# 2009

# SUPREME COURT LATEST CASE LAWS FOR NOV'09 CA FINAL


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# ☺ SUPREME COURT RECENT CASE LAWS ☺

## ASSESSMENT PROCEEDINGS, APPEAL & REVISION PROCEDURE

**Title : ACIT vs. Saurashtra Kutch Stock Exchange Ltd.**
**Details: (REFER BANGAR PAGE NO. 16.9)**

The assessee, Saurashtra Kutch Stock Exchange Ltd., a company registered under Section 25 of the Act made an application on 10-02-1992 for registration under Section 12A of the Act. The assessee filed its return of income for the assessment year 1996-97, declaring nil income claiming exemption u/s. 11 of the Act, though it had not been registered u/s. 12A of the Act. The return was processed u/s. 143(1)(a) of the Act. On 07-11-1997 a notice was issued to the assessee u/s. 154 to show cause why the exemption granted u/s. 11 should not be withdrawn. In reply it was stated that as it had made an application for registration it was entitled to exemption u/s.11 of the Act. Meanwhile, the CIT on 20-02-1998 granted registration to the assessee on condition that the eligibility regarding exemption u/s. 11 of the Act would be examined by the A. O. for the each assessment year. In an order dated 03-12-1999 passed u/s. 143(3) of the Act, the A. O. rejected the claim of exemption u/s. 11 of the Act. The CIT(A) rejected the appeal of the assessee. The Tribunal also dismissed the appeal of the assessee. The assessee filed a miscellaneous application u/s. 254(2) of the Act to rectify the error committed by the Tribunal in the decision rendered by it in appeal. The Tribunal allowed the miscellaneous application and recalled its earlier order passed in appeal. For allowing the application, the Tribunal relied upon the decision of the jurisdictional High Court.

Dissatisfied with the order passed by the Tribunal in miscellaneous application, the Revenue filed a writ petition which was dismissed by the High Court. **On an appeal, the Supreme Court first considered as to what is a mistake apparent from record. After noting the precedent, the Supreme Court held that a patent, manifest and self-evident error which does not require elaborate discussion of evidence or argument to establish it, can be said to be an error apparent on the face of the record and can be corrected while exercising certiorari jurisdiction. An error cannot be said to be apparent on the face of the record if one has to travel beyond the record to see whether the judgment is correct or not. An error apparent on the face of the record means an error which strikes on mere looking and does not need a long drawn out process of reasoning on points where there may conceivably be two opinions. Such error should not require any extraneous matter to show its incorrectness.** To put it differently, it should be so manifest and clear that no Court would permit it to remain on record. If the view accepted by the Court in the original judgment is one of possible views, the case cannot be said to be covered by an error apparent on the face of the record.

The Supreme Court thereafter considered as to whether non-consideration of a decision of a jurisdictional Court or of the Supreme Court can be said to be a mistake apparent from record.

The Supreme Court held that **it was well settled that a judicial decision acts retrospectively**. Accordingly to Blackstonian theory, **it is not the function of the Court to pronounce a 'new rule', but to maintain and expound the 'old one'.** In other words, Judges do not make law, they only discover or find the correct law. The law has always been the same. If a subsequent decision alters the earlier one, it (the latest decision) does not make new law. It only discovers the correct principle of law which has to be applied retrospectively. To put it differently, even where an earlier decision of the Court operated for quite some time, the decision rendered later on would have retrospective effect clarifying the legal position which was earlier not correctly understood.

The Supreme Court held that in the present case, according to the assessee, the Tribunal decided the matter on October 27, 2000. Hiralal Bhagwati was decided a few months prior to that decision by the jurisdictional High Court, in which it was held that a trust could claim exemption under Section 11, but it was not brought to the attention of the Tribunal. In the circumstances, the Tribunal had not committed any error of law or of jurisdiction in exercising power under sub-Section (2) of Section 254 of the Act and in rectifying the 'mistake apparent from the record'. Since no error was committed by the Tribunal in rectifying the mistake, the High Court was not wrong in confirming the said order. **Both the orders, therefore, in the opinion of the Supreme Court, were strictly in consonance with law and no interference was called for.**

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**Month-Year :** **Apr - 2009**
**Authors :** **(2008) 304 ITR 61 (SC) [BCAJ]**
**Title :** **C. K. Gangadharan & Anr. v. CIT**
**Details :** **(REFER BANGAR PAGE NO. 16.12)**

By order dated March 13, 2008, a reference was made to a **larger Bench** of the Supreme Court and the order, of reference, *inter alia,* read as follows :

"In view of the aforesaid position, we are of the opinion that the matter requires consideration by a larger Bench to the extent **whether the Revenue can be precluded from defending itself by relying upon the contrary decision.**"

The Supreme Court made it clear that it was not doubting the correctness of the view taken by it in the cases of *Union of India v. Kaumudini Narayan Dalal,* (2001) 249 ITR 219, *CIT v. Narendra Doshi,* (2002) 254 ITR 606 and *CIT v. Shivsagar Estate,* (2002) 257 ITR 59 **to the effect that if the Revenue has not challenged the correctness of the law laid down by the High Court and accepted it in the case of one assessee, then it is not open to the Revenue to challenge its correctness in the case of other assessees, *<u>without just cause.</u>*** The Supreme Court after noting its decisions in *Bharat Sanchar Nigam Ltd. v. Union of India,* (2006) 282 ITR 273 (SC), *State of Maharashtra v. Digambar,* (1995) 4 SCC 683, *Government of West Bengal v. Tarun K. Roy,* (2004) 1 SCC 347, *State of Bihar v. Ramdeo Yadav,* (1996) 3 SCC 493 and *State of West Bengal v. Devdas Kumar,* (1991) Supp (1) SCC 138, observed that if the assessee takes the stand that the Revenue acted *mala fide* in not preferring appeal in one case and filing the appeal in other case, it has to establish *mala fides*. The Supreme Court accepted the contention of the learned counsel for the Revenue that there may be certain cases where because of the small amount of revenue involved, no appeal is filed or where policy decisions have been taken not to prefer appeal where the revenue involved is below a certain amount. Similarly, where the effect of the decision is **revenue neutral**, there may not be any need for preferring the appeal. All these provide the foundation for making a departure.

The Supreme Court held that **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.**

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**Month-Year :** **Apr - 2009**
**Author/s :** **(2008) 304 ITR 55 (SC) [BCAJ]**
**Title :** **CIT v. Oriental Insurance Co. Ltd.**
**Details :**

The assessee, an insurance company was covered by the Insurance Act, 1938. According to the appellant, every insurance company has to be assessed u/s.44 of the Income-tax Act, 1961 as per Rule 5 of the First Schedule. An assessment was made and the same was upheld by the Commissioner of Income-tax (Appeals). The Income-tax Appellate Tribunal deleted the addition made. The Tribunal accepted the stand of the respondent-insurance company. The question arose as to whether the Department would prefer appeals and/or file petitions without obtaining necessary clearance from the Committee of Disputes (in short 'the COD') constituted in terms of order of the Supreme Court. According to the High Court, it was necessary to refer the matter to the said Committee. The High Court held that the same was to be done within a period of one month in terms of the order of the Supreme Court in *Oil and Natural Gas Commission v. Collector of Central Excise,* (2004) 6 SCC 437. The High Court dismissed the appeal. The High Court held that since this Court had set the time frame, there was no scope for any deviation therefrom.

On an appeal to the Supreme Court, it was clarified that there was actually no rigid time frame indicated by it. The emphasis on one month's time was to show the urgency needed. Merely because there is some delay in approaching the Committee that does not make the action illegal. The Committee is required to deal with the matter expeditiously, so that there is no unnecessary backlog of appeals which ultimately may not be pursued. In that sense, it is imperative that the concerned authorities take urgent action, otherwise the intended objective would be frustrated. There is no scope for lethargy. It is to be tested by the Court as to whether there was any indifference and lethargy and in appropriate cases refuse to interfere. In the instant case the Supreme Court found that factual position was not that. The Supreme Court therefore, set aside the order of the High Court and directed consideration of the question of desirability to proceed in the matter before it on receipt of the report from the concerned Committee.

