquires goods or services from other business of the assessee, then the deduction will be computed by taking the market value of the goods or services transferred or acquired by the unit from the other business of the assessee. Market value has been defined to be the price at which the unit would have transferred in the open market or acquired from the open market, the goods and services, subject to statutory or regulatory restrictions, if any.

- **S. 80CCD:**

(i) S. 80 CCD provides for deduction for contribution to certain notified pension schemes by salaried assessees. The amendment to Ss.(1) extends the benefit of deduction to all individuals, whether employed or otherwise. This will be effective from 1st April, 2009 (A.Y. 2009-10). However, the limit of 10% of salary on contribution to the scheme continues in this sub-section. In the case of self-employed assessee, the limit will be 10% of his gross total income.

(ii) Amount received on closure of account or on opting out of the pension scheme or pension received from annuity purchased is chargeable to tax. Ss.(5) has been introduced to provide that the amount received shall not be considered as received and will not be chargeable to tax if it is utilised for purchase of annuity plan in the same year. This is to avoid unintended double taxation.

- **S. 80DD**:

S. 80DD presently provides for deduction of Rs.50,000 for expenditure incurred for maintenance, medical treatment, etc. of a dependant having disability as defined in the Section. The deduction is Rs.75,000 where the disability is severe. This limit of Rs.75,000 is increased to Rs.1,00,000 and the other limit remains unchanged. The amendment is effective from A.Y. 2010 -11.

- **S. 80E:**

S. 80E provides for deduction of interest on loan taken for pursuing higher education. Presently, higher education is defined to include professional courses like medicine, engineering or post-graduate course in applied or pure sciences. The Section has been amended effective from A.Y. 2010-11 to include <u>any course pursued after passing Senior Secondary Examination or recognised equivalent examination</u>. Further, the term 'relative' will now include <u>spouse and children of the individual or the student for whom the individual is the legal guardian</u>.

- **S. 80IA**:

This Section provides for deduction in respect of undertakings in certain infrastructure activities. The Section will not now apply to undertaking which lays and begins to operate a cross- country natural gas distribution network effective from A.Y. 2010-11 in view of insertion of new S. 35 AD. The Section covers undertakings set up for generation and/or transmission or distribution of power or renovation and modernisation of transmission network or distribution lines. In all these cases, the date before which the undertaking will have to start operating to be eligible for deduction has been extended to 31st March, 2011.

Further, Explanation below Ss.(13) is substituted retrospectively with effect from 1st April, 2000 (A.Y. 2000-01) to clarify that this Section shall not apply to business in the nature of works contract, awarded by any person including the Central or State Governments, executed by the undertaking or enterprise.

- **S. 80IB(9)**:

This Section relates to deduction in respect of profits and gains from certain industrial undertakings. The deduction given is 100% of profits of the undertaking for 7 assessment years. New Ss.(9) replaces old Ss.(9) effective from A.Y. 2000-01. The benefit will now be available to undertaking engaged in refining of mineral oil which begins such refining on or after 1-10-1998 and not later than 31-3-2012. This benefit will be available if the financial undertaking is engaged in commercial production of natural gas in blocks licensed under the VIII Round of bidding for award of exploration contracts under NELP announced by the Government on 10-2-1999. This benefit will also be available if the undertaking is engaged in commercial production of natural gas licensed under the IV Round of bidding for award of exploration contracts for coal bed Methane blocks and begins such production on or after 1-4-2009. It is further clarified that the term 'undertaking' will mean all blocks licensed under a single contract under NELP. Thus, each well in the block cannot be considered as a separate undertaking for the purpose of claiming deduction under this Section.

- **S. 80IB(10)**:

This Section provides for deduction of profits derived from developing and building housing projects. The first condition that the housing project should be approved before 31-3-2007 has now been amended and it is provided w.e.f. 1-4-2009 (A.Y. 2009-10) that even if the project is approved before 31-3-2008 by local authority, the benefit of the Section will be available. Further, the Section has been amended by inserting additional condition for entitlement to deduction. The newly inserted condition requires that where the buyer of the residential unit is not an individual, not more than one unit in the project shall be allotted to such buyer; and where the buyer is an individual, no unit in the project shall be allotted to the spouse, minor children or HUF of which the individual is karta or to any person representing such individual, spouse, minor children or HUF. This is applicable from A.Y. 2010-11.

An explanation has been added in this Section w.e.f. 1-4-2001 to clarify that deduction under this Section shall not be available to a person executing such housing project as works contract.

- **S. 80IB(11A)**:

This sub-section provides for deduction of specified profits of an undertaking for a period of 10 years from the business of processing, preservation and packaging of fruits and vegetables, etc. Effective from A.Y. 2010-11, this benefit is extended to production of meat and meat products or poultry, marine or dairy products, provided that the undertaking for this purpose is started on or after 1-4-2009.

- **S. 80U**:

This Section allows deduction in the computation of total income of an individual with disability. This deduction is Rs.50,000. If the assessee is suffering from severe disability, as defined in the Section, the deduction allowable at present is of Rs.75,000. From A.Y. 2010-11 this deduction of Rs.75,000 is increased to Rs.1,00,000.

<u>Question :</u>

The Finance (No.2) Act, 2009 has introduced investment-linked tax incentives for specified businesses. In this context, explain the concept of investment-linked tax incentives and name the specified businesses eligible for such benefits.

<u>Answer:</u>

Although there are a plethora of tax incentives available under the Income-tax Act, they do not fulfill the intended purpose of creating infrastructure since these incentives are linked to profits and consequently have the effect of diverting profits from the taxable sector to the tax-free sector. Therefore, with the specific objective of creating rural infrastructure and environment friendly alternate means for transportation of bulk goods, investment-linked tax incentives have been introduced for specified businesses, namely, –

- setting-up and operating 'cold chain' facilities for specified products;
- setting-up and operating warehousing facilities for storing agricultural produce;
- laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network.

100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above businesses would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

Minimum Alternate Tax (MAT)

- **S. 115JB**:

This Section, dealing with Minimum Alternate Tax has been amended as under:

(i) It is now provided that for computing 'Book Profit' for levy of MAT, the net profit as per books will be increased by the provision for diminution in the value of any asset debited to the Profit & Loss A/c. This provision is made with retrospective effect from 1-4-2001 (A.Y. 2001-02).

(ii) The rate of tax payable on book profit is increased from 10% to 15% plus applicable surcharge and education cess from A.Y. 2010-11.

- **S. 115JAA**:

Under this Section tax credit (MAT credit) is allowed to be carried forward for 7 assessment years immediately succeeding the assessment year in which MAT is paid u/s.115JB. This can be set off in the assessment year in which tax is payable under the normal provisions of the Act. This period is now extended from 7 years to 10 years and this will apply to MAT credit carried forward from earlier years also.

Assessment procedure

- **S. 147**:

There are several judicial pronouncements that reassessment proceedings shall be restricted to only such issues which have been specifically recorded by the AO before issuing the notice for re-opening of the assessment. An explanation is now inserted with retrospective effect from 1st April, 1989 to provide that the AO can assess or re-assess income in respect of any issue which has escaped assessment even if the same comes to his notice subsequently in the course of the re-assessment proceedings and the same was not recorded by him earlier at the time of issuing the notice for re-opening the assessment.

- **S. 281B**:

The Assessing Officer is presently empowered to make provisional attachment to protect the interest of the Revenue. This provisional attachment is valid for a period of six months from the date of the order and its validity can be extended up to a maximum period of two years with the permission of the Chief Commissioner.

Now, it is provided that the period for which stay on assessment or re-assessment proceeding is granted by the High Court or the Supreme Court shall be excluded while calculating the maximum period available for provisional attachment.

This amendment is effective retrospectively from 1st April, 1988.

- **S. 282**:

Presently, a notice or summon or requisition under the Act may be served either by post or in a manner by which summons are issued by a Court.

Now, service of a notice or summon or requisition or any other communication or order can also be made by courier services or in the form of electronic record or by any other means as may be prescribed by the CBDT.

It is also provided that the CBDT may make rules providing for the addresses, including the address for electronic mail, to which such communication may be delivered. This amendment is effective from 1st October 2009.

Question:

"Any summons under the Income-tax Act has to be delivered only in such manner as provided in the Code of Civil Procedure, 1908 for the purpose of service of summons." Is this statement correct? Discuss.

Answer:

Section 282 has been substituted w.e.f. 1.10.2009 to provide that the service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -

(1) by post or such courier services as approved by the CBDT; or

(2) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or

(3) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or

(4) by any other means of transmission as may be provided by rules made by the CBDT in this behalf.

Therefore, there is no restriction that the summons under the Income-tax Act have to be delivered only in such manner as provided in the Code of Civil Procedure, 1908 for the purpose of service of summons. Hence, the statement is not correct.

- **S. 282B**:

Every Income-tax authority shall allot a computer-generated Document Identification Number (DIN) in respect of every notice, order, letter or any correspondence issued by him to any other Income-tax authority or to assessees or to any other person and such number shall be quoted thereon. If such notice, order, etc. does not bear a DIN, such notice, order, etc. shall be treated as invalid and shall be deemed never to have been issued.

It is further provided that every document, letter or any correspondence received by an Income-tax authority or on behalf of such authority, shall be accepted only after allotting and quoting computer-generated DIN. If such document, etc. does not bear DIN, the same shall be treated as invalid and shall be deemed never to have been received. This is effective from 1st October, 2010.

Other amendments

- **Fringe Benefit Tax**:

Chapter XII-H containing S. 115W to S. 115WL providing for levy of Fringe Benefit Tax was inserted by the Finance Act, 2005 w.e.f. 1-4-2006. This provision was most controversial. By insertion of S. 115WM it is provided that no FBT will be payable from A.Y. 2010-11 (A/c year 1-4-2009 to 31-3-2010) onwards. This tax was payable in advance on a quarterly basis.

CIRCULAR NO. 2/2010.

During the current Financial Year 2009-10 some assessees have paid “advance tax in respect of fringe benefits” for Assessment Year 2010-11. In such cases the Board has decided that any installment of “advance tax paid in respect of fringe benefits” for A.Y. 2010-11 shall be treated as Advance Tax paid by assessee concerned for A.Y. 2010-11. The assessee can adjust such sum against its advance tax obligation in respect of income for A.Y. 2010-11 or in case of loss etc claim such payment as refund as advance tax paid in A.Y. 2010-11.

- **S. 208**:

This Section specifies that advance tax shall be payable in every case where the amount of such tax for the financial year is Rs.5,000 or more. This limit is now increased to Rs.10,000 w.e.f. 1-4-2009.

- **S. 271(1) — New Explanation 5A**:

In the course of search initiated on or after 1st June, 2007, if the assessee is found to be the owner of

(i) any money, bullion, jewellery or other valuable article or thing acquired out of income of any previous year ended before the date of search, or

(ii) any income based on any entry in any books or other documents or transactions which represent income of any previous year ended before the date of search;

he shall be deemed to have concealed particulars of income or furnished inaccurate particulars of income if :

(i) return of income submitted before the date of search does not reflect this income, or

(ii) return of income has not been submitted where the due date of filing has expired.

The amended provision will now cover cases where return of income submitted prior to search does not include such income. This amendment is effective from 1-6-2007.

- **S. 13 of Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002**:

Income-tax exemption to erstwhile UTI which was to expire on 31-3-2009 has been extended up to 31-3-2014.

- **Securities Transaction Tax**:

It is now provided w.e.f. 1-10-2009 that STT will not be payable for any transaction through recognised Stock Exchange entered into by the New Pension System Trust.

- **Commodities Transaction Tax**:

The Finance Act, 2008, had provided for levy of CTT w.e.f. 1-4-2009. This provision is now amended and this tax is withdrawn w.e.f. 1-4-2009.

- **Wealth-tax :**

Presently wealth-tax is payable on specified assets with a threshold limit of Rs.15 lacs at the rate of 1%. By amendment of S. 3 of the Wealth-tax Act, this threshold limit is increased to Rs.30 lacs effective from A.Y. 2010-11.

New Perquisite Rules not to apply for May 2010 Pronouncement of the Institute

(1) Fringe Benefit Tax is not applicable from A.Y.2010-11 and hence, is not relevant for May 2010 examination.

(2) Consequential Notification of new perquisite rules on 18.12.2009 not to apply for May 2010 examination.

Consequent to abolition of fringe benefit tax, certain benefits taxed earlier as fringe benefits in the hands of the employer would now be taxable as perquisites in the hands of the employees. For this purpose, new perquisite valuation rules have been notified vide Notification No.94/2009/ F.No.142/25/2009-S.O.(TPL), dated 18.12.2009 with retrospective effect from 1.4.2009. However, the new perquisite valuation rules would be applicable only for November 2010 examination. They would not be applicable for May 2010 examination, since only notifications/circulars issued up to 31st October, 2009 are relevant for May 2010 examination.

(3) Applicability of erstwhile Rule 3 for May 2010 examination. Therefore, the erstwhile Rule 3 would be applicable for May 2010 examination. All the perquisites which were earlier taxable in the hands of the employee, only if the employer was not liable to pay fringe benefit tax, would now be taxable in the hands of the employee in all cases, since no employer is liable to pay fringe benefit tax for A.Y.2010-11.

Rule 3(7), providing for valuation of “other fringe benefits and amenities”, is based on the terms of the provisions contained in the erstwhile clause (vi) of section 17(2). The Finance (No.2) Act, 2009 has amended section 17(2) by including certain other perquisites under clauses (vi) and (vii) of section 17(2). Consequently, the residual clause, namely, clause (viii) of section 17(2), now provides for taxing the value of any other fringe benefit or amenity as may be prescribed. Therefore, the Rule 3(7), prescribing the fringe benefits or amenities in terms of the erstwhile clause (vi) [now clause (viii)] of section 17(2)] have been given in the latest study material relevant for May 2010 examination.

Rule 3(7): The following Rule 3 (7) shall be applicable for May 2010 exams. The point to be noted is that all the below mentioned perquisites shall be considered as taxable for all employees irrespective of the fact that employer was liable for payment of FBT on these perquisites under FBT provisions.

(i) Provision of **interest-free or concessional loan** for any purpose made available to the employee or any member of his household - the sum equal to the interest computed at the rate charged per annum by the State Bank of India, as on the 1st day of the relevant previous year in respect of loans for the same purpose advanced by it on the maximum outstanding monthly balance as reduced by the interest, if any, actually paid by him or any such member of his household.

However, no value would be charged if such loans are made available for medical treatment in respect of diseases specified in rule 3A of these Rules or where the amount of loans are petty not exceeding in the aggregate Rs. 20,000 :

Provided that where the benefit relates to the loans made available for medical treatment referred to above, the exemption so provided shall not apply to so much of the loan as has been reimbursed to the employee under any medical insurance scheme.

(ii) The value of **travelling, touring, accommodation and any other expenses paid for or borne or reimbursed by the employer**, who is not liable to pay fringe benefit tax under Chapter XII-H of the Act, for any holiday availed of by the employee or any member of his household, other than concession or assistance referred to in rule 2B of these rules - sum equal to the amount of the expenditure incurred by such employer in that behalf.

Where such facility is maintained by the employer, and is not available uniformly to all employees, the value of benefit shall be taken to be the value at which such facilities are offered by other agencies to the public. Where the employee is on official tour and the expenses are incurred in respect of any member of his household accompanying him, the amount of expenditure so incurred shall also be a fringe benefit or amenity. However, where any official tour is extended as a vacation, the value of such fringe benefit shall be limited to the expenses incurred in relation to such extended period of stay or vacation. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity.

(iii) The value of **free food and non-alcoholic beverages provided by the employer**, who is not liable to pay fringe benefit tax under Chapter XII-H of the Act, to an employee shall be the amount of expenditure incurred by such employer. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity:

Provided that nothing contained in this sub-rule shall apply to free food and non-alcoholic beverages provided by such employer during working hours at office or business premises or through paid vouchers which are not transferable and usable only at eating joints, to the extent the value thereof in either case does not exceed Rs. 50 per meal or to tea or snacks provided during working hours or to free food and non-alcoholic beverages during working hours provided in a remote area or an off-shore installation.

(iv) The value of any gift, or voucher, or token in lieu of which such gift may be received by the employee or by member of his household on ceremonial occasions or otherwise from the employer, who is not liable to pay fringe benefit tax under Chapter XII-H of the Act, shall be determined as the sum equal to the amount of such gift. However, where the value of such gift, voucher or token, as the case may be, is below Rs. 5,000 in the aggregate during the previous year, the value of perquisite shall be taken as 'nil'.

(v) The amount of expenses including membership fees and annual fees incurred by the employee or any member of his household, which is charged to a credit card (including any add-on-card), provided by the employer, who is not liable to pay fringe benefit tax under Chapter XII-H of the Act, or otherwise, paid for or reimbursed by such employer shall be taken to be the value of perquisite chargeable to tax. However, there shall be no value of such benefit where the expenses are incurred wholly and exclusively for official purposes and the following conditions are fulfilled—

(a) complete details in respect of such expenditure are maintained by the employer which may, inter alia, include the date of expenditure and the nature of expenditure;

(b) the employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties.

The amount so determined shall be reduced by the amount, if any paid or recovered from the employee for such benefit or amenity.

(vi) (A) The value of benefit to the employee resulting from the payment or reimbursement by the employer, who is not liable to pay fringe benefit tax under Chapter XII-H of the Act, of any expenditure incurred (including the amount of annual or periodical fee) in a club by him or by any member of his household shall be determined to be the actual amount of expenditure incurred or reimbursed by such employer on that account. The amount so determined shall be reduced by the amount, if any paid or recovered from the employee for such benefit or amenity. However, where the employer has obtained corporate membership of the club and the facility is enjoyed by the employee or any member of his household, the value of perquisite shall not include the initial fee paid for acquiring such corporate membership.

(B) Nothing contained in this sub-rule shall apply if such expenditure is incurred wholly and exclusively for business purposes and the following conditions are fulfilled:—

(a) complete details in respect of such expenditure are maintained by the employer which may, inter alia, include the date of expenditure, the nature of expenditure and its business expediency;

(b) the employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties;

(c) nothing contained in this sub-rule shall apply for use of health club, sports and similar facilities provided uniformly to all employees by the employer.]

(vii) The value of benefit to the employee resulting from the use by the employee or any member of his household of any movable asset (other than assets already specified in this rule and other than laptops and computers) belonging to the employer or hired by him shall be determined at 10% per annum of the actual cost of such asset or the amount of rent or charge paid or payable by the employer, as the case may be, as reduced by the amount, if any, paid or recovered from the employee for such use.

(viii) The value of benefit to the employee arising from the transfer of any movable asset belonging to the employer directly or indirectly to the employee or any member of his household shall be determined to be the amount representing the actual cost of such asset to the employer as reduced by the cost of normal wear and tear calculated at the rate of 10% of such cost for each completed year during which such asset was put to use by the employer and as further reduced by the amount, if any, paid or recovered from the employee being the consideration for such transfer:

Provided that in the case of computers and electronic items, the normal wear and tear would be calculated at the rate of 50% and in the case of motor cars at the rate of 20% by the reducing balance method.

(ix) The value of any other benefit or amenity, service, right or privilege provided by the employer shall be determined on the basis of cost to the employer under an arm's length transaction as reduced by the employee's contribution, if any:

Provided that nothing contained in this item shall apply to the expenses on telephones including a mobile phone actually incurred on behalf of the employee by the employer.

Recent Circulars

Circular No.9/2009 - Section 194J of the Income-tax Act, 1961 - Deduction of tax at source - Fees for professional or technical services - Applicability of provisions under section 194J, in the case of transactions by the Third Party Administrators (TPAs) with hospitals etc

A number of representations have been received from various stakeholders regarding applicability of provisions under section 194J of Income-tax Act, 1961 on payments made by Third Party Administrators (TPAs) to hospitals on behalf of insurance companies for settling medical/insurance claims etc. with the hospitals.

2. The matter was examined by the Board. As per provisions of section 194J(1) Any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any sum by way of

(*a*) fees for professional services, or

(*b*) fees for technical services, or

(*c*) royalty, or

(*d*) any sum referred to in clause (*va*) of section 28,

shall, at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to ten per cent of such sum as income-tax on income comprised therein.... Further as per *Explanation (a)* to section 194J professional services means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession etc..

