Direct Tax – November 2008

Case Laws

1. CIT v Bilahari Investment (P) Ltd (SC)

Assessees are private limited companies subscribing to chits as their business activities. They were maintaining their accounts on mercantile basis and they were computing profit/loss, as the case may be, at the end of the chit period following completed contract method, which was earlier accepted by the Department over several years.

Chit funds are basically saving schemes in which certain number of subscribers join together and each contributes a certain fixed sum each month, the total number of months being equal to the total number of subscribers. The subscriptions are paid to the Manager of the fund by a certain prescribed date each month and the total subscriptions to the fund are auctioned each month amongst the subscribers. At each auction, the lowest bidder is paid the amount of his bid and the balance received from out of the total subscriptions received is distributed equally amongst other subscribers, as premium. The Manager is paid a certain percentage of the collections each month on account of expenses and charges for conducting the auction. In the auction, a maximum amount, which the highest bidder agrees to forego, is the amount, which is distributed to the other members, subject to deduction of the Manager's commission.

The issue involved is regarding the tax treatment of the difference between the amount contributed and the amount received. In other words, in this case, the concern is with allowability of the claim for discount in order to arrive at income under the Act.

As stated hereinabove, assessees herein have been following completed contract method over the years, which was accepted by the Department. However, for the assessment years under consideration, the AO came to the conclusion that the completed contract method was not accurate in recognizing/identifying income. In the context of the "chit discount", the correct method was deferred revenue expenditure calculated on proportionate basis. In other words, the AO has preferred percentage of completion method as the basis for recognizing/identifying income in substitution of completed contract method.

According to the Department, chit dividend had to be subjected to tax on accrual basis as the assessees were following the mercantile system of accounting. According to the Department, income accrued to the assessees in the form of chit dividend during the year whereas liability arose in the form of chit discount over the relevant period depending upon the remaining number of installments to be paid.

Under completed contract method, the revenue is not recognized until the contract is complete. Under the said method, costs are accumulated during the course of the contract. The profit and loss is established in the last accounting period and transferred to P & L account. The said method determines results only when contract is completed. On the other hand, percentage of completion method tries to attain periodic recognition of income in order to reflect current performance. The amount of revenue recognised under this method is determined by reference to the stage of completion of the contract. The stage of completion can be looked at under this method by taking into consideration the proportion that costs incurred to date bears to the estimated total costs of contract.

Supreme Court ruled that as far as the chit dividend is concerned, the , income accrued to the assessees in the form of chit dividend during the year and would be taxable on accrual basis and not under the completed contract method.

As regards Chit discount, it is the case of the assessees that, profits (loss) accrued to the assessees only when the dividends exceeded the discount paid and that difference could be known only on the termination of the chit when the total figure of dividend received and discount paid would be available. That, it would be possible for the assessees to make profits only when the sum total of the dividend received exceeded the sum total of discounts suffered which is debited to P & L account.

In the past, the Department had accepted the completed contract method and because of such acceptance, the assessees, in these cases, have followed the same method of accounting, particularly in the context of chit discount. Every assessee is entitled to arrange its affairs and follow the method of accounting, which the Department has earlier accepted. It is only in those cases where the Department records a finding that the method adopted by the assessee results in distortion of profits, the Department can insist on substitution of the existing method. Further, in the present cases, we find from the various statements produced before us, that the entire exercise, arising out of change of method from completed contract method to deferred revenue expenditure, is revenue neutral. Therefore, the Completed Contract Method of accounting adopted by the respondents-assessees was correct and is not required to be substituted by percentage of Completion Method as contended by the AO.

2. DCIT v Gujarat Alkalies & Chemicals Ltd (SC)

The assessee had borrowed Rs.30 crores from IDBI which in turn was refinanced by COFACE (foreign company) for which the foreign company had charged interest, commitment charges and insurance charges payable by the assessee. The said "commitment charges" was an upfront payment.

The supreme Court relying on its earlier judgement in case of Akkamamba Textiles Ltd. held that commitment charges was allowable as deduction under section 37 and not only under section 36(1)(iii).

Further on another part, the assessee established phosphoric Acid Project as an extension to its present business activities and for that purpose obtained foreign currency loan from IDBI which in turn was refinanced by COFACE subject to the assessee paying finance charges to COFACE. The Department disallowed the said item on the ground that finance charges paid to COFACE on foreign currency loan was in the nature of interest and commitment charges and since the charges have been paid in relation to the project of manufacturing phosphoric acid which did not commence production during the assessment year under consideration, the expenses incurred were capital in nature. The Department also placed reliance in this connection on Explanation 8 to Section 43(1) of the Income-tax Act, 1961. The assessee was of the contention that the finance charge was similar to payment of interest and hence allowable.

The Supreme Court relying on its recent ruling of Core Health Care Ltd., ruled that such interest is also allowable under section 36(1)(iii). Further if the finance charges paid by the assessee to COFACE have also been equated by the Department with commitment charges which, then in that character also they are allowable as ruled earlier in this case.

3. Malayala Manorama Co. Ltd. v CIT(SC)

The assessee the assessee has debited in the P.L. Account, depreciation at the rates prescribed by the Income-tax Rules, 1962. This has been the consistent practice of the assessee throughout. The accounts of the assessee for the relevant assessment years are audited. The audit report confirms that the accounts of the assessee represent a “true and fair view”. The accounts have further been passed and approved by the general body of shareholders at the Annual General Meeting. The said accounts have been filed with the Registrar of Companies and no objections have been raised in relation to them.

The AO reworked the profit as per P.L. Account by ignoring the higher depreciation debited by the assessee and considering the depreciation as per Schedule XIV. The AO is of the opinion that charging depreciation as per the Income Tax Rules does not result in Profit and Loss Account being prepared as per Part II and Part III of Schedule VI, which is the requirement of section 115J.

The issue before the Court was whether in respect of a company consistently charging depreciation in its books of account at the rates prescribed in the Income-tax Rules, the Income Tax Officer has jurisdiction under section 115J of the Income Tax Act, 1961 to rework net profits by substituting the rates prescribed in Schedule XIV of the Companies Act, 1956

The assessee had prepared his profit and loss account as per Parts-II and III of Schedule VI to the 1956 Act, in terms of section 115J. No dispute has been raised at any stage of the proceedings by the revenue that the profit & loss account of the assessee is not in compliance with the provisions of the 1956 Act, particularly Schedule VI, Parts II and III.

The Court observed that the rates of depreciation prescribed in Schedule XIV are the minimum rates as per the Circular No.2 of 1989 dated 7th March, 1989 of the company Law Board.

The Supreme Court ruled that section 115J makes the income reflected in the companies books of accounts as the deemed income for the purpose of assessing the tax. If we examine the said provision in the above background, we notice that the use of the words in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act was made for the limited purpose of empowering the assessing authority to rely upon the authentic statement of accounts of the company. While so looking into the accounts of the company, an Assessing Officer under the Income Tax Act has to accept the authenticity of the accounts with reference to the provisions of the Companies Act which obligates the company to maintain its account in a manner provided by the Companies Act and the same to be scrutinized and certified by statutory auditors and will have to be approved by the company in its general meeting and thereafter to be filed before the Registrar of Companies who has a statutory obligation also to examine and satisfy that the accounts of the company are maintained in accordance with the requirements of the Companies Act. In spite of all these procedures contemplated under the provisions of the Companies Act. The Court observed that it is difficult to accept the argument of the Revenue that it is still open to the Assessing Officer to rescrutinize this account and satisfy himself that these accounts have been maintained in accordance with the provisions of the Companies Act.

The Court relying on its earlier ruling in the case of Apollo Tyres Ltd., categorically held that "The Assessing Officer while computing the income under Section 115-J has only the power of examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. The Assessing Officer thereafter has the limited power of making increases and reductions as provided for in the Explanation to the said section. To put it differently, the Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in the Explanation to Section 115-J.

Therefore the AO cannot rework the profits as approved by the auditors. The depreciation as per Income tax Rules debited to the P.L. Account even though results in lower book profits is acceptable.

4. CIT v. Taj Borewells (2007) 292 ITR 232 (Mad.)

The assessee is a firm consists of seven partners with equal shares and claimed the status of association of persons. The assessee-firm did not maintain any books of accounts for the reason that the total gross receipts were below Rs. 5 lakhs. The assessee-firm filed a return of loss and the said return was processed under section 143(1) of the Income tax Act, 1961. While completing the assessment, the Assessing Officer had not accepted the amount of Rs. 5,25,000 which was shown as amount invested by the partners, and concluded that this amount was to be added under the head “Other sources” under section 68 of the Income-tax Act, 1961. The Commissioner of Income-tax (Appeals) confirmed the addition but the Tribunal deleted it.

The High Court held that Section 68 of the Income-tax Act, 1961, is a charging section and it is also a deeming provision. Unless circumstances exist, the Revenue cannot rely on section 68 of the Act. The following features were present (a) since there were no books of account, there could be no credits in such book; (b) it was the first year of assessment of the assessee; (c) the explanation offered by the assessee-firm was not rejected and only the explanation offered by the partners was rejected. Unless and until the explanation offered by the firm was rejected and was found not genuine, the Assessing Officer could not invoke the provision of section 68. The addition could not be made.

5. Gorakhpur Kshetriya Gramin Bank Vs. CIT (2007) 292 ITR 205 (SC)

The assessee, a co-operative society, was engaged in the business of banking. For carrying on the banking business, it provides training to their employees and recovered the cost of training. Under the terms of the contract, if an employee left the service midway, the assessee forfeit the amount of security furnished by such an employee.

The High court held that for claiming exemption under section 80P(2)(a), the assessee is required to establish that the income is attributable to carrying on the business of banking. The business of banking could not be carried out without the aid of the employees and therefore whatever amount the assessee had received either towards the excess provision of pay recovered from resigned staff, training cost, recovery and forfeiture of security of employees was attributable to the activity of carrying on the business of banking.

6. CIT v. Century Building Industries P. Ltd. (2007) 293 ITR 194 (SC)

The Directors of the assessee-company took loans in their individual capacities from the creditors in the name of the company. The loan amounts were received by cheques in the name of the assessee-company and were deposited in the bank account of the company and transferred to the accounts of the directors on the same day by cheques.

When the directors repaid the loan amounts or interest thereon the payments were also routed through the assessee-company. The books of account of the assessee-company did not reflect the loans borrowed and there was no resolution of the company whereby the company had agreed to act as the medium for routing the borrowings and repayments. No deduction of tax at source was made under section 194A on repayments of interest. The Assessing Officer passed an order under section 201(1A) imposing interest on the assessee-company for not deducting tax at source.

The Supreme Court held that the lender had advanced the loans to the assessee company, the assessee made the debit to the “interest account” for a specific amount calculated with reference to the deductor’s liability to a creditor. It could not be said that the assessee-company was in charge of disbursing the repayments made by the directors in their individual capacities, and the Department was right in invoking the provisions of sections 201(1A).

7. J. K. Kashyap vs. Assistant CIT (DEL) 11 Mar 2008

The assessee, engaged in the real estate business, filed his return of income. During the course of assessment proceedings, it was noted by the Assessing Officer that apart from the profit declared by the assessee in the real estate business, the assessee received a sum for extinguishing his rights in a certain property and as this transfer had taken place as per section 2(47), he is liable to capital gain tax under section 45. The issue under consideration is whether the assessee is liable to capital gains tax.