Learned counsel for the Department submitted to the Supreme Court that even if the Committee has declined to grant permission, it was still open to raise the issues in appropriate proceedings. The Supreme Court expressed no opinion in that regard, but observed that where the Committee has declined to deal with the matter on the ground of belated approach, the same cannot be sustained. The Committee has to consider the matter on merits.

The Supreme Court further observed that where permission has been granted by the Committee, there is no impediment on the Court to examine the matter and take a decision on merits. But where there is no belated approach, the matter has to be decided. The Court has to decide whether because of unexplained delay and lethargic action it would decline to entertain the matters. That would depend on the factual scenario in each case, and no straitjacket formula can be adopted.

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**Month-Year :** **Apr - 2009**
**Author/s :** **(2008) 305 ITR 103 (SC) [BCAJ]**
**Title :** **Kvaverner John Brown Engg. (India) P. Ltd. v. ACIT**
**Details :**

During the relevant assessment years, the appellant claimed deduction u/s.80-0 in respect of qualifying income brought into India in convertible foreign exchange. In its return, the appellant indicated the qualifying income as the gross figure. By way of adjustment u/s.143(1)(a), the Income-tax Officer restricted the qualifying income to the net figure. In other words, the assessee claimed the gross income earned in foreign exchange as the qualifying income, whereas the Income-tax Officer granted deduction by restricting the claim of the assessee to the net income.

On December 17, 1997, whether the eligible income should be taken at the gross figure or net figure, was the question for interpretation. There were several conflicting decisions on this point. Therefore, according to the appellant, S. 143(1)(a) was not applicable and consequently the appellant was not liable to pay the additional tax u/s.143(1A).

The Supreme Court observed that the only point raised by the appellant was that it was not liable to pay additional tax, as S. 143(1)(a), as it stood during the relevant year, was not applicable to the facts of this case, because a moot point had arisen which could not have been a matter for adjustment under that Section and which point needed consideration and determination only under regular assessment vide S. 143(3) of the 1961 Act. The Supreme Court held that for the A.Ys. 1996-97 and 1997-98 with which it was concerned, one of the main conditions stipulated by way of the first proviso to S. 143(1)(a), as it stood during the relevant time, referred to *prima facie* adjustments. The first proviso permitted the Department to make adjustments in the income or loss declared in the return in cases of mathematical errors or in case where any loss carried forward or deduction or allowance which on the basis of information available in return was *prima facie* admissible, but which was not claimed in the return or in cases where any loss carried forward or deduction or allowance claimed in the return which on the basis of information available in the return, was *prima facie* inadmissible. In the present case, therefore, when there were conflicting judgments on interpretation of S. 80-0, the Supreme Court was of the view that *prima facie* adjustments contemplated u/s.143(1)(a) were not applicable and therefore the appellant was not liable to pay additional tax u/s.143(1A) of the Act.

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**Month-Year : Feb – 2009**
**Author/s : (2008) 301 ITR 184 (SC) [BCAJ]**
**Title : L. N. Hota and Company v. CIT**
**Details :**

The Assessing Officer issued a notice on 3-12-1998 to the assessee u/s.148 (income escaping assessment) of the Act, requiring the assessee to file the return of its income for the A.Y. 1997-98, which was **served on 7-12-1998**. The assessee filed the return of income on **5-1-1999**, whereafter the AO issued a notice u/s.142(1) (attend office and/or produce books) on 28-6-2000. The AO, vide his order dated 27-11-2000, completed the assessment estimating the income of the assessee from the business by applying the provisions of S. 145 (Best Judgment Assessment) of the Act. The assessee's appeal was dismissed by the Commissioner of Income-tax (Appeals) vide his order dated 4-1-2002 without adjudicating the issue of legality of the assessment. An application u/s.154 (Rectifying mistake apparent) was also rejected by the Commissioner of Income-tax (Appeals) vide his order dated 25-2-2002. The Tribunal vide its order dated 13-4-2004, rejected the priority prayer of the assessee that assessment made without issuance of notice u/s.143(2) within a period of one year was invalid, but on the merits of the case, remanded the matter to the AO. On appeal, the Orissa High Court in its order dated 14-8-2006 dismissing the appeal held that as the assessment order had not come about by way of scrutiny, the provisions of S. 143(2) would not be applicable.

On an appeal by way of special leave to the Supreme Court, it was held that though the question of the applicability of S. 143(2) (Scrutiny Notice) was specifically raised throughout, *prima facie*, no finding based on law as it stood, had been recorded. The Supreme Court therefore remitted the matter to the High Court for a fresh decision in accordance with the law.

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**Month-Year : Jan - 2009**
**Author/s : (2008) 300 ITR 302 (SC) [BCAJ]**
**Title : K. P. Mohammed Salim v. CIT**
**Details :**

A search was conducted by the officers of the Income-tax Department in the residence as also in the business premises of the assessee, his sons and other associates, consequent whereupon, it was proposed to transfer the cases pertaining to the assessee to the Income-tax (Inv.) Circle, Calicut, to facilitate effective and co-ordinated investigation. An order was passed to that effect by the Chief Commissioner of Income-tax, Bangalore, u/s.127(2) of the Act. A notice was issued by the Assessing Officer u/s.158 BC of the Act to file a return setting forth the total income including the undisclosed income for the block period. The assessee filed a **writ petition** in the High Court of Karnataka challenging the said order of transfer of cases passed by the Chief Commissioner of Income-tax. The said writ petition was dismissed. A notice was thereafter issued by the assessing authority asking the assessee to file a return setting forth the total income including the undisclosed income for the block period. Pursuant thereto, the return was filed. The purported undisclosed income of the assessee was determined. The said order of the Assessing Officer, Calicut was challenged on the ground that **he had no jurisdiction to make the block assessment, as the authority therefore remained with the Assessing Officer originally having the jurisdiction over the assessee.** A Division Bench of the High Court by reason of the impugned judgment opined that the provisions of S. 127 of the Act can also be resorted to for a block assessment.

On an appeal, the Supreme Court held that an order of transfer is passed for the purpose of assessment of income. It serves a larger purpose. Such an order has to be passed in public interest. Only because in the said provision the words 'any case' has been mentioned, the same, in the opinion of the Supreme Court, would not mean that an order of transfer cannot be passed in respect of cases involving more than one assessment year. It would not be correct to contend that only because Explanation appended to S. 127 refers to the word 'case' for the purpose of the said Section as also S. 120, the source of power for transfer of the case involving block assessment is relatable only to S. 120 of the Act. **It is a well-settled principle of interpretation of statutes that a provision must be construed in such a manner as to make it workable.** When the Income-tax Act was originally enacted, Chapter XIV-B was not in the statute book. It was brought in the statutes book only in the year 1996. The power of transfer in effect provides for a machinery provision. It must be given its full effect. It must be construed in a manner so as to make it workable. Even S. 127 of the Act is a machinery provision. It should be construed to effectuate a charging Section so as to allow the authorities concerned to do so in a manner wherefor the statute was enacted. Affirming the decision the Andhra Pradesh High Court in *Mukutla Lalita v. CIT* reported in (1997) 226 ITR 23 the Supreme Court held that the word 'any' must be read in the context of the statute and for the said purpose, it may in a situation of this nature, means all. The Supreme Court held that the *power u/s.127 can also be exercised in respect of a block assessment.*

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**Month-Year :** **Jan - 2009**
**Author/s :** **(2008) 300 ITR 251 (SC) [BCAJ]**
**Title :** **Malayala Manorama Co. Ltd. v. CIT**
**Details :**

The main question which had arisen for consideration before the High 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 u/s.115J of the Income-tax Act, 1961, **to rework net profit by substituting the rates prescribed in Schedule XIV to the Companies Act, 1956 ?** The Kerala High Court (253 ITR 378) had held that for the purposes of S. 115J the depreciation must be calculated in terms of the Companies Act.