3. The services rendered by hospitals to various patients are primarily medical services and, therefore, provisions of section 194J are applicable on payments made by TPAs to hospitals etc. Further for invoking provisions of section 194J, there is no stipulation that the professional services have to be necessarily rendered to the person who makes payment to hospital. Therefore TPAs who are making payment on behalf of insurance companies to hospitals for settlement of medical/insurance claims etc. under various schemes including Cashless schemes are liable to deduct tax at source under section 194J on all such payments to hospitals etc.

3.1 In view of above, all such past transactions between TPAs and hospitals fall within provisions of section 194J and consequence of failure to deduct tax or after deducting tax failure to pay on all such transactions would make the deductor (TPAs) deemed to be an assessee in default in respect of such tax and also liable for charging of interest under section 201(1A) and penalty under section 271C.

4. Considering the facts and circumstances of the class of cases of TPAs and insurance companies, the Board has decided that no proceedings under section 201 may be initiated after the expiry of six years from the end of financial year in which such payment have been made without deducting tax at source etc. by the TPAs. The Board is also of the view that tax demand arising out of section 201(1) in situations arising above, may not be enforced if the deductor (TPA) satisfies the officer in charge of TDS that the relevant taxes have been paid by the deductee-assessee (hospitals etc.). A certificate from the auditor of the deductee assessee stating that the tax and interest due from deductee-assessee has been paid for the assessment year concerned would be sufficient compliance for the above purpose. However, this will not alter the liability to charge interest under section 201(1A) of the Income-tax Act till payment of taxes by the deductee assessee or liability for penalty under section 271C of the Income-tax Act as the case may be.

5. The contents of the circular may be brought to the notice of officers and officials working under you for strict compliance.

Circular No. 7/2009 - Section 9 of the Income-tax Act, 1961 - Income - Deemed to accrue or arise in India - Withdrawal of Circulars No. 23 dated 23rd July, 1969, No. 163 dated 29th May, 1975 and No. 786 dated 7th February, 2000

1. The Central Board of Direct Taxes had issued Circular No. 23 (hereinafter called "the Circular") on 23rd July 1969 regarding taxability of income accruing or arising through, or from, business connection in India to a non-resident, under section 9 of the Income-tax Act, 1961.
2. It is noticed that interpretation of the Circular by some of the taxpayers to claim relief is not in accordance with the provisions of section 9 of the Income-tax Act, 1961 or the intention behind the issuance of the Circular.
3. Accordingly, the Central Board of Direct Taxes withdraws Circular No 23 dated 23rd July, 1969 with immediate effect.

4. Even when the Circular was in force, the Income-tax Department has argued in appeals, references and petitions that-

   (i) the Circular does not actually apply to a particular case, or
   (ii) that the Circular can not be interpreted to allow relief to the taxpayer which is not in accordance with the provisions of section 9 of the Income-tax Act or with the intention behind the issue of the Circular.

It is clarified that {he withdrawal of the Circular will in no way prejudice the aforesaid arguments which the Income-tax Department has taken, or may take, in any appeal, reference or petition.

5. The Central Board of Direct Taxes also withdraws Circulars No. 163 dated 29th May, 1975 and No. 786 dated 7th February, 2000 which provided clarification in respect of certain provisions of Circular No 23 dated 23rd July, 1969.

Direct Tax Code

Question:

The Finance Minister while delivering a budget speech has proposed to bring into new Direct Tax Code, Please give glimpse of New Proposed Direct Tax Code:

Answer:

The **New Direct Tax Code (DTC) is said to replace the existing Income Tax Act of 1961 in India** - and would be presented in the winter session of the Parliament. It is expected to be passed in the monsoon session of 2010 and is expected to be enforced from 2011. During the budget 2010 presentation, the finance minister Mr. Pranab Mukherjee reiterated his commitment to bringing into fore the new direct tax code (DTC) into force from 1st of April, 2011.

The new code will completely overhaul the existing tax proposals for not only individual tax payers, but also corporate houses and foreign residents. It has been drawn with inspiration from the prevailing tax legislation in US, Canada, UK. It is a topic of interest and a matter of concern for every taxpayer in India. **The new DTC also seeks to take the bold step of moving from EEE (Exempt-Exempt-Exempt) to EET (Exempt-Exempt-Taxed)** system of taxation for various investment avenues, most importantly the PPF.

The most striking feature is the **rationalisation level of tax slabs** at various levels. The proposed slabs suggest a major overhaul in the intent of CBDT. A glimpse of the intended structure has already been seen in the Union Budget 2010 wherein the tax slabs have been liberalised to a great extent. More on Budget 2010 here:

Here are some of the salient features and highlights of the DTC:

1. **The concept of "Previous Year" has been replaced with "Financial Year",** which essentially means the year beginning from 1st of April of the respective year. Thus financial year 2009-10 would mean the year beginning on 1st of April, 2009.

2. **Income has been broadly classified into two heads,** which are:

- Income from Ordinary Sources
- Income from Special Sources

3. **Income from Ordinary Sources includes:**

- Income earned as Salary
- Income from Business or Profession
- Income from House Property (rental income)
- Capital Gains
- Residual income from miscellaneous sources

4. **Income from Special Sources includes:**

- Winning from Lotteries
- Winning from Horse Race etc.
- Specified income of Non Residents

5. **Any losses arising of Ordinary Sources may be eligible to be set off or carried forward** against income from Ordinary Sources ONLY without any time limit. Similarly for Income from Special Sources.

6. **Scope of income is expanded** to include value of perks, gifts, profit in lieu of salary and capital gains but excludes farm income.

7. **DTC removes most of the categories of exempted income.** In order to make up for the same, the tax rates and slabs have been modified. In effect on the first glance the tax liability looks a lot less with the new rates and slabs – however, there needs to be calculations made to get the true impact of overall tax liability. This particularly holds true for people who have been claiming the "home loan" tax benefits.

8. **The tax rates and slabs have been modified.** The proposed rates and slabs are as follows:

Annual Income	**Tax Slab**
Upto INR 160,000	Nil
Between INR 160,000 to 1,000,000	10%
Between INR 1,000,000 to 2,500,000	20%
Above INR 2,500,000	30%

9. **The DTC abolishes the difference between Short Term Capital Gain and Long Term Capital Gain** - and makes Long Term Capital Gain taxable. Therefore, the "Capital Gains" on shares and securities is to be taxed as income.

10. **The securities transaction tax or STT has been abolished.**

11. **The upper limit on Tax Savings** based investment has been hiked from INR 100,000 to 300,000.

12. **The long term savings schemes** (e.g. PPF) would be **moved from EEE (**Exempt-Exempt-Exempt) to **EET** (Exempt-Exempt-Taxed) method of taxation.

- The savings are exempted from Taxation (subject to the INR 300,000 limit)
- The accretion of income till withdrawal is exempted
- Any withdrawal made is taxable with the only exception of: Withdrawals pertaining to approved Provident Fund accumulated balance as on 31 st of March, 2011.

13. **No tax deduction is allowed on interest payable** to banking firms and insurers.

14. **Dividend** will continue to be **tax-free** in the hands of investors.

15. **For incomes arising of House Property,** the Gross rent is to be calculated as the higher amount of:

- The contractual value of the rent'
- Presumptive rate of six percent of rateable value / construction cost / acquisition cost

16. **Deductions towards interest payment of House Loan** for the self occupied property would **not be allowed** in the DTC.

17. **Deductions for Rent and Maintenance** would be **reduced** from **30% to 20%** of the Gross Rent.

Recent Case Laws

Business and Profession

Employee's contribution to PF / ESI – deposited after due date as prescribed in PF Act etc – But before due date of filing ROI – Allowable u/s 43B

1. **CIT vs. AIMIL Ltd. [321 ITR 508 (Delhi High Court)]**

Even employees' contribution to PF paid before due date of filing ROI is allowable u/s 43B

Facts / Issue

S. 2 (24) (x) provides that amounts received by an assessee from employees towards PF contributions etc shall be "income". S. 36 (1) (va) provides that if such sums are contributed to the employees account in the relevant fund on or before the due date specified in the PF etc legislation, the assessee shall be entitled to a deduction. The second Proviso to s. 43B (b) provided that any sum paid by the assessee as an employer by way of contribution to any provident etc fund shall be allowed as a deduction only if paid on or before the due date specified in 36(1)(va). After the omission of the second Proviso w.e.f 1.4.2004, the deduction is allowable under the first Proviso if the payment is made on or before the due date for furnishing the return of income. The High Court had to consider whether the benefit of s. 43B can be extended to employees' contribution as well which are paid after the due date under the PF law but before the due date for filing the return

Held

(i) Though the revenue has argued that a distinction is to be made between "employers' contribution" and "employees' contribution" and that employees' contribution being in the nature of trust money in the hands of the assessee cannot be allowed as a deduction if not paid on or before the due date specified in the PF etc law, the scheme of the Act is that employees' contribution is treated as income u/s 2 (24) (x) on receipt by the assessee and allowed as a deduction u/s 36 (1) (va) on making deposit with the concerned authorities. S. 43B (b) stipulates that such deduction would be permissible only on actual payment;

(ii) The question as to when actual payment should be made is answered by **Vinay Cements** 213 CTR 268 where the deletion of the second Proviso to s. 43B w.e.f 1.4.2004 was held applicable to earlier years as well. As the deletion of the 2nd Proviso is retrospective, the case has to be governed by the first Proviso. **Dharmendra Sharma** 297 ITR 320 (Del) & **P.M. Electronics** 313 ITR 161 (Delhi) followed;

(iii) If the employees' contribution is not deposited by the due date prescribed under the relevant Acts and is deposited late, the employer not only pays interest on delayed payment but can incur penalties also, for which specific provisions are made in the Provident Fund Act as well as the ESI Act. Therefore, the Act permits the employer to make the deposit with some delays, subject to the aforesaid consequences. **Insofar as the Income-tax Act is concerned, the assessee can get the benefit if the actual payment is made before the return is filed, as per the principle laid down in Vinay Cement**.

2. Alom Extrusion 319 ITR 306 (SC)

Section 43B of the Income-tax Act, 1961 - Business disallowance - Certain deductions to be allowed only on actual payment - Whether deletion of second proviso to section 43B by Finance Act, 2003 is retrospective and it would operate with effect from 1-4-1988 - Held, yes

Depreciation

3. CIT vs. Bharat Aluminium [187 Taxman 111 (Delhi High Court)]

Under "block of assets", user of individual assets is not required

Facts / Issue

The assessee purchased machinery which was **not** put to use during the year though it formed a part of the "block of assets". On the question whether depreciation on the said machinery was allowable, the Tribunal held that once a particular asset falls within the block, it is added to the WDV and depreciation is to be allowed on the block. The individual asset loses its identity and the question whether an individual asset is put to use in a particular year or not is irrelevant inasmuch as the requirement of law is to establish the use of the block of assets and not the use of particular equipment. On appeal by the Revenue:

HELD

(i) The rationale and purpose for which the concept of block asset was introduced, as reflected in the CBDT's Circular dated 23.09.1988 is that **once the various assets are clubbed together and become 'block asset' within the meaning of s. 2(11), it**

becomes one asset. Every time, a new asset is acquired, it is to be thrown into the common hotchpotch, i.e., block asset on meeting the requirement of depreciation being allowable at the same rate. **Individual assets lose their identity and become an inseparable part of block asset insofar as calculation of depreciation is concerned**;

(ii) Though as per s. 32(1) the asset is to be owned and "used" for the purpose of business or profession, **the expression "used for the purpose of business" when applied to block asset would mean use of block asset and not any specific items in the said block as individual assets have lost their identity after becoming inseparable part of the block asset**;

(iii) The fact that under the second proviso to s. 32 assets acquired after 30th Sept shall be entitled to 50% depreciation of amount admissible does not mean requirement of user of individual asset remains intact. **In the first year when the particular asset is acquired, user of the asset is required**. In subsequent years, the user of individual assets is not required.

4. **<u>CIT v. Kotak Mahindra Finance Ltd [317 ITR 236 (Bom.)]</u>**

Depreciation admissible even though assets not put to use.

<u>Facts</u>

The assessee was in the business of leasing. In the relevant accounting year the assessee had leased out breakers to TECL. The lessee installed the breakers in the subsequent year. The Assessing Officer disallowed the claim for depreciation on the ground that asset was not put to use in the relevant year. The Tribunal allowed the assessee'e claim.

<u>Held</u>

On appeal by the Revenue, the Bombay High Court upheld the decision of the Tribunal and held as under :

> "(i) The assessee, admittedly had supplied the machinery before the end of the financial year and the assessee had received the lease rental for the same. Whether the lessee had put to use the lease equipment would be irrelevant as long as the machinery in fact had been given on lease before the end of the financial year, as then it could be said that the assessee for the purposes of business had 'used' the leased equipment.

(ii) The assessee was entitled to depreciation."

5. CIT vs. G.R.Shipping (Bombay High Court)

Depreciation allowable even if asset not used at all for entire year

The assessee, engaged in shipping business, owned a barge which was included in the block of assets. The barge met with an accident and sank on 6.3.2000 (AY 2000-01). As efforts to retrieve the barge were uneconomical, the barge was sold on as-is-where-is in May 2001 (AY 2002-03). **As the barge was non-operational and not used for business at all in AY 2001-02, the AO denied depreciation**. The CIT (A) upheld the stand of the AO. On appeal by the assessee, the Tribunal took the view that after the insertion of the concept of "block of assets" by the T. L. (A) Act, 1988 w.e.f 1.4.1988 **individual assets had lost their identity and only the "block of assets" had to be considered**. It was held that **the test of "user" had to be applied upon the block of assets as a whole and not on individual assets**. On appeal by the Revenue, the High Court **dismissed the appeal** holding that the issue was squarely covered in favour of the assessee by its earlier judgements in **Whittle Anderson** 79 ITR 613 and **G. N. Agrawal** 217 ITR 250.

Bad Debt u/s 36(1)(vii) in the hands of Share brokers

6. CIT vs. Bonanza Portfolio [320 ITR 178 (Delhi)]

Share broker is eligible to claim "bad debts" u/s 36 (1) (vii) / 36 (2)

Facts / Issue :

The assessee, a share broker, purchased shares on behalf of its client and paid for them. The brokerage on the said transaction was offered to tax. As the client did not pay for the shares, the assessee wrote off the amount due and claimed the same as a bad debt u/s 36 (1) (vii). The AO rejected the claim on the ground that **as the said "debt" had not "been taken into account in computing the income", the conditions of s. 36 (2) (i) were not satisfied**. This was confirmed by the CIT (A). On appeal, the Tribunal upheld the claim on the ground that **s. 36 (2) (i) required "such debt or part thereof" to be taken into**

account in computing the income and as the brokerage had been offered to tax, s. 36 (2) (i) was satisfied.

HELD

(i) The assessee being a broker, the fact that it paid for the shares did not make it an "investment" for the assessee. The transaction was one of brokerage on purchase / sale on behalf of the client;

(ii) The money receivable from the client for the said shares was a "debt" and since it became bad, it was rightly treated as a "bad debt";

(iii) **Since the brokerage payable by the client was a part of the debt and that debt had been taken into account in computing the income, the conditions of s. 36 (2) (i) read with s. 36 (1) (viii) were satisfied and the entire bad debt was allowable as a deduction**.

7. **DCIT vs. Shreyas S. Morakhia (ITAT Mumbai Special Bench)**

If brokerage offered to tax, the principal debt qualifies as a "bad debt" u/s 36(1)(vii) r.w.s. 36(2)

The assessee, a broker, claimed deduction for bad debts in respect of shares purchased by him for his clients. The AO rejected the claim though the CIT (A) upheld it. On appeal by the Revenue, the matter was referred to the Special Bench. Before the Special Bench, the department argued that u/s 36(2), no deduction on account of bad debt can be allowed unless "such debt or part thereof has been taken into account in computing the income of the assessee". It was argued that as the assessee had offered only the brokerage income to tax but not the value of shares purchased on behalf of clients, the latter could not be allowed as a bad debt u/s 36(1)(vii). HELD rejecting the claim of the department:

(i) In **Veerabhadra Rao** 155 ITR 152 the Supreme Court held in the context of a loan that if the interest is offered to tax, the loan has been "taken into account in computing the income of the assessee" and qualifies for deduction u/s 36(1)(vii). **The effect of the judgement is that in order to satisfy the condition stipulated in s. 36(2)(i), it is not necessary that the entire amount of debt has to be taken into account in computing the income of the assessee and it will be sufficient even if part of such debt is taken into account in computing the income of the assessee. This principle applies to a share broker**. The amount receivable on account of brokerage is a part of debt receivable by the share broker from his client against purchase of shares and once such brokerage is credited to the P&L account and taken into account in computing his income, the condition stipulated in s. 36(2)(i) gets satisfied. Whether the gross amount is reflected in the credit side of the P&L A/c or only the net amount is finally reflected as profit after deducting the corresponding expenses or only the net amount of brokerage received by the share broker is reflected in the credit side of the P&L account makes no difference because the ultimate effect is the same;

(ii) The argument that the loss was suffered owing to breach of SEBI Guidelines framed to safeguard the interest of brokers in respect of amount receivable from the clients against purchase of shares is irrelevant. If the broker chooses not to follow the guidelines, **it is a decision taken by him as a businessman having regard to his business relations with the client**. The loss **cannot be equated to expenditure incurred by the assessee for any purpose which is an offence or which is prohibited by law**. (**CIT vs. Pranlal Kesurdas** 49 ITR 931 (Bom) followed where bad debts on account of forbidden vayada transactions were held allowable);

(iii) The contention of the Revenue that the sale value of the shares remaining with the assessee should be adjusted against the amount receivable from the client so as to arrive at the actual amount of bad debt should be raised, if permissible, before the Division Bench.

DB (India) Securities 318 ITR 26 (Del) & **Bonanza Portfolio** 320 ITR 178 (Del) followed. **India Infoline Securities** 25 SOT 123 (Mum), **B.N. Khandelwal** 101 TTJ 717 & **Mahesh J. Patel** 109 ITD 35 (TM) overruled.

Bad Debts u/s 36(1)(iii) of the Act, otherwise

8. **TRF Limited vs. CIT [190 ITR 391 (SC)]**

Bad debts need not be proven to be irrecoverable u/s 36(1)(vii). It is sufficient if they are written off.

The Supreme Court had to consider whether after the amendment to s. 36 (1) (vii) w.e.f. 1.4.1989, an assessee had to establish, as a matter of fact, that the debt advanced by the assessee had, in fact, become irrecoverable or whether writing off the debt as irrecoverable in the accounts was sufficient. HELD deciding in favour of the assessee:

(i) The position in law is well-settled. After 1.4.1989, **it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable. It is enough if the bad debt is written off as irrecoverable in the accounts of the assessee**. When a bad debt occurs, the bad debt account is debited and the customer's account is credited, thus, closing the account of the customer. In the case of companies, the provision is deducted from Sundry Debtors.

(ii) As the AO has not examined whether the debt has, in fact, been written off in accounts of the assessee. The matter is remitted to the AO for de novo consideration of the above-mentioned aspect **only** and that too **only to the extent of the write off**.

9. <u>Vijaya Bank vs. CIT [323 ITR 166 (SC)</u>

For s. 36(1)(vii) Bad Debt, write off of individual debtor's a/c is not necessary

The assessee made a provision for bad debts by debiting the P & L A/c and crediting the Provision for Bad debts A/c. Thereafter, the provision account was debited and the loans and advances a/c was credited. The AO denied the claim for bad debts u/s 36(1)(vii) on the ground that **the individual account of the debtor had not been written off**. The CIT (A) and Tribunal allowed the assessee's claim though the High Court reversed it. On appeal by the assessee, HELD reversing the High Court:

(i) Pursuant to the Explanation inserted w.r.e.f. 1.4.1989 **a mere provision for bad debt is not entitled to deduction u/s 36(1)(vii)**. However, in the present case, besides debiting the P&L A/c and creating a provision for bad debts, **the assessee had also obliterated the said provision by reducing the corresponding amount from the debtors account** in the Balance Sheet. Consequently, the figure in the loans and advances in the Balance Sheet was shown net of the provision for bad debts;

(ii) The AO's insistence that the individual account of the debtor should be written off was not acceptable because (a) it was based on a mere apprehension that the assessee might claim deduction twice over and it was open to the AO to check whether the assessee was claiming double deduction, (b) if the individual accounts were closed, the Debtor could in the recovery suits rely on the Bank statement and contend that no amount is due and payable to the assessee and (c) the AO was empowered by s. 41(4) to tax the recovery.