The High Court held that the transfer of capital assets is not confined to the transfer of immovable property only, but its scope is much wider for the purpose of the Act. Section 45(1) would apply even if the consideration is received from a party other than the one in whose favour the transfer is effected.

The Court further observed that even if the assessee has not become the owner of the property due to litigation, the fact remains that he received consideration for acquiring interest in the property and that the interest was ultimately relinquished by him in favour of the new vendor. The consideration received by him for relinquishing his right in the property, thus attract the provisions of section 45(1), making him liable to capital gains tax.

8. Administrator, UTI v B.M.Malani (2007) 164 Taxman 463(SC)

The assessee had invested an amount of Rs.65 lakhs in units of monthly income plan offered by the appellant Unit Trust of India under capital gain scheme. Said plan was a five year close ended income plan and face value of a unit was Rs.10. Since certain sum was due from assessee on account of income-tax, Department issued a notice (Garnishee order) to UTI under section 226(3) to pay the amount due. In compliance of the demand made, appellant paid certain amount to department wherefore value of unit at relevant time was calculated at the rate of Rs.6.93 per unit.

The assessee filed a writ petition questioning the action of the appellant in resorting to sale of the said units without his consent. The High Court held that although the units were transferred, their value had not become due to the assessee on date on which such notice was given and, therefore, such transfer of units was to be quashed and assessee was entitled to redemption value of units at rate of Rs.10 unit after five years.

Supreme Court on appeal ruled that Section 226(3) is applicable only when money is due to the assessee from any person. The appellant was a statutory authority. It had floated the scheme. It knew the terms and conditions thereof. On a plain reading of the highlights of the scheme, it was evident that repurchase was allowed only from 1-9-2001 even without the consent of the assessee. It was for the assessee to give his option. The ITO could not have exercised the said option on behalf of the assessee.

The assessee made all sincere efforts to pay the tax. It made an offer to the ITO to transfer the bonds at their face value at Rs.10 per unit. Unfortunately, the Department neither replied to the said letter nor paid heed to his request. The assessee had invested a sum of Rs.65 lakhs. He, therefore, was entitled to, least, that amount. Government of India had already been considering the matter of reimbursement to the holders of the units at least at the purchase rate. In that view of the matter, it must be held that it not only acted hastily but also illegally. Section 226(3) in categorical terms created a legal fiction to the effect that when an amount is not payable, the assessee is not required to pay any such amount or part thereof. Appellant being a statutory authority should have acted strictly in terms of the conditions of the contract. The assessee never authorized the appellant to sell the same in the market at the lower price as assessee had stated that due to the fall in the prices in the market, he was not able to dispose of the units. The assessee further prayed time till May 2002 to clear the dues and was awaiting information from ITO but in the meantime the appellant sold the same in the market without any intimation to assessee.

Section 226(3) cannot be interpreted to mean that the Union Trust of India was fully authorized to dispose of the units on its own without any notice to the holder of the units. Having regard to section 226(3), it could not be said that the appellant was holding the money of the assessee in the instant case. The amount in question could have been held by the appellant only when the assessee had exercised his opinion. Therefore, there was no error in the judgment of the High Court as the assessee was entitled to be restituted.

9. Hindustan Coca Cola Beverage Private Limited v CIT (SC) 16 Aug 2007

The appellant-assessee is engaged in the manufacture and sale of soft drinks. It entered into an agreement with another company for use of their premises for receipt, storage and dispatch of goods belonging to the appellant-company. The appellant had paid the warehousing charges on which tax was deducted under Section 194C, Income Tax Act, 1961 @ 2%. The Assessing Officer held the appellant to be 'assessee in default' for failure to deduct tax at source in respect of warehousing charges and further held that the warehousing charges were in the nature of rent as defined in Explanation to Section 194-1 and, therefore, tax ought to have been deducted at 20%.

10. Golden Insulation and Engineering Limited vs CIT

The assessee was valuing its closing stock at estimated realisable value or at market value of the stocks. The assessee stopped following the earlier method adopted for valuing the closing stock as it was defective and did not correctly reflect the profit and loss for each accounting year. The assessee started following a new method of valuing the closing stock at cost price adequately reflected the profit and loss position in regard to the previous year's operations.

The issue that arose for consideration was whether the Tribunal was right in law in holding that the change in the method of valuation adopted by the assessee was neither for any valid reasons nor bonafide and in consequentially sustaining an addition to the total income.

The High Court held that the assessee may file a revised return if it discovers any omission or any wrong statement. There is no omission or wrong statement which required the assessee to file a revised return. The result of change in the method of valuation was that the assessee showed a increase in loss. It was not a legally valid reason nor was it bona fide. The change was not justified or legally permissible.

11. CIT and Others vs. All India Films Corporation and Others (Del)

The assessee took on lease two cinema halls. It was exhibiting films in them and earning a part of its income from that activity. Due to an internal arrangement, the assessee handed over possession of the cinema halls to the lessor. The assessee has been compensated by the landlord towards the business loss resulting from it having to vacate premises which did not belong to it but which was in its possession pursuant to a lease.

The assessee showed the sum of Rs.1,24,000/-in the credit side of the profit and loss account under the heading 'compensation for premature closure of the cinema halls. The ITO treated the entire sum as revenue receipt.

The issue that arises for consideration is whether the sum realised by the assessee by way of compensation for the termination of the lease of the two cinemas by the lessor constituted a revenue receipt.

The High Court observed that there was no complete cessation of the assessee's business activity. Further, no part of the profit-making apparatus of the assessee had been extinguished so as to render the amount of compensation received for the said purpose a capital receipt. Held that the compensation amount received by the assessee towards the business loss was in fact a revenue receipt.

12. Enterprising Enterprises v. DCIT (2007) 293 ITR 437 (SC)

The assessee had taken a quarry on lease for 10 years. It paid a one-time lease rental for acquiring such leasehold

rights for extracting minerals from mineral bearing land. The assessee claimed proportionate lease rental for acquiring such leasehold rights as revenue expenditure. The issue under consideration is whether the proportionate lease rent paid by the mining lessee for acquiring such leasehold rights would be a capital expenditure or revenue expenditure. The Supreme Court observed that there is a distinction between a case where royalty or rent is paid and a case where the entire amount of lease is paid either one-time or in installments. The Apex Court observed that in the former case. ii would be a revenue expenditure but in the latter case. it would be a capital expenditure.

Therefore. in the case on hand. the one-time lease rental paid is a capital expenditure.

13. CIT v. Sree Ayyanar Spinning & Weaving Mills Limited 301 ITR 343 (SC)

The only issue to be considered was whether the Tribunal can pass the order of rectification u/s. 254(2) beyond the specific period of four years when the application for such rectification is moved within the specified period of four years.

The Supreme Court observed that Appellate Tribunal may, at any time, within four years from the date of the order, rectify any mistake apparent from the record and amend any order passed by it either on application or suo-moto. The application for rectification was made within four years. It is the Tribunal which took its own time to dispose of the application.

The Supreme Court ruled that once the assessee has moved the application within four years from the date of appeal, the Tribunal cannot reject that application on the ground that four years have lapsed, which includes the period of pendency of the application before the Tribunal. If the assessee has moved the application within four years from the date of the order, the Tribunal is bound to decide the application on the on merits and not on the ground of limitation. Section 254(2) lays down that the Appellate Tribunal may at any time within four years from the date of the order rectify the mistake apparent from the record, but that does not mean that if the application is moved within the period allowed, i.e., four years, and remains pending before the Tribunal, after the expiry of four years the Tribunal can reject the application on the ground of limitation.

14. CIT v Neha Proteins Ltd, 306 ITR 102 (Raj.)

The assessee had claimed set-off of the interest earned on the share application money against the public issue expenses which were to be amortised in future under and in accordance with the provisions of S. 35D of the Income-tax Act, 1961. The assessee had therefore claimed that the interest income is not taxable. The Assessing Officer disallowed the claim for set-off and added the interest amount to the income of the assessee. The Tribunal held that the assessee was entitled to set-off of the interest against the public issue expenses and deleted the addition.

The High Court ruled as under:

(i) The amount of interest accruing on the share application money could not be used by the assessee for any purpose whatever, other than those metioned in Section 73(3) and Section 73(3A) of the Companies Act, 1956, and on the allotment of shares, the assessee was to take stock of things about the expenditure incurred by it, being the public issue expenses. The interest accrued did reduce that expenditure and it was rightly required to be adjusted against the expenditure, i.e., the assessee was entitled to claim amortization of the public issue expenses only on the figure so reduced, after setting off, or adjusting.

(ii) The interest accrued on the share application money lying with the bank under the mandate of Section 73 of the Companies Act was not taxable as 'Income from other sources' and was required to be set off or adjusted against the public issue expenses, so as to reduce the amount of public issue expenses, for the purpose of enabling the assessee to claim amortization, in accordance with the provisions.

15. CIT v Hotel Hilltop 217 CTR 527 (Raj)

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. Hiltop Palace Hotels (P) Ltd. in which the two partners of the assessee firm held 48.33% of the shares.

The High Court ruled as under:

(i) The important aspect, being the requirement of Section 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 concern 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 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.

16. CIT v Dy. Chief Accounts Officer, Markfed, Khanna 304 ITR 17 (P&H)

The assessee had purchased printed packing material, but did not deduct tax at source on the payment therefore. The Assessing Officer was of the view that the transaction was a works contract and therefore it attracted 194C.

The High Court ruled as under:

(i) There was no dispute that the main purpose of the assessee in buying packing material was to obtain goods for the purpose of packing its finished products. The factum of such packing material carrying some printed work could only be regarded as the work executed by the supplier incidental to the sale to the assessee. The fact of some printing being done as a part of supply was of no consequence to the contract being essentially of a sale of chattel. The predominant object underlying the contracts was sate / purchase of goods and the only in intention of the assessee was to buy packing material.

(ii) Admittedly, the raw material for the manufacturing of such packing material was not supplied by the assessee. Thus, it was a case of sale and not a contract for carrying out any work.

(iii) The purchase of particular printed packing material by the assessee was a contract for sale and outside the purview of S. 194C."

17. Kerala Road Lines v CIT (2008) 299 ITR 343 (SC)

The assessee entered into an agreement with M/s. Peirce Leslie (India) Ltd. on Septemer 27, 1983, for purchase of 466 cents of land with buildings thereon at Calicut. It was agreed that the sale deed will either be got executed in favour of the assessee or its nominees. As per the agreement, if the purchase price was not paid within the specified time, the assessee was liable to pay interest at the rate of 18% per annum. The buildings standing on the lands were demolished and the scrap materials were sold for Rs,5,88,000. This income was treated as business business income.

Under the agreement, the assessee had to pay an interest of Rs.4 lakhs for the delayed payment of purchase consideration. The assessee claimed this amount as a revenue expenditure. The assessing authority disallowed the claim of the assessee on the ground that the payment of interest on the purchase of the property would be in the nature of capital expenditure and not revenue expenditure.

It was observed by the Supreme court that the intention of the assessee was to enter into an adventure in the nature of trade and ultimately the assessee had retained only 65.57 cents of land with it and the remaining land was purchased by the sister concerns of the assessee in small pieces. Since the assessee was only an intermediary for the other sister concerns, the part of the interest referable to the lands sold to the lands sold to the sister concerns should be treated as revenue expenditure.