On an appeal to the Supreme Court, it was submitted on behalf of the appellant that in the profit and loss account the assessee has debited depreciation at the rates prescribed by the Income-tax Rules, 1962. This has been the consistent practice of the assessee throughout. S. 211(2) of the 1956 Act mandates that every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year and shall comply with the requirements of Parts II and III of Schedule VI so far as they are applicable thereto. The accounts of the assessee for the relevant A.Ys. 1988-89 and 1989-90 are audited u/s.227 of the 1956 Act. 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. It was further submitted that u/s.115J the assessee has the obligation to prepare his profit and loss account as per Parts II and III of Schedule VI to the 1956 Act. No dispute has been raised at any stage of the proceedings by the Revenue that the profit and loss account of the assessee is not in compliance with the provisions of the 1956 Act, particularly Schedule VI, Parts II and III. In Schedule VI, there is no reference to S. 205 and S. 350 or Schedule XIV to the 1956 Act. The appellant referred to Note 3(iv) of Part II (Requirements as to profit and loss account) of Schedule VI to the 1956 Act which reads as under : "(iv) The amount provided for depreciation, renewals or diminution in value of fixed assets. If such provision is not made by means of a depreciation charge, the method adopted for making such provision. If no provision is made for depreciation, the fact that no provision has been made shall be stated and the quantum of arrears of depreciation computed in accordance with S. 205(2) of the Act shall be disclosed by way of a note". <u>It was submitted that this made it clear that Schedule VI to the 1956 Act does not create any obligation on a company to provide for any depreciation much less provides for depreciation as per Schedule XIV to the Act.</u> <u>It was also submitted by the appellant that it is a long-standing accepted position by the Company Law Department that the rates of depreciation prescribed in Schedule XIV **are the minimum rates**</u> (See : Circular No. 2 of 1989, dated Mach 7, 1989). Paragraph (3) of the said Circular reads as under :

> "(3) Can higher rates of depreciation be charged ?
>
> It is stated that Schedule XIV clearly states that a company should disclose depreciation rates if they are different from the principal rates specified in the Schedule. On this basis, it is suggested that a company can charge depreciation at rates **which are lower or higher** than those specified in Schedule XIV. It may be clarified that the rates as contained in the Schedule XIV **should be viewed as the minimum rates** and, therefore, a company shall not be permitted to charge depreciation at rates lower than those specified in the Schedule in relation to assets purchased after the date of applicability of the Schedule."

Moreover, Note 5 of Schedule XIV contemplates that rate may be different from the rates specified in the said Schedule. This note reads as :

> "5. The following information should also be disclosed in the accounts :
>
> > (i) depreciation methods used; and
> >
> > (ii) depreciation rates or the useful lives of the assets, if they are different from the principal rates specified in the Schedule."

It was submitted by the learned counsel on behalf of the appellant that this case was squarely covered by a three-Judge Bench decision of this Court in *Apollo Tyres Ltd. v. CIT,* (2002) 9 SCC 1. Referring to Explanation (ha)(iv) to S. 115J, the Revenue submitted that before the High Court, it was argued by counsel for the Revenue that S. 205 of the Companies Act, 1956 has been legislatively incorporated into the Income-tax Act for the purposes of S. 115J and since this is a legislation by incorporation, the said provision of the Companies Act, 1956, has to be applied as indicated by that provision in the Companies Act. It was also pointed out that in S. 205 of the Companies Act, it has been provided that for the purposes of calculating depreciation u/s.205(1), the same could be provided to the extent specified u/s.350 of the Companies Act. A reference to S. 350 of the Companies Act would show that the amount of depreciation to be deducted shall be the amount, calculated with reference to the written-down value of the assets, as shown by the books of the company at the end of the financial year expiring at the commencement of the Act or immediately thereafter and at the end of each subsequent financial year and the rates specified in Schedule XIV to the Companies Act. Therefore, according to the Revenue, the calculation of depreciation in terms of the Companies Act and Schedule XIV thereof becomes a must, while assessing an assessee u/s.115J of the Income-tax Act.

The Supreme Court allowing the appeal of the appellant, held that the controversy involved in this case was no longer *res integra*. Its three-judge Bench in Apollo Types (*supra*) had clearly interpreted S. 115J of the Act and there was no scope for any further discussion.

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**Month-Year :** **May - 2009**
**Author/s :** **(2008) 305 ITR 409 (SC) [BCAJ]**
**Title :** **CIT vs. HCL Comnet Systems and Services Ltd.**
**Details :**

The assessee-company was engaged in trading in data communication equipment and satellite communication services. During the course of assessment proceedings, the Assessing Officer found that the assessee had debited an amount of Rs.92,15,187 on account of bad debts to the profit and loss account. However, on the ground that **it was a provision** for bad and doubtful debts, the Assessing Officer added the aforestated amount to the book profits as per Explanation (c) to Section 115JA of the Act.

On appeal, the Commissioner of Income-tax (Appeals) allowed the assessee's appeal. That decision of the Commissioner of Income-tax (Appeals) stood affirmed by the Tribunal and also by the High Court.

On further appeal by the Revenue, the Supreme Court held that the **Assessing Officer does not have the jurisdiction to go beyond the net profit shown in the profit and loss account except to the extent provided in the Explanation.** The Assessing Officer has to make adjustment permissible under the Explanation given in Section 115JA of the 1961 Act.

The said Explanation has provided six items, *viz.*, item Nos. (a) to (f), which if debited to the profit and loss account can be added back to the net profit for computing the book profit.

Item (c) deals with amount(s) set aside as **provision made for meeting liabilities, other than ascertained liabilities**. 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. The Supreme Court observed that 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 was 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 irrecoverability of**

**the debt cannot be said to be a provision for liability**. The Supreme Court therefore was of the view that item (c) of the Explanation was not attracted to the facts of the present case. In the circumstances, the Assessing Officer was not justified in adding back the provision for doubtful debts of Rs.92,15,187 under clause (c) of the Explanation to Section 115JA of the 1961 Act.

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**Month-Year : Apr – 2009**
**Author/s : (2008) 305 ITR 75 (SC) [BCAJ]**
**Title : CIT v. Enron Oil and Gas India Ltd.**
**Details :**

The respondent-Enron Oil and Gas India Ltd. ('the EOGIL'), a company incorporated in **Cayman Islands (Tax Heaven)** was engaged in the business of oil exploration. In 1993, the Government of India through the Petroleum Ministry invited bids for development of concessional blocks. EOGIL offered its bid for the development of concessional blocks. A consortium of EOGIL with RIL was given the contract. Later on, ONGC joined. EOGIL with RIL and ONGC executed a **production sharing contract (PSC) with the Government of India**. EOGIL was entitled to a participating interest of 30% in the rights and obligations arising under the PSC. RIL was also entitled to participating interest of 30%. ONGC was entitled to a participating interest of 40%. EOGIL was designated as the operator under the said PSC.

Vide Notification No. 1997, dated March 8, 1996, u/s.293A of the Income-tax Act, 1961 ('the 1961 Act'), **each co-venturer was liable to be assessed for his own share of income**. **They were not to be treated as an association of persons**.

EOGIL filed its return of income for the assessment year 1999-2000 declaring its taxable income of Rs. 71,19,50,013 u/s.115JA.

During the year, EOGIL debited its profit and loss account by exchange loss of Rs.38,63,38,980. The Assessing Officer disallowed this loss on the ground that it was a mere book entry and actually no loss stood incurred by the assessee.

