1

BASIC CONCEPTS

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

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

   Relevant Section: 2(24)

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

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

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

2. Whether the amount received by the assessee from WAFM for holding a national convention for farmers was a capital receipt in the hands of the assessee or income under section 2(24)(iia)?

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

   Relevant Section: 2(24)(iia)

   The assessee had received an amount of Rs.2,00,000 from WAFM for the purposes of holding a national convention of farmers. According to the assessee, the amount was received by way of advance for holding the convention but the convention could not be held in that year and was only held in the subsequent year. The assessee claimed that this amount constituted a capital receipt in its hands. The Assessing Officer rejected the claim. The Tribunal held that the amount was assessable under section 2(24)(iia).

The High Court held that there was nothing in the record of the case to suggest that the amount was actually received by the assessee as an advance as contended. The amount received was for holding a national convention. It is also not clear from the record whether the national convention of farmers was to be held for and on behalf of the donor or was to be utilised for holding a national convention of the assessee. Under the circumstances, in view of the failure of the assessee to explain the receipt of Rs.2,00,000 the provisions of section 2(24)(iia) of the Act would be attracted and the amount must be treated as income of the assessee and not as a capital receipt.

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

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

Relevant Section: 2(34) & 3

A plain reading of section 2(34) of the Income-tax Act, 1961, shows that for a new business the previous year is the period beginning with the date of setting up of the business. There is a distinction between setting up and commencement of a business. There may be an interregnum, there may be an interval between a business which is set up and a business which is commenced and all expenses incurred during the interregnum after the setting up of the business and before the commencement of the business, all expenses would be permissible deductions.

The assessee carried on the business of satellite business communications for which very small aperture terminal VSAT equipment is used. The VSAT can be used only after establishing, maintaining and using the communication facilities on a licence from the Department of Telecommunications. The assessee made an application to the Department of Telecommunications for grant of such licence and entered into a licence agreement on August 1994, with the Department of Telecommunications. The assessee placed a purchase order dated July 1994, with H, USA for the purchase of the VSAT equipment. In its return, the assessee claimed an expenditure of Rs.28,96,269. The Assessing Officer rejected the claim on the ground that the assessee had begun receiving the satellite signals only in the month of February and further since the installation was complete only on March, it could be said that the business of the assessee had been set up only on March. The Tribunal, however, allowed the assessee’s claim.

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

4. Whether the Tribunal was justified in upholding the order of Commissioner of Income-tax (Appeals) deleting the addition of Rs.10 lakhs as deemed dividend under section 2(22)(e) of the Income-tax Act ?

   CIT v. Hotel Hilltop (2009) 313 ITR 116 (Raj.)

   Relevant Section: 2(22)(e)

   The assessee-firm constituted of two partners ran a hotel business. It entered into an agreement with a private limited company formed by the two partners with their close relations under which the management of the firm's hotel was to be handed over to the company. The assessee-firm received a sum of Rs.10 lakhs as advance against security. The Assessing Officer made an addition to the income of the assessee treating the amount as deemed dividend under section 2(22)(e) of the Act. The Commissioner (Appeals) deleted the addition on the ground that the firm was not a shareholder of the company. The Tribunal confirmed the deletion.

   The High Court held that in order to attract the provisions of section 2(22)(e) of the Income-tax Act, 1961, the following four conditions are the sine qua non : (i) the assessee should be a shareholder of the company ; (ii) the company should be a closely held company in which the public are not substantially interested ; (iii) there must be payment by way of advance or loan to a shareholder or any payment by the company on behalf of or for the individual benefit of the shareholder ; and (iv) there must be sufficient accumulated profits in the hands of the company up to the date of such payment.

   It was further held that the assessee was not shown to be the shareholder of the company and the two individuals who were partners of the firm were the majority shareholders of the company. Therefore, the security advanced by the company to the assessee could not be deemed to be dividend as the assessee was not a shareholder in the company. The amount was paid by the company to the assessee on behalf of the individuals. Therefore, the liability of tax as deemed dividend could be attracted in the hands of the individuals, being the shareholders in the company. The Tribunal was justified in upholding the order of the Commissioner (Appeals) deleting the addition of Rs.10 lakhs made as deemed dividend under section 2(22)(e) of the Act.

5. Whether the Tribunal was justified in deleting the addition which has been received on account of gift when no relation has been established from whom gifts have been received?

   CIT v. Padam Singh Chouhan (2009) 315 ITR 433 (Raj.)

Relevant Section: 68

The Assessing Officer found that the assessee and his family had received huge gifts from a person residing abroad and concluded that the gifts were not genuine. The Commissioner (Appeals) held that the gifts were made out of love and affection towards the assessee and having gone through the bank accounts of the donors he found there was sufficient cash balance on the date of the gift to the assessee and deleted the addition. The Tribunal affirmed the finding of the Commissioner (Appeals).

The High Court held that there was no legal basis to assume that to recognise the gift to be genuine, there should be any blood relationship, or any close relationship between the donor and the donee. The assessee had produced the copies of gift deeds and the affidavits of the donors. In the absence of anything to show that the act of the assessee in claiming gift was an act by way of money laundering, simply because he happened to receive gifts, it could not be said that they had to be added in his income.

2

INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME

1. Whether the Tribunal was justified in directing the Assessing Officer to allow the claim of the assessee for exemption under section 10(10C) of the Income-tax Act, 1961 to the extent of Rs.5,00,000 by applying the prospective amendment retrospectively?

Income-tax Officer v. Dhan Sai Srivas (2009) 315 ITR 318 (Chhattisgarh)

Relevant Section: 10(10C)

The assessee's employer had determined the ex-gratia amount payable to the assessee on his voluntary retirement at Rs. 7,13,513, but out of this amount only one-fifth, i.e., Rs. 1,42,703 was actually paid to the assessee in the previous year relevant to the assessment year 2003-04. The assessee, however, claimed deduction for a total sum of Rs.5,00,000, the maximum limit under section 10(10C) of the Income-tax Act, 1961. The Assessing Officer allowed exemption only for Rs.1,42,703 and added back the balance. The assessee preferred an appeal, whereupon the Commissioner (Appeals) partly allowed the appeal. The appeal preferred by the Department was dismissed by the Tribunal.

The High Court held that under the scheme, the liability to pay was incurred and the amount became payable at the time when the employee was released, having opted for the voluntary retirement under the scheme. Salary or benefit in lieu of salary payable to an employee opting for voluntary retirement was chargeable to tax under section 15(a) as soon as it became due, though not paid. The amount so received was exempt from being charged to tax to the extent of Rs. 5,00,000 by reason of section 10(10C) of the Act. Even if the payment was stretched over a period of years, it would not become chargeable to tax in any subsequent assessment year.

Section 10(10C) of the Act was inserted in order to make voluntary retirement more attractive and beneficial to employees opting for voluntary retirement. Therefore, this has to be interpreted in a manner beneficial to the optee for voluntary retirement, if there is any ambiguity.

It could not have been the intention of the Legislature to restrict the benefit under section 10(10C) of the Act to employees, who retired before April 1, 2004, to the extent of the amount actually received by them at the time of voluntary retirement for that particular assessment year and to other employees of the same organization who opted for voluntary retirement after that to extend that benefit for the amount received by them as well as the amount receivable by them in the subsequent financial years. Therefore, the amendment to clause (10C) of section 10 of the Act by the Finance Act, 2003 with effect from April 1, 2004 adding the words "or receivable" after the words "received" is clarificatory.

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

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

Relevant Section: 10(B)

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

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

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

3

CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS

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

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

   Relevant Section: 11

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

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

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

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

   Relevant Section: 11

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

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

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

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

Relevant Section: 12AA

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

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

4

INCOME FROM SALARIES

1. Can reimbursement of expenditure on medical treatment taken by the assessee, who was a member of the Legislative Assembly, be taxed as perquisite under section 17(2)(iv)?