The assessee had entered into an agreement to purchase the entire property including buildings standing thereon. The buildings were demolished and structures standing thereon were sold as scrap material for Rs,5,88,000. This sum was offered for assessment as business income and assessed as such. The payment of interest of Rs.4 lakhs for the delayed payment of purchase consideration has been provided in the agreement and thus, the payment of interest was a contractual obligation. The payment of interest was to be viewed as an expenditure u/s. 37 of the Income-tax Act, 1961, especially when the sale proceeds of the scrap materials from the demolished structures have been treated as business income.

Supreme Court held that once the Revenue has accepted the sum of Rs.5,88,000 (being sale proceeds from the scrap material of the structures standing on the lands) as business income, then correspondingly the assessee would be entitled to claim the sum of Rs.4 lakhs as revenue expenditure paid as interest on the delayed payment of the purchase consideration.

18. CIT v Sarabhai Holdings P. Ltd. (2008) 307 ITR 89 (SC)

By an agreement dated February 28, 1977, the assessee agreed that with effect from March 1, 1977, its industrial undertaking and business activity would be sold as a going concern to E. Under this agreement, a sum of Rs. 49 lakhs was to be paid by way of deposit / earnest money and a sum of Rs. 4.42 crores was to be set off against the amount due from the assessee to E. The balance of the sale consideration (approximately Rs. 6.55 crores) was to be paid in eight equal installments starting from October 1, 1979, the further installments being payable on October 1 each year.

Under a further agreement dated March 4, 1977, interest at 11% p.a. was payable on the balance of the sale consideration which would remain outstanding. On 15th June, 1978, E wrote to the assessee proposing modification in the terms of payment, inter alia:

(i) Rs.1.68 crores would be paid when demanded and that amount would not carry interest; and

(ii) Rs. 4.7 crores would be payable in six annual installments, the first of them being payable on March 1, 1987, and that simple interest at 11% would be payable with effect from July 1, 1979.

The assessee passed a resolution dated 30 June 1978, waiving off the interest for the year 1977-78 and also deferred the interest for 1978-79 to commence from 1 July 1979.

The Supreme Court held that since the interest for the assessment year 1979-80 had already accrued to the assessee, it could not be wiped out latter on by passing the resolution dated June 30 1978.

So far as the assessment year 1980-81 was concerned, the interest had not accrued, since the assessee had deferred it by passing the resolution dated June 30, 1978. There was full scope for the assessee to adjust the interest, or as the case might be, to defer the interest. The law permitted the contracting parties to lawfully change their stipulations by mutual agreement and, therefore, the assessee and the vendee had no legal impediment in modifying the terms of their contract.

19. CIT v Ponni Sugars & Chemicals Ltd. [(2008) 174 Taxman 87 (SC)

The assessee-company had received subsidy under the Incentive Subsidy Scheme, 1980. The incentives conferred under the scheme were two fold; first, in nature of a higher free sale sugar quota and second, in allowing the manufacturer to collect excise duty on the sale price of the normal quota, but to pay to the Government only the excise duty payable on the price of levy sugar.

As per the scheme, the assessee was obliged to utilize he subsidy only for repayment of term loans undertaken by it for setting up new units / expansion of existing business. The assessee claimed that incentive received by it was a capital receipt, not includible in the total income. According to the department, since incentives were given through price and duty differentials, the character of the impugned incentives was revenue and not capital in nature.

On appeal the Supreme Court ruled that test is that the character of the receipt (subsidy) in the hands of the assessee has to be determined with respect to the purpose for which the subsidy is given. In other words, in such cases, one has to apply the purpose test. The point of time at which the subsidy is paid is not relevant. The source is immaterial. The form of subsidy is immaterial. The main eligibility condition in the scheme with which we are concerned in this case is that the incentive must be utilized for repayment of loans taken by the assessee to set up new units or for substantial expansion of existing units. On this aspect there is no dispute. 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 the 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. Therefore, it is the object for which the subsidy / assistance is given which determines the nature of the incentive subsidy. The form of the mechanism through which the subsidy is given is irrelevant."

Further, receipt of the subsidy was capital in nature as the assessee was obliged to utilize the subsidy only for repayment of term loans undertaken by the assessee for setting up new units / expansion of existing business.

20. CIT vs. HCL Comnet Systems and Services Ltd., (2008) 305 ITR 409 (SC).

The question before the Supreme Court was whether the Provision for Bad and Doubtful Debts made in the books of accounts can be added back, whiel calculating book profit under section 115JB.

Section 115JB, Item (c) of the Explanation deals with amount set aside as provision made for meeting liabilities, other than ascertained liabilities and requires such provision to be added back while calculating book profit.

The Hon'ble Supreme Court held that the provision for bad and doubtful debts can be added back to the net profit only if item (c) stands attracted. The assessee's case would, therefore, fall within the ambit of item (c) only if the amount is set aside as provision; the provision is made for meeting a liability; and the provision should be for other than an ascertained liability, i.e., it should be for an unascertained liability.

In other words, all the ingredients should be satisfied to attract item (c) of the Explanation to section 115JB.

In our view, item (c) is not attracted for PBDD.

There are two types of "debt". A debt payable by the assessee is different from a debt receivable by the assessee. A debt is payable by the assessee where the assessee has to pay the amount to others whereas the debt receivable by the assessee is an amount which the assessee has to receive from others. In the present case, the "debt" under consideration is a "debt receivable" by the assessee. The provision for bad and doubtful debt, therefore, is made to cover up the probable diminution in the value of the asset, i.e., debt which is an amount receivable by the assessee. Therefore, such a provision cannot be said to be a provision for a liability, because even if a debt is not recoverable no liability could be fastened upon the assessee. In the present case, the debt is the amount receivable by the assessee and not any liability payable by the assessee and, therefore, any provision made towards ir-recoverability of the debt cannot be said to be a provision for liability. Therefore, PDBB is not required to be added back while calculating Book Profit under section 115JB.

21. CIT v Bharat Cellular Ltd. – 175 Taxman 573 (Delhi)

The facts of the case are that the assessee company is in the business of providing cellular facilities to its subscribers. The assessee had to provide its subscribers connectivity between two different circles which had to be routed through MTNL / BSNL. For the purposes of providing this connectivity, the assessee had entered into agreements with BSNL / MTNL, under which the assessee had to pay inter connection access charges. The Department held that such payments to BSNL / MTNL, were in the nature of technical services and hence the provisions of Section 194J would be applicable.

On appeal to the High Court ruled that " technical services" is not to be constructed in the abstract and general sense, but in a very narrow sense as circumscribed in the "managerial service and consultancy service" as appearing in the Explanation 2 to Section 9(i) (vii) would relate to technical services rendered by human, and it would not include any service provided by machines and robots, and, therefore, held that inter connect charges could not be regarded as fees for technical services within the meaning of Section 194J as to be liable for tax deduction at source.

22. CIT v Realest Builders & Services Ltd. [2008] 170 Taxman 218 (SC)

The short point arising in this case was whether income accrued to the assessee on registration of the sale deed in favour of the third party (plot purchaser) or whether it accrued at the time of execution of the tripartite agreement ?

The assessee entered into a tripartite agreement in 194-95 to sell a plot of land against which the sale agreement was received which was shown as advance. However, the transfer of title / right took place at a later date when the sale deed was registered in favour of the buyer.

According to the Department, income accrued on the date of execution of the tripartite agreement when the assessee received full consideration of the plot and not in the year in which the sale deed stood executed.

According to the assessee, since there was no transfer of right, title and interest up to the date of execution of conveyance, income did not accrue to the assessee till the date of conveyance and, therefore, there was no accrual of income at the time of execution of the tripartite agreement (s) which took place during the assessment year 1994-95.

The Supreme Court further observed that in cases where the Department wants to tax an assessee on the ground of the liability arising in a particular year, it should always ascertain the method of accounting the method of accounting followed by the assessee in the past and whether change in method of accounting was warranted on the ground that profit is being underestimated under the impugned method of accounting. If the Assessing Officer comes to the conclusion that there is under-estimation of profits, he must give fact and figures in that regard and demonstrate to the Court that the impugned method of accounting adopted by the assessee results in under-estimation of profits and is, therefore, rejected. Otherwise, the presumption would be that the entire exercise is revenue neutral. The Assessing Officer was required to demonstrate both the methods, one adopted by the assessee and the other by the Department.

The Supreme Court decided in favour of the assessee and approved the manner of recognition of income.

23. CIT v Hewlett Packard India (P) Ltd. (2008) 171 TAXMAN 13 (DEL)

The assessee-company was carrying on the business of dealing in computers and computer peripherals. It provided a warranty to its customers for replacing defective parts within a period ranging from one to three years, depending upon the goods supplied. The obligation to accept the warranty claim was in-built in the contract of with its customers. The assessee made a provision of certain sum for warranties and claimed deduction of the same. The assessing authority disallowed the provision on the ground that the amount did not represent an accrued liability.

The High Court observed that the assessee followed a scientific method of making the estimate. That was based on the past historical cost, failure rate experienced in the past, the length of warranty, increase in volumes, etc. On that basis, it was held that the estimation made by the assessee was not at all arbitrary and, therefore, it was entitled to deduction. The warranty clause is a part of the sale document and it imposes a liability on the assessee to discharge its obligation for the period of warranty, the liability could be capable of being construed in definite terms and, therefore, could be deducted while working out the profits and gains of business.

24. Delhi Milk Scheme v CIT (2008) 173 TAXMAN 54

During the course of survey, it was found that:

(a) the assessee had appointed a large number of agents to sell its milk and milk products from booths owned by it;

(b) that the commission was being paid to the agents for the milk sold; and

(c) that the milk, which was not sold, was taken back by the assessee at same price.

The assessee claimed that there was no principal to agent relationship between it and the agents, but was a principal-to-principal relationship and, therefore, commission paid did not attract 194H. The contention of the assessee was rejected by the Assessing Officer.

The High Court ruled that on the facts of the case, it is quite clear that the milk and milk products were not sold by the assessee to the concessionaires. On the contrary, unsold milk was taken back by the assessee from the Concessionaires, without any price reduction. Therefore, whichever way one looked at the matter from the point of view of the definition of the word ‘commission’, as appearing in the Explanation to section 194H or from the meaning of the word ‘discount’, the transaction between the assessee and the concessionaires was a principal to agent transaction and not a principal to the principal transaction.

As a matter of fact, that the milk booths were owned by the assessee; the assessee had a right to enter the milk booth and lake charge thereof at any time without assigning any reason or without any intimation to the concessionaires; unsold milk was taken back by the assessee from the concessionaires; the concessionaires only rendered a service to the assessee for selling milk to the customers; and finally, ownership of the goods did not pass from the assessee to the concessionaires in as much as there was no sale of the milk or milk products to the concessionaires. Hence the provisions of section 194H were clearly attracted.

25. ACIT v F.P. Gaekwad (2008) 174 TAXMAN 5551(GUJ)

The assessee had furnished the return of wealth for the relevant assessment years during his life time. The Assessing Officer had also initiated penalty proceedings under sections 18. However, before the penalty proceedings could be completed, the assessee expired. Thereafter, the Assessing Officer vide his order levied penalties under Sections 18 upon the legal representatives of the deceased assessee.

On appeal the High Court ruled that:

(i) The legal representatives of the deceased are not liable for penalty for which default was committed by the deceased assessed.

(ii) The liability of the legal representative is only to pay the tax assessed as payable or any other sum which would have been payable by the deceased, had he been alive, out of the estate of the deceased.