The decision of the Assessing Officer was challenged in appeal by EOGIL before the Commissioner of Income-tax (Appeals), who after analysing PSC held that each co-venturer in this case had made contribution at a certain rate, whereas the expenditure incurred out of the said contribution stood converted on the basis of the previous month's average daily means for the buying and selling rates of exchange which exercise resulted in loss/profit on conversion. Under the circumstances, according to the Commissioner of Income-tax (Appeals), it could not be said that the assessee had incurred notional loss. In fact, during the course of proceedings, the Commissioner of Income-tax (Appeals) found that during the A.Ys. 1995-96 and 1996-97 the assessee had earned profits which stood taxed by the Department. He further found that one co-venturer (ONGC) had gained Rs.293.73 crores during the A.Y. 1997-98 because the Indian rupee had appreciated as compared to foreign currency and the Department had taxed the same, but when during the assessment year in question there is a loss on account of such conversion, the Department has refused to allow the deduction for such conversion losses. According to the Commissioner of Incometax (Appeals), **the Department cannot blow hot and cold**. Consequently, it was held that **just as the foreign exchange gain was taxable, loss was allowable** u/s.42(1) of the Income-tax Act in terms of the PSC. Therefore, the Commissioner of Income-tax (Appeals) allowed as deduction, the loss of Rs. 38,63,38,980.

Aggrieved by the order passed by the Commissioner of Income-tax (Appeals), the Department carried the matter in appeal to the Income-tax Appellate Tribunal objecting to the deletion made by the Commissioner of Income-tax (Appeals) on the ground that the loss was only a book entry. Before the Tribunal the matter pertained to the A.Ys. 1999-2000, 1998- 99, 2000-01 and 1996-97. However, for the sake of convenience, the Tribunal focussed its attention on the facts and figures given for the A.Y. 1999-2000. Before the Tribunal, the Department contended that the assessee borrows in USD and repays in the same currency for the preparation of the balance sheet. The loans, according to the Department, were stated at prevalent exchange rates and the loss arrived at was charged to the profit and loss account. Therefore, according to the Department, the said loss was a book entry and it was not an actual loss in foreign exchange caused to the assessee. This argument of the Department was rejected by the Tribunal. It was held that the assessee was a foreign company. It carried out business activity in India. It had to maintain its accounts in rupees for the purpose of income-tax, that the PSC had to be read with S. 42(1) of the Income-tax Act, which entitled the assessee to claim conversion loss as deduction, particularly when the said PSC provided for realised and unrealised gains/losses from the exchange currency. According to the Tribunal, the assessee was maintaining its accounts in rupees and such accounts had to reflect the loan liability under consideration as the loan had been taken for the Indian activity. Therefore, according to the Tribunal, the liability arising as a consequence of depreciation of the rupee had to be considered both for accounting and tax purposes. **Accordingly, the Tribunal refused to interfere with the findings returned by the Commissioner of Income-tax (Appeals).**

The above concurrent finding stood confirmed by the judgment delivered by the Uttarakhand High Court.

On further appeal, the Supreme Court observed that the only question which needed consideration was whether the assessee was entitled to claim deduction for foreign exchange losses on account of foreign currency translation. In other words, whether loss arising on account of foreign currency translation is allowable deduction or not and conversely whether the gains on account of foreign currency translation is to be treated as a receipt liable to tax. **Analysing the provisions of S. 42(1), the Supreme Court held that it was clear that the said Section was a special provision for deductions in the case of business of prospecting, extraction/production of mineral oils.** S. 42(1) provides for admissibility in respect of three types of allowances provided they are specified in the PSC. They relate to expenditure incurred on account of abortive exploration, expenditure incurred before or after the commencement of commercial production in respect of drilling or exploration activities and expenses incurred in relation to depletion of mineral oil in the mining area. **If one reads S. 42(1) carefully, it becomes clear that the above three allowances are admissible only if they are so specified in the PSC.**

Accordingly, the Supreme Court noted that the PSC in question **provided for both capital and revenue expenditures**. It also provided for a method in which the said expenses had to be accounted for. The Supreme Court held that the said PSC was an independent accounting regime which included tax treatment of costs, expenses, incomes, profits, etc. It prescribed a separate rule of accounting. In normal accounting, in the case of fixed assets, <u>generally when currency fluctuation results in an exchange loss, addition is made to the value of the asset for depreciation.</u> **However, under the PSC, instead of increasing the value of expenditure incurred on account of currency variation in the expenses itself, EOGIL was required to book losses separately.** The said PSC prescribed a special manner of accounting which was at variance with the normal accounting standards. The said 'PSC accounting' obliterated the difference between capital and revenue expenditure. It made all kinds of expenditure chargeable to the profit and loss account without reference to their capital or revenue nature. But for the PSC accounting there would have been disputes as to whether the expenses were of revenue or capital nature. **<u>In view of the special accounting procedure prescribed by the PSC, Accounting Standard 11 had to be ruled out</u>**.

The Supreme Court observed that Appendix C prescribed the manner in which a contractor is required to maintain his accounts. It stipulated that each of the co-venturers had to follow the computation of Income-tax under the 1961 Act. Clause 1.6.1. of appendix C referred to currency exchange rates. It stated that for translation purposes between USD and INR, the previous month's average of the daily means of buying and selling rates of exchange as quoted by SBI shall be used for the month in which revenue, costs, expenditure, receipts or incomes are recorded. The Supreme Court therefore, held that clause 1.6.1 of appendix C provided for translation. The Supreme Court noted that subsequent to the award of the concession, EOGIL along with RIL and ONGC executed the PSC with the Government of India. Under the said PSC, each co-venturer remitted money, known as cash call to the bank account of the operator in the USA. The expenditure for the joint venture was made out of the said account. The trial balance was required to be prepared at the end of the month in USD, which was then required to be translated on the basis of accounting procedure mentioned in Appendix C to the PSC. The Supreme Court held that the cash call in other words was not a loan. Cash call was a contribution. It was made by each co-venturer at a certain rate, whereas the expenditure against it had to be converted on the basis of the exchange rates as provided for in the PSC, which stated that the same had to be converted on the basis of the previous month's average of the daily means of buying and selling rates of exchange. The above analysis showed that the capital contribution had to be converted under the PSC at one rate, whereas the expenditure had to be converted at a different rate. This exercise resulted in loss/ profit on conversion. Under the PSC, the respondent had to convert revenue, costs, receipts and incomes. If EOGIL had a choice to prepare its accounts only in USD, there would have been no loss/profit on account of currency translation. It is because of the specific provision in the PSC for currency translation that loss/profit accrued to EOGIL. The Supreme Court further held that in the PSC, the foreign company provides the capital investment and cost and the first proportion of oil extracted is generally allocated to the company which uses oil sales to recoup its costs and capital investment. The oil used for that purpose is termed 'cost oil'. Often a company obtains profit not just from the 'profit oil', but also from the 'cost oil'. Such profits cannot be ascertained without taking into account translation losses. Moreover, taxes are embedded in the profit oil. If these concepts are kept in mind, then **it cannot be said that 'translation losses' under the PSC are illusory losses.**

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**Month-Year :** **Jan - 2009**
**Author/s :** **(2008) 300 ITR 337 (SC) [BCAJ]**
**Title :** **CIT v. Xpro India Ltd.**
**Details :**

The following substantial question of law arose for determination u/s.260A of the Income-tax Act, 1961.

> "Whether, on the facts and in the circumstances of the case, the Hon'ble High Court was right in allowing credit for MAT, u/s.115JAA of the Income-tax Act, 1961, before charging interest u/s.234B and u/s.234C of the Income-tax Act ?"

The Supreme Court held that the High Court erred in coming to the conclusion that no substantial question of law arose, and consequently the Department's appeal was dismissed. The Supreme Court was of the view that, in the present case, the question of interpretation of S. 234B in the context of short payment of interest on advance tax arose for determination before the High Court, which warranted interpretation of S. 115JAA of the 1961 Act read with S. 234B and S. 234C. The shortage in payment according to the respondent was on account of applicability of S. 115JAA. The High Court in that connection was required to decide the nature of the levy u/s.234B, whether the levy is penal or mandatory. It had also not considered the judgment of the Bombay High Court in the matter of *CIT v. Kotak Mahindra Finance Ltd.,* (2004) 265 ITR 119. The civil appeal was therefore allowed by the Supreme Court and the impugned judgment was set aside with the direction to the High Court to consider the above question in accordance with law.