Business Income vs. Capital gain

10. CIT vs. Gopal Purohit [188 Taxman 140 (Bombay)]

Shares activity treated as investment in earlier years cannot be treated as business in subsequent years if facts are the same.

The assessee was engaged in two different activities of sale and purchase of shares. The first set of transactions involved **investment in shares** in which the assessee took delivery of the shares. The second set of transactions involved **dealing in shares** for business purposes. The assessee was accordingly an investor as well as a dealer. The income from investment activity was offered as capital gains while the income from dealing activity was offered as business income. **This position was accepted by the AO in the earlier years**. In AY 2005-06, the AO took a different view and held that even the shares held on investment account had to be assessed as business income. The Tribunal allowed the assessee's appeal (see 122 TTJ (Mum) 87). On appeal by the Revenue, HELD dismissing the appeal:

(a) The Tribunal has correctly applied the principle of law in accepting the position that **it is open to an assessee to maintain two separate portfolios**, one relating to investment in shares and another relating to business activities involving dealing in shares. Delivery based transactions were rightly treated as being in the nature of investment transactions giving rise to capital gains.

(b) The Tribunal correctly accepted the position that though the principle of res judicata is not attracted, **there ought to be uniformity in treatment and consistency when the facts and circumstances are identical**. The Tribunal has noted that the assessee has followed a consistent practice in regard to the nature of the activities, the manner of keeping records and the presentation of shares as investment at the end of the year in all the years and there is no justification for a different view being taken by the AO.

(c) The Tribunal applied the correct principle in holding that while entries in the books of account alone are not conclusive in determining the nature of income, it does have a bearing.

<u>Roll over charges for foreign currency</u>

11. <u>ACIT</u> vs. Elecon Engineering (Supreme Court)

Roll-over charges for foreign currency contracts have to be capitalized u/s 43A

The assessee procured a foreign currency loan for expansion of its existing business. To ensure availability of foreign currency, the assessee booked forward contracts with a bank. The contract was for the entire amount and delivery of foreign currency was obtained from the bank for the installment due from time to time. The balance value of the contract was rolled over for a further period up to the date of the next installment. The assessee paid "roll over premium charges" for the same. The AO disallowed the said charges on the ground that as it were incurred for purchase of plant & machinery, it was capital expenditure. The CIT (A) reversed the AO on the ground that the charges were expenditure for raising a loan and was consequently revenue in nature. The Tribunal reversed the CIT (A) on the ground that u/s 43A the expenditure had to be capitalized. The High Court reversed the Tribunal on the ground that the charges were in the nature of interest or commitment charges and allowable u/s 36(1) (iii). On appeal, HELD reversing the High Court:

(a) **Exchange differences are required to be capitalized if the liabilities are incurred for acquiring fixed assets like plant and machinery. It is the purpose for which the loan is raised that is of prime significance. Whether the purpose of the loan is to finance the fixed asset or working capital is the question which one needs to answer**;

(b) The cost for carrying forward the contracted foreign currency not immediately required for repayment is called the roll over charge(s). The argument that s. 43A applies only to cases where there is a fluctuation in the rate of exchange and that since roll over charges are paid to avoid increase or reduction in liability on account of such fluctuation, s. 43A does not apply has no merit because **s. 43A applies to the entire liability remaining outstanding at the year end and is not restricted merely to the installments actually paid during the year**. Therefore the year-end liability of the assessee has to be looked into. Further, it cannot be said that roll over charge has nothing to do with the fluctuation in the rate of exchange. Roll over charges represent the difference arising on account of change in foreign exchange rates. **Roll over charges paid/ received in respect of liabilities relating to the acquisition of fixed assets should be debited/ credited to the asset in respect of which liability was incurred**. However, roll over charges not relating to fixed assets should be charged to the Profit & Loss Account.

12. Southern Technologies Ltd vs. JCIT (SC)

Provisions for NPA as per RBI Norms by NBFC is not deductible

The assessee, a NBFC, made a 'Provision for NPA' in terms of the RBI Directions 1998. It claimed a deduction for the said provision u/s 36 (1)(vii) on the ground that as it was debited to the P&L Account and reduced the profits, it was a 'write off'. In the alternative, it was claimed that there was a diminution in the value of its assets for which a deduction u/s 37 as a trading loss was eligible. It was also claimed that the RBI Directions overrode the I. T. Act. The Tribunal allowed the claim but the High Court rejected it. On appeal, HELD dismissing the claim:

(i) The RBI Directions issued u/s 45JA of the RBI Act provide that anticipated losses must be taken into account but expected income need not be taken note of. This is for ensuring that NBFCs state true and correct profits without projecting inflated profits. **These are prudential norms or disclosure norms but have nothing to do with the computation or taxability of the provisions for NPA under the IT Act**. Further though the RBI Directions deviate from the accounting practice as provided in the Companies Act, **they do not override the provisions of the IT Act**. The RBI Directions 1998 and the IT Act operate in different fields.

(ii) The "Provision for NPA" made in terms of the RBI Directions does not constitute expense for purposes of s. 36(1)(vii). The said Provision is for presentation purposes and in that sense it is notional.

13. Can the assessee treat shares held in subsidiary company, which is ordered to be wound up, as trading loss?

CIT v. H. P. Mineral and Industrial Development Corporation Ltd. (2008) 305 ITR 111 (HP)

One of the assessee's subsidiary companies was ordered to be wound up and the assessee decided to write off the value of the shares held by it in the subsidiary company. The lower authorities decided in favour of the assessee holding that there was no question of selling off the shares as the subsidiary company had gone into liquidation.

The High Court held that once a company had been ordered to be wound up, there was no question of any party dealing in the shares of that company. The Tribunal had come to a finding that the shares were stock-in-trade and had therefore allowed the loss. The loss had to be treated as a trading loss. The mere fact that the shares were not sold was of no significance since in fact the shares could not have been sold and had become worthless.

14. <u>CIT vs. Sri Mangayarkarasi Mills [182 Taxman 141(SC)]</u>

Replacement expenditure is neither "current repairs" nor "revenue"

The assessee incurred expenditure on replacement of machinery in a textile mill and claimed the same as revenue expenditure on the ground that it was merely for **replacement of spare parts** in the spinning mill system and did not give rise to a new asset. **In the books, the expenditure was capitalized**. The CIT (A), ITAT and High Court decided in favour of the assessee. However, on appeal by the revenue, HELD, **reversing all the lower authorities**:

(i) Each machine in a textile mill is a **separate and independent item** though it is a part of the **integrated process** of manufacture of yarn and is **integrally connected** to the other machines in the mill for production of the final product. The machine cannot be treated as a mere part of an entire composite machinery of the spinning mill.

(ii) **To constitute "current repairs" u/s 31 the expenditure must be incurred to 'preserve and maintain' an already existing asset and not to bring a new asset into existence or to obtain a new advantage**. For determination of 'current repairs' the question whether the expenditure is revenue or capital is not the proper test. However, as the machine was an independent entity, its' replacement brought into existence a new asset and was not current repairs.

(iii) The expenditure was also not "revenue" u/s 37 (1) as the replacement brought into existence a new asset and also gave rise to an enduring benefit.

(iv) **Though accounting practices may not be the best guide in determining the nature of expenditure, the fact that the assessee treated the expenditure as an addition to the existing assets shows that the claim for deduction under the Act was made merely to diminish the tax burden and not under the belief that it was actually revenue expenditure**.

15. Nectar Beverages vs. DCIT (Supreme Court)

Balancing charge is not chargeable to tax

The assessee purchased bottles and crates costing less than Rs. 5,000/- and was allowed 100% depreciation thereon u/s 32 (1) (ii). When the bottles and crates got worn out, they were sold by the assessee. The question arose whether the said sale proceeds were assessable to tax. Prior to AY 1988-89, the sale proceeds would have been assessable as a "balancing charge" u/s 41 (2). After the deletion of s. 41 (2), the department claimed that depreciation constituted "**expenditure**" and that the sale proceeds represented a "**recoupment of that expenditure**" which was chargeable as business profits u/s 41 (1). HELD, rejecting the stand of the department that:

(i) Prior to 1.4.1988, Ss. 41(1) and 41(2) both existed on the statute book. S. 41(1) deals with recoupment of trading liability while s. 41(2) deems balancing charge to be business income. Both operate in different spheres. **If the argument of the department that balancing charge should be read as falling within the scope of s. 41(1) is accepted then it was not necessary for Parliament to enact S. 41(2) in the first instance**. Section 41(1) alone would have sufficed.

(ii) The necessity to enact s. 41(2) in addition to s. 41(1) arose from the fact that, in its very nature, **depreciation is neither a loss, nor expenditure, nor a trading liability**, referred to in s. 41(1). Depreciation recovered on sale of a capital asset was includible in the total income as balancing charge only under s. 41(2). That concept was foreign to the scheme of s. 41(1).

(iii) Even after the introduction of the concept of "block of assets" w.e.f. 1.4.1988, the proviso to s. 32(1) (ii) continued till 1.4.1995. After that date, even purchases below Rs. 5,000 came within "block of assets". **Accordingly, assets purchased prior to 31.3.1995 do not form part of the block of assets and profits on sale of such assets are not taxable as a balancing charge either u/s. 41(1) or u/s 50**.

16. Rotork Controls vs. CIT [180 Taxman 422(SC)]

Estimated expenditure towards warranty is allowable u/s 37 (1)

The assessee sold valve actuators. At the time of sale, the assessee provided standard warranty that if the product was defective within the stated period, the product would be rectified or replaced free of charge. For AY 1991-92, the assessee made a provision for warranty at Rs.10,18,800 at the rate of 1.5% of the turnover. As the actual expenditure was only Rs. 5,18,554, the excess provision of Rs.5,00,246 was reversed and only the net provision was claimed. The Tribunal allowed the claim on the basis that the provision had been consistently made and on a realistic manner. The High Court reversed the Tribunal on the basis that the liability was contingent and not allowable u/s 37 (1). HELD, **reversing** the High Court that:

(1) A provision is a liability which can be measured only by using a substantial degree of estimation. A provision is recognized when: (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognized;

(2) A Liability is defined as a present obligation arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits;

(3) A past event that leads to a present obligation is called as an obligating event. The obligating event is an event that creates an obligation which results in an outflow of resources. It is only those obligations arising from past events existing independently of the future conduct of the business of the enterprise that is recognized as provision. **For a liability to qualify for recognition there must be not only present obligation but also the probability of an outflow of resources to settle that obligation. Where there are a number of obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement, is determined by considering the said obligations as a whole**;

(4) **In the case of a manufacture and sale of one single item the provision for warranty could constitute a contingent liability not entitled to deduction u/s 37 of the said Act. However, when there is manufacture and sale of an army of items running into thousands of units of sophisticated goods, the past event of**

defects being detected in some of such items leads to a present obligation which results in an enterprise having no alternative to settling that obligation;

(5) On facts, the assessee has been manufacturing and selling Valve Actuators in large numbers since 1983-84 onwards. Statistical data indicates that every year some Actuators are found to be defective. The data over the years also indicates that being sophisticated item no customer is prepared to buy the Valve Actuator without a warranty. **Therefore, warranty became integral part of the sale price of the Valve Actuator(s). In other words, warranty stood attached to the sale price of the product and a reliable estimate of the expenditure towards such warranty was allowable**.

17. CIT vs. Woodward Governor [321 ITR 147 (SC)]

Foreign Exchange fluctuation losses are allowable on accrual basis

Where the assessee carrying on the mercantile system of accounting claimed that:

(i) The additional liability arising on account of fluctuation in the rate of exchange in respect of loans taken for revenue purposes was allowable as deduction u/s 37(1) in the year of fluctuation in the rate of exchange and not in the year of repayment of such loans; and

(ii) The actual cost of imported assets acquired in foreign currency is entitled to be adjusted u/s 43A (prior to the amendment by the FA 2002) on account of fluctuation in the rate of exchange at each balance sheet date, pending actual payment of the varied liability HELD **approving the claim** that:

(a) The term "expenditure" in s. 37 covers an amount which is a "loss" even though the said amount has not gone out from the pocket of the assessee. The "loss" suffered by the assessee on account of the exchange difference as on the date of the balance sheet is an item of expenditure u/s 37(1) ;

(b) Profits and gains are required to be computed in accordance with **commercial principles** and accounting standards (AS-11);

(c) Accounts and the accounting method followed by an assessee continuously for a given period of time **needs to be presumed to be correct** till the AO comes to the conclusion for reasons to be given that the system does not reflect true and correct profits;

(d) The fact that the department taxed the gains on fluctuation on the basis of accrual while disallowing the loss is important and indicates the **double standards adopted by the Department**;

(e) U/s 43A (pre-amendment), the change in the rate of exchange subsequent to the acquisition of asset triggers the adjustment in the actual cost of the assets. Actual payment of the liability as a consequence of the exchange variation is not required. The amendment of s. 43A by the FA 2002 w.e.f. 1.4.2003 is not clarificatory.

18. DCIT vs. Gujarat Alkalies (Supreme Court)

Commitment charges paid in respect of borrowed moneys are allowable as a deduction u/s 37(1) of the Act.

19. <u>S.A. Builders Ltd. v CIT and another (SC) [2007 (288) ITR 1] (14/12/2006)</u>

Income Tax Act, 1961, s. 36 (1) (iii) – **Held, we have to see the transfer of the borrowed funds commercial expediency and not from the** point of view **whether the amount was advanced for earning profits** - where it is obvious that a holding company has a deep interest in its subsidiary, and hence if the holding company advances borrowed money to a subsidiary and the same is used by the subsidiary for some business purposes, the assessee would ordinarily be entitled to deduction of interest on its borrowed loans - Set aside the impugned judgments and remand the matter to the Tribunal for a fresh decision, in accordance with law - Appeal Allowed.

Capital Gains

20. Vodafone International ltd. vs. UOI (Bombay High Court)

The purchase of shares of a foreign company by one non-resident from another non-resident attracts Indian tax if the object was to acquire the Indian assets held by the foreign company

A Cayman Island company called CGP Investments held 52% of the share capital of Hutchison Essar Ltd, an Indian company engaged in the mobile telecom business in India. The shares of CGP Investments were in turn held by another Cayman Island company called Hutchison Telecommunications. The assessee, a Dutch company, acquired from the second Cayman Islands company, the shares in CGP Investments for a total consideration of US $ 11.08 billion. The AO issued a show-cause notice u/s 201 in which he took the view that as the ultimate asset acquired by the assessee were shares in an Indian company, the assessee ought to have deducted tax at source u/s 195 while making payment to the vendor. This notice was challenged by a Writ Petition but was dismissed by the Bombay High Court. In appeal, the Supreme Court remanded the matter to the AO to first pass a preliminary order of jurisdiction which the AO did. This order was challenged by the assessee by a Writ Petition on the ground that ***as one non-resident had acquired shares of a foreign company from another non-resident, s. 195 had no application***. HELD dismissing the Petition:

(i) **An assessee is entitled to arrange his affairs so as to avoid tax and the department is not entitled to disregard it on the ground of motive**. However, a "sham" or "colourable" transaction can be disregarded by the AO. **Azadi Bachao Andolan** 263 ITR 706 (SC) & **Wallfort** followed;

(ii) A share, being a capital asset, comprises of an indivisible set of rights, not capable of being separately transferred at law. **A controlling interest does not constitute a distinct capital asset because it is an incident of the ownership of shares and flows out of the holding of shares**. Also, the business of a company is not the business of its shareholders and the assets of a company are not the assets of its shareholders;

(iii) **The State has jurisdiction to tax non-residents if there is a nexus connecting the non-resident and the State**. The nexus arises where the source of income originates in the jurisdiction. The source of income is determined in accordance with source rules. U/s 5 & 9, the nexus for charging a non-resident is provided by the receipt or accrual of income in India. If the income can be taxed in more than one jurisdiction, it has to be apportioned;

(iv) U/s 9(1)(i), income arising from the transfer of a capital asset situated in India is chargeable to tax. **The situs of the capital asset is the crucial jurisdictional condition that must be fulfilled in order to attract chargeability to tax of income arising from the transfer of a capital asset**;

(v) Article 13 of the OECD Model Convention illustrates how a value driven deeming nexus may be created by legislation and how **one can look behind corporate structures if the ownership of shares represents an interest of a certain value** in real estate situated within the taxing jurisdiction;

(vi) S. 195 creates an obligation to deduct tax where the sum payable to a non-resident is (even partly) chargeable to tax. **If the sum payable is not assessable in India, there is no question of TDS being deducted by an assessee**. **The argument that as the payer is a non-resident, it was not obliged to deduct tax is not acceptable because there is sufficient territorial connection or nexus between the payer and India**. The fact that enforcement of the obligation may be difficult as the payer is a non-resident does not mean that obligation is not applicable;

(vii) On facts, the argument that the transaction involved merely a sale of a share of a foreign company by one non-resident to another is not acceptable. **It would be simplistic to assume that the entire transaction between the non-residents was fulfilled merely upon the transfer of a single share of the Cayman Islands company**. The commercial and business understanding between the parties postulated that what was being transferred from one non-resident to the other was the **controlling interest** in Hutchison Essar, an Indian company. **The object and intent of the parties was to achieve the transfer of control over the Indian company and the transfer of the solitary share of the Cayman Islands company was put into place as a mode of effectuating the goal**;

(vii) Even the price of US $ 11.01 Billion paid by the assessee factored in diverse rights and entitlements that were being transferred to the assessee. Many of these entitlements were not relatable to the transfer of the CGP share. The transactional documents were not merely incidental or consequential to the transfer of the CGP share, but recognized independently the rights and entitlements of the vendor in relation to the Indian business which were being transferred to the assessee;

(viii) As the consideration was paid for acquisition of a **panoply of entitlements** including a control premium, use and rights to the Hutch brand in India, non-compete agreement with the Hutch group etc, it will have to be **apportioned** by the AO to determine which portion has a nexus within the Indian taxing jurisdiction and which lies outside;

(ix) Accordingly, **as the transaction between the assessee and Hutchison Telecommunications had sufficient nexus with Indian fiscal jurisdiction, the AO did have jurisdiction to initiate proceedings against the assessee for failure to deduct tax at source**.

21. <u>CIT vs. D. Ananda Basappa 309 ITR 329 (Karn)</u>

<u>Facts</u>

In October 1995 the assessee sold a residential house for Rs.2,12,50,000 resulting in long-term capital gain. The assessee purchased two residential flats adjacent to each other executing two separate registered sale deeds in respect of two flats situated side by side, on the same day. The two flats were modified to make it one residential apartment. The assessee claimed exemption u/s. 54 in respect of investment in the two flats. It was found by the inspector that the two flats were in the occupation of two different tenants. The Assessing Officer held that Section 54(1) does not permit exemption for the purchase of more than one residential premises and therefore allowed exemption to the extent of purchase of one residential flat. The Tribunal allowed the assessee's claim in full.

<u>Held</u>

On appeal filed by the Revenue, the Karnataka High Court upheld the decision of the Tribunal and held as under:

"i) A plain reading of the provisions of section 54(1) of the Income-tax Act, 1961, discloses that when an individual or Hindu undivided family sells a residential building or land appurtenant, he can invest the capital gains for purchase of a residential building to seek exemption of the capital gains tax. Section 13 of the General Clauses Act, 1897, declares that whenever a singular is used for a word, it is permissible to include the plural. The expression 'a' residential house should be understood in a sense that the building should be residential in nature and 'a' should not be understood to indicate a singular number.

ii) It was shown by the assessee that the apartments were situated side by side. The builder had also stated that he had effected modifications of the flats to make them one unit by opening the door in between the two apartments. The fact that at the time when the Inspector inspected the premises, the flats were occupied by two different tenants was not a ground to hold that the apartment was not one residential unit. The fact that the assessee could have purchased both the flats in one single sale deed or could have narrated the purchase of two premises as one unit in the sale deed was not a ground to hold that the assessee had no intention to purchase two flats as one unit. The assessee was entitled to the exemption u/s. 54."

Exempt Income

22. Whether the assessee can exemption under section 10B in respect of interest earned from advance amount received from its sister concern for purchasing goods?

CIT v. Hycon India Ltd. (2009) 308 ITR 251 (Raj.)