   CIT v. Shiv Charan Mathur (2008) 306 ITR 126 (Raj)

   Relevant Section: 15 & 17(2)

   Notice under section 148 was issued to the assessee, at the relevant time a sitting MLA and former Chief Minister of the State, for the reason that he received a sum from the State Government as reimbursement of medical expenses which amount was liable to be taxed under section 17 but had not been offered for taxation. The contention of the assessee was that the amount received by MPs and MLAs was not taxable under the head "Salary" but under the head "Income from other sources".

   The High Court held that MLAs and MPs are not employed by anybody rather they are elected by the public, their election constituencies and it is consequent upon such election that they acquire constitutional position and are in charge of constitutional functions and obligations. The remuneration received by them, after swearing in, cannot be said to be "salary" within the meaning of section 15 of the Income-tax Act, 1961. The fundamental requirement for attracting section 15 is that there should be a relationship of employer and employee whether in existence or in the past. This basic ingredient is missing in the cases of MLAs and MPs. When the provisions of section 15 were not attracted to the remuneration received by the assessee, section 17 could not be attracted as section 17 only extends the definition of "Salary" by providing certain items mentioned therein to be included in salary. Thus, the reimbursement of medical treatment taken by the assessee, who was a member of the Legislative Assembly for open heart surgery conducted abroad was not taxable as perquisite under section 17(2)(iv).

5

INCOME FROM HOUSE PROPERTY

1. Is the rental income from the sub-letting of a building taken on lease taxable under the head 'income from other sources' or 'income from house property' or 'income from business?

   Harikrishna Family Trust v. CIT (2008) 306 ITR 303 (Guj.)

   Relevant Section: 22

   A lease deed was executed between the owners of a property partly constructed and the assessee-trust. The trust took on lease the said property at a monthly lease rent of Rs.4,000. The beneficiaries were dependent relatives of the co-owners of the property. The trust, after completing construction work of the balance portion of the building, rented out the whole premises and the rental income was shown as income from property and originally assessed as such. Subsequently, by virtue of action under section 263 of the Income-tax Act, 1961, the CIT set aside the order. After enquiry the Assessing Officer assessed the income as business income but the CIT(A) on appeal held that it was income from other sources. The Tribunal held that the amount was assessable as business income.

   The High Court held that the assessee-trust was merely a lessee of the property and had sub-let the property after completing the partly constructed building which the assessee-trust had taken on lease. In the circumstances, in the absence of the assessee-trust being the owner of the property, there could be no question of taxing the rental income from the said property in the hands of the assessee-trust under the head "Income from house property". The assessee-trust at no point of time indulged in any systematic activity so as to treat the assessee as having indulged in business or a venture in the nature of business. On facts the income was liable to be taxed as "Income from other sources".

6

PROFITS AND GAINS OF BUSINESS OR PROFESSION

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

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

   Relevant Section: 28

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

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

2. Whether the amount transferred to the reserve fund account as per the provisions of section 67 of the Gujarat Co-operative Societies Act, 1962, was diversion of income at source by overriding title or could such transfer be treated as business expenditure deductible either under section 28 or section 37?

   CIT v. Mehsana District Co-op. Milk Producers' Union Ltd. (2008) 307 ITR 83 (Guj.)

   Relevant Section: 28

   The assessee contended that under sub-section (2) of section 67 of the Gujarat Co-operative Societies Act, 1962, at least one-fourth of the net profits of the society were required to be carried to the reserve fund every year, and hence there was a diversion at source by virtue of the provisions of section 67 which operates as an overriding title. Hence, it was submitted that the amount transferred to the reserve fund could not be charged as income liable to tax under the Act. Alternatively, it was pleaded that the amount of profits transferred to the reserve fund would constitute a charge on the taxable income under the provisions of section 28 of the Income-tax Act, 1961, or an expenditure having the characteristics of business expenditure under section 37. The Assessing Officer rejected the contention and this was upheld by the Tribunal.

The High Court held that it was only in the event the society did not choose to use the reserve fund for the business of the society that the question about investing the reserve fund in the specified category of investments and thereafter utilizing the same for the objects specified by the State Government could arise. Hence, not only was there no diversion of income by overriding title but in fact there was no outgoing of funds from the domain of the assessee-society. In fact, the profits at the specified percentage were set apart so as to be available to the society for use in the business of the society at a later point of time. Once the society was in a position to use the funds lying in the reserve fund for the business of the society as and when the society so chose, there could be no question of keeping out such profits from the purview of taxation. The Tribunal was right in law in holding that the amount transferred to the reserve fund account as per the provisions of section 67 of the Gujarat Co-operative Societies Act, 1962, was not diversion of income at source by overriding title nor could such transfer be treated as business expenditure deductible either under section 28 or section 37.

3. Whether the amount received by the assessee under a lease agreement is income from other sources or business income?

   East West Hotels Ltd. v. DCIT (2009) 309 ITR 149 (Kar.)

   Relevant Section: 28

   The assessee was engaged in the hotel business activities. The assessee by an agreement with IHC gave one of its hotels on lease for an initial period of 33 years with an option to renew for a further period of 33 years. The assessee claimed that the amount received from IHC had to be treated as its business income. The claim was rejected by the Assessing Officer on the ground that the assessee was not getting any business income as the hotel had been leased out by the assessee to IHC and any amount received by the assessee from such company had to be treated as income from other sources and not business income. The Commissioner (Appeals) as well as the Tribunal held that the income received by the assessee from such hotel building was income from other sources.

   The High Court held that the clauses in the agreement were more in the nature of a lease deed and not a licence given for a particular period with no intention to resume its business of hotel in the premises. It could not be said that the assessee had been managing the hotel through IHC. Therefore, the amount received from IHC had to be treated as income from other sources and not as business income.

4. Whether the swapping premium is profit derived from the business of providing long-term finance in terms of section 36(1)(viii) of the Income-tax Act, 1961 ?

   Rural Electrification Corporation Ltd., In re (2009) 308 ITR 321 (AAR)

   Relevant Section: 36(1)(viii)

   The main object of the applicant, a public sector undertaking, was to provide long-term finance, primarily to State Electricity Boards, for the purpose of transmission, distribution and generation of electricity to enable industrial, agricultural and infrastructure development. The applicant was filing income-tax returns right from the beginning and the Department had all along, in the past, allowed deduction under section 36(1)(viii) of the Income-tax Act, 1961, in respect of the special reserve created and maintained for providing long-term finance for industrial or agricultural development or development of infrastructure. For the assessment year 2004-05, the applicant credited Rs.170.85 crores as "swapping premium" received and claimed deduction thereon under section 36(1)(viii). "Swapping premium" was a scheme under which long-term finance given at a higher percentage of interest was converted to a lower rate of interest. The applicant itself had declared the swapping premium receipt in its balance-sheet as "Other income" and not income from lending operations. The Assessing Officer held that the applicant forfeited the claim for allowance of deduction under section 36(1)(viii) in respect of the "swapping premium". The Commissioner (Appeals) agreed with the Assessing Officer. The applicant appealed to the Appellate Tribunal but withdrew the appeal. Meanwhile, the applicant obtained permission of the Committee on Disputes to pursue the matter before the Authority. The Authority ruled:

(i) That the applicant was an eligible entity, i.e., a financial corporation as laid down in section 36(1)(viii).