## DEDUCTIONS

**Title : Modyset P. Ltd. vs. CIT (2008)**
**Details :**

The asessee, a limited company, purchased 105 computers for Rs.90,91,063. It exported them and realised export sales of Rs.90,91,063. There was no export profit during the relevant assessment year 1990-91. The Income-tax Officer allowed the claim of deduction under Section 80HHC at Rs.15,81,389 as the total business income of the assessee stood at Rs.55,31,941 by applying the ratio in terms of Section 80HH(3)(b) as follows :

Export Profits =

90,91,063 (export sale) x 55,31,941 (business profit) / 3,18,01,941 (total sales)

The Commissioner of Income-tax revised the aforesaid assessment order in exercise of his powers under Section 263 denying the deduction under Section 80 HHC, holding that Section 80 HHC confers the benefit only on those assessees who have **not only carried on the export business, but who have also derived profits on such business**. On an appeal, the Tribunal allowed the assessee's appeal following the decision of its Delhi Special Bench in *International Research Park Laboratories Ltd. vs. Asst. CIT* [(1995) 212 ITR (AT) 1], in which it was held that profits need not be earned in the export business alone to claim special deduction under Section 80 HHC. On a reference by the Revenue, the Karnataka High Court following the decision of the Supreme Court in *Ipca Laboratory Ltd. vs. Dy CIT* [(2004) 266 ITR 521] held that since the assessee had not earned profits from export sales during the year in question, the assessee was not entitled for deduction under Section 80 HHC.

On an appeal to the Supreme Court by the assessee, it was held that the eligibility for deduction is contemplated by Section 80 HHC(1), whereas the quantum of deduction is determined under Section 80 HHC(3). In the matter of determining the quantum of deduction, the 'principle of proportionality' applied. There are two situations which are covered by Section 80HHC (3), namely, turnover only from export sales and secondly turnover from composite sales (domestic and export business). In both cases the formula applied as under :

Section 80 HHC concession = export profit =

Profits of business x

Export turnover /

Total turnover

The Supreme Court on facts held that the calculation had been correctly done by the Income-tax Officer. The Supreme Court further held that the High Court had erred in relying upon the judgment in case of Ipaca Laboratories Ltd., inasmuch as the provisions as applicable in that case were for the assessment year 1996-97 which were different from the provisions for the assessment year 1990-91 with which it was concerned and that for the relevant assessment year the CBDT Circular No. 564 indicated that **Section 80HHC (3) statutorily fixes the quantum of deduction on the basis of a proportion of business profits under the head 'Profits and gains of business or profession', irrespective of what could strictly be described as profits derived from export of goods out of India**. According to the Supreme Court, the Circular supported its above reasoning. The Supreme Court however, clarified that the above reasoning was strictly applicable to the law as it stood during the relevant assessment year.

**Month-Year :** **Feb - 2009**
**Author/s :** **(2008) 301 ITR 439 (SC) [BCAJ]**
**Title :** **B. Desraj v. CIT**
**Details :**

The appellant was a sole proprietor of M/s. D. R. Enterprises engaged in the business of export of textiles/fabrics. Consequent upon exports made by him, inward remittance came into India in foreign exchange during the accounting year ending 31-3-1991 (A.Y. 1990-91). However, the appellant recovered cash compensatory allowance of Rs.7,74,785 and duty drawback of Rs.35,565 in the next accounting year ending on 31-3-1992 (A.Y. 1991-92). The appellant, who was following cash system of accounting, claimed deduction u/s.80HHC on the aforesaid amounts in A.Y. 1991-92, that is, in the year of receipt.

According to the AO, admittedly, the appellant had not made export sales during A.Y. 1991-92 and therefore, the said duty drawback and cash compensatory allowance did not constitute eligible income deductible from the gross total income u/s. 80HHC. On appeal, the Commissioner of Income-tax (Appeals) took the view that the above amounts were admittedly relatable to the sales made during the earlier year and consequently, the Assessing Officer had wrongly rejected the appellant's claim for deduction u/s.80HHC. The Tribunal upheld the decision of the Commissioner of Income-tax (Appeals).

On an appeal by the Department, the Madras High Court overruled the decision of the Tribunal on the ground that during the A.Y. 1991-92, the assessee had received cash compensatory support and duty drawback for the exports made in the earlier year and that there were no exports made in that year and therefore, the said amounts did not constitute eligible income for deduction u/s.80HHC.

On an appeal by the appellant, the Supreme Court observed that by the Finance Act, 1990 it was clarified that <u>cash compensatory support and duty drawback would be taxable u/s.28(iiib) and in a Circular issued by the CBDT it was clarified that export incentives, namely, cash compensatory support and duty drawback have to be included in the profits of the business for computing the deduction u/s.80HHC</u>. According to the Supreme Court, with the issuance of the said Circular, the point was no more *res integra*. The Supreme Court after noting the formula for the purpose of computing deduction u/s.80HHC observed that the business profits included export incentives. The Supreme Court, therefore, held that the words 'business profits' in the formula u/s. 80HHC(3) would include cash compensatory allowance and duty drawback, and the AO was directed to work out the deduction in accordance with the law as it stood during the relevant A.Y. 1991-92.

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## <u>DEPRICIATION</u>

**Month-Year :** **Apr - 2009**
**Author/s :** **(2008) 305 ITR 132 (SC) [BCAJ]**
**Title :** **CIT v. Gupta Global Exim P. Ltd.**
**Details :**

The Assessing Officer (AO) took the view that the assesseé was, during the relevant assessment year, in the business of timber trading and it was only occasionally that the trucks owned by the assessee were given out on hire to outside parties and, hence, the assessee was not in the business running the trucks on hire and, therefore, the assessee was not entitled to claim higher rate of depreciation at 40%. This finding of the Assessing Officer was reversed by the Commissioner of Income-tax (Appeals). It was held by the Commissioner of Income-tax (Appeals) that the transportation income of 12,50,639 by way of running the subject vehicles on hire was an integral part of the assessee's business and that its inclusion under the head 'Business income' was not disputed even by the Assessing Officer. This finding of the Commissioner of Income-tax (Appeals) was affirmed by the Tribunal. The High Court had refused to interfere on the ground that the matter involved essentially questions of fact. On an appeal to the Supreme Court, it held that generally, the Supreme Court does not interfere with the concurrent finding of facts recorded by the authorities below. However, in this case, the Supreme Court was of the opinion that a neat substantial question of law arose for determination which needed interpretation of the depreciation table given in Appendix I to the Income-tax Rules, 1962.

The Supreme Court held that under item (2)(ii) of heading III, higher rate of depreciation is admissible on motor trucks used in a business of running them on hire. Therefore, the user of the same in the business of the assessee of transportation is the test.

According to the Supreme Court, in the present case, none of the authorities below (except the Assessing Officer) had examined the matter by applying the above test. The Assessing Officer had given his finding that the assessee was not in the business of transportation as he was only in the business of trading in timber logs. That, the burden was on the assessee to establish that it is the owner of motor lorries and that it used the said motor lorries/trucks in the business of running them on hire.

In the view of the Supreme Court, the entire approach of the Commissioner of Income-tax (Appeals) was erroneous when he had stated that the transportation income of Rs.12,50,639 by way of running the subject vehicles on hire was an integral part of the appellant's business and its inclusion in the head 'Business income' is not disputed even by the AO. According to the Supreme Court, mere inclusion of Rs.12,50,639 in the total business income is not the determinative factor for deciding whether trucks were used by the assessee during the relevant year in a business of running them on hire. The Supreme Court therefore set aside the judgment of the High Court and remitted the matter to the Commissioner of Income-tax (Appeals) for *de novo* examination of the case in accordance with law.

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| **Month-Year :** | **Apr – 2009** |
| **Author/s :** | **(2008) 305 ITR 274 (SC) [BCAJ]** |
| **Title :** | **Dy. CIT v. N. K. Industries Ltd.** |
| **Details :** | |

The Supreme Court was concerned with the block period April 1, 1988, to February 24, 1999. The main contention advanced on behalf of the Department was that **<u>for allowance of deduction for depreciation, the asset must not only be owned by the assessee but it must also be used for the purposes of business or profession of the assessee.</u>** It was the case of the Department that the **word 'used' in S. 32 of the Income-tax Act, 1961, refers to actual use of the asset;** that having regard to the scheme of the Income-tax Act, 1961, and particularly, after the introduction of the concept of 'block of assets', actual use is the only requirement apart from ownership for allowance of depreciation u/s.32. It was also the case of the Department that an important question of law arose for determination before the High Court; that the High Court has failed to examine the said question; and that it had erred in dismissing the tax appeals only on the ground that no substantial question of law had arisen.