Relevant Section: 10(B)

The assessee purchased goods from its sister concern and for such purchases it paid in advance to the seller and the advance amount yielded interest income to the assessee. The Assessing Officer allowed exemption to the interest income under section 10B holding that the interest income was attributable to the business of the undertaking. The Commissioner found that there was nothing on record to show that the sister concern had desired the deposit any specific amount of advance prior to its agreeing to supply raw material to its own sister concern nor was there anything to indicate that the Assessing Officer examined the case from this angle, before allowing the exemption under section 10B. Likewise, the Commissioner considered that even if there was a business practice where the suppliers of certain goods required an advance for future purchase, the transactions of the assessee with its own sister concern were to be considered on a different footing. On these findings, the Commissioner revised the order of the Assessing Officer under section 263 on the ground that it was prejudicial to the interests of the Revenue. The Tribunal did not agree with the view of the Commissioner and held that interest income received by the assessee from its sister concern was income from business.

The High court held that "Profits and gains of business or profession" and "Income from other sources" are different species of income. Section 2(24) of the Income-tax Act, 1961, does not categorise separately, profits and gains of business or profession. The expression "profits and gains" as used in section 2(24) is wider and is not confined to "Profits and gains of business or profession". Section 10B provides for exemption with respect to any "profits and gains" derived by the assessee, and is not confined to "profits and gains of business or profession".

Hence, the interest income received by the assessee from its sister concern did fall within the expression "profits and gains" and was eligible for exemption as business income under section 10B.

Assessment Procedure

Decisions on Defective Return

23. CIT v. Bhiwani Synthetics Ltd [318 ITR 177 (Del.)]

Signing of return by person other than the specified person u/s 140 will render return defective and not invalid.

Facts

For the A.Y. 1994-95, the assessee company had filed its return of income on 30-11-1994 declaring a loss. The return was signed by the general manager (finance) and the company secretary of the assessee. The Assessing Officer came to the conclusion that since the return was not signed by the managing director or a director as provided in S. 140(c) of the Income-tax Act, 1961, it was *non est*.

Held

The CIT(A) held that the defect was a curable defect and an opportunity ought to have been given to the assessee to rectify it. He, accordingly, directed the Assessing Officer to give such an opportunity to the assessee. The Tribunal upheld the decision of the CIT(A).

On appeal by the Revenue, the Delhi High Court upheld the decision of the Tribunal and held as under :

> "(i) We are of the view that on the facts of this case, since there is nothing on record to suggest that the assessee has disowned the return that was signed by the general manager (finance) of the assessee and on the contrary, a power of attorney was given by the assessee to its general manager (finance) for signing the return, it would have been appropriate if an opportunity had been granted to the assessee to have the return signed

by the managing director or its director in accordance with the directions given by the CIT(A).

(ii) There is nothing to suggest that any prejudice will be caused to the Revenue if this direction is complied with."

24. Prime Securities Ltd. v. ACIT [182 Taxman 221 (Mum.)]

Signing of return by person other than the specified person u/s 140 will render return defective and not invalid.

<u>Facts</u>

For the relevant year *i.e.,* A.Y. 1991-92, the assessee company had filed its return of income on 31-12-1991 which was signed by the company secretary. On 9-10-1992 the Assessing Officer issued a notice proposing to treat the return as invalid. On 15-10-1992, the assessee substituted the return filed on 31-12-1991 by another return which was identical to the one filed on 31-12-1991 except that it was signed by the director in accordance with S. 140 and requested the Assessing Officer to treat the original return filed on 31-12-1991 as a valid return. Subsequently, the Assessing Officer issued another notice dated 1-1-1993 proposing to treat the return filed on 31-12-1991 as an invalid return.

<u>Held</u>

The Bombay High Court allowed the writ petition challenging the said action of the Assessing Officer and held as under :

"(i) The return filed on 31-12-1991 would have to be treated as defective.

(ii) A perusal of Ss.(9) of S. 139 indicates that a duty is cast on the Assessing Officer when he considers the return of income to be defective to intimate the defect to the assessee and to give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation or within such further period which, on an application made in this behalf, the Assessing Officer may allow.

(iii) In the instant case, the notice of 9-10-1992 must be read as an intimation to the assessee u/s.139(9). The assessee had removed the defect within 15 days by filing the same return but with the signature of the director. If the defect in return was cured by virtue of S. 139(9), then the return became a valid return.

(iv) A bare reading of the provisions of S. 292B makes it clear that a return of income shall not be treated as invalid merely by reason of any mistake, defect or omission in such return of income, if such return of income is in substance and effect in conformity with or according to the intent and purpose of the Act. The return of income, therefore, if not signed by signatory as contemplated by S. 140, would be mistake, defect or omission. Question is whether in spite of the defect, the return was, in substance and effect, in conformity with or according to the intent and purpose of the Act. The test to be applied is whether on the date the original return was filed, the return was in conformity with or according to the purpose of the Act.

(v) It was true that the return was invalid as originally filed because of defect in the person signing the return, but by virtue of 139(9), that defect could be cured and was, in fact, cured. Though the defect was cured on 15-10-1992, it would take back to 31-12-1991, the date of original filing of the return."

Fresh Claim before Assessing Officer

25. Goetze (India) Limited Versus Commissioner of Income-Tax [284 ITR 323 (SC)

Whether the appellant assessee could make a claim for deduction other than by filing a revised return - held that the power of the Tribunal under section 254, is to entertain for the first time a point of law provided the fact on the basis of which the issue of law can be raised before the Tribunal. The decision does not in any way relate to the power of the AO to entertain a claim for deduction otherwise than by filing a revised return - appeal is dismissed

26. Commissioner of Income Tax Versus M/s. Jai Parabolic Springs Ltd. [306 ITR 42(Dl)]

Revenue expenditure shown as deferred revenue expenditure in the audited balance sheet. Tribunal on the basis of additional ground raised by the assessee allowed full deduction even if he failed to claim deduction in the original return (neither he filed revised return) - tribunal decision upheld

On Rectification of Mistake u/s 154

27. Mepco Industries vs. CIT (Supreme Court)

Debatable issues are not "mistakes apparent from the record" u/s 154

The assessee filed a revision petition u/s 264 in which it claimed that the subsidy received by it from the government was a capital receipt and not chargeable to tax in view of **P.J. Chemicals Ltd** 210 ITR 830 (SC). The Petition was allowed by the CIT. Subsequently, the Supreme Court held in **Sahney Steel and Press Works** 228 ITR 253 that the subsidy received by that assessee was a revenue receipt. Pursuant to this judgement, the CIT passed a rectification order u/s 154 by which he held that the subsidy was a revenue receipt. The assessee challenged the said order by a writ petition before the Madras High Court which was dismissed. On appeal by the assessee, HELD allowing the appeal:

The case was a classic one of change of opinion. The question whether a subsidy is capital or revenue depends on the facts of the case. S. 154 can only apply to a "mistake apparent from the record". A "rectifiable mistake" is a mistake which is obvious and not something which has to be established by a long drawn process of reasoning or where two opinions are possible. A decision on a debatable point of law cannot be treated as a "mistake apparent from the record".

28. <u>CIT vs. Tony Electronics (Delhi High Court)</u>

Limitation period u/s 154 (7) for rectification begins from date of appeal order

Facts / Issue :

S. 154 (7) provides that a rectification order can be passed within four years "from the end of the financial year in which the order sought to be amended was passed". The AO passed an assessment order u/s 143 (3) on **24.11.1998** in which he committed the mistake of reducing the depreciation instead of adding to the income resulting in double deduction. The assessee went up in appeal **on other issues** to the CIT (A) who decided the appeal on **28.6.2004**. The AO gave effect to the CIT (A)'s order vide order dated **23.7.2004**. The AO thereafter passed an order u/s 154 dated **26.4.2006** by which he rectified the mistake committed in the order dated 24.11.1998. On the question whether the said order was barred by limitation, the Tribunal decided the issue in favour of the assessee on the ground that the rectification order was passed beyond four years.

<u>HELD:</u>

(1) Under the **Doctrine of Merger**, once an appeal against the order passed by an authority is preferred and is decided by the appellate authority, the order of the said authority merges into the order of the appellate authority. **With this merger, the order of the original authority ceases to exist and the order of the appellate authority prevails, in which the order of the original authority is merged**. For all intent and purposes, it is the order of the appellate authority that has to be seen;

(2) The word "order" in s. 154 (7) has not been qualified in any way and it does not mean only the original order but includes the appeal – effect order.

(3) On facts, **the assessment order dated 24.11.1998 merged in the CIT (A)'s order dated on 28.6.2004**. This date had to be considered for computing the limitation period of four years. **The fact that the error sought to be rectified occurred in the original assessment order and was not subject matter of appeal is irrelevant**.

On Reassessment Proceedings u/s 147 and 148

29. CIT vs. Kelvinator of India [320 ITR 561(SC)]

AO deemed to have applied his mind if facts are on record and reopening on change of opinion is not permissible even within 4 years

In **CIT vs. Kelvinator of India Ltd**. 256 ITR 1 the Full Bench of the Delhi High Court was considering a case of reopening u/s 147 within 4 years from the end of the assessment year. The Court held that when a regular order of assessment is passed in terms of section 143 (3) of the Act, **a presumption can be raised that such an order has been passed on application of mind. It was held that if it be held that an order which has been passed purportedly without application of mind would itself confer jurisdiction upon the Assessing Officer to reopen the proceeding without anything further, the same would amount to giving premium to an authority exercising quasi-judicial function to take benefit of its own wrong. It was held that section 147 of the Act does not postulate conferment of power upon the Assessing Officer to initiate reassessment proceedings upon a mere change of opinion**. On appeal by the department to the Supreme Court, HELD dismissing the appeal:

Though the power to reopen under the amended s. 147 is much wider, one needs to give a schematic interpretation to the words "reason to believe" failing which s. 147 would give **arbitrary powers to the AO to re-open assessments on the basis of "mere change of opinion", which cannot be per se reason to re-open**. One must also keep in mind the conceptual difference between power to review and power to re-assess. The AO has no power to review; he has the power to re-assess. But **re-assessment has to be based on fulfillment of certain pre-condition and if the concept of "change of opinion" is removed, as contended on behalf of the Department, then, in the garb of re-opening the assessment, review would take place**. **One must treat the concept of "change of opinion" as an in-built test to check abuse of power by the AO**. Hence, after 1.4.1989, the AO has power to re-open, provided there is "**tangible material**" to come to the conclusion that there is escapement of income from assessment. Reasons must have a live link with the formation of the belief. This is supported by Circular No.549 dated 31.10.1989 which clarified that the words "reason to believe" did not mean a change of opinion.

30. Bhavesh Developers vs. AO (Bombay High Court)

Reopening u/s 147 not valid if there is no finding regarding failure to disclose material facts

Facts / Issue :

In AY 2002-2003, the assessee claimed deduction u/s **80-IB (10)** of Rs. 3.85 crs which was allowed by the AO vide s. 143 (3) order. The assessment was reopened u/s 147 after the expiry of four years from the end of the assessment year on the ground that the **claim for deduction u/s 80IB (10) included ineligible items of other income** such 'society deposit', 'stilt parking' and sundry credit balances and that income had thereby escaped assessment. The assessee filed a writ petition to challenge the s. 148 notice.

Held :

(i) **Under the proviso to s. 147, an assessment made u/s 143 (3) can be reopened after the expiry of 4 years from the end of the assessment year only if there is a failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment**;

(ii) On facts, the assessee had furnished details of the claim u/s 80IB (10) including the break up of the other income. **Even the recorded reasons showed that the inference that the income has escaped assessment was based on the disclosure made by the assessee itself. Further, there was no finding in the recorded reasons that that there was a failure to disclose necessary facts**;

(iii) **Accordingly, the condition precedent to a valid exercise of the power to reopen the assessment was absent. An exceptional power has been conferred upon the Revenue to reopen an assessment after a lapse of four years and the conditions prescribed by the statute for the exercise of such a power must be strictly fulfilled and in their absence, the exercise of power would not be sustainable in law**.

31. <u>Hindustan Unilever vs. DCIT (Bombay High Court)</u>

S. 147 reopening for rectifying s. 154 mistakes is invalid

The AO issued a notice u/s 148 to reopen the assessment within 4 years from the end of the assessment year. There were four recorded reasons and one of them was that the AO had committed a computational error in the assessment order by deducting the wrong figure instead of the right figure. The assessee filed a Writ Petition to challenge the reopening inter alia on the ground that as the mistake could be rectified u/s 154, the reopening was bad. HELD upholding the challenge:

(i) While Explanation 2 to s. 147 deems income to have escaped assessment if excessive deduction is allowed, **the reopening of an assessment u/s 147 has serious ramifications because the AO is empowered to reassess income even in respect of issues not set out in the notice**. Therefore, **if the power to rectify an order u/s 154(1) is adequate to meet a mistake or error in the order of assessment, the AO must take recourse to that power as opposed to the wider power to reopen the assessment**. If the error can be rectified u/s 154, it would be arbitrary for the AO to reopen the entire assessment u/s 147. Further, the error in the order was not attributable to a fault or omission on the part of the assessee and **the assessee cannot be penalized for a fault of the AO**;

(ii) When one or more modes of assessment or remedies are available to the taxing Authority, the Authority must adopt that remedy which causes least prejudice to the assessee.

32. Sadbhav Engineering vs. DCIT (Gujarat High Court)

Reopening beyond 4 years on basis of retrospective amendment not justified if assessee has not failed to disclose material facts

In respect of AY 2003-04, the assessee claimed deduction u/s 80IA (4) which was partly allowed by the AO vide assessment order passed u/s 143(3). Subsequently, a **retrospective amendment** was made to s. 80IA by the Finance (No. 2) Act, 2009 w.e.f 1.4.2000 to provide that **s. 80IA deduction would not be admissible to an assessee who carries on business which is in the nature of works contract**. After the expiry of 4 years from the end of the assessment year, the AO reopened the assessment u/s 147 to deny the deduction u/s 80IA in view of the retrospective amendment. The assessee challenged the reopening by a Writ Petition. The department argued that the **by virtue of the retrospective amendment, it had to be deemed that the assessee had submitted untrue facts at the relevant time** and that s. 147 was attracted. HELD allowing the Petition:

Under the first proviso to s. 147 where an assessment has been made u/s 143(3), the assessment cannot be reopened after expiry of four years from the end of the relevant assessment year unless if income has escaped assessment by reason of failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment. In the present case, **there was no failure on the part of the assessee to make a full and true disclosure of the material facts**. **The argument that in view of the retrospective amendment of section 80IB, it is deemed that the petitioner has failed to disclose the correct facts is not acceptable**. The question whether there is a failure to disclose all material facts is a matter of fact and there can be **no deemed failure** as contended by the department. Consequently, in the absence of any failure on the part of the assessee to make a full & true disclosure of material facts, the initiation of proceedings u/s 147 was vitiated and could not be sustained.

33. Ashoka Buildcon vs. ACIT (Bombay High Court)

Assessment order is not effaced in respect of items that are not subject of reassessment. Time limit for s. 263 begins from date of original order for such items

An assessment order u/s 143(3) was passed on 27.12.2006. A reassessment order u/s 147 was passed on 27.12.2007. A show-cause notice u/s 263 was issued by the CIT on 30.4.2009 in respect of issues that were not the subject matter of the reassessment order. The s. 263 notice was time-barred if reckoned from the date of the assessment order but was within time if reckoned from the reassessment order. The revenue urged that the time limit should be reckoned from the date of the reassessment order on the basis of **ITO vs. K.L. Srihari (HUF)** 250 ITR 193 (SC) where it was held that the reassessment order "made a fresh assessment of the entire income of the assessee" and "the original order stood effaced by the reassessment order". HELD rejecting the plea of the department:

(i) In **CIT vs. Alagendran Finance** 293 ITR. 1 (SC) it was held that the doctrine of merger does not apply where the subject matter of reassessment and original assessment is not one and the same. **Where the assessment is reopened on a specific ground and the reassessment is confined to that ground, the original assessment continues to hold the field except for those grounds on which a reassessment has been made**. Consequently, an appeal on the grounds on which the original assessment was passed and which does not form the subject of reassessment continues to subsist and does not abate. **The order of assessment is not subsumed in the order of reassessment in respect of those items which do not form part of the order of reassessment**;

(ii) Consequently, the time limit for exercise of power u/s s. 263 with reference to **issues which do not form the subject of the reassessment order commences from the date of the original order** and not the reassessment order;

(iii) The principle laid down in **K. L. Srihari** applies to a case where the subject matter of the original assessment as well as of the reassessment was the same and not to a case like **Alagendran Finance** where the subject matter of the original assessment and the reassessment were not the same;

(iv) The fact that under Explanation 3 to s. 147 inserted by the Finance (No.2) Act 2009 with retrospective effect from 1.4.1989 the AO can reassess even in respect of items that are not the subject-matter of the recorded reasons makes no difference to this principle of law.

34. Rallis India vs. ACIT (Bombay High Court)

Validity of s. 147 reopening has to be determined on the basis of law prevailing on date of issue of s. 148 notice and not on retrospectively amended law

In respect of AY 2004-05, the assessee computed its book profits u/s 115JB by claiming a deduction for provision for doubtful debts and advances and the same was allowed vide order u/s 143 (3). On 18.7.2008 (**within 4 years**), the AO issued a notice u/s 148 inter alia on the ground that the provision for doubtful debts had to be added back to the book profits. The assessee filed a writ petition to challenge the reopening. HELD allowing the Petition:

(i) U/s 115JB as it stood at the relevant time, the AO was authorized by cl (c) of Expl (1) to s. 115JB to add back "amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities". In **HCL Comnet Systems** 305 ITR 409 the Supreme Court held that a provision for doubtful debts was a provision for diminution in the value of the assets and did not fall under the said provision. To supercede this judgement, cl (i) was inserted in the Expl to s. 115JB by the FA 2009 w.r.e.f 1.4.2001 to provide that even amounts set aside as provision for diminution in the value of an asset had to be added to the book profits.

(ii) **The retrospective amendment was of no avail because it was enacted after the issue of the s. 148 notice**. In **Max India** 295 ITR 282, the SC held in the context of s. 263 that the validity of the revision order had to be determined on the basis of the law on the date the order was passed. **This principle is applicable to s. 147 as well and the validity of the reopening has to be determined on the basis of the law as it stands on the date of issue of the s. 148 notice**. As the retrospective amendment to s. 115JB was not and could not have formed the basis for reopening the assessment, the same could not be relied upon to justify the reopening. **The validity of the s. 148 notice must be determined with reference to the recorded reasons and the same cannot be allowed to be supplemented on a basis which was not present to the mind of the AO and could not have been so present on the date on which the power to reopen the assessment was exercised**. Consequently, the reopening was without jurisdiction.