(ii) That the applicant was engaged in the business of providing long-term finance to its clients for rural electrification which paved the way for industrial, agricultural and infrastructural development. The availability of electricity contributed significantly to the overall development of the country including that of industry, agriculture and infrastructure. The provision of electricity was essential for modernization and growth of agriculture and also catered to the requirements of industry including small and medium industries, agro-industries, Khadi and village industries, etc. The applicant had been providing finance for industrial and agricultural development and, keeping in view these very goals, the Government of India had granted approval to the applicant for deduction under section 36(1)(viii). The applicant could be said to be engaged in providing long-term finance for industrial and agricultural development in India.

(iii) That the long-term loan financed by the applicant to its clients in the beginning had not been tampered with on rescheduling of the interest and no fresh loan agreements had also been drawn.

(iv) That clause (e) of the Explanation to section 36(1)(viii) defined long-term finance as "any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereon during a period of not less than five years". In this case, the loans had been advanced in the beginning for five years and those loan amounts had not undergone any change, so the period of five years had to be counted from the date of advancing the initial loans and not from the date of rescheduling the interest rates.

(v) That the "swapping premium" was nothing but discounted interest and had "originated" in the long-term finance initially advanced. The premium was actually traced to the original source and was not a step removed from the business of providing long-term finance. No fresh agreement had been entered into for advancing long-term financing and the one-time measure for rescheduling the interest had been actuated by business expediency. The swapping premium was simply a compensation received for agreeing to a lesser amount as against a higher fixed rate of interest initially fixed. The business of providing long-term finance was the immediate and effective source of the swapping premium received.

(vi) That the swapping premium could not be termed as compensation for breach of contract because neither party had breached the contract. The disclosure of the swapping premium in the balance-sheet as "Other income" instead of business income was also immaterial since entries in the books of account are not determinative of the true character of a receipt.

(vii) That, therefore, the applicant was entitled to deduction under section 36(1)(viii) in respect of the swapping premium received.

5. Whether the payments made by the assessee to its employees under the nomenclature 'Good work reward' constitute bonus within the meaning of section 36(1)(ii) of the Income-tax Act, 1961 or were allowable as normal business expenditure under section 37 ?

Shriram Pistons and Rings Ltd. v. CIT (2008) 307 ITR 363 (Del.)

Relevant Section: 37

The "good work reward" that was given by the assessee to some employees on the recommendation of senior officers of the assessee did not fall in any of the categories of bonus specified under the industrial law. There was nothing to suggest that the good work reward given by the assessee to its employees had any relation to the profits that the assessee may or may not make. The reward had relation to the good work done by the employee during the course of his employment and at the end of the financial year on the recommendation of a senior officer of the assessee, the reward was given to the employee. Consequently, the "good work reward" could not fall within the ambit of section 36(1)(ii) of the Income-tax Act, 1961. The "good work" reward was allowable as business expenditure under section 37(1) of the Act.

6. Whether the Tribunal was justified in deleting the addition of an amount represented rate difference payment in the purchase of milk paid by the assessee even though the said payment was paid at the end of the previous year?

CIT v. Solapur Dist. Co-Op. Milk Producers and Process Union Ltd. (2009) 315 ITR 304 (Bom.)

Relevant Section: 37

The assessee-societies were federal milk societies and their members were primary milk co-operative societies. The business of the assessee was to purchase milk from its members and other producers of milk at the rate, i.e., similar to both the members and outside milk producers and sell the milk to various parties. The rate of purchase price was fixed by the board of the assessee-societies. The purchase price was linked to the fat content of milk and also varied according to seasons. For instance, the rate for purchase of milk in the lean season was different from the flush seasons. The assessee-societies fixed the rate of processing of milk at the beginning of the year on the basis of the price declared by the Government of Maharashtra and the price which other buyers paid to the vendors. These rates were revised from time to time. It was made always clear that the rates were provisional and the final milk rate difference was determined in the month of March every year and the difference was paid subsequently in the following year. The primary milk society also in turn made payment of the final rate difference to the individual milk producers around Diwali. The assessees claimed deduction of the final rate difference. The Assessing Officer refused to exclude the final rate difference paid from the total amount paid by the assessee. The Commissioner (Appeals) upheld the order. The Tribunal allowed the appeal and allowed deductions of the final rate.

The High Court held that the amount to be paid was not out of the profits ascertained at the annual general meeting. It was not paid to all shareholders. The amount which was the subject-matter was paid to members who supplied milk and in some case also to non-members. The payment was for the quantity of milk supplied and in terms of the quality supplied. The commercial expediency for payment of this price was the market conditions and the need to procure more milk from the members and non-members to the assessee. Therefore, the amount paid could not be said to be dividend to the members or shareholders or payment in the form of bonus as bonus also had to be paid from the accrued profits. It was deductible.

7. Whether the expenses incurred by the assessee for promotion films, slides, advertisement films is capital expenditure?

CIT v. Geoffrey Manners and Co. Ltd. (2009) 315 ITR 134 (Bom.)

Relevant Section: 37

The assessee incurred expenditure on film production by way of advertisement for the marketing of products manufactured by it. The Assessing Officer disallowed the expenses incurred by the assessee for promotion films, slides, advertisement films and treated it as capital expenditure. The Commissioner (Appeals) held that the films were in the form of advertisement whose life term could not be ascertained. Therefore, they could not be held as capital expenditure. The Tribunal upheld the order of the Commissioner (Appeals).

The High Court held that if the expenditure is in respect of an ongoing business of the assessee and there is no enduring benefit it can be treated as revenue expenditure. If the expenditure is in respect of business which is yet to commence then it cannot be treated as revenue expenditure since the expenditure is on a product yet to be marketed. Hence, the expenditure incurred in respect of promoting ongoing products of the assessee was revenue expenditure.

8. Whether the expenditure incurred by the assessee in the machinery repairs could be treated as revenue expenditure though this related to the cost of motors and other items resulting in an enduring benefit to the assessee and was in the nature of capital expenditure?

CIT v. Hero Cycles P. Ltd (2009) 311 ITR 349 (P&H)

Relevant Section: 37

The assessee claimed expenditure of Rs. 73,180 on purchase of motors and certain other items of machinery. The Assessing Officer rejected the claim for treating the amount as revenue expenditure on the ground that the items purchased by the amount were not spare parts but independent items and the amount had, thus, to be treated as capital expenditure. On appeal, the plea of the assessee that most of the items purchased were electric motors for replacement of existing machinery, was upheld. The Tribunal affirmed the order and held that occasional replacements were necessary having regard to the machinery installed.

The High court held that the Tribunal was right in law in allowing expenditure of Rs.73,180 shown by the assessee in the machinery repairs account as revenue expenditure.

9. Whether the fine paid for belated payment of excise duty is a allowable business expenditure?

CIT v. Hoshiari Lal Kewal Krishan (2009) 311 ITR 336 (P&H)

Relevant Section: 37

The assessee claimed deduction of Rs. 31,433 paid as fine for belated payment of the excise duty instalment. This was disallowed by the Assessing Officer as well as the appellate authority but the Tribunal allowed it.

The Supreme Court in Prakash Cotton Mills P. Ltd. v. CIT [1993] 201 ITR 684, observed that whenever any statutory impost paid by an assessee by way of damages or penalty or interest is claimed as an allowable expenditure under section 37(1) of the Income-tax Act, the assessing authority is required to examine the scheme of the provisions of the relevant statute providing for payment of such impost notwithstanding the nomenclature of the impost as given by the statute, to find whether it is compensatory or penal in nature. The authority has to allow deduction under section 37(1) of the Income-tax Act, wherever such examination reveals the concerned impost to be purely compensatory in nature.

Hence, in the present case, the High Court held that it had been clearly found that though termed as fine, the payment was not in the nature of punishment but was by way of compensation. The payment was deductible.

10. Whether section 40(b) of the Income-tax Act, 1961, is applicable to the amount of salary and bonus paid by the assessee-firm to its partners for their individual service as against their Hindu undivided family character?