The Supreme Court observed that in the present case, the Tribunal had examined the statements of certain witnesses and after analysing the material on record, it had come to the conclusion on facts that there was nothing to show that the machinery, namely, expellers remained idle for the entire block period April 1, 1988 to February 24, 1999. The Supreme Court after having examined the record itself, agreed with the view expressed by the Tribunal on the facts of the present case. The Supreme Court was of the view that hence, it is not necessary for it to go into the larger question of law regarding the connotation of the word 'used' appearing in S. 32 of the Income-tax Act, 1961. The Supreme Court dismissed the appeal for the aforesaid reasons. **The question of law was however kept open.**

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**INCOME EXEMPT FROM TAX (SEC. 10, 10A, 10AA, 10B, 11, 12, 13)**

**Month-Year :** **Apr – 2009**
**Author/s :** **(2008) 305 ITR 1 (SC) [BCAJ]**
**Title :** **Agricultural Produce Market Committee, Narela v. CIT & Anr.**
**Details :**

The appellant-Committee was established under the Delhi Agricultural Produce Marketing (Regulation) Act, 1998 (the 1998 Act). The provisions of the said 1998 Act enjoined upon the appellant to provide facilities for marketing of agricultural produce in Narela, Delhi. This is apart from performing other functions and duties such as superintendence, direction and control of markets for regulating the marketing of agricultural produce.

For the A.Y. 2003-04, the appellant-Committee claimed exemption from payment of tax on the income earned by it, on the ground that it was a 'local authority' within the meaning of S. 10(20) of the Income-tax Act, 1961 (the 1961 Act). It relied upon the definition of 'local authority' in S. 2(1)(l) of the said 1998 Act. The Assessing Officer rejected the appellant's claim for exemption relying upon Circular No. 8/2002, dated August 27, 2002 issued by the Central Board of Direct Taxes. The view taken was that the amended provisions of S. 10(20) of the 1961 Act were not attracted to 'Agricultural Produce Marketing Societies' or 'Agricultural Market Boards' *even when they may be local authorities under the Central or State legislation*.

Aggrieved by the said order, the appellant filed an appeal before the Commissioner of Income-tax (Appeals) who upheld the view taken by the Assessing Officer and declined the exemption claimed by the appellant.

A further appeal by the appellant, before the Tribunal, also failed.

Aggrieved by the decision of the Tribunal, the appellant moved the High Court by way of an appeal u/s.260A of the 1961 Act. The Delhi High Court following its earlier judgment in the case of *Agricultural Produce Market Committee, Azadpur v. CIT,* (ITA No. 749/2006), dismissed the appellant's appeal.

On further appeal, the Supreme Court noted that prior to the Finance Act, 2002, the said 1961 Act did not contain the definition of the words 'local authority'. Those words came to be defined for the first time by the Finance Act, 2002, vide the Explanation/ definition clause.

After hearing the parties, the Supreme Court observed that u/s.3(31) of the General Clauses Act, 1897, 'local authority' was defined to mean "a municipal committee, district board, body of port commissioners or other authority legally entitled to the control or management of a municipal or local fund. The words 'other authority' in S. 3(31) of the 1897 Act have been omitted by Parliament in the Explanation/definition clause inserted in S. 10(20) of the 1961 Act, vide the Finance Act, 2002. Therefore, it was not correct to say that the entire definition of the words 'local authority' was bodily lifted from S. 3(31) of the 1897 Act and incorporated by Parliament, in the Explanation to S. 10(20) of the 1961 Act. This deliberate omission was important. The Supreme Court noted that various High Courts had taken the view prior to the Finance Act, 2002, that AMC(s) is a 'local authority'. That was because there was no definition of the words 'local authority' in the 1961 Act.

Those judgments proceeded primarily on the functional tests as laid down in the judgment of the Supreme Court in the case of R. C. Jain [(1981) 2 SCC 308].

In the case of R. C. Jain, the test of 'like nature' was adopted as the words 'other authority' came after the words 'Municipal Committee, District Board, Body of Port Commissioners'. Therefore, the words 'other authority' in S. 3(31) took colour from the earlier words, namely, 'Municipal Committee, District Board or Body of Port Commissioners'. This is how the functional test was evolved in the case of R. C. Jain. The Supreme Court held that **Parliament in its legislative wisdom had omitted the words 'other authority' from the said Explanation to S. 10(20) of the 1961 Act.** The said Explanation to S. 10(20) provides a definition to the words 'local authority'. It is an exhaustive definition. It is not an inclusive definition. The words 'other authority' do not find place in the said Explanation. Even according to the appellant(s), AMC(s) was neither a Municipal Committee nor a District Board nor a Municipal Committee nor a Panchayat. Therefore, according to the Supreme Court, the functional test and the test of incorporation as laid down in the case of R. C. Jain, was no more applicable to the Explanation to S. 10(20) of the 1961 Act.

However, the Supreme Court felt that the question still remained as to why Parliament had used the words 'Municipal Committee' and 'District Board' in item (iii) of the said Explanation. According to the Supreme Court, Parliament defined 'local authority' to mean — a panchayat as referred to in clause (d) of Article 243 of the Constitution of India, Municipality as referred to in clause (e) of Article 243P of the Constitution of India. However, there was no reference to Article 243 after the words 'Municipal Committee' and 'District Board'. It appeared that the Municipal Committee and District Board in the said Explanation were used out of abundant caution. In 1897 when the General Clauses Act was enacted there existed in India, Municipal Committees and District Boards and it was quite possible that in some remote place a District Board still existed. **The Supreme Court in conclusion observed that having taken the view that AMC(s) is neither a Municipal Committee nor a District Board under the Explanation to S. 10(20) of the Act, it refrained from going into the question : whether the AMC(s) is legally entitled to the control of the local fund, namely, Market Fund, under said 1998 Act, because vide the Finance Act, 2008, income of AMC(s) is exempted under sub-section <u>(26AAB) of S. 10</u> with effect from April 1, 2009.**

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**Month-Year :** **Mar - 2009**
**Author/s :** **(2008) 304 ITR 1 (SC) [BCAJ]**
**Title :** **Union of India v. Belgachi Tea Co. Ltd. & Ors.**
**Details :**

The assessee, a public limited company carrying on the **composite business of growing and manufacturing tea** in the district of Darjeeling, has tea gardens known as Belgachi Tea Estate, which consists of the gardens and a factory for manufacture of tea. The asseessee-company sells the tea grown and manufactured in the said tea gardens. The factory in the said tea gardens is licensed under Factories Act. The assessee-company is **also selling tea leaves produced in its tea gardens which are *<u>agricultural produce</u>***. The assessee is also involved in manufacturing of tea. The income from such business has been assessed all along under the provisions of the Income-tax Act, 1961. The claim of the assessee-company is that the entire income should be assessed under the provisions of the 1961 Act and after the income is assessed, tax should be charged on 40% of such income under the 1961 Act and on the balance 60%, the State can tax under the Bengal Agricultural Income-tax Act, 1944. According to the assessee, in view of the scheme of the 1961 Act read with Rule 8 of the Income-tax Rules, 1962, the income derived from the sale of the tea grown and manufactured by a seller in India should be computed under the provisions of the Act by the Income-tax Officer on the basis of the aforementioned formula and that the sale proceeds of green tea leaves should be treated as incidental to business and its income should also be computed on the basis of aforementioned formula.