35. Prashant S. Joshi vs. ITO (Bombay High Court)

Even if there is no assessment u/s 143 (3), reopening u/s 147 is bad if there are no proper "reasons to believe". AO cannot go beyond the recorded reasons

The assessee was a partner in a firm. Upon retirement, he received an amount of Rs. 50 lakhs in addition to the balance lying to his credit in the books of the firm in full and final settlement of his dues. The assessee filed a return in which the said amount was not offered to tax on the ground that it was a capital receipt. **No assessment order was passed**. The AO issued a notice for reopening u/s 148 on the ground that as in the assessment of the firm the amount paid by it to the assessee had been allowed as a revenue deduction, the amount received by the assessee had to be assessed as income. Reliance was also placed on ss. 28 (iv) & (v). The assessee filed a Writ Petition to challenge the reopening. HELD allowing the Petition:

(i) **The basic postulate which underlines s. 147 is the formation of the belief by the AO that income chargeable to tax has escaped assessment**. The AO must have reason to believe that such is the case before he proceeds to issue a notice u/s 147. **The reasons which are recorded by the AO for reopening an assessment are the only reasons which can be considered when the formation of the belief is impugned**. The recording of reasons distinguishes an objective from a subjective exercise of power. The requirement of recording reasons is a check against arbitrary exercise of power. **The validity of the reopening has to be decided on the basis of the reasons recorded and on those reasons alone**. **The reasons recorded while reopening the assessment cannot be allowed to grow with age and ingenuity, by devising new grounds in replies and affidavits not envisaged when the reasons for reopening an assessment were recorded**;

(ii) The only reason recorded by the AO was that as the firm had been held eligible to claim a deduction of the amount paid to the assessee, the amount received by the assessee was chargeable to tax. However, this is unsustainable because **the law is well settled that what the partner gets upon dissolution or retirement is the realization of a pre-existing right or interest which is not assessable to tax**. **Mohanbhai Pamabhai** 165 ITR 166 (SC) followed. Even u/s 45 (4) (which applies only where there is a distribution of assets on dissolution or otherwise), the gains are taxable in the hands of the firm and not in the hands of the partner. The amount received by the assessee is also not chargeable u/s 28 (iv) {value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of profession} and 28 (v) {any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from such firm}. **A payment made to a partner on dissolution does not fall u/s 28 (v)**;

(iii) Though in **Rajesh Jhaveri** 291 ITR 500 (SC) the Supreme Court held that the passing of an Intimation u/s 143 (1) does not amount to an "assessment" and in the absence of an assessment, there was no question of a "change of opinion", **the Court also held that there must be "reason to believe" i.e. "cause or justification" that income had escaped assessment**. There must be relevant material on which a reasonable person could have formed a requisite belief even though the material need conclusively prove the escapement;

(iv) Though **Explanation (2) (b) to s. 147** creates a deeming fiction of income having escaped assessment in cases where an assessment has not been made, the act of taking notice cannot be at the arbitrary whim or caprice of the AO but **must be based on a reasonable foundation**. Though the sufficiency of the evidence or material is not open to scrutiny by the Court, the existence of the belief is the sine qua non for a valid exercise of power;

(v) On facts, it was impossible for any prudent person to form a reasonable belief that the income had escaped assessment. Consequently, the s. 148 notice was quashed

36. Hynoup Food and Oil Industries Ltd. v. ACIT 307 ITR 115 (Guj.)

Facts

For the A.Ys. 1990-91 and 1991-92 the Assessing Officer issued notices u/s.148 for reopening the assessments. But the Assessing Officer who had issued the notice was different from the officer who had recorded the reasons.

Held

On a writ petition filed by the assessee challenging the validity of the notice u/s.148, the Gujarat High Court quashed the notice and held as under :

> "(i) The opening portion of S. 147 of the Income-tax Act, 1961, stipulates that action may be initiated if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year. This provision must be read in conjunction with S. 148(2) of the Act which mandates that the Assessing Officer shall, before issuing any notice u/s.148 of the Act, record his reasons for issuing the notice. It is, therefore, clear that the officer recording the reasons u/s.148(2) and the officer issuing notice u/s.148(1) has to be the same person.
>
> (ii) In the instant case, the officer who had issued the notice u/s.148 was different from the officer who had recorded the reasons and hence, the notices for both these years were invalid and deserved to be quashed."

37. CIT v. Shri Ram Singh 217 CTR 345 (Raj.)

Facts

In the course of search of some business establishment, a diary was found, which showed some entry regarding purchase of plot of land by the assessee for a consideration of Rs.1,66,000, while in the agreement it was shown to have been purchased for Rs.45,000. On this basis the Assessing Officer issued notice u/s.148. In the course of the reassessment proceedings the Assessing Officer was satisfied with the source of investment in land and no addition was made on that count. However, in the course of reassessment proceedings the Assessing Officer found that during the relevant year the assessee had made deposits of Rs.1,65,000 cash, for which there was no explanation. He therefore made an addition of Rs.1,65,000 and completed the reassessment proceedings. The Tribunal found that the Assessing Officer has accepted the investment in the plot of land which was the very basis of reopening. The Tribunal held that when the very base of the reopening goes, the reason for reopening also goes. The Tribunal, therefore, held that the action taken by the Assessing Officer is illegal and accordingly quashed the reassessment order.

Held

On appeal by the Revenue, the Rajasthan High Court upheld the decision of the Tribunal and held as under :

"Once the Assessing Officer came to the conclusion that the income with respect to which he had entertained 'reason to believe' to have escaped assessment, was found to have been explained, his jurisdiction came to a stop at that. He did not continue to possess jurisdiction to put to tax any other income, which subsequently came to his notice in the course of reassessment proceedings, which was found by him to have escaped assessment."

38. **Star Television News Ltd. v. UOI (Bom.)**

The Finance Act, 2007, amended S. 245D(4A) and S. 245HA to provide that if in respect of a settlement application filed before 1-6-2007, the Settlement Commission did not pass a final order before 31-3-2008, the proceedings would abate. In a group of writ petitions the constitutional validity of the said amendment was challenged. The Bombay High Court allowed the petitions and held as under :

"(i) The fixing of the cut-off date u/s.245D(4A)(i), the abatement of proceedings u/s.245HA(1)(iv) and the making available of confidential information u/s.245HA(3) for no fault of the applicant are *ultra vires* the Constitution. In order to save these provisions from being struck down as being unconstitutional, they will have to be read down as applying only to cases where the Settlement Commission is unable to pass an order on or before 31-3-2008 for any reasons attributable on the part of the applicant.

(ii) Accordingly, the Settlement Commission has to consider whether the proceedings have been delayed on account of any reasons attributable on the part of the applicant. If it comes to the conclusion that it is not so, then it has to proceed with the application as if not abated.

(iii) The Government shall consider appointment of more benches of the Settlement Commission if it desires early disposal of pending applications."

39. **B. M. Malani vs. CIT (Supreme Court)**

Where pursuant to action u/s 132, the assessee made a declaration of income u/s 132 (4) and opted to pay taxes from out of the seized shares and securities and requested that the shares be expeditiously disposed of and the sale proceeds there from be appropriated towards taxes and the revenue did not act on this request and thereafter the assessee applied for waiver of interest under section 220(2A) on the ground that the failure of the department to sell the shares had caused "genuine hardship", HELD:

(i) Levy of interest is for compensating the revenue from loss suffered by non-deposit of tax by the assessee within the time specified therefor. This principle should also be applied for determining whether any hardship had been caused or not. A genuine hardship means a genuine difficulty. It cannot be concluded that a person having large assets would never be in difficulty as he can sell those assets and pay the amount of interest levied.

(ii) A person cannot take advantage of his own wrong. A statutory authority on receipt of a request from the assessee top sell the shares could not have kept mum and should have taken action and responded to the prayer of the assessee. It would have been in the interests of the revenue to do so;

(iii) U/s 220 (2A), the CIT has the discretion not to waive interest but that discretion must be judiciously exercised. He has to arrive at a satisfaction that the three conditions laid down therein have been fulfilled before passing an order waiving interest.

(iv) As the issue had not been considered by the CIT in the proper perspective, matter remanded.

40. ACIT vs. Saurashtra Kutch SE (Supreme Court)

The non-consideration of a decision of jurisdictional Court or of the Supreme Court is a "mistake apparent from the record" irrespective of whether such decision was rendered prior or subsequent to the rectification.

Where the Tribunal had dismissed the appeal filed by the assessee by holding that it was not entitled to exemption u/s 11 and subsequently, on an application filed by the assessee u/s 254(2), recalled the said order on the ground that it had not considered a judgement of the jurisdictional High Court and that there was a mistake apparent from the record and the question arose whether such recall was justified, HELD, upholding the order of the Tribunal:

(i) A mistake apparent from the record is one that is patent, manifest and self-evident and which does not require elaborate discussion of evidence or argument to establish it;

(ii) The non-consideration of a decision of jurisdictional Court or of the Supreme Court is a "mistake apparent from the record" irrespective of whether such decision was rendered prior or subsequent to the rectification;

(iiii) A judicial decision acts retrospectively because it is not the function of the Court to pronounce a `new rule' but to maintain and expound the `old one'. Judges do not make law; they only discover or find the correct law. A subsequent decision which alters the earlier one has to be applied retrospectively;

41. Kvaerner John Brown vs. CIT (Supreme Court)

Jurisdiction u/s S. 143(1)(a) and 143 (1A) is confined to making "prima facie" adjustments. When there are conflicting judgments on interpretation of Section 80-O, it is not permissible to make "prima facie" adjustments u/s 143(1)(a) and consequently additional tax u/s 143(1A) is not payable.

42. Sahara India vs. CIT (Supreme Court) (Larger Bench)

Recourse to s. 142 (2A) cannot be had by the AO merely to shift his responsibility of scrutinizing the accounts of an assessee and pass on the buck to the special auditor.

(i) Before dubbing the accounts to be complex or difficult to understand, there has to be a genuine and honest attempt on the part of the AO to understand accounts maintained by the assessee; appreciate the entries made therein and in the event of any doubt, seek explanation from the assessee. The opinion must be based on objective criteria and not on the basis of subjective satisfaction. Recourse to s. 142 (2A) cannot be had by the AO merely to shift his responsibility of scrutinizing the accounts of an assessee and pass on the buck to the special auditor.

(ii) The CIT has a very heavy duty to see that the requirement of the previous approval is not an empty ritual. Before granting approval, the CIT must have the material on the basis whereof an opinion has been formed by the AO. The approval must reflect application of mind.

(iii) While there is no general rule of universal application as to the applicability of the principle of natural justice the requirement of giving reasonable opportunity of being heard before an order is made, is generally read into the provisions of a statute, particularly when the order has adverse civil consequences for the party affected unless a statutory provision either specifically or by necessary implication excludes the application of principles of natural justice. This principle holds good irrespective of whether the power conferred on a statutory body or tribunal is administrative or quasi-judicial.

(iv) The exercise of power under S.142 (2A) leads to serious civil consequences and, therefore, even in the absence of express provision for affording an opportunity of pre-decisional hearing to an assessee the requirement of observance of principles of natural justice is to be read into the said provision.

43. K.C.C. Software Ltd vs. DIT (Inv.) (Supreme Court)

Cash in bank is conceptually different from cash in hand. It is not permissible for the Revenue to withdraw money from the attached bank accounts. However, as the order u/s 132B was not challenged, no relief given. Directions given for deposit of seized moneys in fixed deposit.

44. CCE vs. Hongo India (SC – Larger Bench)

High Court has no power to condone delay in filing appeals

Where s. 35G of the Central Excise Act (= 260A of the I. T. Act) provided a time limit of 180 days for filing an appeal and there was no provision for condoning delay by showing sufficient cause after the prescribed period, there was complete exclusion of section 5 of the Limitation Act and the High Court had no power to condone the delay after expiry of the prescribed period. Even otherwise, the legislature had provided sufficient time for filing a reference to the High Court which was more than the period prescribed for an appeal and revision.

45. <u>CIT v. M/s. Grasim Industries Ltd. (Bom.)</u>

<u>Held</u>

In this Notice of Motion the Revenue was seeking condonation of delay in filing the appeal u/s.260A of the Income-tax Act, 1961.

Following the judgment of the Supreme Court in *Chaudharana Steels (P) Ltd v. CCE,* (2009) 238 ELT 705 (SC) the Bombay High Court held that the High Court had no power to condone delay in filing appeal u/s.260A of the Act.

Trusts

46. Whether the Tribunal was right in negating the assessee's claim for accumulation of unspent income?

Bharat Krishak Samaj v. Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del)

Relevant Section: 11

The assessee, a society registered under section 12A of the Income-tax Act, 1961, filled in Form No. 10 provided under the Income-tax Rules, 1962, and submitted it to the Assessing Officer along with its resolution, seeking permission to accumulate unspent funds under section 11(2) of the Act for the objects of the trust. The Assessing Officer was of the view that the objects for which accumulation was sought were not particularised inasmuch as they covered the entire range of objects of the trust. On this basis, the Assessing Officer denied the benefit of accumulation to the assessee. This was upheld by the Tribunal.

The High Court held that it is not necessary for a charitable trust to particularise each and every object for which accumulation is sought. It is enough if the assessee seeks accumulation for the objects of the trust. Hence, the assessee had sought to accumulate the sum for purposes of the trust and had specified such objects. It was therefore, entitled to accumulate the sum under section 11.

47. Whether repayment of borrowed funds utilised for construction of commercial complex augmenting income of trust and amounts to application of income for charitable purpose eligible for exemption under section 11?

Director of Income-tax (Exemption) v. Govindu Naicker Estate (2009) 315 ITR 237 (Mad.)

Relevant Section: 11

During the assessment under section 143(3) of the Act, the Assessing Officer noted that, the trust had made part repayment of a loan taken from the bank for constructing a multi-storied building. The Assessing Officer opined that the multi-storied commercial complex was not one of the objects of the trust and the expenditure incurred for the construction of the building could not be treated as charitable in nature, that the repayment of loan could not be regarded as application of income towards the charitable objects of the trust and rejected the claim of the assessee. The Commissioner (Appeals) allowed the appeal on the ground that the property of the trust was in a dilapidated condition and fresh construction had to be undertaken by obtaining a loan. The subsequent letting out of the property was connected with the carrying out of the objects of the trust and hence, the repayment of loan ought to have been treated as eligible application. The finding of the Commissioner (Appeals) was confirmed by the Tribunal.

The High Court held that the Tribunal was right in holding that the repayment of loan taken from the bank for construction of commercial complex was application of income for charitable purposes and the assessee-trust was eligible for exemption under section 11 of the Act. Even though the expenditure incurred is capital in nature, if the expenditure is incurred for the purpose of promoting the object of the trust, it could be considered as application of the income for the purpose of the trust. If the application of the income resulted in the maintenance of the property held under trust for charitable purpose, is for the purpose of augmenting income in order to pursue the objects of the trust that would amount to application of income for the purpose of the trust.

48. Whether the Tribunal has erred in law in holding that the assessee carried on activity for charitable purpose in terms of section 2(15) and directing the Commissioner of Income-tax to grant registration under section 12AA of the Act to the assesseesociety?

CIT v National Institute of Aeronautical Engineering Educational Socieity (2009) 315 ITR 428 (Uttarakand)

Relevant Section: 12AA

The assessee, a registered society, moved an application before the Commissioner for grant of registration under section 12AA(1)(b)(i) of the Act, in Form 10A. The Commissioner examined the papers including the income and expenditure of the assessee for the previous years and concluded that the assessee was not carrying on any charitable activity within the meaning of section 2(15) of the Act, as it was in a profit making business. Consequently, he

rejected the application for registration under section 12AA of the Act. The assessee preferred an appeal before the Appellate Tribunal, which was allowed.

The High Court held that section 12AA of the Act provides the procedure for registration. Clause (a) of sub-section (1) of section 12AA empowers the Commissioner to call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of the activities of the trust or institution and he may also make such inquiries, as he may deem necessary in this behalf. The Commissioner is not supposed to allow registration with blind eyes. The Commissioner had considered the relevant papers before him, which included the income and expenditure accounts of the previous years after the assessee society got registered with the Assistant Registrar of Firms, Societies and Chits. The Commissioner observed that the society was charging substantial fees from the students and making huge profits. Merely imparting education for the primary purpose of earning profits could not be said to be a charitable activity. In the expression "charitable purpose", "charity" is the soul of the expression. Mere trade or commerce in the name of education cannot be said to be a charitable purpose and the Commissioner has to satisfy itself as provided under section 12AA of the Act before allowing the registration. The order of the Commissioner was justified.

TDS

49. CIT vs. Eli Lilly [178 Taxman 505 (SC)]

TDS on foreign salary is required even though assessee is not the payer

Where the assessee-employer obtained expatriate-employees from a foreign company and the said employees, continuing to be employees of the foreign company, received salary and allowance in their home country in foreign currency and the question arose whether the assessee was obliged to deduct tax thereon at source u/s 192 and the High Court held that the assessee was not obliged to deduct tax at source on the ground that the payment was by the foreign company and not by the assessee, HELD, reversing the High Court that:

(i) Though the payment of salary to the expatriate was made by the foreign company outside India, the TDS provisions did apply as the Act had extra-territorial operation as there was a nexus between the said salary and the rendering of services in India;

(ii) U/s 9 (1) (ii), salary received abroad is deemed to arise in India if it is for services rendered in India. This charging provision has to be read with the machinery provision of s.192 and both are part of an integrated code;

(iii) S. 192 requires the employer to deduct tax after "estimating" the salary payable to the employee. The act of "estimation" is akin to computation of income. In making the estimate, s. 9 (1) (ii) has to be taken into account;

(iv) On facts, as it was found that the salary paid by the foreign company was for services in India the same was deemed to accrue in India u/s 9 (1) (ii) and the assessee ought to have deducted tax u/s 192 though it was not the payer;

(v) Levy of interest u/s 201 (1A) is mandatory and has to be calculated from the date of default to the date of payment either by the assessee or the payee-employee;

(vi) However, levy of penalty u/s 271C is not mandatory or compensatory or automatic. Penalty can be levied only if there is no good and sufficient reason for the failure to deduct tax at source. On facts, as the issues were controversial and the assessees acted bona fide, penalty could not be imposed.

50. <u>CIT v. Sahib Chits (Delhi) (P) Ltd. [226 CTR 119 (Del.)]</u>

Distribution of bid amount or discount allotted to the subscriber of the chit is not interest as there is no money borrowed or debt incurred and therefore there is no question of deducting tax at source u/s.194A.

The assessee is a chit fund company. The assessee had not deducted tax at source on the amounts paid to its members on the chits contributed by them. The AO held that there was default on the part of the assessee company for not deducting tax u/s.194A of the Income-tax Act, 1961. Therefore, the AO passed order u/s.201 and quantified the default amount at Rs.8,17,683. CIT(A) and the Tribunal quashed the order.

On appeal by the Revenue, the following two questions were raised :

"(a) Whether the Tribunal was correct in law in holding that the assessee had not paid any interest to the subscribers of the chit and such payment does not fall within the meaning of interest as defined u/s.2(28A) of the Act ?

(b) Whether the Tribunal was correct in law in holding that the assessee was not required to deduct the tax at source within the meaning of S. 194A of the Act and as such the assessee was not in default u/s.201 of the Act ?"

The Delhi High Court upheld the decision of the Tribunal and held as under :

“Distribution of bid amount or discount allotted to the subscriber of the chit is not interest as there is no money borrowed or debt incurred and therefore there is no question of deducting tax at source u/s.194A."

51. CIT vs. Singapore Airlines (Delhi High Court)

TDS required even on commission retained by agent

Where the assessee-airline supplied blank tickets to the travel agent, on terms that the same be sold at a minimum price and the difference between the said minimum price and the price at which the tickets were sold to the passenger was retained by the travel agent and the question arose whether the amount so retained by the agent was “commission” and whether the assessee was required to deduct tax thereon u/s 194-H of the Act, HELD, reversing the decision of the Tribunal:

(a) The relationship between the airline and the travel agent was that of a **principal and agent** as all the requirements of s. 182 of the Contract Act were fulfilled by the PSA. By the acts of the travel agent, a legal relationship was created between the airline and the passenger;

(b) The monies retained by the travel agent in the form of supplementary commission is not a "**discount**" because the travel agent never obtains proprietary rights to the tickets and has never paid a "price" for the same. Instead, the same is "**commission**" because it is received for services rendered on behalf of the assessee-airline and the airline ought to have deducted tax u/s 194-H;

(c) The argument that the assessee-airline is unable to deduct tax at source since it is unaware of the commission retained by the agent till a billing analysis is done is not acceptable because once an obligation is cast, it is for the assessee-airline to retrieve the necessary information from the travel agent and put itself in a position to deduct tax. **The assessee cannot take up the stand that the machinery for deduction of tax has failed**;

(d) However, in respect of the issue of "concessional" tickets to the agents, the difference between the full value and the concessional price was not "commission" because though it was a reward for services, title to the ticket passes to the agent and the relationship was that of a principal to principal. The difference was a "discount".

52. <u>CIT vs. ITI Ltd [183 Taxman 219 (SC)</u>

Employer not required to check proof when deducting TDS u/s 192

Where the assessee-employer allowed the employees the benefit of deduction under section 10 (5) of the Act without collecting evidence to show that its employees had actually utilized the amounts paid towards Leave Travel Concessions/Conveyance Allowance and the question arose whether the employer could be said to have wrongly allowed the deduction, HELD:

As the beneficiary of exemption under Section 10(5) is an individual employee and there is no circular of the Central Board of Direct Taxes (CBDT) requiring the employer under Section 192 to collect and examine the supporting evidence to the Declaration to be submitted by an employees, the employer was not at fault.

