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LATEST IN JUDICIARY, 2009

1. HINDUSTAN ZINC LTD. (SUPREME COURT) [2007]

The assessee valued the inventory of Zinc on the basis of price prevailing at the London Metal Exchange and did not value the inventory at the price prevailing in domestic market. The price at the London Metal Exchange was lower than the price in domestic market.

Held, that the assessee was not justified in valuing the inventory below cost price by estimating net realizable value at London Metal Exchange price and not at domestic price.

2. SURAT CITY GYMKHANA (SUPREME COURT) [2008]

Once the Commissioner of Income tax has granted registration to a trust under section 12A as religious or charitable trust, then the Assessing Officer cannot further probe or inquire into the objects of the Trust. The Assessing Officer shall have to treat the trust as a religious/ charitable trust once Commissioner of Income-Tax has approved the trust under section 12A.

3. INDIAN VISIT.COM(P) LTD. (DELHI HIGH COURT) [2008]

Expenditure on development of website incurred by the assessee engaged in travel business, to disseminate information about its business, is of revenue nature and not of capital nature. Such expenditure is allowable as business expenditure since website helps in promoting and publicizing the business of the assessee.

4. KERALA ROAD LINES (SUPREME COURT) [2008]

The assessee has entered into an agreement for purchase of land with buildings thereon. The buildings standing on the land were demolished and the income from the sale of scrap material was treated as business income. The assessee had to pay certain interest on delayed payment for the purchase price and it claimed the same as revenue expenditure. The Assessing Officer disallowed the claim of the assessee on the ground that the payment of interest on the purchase of property was in the nature of a capital expenditure and not a revenue expenditure.

Held, that the sale proceeds of the scrap material after demolishing the structures standing on the land was treated as business income of the assessee. If that was so, payment of interest which was the contractual obligation, would also be a business expenditure. Once the revenue had accepted the sale proceeds of the scrap material of structures standing on land as business income, then, correspondingly, the assessee would be entitled to claim the amount of interest paid as revenue expenditure.

5. *LOVELY EXPORTS (P) LTD. (SUPREME COURT) [2008]*

If the share application money is received by the assessee-company from alleged bogus shareholders, whose names are given to the Assessing Officer, then the department is free to proceed to reopen their individual assessments in accordance with law but this amount of share money cannot be regarded as undisclosed income under section 68 of the assessee company.

6. *MALAYALA MANORAMA CO. LTD. (SUPREME COURT) [2008]*

Where assessee was consistently charging depreciation in its books of accounts at rates prescribed in Income-tax Rules and accounts of the assessee had been prepared and certified as per the provision of Companies Act, 1956, Assessing Officer would not have any jurisdiction under section 115JB to rework net profits of assessee by substituting the rates of depreciation prescribed in Schedule XIV to Companies Act.

The Supreme Court in *Apollo Tyres Ltd. (SC)* held that the Assessing Officer under the Act has to accept the authenticity of the accounts with reference to the provisions of the Companies Act, 1956 which obligates the company to maintain its accounts in a manner provided by the Companies Act and the same has to be scrutinized and certified by the statutory auditors and will have to be approved by the company in its general meeting and thereafter, has to be filed before the Registrar of Companies, who has a statutory obligation also, to examine and satisfy himself that the accounts of the Company have been maintain in accordance with the requirements of the Companies Act, 1956.

The Assessing Officer while computing the book profits under section 115JB has only the power to examine whether the books of accounts have been certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act.

7. *DR. PRANNOY ROY VS. COMMISSIONER OF INCOME-TAX (SUPREME COURT) [2008]*

The petitioner had earned substantial capital gains for the assessment year 2008-09 for which the return was due to be filed on 30.09.2008. However, taxes due were paid on 25.08.2008 i.e., before the due date of filing of the return, but the return was filed on 29.09.2009, i.e., after a delay of about 12 months. Though the returned income was accepted on 29.01.2010, yet interest had been charged under the provisions of section 234A on the ground that tax paid on 25.08.2008 could not be reduced from the tax due on assessment.