(iii) The words 'any sum which would have been payable by him under the Act if he had not died' mentioned in section 19(1) do not authorize the department to levy penalty on the legal representatives for the default committed by the deceased assessee.

(iv) Section 19(1) does not provide for the continuation of penalty proceedings against the legal representative when the assessee dies before the proceedings are concluded.

(v) The definition of an 'assessee' under Wealth tax Act in section 2(c) does not provide that the legal representative of an assessee would be deemed to be an assessee for all purposes under the Act.

(vi) The omission of section 18(3) of section 19 is quite significant, which clearly shows that intention of the Legislature that in a case where action would be taken under section 19(2), the question of imposing any penalty on the legal representative cannot arise.

In the instant case, the returns were filed by the deceased assessee and there was no obligation n the legal representative to file the return of wealth. Pursuant to the returns of wealth filed by the deceased assessee, assessments had been completed and penalty notice had been issued. However, before the penalty orders were passed, the deceased expired. Thus, the penalty orders passed on the legal representative were contrary to the provisions of law and he could not be made liable to any penalty. Therefore the penalty order is liable to be set aside.

26. CIT (TDS) v Reliance Industries Ltd. (2008) 175 TAXMAN 367 (GUJ)

The assessee-company distributed free food/meal coupons to its employees for purchase of meals as per company's policy. For that purpose, it had entered into an agreement with 'A'. The employees were provided with coupons of 'A' at the rate of Rs.50 per day. The assessee-company claimed that amount paid to 'A' for food/meal coupons given to the employees was not taxable perquisite within the meaning of rule 3(7)(iii) and, therefore, it did not deduct the tax at source on coupons misused by some of the employees for purchase of grocery items, cosmetics items, etc. from shops/super stores selling such items. The Assessing Officer, therefore, estimated certain amount as being taxable perquisite in hands of the employees and initiated proceedings for non-compliance with requirement of deducting tax at source by the assessee under section 192.

On appeal, the Commissioner (Appeals) held that the assessee could not be liable for such misuse. However, thereafter, the Commissioner (Appeals) estimated 30 per cent value of the coupons as having been misused and treated the assessee-company in default for levy of interest towards short deduction of tax and levy of penalty. On cross appeals, the Tribunal held that the assessee had not defaulted in any manner for non-deduction of tax at source. The Revenue appealed to the High Court.

The High court ruled that on a plain reading of rule3(7)(iii), it is clear that the value of free meals provided by an employer to an employee shall not be taxed as a perquisite in the hands of the employee if during office hours at condition that such vouchers are not transferable and are usable only at the specified eating points, again to be used during office hours. Admittedly, in the instant case, it was an accepted position between the parties that the assessee had distributed such meal coupons pursuant an agreement with 'A'. Such coupons were to be used by the employees only at the specified eating points, including canteen of the assessee; such coupons were not transferable; and the value of each coupon did not exceed the specified monitory limit. The assessee, at the time of issuance of coupons, could not envisage as to which of the employees would misuse the coupons, because the liability to deduct tax at source is correlated with the taxability of the amount in the hands of a particular employee and there can be no case of an estimation on percentage basis. The primary liability to offer the amount for tax is that of an employee concerned and it is only by a prescribed mode of recovery that the employer is required to deduct tax at source. Such deduction has to be specifically employee-wise and the employer cannot be called upon to presume that a particular percentage of employees, out of the total work force, shall misuse the facility so as to warrant deduction of tax at source. Furthermore, correspondingly, such tax deducted at source has to be given credit to the employee concerned in his assessment and unless and until the tax deduction certificate specifies the employee concerned, there can be no corresponding credit given to the employee. In the circumstances, it is not possible to accept the stand of the revenue.

27. U. K. Mahapatra & Co. v ITO 221 CTR 328 (Ori)

The petitioner is a firm of Chartered Accountants engaged in the practice of accountancy involving auditing, consultancy, financing and other services to their clients. A survey party conducted a survey at the premises of the petitioner-firm and also impounded certain books of account and documents. Subsequently it was revealed that the survey was in consequence to a survey conducted at the premises of one of the clients of the petitioner. The survey party was of the belief that some of books of the clients were kept at the premises of the petitioner.

On appeal the High court observed and ruled that:

(i) The precondition for conducting survey u/s 133A in the premises of a Chartered Accountant, lawyer, tax practitioner in connection with survey of the business place of their client is that the client in the course of survey must state that his books of account/documents and records are kept in the office of his Chartered Accountant/lawyer/tax practitioner. Unless this precondition is fulfilled, the IT authority does not assume any power to enter the business premises/office of the Chartered Accountant/lawyer/tax practitioner to conduct survey u/s.133A in connection with survey of the premises of their client.

(ii) There being no material to show that survey of premises of firm of Chartered Accountants was undertaken consequent upon any statement of its client that its books of account were kept in the premises of the Chartered Accountants, survey conducted at the premises of Chartered Accountant's firm was without authority of law.

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

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 in as much as the assessee had acquired an asset, which would provide it with an enduring benefit. The High Court ruled as under:

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

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

For the relevant assessment years 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. On writ the High Court ruled as under:

Section 147 stipulates that 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 Section 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. 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 these years were invalid and deserved to be quashed.

30. Peninsula Land Ltd. v CIT 175 Taxman 58 (Bom)

For the A.Y. 1994-95 the AO passed an order u/s.154 of the Income-tax Act, 1961, on 9-6-2006 giving effect to the order of the Commissioner (Appeals). In that order he allowed set-off of carried forward depreciation of the preceding years. Subsequently, he passed another order u/s.154 dated 22-2-2007 withdrawing the earlier order u/s.154, dated 9-6-2006 claiming it to be beyond the period of limitation of 4 years as prescribed u/s.154(7). The Bombay High Court allowed the writ petition filed by the assessee and held as under:

It was clear from the order dated 9-6-2006, that the set-off was granted in order to pass on to the assessee the benefit that it had obtained under the order passed by the Appellate authority in the statutory appeal. This order was not an order passed u/s.154 of the Act. The power to pass such an effect order was inherent in Section 143 or Section 144 read with section 153(3). The power of the Income-tax Officer to amend the assessment in consequence of decision in an appeal, revision, reference or by a High Court or Supreme Court was not traceable to S. 154, but was inherent and traceable to S. 143 and S. 144 of the Act. Therefore the limitation as contained in S. 154(7) would not apply to the passing of such an order.

Therefore the finding that the order passed on 9-6-2006 was beyond the period of limitation as prescribed u/s.154(7) was erroneous.

Indirect Tax – November 2008

Case Laws

1. CC v. Galaxy Entertainment (I) P. Ltd. 2007 (214) ELT 14 (SC)

The assessee had imported certain equipment from a foreign supplier after a hectic bargain for US $ 15000, records to that effect was also produced by the assessee. The equipment imported required specialized knowledge for its installation. Such expertise was available with the subsidiary of the said foreign supplier which signed Technical and Installation Charges Agreement with the importer. The agreement provided that the importer would pay Rs.59 lakh as technical and installation fee to the said subsidiary of the foreign supplier over a period of three years.

The Department contended that the whole practice of separate agreement was undertaken to bifurcate the cost of the equipment in order to pay less duty. In order to consider and verify Department relied on nine imports of similar equipments during the relevant period so as consider the transaction value of the identical goods. However, none of the transactions relied by the Department were of the same technical specification as that of the one imported by the assessee.

The Apex Court did not accept the Department's plea that technical and installation charges were a disguise to cover the true cost of equipment as there was no evidence of any flowback or extra-consideration deflating the price. The Supreme Court held that the Technical and Installation Charges Agreement was a post clearance revenue generation agreement which had no nexus with the sale proceeds of the equipment, more so that it could not be established that payment of technical and installation charges was incidental to import.. Thus, the Court held that in this case, the transaction value under rule 4(1) should be accepted and the transaction value of identical goods.

2. CCEx. v. Bombay Dyeing & Mfg. Co. Ltd. 2007 (215) ELT 3 (SC)

The assessee has two textile mills known as the Spring Mills and the Textile Mills. Spring Mills is a composite name of the mill in whichthere is a spinning section where yarn is spun from raw cotton, and a weaving section where grey fabrics is woven from such yarn.

The grey fabrics woven in the Spring Mills are not processed at Spring Mills. Most of the grey fabrics manufactured by the assessee are processed by the Textile Mill though some quantity thereof is sold to third parties.

Notification No. 14/2002-CE granted exemption, both full and partial to a range of goods. As the assessee was not in a position to ascertain the variety and quantity of yarn entering into the manufacture of export production of "grey fabrics" and grey fabrics meant for home consumption, it was not in a position to pay duty on yarn at spindle stage. Hence, it opted to pay duty on yarn on deferred basis at the time of clearance of grey fabrics for home consumption along with interest at the rate prescribed. According to the Department, the assessee had failed to pay duty on yarn at the spindle stage and, secondly, it had taken credit for the duty paid on inputs under Cenvat Credit Rules, 2002, therefore was not entitled to claim nil rate of duty.

The Court observed that under Exemption Notification no. 14/2002-CE, the requirement was that exemption on grey fabrics was admissible subject to the assessee paying duty on yarn before claiming exemption and subject to the assessee not claiming CENVAT credit before claiming exemption. As payment of duty on yarn on deferred basis took place before clearance of grey fabrics on which exemption was claimed, payment was made before the stage of exemption. On payment of duty on the input (yarn) the assessee got the credit which was never utilized. Hence, Item no. 1 of the table to notification no. 14/2002-CE would apply and accordingly the grey fabrics would attract nil rate of duty.

3. CCE v Ballarpur Industries Ltd. 2007 (215) ELT 489 (SC)

As per Cenvat Credit Rules, where common inputs, on which credit is taken, are used to manufacture dutiable and exempted final products and separate accounts are not maintained, the manufacturer has to pay an amount equal to 10% of the price (excluding sales tax and other taxes, if any, payable on such goods) of the exempted final goods charged for sale of such goods at the time of clearance of such goods from the factory. The contention of the assessee was the provisions of Rule 6 of the CCR would not apply in case of stock transfer but only in case of sale of goods.

The Tribunal, when the issue was brought before it, ruled in favour of the assessee and opined that rule 6 would not apply in case of stock transfer as it applies only in case of sale. However, the Supreme Court rejected the Tribunal's view. The Apex court observed that the rule is a provision which sought to recover presumptive amount @ 10% of the price of exempted final goods at the time of removal for sale. Thus, rate of 10% was the measure to calculate the presumptive sum. The Court opined that since the entire rule was based on "deemed price" and "recovery of presumptive amount" hence, the words "price charged at the time of sale" must be read as "ten percent of the value of exempted goods".

Thus, the Supreme Court held that rule 6 applied in cases of stock transfers also.

4. MATSUSHITA TELEVISION & AUDIO (I) LTD v CC 2007 (211) E.L.T. 513(SC)

M/s. Salora International Ltd. (SIL) has entered into an agreement with M/s. Matsushita Electric Industrial Co. Ltd. (MEI) for obtaining technical assistance and know-how. The technical assistance and know-how was assigned by M/s. SIL to the appellants - MEI. Appellants were required to pay royalty at 3% on net ex-factory sale price of the colour TV manufactured by them towards technical assistance rendered by MEI. In addition to royalty the appellants were also sequired to pay USD 2 lakhs, as lump-sum payment to assist the appellants by selling the equipment at commercial prices.