CIT v. Unimax Laboratories (2009) 311 ITR 191 (P&H)

Relevant Section: 40(b)

The Assessing Officer made an addition under section 40(b) of the Income-tax Act, 1961, on account of salary and bonus paid by the assessee-firm to its four working partners. Those partners were partners in their representative capacity as karta of their Hindu undivided families. Since these partners represented their respective Hindu undivided families, they were treated to be partners for the purpose of disallowance of benefits under section 40(b) of the Act by the Assessing Officer. However, on appeal the addition was deleted on the ground that the salary and bonus were paid to these persons as individuals and in these circumstances section 40(b) of the Act had no application.

The High Court held that the Tribunal was right in allowing the amount of salary and bonus paid by the firm to partners for services rendered by them on the ground of having technical qualification and expertise, though they represented their Hindu undivided families and section 40(b) of the Act was not attracted.

11. Whether the amount written back by the assessee to the credit of its profit and loss account during the accounting period under consideration constituted income of the assessee-company under section 41(1) of the Income-tax Act 1961?

Jay Engineering Works Ltd. v. CIT (2009) 311 ITR 299 (Del.)

Relevant Section: 41(1)

The assessee had written back in its accounts unclaimed balances totalling Rs.1,16,240. The Inspecting Assistant Commissioner added back this amount to the income of the assessee. This was upheld by the Commissioner (Appeals) as well the Tribunal.

The High Court held that the amounts were not statutory liabilities but contractual liabilities. These amounts were unilaterally written off by the assessee. Therefore, the unclaimed liability written off by the assessee was taxable as income.

12. Whether the amount transferred to profit and loss account in case of waiver of loan taken by assessee for business purposes assessable as business income under section 41(1) of the Income-tax Act, 1961?

Solid Containers Ltd. v. DCIT (2009) 308 ITR 417 (Bom.)

Relevant Section: 41(1)

The assessee had taken a loan for business purposes which was written back and directly credited to the reserves account, as a result of consent terms arrived at in a suit. The assessee claimed this amount as capital receipt, even though it had offered the interest on the said loan as its income by crediting the same to its profit and loss account. The Assessing

Officer added the amount to the total income of the assessee as its income and this was upheld by the Tribunal.

The High Court held that it was a loan taken for trading activity and ultimately, upon waiver the amount was retained in the business by the assessee. The amount had become the assessee's income and was assessable.

13. Is depreciation under section 32 allowable in respect of emergency spares of plant and machinery, which though acquired during the previous year, have not been put to use in that year?

CIT v. Insilco Ltd. (2009) 179 Taxman 55 (Del.)

Relevant Section: 32

On this issue, the Delhi High Court observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

Note – One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is "kept ready for use". For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term "use" embraces both active use and passive use. However, such passive use should also be for business purposes.

14. What is the tax treatment of pre-payment premium paid by the assessee-company to IDBI for restructuring its debt?

CIT v. Gujarat Guardian Ltd. (2009) 177 Taxman 434 (Del.)

Relevant Section: 43B

The assessee-company paid pre-payment premium to IDBI during the relevant previous year for restructuring its debts and reducing the rate of interest. It claimed the full payment as business expenditure in that year on the reasoning that it was an upfront payment representing the present value of the differential rate of interest that would have been due on the loan if the restructuring of loan had not taken place. The Assessing Officer and Commissioner (Appeals) were of the view that the premium has to be amortised over 10 years, and accordingly allowed only 1/10th of the premium as deduction for the relevant previous year. The Tribunal, however, concurred with the assessee's view and held that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable.

The issue under consideration is whether the deduction has to be allowed in one lump-sum as claimed by the assessee or should the same be deferred over a period of time as opined by the Assessing Officer and Commissioner (Appeals).

The Delhi High Court concurred with the Tribunal's view that the deduction has to be allowed to the assessee-company in one lump sum according to the provisions of section 43B(d). Section 43B(d) provides that any sum payable by the assessee as interest on any loan or borrowing from any public financial institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the period or periods in which the liability to pay such sum is incurred by the assessee according to the method of accounting regularly followed by the assessee. As there was no dispute that the pre-payment premium paid represented interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, as per the provisions of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the actual payment was made i.e. the previous year relevant to the assessment year under consideration.

Note – Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Section 2(28A) defines interest to include, inter alia, any other charge in respect of the moneys borrowed or debt incurred. Section 43B provides for certain deductions to be allowed only on actual payment. From a combined reading of these three sections, it can be inferred that –

(i) pre-payment premium represents interest as per section 2(28A);

(ii) such interest is deductible as business expenditure as per section 36(1)(iii);

(iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).

7

CAPITAL GAINS

1. Can the loss on account of forfeiture of share application money be treated as short-term capital loss?

   DCIT v. BPL Sanyo Finance Ltd. (2009) 312 ITR 63 (Kar.)

   Relevant Section: 45

   The assessee company is engaged in non-banking financial business and applied for allotment of one lakh equity shares of the IDBI in response to the public issue of shares and remitted the share application money. The IDBI allotted 89,200 shares to the assessee as against one lakh equity shares applied for. Thereafter, the IDBI called the assessee to pay the balance sum for issuance of shares in its favour. As the assessee-company failed to remit the balance outstanding allotment money, the IDBI cancelled the allotment and forfeited the share application money. The assessee claimed it as a short-term capital loss in its return of income. The Assessing Officer disallowed the claim. The Commissioner(Appeals) confirmed the order passed by the Assessing Officer. The Tribunal allowed the appeal filed by the assessee.

   The High Court held that consequent to the assessee's default in not paying the balance of money on allotment, its right in the shares stood extinguished on forfeiture by the IDBI. The loss suffered by the assessee, i.e., the non-recovery of share application money was consequent to the forfeiture of its right in the shares and was to be understood to be within the scope and ambit of transfer. It would amount to short-term capital loss to the assessee.

2. Can the transfer of capital asset by a company to its wholly owned subsidiary company be regarded as transfer and, therefore, attract levy of capital gains tax?

   CIT v. Coats of India Ltd. (2009) 315 ITR 215 (Cal.)

   Relevant Section: 47

   The entire packaging coating units of the assessee was transferred to CCIPL for a sum of Rs. 29,89,87,000 by way of adjustment and issue of equity shares of Rs.10 each in CCIPL credited as fully paid-up share capital. In the process of such transfer a surplus amount of Rs. 19,14,55,804 was credited to the accounts of the assessee over and above the book value of the assets actually transferred to CCIPL. The assessee claimed that this excess amount was not taxable on the ground that the assessee transferred the assets of the company to its wholly owned subsidiary company. It was further stated that the unit was transferred with all its assets and, therefore, the value of each of the items could not be determined separately as the sale was made on slump basis and, accordingly, the actual profit from each asset could not be determined. The Tribunal held that the entire packaging coating business undertaking itself constituted a distinct "capital asset" under section 2(14) of the Income-tax Act, 1961, for which consideration was not determined with reference to individual assets but with reference to the capitalised value of the said business, that the proviso to section 47(v) and (iv) was applicable only if, in the hands of the transferee the capital asset on its transfer constituted stock-in-trade, that such packaging coating business on its transfer was not accounted for in the books of CCIPL as stock-in-trade and that, therefore, since the entire paid-up capital of CCIPL as on December 31, 1997, was held by the assessee the transfer of the undertaking was covered by the provisions of section 47(iv) and, therefore, no income under the head "Capital gains" was assessable in the assessment year 1998-99 .

The High Court held that the Tribunal was right and no capital gains arose.

3. Can the actual sale consideration recorded in the agreement to sell of the asset and received by the assessee be substituted by the value as adopted by the District Valuation Officer under section 55A of the Act for the purpose of computing the capital gains chargeable to tax ?