The High Court took the view that the interest under section 234A is compensatory in nature. If the assessee deposits the entire tax on or before the due date of filing of return and files the return late, then there is no loss of interest to the Government. The High Court held that if self assessment tax is paid on or before the due date of filing of return, then the same shall also be deducted while computing interest under section 234A. Although section 234A does not provide for such reduction but on the basis of harmonious interpretation of Law it should be deducted as per Delhi High Court.

The High Court held that in the present case since the entire tax was paid before the due date of filing of return of income and although return was filed late, the interest under section 234A shall not be levied. The High Court accordingly deleted the interest under section 234A levied by the Assessing Officer. **The Supreme Court has affirmed the above judgement of Delhi High Court.**

8. *COMMISSIONER OF INCOME-TAX VS. ELI LILLY & CO. (INDIA) P. LTD. (SUPREME COURT) [2009]*

Foreign company seconded some employees to Indian joint venture, i.e., assessee. Home salary and special allowance (education allowance and retention allowance) was paid by foreign company abroad for rendition of services in India and no work is found to have been performed for foreign company by such employees.

Assessee had not deducted tax at source on home salary/special allowance (education allowance and retention allowance) payments made outside India in foreign currency by foreign company/head office to its expatriated employees in India.

The question arose before the Supreme Court that whether the Indian assessee was required to deduct TDS under section 192 on the home salary and special allowances paid by the foreign company abroad for rendering of services in India.

The Supreme Court held that if the home salary and special allowance payment made by the foreign company abroad is for rendition of services in India and if no work is found to have been performed for foreign company, then such payment would certainly come under section 192 (1) of the Income tax Act.

The Supreme Court held that the tax-deductor-assessee was duty bound to deduct tax at source under section 192(1) from the home salary/special allowance(s) paid abroad by the foreign company, particularly when no work stood performed for the foreign company and the total remuneration stood paid only on account of services rendered in India during the period in question.

9. *COMMISSIONER OF INCOME-TAX VS. DOOM DOOMA INDIA LTD. (SUPREME COURT) [2009]*

The assessee company was engaged in the business of growing and manufacturing tea in India. During the previous year 31-3-2008, the income was computed as under:

Composite income from growing & manufacturing tea in India before depreciation	3000 Lakhs
Less: Depreciation on actual cost of assets of Rs. 1000 Lakhs @ 15%	150 Lakhs
Total Income	**2850 Lakhs**

Out of which 60% is agricultural income and 40% of 2850 Lakhs i.e., 1140 Lakhs is taxable business income. The question arose before the Supreme Court that whether WDV of block of assets for the next year shall be:

Actual Cost	1000 Lakhs
Less: Depreciation	150 Lakhs
WDV	**850 Lakhs**

Or WDV of block of assets for the next year shall be:

Actual Cost	1000 Lakhs
Less: Depreciation	60 Lakhs
WDV	**940 Lakhs**

The question before the Supreme Court was whether in cases where Rule 8 applies, income which is brought to tax as 'business income' is only 40% of composite income, only 40 per cent of depreciation allowed at prescribed rate is required to be taken into account for computing WDV of Block of Assets because that is depreciation 'actually allowed'.

Supreme Court held that in case where Rule 8 applies, the income which is brought to tax as 'business income' is only 40 per cent of the composite income and, consequently, proportionate depreciation is required to be taken into account because that is the depreciation 'actually allowed'. Therefore, WDV of block of asset shall be taken as Rs. 940 Lakhs.

10. CIT VS. SRI MANGAYARKARASI MILLS (P.) LTD. (SUPREME COURT) [2009]

The assessee incurred expenditure on replacement of machinery in a textile mill and claimed the same as revenue expenditure on the ground that it was merely for replacement of spare parts in the spinning mill system and did not give rise to a new asset. In the books, the expenditure was capitalized. The Supreme Court held that expenditure on replacement of old machinery by new machinery is not a revenue expenditure and the cost of new machinery should be added to the block of assets. The Supreme Court observed as under:

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

(ii) **To constitute "current repairs" under section 31, the expenditure must be incurred to 'preserve and maintain' an already existing asset and not to bring a new asset into existence or to obtain a new asset.** For determination of 'current repairs' the question whether the expenditure is revenue or capital is not the proper test.