53. <u>CIT v. M/S. LARSEN & TOUBRO LTD. 314 ITR 81(SC)</u>

Employer not required to check proof when deducting TDS u/s 192

Where the assessee-employer allowed the employees the benefit of deduction under section 10 (5) of the Act without collecting evidence to show that its employees had actually utilized the amounts paid towards Leave Travel Concessions/Conveyance Allowance and the question arose whether the employer could be said to have wrongly allowed the deduction, HELD:

As the beneficiary of exemption under Section 10(5) is an individual employee and there is no circular of the Central Board of Direct Taxes (CBDT) requiring the employer under Section 192 to collect and examine the supporting evidence to the Declaration to be submitted by an employees, the employer was not at fault.

54. <u>Bapusaheb Nanasaheb Dhumal vs. ACIT (Mumbai ITAT)</u>

Default u/s 194C does not result in s. 40(a)(ia) disallowance if TDS paid before due date of filing ROI

The assessee made payments to sub-contractors during the previous year and though s. 194C requires TDS at the stage of payment/credit, did not do so. The tax was, however, deducted on 31st March and paid over in Sept before the due date for filing the return. The AO took the view that while the payment made to the sub-contractor for March was allowable, the payments for the earlier months was disallowable u/s 40(a)(ia). This was confirmed by the CIT (A). On appeal by the assessee, HELD allowing the appeal:

Failure to deduct or deposit tax as per s. 194C or Chapter-XVII makes the assessee liable to the consequences provided under the said Chapter-XVII. However, **s. 40(a)(ia) is in addition to Chapter XVII**. S. 40(a)(ia)(A) provides that if tax is deducted during the last month of the previous year and paid on or before the due date of filing of return as per s. 139(1), then such sum shall be allowed as deduction. In cases where tax is deducted other than the last month of previous year but is deposited before the last day of the previous year, then it will be allowed as deduction. Therefore, **the conditions for allowability of deduction are prescribed u/s 40(a)(ia) itself and Chapter-XVII and s. 194C are not relevant**. If the condition of deduction and payment prescribed u/s 194C / Chapter XVII are held applicable for disallowance of deduction u/s 40(a)(ia), then **s. 40(a)(ia) will be rendered meaningless, absurd and otiose**. Since the assessee had (belatedly) deducted tax in the last month of the previous year i.e. March 2005 and deposited the same before the due date of filing the return u/s 139(1), deduction had to be allowed u/s 40(a)(ia) (A).

55. <u>CIT vs. Glenmark Pharmaceuticals [191 Taxman 495 (Bombay)]</u>

Tests laid down to determine when contract manufacturing will amount to a contract of sale for S. 194C TDS

The assessee entered into an agreement with a third party for the manufacture of certain pharmaceutical products under which it provided the formulations and specifications and the manufacturer affixed the trademark of the assessee on the articles produced. The raw materials were purchased by the manufacturer and property in the goods passed to the assessee only on delivery. The agreement was on a principal to principal basis. The AO took the view that the contract was a contract of 'work' and tax was deductible at source u/s 194C though the Tribunal upheld the contention of the assessee that the contract involved a sale and did not represent a 'contract for work' u/s 194C. On appeal by the Revenue, HELD dismissing the appeal:

(i) A contract for sale has to be distinguished from a contract of work. **If a contract involves the sale of movable property as movable property, it would constitute a contract for sale**. On the other hand, if the contract primarily involves carrying on of work involving labour and service and the use of materials is incidental to the execution of the work, the contract would constitute a contract of work and labour;

(ii) The argument of the Revenue that **the restrictions imposed on the manufacturer** to (a) utilise the formula provided by the assessee, (b) affix the trade-mark of the assessee, (c) manufacture as per specifications provided by the assessee and (iii) deal exclusively with the assessee show that the contract is not one of sale is not acceptable because this has not been the understanding of the law at any point of time even by the CBDT and judicial precedents;

(iii) **Though a product is manufactured to the specifications of a customer, the agreement would constitute a contract for sale, if (i) the property in the article passes to the customer upon delivery and (ii) the material that was required was not sourced from the customer / purchaser, but was independently obtained by the manufacturer from a third party**;

(iv) This position is now statutorily recognized in Expl. (e) to s. 194C inserted by the FA 2009 to provide that **the expression 'work' shall not include manufacture or supply of a product according to the requirement or specification of a customer by using material which is purchased from a person other than such customer**;

(v) On facts, as (i) the agreement was on a principal to principal basis, (ii) the manufacturer had his own establishment where the product was manufactured, (iii) the materials required in the manufacture of the article or thing was obtained by the manufacturer from a person other than the assessee and (iv) the property in the articles passes only upon the delivery of the product manufactured, the contract was one of "sale" and there was no obligation to deduct tax u/s 194C. **The fact that the assessee imposed restrictions on the manufacturer as to quality of the goods, user of trade marks etc are merely matters of business expediency**.

Miscellaneous

56. CIT V. PRANOY ROY ANR ANOTHER & INDIA METERS LTD. 309 ITR 231 (SC)

Levy of interest u/s 234A – HC held that interest would be payable in a case, where tax has not been deposited prior to the due date of filing of the income-tax return. - High Court is justified in holding that that interest is not a penalty and that the interest is levied to compensate the revenue - Since the tax due had already been paid which was not less than the tax payable on the returned income which was accepted, the question of levy of interest does not arise – this appeal is dismissed

57. Whether the refund collected illegally by the assessee by producing bogus TDS certificates can be treated as income of the assessee?

CIT v. K. Thangamani (2009) 309 ITR 015 (Mad.)

The expression income in section 2(24) of the Income-tax Act, 1961 is wide and the object of the Act being to tax income it has to be given an extended meaning. Any kind of income earned by the assessee attracts income-tax at the point of earning and tax law is not concerned with the ultimate event how the income is expended. The Act makes an obligation to pay tax on all income received. The Act considers income earned legally as well as tainted income alike.

The assessee was engaged in tax consultancy and audit work. During the search conducted at the residential premises and office of the assessee certain incriminating documents were seized. From the documents seized it was revealed that the assessee had been claiming and receiving income-tax refunds by filing bogus TDS certificates with returns of income prepared by him even in the names of non-existing persons. The Assessing Officer treats the deposits, being the TDS certificates encashed by the assessee during the previous year, as professional income during the previous year. The Commissioner (Appeals) reduced the income on account of the refunds received by him and held it taxable under residuary head instead of Profession. The Tribunal held that the amount of refunds received by the assessee by fraudulent means could not be assessed as income of the assessee.

The High Court held that when the Tribunal found that the assessee had indulged in fabricating TDS certificates and got refunds from the Department it should not have come to the conclusion that such income was not taxable.

58. Can the expenditure incurred after the setting up of the business but before the commencement of the business, be allowed as a permissible deduction?

CIT v. Hughes Escorts Communications Ltd. (2009) 311 ITR 253 (Del)

A plain reading of section 2(34) of the Income-tax Act, 1961, shows that for a new business the previous year is the period beginning with the date of setting up of the business. There is a distinction between setting up and commencement of a business. There may be an interregnum, there may be an interval between a business which is set up and a business which is commenced and all expenses incurred during the interregnum after the setting up of the business and before the commencement of the business, all expenses would be permissible deductions.
The assessee carried on the business of satellite business communications for which very small aperture terminal VSAT equipment is used. The VSAT can be used only after establishing, maintaining and using the communication facilities on a licence from the Department of Telecommunications. The assessee made an application to the Department of Telecommunications for grant of such licence and entered into a licence agreement on August 1994, with the Department of Telecommunications. The assessee placed a purchase order dated July 1994, with H, USA for the purchase of the VSAT equipment. In its return, the assessee claimed an expenditure of Rs.28,96,269. The Assessing Officer rejected the claim on the ground that the assessee had begun receiving the satellite signals only in the month of February and further since the installation was complete only on March, it could be said that the business of the assessee had been set up only on March. The Tribunal, however, allowed the assessee's claim.

The High Court held that the business of the assessee involved different activities in which the first step was the purchase of the VSAT equipment. The purchase order was placed on July. The application to the Department of Telecommunications for licence and the receipt of the satellite signals were the consequential stages. The signals were to be received after the VSAT equipment was installed in the premises of the customer. In the circumstances, the business of the assessee should be held to have been set up on July. This was the relevant date for determining the nature of the expenses incurred thereafter. The expenses incurred in the previous year, prior to the commencement of the business but after the setting up its business, which two dates need not be the same, would be deductible as revenue expenditure.

59. Khoday Distilleries vs. CIT (Supreme Court)

Where the department held that on the Company allotting rights and bonus shares to its shareholders in a disproportionate manner, it had made a "gift", HELD, rejecting the contention that:

(i) An allotment of shares is a "creation" of shares and not a "transfer" of shares. There is a vital difference between the two. An "allotment" is the creation of shares by appropriation out of the unappropriated share capital to a particular person. A share is a chose in action. A chose in action implies existence of some person entitled to the rights in action in-contradistinction from rights in possession. There is a difference between issue of a share to a subscriber and the purchase of a share from an existing shareholder. The first case is that of creation whereas the second case is that of transfer of chose in action. An allotment is not a transfer and does not attract s. 4(1)(a) of the Gift-tax Act.

(ii) The issuance of bonus shares was nothing but mere capitalisation of the profits of the Company in respect of which certificates are issued to the shareholders entitling them to participate in the amount of the reserve but only as part of the capital. When a shareholder gets a bonus share the value of the original share held by him goes down. In effect, the shareholder gets two shares instead of the one share held by him and the market value as well as the intrinsic value of the two shares put together will be the same or nearly the same as the value of the original share before the bonus issue. The issuance of bonus shares does not amount to distribution of accumulated profit of a company. It would be a misnomer to call the recipients of bonus shares as donees of shares from the company.

60. CIT vs. Panchratna Hotels (HP High Court)

<u>No "succession of business" u/s 170 even on 100% sale of shares</u>

Facts / Issue:

170 provides that where there is a "succession of business", the predecessor has to be assessed in respect of the income upto the date of succession and the successor has to be assessed thereafter. 100% of the assessee's shares were sold by the existing shareholders to another person. The CIT in revision took the view that the result of the said transfer of shares was that there was a "succession" and that the loss incurred prior to the date of succession could not be allowed to the "successor" assessee. The assessee's appeal was allowed by the Tribunal.

Held

(1) The term "succession" in s. 170 has a somewhat artificial meaning. The tests of change of ownership, integrity, identity and continuity of a business have to be satisfied before it can be said that a person "succeeded" to the business of another;

(2) Even if it is accepted that by a transfer of shares u/s 2(47), there is a transfer in the right to use the capital assets of the company, still **s. 170 is not attracted because there is no "transfer of business"**. **A company is a juristic person and owns the business. The share holders are not the owners of the company. By a transfer of the shares, there is no transfer so far as the company is concerned**

61. CIT vs. Reliance Utilities [314 ITR 340(Bombay)]

Advances to sister concerns must be presumed to have come out of own funds and not borrowed funds.

Where the assessee had its own funds as well as borrowed funds and it advanced funds to its sister concerns for allegedly non-business purposes and the question arose whether the AO was justified in disallowing the interest on the borrowed funds on the ground that they had been used for non-business purposes, HELD:

Where an assessee has his own funds as well as borrowed funds, a presumption can be made that the advances for non-business purposes have been made out of the own funds and that the borrowed funds have not been used for this purpose. Accordingly, the disallowance of the interest on the borrowed funds is not justified.

62. Perot Systems TSI vs. DCIT (ITAT Delhi)

Notional interest on interest-free loans is assessable under transfer pricing law

The assessee, an Indian company, advanced interest-free loans to its 100% foreign subsidiaries. The subsidiaries used those funds to make investments in other step-down subsidiaries. On the question whether notional interest on the said loans could be assessed in the hands of the assessee under the transfer pricing provisions of Chapter X, the assessee argued that the said "loans" were in fact "quasi-equity" and made out of commercial expediency. It was also argued that notional income could not be assessed to tax. HELD rejecting both arguments:

(i) The argument that the loans were in reality not loans but were quasi-capital cannot be accepted because the agreements show them to be loans and there is no special feature in the contract to treat them otherwise. There is also no reason why the loans were not contributed as capital if they were actually meant to be a capital contribution;

(ii) The argument that the loans were given on interest-free terms out of commercial expediency is not acceptable because this was not a case of an ordinary business transaction but was an international transaction between associated enterprises. **One had to see whether the transaction was at *arms length* under the transfer pricing provisions**;

(iii) **The argument that notional interest income cannot be assessed is not acceptable in the context of transfer pricing**. S 92(1) provides that any income arising from an international transaction has to be computed having regard to the arm's length price. S. 92B (1) defines an "international transaction" to mean "*a transaction between two or more associated enterprises … in the nature of … lending or borrowing money …*" **In considering the "arms length" price of a loan, the rate of interest has to be considered and income on account of interest can be attributed**;

(iv) **The result of the transaction was that the income of the assessee in India would reduce while that of the assessee in Bermuda, a tax haven, would increase. This was a classic case of violation of transfer pricing norms where profits were shifted to tax havens to bring down the aggregate tax incidence of a multi national group**;

(v) The Proviso to s. 92C (2) which allows a variation of 5% from the arms length price applies only when "*more than one price is determined*" and an arithmetic mean is adopted. The TPO had adopted the LIBOR rate of 2.39 and added the arithmetic mean of 'average basis point' charged by other companies which came to 1.64 and worked out the arms length price at LIBOR + 1.64%. As only one LIBOR rate has been applied which has been adjusted for some basis points, it cannot be said that "more one price" has been used so as to attract the Proviso.

63. CIT vs. Divine Leasing & Finance (Supreme Court)

The amount of share application money received by a Company from alleged bogus shareholders cannot be regarded as undisclosed income under S. 68 of I. T. Act for the simple reason that if the names of the alleged bogus shareholders are given to the AO, then the Department is free to proceed to re-open their individual assessments in accordance with law.

64. Dynamic Orthopedics vs. CIT (Supreme Court)

Issue whether MAT companies can provide depreciation as per Income-tax Rules while computing s. 115J book profits referred to Larger Bench.

The assessee, a private limited company, provided for depreciation in its Profit & loss account by adopting the rates specified in the Income-tax Rules and computed its "book profits" u/s 115J on that basis. The AO recomputed the book profits by adopting the depreciation rates as per Schedule XIV to the Companies Act as those were lower than the income-tax rates. The CIT (A) & Tribunal upheld the stand of the assessee on the ground that Schedule XIV was not applicable to a private limited company though the High Court took the view that s. 205 of the Companies Act stood incorporated into s. 115J and consequently depreciation had to be provided at the rates specified in Schedule XIV and not in terms of the Income-tax Rules. On appeal by the assessee, HELD doubting its own judgement in Malayala Manorama 300 ITR 251:

(i) The law laid down in **Malayala Manorama 300 ITR 251** {that (i) Schedule VI does not create any obligation to provide for any depreciation much less for depreciation at Schedule XIV rates, (ii) As per the Company Law Board Circular the rates in Schedule XIV are the minimum rates and a company can provide for higher rates and (iii) Schedule XIV itself contemplates that depreciation can be provided at rates different from the Schedule rates} needs re-consideration because s. 115J by a deeming fiction legislatively only incorporates provisions of Parts II and III of Schedule VI of the Companies Act and not sections 205, 350 or 355. Once a company, whether private or public, falls within the ambit of it being a MAT company, s. 115J applies and is required to prepare its Profit & loss account only in terms of Parts II and III of Schedule VI. By the Companies (Amendment) Act, 1988, the linkage between depreciation as per Rule 5 and the Companies Act have been expressly de-linked and the rates are also different.

(ii) If the judgement in Malayala Manorama is to be accepted, the very purpose of enacting s. 115J would stand defeated particularly when the said section does not make any distinction between public and private limited companies.

(iii) Accordingly, the matter needs re-consideration by a larger Bench of the Court.

Penalty

65. UOI vs. Dharmendra Textile (Supreme Court 3 Judges)

Wilful concealment is not an essential ingredient for attracting civil liability unlike the matter of prosecution under Section 276C.

Held by 3 Judge Bench in the context of Section 11AC of the Central Excise Act, 1944 {which corresponds to s. 271 (1) (c)} that:

(i) In **Dilip Shroff vs. JCIT**, the SC held that the order imposing penalty was quasi-criminal in nature and thus the burden lies on the department to establish that the assessee had consciously concealed his income. **This view is not correct**.

(ii) The object behind enactment of s. 271 (1) (c) read with Explanations indicate that the said section has been enacted to provide for a remedy for loss of revenue and they create the element of strict liability on the assessee for concealment or for giving inaccurate particulars while filing return. The penalty under that provision is a civil liability. Wilful concealment is not an essential ingredient for attracting civil liability unlike the matter of prosecution under Section 276C.

(iii) **Dilp N. Shroff**'s case (supra) has not considered the effect and relevance of s. 276C.

(iv) It cannot be said that the absence of specific reference to mens rea is a case of casus omissus. The law on two principles of construction – one relating to casus omissus and the other in regard to reading the statute as a whole has been considered in detail.

66. UOI vs. Rajasthan Spinning (Supreme Court)

Supreme Court explains UOI vs. Dharmendra Textile 306 ITR 277 (SC)

Held in the context of s. 11AC of the Excise Act (which provides that where any duty of excise has not been .. paid .. by reasons of fraud, collusion or any wilful mis-statement or suppression of facts ….. or contravention of any of the provisions of this Act … with intent to evade payment of duty, the person who is liable to pay duty as determined under sub-section (2) of section 11A, shall also be liable to pay a penalty equal to the duty so determined) that

(1) "At this stage, we need to examine the recent decision of this Court in **Dharamendra Textile** (supra). In almost every case relating to penalty, **the decision is referred to on behalf of the Revenue as if it laid down that in every case of non-payment or short payment of duty the penalty clause would automatically get attracted and the authority had no discretion in the matter**. One of us (Aftab Alam,J.) was a party to the decision in **Dharmendra Textile** and **we see no reason to understand or read that decision in that manner**."

(2) After quoting from **Dharmendra Textiles** "**we fail to see how the decision in Dharamendra Textile can be said to hold that section 11AC would apply to every case of non-payment or short payment of duty regardless of the conditions expressly mentioned in the section for its application**."

(3) "There is another very strong reason for holding that **Dharamendra Textile** could not have interpreted section 11AC in the manner as suggested because in that case **that was not even the stand of the revenue**."

(4) "The decision in **Dharamendra Textile** must, therefore, be understood to mean that though the **application of section 11AC would depend upon the existence or otherwise of the conditions** expressly stated in the section, **once the section is applicable in a case the concerned authority would have no discretion in quantifying the amount and penalty** must be imposed equal to the duty determined under sub-section (2) of section 11A. That is what **Dharamendra Textile** decides".

67. Reliance Petroproducts [322 ITR 158 (SC)]

S. 271 (1) (c) penalty cannot be imposed even for making unsustainable claims

The assessee claimed deduction u/s 36 (1) (iii) for interest paid on loan taken for purchase of shares. The AO disallowed the interest u/s 14A and levied penalty u/s 271 (1) (c) on the ground that the claim was unsustainable. The penalty was deleted by the appellate authorities. On appeal by the department to the Supreme Court, HELD dismissing the appeal:

(i) S. 271 (1) (c) applies where the assessee "has concealed the particulars of his income or furnished inaccurate particulars of such income". The present was not a case of concealment of the income. As regards the furnishing of inaccurate particulars, no information given in the Return was found to be incorrect or inaccurate. **The words "inaccurate particulars" mean that the details supplied in the Return are not accurate, not exact or correct, not according to truth or erroneous**. In the absence of a finding by the AO that any details supplied by the assessee in its Return were found to be incorrect or erroneous or false, there would be no question of inviting penalty u/s 271(1)(c).

(ii) The argument of the revenue that "submitting an incorrect claim for expenditure would amount to giving inaccurate particulars of such income" is not correct. By no stretch of imagination can the making of an incorrect claim in law tantamount to furnishing inaccurate particulars. **A mere making of the claim, which is not sustainable in law, by itself, will not amount to furnishing inaccurate particulars regarding the income of the assessee**. If the contention of the Revenue is accepted then in case of every Return where the claim made is not accepted by the AO for any reason, the assessee will invite penalty u/s 271(1)(c). That is clearly not the intendment of the Legislature.

(iii) The law laid down in **Dilip Shroff** 291 ITR 519 (SC) as to the meanings of the words "conceal" and "inaccurate" **continues to be good law** because what was overruled in **Dharmendra Textile Processors** 306 ITR 277 (SC) was only that part in **Dilip Shroff** where it was held that mens rea was an essential requirement for penalty u/s 271 (1)(c).