The Adjudicating authority loaded the value of the said components by 2% and 1.58% in terms of Rule 4(2) and Rule 9(1) (c) of the Customs Valuation Rules.

The Supreme Court observed that payment of continuing royalty was payable at the rate of 3% of the net ex factory sale price of colour T.V. exclusive of taxes, freight and insurance but including the cost of imported components. Further, royalty payment was to be computed not only on domestic element of net sale price of colour T.V. but also on cost of imported components. Supreme Court ruled that cost of imported components was expressly included in net ex-factory sale price of colour T.V when payment to foreign collaborator was @ 3% of sales turnover of final product, including cost of imported components (which was a condition of sale of finished goods) Therefore such royalty payment is includible in AV.

5. Fedders Lloyd Corporation Limited v CCE (SC)

The appellant cleared condensing units from their unit in New Delhi to Mumbai, where the appellant purchased cooling units from local manufacturers fabricated on order with motors, etc., supplied by the appellant. After carrying out certain tests for quality by filling gas, affixing the brand name etc, the complete unit was cleared along with pipe kits, electrical cord, remote control, etc., to various customers from their warehouse / godown at Mumbai. The invoices were raised by the appellant's Mumbai office for supply of split air-conditioners. A show cause notice was issued to the appellant, alleging that split air conditioners were clandestinely removed by the appellant without payment of duty and that the department was unaware of the fact that the appellant was manufacturing split airconditioners.

The Supreme Court held that neither the condensing unit nor the cooling unit by itself is a complete air conditioner. It is only when these two, condensing unit and cooling units are put together the complete unit of air conditioner fit for use came into existence in Bombay workshop. Hence, the contention of the appellant that there is no manufacture at their Bombay Unit stands belied and cannot be accepted.

Further, the issue of clearing complete units of air-conditioners from Bombay Branch of the appellant was evident from the depositions of the appellant's own employees and the partners of the agency who had supplied the cooling units and the invoice raised by the appellant. Hence, the appellant was manufacturing the split air-conditioners.

6. FERODO INDIA PVT. LTD. v CC (SC)

The company entered into a Technical Assistance and Trade mark Agreement (TAA) with its foreign collaborator for the manufacture of goods in India. The respondent paid royalty and license fees under the TAA to the foreign company. The respondent company imported goods from its foreign collaborator and paid customs duty on its value. The Department sought to include the value of royalties and license fees paid by the respondent for the purposes of calculating the customs duty liability.

On appeal the Supreme Court ruled that Rule 10(1)(c) stipulates that payments made towards technical know-how must be a condition pre-requisite for the supply of imported goods by the foreign supplier and if such condition exists then such royalties and fees have to be included in the price of the imported goods. Under rule 10(1) (c) the cost of technical know-how is included if the same is to be paid, directly or indirectly, as a condition of the sale of imported goods.

As stated above, the buyer/importer makes payment of the price of the imported goods. He also incurs the cost of technical know-how. Therefore, the Department in every case is not only required to look at TAA, but also required to look at the pricing arrangement/agreement between the buyer and his foreign collaborator. For example if on examination of the pricing arrangement in juxtaposition with the TAA, the Department finds that the importer/buyer has misled the Department by adjusting the price of the imported item in guise of increased royalty/license fees then the adjudicating authority would be right in including the cost of royalty/license fees payment in the price of the imported goods. In such cases the principle of attribution of royalty/license fees to the price of imported goods would apply. This is because every importer/ buyer is obliged to pay not only the price for the imported goods but he also incurs the cost of technical know-how which is paid to the foreign supplier. Therefore, such adjustments would certainly attract rule 10(1)(c).

On reading TAA we find that the payments of royalty/licence fees was entirely relatable to the manufacture of brake liners and brake pads (licensed products). The said payments were in no way related to the imported items. In the present case, no effort was made by the Department to examine the pricing arrangement. Therefore the contention of the department is not correct.

7. PRACHI INDUSTRIES v CCE (SC)

The assessee is a small scale unit. It buys duty-paid MS tubes from its manufacturers. After receiving MS tube from the manufacturers, the Appellant cuts the same into requisite lengths. The cut MS tube is thereafter put in the swaging machine in which dies are fitted which imparts “folds” to the flat surface of the MS tube/pipe. The department is of the opinion that the process of swaging undertaken by the Appellant on swaging machine on duty paid MS tubes amounts to “manufacture” within the meaning of Section 2(f) of the Act.

Swaging is a general term which is applied to a number of metal forming operations. Production Swaging Operations are commonly performed on rotary swaging machines. **Swaging has proved to be an economical-production method for forming shapes confined to a portion of the total length of a given pipe or tube, by tapering, pointing, reducing or sizing. Swaging process is also used for joining and fastening operations. It is also used in assembling two or more components by joining a busing to a shaft, swaging of rings onto wire for use as electrical connectors, and for attaching fittings to tubes**.

According to Dictionary "swage" is defined to mean a form of die used as an aid in forming forged work. According to the said Dictionary the word "profile" refers to an outline or contour. Swaging provides a pattern or contour, with peaks and valleys, depending upon the desired configuration. Therefore, even in matter of classification, distinction is made between pipes and tubes on one hand and hollow profile on other hand.

The Apex Court ruled that the rotary swaging machine with different dies therein imparts a change of lasting character to the plane pipe or tube by use of dies. That, a work piece having a distinguishable identity comes into being depending on the shape of the die and the punch used. On facts, we find that after undergoing the swaging process a work piece of a different shape and user emerges and, therefore, in our view, the process of swaging amounts to manufacture under section 2(f).

8. CCE v KRAFTECH PRODUCTS INC. [SC]

The assessee company manufactures hair dye. It is packed in pouches each containing 3 Gms. 3 pounches (sachets) are sold in one packet. The net weight of each pouch, as also the net weight of the commodity in 3 pouches and the maximum rate is printed on the pouches. Revenue claimed that duty has to be paid on the pouches under section 4A of the Central Excise Act.

Supreme Court noted that it is beyond any doubt or dispute that the commodity in question is being sold in 'multi piece package'. Identical quantity of commodity is packed in each sachet. Yet again admittedly three sachets are packed in one packet. The weight of three sachets is 9 gms, that is, less than the prescribed weight of 10 gms. The packet describes the commodity in question. It discloses also the weight. It not only discloses the weight contained in each sachet but also discloses the weight contained in the packet of three sachets. Therefore, the intention of the manufacturer to sell the commodity by weight is explicit.

The MRP rules provides for additional declarations to be made on multi-piece packages. It envisages declaration of the quantity and the sale price thereof on each of the packets when the quantity is sold in the multi-piece package. Requirements of Rule 17 have been complied with. Section 4A of the Act would apply only when it is statutorily required to apply the provisions of the Rules.

The rules also provide an exemption clause. The exemption clause would apply if the commodity is sold by weight or measure, subject of course to the condition that the net weight of the commodity is 10gms, or less. This legal requirement in this case also stands complied with. Once it is held that the Rules have no application in respect of the commodity as marketed and sold by the respondent, Section 4A of the Act will have no application. Therefore the contention of the Department is not justified.

9. GEO TECH FOUNDATIONS & CONSTRUCTION v. CCE [SC]

Appellant manufactures PSC girders at site to be used in the construction of Railway Bridge for Konkan Railways. These articles were cleared without payment of central excise duty. A show cause notice was issued and the Appellant was asked to show cause as to why duty amounting to Rs.53, 91,498/- should not be demanded from it, as the girders were cleared without payment of duty, why they should not be confiscated and why penalty should not be imposed on the person concerned. The Commissioner adjudicated the case demanding duty and confiscating the girders and imposed penalties. The CESTATheld that the period of 5 years was available for the SCN.

The Supreme Court observed that when the first show cause notice was issued, the extended period of limitation was not resorted to. A notice should ordinarily be issued within a period of 1 year i.e. within the prescribed period of limitation but only in exceptional cases, the said period could be extended to five years. When in the original notice, such an allegation had not been made; we are of the opinion that the same could not have been made subsequently as the facts alleged to have been suppressed by the Appellant were known to them.

The Appellant as well as Konkan Railways raised a definite plea of bonafide. Such a plea had not been rejected. As the facts alleged to have been suppressed by the Appellant were known to the department, in that view of the matter the extended period of limitation under Section 11A of the Act has no application. Invocation of Section 11-A, under the extended period was impermissible.

10. CCE v INSULATION ELECTRICAL (P) LTD. [SC]

The issue before the Court was whether seats of car could be classified as parts and accessories of motor vehicles (15% duty) or as seats or parts thereof (18% duty).

The Supreme Court pointed out the following - Chapter 9401 covers all types of seats and not only the seats of a car and a seat is complete even without the rail assembly front seat, adjuster/assembly slider seat and rear back lock assembly. They are not essential parts of the seat. Chapter heading 9401 covers only the parts of seats and not accessories to the seats. A ‘part’ is an essential component of the whole without which the whole cannot function.

The products manufactured by the assessee cannot be the ‘parts’ of seats, as claimed by the revenue. Chapter heading 8708 covers both the ‘parts’ as well as ‘accessories’. The items manufactured by the assessee are only adjuncts. These are to be affixed on the floor of motor vehicles. When seats are affixed on these rails, seats can slide back and forth with the operation of a lever forming part of other rail assembly front seat adjuster. This enables the driver or the passenger, to adjust the position of the seat to suit his comfort and convenience. These are merely to improve the efficiency and convenience of the seat and does not form part of the seat. The sears are complete in themselves without these mechanisms and therefore it cannot be held that the parts manufactured by the assessee merit classification under chapter 9401. Rather the same would be accessories to the motor vehicles as claimed by the assessee and would merit classification under chapter heading 8708, because they are fitted in the motor car for adjustment of the seats for the convenience and comfort of the passengers. The Rail Assembly front seat (Omni), Adjuster/assembly slider seat, YE-2 rear back lock assembly and 1000cc rear back lock assembly being manufactured by the assessee can at best be termed as accessories to the motor vehicle for better convenience of the passengers/drivers traveling in the car.

11. LOHIA SHEET PRODUCTS v CC [SC]

The issue involved in this case is as to whether the scrap imported by the appellants is chargeable to 'NIL' rate of CVD under Section 3 of the Customs Tariff Act 1975.

The appellants imported copper/brass waste and scrap for use in the manufacture of handicrafts and filed bills of entry and claimed benefit under Exemption Notification. In order to avoid unnecessary delay and demurrage, the appellants paid the duty under protest and filed refund claim before the Asst. Commissioner (Refund) who, having gone through the record and the facts of the case rejected the claim of the appellants. This finding arrived at in the order in original was confirmed by the Commissioner of Customs (Appeals). Being aggrieved, the appellants appealed to the Tribunal. The Tribunal dismissed the appeal by holding that the condition of the notification of the Tariff Heading 7404.10 had not been satisfied by the appellants as the copper waste and scrap has been imported by the appellants from foreign country and the same had not been generated in the factory of the appellants.

The Supreme Court observed that Entry 74.04 can be divided into three parts, viz. (i) copper waste and scrap '(ii) used within the factory of production; and (iii) for the manufacture of unrefined or unwrought copper, copper sheets or circles and handicrafts. The sum and substance of the entry, in our opinion, is that if a manufacturer uses copper waste and scrap within the factory of production for the manufacture of 'unrefined or unwrought copper, copper sheets or circles and handicrafts', then it would be entitled to the exemption under the impugned notification. In the present case, the appellants satisfy all the three conditions as they had used the copper/brass waste and/or scrap within the factory of production, and for the manufacture of handicrafts. The entry nowhere uses the word 'generated' or 'imported'.