The Supreme Court observed that :

> (i) There was no dispute on the fact that from the income assessed, 60% is taxable by the State under the 1944 Act and 40% is taxable by the Centre under the 1961 Act.
>
> (ii) The object behind taxing the 60% and 40% shares of the income assessed appears that there are common expenses on establishment and staff for the two different activities that is tea grown and tea manufactured. **There can be independent income from the sale of green tea leaves and by sale of tea, that is, after processing of green tea leaves when green tea leaves become tea for use.** Income from agriculture is taxable by the State and sale of tea after manufacturing is taxable by the Union of India as business income. To segregate income and expenses from the two combined activities of the assessee is not possible, but at the same time **there cannot be two assessments of income by two different authorities**. Therefore, there can be only one assessment of income from the tea business.
>
> (iii) For the purpose of tax on agriculture income, the Agriculture Income-tax Officer will go by the assessment order made under the provisions of the 1961 Act and the contents of the assessment for the year made by the Assessing Officer under the 1961 Act shall be conclusive evidence of the contents of such order and he has to go by the assessment and tax only 60% income made under the assessment for the purpose of the 1944 Act. If there is any apparent mistake in the order of the Income-tax Officer, he can bring it to the notice of the Income-tax Officer and that can be rectified by the Income-tax Officer, but no separate assessment of the income from 'tea grown and manufactured' business can be made by the Agricultural Income-tax Officer under the 1944 Act. He cannot once again assess that business income under the 1944 Act.

According to the Supreme Court, the question which however required to be considered was whether the agriculture income be taxed under the 1961 Act. The Supreme Court noted that both Rule 8 of the Income-tax Rules, 1962, and S. 8 of the 1944 Act provide how the mixed income from the growing tea leaves and manufacturing can be taxed. 'Mixed income' means the income derived by an assessee from the combined activities, *i.e.,* growing of tea leaves and manufacturing of tea. Therefore, for purpose of computation of income under the 1961 Act, it should be the mixed income from 'tea grown and manufactured' by the assessee. **The Supreme Court observed that if the income is by sale of green tea leaves by the assessee, it cannot be called income assessable under the 1961 Act for the purpose of 40 : 60 share between the Centre and the State.** In both the provisions, *i.e.,* Rule 8 of the Income-tax Rules, 1962, and S. 8 of the 1944 Act, the words used are income derived from the sale of 'tea grown and manufactured'. The Supreme Court held that the **income from sale of green tea leaves is purely income from the agricultural products.** There is no question of taxing it as incidental income of the assessee when there is a specific provision and authority to tax that income, *i.e.,* the State under the 1944 Act. <u>In that view of the matter, the agricultural income could not be tax under 1961 Act.</u>

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**Month-Year :** **Jan – 2009**
**Author/s :** **(2008) 300 ITR 214 (SC) [BCAJ]**
**Title :** **ACIT v. Surat City Gymkhana**
**Details :**

The respondent-assessee claimed exemption u/s. 10(23) of the Income-tax Act, 1961, for the A.Ys. 1991-92 and 1992-93. The said exemption was claimed on the basis that the objects of the respondent-assessee were exclusively charitable. The Assessing Officer rejected the claim. The appeals filed before the Commissioner of Income-tax (Appeals) were dismissed. Aggrieved thereby, the assessee filed further appeals before the Tribunal. The Tribunal, by its order dated January 20, 2000, allowed the appeals filed by the respondent-assessee. The Revenue filed appeals before the High Court of Gujarat. The Revenue claimed that the following two substantial questions of law arise from the order of the Tribunal :

> (A) Whether, on the facts and circumstances of the case, the Income-tax Appellate Tribunal was justified in law in holding that the objects of the trust restricting benefits to the members of the club would fall within the purview of the act of 'general public utility' u/s.2(15) of the Income-tax Act constituting as a section of public and not a body of individuals ?
>
> (B) Whether, on the facts and circumstances of the case, the Income-tax Appellate Tribunal was justified in law in holding that registration u/s.12A was a *fait accompli* to hold the AO back from further probe into the objects of the trust ?

The High Court dismissed the appeals, *in limine*, relying on a decision of the same Court in the case of *Hiralal Bhagwati v. CIT,* (2000) 246 ITR 188; (2000) 161 CTR 401. Being dissatisfied by the order of the High Court, the Revenue has filed these appeals.

The Supreme Court, on July 22, 2002, granted leave in respect of question No. 'B' only. The appeals were not entertained in respect of the question No. 'A' and it was noted that the appeals were **rightly dismissed by the High Court insofar as question No. 'A' is concerned, as the appellant did not challenge the correctness of the judgment in the case of Hiralal Bhagwati** (*supra*). At the hearing the Supreme Court found that on a perusal of the judgment of the Gujarat High Court in the case of Hiralal Bhagwati (*supra*), question No. 'B' was also concluded by the said judgment (for 1st para of page 196). Further, since the Revenue had not challenged the decision in the said case, the same has attained finality. The Supreme Court held that question No. 'B', therefore, should also meet the same fate as question No. 'A', as this Court had declined to grant leave in respect of question No. 'A' on the ground that the Revenue did not challenge correctness of the decision in the case of Hiralal Bhagwati (*supra*). It appeared that the fact that question No. 'B' was also covered by the aforementioned judgment, was not brought to the notice of their Lordships and, therefore, leave granted was restricted to question No. 'B'. In this view of the matter, the appeals were dismissed.

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## SET OFF AND CARRY FORWARD OF LOSSES

**Month-Year :** **Mar - 2009**
**Author/s :** **(2008) 302 ITR 190 (SC) [BCAJ]**
**Title :** **CIT v. Joseph Valakuzhy**
**Details :**

During the previous year relevant to the A.Y. 1992-93, the assessee, a film producer, produced two films, namely, (i) Ex Kannikcodi; and (ii) Santhwanam. While the first film was released and exhibited for more than 180 days, the second film was released and exhibited for less than 180 days. In his return of income, the assessee claimed the benefit of carry forward of Rs.39,43,830 as amortisation expenses relying on Rule 9A(3) which according to the assessee provided that the <u>*cost of production of the film equal to the amount realised by the film producer by exhibiting the films that year should be allowed as deduction in computing the profit and loss of the said previous year and the balance, if any, carried forward to the next following previous year and allowed as deduction in that year.*</u>

The Assessing Officer allowed the amortisation as claimed. But the Commissioner of Income Tax in exercise of the power u/s.263 (Revisionary Power) of the Act set aside the order and directed the Assessing Officer to withdraw the benefit of loss in view of S. 80, as the assessee had not filed his return of income within the time prescribed u/s.139(3) (Return of Loss) of the Act.

The assessee filed an appeal to the Tribunal against the order passed u/s.263. In the meantime, the Assessing Officer passed a fresh assessment order in terms of the order passed in revision. The assessee filed an appeal before the CIT(A) against the said order.

The CIT(A) took the view that S. 80 of the Act could not be applied to the situation to which Rule 9A(3) was applicable. The CIT(A) however found that the computation of amortisation expenses to be carried forward, as shown by the assessee was not correct. The CIT(A) directed the AO to obtain separate accounts in respect of the different films produced by the assessee and determine the claim of the amortisation in accordance with the Rule 9A, clarifying that in case there was a loss in respect of the old film on such computation, that would have to be subject to the provisions of S. 139(3) and S. 80 of the Act. In regard to the second film, it was held that the amortisation allowance for the next year was not subject to the provisions of S. 80 and S. 139(3) of the Act.

Being aggrieved by the order of the CIT(A), the Revenue filed an appeal before the Tribunal. Both the appeals were taken up together for hearing by the Tribunal and were dismissed with certain clarifications.

The High Court held that the amortisation loss computed under Rule 9A was not subject to the provisions of S. 80 and S. 139 of the Act.