68. VIP Industries Ltd. 30 SOT 254 (Mum.)
69. Kanbay Software India Pvt. Ltd. 122 TTJ 721 (Pune)
70. Prem Chang Garg 31 SOT 97 (Delhi)(TM)
71. Haryana Warehousing Corporation ITA No.871 of 2008 (P&H)

72. CIT v. Reliance Industries Ltd. 308 ITR 82 (Guj.)

Facts

The assessee-company distributed free meal coupons to its employees. It had entered into an agreement with A for this purpose. The assessee-company did not deduct tax at source on the amount paid to A, on the ground that it did not constitute perquisite. The AO held that the coupons had been misused by some of the employees. He therefore estimated certain amount as being taxable perquisite in the hands of the employees and passed orders u/s.201, u/s.201(1A) and u/s.271C of the Income-tax Act, 1961 for default of non-deduction of tax at source on such estimated amount. The Tribunal held that the assessee had not committed any default.

Held

On appeal by the Revenue, the Gujarat High Court upheld the decision of the Tribunal and held as under :

"With regard to the free meal coupons the employer could not presume that a particular percentage of employees, out of the total work force, misused the facility so as to warrant deduction of tax at source. Furthermore, correspondingly such tax deducted at source had to be given credit in the assessment of the employee concerned and unless and until the tax deduction certificate specified the employee concerned there could be no corresponding credit given to the employee. The assessee could not be treated as being in default in respect of such sum."

73. Commnr. of Income Tax-I, Ahmedabad Versus Gold Coin Health Food Pvt. Ltd. 304 ITR 308 (SC).

Whether the penalty under Section 271 (1) (c) of the Income Tax Act, 1961 (in short the `Act') can be levied if the returned income is a loss – held that Explanation 4 to Section 271(1)(c) is clarificatory and not substantive – though penalty can be levied even if returned income is a loss the same can not be levied with retrospective effect - Decision of division bench of apex court Virtual Soft Systems Ltd. V. CIT overruled

Deductions

74. The Totgars' Cooperative vs. ITO (Supreme Court)

Interest on surplus funds is "other income" and not eligible for deduction u/s 80P

The assessee, a co-op credit society, was engaged in providing credit facilities to its members and also marketing the agricultural produce of its members. The assessee had surplus funds which it invested in short-term deposits with banks and govt securities. The question arose whether the said interest earned on the said deposits was "business profits" and eligible for deduction u/s 80P(2)(a)(i). The assessee argued that its activity of providing credit facilities to its members was an "eligible activity" u/s 80P(2)(a)(i) and that as the investments were made as per statutory requirement, the benefit was allowable from the gross total income. HELD deciding against the assessee:

(i) S. 80P(2)(a)(i) allows a deduction in the case of a co-op society engaged in carrying on the business of providing credit facilities to its members of the whole of the amount of profits and gains of business attributable to such activity. The words “profits and gains of business” means “business profits” and not “Income from other sources”;

(ii)The interest on surplus invested in short-term deposits, not being attributable to the business of providing credit facilities to the members or marketing of agricultural produce of the members, is assessable as “other income” and not as “business profits”;

(iii) The words “the whole of the amount of profits and gains of business” attributable to one of the activities specified in s. 80P (2)(a) mean that the source of income is relevant and that the income must be “operational income”.

75. Commissioner of Income Tax, Jaipur Versus Rajasthan Rajya Bunkar S. Samiti Limited

Deduction u/s 80P – Cottage industry - Assessee-Society is an Apex Society. It carries on the activity of manufacturing of cloth by supplying raw-material, i.e., yarn, to the weavers, who are the members of the primary societies, which, in turn, are the members of the Assessee-Society. The weavers produce cloth strictly in accordance with the directions given and under the control of the assessee. The assessee pays weaving charges to the weavers and thereafter markets and sells goods so produced. – whether the assessee can be said to be engaged in a Cottage Industry under Section 80P(2)(a)(ii) of the Act or whether it could be said to be engaged in the collective disposal of labour of its members under Section 80P(2)(a)(vi) of the Act – held that - on both these questions, the Assessing Officer ought to have called for the Bye-laws. It appears that Bye-laws were not produced before the Assessing Officer. It appears that the Bye-laws have not been examined by the Assessing Officer. Further, it is not clear as to whether a weaver could or could have become a member of the Apex Society under the Bye-laws. Even to answer the question whether the assessee-Society is engaged in the Cottage Industry, the Department ought to have called for the Bye-laws. This exercise has not been done – matter remanded.

76. Liberty India vs. CIT (Supreme Court)

DEPB and Duty Drawback are not eligible for deduction u/s 80-IB

The assessee claimed that profit from Duty Entitlement Passbook Scheme (DEPB) and Duty Drawback Scheme are "derived from the business of the Industrial Undertaking" and consequently eligible for deduction u/s 80-IB. On appeal by the assessee, HELD, rejecting the plea:

(1) The Act broadly provides for two types of tax incentives, namely, investment linked incentives and profit linked incentives. Ch VI-A essentially belongs to the category of "profit linked incentives";

(2) When ss. 80-IA/80-IB refer to profits derived from eligible business, **it is not the ownership of that business which attracts the incentives but the generation of profits (operational profits)**. It is for this reason that Parliament has confined deduction to profits derived from eligible businesses;

(3) **Each of the eligible business in sub-sections (3) to (11A) constitutes a stand-alone item in the matter of computation of profits**. That is the reason why the concept of "Segment Reporting" stands introduced in the Indian Accounting Standards (IAS) by the Institute of Chartered Accountants of India (ICAI);

(4) Ss. 80-IB/80-IA are a Code by themselves as they contain both substantive as well as procedural provisions. S. 80-IB allows deduction of profits and gains derived from the eligible business. **The words "derived from" is narrower in connotation as compared to the words "attributable to". By using the expression "derived from", Parliament intended to cover sources not beyond the first degree**;

(5) **Though the object behind DEPB etc is to neutralize the incidence of customs duty payment on the import content of export product DEPB credit/duty drawback receipt do not come within the first degree source** as the said incentives flow from Incentive Schemes enacted by the Government or from s. 75 of the Customs Act. Such incentives profits are not profits derived from the eligible business u/s 80-IB. They are 'ancillary profits' of such undertakings;

(6) Even as per AS-2 and the ICAI Guidance Note, duty drawback, DEPB benefits, rebates etc. cannot be credited against the cost of manufacture of goods but have to be shown as an independent source of income beyond the first degree nexus between profits and the industrial undertaking.

77. **Topman Exports vs. ITO (ITAT Mumbai Special Bench)**

For s. 80HHC r.w.s 28(iiid), only DEPB 'profits' to be reduced / added & not sale value

Expl. (baa) to S. 80HHC defines the term "profits of the business" to mean the profits under the head "profits and gains" as **reduced** by 90% of the sum referred to in s. 28 (iiid). The 2nd & 3rd Provisos to s. 80HHC (3) provide that the profits computed there under shall be **increased** by the said 90% amount computed in the proportion of export turnover to total turnover. S. 28 (iiid) refers to "any profit on the transfer of the Duty Entitlement Pass Book Scheme ('DEPB')". The Special Bench had to consider **whether the entire amount received on sale of DEPB entitlements represents 'profits' chargeable u/s 28 (iiid) or the profit referred to therein requires any artificial cost to be imputed**. HELD deciding in **favour of the assessee**:

(i) The argument of the Revenue that DEPB is a post export event and has no relation with the purchase of goods cannot be accepted. **There is a direct relation between DEPB and the customs duty paid on the purchases**. For practical purposes, DEPB is a reimbursement of the cost of purchase to the extent of customs duty;

(ii) **The DEPB benefit (face value) accrues and becomes assessable to tax when the application for DEPB is filed with the concerned authority**. Subsequent events such as sale of DEPB or making imports for self consumption etc are irrelevant for determining the accrual of the income on account of DEPB;

(iii) Though s. 28 (iiib) refers to a "cash assistance against exports", it is wide enough to cover the face value of the DEPB benefit;

(iv) S. 28 (iiid) which refers to the "**profits on transfer of the DEPB**" obviously refers only to the "**profit**" element and not the gross sale proceeds of the DEPB. If the Revenue's argument that the sale proceeds should be considered is accepted there would be absurdity because the face value of the DEPB will then get assessed in the year of receipt of the DEPB and also in the year of its transfer;

(v) Consequently, **only the "profit" (i.e. the sale value less the face value) is required to be considered for purposes of s. 80HHC**.

Capital v Revenue Expenditure

78. CIT v. Indian Visit.com (P) Ltd. 176 Taxman 164 (Del.)

The expenditure on the website was of a revenue nature and not a capital nature.

Facts

The assessee was engaged in travel business. The assessee made all kinds of arrangements for its clients such as booking of hotel rooms, providing taxi services, booking of air tickets and railway tickets, etc. During the relevant year the assessee had incurred an expenditure of Rs.20,23,317 on development of its website. The assesse's clients could use the said website for the purpose of availing of the services provided by it. The assessee had claimed the deduction of the said expenditure as business expenditure u/s.37(1) of the Income-tax Act, 1961. The Assessing Officer disallowed the claim holding that the expenditure was of capital nature inasmuch as the assessee had acquired an asset, which would provide it with an enduring benefit. The Tribunal allowed the assessee's claim.

Held

On appeal by the Revenue, the Delhi High Court upheld the decision of the Tribunal and held :

"(i) Considered in the light of the principles enunciated by the Supreme Court, it is clear that just because a particular expenditure may result in an enduring benefit it would not make such an expenditure capital in nature. What is to be seen is what is the real intent and purpose of the expenditure and as to whether there is any accretion to the fixed capital of the assessee. In the case of expenditure on website, there is no change in the fixed capital of the assessee. Although the website may provide an enduring benefit to an assessee, the intent and purpose behind a website is not to create an asset, but only to provide a means for disseminating the information about the assessee. The same could very well have been achieved and, indeed, in the past, it was achieved by printing travel brouchers and other published material and pamphlets. The advance of technology and the wide-spread use of the Internet has provided a very powerful medium to companies to publicise their activities to a larger spectrum of people at a much lower cost. Websites enable companies to do what the printed brouchers did, but in a much more efficient manner as well as in a much shorter period of time and covering a much larger set of people worldwide.

(ii) The Tribunal has correctly appreciated the facts as well as the law on the subject and has come to the conclusion that the expenditure on the website was of a revenue nature and not a capital nature."

79. CIT vs. Varinder Agro Chemicals Ltd. 309 ITR 272 (P&H)].

Facts

For the A. Y. 2002-03, the Assessing Officer disallowed the claim of the appellant for deduction of the expenditure on acquisition of computer software holding that it is capital in nature on the ground that enduring advantage was derived by the assessee by incurring such expenditure. The Tribunal allowed the assessee's claim.

Held

On appeal by the Revenue, the Punjab and Haryana High Court upheld the decision of the Tribunal and held as under :

"There is nothing to show that the software used by the assessee was of enduring nature and will not become outdated. Since technology is fast changing and day by day systems are being developed in a new way, software may be needed like raw material. The view taken by the Tribunal is certainly a possible view."

80. CIT v. M/s. Secure Meters Ltd. (Raj.) [Unreported]

Facts

The assessee incurred expenditure on issue of convertible debentures: The assessee's claim for deduction of the expenditure was rejected on the ground that it is capital expenditure. The Tribunal held that the expenditure is revenue expenditure and allowed the deduction.

In appeal, the Revenue contended that convertible debentures were akin to shares and that in line with the judgment of the Supreme Court in *Brooke Bond India v. CIT,* 225 ITR 798 (SC), the expenditure was capital in nature.

Held

The Rajasthan High Court upheld the decision of the Tribunal and held as under :

"A debenture, when issued, is a loan. The fact that it is convertible does not militate against it being a loan. In accordance with the judgment of the Supreme Court in the case of *India Cement v. CIT,* 60 ITR 52 (SC), expenditure on loan is always revenue in nature even if loan is taken for capital purposes. Consequently the expenditure on convertible debenture is admissible as revenue expenditure."

81. CIT v. Velumanickam Lodge [317 ITR 338 (Mad.)]

Facts

The assessee, a civil contractor, wrote a letter to the District Collector to secure the DRDA contract from the office of the District Collectorate, expressing its willingness to construct a hockey stadium in the Collectorate Complex and after receipt of the letter the DRDA contract was awarded by the Collector to the assessee. In the previous year relevant to A.Y. 2004-05 the assessee constructed the hockey stadium and the expenditure on the construction of the hockey stadium of Rs.24 lakhs was claimed as revenue expenditure. The Assessing Officer disallowed the claim treating the expenditure as capital expenditure. The Tribunal allowed the assessee's claim holding that the assessee volunteered to construct the hockey stadium for generating goodwill and for promoting its business activities, especially where such construction of the hockey stadium was for the welfare of the public, which was not prohibited by law. The Tribunal observed that the mere willingness expressed by the assessee to construct the hockey stadium in the District Collectorate Complex for a value of Rs.24 lakhs could not be construed as bribe to a person or as contribution for a private fund or for the benefit of any individual which could be regarded as a form of illegal gratification.

Held

On appeal by the Revenue, the Madras High Court upheld the decision of the Tribunal and held as under:

"The construction of the hockey stadium by the assessee was in the regular course of business apart from the fact that such construction came to be made on property belonging to the

District Collectorate meant solely for the use of public at large. Thus, the investment made by the assessee for construction of the hockey stadium was in the regular course of business and such investment could be construed as one made with a view to enlarge its scope of business and could be termed as business expenditure."

82. CIT vs. Ponni Sugars and Chemicals LTd. 306 ITR 392 (Supreme Court)

Where the Government formulated a scheme of subsidy to encourage the setting up of sugar factories and to make them viable under which new sugar factories were entitled to a subsidy in the form of enhancement of free sale sugar quota and excise duty rebate thereon which could only be used for repayment of loans taken for the unit and the question arose whether such subsidy was taxable

The main controversy arose in these cases because of the reason that the incentive were given through the mechanism of price differential and the duty differential. According to the Department, price and costs are essential items that are basic to the profit making process and any price related mechanism would normally be presumed to be revenue in nature. On the other hand, according to the assessee, what was relevant to decide the character of the incentive was the purpose test and not the mechanism of payment.

According to the Supreme Court, the above controversy could be resolved if it applied the test laid down in its judgment in the case of Sahney Steel and Press Works Ltd. According to the Supreme Court the test to be applied was that the character of the receipt in the hands of the assessee had to be determined with respect to the purpose for which the subsidy was given. The point of time at which the subsidy is paid is not relevant. The source is immaterial. The form of subsidy is immaterial. If the object of the subsidy scheme was to enable the assessee to run the business more profitably then the receipt is on revenue account. On the other hand, if the object of the assistance under subsidy scheme was to enable the assessee to set up a new unit or to expand the existing unit then the receipt of the subsidy was on capital account.

The Supreme Court referred to the decision of the House of Lords in the case of Seaham Harbour Dock Co. v. Crook, (1931) 16 TC 333. In that case the Harbour Dock Co. had applied for grants from the Unemployment Grants Committee from funds appropriated by Parliament. The said grants were paid as the work progressed. The payments were made several times for some years. The Dock Co. had undertaken the work of extension of its docks. The extended dock was for relieving the unemployment. The main purpose was relief from unemployment. Therefore, the House of Lords held that the financial assistance given to the company for dock extension cannot be regarded as a trade receipt.

The Supreme Court observed that the aforesaid judgment of the House of Lords showed that the source of payment or the form in which the subsidy is paid or the mechanism through which it is paid is immaterial and what is relevant is the purpose for payment of assistance.

Applying the above tests to the facts of the present case and keeping in mind the object behind the payment of the incentive subsidy, the Supreme Court was satisfied that payment received by the assessee under the scheme was not in the course of a trade, but was of capital nature.

Decisions on Section 14A

83. Godrej & Boyce vs. DCIT (Bombay High Court)

Rule 8D r.w. S. 14A (2) is not arbitrary or unreasonable but can be applied only if assessee's method not satisfactory. Rule 8D is not retrospective and applies from AY 2008-09. For earlier years, disallowance has to be worked out on "reasonable basis" u/s 14A (1)

In AY 2002-03, the assessee claimed that no disallowance u/s 14A in respect of the tax-free dividend earned by it could be made as it had not incurred any expenditure to earn the dividend. The AO rejected the claim and made a disallowance u/s 14A. This was deleted by the CIT (A). On appeal by the department, the Tribunal followed the judgement of the Special Bench in **Daga Capital** 117 ITD 169 (Mum) (where it had been held that s. 14A(2) & (3) & Rule 8D are procedural in nature and have retrospective effect) and remanded the matter to the AO for re-computing the disallowance. The assessee challenged the decision of the Tribunal. HELD:

(1) The argument that dividend on shares / units is not tax-free in view of the dividend-distribution tax paid by the payer u/s 115-O is not acceptable because such tax is not paid on behalf of the shareholder but is paid in respect of the payer's own liability;

(2) S. 14A supersedes the principle of law that in the case of a composite business expenditure incurred towards tax-free income could not be disallowed and incorporates an implicit theory of apportionment of expenditure between taxable and non-taxable income. **Once a proximate cause for disallowance is established – which is the relationship of the expenditure with income which does not form part of the total income – a disallowance u/s 14A has to be effected**;

(3) The argument that a literal interpretation of s. 14A leads to absurd consequences is not acceptable. **S 14A is founded on a valid rationale** that the basic principle of taxation is to tax net income i.e gross income minus expenditure;

(4) The argument that the method in Rule 8D r.w.s 14A (2) for determining expenditure relating to the tax-free income is arbitrary and violative of Article 14 is not acceptable because there is an adequate safeguard before Rule 8D can be invoked. **The AO cannot ipso facto apply Rule 8D but can do so only where he records satisfaction on an objective basis that the assessee is unable to establish the correctness of its claim**. Also a uniform method prescribed to resolve disputes between assessees and the department cannot be said to be arbitrary or oppressive. There is a rationale in Rule 8D and its method is "fair & reasonable". It cannot be said that there is "madness" in the method of Rule 8D so as to render it unconstitutional;

(5) Rule 8D, inserted w.e.f 24.3.2008 **cannot be regarded as retrospective** because it enacts an artificial method of estimating expenditure relatable to tax-free income. **It applies w.e.f AY 2008-09**;

(6) For the AYs where Rule 8D does not apply, the AO will have to determine the quantum of disallowable expenditure by a **reasonable method** having regard to all facts and circumstances;

(7) On facts, though in the earlier years, the Tribunal had held that the tax-free investments had been made out of the assessee's own funds, this did not mean that there was no expenditure incurred to earn tax-free income. **Even though Rule 8D did not apply to AY 02-03, the AO had to consider whether disallowance could be made u/s 14A (1)**. Also, the principle of consistency would not apply as s. 14A had introduced a material change in the law.

84. <u>CIT vs. Leena Ramachandaran (Kerala High Court)</u>

S. 14A applies where shares are held as investment and the only benefit derived is dividend. S. 36(1)(iii) deduction allowable if shares held as stock-in-trade

The assessee borrowed funds to acquire controlling interest shares in a company with which she claimed to have business dealings. The interest on the borrowings was claimed as a deduction u/s 36(1)(iii). The AO rejected the claim on the ground that the only benefit derived from the investment in shares was dividend and that the interest had to be disallowed u/s 14A. This was confirmed by the CIT (A). The Tribunal held that the deduction of interest was allowable u/s 36(1)(iii) in principle though a portion of the interest paid had to be regarded as attributable to the dividend and was disallowable u/s 14A. On appeal by the Revenue, HELD reversing the order of the Tribunal:

(i) The only benefit derived by the assessee from the investment in shares was the dividend income and no other benefit was derived from the company for the business carried on by it. As dividend is exempt u/s 10(33), the disallowance u/s 14A would apply. **The Tribunal was not correct in estimating the s. 14A disallowance to a lesser figure than the interest paid on the borrowing when the whole of the borrowed funds were utilized by the assessee for purchase of shares**;

(ii) **Deduction of interest u/s 36(1)(iii) on borrowed funds utilized for the acquisition of shares is admissible only if shares are held as stock in trade and the assessee is engaged in trading in shares. So far as acquisition of shares in the form of investment is concerned and where the only benefit derived is dividend income which is not assessable under the Act, disallowance u/s 14A is squarely attracted**.