The condition that only that scrap would be entitled to exemption which has been generated in the factory of production is, therefore, unwarranted and unsustainable. The word, 'within' occurs after the word, 'used'. The test laid down by the Tribunal that the benefit of the notification/tariff heading would be admissible to only that copper waste and scrap which is generated in the factory of production, and not the imported waste and scrap, is not supported either by the text of the exemption notification, heading 74.04 or any other authority.

In the present case, it is a matter of fact that duty was paid by the appellant at the time of import of waste or scrap. Mere fact that the goods were imported would not make any difference. The intention behind the grant of exemption under the notification was to prevent the duty being paid at two stages. In the present case, an amount equivalent to the excise duty had been paid by the appellants at the time of import on the waste and scrap. If the benefit of the notification is not given to the appellants it would mean double payment of duty which goes contrary to the.

12. Whirlpool of India Limited vs. UoI and Others (SC)

The appellant is engaged in manufacturing refrigerators. The central government issued a notification under section 4A (1) of Central Excise Act and specified the goods mentioned in column 3 of the said notification.

The issue under consideration is whether refrigerator is a 'packaged commodity'. The Supreme Court observed that even if the package of the refrigerator is required to be opened for testing, even then the refrigerator would continue to be a 'pre- packed commodity

The court further held that as sale of the refrigerator is covered under the 'retail sale'. Standards of weights and measures (packaged commodities) rules, 1977, would specifically include the refrigerator and would carry along with it the requirements by that rule of printing certain information including the sale price on the package. Once it is included in the notification, unless the notification is faulted on any other ground, the effect of the notification would remain intact in so far as refrigerator is concerned.

13. C.C.Ex., Delhi vs Frick India Limited and Another (SC)

The assessee cleared compressors falling under CETA. Sub Heading 8414.10. They also cleared to its buyers separately "fly wheel" under Sub Heading 8483.00, "safety valve" under S.H. 8481.80 and "filter" under S.H.8421.00. Apart from the above three items, assessee supplied to its buyers bought out items, namely, V. belt, motor, pulley, belt guard, gauge, gauge board, angle valve, MS male flange, CAF. Gasket, set of tools, bolts and nuts, etc.

Show cause notice issued on the ground that the assessee had evaded payment of duty on the full value of the compressors, manufactured and cleared by them, by separately invoicing clearance of bought-out items and manufactured items.

The Supreme Court observed that the General Interpretative Rule 2(a) has no application to the present case. Firstly, the compressor manufactured by the assessee was removed as a "stand-alone" item. It was not cleared in an unassembled or disassembled condition. Secondly, section and chapter notes in Central Excise Tariff Act, 1985 and the Interpretative Rules do not provide guidelines for valuation of excisable goods as they decide classification of a product under different headings/sub-headings of the tariff.

The Court ruled that parts / accessories could not have been classified as "compressors" under tariff Heading 84.14.

14. CCE v Damnet Chemicals Private Limited (SC)

The assessee company DCPL were manufacturing the products 'CRC 2-26 Aerosol' and 'CRC Acryform Aerosol. They were claiming exemption under Notification No. 120/84-CE for the product 'CRC 2-26' and SSI exemption for the product 'CRC Acryform.

In their declarations, they claimed the classification of the products 'CRC 2-26' under Chapter 2710.99 and 'CRC Acryform' under Chapter 3203.40. The Department denied benefit of Notification No. 120/84-CE on the ground that the product 'CRC 2-26' was not a blended lubricating oil and that the product 'CRC Acryform' was not entitled to the benefit of SSI Notification in as much as the product carried on it the brand name/trademark of a person not entitled to the benefit of the Notification.

The issues that arose for consideration were (1) whether the product 'CRC 2-26' is a blended lubricating oil and thus is entitled to exemption under Notification No. 120/84?

(2) Whether the respondent is entitled to the benefit of Notification No. 175/86 in respect of the product 'CRC Acryform'?

The Supreme Court held that as there is no dispute that the product contains 70% or more of mineral oil apart from 20% petroleum oil, the product is predominantly a blended lubricating oil. Negligible percentage of rust preventives does not make the product in question to be a rust preventive one.

(2) There was no evidence made available by the Department that the same trade name or brand name was used by some other company apart from the respondent assessee. As the respondent assessee continued to be a small- scale industry, it was entitled to the benefit of SSI Notification in respect of 'CRC Acryform'.

15. National Organic Chemical Industries Ltd v CCE 2008 (232) ELT 193 (SC)

The assessee manufactures petro chemicals falling under chapters 27 (Ethylene and propylene) and 29 (Methane and the ethane) by cracking raw naphtha in a naphtha cracker. During the process of cracking raw naphtha, gases such as methane and ethane automatically emerge as by-products and is an inevitable consequence of cracking of raw naphtha.

Raw Naptha is cracked in cracker containing number of burners and heated upto 800 degree centigrade. After the process of cracking, Ethylene and Propylene gases are produced in the factory. These gases are also captively consumed as a refrigerant for cooling since they have the property of reducing temperatures upto 100 degree c. and 30 degree c. respectively. The captively consumed ethylene and propylene are further used in refrigeration to manufacture products falling under chapters 27 and 29.

A part of the ethylene and propylene manufactured by the aforesaid process is captively consumed by using the same as a refrigerant in the process of separation and to provide external treatment to keep some of the products at low-temperature to prevent their polymerization. The remaining quantity of ethylene and propylene is sold as the final product.

As per Exemption Notification No. 217/86-C.E., the inputs ethylene and propylene (falling under chapter 29) captively consumed in the manufacture of finished goods falling under chapter 29 are exempted from excise duty. As per the said notification such exemption will not be available to ethylene and propylene used in the manufacture of goods falling under chapter 27, namely methane and ethane. In other words, excise duty will have to be paid for such of the quantity of ethylene and propylene (inputs) captively consumed and used in the manufacture of products falling under chapter 27 namely methane and ethane.

According to the Department, the assessee is not entitled to get the benefit of the exemption notification if the inputs manufactured in the factory are captively used for the manufacture of final products not specified in the notification. Products of Chapter heading 27 is not specified in the notification . Methane and ethane, the finished products manufactured by using ethylene and propylene as refrigerant fall under chapter 27. Hence, as per the notification the ethylene and propylene (inputs) used for the manufacture of goods falling under chapter 27 are not entitled to get exemption from duty as per the notification.

It was contended by the respondent that ethylene and propylene were used as refrigerant to cool hydrocarbon gases, which result from the cracking of naphtha. It is as a result of this cracking that ethylene, propylene along with ethane, methane and other substances emerge. The emergence of ethane and methane is inevitable. Since it only emerges in the manufacture of other substances, which are specified in notification, their emergence (ethane and methane) should not by itself justify denial of the benefit.

The Supreme Court observed that the process of manufacture indicated that some gases automatically emerge in the process of cracking of naphtha, including ethane and methane. Also it was submitted that there was no way by which the assessee could have manufactured ethylene and propylene without producing ethane and methane. It is not as if by using a smaller quantity of raw material or other goods involved in the process, the assessee could have averted the emergence of ethane and methane. In other words, in the technology utilized for the manufacture of ethylene and propylene, the emergence of ethane and methane was inevitable. In any technology the emergence of ethane and methane was inevitable and hence while it is not correct to say that the ethylene and propylene have been used in or in relation to the manufacture of ethane and methane, the identical quantity of the same goods has simultaneously been used in the manufacture of ethylene and propylene.

The Supreme Court ruled that the emergence of ethane and methane, therefore, cannot be a ground to deny the benefit of exemption to the assessee.

16. CC v SONY India Ltd 2008 (231) ELT 385 (SC)

Import of Colour Television (CTV) components in CKD condition whether assessable as CTVs.

The assessee had imported components of CTV's at various occasions. The Department relying on Rule 2(a) of Rules for Interpretation of Tariff, issued Show Cause Notice treating the components actually CTV's in CKD condition. The assertion in the Show Cause Notice, therefore, was that though the respondent was importing the CKD Kits of CTVs for their assembly in India, which attracted higher customs duty, the said imports were being shown as the imports of the components of the CTVs, attracting lesser customs duty and as such, the respondent was liable to pay not only the differential duty, but also the penalties on account of the clandestine imports.

The Supreme Court observed that in this case the goods were brought in 94 different consignments. Rule 2(a) of Rules for Interpretation of Tariff is applicable only if all components are presented at same time for customs clearance. Clubbing of all consignments of different dates not permissible for applying Rule 2(a). Further, goods brought does not have essential character of CTV and therefore cannot be taken as complete CTVs applying Rule 2(a). The Department has not put up any finding in impugned orders that goods brought could make specified number of CTVs. It was also pointed out that it was a complicated process to be undertaken for making impugned goods useable as CTVs by assembling.

The Supreme Court ruled that Rule 2(a) of Rules for Interpretation of Tariff applicable only if all components intended to make a final product presented at same time for customs clearance. The Rule is applicable only when imported goods presented unassembled or disassembled can be put together by means of simple fixing device or by riveting or welding. Goods requiring complicated process to make final product, not to be considered as unfinished goods having essential character of complete articles. Therefore in this case it cannot be said that the components imported were actually CTV's in CKD condition.

17. CCEx v Ratan Melting and Wire Industries 2008 (12) STR 416 (SC)

The assessee's contention was that once a circular has been issued, even if it runs counter to the decision of Supreme Court, it is binding on the Revenue authorities. The circulars issued by the Board are not binding on the assessee but are binding on Revenue. The consequence of issuing a circular is that Revenue cannot act contrary to the circular. Once the circular is brought to the notice of the Court, the Revenue cannot lodge an appeal taking the ground which is contrary to the circular. Assessee contended that Revenue authorities cannot take advantage of Supreme Court decision which runs contrary to the Circular and file appeal taking position contrary to CBEC Circulars.

The Revenue pleaded that the law declared by Supreme Court is supreme law of the land under article 141 of the Constitution of India. The law so laid down is binding on all courts/tribunals and bodies. It is clear that circulars of the Board cannot prevail over the law laid down by Supreme Court.

Supreme Court pointed out that circulars and instructions issued by the Board are no doubt binding in law on the authorities under the respective statutes, but when the Supreme Court or the High Court declares the law on the question arising for consideration, it would not be appropriate for the Court to direct that the circular should be given effect to and not the view expressed in a decision of this Court or the High Court. So far as the clarifications/circulars issued by the Central Government and of the State Government are concerned, they represent merely their understanding of the statutory provisions. They are not binding upon the court. It is for the Court to declare what the particular provision of statute says and not for the Executive. Looked at from another angle, a circular which is contrary to the statutory provisions has really no existence in law.

Supreme Court ruled that the assessees submission not acceptable as that would indicate absence of scope for filing an appeal. In that case, there is no question of a decision of this Court on the point being rendered.

Obviously, the assessee will not file an appeal questioning the view expressed vis-a-vis the circular. It has to be the revenue authority to question that. To lay content with the circular would mean that the valuable right of challenge would be denied to him and there would be no scope for adjudication by the High Court or the Supreme Court. That would be against the very concept of majesty of law declared by this Court and the binding effect in terms of Article 141 of the Constitution. In other words the Revenue authorities can take advantage of Supreme Court decision and file an appeal taking position contrary to CBEC Circulars.