However, as the machine was an independent entity, its' replacement brought into existence a new asset and was not current repairs.

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

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

Therefore, expenditure incurred on replacement of old machinery by new machinery is not a revenue expenditure but is to be added to actual cost.

11. S. R. BATLIBOI & CO. VS. DEPARTMENT OF INCOME TAX (INVESTIGATION) (DELHI HIGH COURT) [2009]

The petitioner was a reputed firm of auditors and accountants. The laptops of two employees of the petitioner were seized by the Dy. Director in the course of conducting a search and seizure operation against the assessee. On the request of the Dy. Director, said employees provided him with the electronic data relating to three companies of the assessee group together with the print copies of the data. Nevertheless, the Dy. Director insisted on securing total and unrestricted access to the laptops, obviously in order to gain information and data of all the other clients of the petitioner. That request was refused by the petitioner. The seized laptops were sent by the respondents to the Central Forensic Science Laboratory (CFSL) which, however, could not ascertain the password and, accordingly, could not access the entire data on the laptops. The petitioner was thereupon asked to disclose the password, which it again declined and thereafter, the laptops were sealed in the presence of the said employees of the petitioner. The petitioner, thereafter, filed instant writ petition seeking an appropriate writ to prevent the respondents from forcibly gaining or securing access to the data contained in two seized laptops.

Held that granting absolute access to the department of all the data even pertaining to the other clients of the petitioner having no dealings with the assessee group, would tantamount to grave professional misconduct and would be contrary to the Code of Ethics applicable upon the petitioner as well as the obligations contained in the Chartered Accountants Act, 1949, which prohibits them from disclosing confidential information to third parties.

It could not be accepted that section 153C would entitle and empower the Dy. Director to seize any or all the articles, valuables or documents found during the course of the search, regardless of whether they are relevant for the purpose of assessment of the assessee on whom a search and seizure is conducted.

It was argued that under section 153C, the department acts as a post office, viz., it sends the seized material to the concerned Assessing Officer. This proposition advanced by the revenue is legally acceptable so long as it is restricted to any person having dealings or transactions with the person who is the subject of the search and seizure operation. The material which is not connected with raided party must be ignored.

The impugned summons were to be set aside, and the respondents were to be directed to forthwith return the laptops to the petitioner.

12. COMMISSIONER OF INCOME-TAX VS. LARSEN & TOUBRO LTD. (SUPREME COURT) [2009]

The question which came up for consideration was whether the assessee-employer was under statutory obligation to collect evidence to show that its employees had actually utilized the amounts paid towards leave travel concession/conveyance allowance.

The beneficiary of exemption under section 10(5) is an individual employee. Further, there is no circular of the CBDT requiring the employer under section 192 to collect and examine the supporting evidence to the declaration to be submitted by employees.

For the above reasons, it was to be held that the assessee-employer was under no statutory obligation to collect the evidence to show that its employees had actually utilized the amounts paid towards leave travel concession/conveyance allowance.

13. COMMISSIONER OF INCOME-TAX, DELHI V. WOODWARD GOVERNOR INDIA (P.) LTD. (SUPREME COURT) [2009]

The assessee-company had debited to its profit and loss account certain unrealized loss due to foreign exchange fluctuation in foreign currency transaction on revenue items, on the last date of the accounting year. The Assessing Officer held that the liability as on the last date of the previous year under consideration was not an ascertained liability, but a contingent liability and, consequently, it had to be added back to the total income of the assessee.