Dev Kumar Jain v. Income-tax Officer (2009) 309 ITR 240 (Del.)

Relevant Section: 55A

The assessee declared income by way of capital gains arising from the sale of property. The Assessing Officer was of the view that the sale price disclosed in the agreement to sell was low and made a reference to the District Valuation Officer under section 55A for determining the fair market value of the property on the date of sale. The District Valuation Officer determined the value of the plot on the date of the sale and this was communicated to the assessee. The Tribunal accepted the stand of the Revenue that the actual sale consideration recorded in the agreement to sell should be substituted by the value arrived at by the District Valuation Officer under section 55A.

The High Court held that section 55A of the Income-tax Act, 1961, applies only where the Assessing Officer is required to ascertain the fair market value of a capital asset. Section 45(1A) stipulates that capital gains shall be computed by deducting from the full value of consideration received or accruing as a result of the transfer of the capital asset, the amount of expenditure incurred wholly and exclusively in connection with such transfer as also the cost of acquisition of the asset and the cost of any improvement thereto. A combined reading of section 45(1A) and section 48 shows that when a sale of property takes place, the capital gains arising out of such a transfer has to be computed by looking at the full value of the consideration received or accruing as a result of such transfer. The expression “full value of sale consideration” is not the same as “fair market value” as appearing in section 55A. Thus, for the purpose of computing capital gains there is no necessity for computing the fair market value. Further, there was nothing on record to show that the assessee received consideration for the sale of the property in excess of that which was shown in the agreement to sell. Thus, the actual sale consideration recorded in the agreement to sell and received by the assessee could not be substituted by the value as adopted by the District Valuation Officer under section 55A for the purpose of computing the capital gains chargeable to tax.

4. Can exemption under section 54(1) be claimed for the purchase of more than one residential premises?

CIT v. D. Ananda Basappa (2009) 309 ITR 329 (Kar.)

Relevant Section: 54

The assessee a Hindu undivided family sold a residential house. The assessee purchased two residential flats adjacent to each other from taking two separate registered sale deeds in respect of the two flats situate side by side purchased on the same day. The vendor had certified that it had effected necessary modifications to the two flats to make it one residential apartment. The assessee sought exemption under section 54. The assessing authority gave exemption for capital gains to the extent of purchase of one residential flat. It was found by the Inspector that the residential flats were in the occupation of two different tenants. The Assessing Officer held that section 54(1) of the Act does not permit exemption for the purchasers for more than one residential premises. The Commissioner (Appeals) confirmed the order of the assessing authority. The Tribunal set aside the order of the Commissioner (Appeals) and held that the flats purchased by the assessee had to be treated as one single residential unit and that the assessee was entitled to full exemption.

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

5. Whether the assessee, in the computation of long-term capital gains, is entitled to deduction under section 54F of the Income tax Act in respect of investment in modification/expansion of an existing residential house?

Mrs. Meera Jacob v. Income-tax Officer (2009) 313 ITR 411 (Ker.)

Relevant section: 54F

The Tribunal took the stand that exemption is available only when the investment is in the construction of a house and not for investment in modification or renovation. Admitted facts are that the assessee had a fairly big house to which the assessee made addition of 140 sq. meters of plinth area. However, it is the conceded position that the assessee has not constructed any separate apartment or house. Section 54F does not provide for exemption on investment in renovation or modification of an existing house. On the other hand, construction of a house only qualifies for exemption on the investment. Even addition of a floor of a self-contained type to the existing house would have qualified for exemption. However, since the assessee has only made addition to the plinth area, which is in the form of modification of an existing house, she is not entitled to deduction claimed under section 54F of the Act.

8

INCOME FROM OTHER SOURCES

1. Whether the Tribunal was right in law in holding that the income from lease of hospital, after giving a finding that the hospital basically remains a business asset, should be assessed as 'Income from other sources' and not as 'Business Income'?

   Orient Hospital Ltd. v. DCIT (2009) 315 ITR 422 (Mad.)

   Relevant Section: 56(2)(iii)

   The assessee-company constructed a hospital building and ran the hospital. As the assessee-company suffered loss in running the business, it leased the hospital building along with equipment and machinery to A on a monthly lease of Rs.3,00,000 per month and claimed this sum as business income against which earlier business losses were set off. The Assessing Officer treated the income from lease of the hospital as "Income from other sources" and disallowed set off of the earlier years' business losses. The Commissioner (Appeals) allowed the assessee's appeal, but the Appellate Tribunal, while holding that the lease income was to be treated as income from other sources, allowed the lease income to be set off against the previous years' losses.

   The High Court held that income derived out of the lease of property and furniture as in this case could not be treated as income from profits and gains of business or profession. The finding given by the Tribunal that the income was income from other sources was correct.

9

DEDUCTIONS FROM GROSS TOTAL INCOME

1. Whether the assessee was entitled to deduction under section 80-IB of the Income-tax Act, 1961, on the ground that conversion of jumbo rolls into salable packets/rolls of standard size was not manufacture or production of article or thing?

   Computer Graphics Ltd. v. ACIT (2009) 308 ITR 96 (Mad.)

   Relevant Section: 80IB

   The assessee, a company engaged in the business of conversion of jumbo rolls of Konica colour paper, Konica graphic art film and medical x-ray films into saleable packets, filed its return of income for the assessment years claiming deduction under section 80-IB of the Income-tax Act, 1961. The Assessing Officer disallowed the deduction on the ground that there was no manufacture of any article or thing. The Commissioner (Appeals) as well as the Tribunal confirmed the disallowance made by the Assessing Officer.

   The High Court held that the activity of converting jumbo rolls into marketable small sizes could not be regarded as a manufacturing activity and the assessee was not entitled to the benefit of section 80-IB of the Act as had been already decided in the assessee's own case in the earlier year.

2. Whether a co-operative society engaged in the business of manufacture and sale of sugar out of the sugarcane grown by its members, can be denied deduction under section 80P(2)(a)(iii) of the Income-tax Act, 1961 on the ground that processing involves use of power ?

   Budhewal Co-op. Sugar Mills Limited v. CIT (2009) 315 ITR 351 (P&H)

   Relevant Section: 80P(2)(a)(iii)

   Section 80P has been enacted with a view to encourage and promote growth of the co-operative sector in the economic life of the country and in pursuance of the declared policy of the Government. It has to be liberally construed. "Marketing" is a comprehensive term. It does not mean merely buying and selling. It includes "processing" which may be necessary for making the agricultural produce marketable.

   The correct way of reading the different heads of exemption enumerated in the section would be to treat each as a separate and distinct head of exemption. Whenever a question arises as to whether any particular category of an income of a co-operative society is exempt from tax, what has to be seen is, whether the case falls within any of the several heads of exemption. If it falls within any one head of exemption, it would be free from tax notwithstanding that the conditions of another head of exemption are not satisfied and such income is not free from tax under that head of exemption.

The case of the growers of agricultural produce is dealt with by section 80P(2)(a)(iii). Sub-clause (iii) has a wider scope. Under this sub-clause, the members have to be growers themselves, meaning thereby, that for the society with members being growers, the deduction is available even if the agricultural produce is marketed without further processing or even if it is processed with the use of power. Sub-clause (v) of section 80P(2)(a) is a restrictive clause and has to be understood as covering a case of members having agricultural produce not grown by them. Sub-clause (v) is applicable on fulfilment of the following conditions: "(a) some processing is to be carried out on the agricultural produce; and (b) the processing is without the aid of power." Clause (v) is different inasmuch as sub-clause (iii) applies where the members of the co-operative societies are the growers of the agricultural produce whereas sub-clause (v) applies in a case where the agricultural produce is not grown by the members but may belong to them. Additionally, there cannot be sufficient market for purchase of sugarcane itself as grown by the members. The sugarcane necessarily is to be converted into sugar before it can be made marketable. Therefore, keeping in view the legislative intent for enacting section 80P(2)(a)(iii), the benefit thereunder could not be denied to a society which manufactures and sells sugar out of the sugarcane grown by its members.