18. UOI v Dharamendra Textile Processors (2008) 174 TAXMAN 571 (SC)

Whether section 11AC with the intention of imposing mandatory penalty on persons who evade payment of tax should be read to contain 'mens rea' as an essential ingredient; and whether there is a scope for levying penalty below the prescribed minimum limits.

Supreme Court ruled that it is a well-settled principle, in law, that the Court cannot read anything into a statutory provision or a stipulated condition which is plain and unambiguous. Section 11AC provides that:

"Where any duty of excise has not been levied or paid or has been short levied or short paid or erroneously refunded by reasons of fraud, collusion or any wilful mis-statement or suppression of facts, or contravention of any of the provisions of this Act or of the rules made thereunder with intent to evade payment of duty, the person who is **liable to pay duty** as determined under 11(2), **shall also be liable to pay a penalty equal to the duty so determined**……."

The assessee is of the argument that the absence of specific reference to *mens rea, in the section is a case of casual omission and not intentional. In other words mens rea (malafide intent) would continue to be an essential ingredient for imposition of penalty under section 11AC*.

Supreme Court ruled that mens rea not an essential ingredient for imposition of penalty thereunder. Penalty under section 11AC is a civil liability, enacted to provide remedy for revenue loss. Wilful concealment not an essential ingredient for attracting civil liability as is the case of prosecution. Union Budget 1996-97 making position clear that the levy of penalty is a mandatory penalty. The notes on Clauses also giving similar indication. As there is no inbuilt discretion under Rules, the penalty imposed is mandatory

Interpretation of statutes - Principles therefor - Court cannot read anything into a statutory provision or a stipulated condition which is plain and unambiguous - A statute is an edict of the legislature - Language employed in statute is determinative factor of legislative intent.

Supreme Court pointed out that as the section uses the expression "assessee shall be liable" the position is clear that there is no scope for any discretion. It can by no stretch of imagination be said that the adjudicating authority has even a discretion to levy duty less than what is legally and statutorily leviable. The Court ruled that no discretion is available on quantum of penalty under Section 11AC.

In this case the Supreme Court had also referred to the provisions of section 271(1)(c) of the Income tax Act and had ruled that this ruling would equally apply to the penalty imposed for concealment of income under section 271(1)(c) of the Income tax Act.

Note : In this case the Supreme court admittedly overruled the other Supreme Court verdict in case of Dilip N Shroff in relation to section 271(1)(c) of the Income tax Act, 1961. In this case the Supreme Court ruled that the law as enunciated in the case of Dilip N Shroff was not correct.

In brief the Supreme Court in case of Dilip N Shroff had ruled that order penalty for concealment of income and inaccurate particulars, is quasi-criminal in nature, thus, burden lies on Department to establish that assessee had concealed his income and that there existed mens rea. Before a penalty can be imposed, entirety of circumstances must reasonably point to conclusion that disputed amount represented income and that assessee had consciously concealed particulars of his income or had furnished inaccurate particulars thereof. If these facts are not established the Assessing Officer would have discretion on imposition of penalty.

19. Camlin Ltd v CCE 2008 (230) ELT 193 (SC)

The assessee manufactures various kinds of marker pens and sketch pen sets. As per the CBEC Trade Notice, it has been clarified that "marker pens", Hi-liter pens, up-liners were "all" different categories of pens. According to the assessee, since various types of inks mentioned aforesaid are used in one or other types of pens which are instruments for writing such inks are to be considered as "writing inks".

It is submitted that initially all types of inks falling under the aforesaid Chapter Heading no. 32.15 were chargeable to duty @ 20%. Subsequently Chapter Heading no. 32.15 has been revised and accordingly "writing ink" is now classifiable under 3215.10 chargeable to duty at nil rate and all varieties of ink other than "writing inks" are classifiable under 3215.90 chargeable to duty @ 16% .

According to the assessee, the legislative intent of the aforesaid amendment was that the units manufacturing pens which are assessed to nil rate of duty should not be paying duty on the inks filled/used in the pens. As the pens manufactured by the assessee are assessed at nil rate, the submission is that the writing inks which are used in these pens are not exigible to the levy of duty.

Chapter heading 32.15 reads as under :-

32.15	Printing ink, writing or drawing ink and other inks, whether or not concentrated or solid.	
3215.10	Writing ink	Nil
3215.90	Other	16%"

The Supreme Court ruled that the Tribunal erred in relying upon the HSN for the purpose of marker inks in classifying them under Chapter Sub-Heading 3215.90 of the said Tariff. The Tribunal failed to appreciate that the entries under the HSN and the entries under the said Tariff are completely different. As mentioned above, it is settled law that when the entries in the HSN and the said Tariff are not aligned, reliance cannot be placed upon HSN for the purpose of classification of goods under the said Tariff. One of the factors on which the Tribunal based its conclusion is the entries in the HSN. The affirmed the order of the Commissioner (Appeals), wherein the contention of the assessee that pens are not writing instruments was accepted. Commissioner (Appeals) further classified all nine types of Inks manufactured by the assessee as "writing ink". The marker inks would be classifiable under 3215.10.

20. CCE v Ishaan Research Lab Private Ltd. 2008 (230) ELT 7 (SC)

The assessee - Ishaan Research Lab Pvt. Ltd (IRLP Ltd.) contended that 16 products of IRLP Ltd. under consideration were ayurvedic medicines covered under the Central Excise Tariff sub-heading 3003.30 chargeable to duty at the rate of 10% advalorem. However, the Department contended that these products were classifiable under Chapter 33 –Cosmetic or toilet preparations, essential oils etc. - of the Tariff. Therefore, the said products would invite the duty at the rate of 40% advalorem.

Department's plea was that these products were cosmetics such as skin beautification creams, lotions, moisturisers, shampoos, etc., and sold to the hotels, beauty parlours etc. It relied on the literature published by M/s. IRLP on the Skin Care Naturals thereby suggesting that the use of biotique products would make the skin beautiful and would help the user retain the bloom of youth. It was also submitted by the Revenue that these products were treated as cosmetic products by the customers.

The Apex Court held that the said products would invite the duty as "ayurvedic medicines" at the rate of 10% advalorem and not at the rate of 40% advalorem as claimed by the Revenue since all these products were produced under the Drugs License issued under the Drugs and Cosmetics Act, 1940. Further, label of the product specified the medicinal properties of the product and there was a specific claim that this was not a cosmetic product. The Supreme Court clarified that the common parlance test is not "be all and end all" of the matter. Merely because the product could be put to cosmetic use, that would not by itself make it a cosmetic product provided there was a rightful claim made that it was an ayurvedic product on the factual basis, and it contained the medicinal ayurvedic medicament.

21. CCE v Sunco Rubbers Ltd 2008 (228) ELT 27 (SC)

The assessee, a job worker, received raw materials required for the manufacture of strips tyres trom the primary manufacturers (viz, raw material suppliers) for further processing and after undertaking the processing returned them to the suppliers, Thereafter, the suppliers carried on the processes of de flashing, testing and inspection on those goods, The Department opined that since the goods processed at the premises of the job worker were fully manufactured goods, the job worker should pay excise duty on such goods before clearing them from its premises.

High Court ruled that having regard to the activities like deflashing. testing. inspection etc, being undertaken by the primary manufacturers. it was evident that the goods were made ready for marketing only after the same were subjected to the above mentioned processes at the hands of the raw material suppliers, Hence, the manufacturing process was complete only after these processes were carried out at the premises of the suppliers, The job worker collected only job charges for the various processes undertaken by him on the goods.

Moreover, as per section-2(f)(i), any activity which is incidental or ancillary to the manufacture of the final product would be considered as a manufacturing activity, Therefore, the goods cleared from the premises of the job worker, could not be regarded as fully manufactured goods, and as such, the activity undertaken by the assessee could not be regarded as a manufacturing process. Therefore Supreme Court answered the question in favour of assessee and against the revenue holding that no excise duty was payable by the job worker in present case,

22. Hindustan Zinc Ltd v. UOI 2008(228) ELT 517

The assessee was availing the credit of duty paid in respect of welding electrodes as capital goods. However, the department denied the credit to the assessee contending that the said goods were not covered under the definition of capital goods, The assessee claimed that the welding electrodes were accessories of machinery for soldering, drazing or welding falling under Chapter Heading No, 84.68. Since Chapter Heading No. 84.68 was an item, eligible as Capital Goods, the welding electrodes acquired eligibility Cenvat Credit.

The assessee further contended that if the credit was not allowed under capital goods scheme, then, the claim of the assessee might be considered treating the electrodes as inputs. The assessee brought to the notice of the Court the ruling in the case of CCE v Jawahar MilIs, wherein the Supreme Court had held that capital goods could be machines, machinery, plant equipment, apparatus, tools or appliances. Even if they were not used for producing the final product or for processing of any product or for the manufacture of final product or for bringing about any change in any substance then also they would be eligible for Cenvat credit. The only requirement to determine Cenvat credit eligibility was the use in the factory of manufacturer.

Further, where any particular process, or activity, was integrally connected with the ultimate production of the goods that process would, fall within expression "in the manufacturing of goods", Considering the proposition propounded in two cases cited above, the Court negatived the contention of the revenue that the goods involved did not satisfy the requirement of capital goods and held that the appellant was entitled to the credit as availed by him.

Note : Students should strictly remember the following and in case of such question, this should go by way of a note:

Welding electrodes and gases used for repair and maintenance of machinery not eligible to CENVAT. The Supreme Court dismissed the Special Leave Petition against the order of the CESTAT denying the CENVAT Credit, in case of Steel Authority of India Ltd. v. Commissioner - 2008 (229) E.L.T. A127 (S.C.)

23. CCE v Gujarat State Fertilizers & Chemicals Ltd. 2008 (229) ELT 9 (SC)

The issue involved in the present case is as to whether the assessee is entitled to cenvat credit on low Sulphur heavy stock (in short “LSHS”) used in the manufacture of steam which in turn was used for the manufacture of the final product, namely, fertilizer which was fully exempt from payment of excise duty.

The assessee was receiving duty paid LSHS and was availing of cenvat credit thereon. The LSHS so procured was used in the generation of steam which in turn was exclusively used in the manufacture of fertilizers exempted from payment of excise duty under the Tariff itself.

As per Rule 2 of the Cenvat Credit Rules, the Cenvat credit was available on the inputs used for generation of electricity or steam, used for manufacture of final products or for any other purpose, within the factory of production. The Supreme Court ruled that the Cenvat credit would be available on inputs used to manufacture steam which was in turn used for manufacture of exempted or nil duty rated final product or for any other purpose.

24. C. K. Gangadharan vs. CIT, Kochi [2008] 304 ITR 61(SC)

The question raised before the Supreme Court was that whether merely because in some cases revenue has not preferred an appeal against order of the High Court, that operates as a bar for revenue to prefer an appeal in another case. In other words, whether the revenue can be precluded from defending itself by replying upon the contrary decision.

The Supreme Court took the view that having not assailed the correctness of the order in one case, it would normally not be permissible to do so in another case on the logic that the revenue cannot pick and choose. There is also another aspect which is the certainty in law.

However, merely because in some cases the revenue has not preferred appeal that does not operate as a bar for the revenue to prefer an appeal in another case where there is just cause for doing so or it is in public interest to do so or for a pronouncement by the higher Court when divergent views are expressed by the Tribunals or the High Courts.