HELD:

(i) The word 'expenditure' is not defined in the Act. The word 'expenditure' is, therefore, required to be understood in the context in which it is used. Section 37 enjoins that any expenditure not being expenditure of the nature described in sections 30 to 36 laid out or expended wholly and exclusively for the purpose of the business, should be allowed in computing the income chargeable under the head 'profits and gains of business'. In sections 30 to 36, the expression 'expenses incurred' as well as 'allowances and depreciation' have also been used. For example, depreciation and allowances are dealt with in section 32. Therefore, the Parliament has used the expression 'any expenditure' in section 37 to cover both. Therefore, the expression 'expenditure' as used in section 37 may, in the circumstances of a particular case, cover an amount which is really a 'loss', even though said amount has not gone out from the pocket of the assessee.

(ii) AS-11 deals with giving of accounting treatment for the effects of changes in foreign exchange rates. In case of the revenue items falling under section 37(1), para 9 of AS-11, which deals with recognition of exchange differences, needs to be considered. Under this para, **exchange differences arising on foreign currency transactions have to be recognized as income or as expense in the period in which they arise.** The important point to be noted is that AS-11 stipulates effect of changes in exchange rate vis-a-vis monetary items denominated in a foreign currency to be taken into account for giving accounting treatment on the balance sheet date. **Therefore, an enterprise has to report the outstanding liability relating to import of raw materials using closing rate of exchange. Any difference, loss or gain arising on conversion of the said liability at the closing rate, should be recognized in the profit and loss account for the reporting period.**

(iii) Therefore, in the instant case, the 'loss' suffered by the assessee on account of the exchange difference as on the date of the balance sheet was an item of expenditure under section 37(1). **If an assessee converts the outstanding liability related to the import of raw materials using the closing rate of exchange as on 31st March i.e. last day of the previous year and such conversion results in a loss, then such loss is allowable under section 37(1) of the Income Tax Act, 1961.**

14. *ROTORK CONTROLS INDIA (P.) LTD. V. COMMISSIONER OF INCOME- TAX (SUPREME COURT) [2009]*

The assessee sold valve actuators. At the time of sale, the assessee provided standard warranty that if the product was defective within the stated period, the product would be rectified or replaced free of charge. For Assessment Year in question, the assessee made a provision for warranty at the rate of 1.5% of the turnover. The Assessing Officer disallowed the provision for warranty on the ground that it is a contingent liability. The Supreme Court held as under:

(i) A provision is a liability which can be measured only by using a substantial degree of estimation. A provision is recognized when: (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are met, provision shall be recognized;

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

(iii) **For a liability to qualify for recognition, there must be not only present obligation but also the probability of an outflow of resources to settle that obligation. Where there are a number of obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement, is determined by considering the said obligations as a whole;**

(iv) **In the case of a manufacture and sale of one single item, the provision for warranty could constitute a contingent liability not entitled to deduction under section 37 of the said Act. However, when there is manufacture and sale of an army of items running into thousands of units of sophisticated goods, the past event of defects being detected in some of such items leads to a present obligation which results in an enterprise having no alternative to settling that obligation;**

(v) On facts, the assessee has been manufacturing and selling Valve Actuators in large numbers since 1983-84 onwards. Statistical data indicates that every year some Actuators are found to be defective. The data over the years also indicates that being sophisticated item no customer is prepared to buy the Valve Actuator without a warranty. **Therefore, warranty became integral part of the sale price of the Valve Actuator(s). In other words, warranty stood attached to the sale price of the product and a reliable estimate of the expenditure towards such warranty was allowable as business expenditure under section 37(1).**

15. *COMMISSIONER OF INCOME-TAX VS. BHARTI CELLULAR LTD. (DELHI HIGH COURT) [2008]*

FACTS:

The assessee-companies were engaged in the business of providing cellular telephone facilities to their subscribers. They had been granted licences by the Department of Telecommunication for operating in their respective specified circles. They were required to set up their own equipments and necessary infrastructure for operating and maintaining their networks. The licences granted to the assessees stipulated that the Department of Telecommunication/ MTNL/BSNL would continue to operate in the service areas for which the licences were issued. In respect of subscribers, which fell within the specified circles of the assessees, the calls would be handled exclusively through the assessees' own networks. However, where calls were to be made by subscribers of one network to another network, such calls were necessarily to be routed through MTNL/BSNL. The interconnection between the two networks was provided by MTNL/BSNL at interconnection points known as 'Ports'. For the purposes of providing that interconnection, the assessees had entered into agreements with MTNL/BSNL, etc., under which they were required to pay interconnection access charges and port charges. According to the revenue, the interconnect/port access charges paid by the assessees to MTNL/BSNL or other companies were in the nature of fees for technical services and, hence, the said charges were liable for tax deduction at source in view of provisions of section 194J.