10

INCOME-TAX AUTHORITIES

1. Whether the transfer of assessee cases from Kolkata to Patna not for the purpose of co-ordinated and effective investigation but for centralization, valid?

   Dillip Kumar Agarwal v. CIT (2009) 314 ITR 291 (Cal.)

   Relevant Section: 127(2)(a)

   In connection with search and seizure operations against the R group of companies, the Commissioner of Income-tax after hearing the assessees passed a reasoned order directing transfer of the cases of the assessees from the Income-tax Officers at Kolkata to Patna.

   On writ petitions challenging the transfer of cases the High Court held that the notices proposing transfer did not indicate that the transfer was for the purpose of co-ordinated and effective investigation. The transfer as proposed was for the purpose of centralisation. The assessees had made categorical statements in their representations that they had no business connection with their father, had no business at any place in Bihar, they managed their businesses on their own and had no business link with R, their father, and had no relation either in the business or otherwise in the R group of companies, but the authorities had not rebutted the categorical statements made in the written objections. Thus, as the order did not disclose any nexus of the assessees with R or the R group of companies, the order was without merit and could not be sustained.

2. Whether revenue was entitled to demand unrestricted access to acquire electronic records present in laptops pertaining to third parties unconnected with person searched?

   S. R. Batliboi and Co. v. Department of Income-tax (Investigation) (2009) 315 ITR 137 (Del.)

   Relevant Section: 132

   The petitioner was a firm of auditors. During the course of search and seizure operations conducted against EMAAR, the laptop computers of two employees of the petitioner, who were conducting an audit of EMAAR, were seized by the Deputy Director. Subsequently, the Deputy Director issued summons under section 131 to the employees of the petitioner and their statements were recorded. On the request of the Deputy Director these employees provided him with the electronic data relating to three companies of the EMAAR group together with the print copies of the data. The Deputy Director insisted on securing total and unrestricted access to the laptops of all the other clients of the petitioner. This request was refused by the employees. The seized laptops were sent by the Deputy Director to the Central Forensic Science Laboratory who, 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 employees of the petitioner.

On a writ petition the High Court held that the powers of search and seizure are very wide and the Legislature has provided a safeguard that the Assessing Officer should have reason to believe that a person against whom proceedings under section 132 of the Income-tax Act, 1961, are to be initiated is in possession of assets which have not been or would not be disclosed. Secondly, the authorised officer is also required to apply his mind as to whether the assets found in the search have been disclosed or not, and if no undisclosed asset is found no action can be taken under section 132(1)(iii) or (3). An arbitrary seizure is not maintainable. The objection of the petitioner was vis-à-vis only the material relating to its other clients and not to material which had causal connection with EMAAR against whom the search and seizure operation was directed. The offer in this regard had been spurned by the Revenue. In view of the fact that the Deputy Director had rejected the offer made by the petitioner the summons had to be set aside and the Deputy Director had to forthwith return the laptops to the petitioner.

11

ASSESSMENT PROCEDURE

1. Whether the Tribunal was right in holding that the assessment framed in the status of HUF by the Assessing Officer as null and void, though the assessee himself admitted during the assessment proceedings that the land sold by him on which consideration was received and was declared in the return of income as capital gains, belonged to HUF?

   CIT v. Rohtas (2009) 311 ITR 460 (P&H)

   Relevant Section: 148

   The assessee sold agricultural land which was assessable to tax under the head Capital gains but the assessee did not file the return. Pursuant to the notice under section 148 of the Income-tax Act, 1961, the assessee filed his return in the status of individual. The Assessing Officer completed the assessment treating the status of the assessee as Hindu undivided family as against individual. This was confirmed by the Commissioner (Appeals). The Tribunal held that the assessment framed by the Assessing Officer was null and void because the notice issued to the assessee under section 148 was without intimating his status to be Hindu undivided family.

   The High Court held that the finding of the Tribunal was that the assessee did not make any statement about the status of Hindu undivided family in the letter in question on which the Assessing Officer had placed heavy reliance. Once a notice under section 148 and other notices under section 143(2) and 142(1) were issued treating the assessee as individual then the Assessing Officer could not have framed the assessment treating the income in the hands of the Hindu undivided family.

2. Whether the Tribunal was right in law in upholding the order of the CIT(A) in deleting the trading addition made by the Assessing Officer, as the assessee failed to produce the quantitative details of raw materials and finished products?

   CIT v. Om Overseas (2009) 315 ITR 185 (P&H)

   Relevant Section: 143

   The assessee-firm derived its income from manufacturing and export of duries, rugs, woollen carpets, made ups, etc., and filed a nil return of income. Subsequently it was assessed under section 143(3) of the Income-tax Act, 1961 and it declared gross profit on the total turnover of 25.38 per cent as against 29.5 per cent declared in the immediate preceding assessment year. Being dissatisfied with the explanation given by the assessee, the Assessing Officer rejected the books of account of the assessee invoking section 145(3) and applied the gross profit rate of 27 per cent which resulted in certain additions. The Commissioner (Appeals) deleted the additions made by the Assessing Officer. The Tribunal upheld the order of the Commissioner (Appeals).

The High Court held that the factual finding given by the Commissioner (Appeals) that the additions were made by the Assessing Officer without pointing out any specific defect in the books of account was upheld by the Tribunal. As no perversity or illegality in the finding was pointed out by the Department, no substantial question of law arose for determination.

3. Whether a proceedings sent pursuant to filing of returns without demand of tax or interest is an intimation under section 143(1)(a) of the Act?

CIT v. Sitaram Textiles (2009) 313 ITR 330 (Ker.)

Relevant Section: 154

The assessee has filed loss returns for the two assessment years which were accepted by the Assessing Officer and intimations were sent under section 143(1)(a) of the Income-tax Act, 1961. After issuing notice under section 143(2) of the Act, regular assessment was completed under section 143(3) of the Act. Later, the Assessing Officer noticed that the intimations sent were incorrect. Accordingly notices were sent under section 154(1)(b) of the Act and assessments were rectified. In the appeals filed by the assessee, the Commissioner of Income-tax (Appeals) held that the proceedings sent under section 143(1)(a) for the respective assessment years do not constitute intimations under section 143(1)(a) of the Act. Consequently, he cancelled the rectification orders in which additional tax was demanded under section 143(1A) of the Act. In second appeal filed by the Department before the Tribunal, the Tribunal confirmed the orders of the Commissioner of Income-tax (Appeals).

The proviso to section 143(1) of the Income-tax Act, 1961, makes it clear that besides acknowledgment of receipt of return, issue of an intimation under section 143(1)(a) is contemplated under the Act. The above provision specifically authorises rectification of mistakes in such intimations issued. In fact, prior to the amendment with effect from June 1, 1999, section 154(1)(b) provided for amendment of any intimation sent by the officer under sub-section (1) of section 143 or to enhance or reduce the amount of refund granted by it under that sub-section. An intimation sent without demand of tax or interest also could be rectified under section 154(1)(b).

Where proceedings issued under section 143(1)(a) are not superseded or merged in the assessment issued under section 143(3), it would be open to the officer to rectify the intimation issued under section 143(1)(a).

4. Whether the Tribunal is right in holding that the rectification order under section 154 was not proper especially when the audit had raised an objection that the interest income was to be brought to tax under the head 'Income from other sources'?

CIT v. A. G. Granites P. Ltd. (2009) 311 ITR 170 (Mad.)