85. CIT vs. Hero Cycles (P&H High Court)

<u>Even under Rule 8D of S. 14A, disallowance can be made only if there is actual nexus between tax-free income and expenditure</u>

<u>Facts / Issue :</u>

The assessee earned dividend income on shares which was exempt from tax. The AO took the view that the investment in shares was made out of borrowed funds on which interest expenditure was incurred and consequently made a disallowance u/s 14A. This was partly upheld by the CIT (A). On further appeal by the assessee, the Tribunal deleted the disallowance by noting that **the assessee had proved that the investment in shares**

was made out of non-interest bearing funds. It held that unless there was evidence to show that the interest – bearing funds had been invested in the tax – free investments and the nexus was established by the Revenue, s. 14A could not be applied on mere presumption. The Revenue appealed to the High Court and claimed that in view of **s. 14A (2) and Rule 8D (1) (b), a disallowance could be made even if the assessee claimed that no expenditure had been incurred in respect of the tax – free income**.

HELD:

(i) If the investment in the shares is out of the non-interest bearing funds, disallowance u/s 14A is not sustainable;

(ii) The contention of the revenue that directly or indirectly some expenditure is always incurred which must be disallowed u/s 14A cannot be accepted;

(iii) **Disallowance u/s 14A requires a finding of incurring of expenditure. If it is found that for earning exempted income no expenditure has been incurred, disallowance u/s 14A cannot stand**;

(iv) The contention of the revenue even if the assessee has made investments in shares out of its own funds, the said own funds are merged with the borrowed funds in a common kitty and, therefore, disallowance u/s 14A can be made is also not justified.

Decisions on Section 2(22)(e) – Deemed Dividend

86. CIT v. Hotel Hilltop 217 CTR 527 (Raj.)

The liability of tax as deemed dividend could be attracted in the hands of the individuals, being the shareholders, and not in the hands of the firm.

Facts

In the scrutiny assessment u/s.143(3) of the Income-tax Act, the Assessing Officer made an addition of Rs.10,00,000 as deemed dividend u/s.2(22)(e), being advance received from M/s. Hilltop Palace Hotels (P) Ltd. in which the two partners of the assessee firm held 48.33% of the shares. CIT(A) deleted the addition holding that the assessee firm is not a shareholder of the company, and therefore, the amount of Rs.10,00,000 cannot be assessed to tax in the hands of the assessee firm. The Tribunal dismissed the appeal filed by the Revenue.

Held

On appeal by the Revenue the Rajasthan High Court upheld the decision of the Tribunal and held as under :

> "(i) The important aspect, being the requirement of S. 2(22)(e) is, that "the payment may be made to any concern, in which such shareholder is a member or the partner, and in which he has substantial interest, or any payment by any such company, on behalf, or for the individual benefit of any such shareholder . . ." Thus, the substance of the requirement is, that the payment should be made on behalf, or for the individual benefit of any such shareholder. Obviously, the provision is intended to attract the liability of tax on the person, on whose behalf, or for whose individual benefit, the amount is paid by the company, whether to the shareholder, or to the concerned firm, in which event, it would fall within the expression 'deemed dividend'.
>
> (ii) Obviously, income from dividend is taxable as income from other sources u/s.56, and in the very nature of things, the income has to be of the person earning the income. The assessee in the instant case is not shown to be one of the persons, being shareholder. Of course the two individuals being 'R' and 'D' are the common persons, holding more than requisite amount of shareholding and are having requisite interest in the firm. But then, thereby the deemed dividend would not be deemed dividend in the hands of the firm, rather it would obviously be deemed dividend in the hands of the individuals, on whose behalf, or for whose individual benefit, being such shareholder, the amount is paid by the company to the concern.
>
> (iii) Thus the significant requirement of S. 2(22)(e) is not shown to exist. The liability of tax as deemed dividend could be attracted in the hands of the individuals, being the shareholders, and not in the hands of the firm."

87. ACIT, Mumbai Vs M/s Bhaumik Colour Pvt Ltd 313 ITR 146 (Mum)(SB)

Income tax - deemed dividend - Sec 2(22)(e) - assessee is a pencil manufacturer - takes a sum as loan from another company - AO finds a common shareholder (a Trust) in both the companies and treats the loan as deemed dividend - CIT(A) deletes the addition on the ground that the Trust was not a beneficial shareholder of shares in both the companies and therefore the second limb of the provisions of Sec.2(22)(e) could not be applied to the Assessee.

Held, deemed dividend can be assessed only in the hands of a person who is a shareholder of the lender company and not in the hands of a person other than a shareholder. T the expression shareholder referred to in Sec.2(22)(e) refers to both a registered shareholder and beneficial shareholder. If a person is a registered shareholder but not the beneficial shareholder then the provisions of Sec 2(22)(e) will not apply. Similarly if a person is a beneficial shareholder but not a registered shareholder then also the provisions of Sec 2(22)(e) will not apply.

Trust ownership is a model of duplicate ownership. Trust property is, in fact, owned by two persons simultaneously in the sense that one is under an obligation to use the property for the benefit of the other. The ownership of the trustee called trust ownership is nominal rather than real. The beneficiary interest is called the beneficial interest. The trustee is to administer the property of another person but the ownership right in the trustee is to be used only on behalf of the real owner. As between trustee and third party ownership conferred on the trustee fictitiously by law prevails, that is, the trustee is clothed with the rights of the beneficiary and is so enable to personate or represent him in dealings with the world at large. The main purpose of Trusteeship is to protect the rights and interest of person who for any reason are unable effectively to protect them for themselves. Therefore provisions of Sec.2(22)(e) would not be applicable at all to the case of the Assessee.

The definition of Dividend u/s 2(22)(e) of the Act is an inclusive definition. Such inclusive definition enlarges the meaning of the term "Dividend" according to its ordinary and natural meaning to include even a loan of advance. Any loan or advance cannot be dividend according to its ordinary and natural meaning. The ordinary and natural meaning of the term dividend would be a share in profits to an investor in the share capital of a limited, company. To the extent the meaning of the word "dividend" is extended to loans and advances to a shareholder of to a concern in which a shareholder is substantially interested deeming them as Dividend in the hands of a shareholder the ordinary and natural meaning of the word "Dividend" is altered. To this extent the definition of the term "Dividend" can be said to operate. If the definition of "Dividend" is extended to a loan or advance to a non shareholder the ordinary and natural meaning of the word dividend is taken away. In the light of the intention behind the provisions of Sec.2(22)(e) and in the absence of indication in Sec.2(22)(e) to extend the legal fiction to a case of loan or advance to a non-shareholder also, loan or advance to a non-shareholder cannot be taxed as Deemed Dividend in the hands of a non-shareholder.

88. CIT vs. Creative Dyeing & Printing (P) Ltd. 318 ITR 476 (Del.)]

Section 2(22) of the Income-tax Act, 1961 - Deemed dividend - Assessee-company was engaged in business of dyeing and printing of cloth and was acting as an ancillary unit of company 'P' for last several years - Both, assessee-company and 'P', had common shareholders/directors - 'P' had 50 per cent shareholding in assessee-company - In order to increase its export business and to compete with international standards in garment exports, 'P' had suggested modernization and expansion of plant and machinery of assessee-company and for that purpose it advanced funds to assessee to extent of 50 per cent - Amount of advance had to be adjusted against entitlement to moneys of assessee-company payable by 'P' in subsequent years - Whether, on facts, amounts advanced for business transaction between parties, namely, assessee-company and 'P' would fall within definition of 'deemed dividend' under section 2(22)(e) - Held, no

Decisions on Section 195

89. CIT vs. Samsung Electronics [320 ITR 209 (Karnataka High Court)]

S. 195 / 201 liability cannot be avoided on ground of non-taxability of recipient

Facts / Issue

The assessee made payments to a foreign company for purchase of 'shrink-wrapped'/ready-made software without deduction of tax at source u/s 195 (1). The AO held that the payments were chargeable to tax in the hands of the foreign company as "royalty" u/s 9 (1) (vi) and that the assessee was liable u/s 201 for non-deduction of tax and interest thereon. On appeal, this view was confirmed by the CIT (A) though the Tribunal (94 ITD 91) held that the payments for software, being a purchase of a 'copyrighted article' and 'goods' as held by in **Tata Consultancy Services** 271 ITR 401 (SC), was not liable to tax in India and consequently there was no obligation on the assessee to deduct tax at source u/s 195 (1).

HELD

(i) The effect of the judgment of the Supreme Court in **Transmission Corporation of India** 239 ITR 587 is that the moment there is a payment to a non-resident, there is an obligation on the payer to deduct tax at source u/s 195 (1). The only way to escape the liability is for the payer to make an application to the AO u/s 195 (2) for non-deduction or for deduction at a lower rate. **If the payer does not make an application and obtain an order u/s 195 (2), it is not open to him to argue that the payment has not resulted in taxable income in the hands of the non-resident recipient and that, therefore, there is no failure on the part of the payer to deduct tax u/s 195 (1)**;

(ii) **In an appeal by the payer against an order u/s 201 imposing liability on the payer for failure to deduct tax u/s 195 (1), there is absolutely no scope for the appellate authority to adjudicate whether the non-resident recipient was chargeable to tax or not and the rate at which it was so chargeable**. If the appellate authority in the payer's case determines the tax liability of the recipient, there may arise conflicts if in the assessment of the recipient a different view is taken as to its taxable status;

(iii) The Tribunal committed an error in determining in the appeals filed by the payer that the payment to the non-resident was not liable to tax and thereby holding the payer was not liable u/s 201 for non-deduction u/s 195 (1).

90. ITO vs. Prasad Production [125 ITD 263 (ITAT Chennai Special Bench)]

S. 195 (1) TDS obligation does not arise if the payment is not chargeable to tax. Samsung Electronics not followed

The assessee made a remittance to IMAX Canada towards technology transfer fee without deduction of tax at source. The AO took the view that the consideration was "fees for technical services" u/s 9 (1)(vii) and that tax ought to have been deducted at source as per **Transmission Corporation** 239 ITR 587 (SC). He accordingly held the assessee to be an "assessee-in-default" u/s 201 though the CIT(A) reversed the same. On appeal by the revenue, the question as to whether a person responsible for making payment to a non-resident was liable to deduct tax at source u/s 195 (1) if he did not apply to the AO u/s 195 (2) for permission to remit without deduction at source was referred to the Special Bench. HELD by the Special Bench:

(i) The effect of the judgements of the Supreme Court in **Transmission Corporation** and **Eli Lilly** 312 ITR 225 is that **s. 195 (1) applies only if the payment made to the non-resident is chargeable to tax. If the payer has a bona fide belief that no part of the payment has income character, s. 195 (1) will not apply and it is not necessary to apply to the AO u/s 195 (2)**. This interpretation is supported by the Circulars of the CBDT setting out the alternative procedure for TDS;

(ii) As regards **Samsung Electronics** 320 ITR 209 (Kar) (which held that s. 195 / 201 liability cannot be avoided on ground of non-taxability of recipient), **a judgement of a non-jurisdictional High Court need not be followed** where there are conflicting High Court judgements or where the judgement is rendered per incuriam (**Kanel Oil** 121 ITD 596 (Ahd)) or where the correct legal position was not brought to the notice of the High Court (**Lalsons Enterprises** 89 ITD 25 (Del) (SB). Apart from the judicial conflict, the alternative TDS procedure as per the CBDT Circulars was not brought to the attention of the High Court. Consequently, the judgement of the Special Bench in **Mahindra & Mahindra** 313 ITR 263 (AT)(Mum) (which held that s. 195 (1) did not apply if the payment was not chargeable to tax) has to be followed in preference to that of **Samsung Electronics**;

(iii) As regards the merits, though the question framed is general and there is no specific direction in the order of reference, the Special Bench, **the entire appeal is open before the Special Bench** and it is not confined to the question framed (**NTPC** 24 ITD 1 (SB) followed);

(iv) On merits, as the services rendered by the payee were auxiliary to the sale of equipment, the consideration was not chargeable to tax in India.

91. Van Oord ACZ India vs. CIT [189 Taxman 232 (Delhi High Court)]

The obligation to deduct the tax at source u/s 195 (1) arises only when the payment is chargeable to tax. Samsung Electronics not followed

The assessee, an Indian company remitted mobilization & demobilization charges of Rs. 8.65 crs by way of reimbursement to its parent company, a company based in Netherlands. The assessee applied to the AO u/s 195 (2) for a Nil withholding rate though the AO held that tax had to be deducted at 11%. The assessee deducted tax on sums aggregating Rs. 6.98 crs. In the assessment order the AO took the view that as the assessee had failed to deduct tax at source u/s 195, the expenditure had to be disallowed u/s 40(a)(i). This was upheld by the CIT (A) and the Tribunal (effectively on the balance amount). The Tribunal followed the judgement of the Supreme Court in **Transmission Corporation of AP** 239 ITR 387 and held that the assessee was duty bound to deduct tax u/s 195 (1) and could not escape liability without obtaining a certificate u/s 195 (2). The Tribunal held that the assessee was not entitled to "step into the shoes of the AO" and examine "whether the receipt was income in the hands of the recipient or not". On appeal by the assessee, HELD reversing the judgement of the Tribunal:

(i) The observations of the Supreme Court in **Transmission Corporation of AP** 239 ITR 387 have to be read in the context of the question before the Court i.e. whether tax was deductible on the gross trading receipts or only on the "pure income profits". The Court was not concerned with a case where the receipt was not chargeable to tax in the hands of the recipient at all. **On the other hand the observations of the Court make it clear that the liability to deduct tax at source arises only when the sum payable to the non-resident is chargeable to tax**;

(ii) Even the plain language of s. 195 shows that the tax at source is to be deducted on the "sum chargeable under the provisions of the Act". **One can, therefore, reasonably say that the obligation to deduct tax at source is attracted only when the payment is chargeable to tax in India**;

(iii) The determination by the AO under s.195(2) of the Act is tentative in nature. In case it is ultimately found in the assessment proceedings relating to the recipient that he was not liable to pay any tax on the sums received, the assessee cannot be treated in "default" inasmuch as s. 195(1) of the Act casts an obligation to deduct the tax at source on the sum 'chargeable under the provisions of this Act';

(iii) As regards **Samsung Electronics** 185 Taxman 313 (Kar), the context was different. **The assessees wanted to show in their own assessment proceedings that the amount paid by them was not assessable to tax at**

the hands of recipient. ***No doubt, they would be precluded to do so***. However, when in the assessment proceedings relating to recipient itself, it is opined by the income tax authorities that the tax is not payable at all on the amounts so received, provision of s. 195 would not be attracted. "**Even otherwise, because of the analysis of what Transmission Corporation of AP decides, we, with due respect, are not in agreement with some of the observations made in the aforesaid judgment of the Karnataka High Court**"

92. GE India Technology Centre vs. CIT (Supreme Court)

TDS obligation u/s 195(1) arises only if the payment is chargeable to tax in the hands of non-resident recipient

The assessee, an Indian company, made remittance to a foreign company for purchase of software. The assessee took the view that the payment was not chargeable to tax in India and did not deduct tax at source u/s 195. The AO & CIT (A) took the view that the payment constituted "royalty" and was chargeable to tax and that the assessee was liable u/s 201 for failure to deduct tax at source though this was reversed by the Tribunal. On appeal by the department, the High Court reversed the Tribunal by taking the view in **CIT vs. Samsung Electronics** 320 ITR 209 that the assessee was not entitled to consider whether the payment was chargeable to tax in the hands of the non-resident or not and had to deduct tax u/s 195 on all payments. On appeal by the assessee, HELD reversing the High Court:

(i) S. 195(1) uses the expression "**sum chargeable under the provisions of the Act**". This means that a person paying interest or any other sum to a non-resident is **not liable to deduct tax if such sum is not chargeable to tax**. Also s. 195(1) uses the word 'payer' and not the word "assessee". The payer is not an assessee. The payer becomes an assessee-in-default only when he fails to fulfill the statutory obligation u/s 195(1). **If the payment does not contain the element of income the payer cannot be made liable**. He cannot be declared to be an assessee-in-default;

(ii) S. 195(2) applies where the payer is in **no doubt that tax is payable** in respect of some part of the remittance but is **not sure as to what is the taxable portion**. In that situation, he is required to make an application to the ITO(TDS) for determining the amount. S. 195(2) & 195(3) are safeguards and of practical importance;

(iii) The department's **apprehension** that if tax is not deducted on all payments, there will be a seepage of revenue is **ill founded** because there are **adequate safeguards** in the Act to prevent the payer from wrongly not deducting tax at source such as s. 40(a)(i) which disallows deduction for the expenditure;

(iv) The Karnataka High Court in **CIT vs. Samsung Electronics** 320 ITR 209 misunderstood the observations in **Transmission Corporation of AP** 239 ITR 387. The only issue raised in that case was whether TDS was applicable only to pure income payments and not to composite payments which had an element of income embedded in them. The controversy was different and the Court held that if some part of the payment was taxable, an application u/s 195(2) had to be made. **The High Court's interpretation completely loses sight of the plain words of s. 195(1) which in clear terms lays down that tax at source is deductible only from "sums chargeable" under the Act i.e. chargeable u/s 4, 5 and 9**;

(v) As the High Court had not decided the question whether the payments for supply of software was "royalty" or not, the matters are remitted to the High Court for a decision on that point.

Deferment of Income over a period of time

93. ACIT vs. Mahindra Holidays & Resorts [3 ITR TRIB. 600 (ITAT Chennai Special Bench)]

Timeshare membership fee is taxable only over the term of contract

The assessee, a time-share company having resorts at tourist places granted membership for a period of 33/25 years on payment of certain amount. During the currency of the membership, the member had the right to holiday for one week in a year at the place of his choice from amongst the resorts of the assessee. The membership fee was received either in lump sum or in installments to the prospective member. In addition to the membership fee, the member was liable to pay maintenance charges or subscription fees irrespective of whether he made use of the resort or not. If the resort was utilized, additional payment towards utilities like electricity, water, etc was payable. **Though the assessee was following the mercantile system of accounting and treated the membership fee as revenue receipt, only 40% of the amount received was offered for taxation in the year of receipt. The balance was equally spread over the period of membership of 25 or 33 years on the ground that it was relatable to the services to be offered to the members.** The AO took the view that as per the accrual system of accounting, *the entire receipt had to be assessed as income in the year of receipt*. The CIT (A) upheld the stand of the assessee. On appeal by the department, the matter was referred to the Special Bench. HELD by the Special Bench:

(i) In **E.D. Sassoon & Co. Ltd. v. CIT** 26 ITR 27, the Supreme Court held that two conditions are necessary for income to have "accrued to" or "earned by" an assessee viz. (i) the assessee has contributed to its accruing or arising by rendering services or otherwise, and (ii) a debt has come into existence and he must have acquired a right to receive the payment. **In the present case, though a debt is created in favour of the assessee immediately on execution of the agreement, it cannot be said that the assessee has fully contributed to its accruing by rendering services because the assessee has a continuing obligation to provide accommodation to the members for one week every year till the currency of the membership**. *Till the assessee fulfils its promise, income has not accrued to it*;

(ii) The argument of the assessee that the balance amount of membership fees has to be spread over the tenure of membership on the ground that heavy expenditure for the upkeep and maintenance of the resorts has to be incurred is not acceptable because separate charges are collected for maintenance and use of utilities and therefore **the matching concept cannot be pressed into service with regard to the membership fee**. The principles laid down in **Calcutta Co. Ltd** 37 ITR 1 (SC) and **Rotork Controls India** 314 ITR 62 are not applicable because **though there is a liability, it is difficult not only to quantify but also to reasonably estimate it on a scientific basis**. *If the assessee had chosen to provide for the liability every year to comply with the matching concept, it would have been wholly unscientific and arbitrary*;

(iii) **Recognizing the entire receipt as income in the year of receipt can lead to distortion**. Following the principles laid down in **Madras Industrial Investment Corporation** 225 ITR 802 (SC), where it was held that allowing the entire expenditure in one year might give a distorted picture of the profits of a particular year, recognizing the entire receipt in one year can also lead to distortion;

(iv) Consequently, **the entire amount of timeshare membership fee receivable by the assessee up front at the time of enrollment of a member is not chargeable to tax in the initial year** on account of contractual obligation that is fastened to the receipt to provide services in future over the term of contract.