HELD:

'Fees for technical services' means any consideration (including any lump sum consideration) for rendering of any managerial, technical or consultancy service.

On going through the dictionary meaning of the words 'managerial and consultancy', it is apparent that both the words 'managerial and consultancy' involve a human element and both, managerial service and consultancy service, are provided by humans. Consequently, the word 'technical' would also have to be construed as involving a human element. The facility provided by MTNL/other companies for interconnection/port access is one which is provided automatically by machines. It is independently provided by the use of technology and that too, sophisticated technology but that does not mean that MTNL/other companies which provide such facilities are rendering any technical services. This is so because the expression 'technical services' takes colour from the expression 'managerial services and consultancy services' which necessarily involves a human element or, what is now-a-days fashionably called, human 'interface'. In the instant case, the services rendered qua interconnection/port access did not involve any human interface and, therefore, the same could not be regarded as technical services as contemplated under said section.

In the instant cases, the interconnect/port access facility was only a facility to use the gateway and the network of MTNL/other companies. MTNL or other companies did not provide any assistance or aid or help to the assessee in managing, operating and setting up their infrastructure and networks. No doubt, the facility of interconnection and port access provided by MTNL/other companies was technical in the sense that it involved sophisticated technology. **The expression 'technical service' would have reference to only technical service rendered by a human. It would not include any service provided by machines or robots.**

Therefore, the interconnect charges/port charges in question could not be regarded as fees for technical services within the meaning of section 194J, so as to be liable for tax deduction at source.

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16. COMMISSIONER OF INCOME-TAX VS. SOUTHERN PETROCHEMICAL INDUSTRIES CORPORATION LTD. (MADRAS HIGH COURT) [2009]

Held that the assessee is entitled to depreciation on spare parts which are stand-by items even though they were not taken for use during the accounting years.

In view of the above, we hold that the stand by assets which are not put to use during the relevant year are entitled to depreciation.

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LATEST CIRCULARS & NOTIFICATIONS

NOTIFIES THE SERVICES RENDERED BY FOLLOWING PERSONS IN RELATION TO THE SPORTS ACTIVITIES AS "PROFESSIONAL SERVICES" UNDER SECTION 194J

NOTIFICATION NO. 88/2008 DATED: AUGUST 21, 2008

In exercise of the powers conferred by clause (a) of the Explanation to section 194J of the Income Tax Act, 1961, Central Board of Direct Taxes, hereby notifies the services rendered by following persons in relation to the sports activities as "Professional Services" for the purpose of the section 194J, namely : -

- Sports Persons,
- Umpires and Referees,
- Coaches and Trainers,
- Team Physicians and Physiotherapists,
- Event Managers,
- Commentators,
- Anchors, and
- Sports Columnists.

CLARIFICATION REGARDING APPLICABILITY OF PROVISIONS OF SECTION 194-I TO PAYMENTS MADE BY THE CUSTOMERS ON ACCOUNT OF COOLING CHARGES TO THE COLD STORAGE OWNERS

CIRCULAR NO. 1/2008, DATED 10-1-2008

1. Representations have been received from various quarters regarding applicability of the provisions of section 194-I to cooling charges paid by the various customers to the owners of cold storages. It has been represented that the cold storage owners provide a composite service which involves preservation of essential food items including perishable goods at various temperatures suitable for specific food items for required periods and storage of goods being incidental to the activity of preservation. The cooling of goods is controlled through mechanical process. The customer brings its packages for preservation for a required period and takes away its packages after paying cooling charges. The customer does not hire the building, plant/machinery, etc., in any manner and does not become a tenant of any kind.