Relevant Section: 154

The assessee-company, an exporter of granite blocks, filed its return of income admitting an income of Rs.9,68,900 after claiming deduction under section 10B of the Income-tax Act, 1961, to the extent of Rs.1,32,389. The return was processed under section 143(1) and refund of Rs.1,280 was allowed. On verification of the records, it was noticed that the assessee had offered interest income on fixed deposit made under the head "Other income", but it was required to be assessed under the head "Income from other sources". Upon a notice under section 154 of the Act to the assessee, the Assessing Officer after considering the reply rectified the assessment order. The appeal filed by the assessee was dismissed by the Commissioner (Appeals). The Tribunal, allowing the appeal filed by the assessee, held that debatable issues were not to be rectified under section 154 of the Act.

Section 154 of the Income-tax Act, 1961, provides for rectification of mistakes, which are apparent from the record. The phraseology "mistake apparent from the record" has been considered by several judicial opinions and all those judicial opinions uniformly held that an error, which is not self-evident, and has to be detected by a process of reasoning, cannot be said to be an error apparent on the face of the record. There is a clear distinction between an erroneous order and an error apparent on the face of the record, while the first can be corrected by the higher forum, the latter can only be corrected by exercise of the power of rectification.

The High Court held that the issue as to the head under which the "interest income" had to be assessed was a debatable issue. Thus, the interest income offered by the assessee under the head "Other income" could not be reassessed under the head "Income from other sources" by way of rectification and on the basis of the objection raised by the audit parties.

12

PENALTIES

1. Whether the Tribunal was right in confirming the penalty under section 271(1)(c) in respect of the inflation of purchase which was actually detected only when the assessment was subjected to audit under section 142(2A) as not a valid and correct ground?

   Kalpaka Bazar v. CIT (2009) 313 ITR 414 (Kar.)

   Relevant Section: 271(1)(c)

   For the assessment year 1984-85, the Income-tax Officer completed the assessment of the assessee by including addition towards purchase and gross profit. In fact, search was carried out in the premises of the assessee and books of account and other documents were seized. Statutory audit was done under section 142(2A) of the Income-tax Act. The auditor brought out bogus purchases accounted by the assessee which represents proforma invoices not representing any actual purchases. Penalty is levied based on inflation of purchase value and on account of gross profit addition. However, in successive appeals, penalty attributable to gross profit addition was deleted which is final. However, the Tribunal sustained penalty pertaining to inflation of purchases.

   The High Court held that the disputed amount represents proforma invoices which do not represent actual purchases and so much so, the disputed expenditure is bogus purchase accounted by the assessee. Accounting of bogus purchase expenditure is nothing but concealment and, therefore, penalty was rightly levied which got confirmed in appeal.

2. Whether, the imposition of penalty under section 271(1)(c) was justified in view of Explanation 4(a) to section 271(1)(c) due to inaccurate particulars of income by wrongly claiming the deduction under section 80P(2)(a)(iii) of the Income-tax Act, as it was engaged in manufacturing and not in marketing business?

   CIT v. Budhewal Co-operative Sugar Mills Ltd. (2009) 312 ITR 92 (P & H)

   Relevant Section: 271(1)(c)

   The assessee, a co-operative society, earned income from the activity of manufacturing of sugar, molasses and other by products from sugarcane. In the return of income, he claimed deduction under section 80P(2)(a)(iii) of the Act. The Assessing Officer disallowed the deduction claimed by the assessee under section 80P(2)(a)(iii) of the Income-tax Act, 1961 and initiated penalty proceedings under section 271(1)(c) of the Act for furnishing inaccurate particulars of income. The Commissioner (Appeals) confirmed the disallowance and penalty imposed on the assessee. The Tribunal upheld the disallowance of deduction but cancelled the penalty levied on the assessee on the grounds that the assessee had disclosed all the particulars relating to the computation of its income, paid the tax in advance and on self-assessment and that the assessee's claim was bona fide.

The High Court held that the society had paid advance tax as well as self-assessment tax not taking into account the deduction claimed under section 80P(2)(a)(iii) of the Act. It was evident from the facts that the assessee's claim was bona fide and that all the particulars relating to the computation of income had been disclosed. Thus, the Tribunal rightly cancelled the penalty levied.

3. Whether the imposition of penalty under section 271(1)(c) for furnished inaccurate particulars of income to the extent of making a wrong claim of share trading loss against the normal income is justified?

CIT v. Auric Investment and Securities Ltd. (2009) 310 ITR 121 (Del.)

Relevant Section: 271(1)(c)

The assessee in its return of income has claimed an amount of Rs.22,15,837 in its profit and loss account on account of share trading loss and has treated the same as normal business expense. However, during the assessment proceedings, the Assessing Officer found that this loss is speculative in nature and cannot be adjusted against normal income of the assessee. Consequently, the loss of the assessee has been assessed at the amount of Rs.85,259 against returned loss of Rs.23,05,096. The Assessing Officer also held that the assessee had furnished inaccurate particulars of income to the extent of making a wrong claim of share trading loss against normal income. Hence, he was liable for imposition of penalty. Therefore, penalty of under section 271(1)(c) of the Income-tax Act, 1961 was levied, for furnishing inaccurate particulars of income.

The High Court held that it is clear from the record that all the requisite information as required by the Assessing Officer, was furnished by the assessee. There is nothing on record to show that in furnishing its return of income, the assessee has either concealed its income or has furnished any inaccurate particulars of income. The mere treatment of the business loss as speculation loss by the Assessing Officer does not automatically warrant inference of concealment of income. The assessee did not conceal any particulars of income, as he filed full details of the sale of shares. In any case, it cannot be said that the assessee has concealed any particulars so far as its computation of income is concerned and as the such provisions of section 271(1)(c) of the Act are not attracted in this case.

4. Whether the Tribunal has erred in law in deleting the penalty under section 271(1)(c) of the Act when concealed income had been brought to tax under section 147/148 of the Act ?

CIT v. Pearey Lal and Sons (Ep) Ltd. (2009) 308 ITR 438 (P&H)

Relevant Section: 271(1)(c)

The Assessing Officer completed the reassessment in respect of the assessee under section 147 of the Act and imposed penalty to the extent of 200 per cent. of the tax sought to be evaded. The Commissioner (Appeals) reduced the penalty to 100 per cent. The Tribunal set aside the penalty imposed by the Assessing Officer on the ground that the mention in the assessment order that "penalty proceedings under sections 271(1)(c) and 273(2)(a) of the Act were being initiated separately" did not amount to recording of satisfaction during the course of assessment in terms of section 271(1)(c) of the Act.

The High Court held the only requirement under section 271(1)(c) of the Income-tax Act, 1961, is that during the course of assessment there must be existence of satisfaction for initiating penalty proceedings and this must be expressly reflected in the assessment order. There is no required format in which such satisfaction is to be recorded. An indication in the assessment order regarding the initiation of penalty proceedings separately is tantamount to an indication as to the satisfaction of the authorities that the assessee has concealed income or furnished inaccurate particulars.

In the present case, the existence of satisfaction during the course of assessment was clear. Absence of satisfaction could not be inferred from the fact that the only words used in the assessment order were that proceedings were being separately initiated. The view of the Tribunal that mere mention of initiation of penalty proceedings separately did not justify initiation of penalty proceedings was to be set aside and the matter was remanded to the Tribunal for a fresh decision on the issue of penalty in accordance with law.

13

DEDUCTION, COLLECTION AND RECOVERY OF TAX

1. Whether the assessee was under statutory obligation under the Income-tax Act, 1961, and/or the Rules to collect evidence to show that its employee(s) had actually utilized the amount paid towards leave travel concession(s)/conveyance allowance?