On appeal, the **Supreme Court held that the balance cost of production which amortised under Rule 9A(2) and allowed as deduction for the next year is not a business loss.** Admittedly, the second film Santhwanam was not exhibited for a period of 180 days in the previous year, and had not covered the cost of production of the film. The assessee was therefore entitled to carry forward the balance of the cost of production to the next following previous year and claim deduction of the same in the year. The Supreme Court therefore dismissed the appeal. (S.80 not apply to such case)

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**RECOVERY PROCEEDINGS**

**Month-Year :** **Feb - 2009**
**Author/s :** **(2008) 301 ITR 337 (SC) [BCAJ]**
**Title :** **Janatha Textiles & Ors. v. Tax Recovery Officer & Anr.**
**Details :**

The appellant M/s. Janatha Textiles was a registered firm with four partners, *viz.,* Radhey Shyam Modi, Pawan Kumar Modi, Padmadevi Modi and Indira Chirmar. The firm and its partners were in arrears of tax for the A.Ys. 1985-86, 1986-87, 1987-88, 1989-90. All the demands pertaining to the A.Ys. 1986-87 to 1989-90 had been stayed by various income-tax authorities and these demands were never enforced for collection. The demand pertaining to the A.Y. 1985-86 was alone enforced.

The agricultural lands owned by the partners of the appellant-firm at Bodametlapalem had been attached and sold in public auction on August 5, 1996, after following the entire procedure laid down under the Second Schedule to the Income-tax Act, 1961. Nine people participated in the public auction held on August 5, 1996. The sale was confirmed in favour of L. Krishna Prasad who offered the highest price. No procedural irregularity or illegality in public auction process was alleged by the appellant.

Even after issuance of sale proclamation, the respondent-Department issued communication in SR No. 2/94 dated July 15, 1996, informing the appellants that a sum of Rs.5,68,913 was due as on that date towards tax, interest and penalty under the 1961 Act. The said amount, however, does not include interest payable u/s.220(2) of the 1961 Act. The appellant-firm acknowledged receipt of the letter on July 17, 1996, and had not contradicted the quantum of tax and interest as mentioned in the said letter. It was made clear that the demand for the A.Y. 1985-86 alone was being enforced.

In an SLP, learned counsel for the appellants contended that even though they had filed objections at various stages of the notice issued for the auction sale, the respondent-Department without disposing of the said objections proceeded with the sale and, therefore, on that ground the sale conducted by the respondent-Department was illegal and unsustainable. The appellants further submitted that with reference to the A.Y. 1985-86, the application for waiver of interest was pending before the authorities and further the stay application filed before the Commissioner was not disposed of. Even on that count also the sale conducted by the respondent-Department on August 5, 1996, was illegal and unsustainable. The appellant contended that the High Court had failed to notice that the nature of the lands in the auction notice was wrongly mentioned as dry lands. In fact the said lands were a mango orchard and building structure and of much higher value. The auction ought to be vitiated on this ground alone.

The appellant also submitted that the appellants had received the notice of demand as defaulters in their individual capacity and also as the partners of the firm. However, the respondent-Department had failed to give notice of demand to the appellants qua their shares. They did not receive notices indicating their respective shares. It was asserted on behalf of the respondent-Department that the amount fetched in the public auction was more than reasonable.

The Supreme Court observed that the appellant had never complained about fixing of the reserve price before holding of auction, though they were intimated of the same through sale proclamation. In pursuance of the notice issued by the Supreme Court, the respondent-Department had filed the counter-affidavit. Respondent No. 2 (auction purchaser) also had filed a separate counter-affidavit. Respondent No. 2 in the counter-affidavit stated that it was totally incorrect to suggest that the auction sale did not fetch the actual market value of the property. Respondent No. 2 also mentioned in the counter-affidavit that the said lands were agricultural dry lands and there were no mango gardens as alleged by the appellant. There were, however, a few mango trees scattered all over the land.

The respondent-Department in the counter-affidavit stated that the appellant-firm had alternative efficacious remedy by way of filing a petition under Rules 60 and 61 of the Second Schedule to the 1961 Act. The appellant ought to have availed of the statutory remedy for ventilating its grievances instead of filing a petition before the High Court.

The Supreme Court further observed that there was another very significant aspect of this case, which pertained to the rights of the *bona fide* purchaser for value. The Supreme Court held that the law makes a clear distinction between a stranger who is a *bona fide* purchaser of the property at an auction sale and a decree-holder purchaser at a court auction. Strangers to the decree are afforded protection by the Court, because they are not connected with the decree. Unless the protection is extended to them court sales would not fetch the market value or fair price of the property. The Supreme Court held that the appeal was devoid of any merit and was accordingly dismissed.

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**<u>PENALTY</u>**

**Month-Year :** **Jan - 2009**
**Author/s :** **(2008) 300 ITR 205 (SC) [BCAJ]**
**Title :** **Sudarshan Silks and Sarees v. CIT**
**Details :**

A search was conducted on the premises of the assessees on October 14/15, 1987, and incriminating documents evidencing concealment of income by the assessee were unearthed apart from cash and jewellary found at the time of search. It was found that the appellant was maintaining double set of books and was accounting for only 50% of sales in the regular set of books. This fact was admitted by Shri J. S. Ramesh, a partner of the firm in the statement recorded u/s.132(4) of the Act. Shri J. S. Ramesh was the person-in-charge of the entire group. The total turnover suppressed by the assessee for the A.Y. 1987-88 was found to be to the tune of Rs.44,07,783. The AO estimated that the sales of the assessee were Rs.50,000 per day, whereas the accounted sales were not found even 50% of the total sales. Apart from this, it was found that certain purchases were also not being accounted for. Similarly, certain payments made were not being accounted for. All these were pointed out to the assessee. The assessee filed a revised return on March 31, 1989, declaring a total income for the A.Y. 1987-88 at Rs.3,74,226 as against the earlier amount of Rs.43,650. This was accepted and after verification the assessment was completed on December 29, 1989. During the course of recording the statement u/s.132(4) of the Act, Shri Ramesh agreed to declare such additional income as had been estimated by the search party in the office of the appellant and its sister concerns. On the basis of these calculations, revised returns were filed by the appellant for A.Ys. 1984-85, 1985-86 and 1986-87. The incomes as per revised returns were also accepted in toto. In the course of assessment proceedings, penal action u/s.271(1)(c) of the Act was initiated and after considering the reply filed by the appellant, the AO chose to levy maximum penalty u/s. 271(1)(c). On appeal the CIT(A) noticed that no books of account or other documentary evidence was discovered that proved any concealment for the earlier years. The CIT(A) held that no penalty is leviable when unproved income is offered to purchase peace, particularly considering that the additional income returned, has only been on the basis of the appellant's own estimates and the appellant's own admission, unsupported by the discovery of any other documentary evidence relevant to years for which higher incomes were returned. The Tribunal upheld the findings recorded by the CIT(A). The High Court on consideration of the matter concluded that the findings recorded by the Tribunal and the CIT(A) being perverse, which no reasonable person could have taken, were liable to be set aside and accordingly accepted the reference and held that in the facts and circumstances of the case, the Tribunal was not right in upholding the order of the CIT(A) in cancelling the penalty levied u/s.271(1)(c). It was held that in the facts of the case the penalty u/s. 271(1)(c) is clearly exigible.

On appeal the Supreme Court held that the question of law referred to the High Court for its opinion was, as to whether the Tribunal was right in upholding the findings of the Commissioner of Income-tax (Appeals) in cancelling the penalty levied u/s.271(1)(c). Question as to perversity of the findings recorded by the Tribunal on facts was neither raised nor referred to the High Court for its opinion. The Tribunal is the final court of fact. The decision of the Tribunal on the facts can be gone into by the High Court in the reference jurisdiction only if a question has been referred to it which says that the finding arrived at by the Tribunal on the facts is perverse, in the sense that no reasonable person could have taken such a view. In reference jurisdiction, the High Court can answer the question of law referred to it and it is only when a finding of fact recorded by the Tribunal is challenged on the ground of perversity, in the sense set out above, that a question of law can be said to arise. Since the frame of the question was not as to whether the findings recorded by the Tribunal on facts were perverse, the High Court was precluded from entering into any discussion regarding the perversity of the findings of fact recorded by the Tribunal. Accordingly, the orders under appeal were set aside by the Supreme Court and that of the Commissioner of Income-tax (Appeals) and the Tribunal restored.