Note : Supreme Court took similar view also in the case of CIT v J.K. CHARITABLE TRUST 2008 (232) E.L.T. 769 (S.C.). However, these ruling have not further relevance due to the insertion of section 268A in the Income tax Act by Finance Act, 2008. However, the students should note that similar amendments have not been made in the Indirect Tax Laws. Therefore the ratios laid by the Supreme Court in these verdicts hold good under the Indirect Tax Laws.

25. Godrej Industries Ltd. v ACCE 2008 (228) ELT 321 (SC)

The assessee manufactures a variety of cosmetics and toilet preparations, including liquid hair dyes since May, 1974, when there was no specific entry relating to “hair dyes” under the Central Excise Tariff. However, “hair lotion” is specified under CETA. The Excise Department did not raise any claim in regard to “liquid hair dyes” under this Tariff Item and no excise duty was demanded in respect of the said item.

Subsequently, Tariff Item 68 was introduced as a residuary entry in the CETA relating to “all other goods not elsewhere specified”. As a result, all goods became excisable. The assessee started paying duty on the said product under the residuary category. However, now the Department was of the contention that “liquid hair dyes” be liable to duty as “hair lotion” and not under the residuary category.

The Supreme Court pointed out that the product is not more than a hair colouring agent. It was not capable of giving soothing, cleansing or antiseptic action while washing out one’s hair. There is no material to show whether the product could be applied to scalp for restoration or nourishment of hair, which could bring it within definition of ‘lotion’ as a medicinal product. The expression “lotion” has been described in Collins English Dictionary as “a liquid preparation having a soothing, cleansing or antiseptic action applied to the skin, eyes etc.” It has also been indicated that the word “lotion” had been derived from the Latin word “lotio” meaning - a washing. Nothing has been disclosed from any of the technical information gleaned from standard text-books that the appellant’s product was anything more than a hair colouring agent or that it was or could be used to have a soothing cleansing or antiseptic action while washing out one’s hair. From the chemical analysis of the appellant’s product nothing has also been shown as to whether the same could be applied to the scalp for restoration or nourishment of hair, which could bring it within the definition of “lotion” as a medicinal product.

Even in common parlance or trader’s jargon a hair dye, unless it had other properties besides the capacity to darken hair, could not be equated with hair lotion. While in a generic sense a hair dye may also be referred to as hair lotion, for purposes of a taxing statute its chemical composition and actual usage become relevant. Therefore it cannot be classified as hair lotion.

26. Aban Lollyd Chiles Offshore Ltd v UOI 2008 (227) ELT. 24 (SC)

Customs law applies fully in territorial waters and only to a limited extent in continental shelf and exclusive economic zones. However, the Central Government by fiction of law, can extend by notification any law, deeming it to be part of territory of India. In exercise of such powers, Customs Act, 1962 and Customs Tariff Act, 1975 have been extended upto the exclusive economic zone. Notification under the Maritime Zones Act of Ministry of External Affairs has specified limit of the ‘designated area’ – upto the exclusive economic zone, within which certain installations/structures/platforms are situated and Ministry of Finance has extended Customs Act and Customs Tariff Act to such areas. Effect of these notifications is that such ‘designated areas’ have to be treated as part of territory of India under Section 2(27) of Customs Act.

Territorial jurisdiction of India extends to Continental shelf and exclusive economic zone and therefore attracts dutiability under Customs and Excise. In these areas, if mineral oil is extracted and brought to main land, it will not be treated as import liable to customs duty. Similarly, goods supplied to these zones cannot be treated as exports liable to duty. However, minerals produced in these zones are liable to excise duty.

In case of Foreign going vessel mainly oil rigs, which are located beyond territorial waters of country but within exclusive economic zone and in notified ‘designated area’ was deemed to be in Indian territory and not a foreign going vessel as in that zone/area country’s fiscal laws were applicable. Therefore, stores imported for transshipment to the rig held liable to import duty as they were to be consumed within the country only, and benefit of Sections 86 and 87 of Customs Act, 1962 would not be available.

Contiguous zone in sea is the area beyond and adjacent to territorial waters of coastal States. In this area, though the coastal State exercises sovereign right to protect its revenue and police jurisdiction, it does not have sovereignty.

Exclusive economic zone is the area where coastal State can exercise only sovereign right of exploitation of resources and not the sovereignty in sense of territoriality/dominium. These rights are subject to navigation and over-freight rights of non-coastal States. In other respects, this zone is part of high seas.

High seas/Open sea, it is area beyond contiguous zone which juristically is international waters where all States enjoy high seas freedom including freedom of navigation. In such an area, the coastal States cannot exercise their right to search, seizure or confiscation of vessel for violation of its customs, fiscal or penal laws, and has no right to hot pursuit except in case of piratical acts regarding which historically any State has jurisdiction irrespective of territorial considerations. It is governed by United Nations Convention on the Law of Sea, 1982.

27. Bhupendra Steel (P) Ltd. v CCE 2008 (227) ELT 20 (SC)

The assessee is engaged in the manufacture of Steel bars and rods falling under sub-heading 7228.30 and steel ingots falling under sub-heading 7226.20 of CETA. Notification No. 208/83-C.E exempted certain final products falling under Chapter 72 from the whole of central excise duty, if they are produced out of the specified inputs being - pieces roughly shaped on which the duty has already been paid. As per the explanation to the notification, inputs purchased from the market will be deemed to be duty paid except such stocks as are clearly recognizable as being non-duty paid and charged to nil rate of duty.

The assessee had purchased iron and steel scrap from the local market and used the same in the form of specified inputs for availing the benefit of exemption for the manufacture of steel ingots. The samples drawn at the time of seizure established that the assessee had purchased iron and steel, bazaar scrap including turning and boring, old dismantled machinery, old broker engineering goods, punch steel metal, containers and other broken articles of iron and steel including small percentage of sample pieces of rods, flats end cutting, on which duty might not have been paid at the time of clearance.

Since the Notification does not cover either “waste and scrap” or “flats”, the assessee would not be entitled to exemption. A bare reading of the notification shows that assessee has to satisfy two conditions for availing the exemption (i) that the products are made from any goods of description specified and (ii) they should fall within Chapter 72 of the Tariff Act.

The Revenue’s case has been that the assessee had purchased trimmings and forgings, old dismantled machines, old broken engineering goods, punched steel metal containers and other broken articles. These certainly cannot be treated as “pieces roughly shaped”.

The Supreme Court ruled that the inputs are squarely covered by the definition of waste and scrap and waste and scrap does not find any mention in Notification. Hence the assessee is not entitled to the benefit of the exemption.

28. Nirlex Spares Pvt. Ltd. v CCE 2008 (222) ELT 3 (SC)

The appellants manufactured goods and sold them in corrugated boxes under their own brand name which were affixed / printed on such boxes. However, the assessee started printing hexagonal artistic design on such boxes along with its brand name. The Department claimed that such hexagonal design was the monogram of its marketing company 'X'. Consequently, the Department contended that the benefit of small scale exemption would not be available to the assessee as they were using a brand name of another person on their goods.

The Supreme Court observed that the printing of the said design on the visiting cards of the executives of the company 'X' could not confer any right or ownership of the company 'X' over the said hexagonal shape/design nor would it show that such design had any association with company 'X''. The Apex Court stated that the hexagonal design affixed on the corrugated boxes of the assessee did not reflect the nexus between the concerned goods and the company 'X'. Further, the said hexagonal shape/design was only printed on the visiting cards of the two executives of the company 'X' and the same was not even printed on the commercial documents like letter heads and sales invoices of the company 'X'. The design printed on the letterheads and sales invoices of the company 'X' was totally different. Moreover, company 'X' never came forward to say that the hexagonal design belonged to them and they had permitted the appellant to use the same on their corrugated boxes. Thus, the Apex Court ruled that the alleged monogram could not be said to be the brand name or trade name of company 'X' who itself disowned the said brand name. Therefore, the Supreme Court held that the printing of hexagonal design on packing of the goods of assessee. where such hexagonal design was not owned by company 'X' would not disentitle the assessee from the benefit of small scale exemption.

29. CCE v Phil Corporation Ltd. 2008 (223) ELT 9 (SC)

The respondent processed cashew nuts, peanuts, almonds etc. by dry roasting, oil roasting, salting, seasoning, packed them in different containers and cleared the same under its brand name. The assessee did not register with the Central Excise Authorities and cleared these goods without payment of excise duty on the ground that such goods were agricultural products classifiable under "Chapter 8- Edible Fruit and Nuts; Peel of Citrus Fruit or Melons" of the Central Excise Tariff and chargeable to nil rate of duty.

However, the Department claimed that such goods were classifiable under Chapter 20 - Preparation of Vegetables. Fruit, Nuts or Other Parts of Plants" of the Central Excise Tariff on the ground that Notes to Chapter 20 of Harmonised System of Nomenclature (HSN) provide that Chapter 20 includes "almonds, ground nuts, areca (or betel) nuts and other nuts, dry-roasted, oil roasted or fat-roasted, whether or not containing or coated with vegetable oil, salt, flavours, spices or other additives"

The Supreme Court observed that the CETA is broadly based on the system of classification from the international convention called the Brussels' Convention on the Harmonised Commodity Description and Coding System (Harmonised System of Nomenclature) with necessary modification. HSN contains a list of all the possible goods that are traded (including animals, human hair etc.) and as such the mention of an item therein does not imply that the same is manufactured and taxable. The Supreme Court reiterated that the HSN is a safe guide for the purpose of deciding issues of classification. In the present case, the HSN explanatory Notes to Chapter 20 categorically state that the products in question are so included in Chapter 20. The HSN explanatory Notes to Chapter 20 also categorically state that its products are excluded from Chapter 8 as they fall in Chapter 20.

Thus, the Apex Court held that processed cashew nuts, peanuts, almonds etc. manufactured by dry roasting, oil roasting, salting, seasoning and packed in different containers and cleared under respondent's brand name would be classifiable under Chapter 20 of Central Excise tariff and not under Chapter 8 in view of HSN explanatory notes to Chapter 20.

30. Indian Drugs Manufacturer's Assn. v. UOI 2008 (222) ELT 22 (Bom)

Should the free samples be valued as per Rule 8 of the Central Excise Valuation and not as per Rule 4 as clarified vide Circular No. 813?

The High Court observed that since Rule 8 of the Valuation Rules only covers cases where goods are not sold but are cleared exclusively for use and consumption in the manufacture of other articles, it would not apply in the instant case as the samples were not cleared for captive consumption but were identical or similar to goods cleared on sale in wholesale trade. The fact that physician's samples may be distributed in a different pack or in a different bottle would not make them different from goods sold in the open market.

The High Court observed that there is nothing in rule 4 which suggests that it applies only to goods sold but not delivered at the time of removal. Rather Rule 4 is a general rule and words "such goods" therein clearly mean that goods in question must be similar or identical to and have same quality or character to the goods sold and delivered. The High Court further explained that by use of words "if necessary" in rule 4 it is made clear that adjustments shall be permitted, wherever necessary Thus. the High Court held that physician's free samples would be valued under Rule 4 read with section 4(1)(b).

The free samples would be valued based on the value of such goods sold and delivered at any other time nearest to the time of removal of such samples. Note: This case establishes that Circular No. 813 states the correct position of law and is in consonance with the Central Excise Act, 1944 and the rules made thereunder.