2. **The matter has been examined. The main function of the cold storage is to preserve perishable goods by means of a mechanical process, and storage of such goods is only incidental in nature. The customer is also not given any right to use any demarcated space/place or the machinery of the cold store and thus does not become a tenant. Therefore, the provision of 194-I is not applicable to the cooling charges paid by the customers of the cold storage.**

3. **However, since the arrangement between the customers and cold storage owners are basically contractual in nature, the provision of section 194C will be applicable to the amounts paid as cooling charges by the customers of the cold storage. This may be brought to the notice of the Assessing Officers under your charge.**

SECTION 43(5)(d)(ii) OF THE INCOME-TAX ACT, 1961
SPECULATIVE TRANSACTIONS - NOTIFIED RECOGNISED STOCK EXCHANGE

NOTIFICATION NO. 46/2009, DATED 22-5-2009

As per section 43(5) of the Income Tax Act, 1961 an eligible transaction in respect of trading in derivatives referred to in section 2 of the Securities Contracts (Regulation) Act, 1956, carried out in a recognised stock exchange shall not be deemed to be a speculative transaction ;

Explanation.—For the purposes of this clause, the expressions—

(i) "eligible transaction" means any transaction,—

(A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under SEBI, in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 or the SEBI, or the Depositories Act, 1996 and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognised stock exchange ; and

(B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note the unique client identity number allotted under any Act referred to in sub-clause (A) and permanent account number allotted under this Act ;

(ii) "recognised stock exchange" means a recognised stock exchange as referred to in Securities Contracts (Regulation) Act, 1956 and which fulfils such conditions as may be prescribed and notified by the Central Government for this purpose.

The Central Government hereby notifies MCX Stock Exchange Ltd. as a recognized stock exchange for the purpose of the section 43(5).

Therefore, the forward contracts in case of commodities entered into on MCX Stock Exchange Ltd. will result in normal business income and will not result in speculation income.

ELECTRONIC-PAYMENT OF TAX

NOTIFICATION NO. 34/2008, DATED: MARCH 13, 2008

"Electronic-payment of tax.

(1) The following persons shall pay tax electronically on or after the 1st day of April, 2008:-

(a) a company; and

(b) a person (other than a company), to whom provisions of Section 44AB are applicable.

(2) For the purposes of this rule:-

(a) "pay tax electronically" shall mean, payment of tax by way of-

(i) internet banking facility of the authority bank; or

(ii) credit or debit cards;

(b) the word "tax" shall have the meaning as assigned to it in clause (43) of Section 2 of the Act and shall include interest and penalty".

MANDATORY E-PAYMENT OF TAXES

CIRCULAR NO. 5/2008, DATED 14-7-2008

1. In context of electronic payment of taxes, representations have been received from some of the foreign assessee highlighting the difficulties being faced by them in complying with the provisions with regard to mandatory e-payment of taxes. It has been pointed out by such foreign assessee that they do not have a presence in India and, therefore, are not able to meet the 'know your customer norms' of the banks. This has resulted in their inability to open bank accounts and make payment of taxes, through the electronic mode. Representations have also been received from the resident taxpayers highlighting difficulties in availing internet banking facilities of the authorized banks. A clarification has also been sought as to whether payment of tax deducted at source by a deductor will fall within the meaning of 'tax' for the purpose of the impugned notification.

2. **With a view to facilitating electronic payment of taxes by different categories of taxpayers, it is hereby clarified that, - an assessee can make electronic payment of taxes also from the account of any other person.** However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. It is not necessary for the assessee to make payment of taxes from his own account in an authorized bank. **Further, it is also clarified that payment of any amount by a deductor by way of Tax Deducted at Source (TDS) or Tax Collected at Source (TCS) shall fall within the meaning of 'tax' for the purpose of the rule 125 of the Income-tax Rules, 1962.**