   CIT v. Larsen and Toubro Ltd. (2009) 313 ITR 1 (SC)

   Relevant Section: 192 & 10(5)

   The employer is not under any statutory obligation under the Income-tax Act, 1961, or the Rules, to collect evidence to show that the employee had actually utilized the amount paid towards leave travel concession or conveyance allowance under section 10(5). Nor is there any circular of the Central Board of Direct Taxes requiring the employer under section 192 to collect and examine the evidence supporting the declaration submitted by the employee.

2. Whether the rental income received by co-owner the assessee is covered by section 194-I(b) of the Act for the purposes of deduction of tax at source on the premise that the rent is paid to a HUF not to an individual?

   CIT v. Lally Motors (2009) 311 ITR 29 (P&H)

   Relevant Section: 194-I

   The assessee had taken on rent the premises at different places and in each there were two landlords. The rental income received by the co-owner had been duly disclosed in their individual returns for the several assessment years which had been accepted as such. The contention of the Revenue that the assessee was covered by section 194-I(b) of the Income-tax Act, 1961, for the purposes of deduction of tax at source on the premise that the rent was not paid to an individual or Hindu undivided family was rejected by the Commissioner (Appeals). The Tribunal upheld the order of the Commissioner (Appeals). The High Court held that the tenancy was common, i.e., of four persons. No material had been placed on record by the Revenue to show that the rent was paid to the conglomeration and thereafter distributed among the co-owners. Therefore, the Tribunal held that the case was covered under section 194-I(a) of the Act and not by the provisions of section 194-I(b). The assessee rightly deducted tax at source at 15 per cent under section 194-I(a).

3. Whether the Tribunal was correct in holding that no interest need to be paid by the assessee for non-deduction of TDS (being consequential) after having held that the assessee was liable to deduct TDS on the interest component paid by having remanded to verify certain facts and recomputed the interest?

   CIT v. Oriental Insurance Co. Ltd. (2009) 315 ITR 102 (Kar.)

Relevant Section: 201(1A)

The proviso to section 201(1) of the Income-tax Act, 1961, empowers the levy of penalty if the tax deducted at source is not affected for any valid reason. However, section 201(1A) is a distinct provision to levy interest for delayed remittance.

Pursuant to the award made under the Motor Vehicles Act, the assessee paid compensation to the victim of the accident which included interest liability. The assessee failed to deduct and remit the tax deducted at source to the Revenue. The Assessing Officer directed the assessee to deposit the tax amount with interest. The Commissioner (Appeals) confirmed the order. The Tribunal set aside the direction to pay interest on the ground that the liability was in the nature of penalty but permitted the assessee to split and spread over the interest liability for each of the assessment years.

The High Court held that the assessee was liable to pay interest at the rate of 12 per cent for belated payment of tax for any reasonable cause. The levy of interest under section 201(1A) of the Act cannot be construed as a penalty. The Tribunal had rightly directed that the interest paid above Rs.50,000 was to be split and spread over the period from the date interest was directed to be paid till payment.

4. Whether the Tribunal were justified in passing an order under section 201 and in levying interest invoking section 201(1A) of the Income-tax Act, without considering the cause and explanation shown by the appellant?

Karnataka Urban Infrastructure Development Finance Corporation v. CIT (2009) 308 ITR 297 (Kar.)

Relevant Section: 201 & 201(1A)

The appellant is a public sector company wholly owned by the State of Karnataka. The appellant-company has entrusted certain contracts to a foreign company, which is a non-resident company, to provide technical know-how and consultancy to the appellant in terms of the contract. Similarly, it also entered into another contract with a company situated in the U. K. As per the terms and conditions of the agreement, the appellant-company in addition to making the payment towards the consultancy fees, the appellant has to reimburse the expenditure that may be incurred by those two companies, when they are in Karnataka (for the accommodation and conveyance of the staff of these two companies, when they are in India). In terms of the agreement, the appellant-company has to take care of the tax liability of the non-resident companies. The Income-tax Officer has initiated the proceedings by invoking the provisions of sections 201 and 201(1A) of the Income-tax Act on the ground that the appellant-company as required under section 195 of the Act did not deduct the tax at source and remit the same in accordance with law, in so far as the reimbursement of expenditure portion only. The assessee has sent the reply by stating that it was under the bona fide impression that no tax was required to be deducted in regard to the reimbursement since it was only an amount spent by the appellant-company towards the conveyance and accommodation to the officers/employees of non-resident companies, when they were in India for the purpose of execution of the agreement. The explanation offered by the assessee was not accepted. Accordingly, an order was passed under section 201 and also under section 201(1A) of the

Income-tax Act.

The High Court held that the authorities had not properly considered the explanation offered by the assessee, and there was no intention on the part of the assessee to violate the provisions of section 195 of the Act. The levy of penalty under section 201 was to be set aside.

Further, it was held that the levy of penalty under section 201 of the Income-tax Act, 1961 and the levy of interest under section 201(1A) of the Act are entirely different. An Assessing Officer has discretion to drop the penalty proceedings. But if the tax is not deducted under section 195 of the Act, the assessee is bound to pay interest, as it is a mandatory provision. Even if the penalty proceedings are dropped under section 201, the assessee cannot escape his liability to pay interest under section 201(1A) of the Act. Both the sections are independent and they are not interlinked and they cannot be read conjunctively as levy of interest and levy of penalty are two different proceedings. Hence, the order levying interest under section 201(1A) of the Act was to be confirmed.

14

ADVANCE RULING

1. Whether the income derived by him on the purchase in India and export of gold jewellery and on the purchase of gold for manufacture of jewellery for export accrued or arose in India and was taxable in India.

   Mustaq Ahmed, In re (2008) 307 ITR 401 (AAR)

   Relevant Section: 9

   The applicant, an individual, was a resident of Singapore. He carried on business in the manufacture and sale of gold jewellery in Chennai (India). He sold jewellery in the local market as well as by export mostly to Singapore. He purchased gold for the purpose of conversion into jewellery and export and also purchased gold jewellery for export. The applicant's banks in Chennai acted on his behalf and received the export sale proceeds in India and they were credited to his account through electronic service. The applicant sought the ruling of the Authority.

   The Authority ruled that the income arising from the sale proceeds of exported goods had actually been received from the importer/buyer at Chennai in India and the applicant's banks at Chennai in India had been crediting the amounts received from the importers/buyers to the account of the applicant. A reasonable inference could be drawn that the right to receive the payments had arisen in India on account of export sales of gold jewellery to the importers abroad (Singapore). The fact that the importers/buyers abroad were companies controlled by the applicant made no difference in law. Since the income actually accrued or arose in India there was no scope to say that the accrual was nullified by clause (b) of Explanation 1 to section 9(1)(i) of the Income-tax Act, 1961. The income was taxable in India.

1

LEVY OF WEALTH TAX

1. Whether the assessee is not entitled to claim exemption under section 5(1)(iv) of the Wealth Tax Act, in respect of hotel building?

   CIT v. Hiro J. Nagpal (2009) 313 ITR 028 (Raj.)

   Relevant Section: 5(1)(iv)

   The assessee claimed exemption under section 5(1)(iv) of the Act in respect of a hotel building. The valuation officer valued the interest of the assessee in the hotel property. The Wealth-tax Officer issued a demand under section 16(3) of the Act. The Appellate Assistant Commissioner of Wealth-tax upheld the order of the Wealth-tax Officer. The Tribunal granted the benefit of exemption under section 5(1)(iv) of the Act.

   The High Court held that Section 5(1)(iv) of the Wealth-tax Act, 1957 was amended on April 1, 1972, taking away the words "exclusively used for dwelling purposes". The word "house" has neither been defined under the Wealth-tax Act nor under the General Clauses Act. The word "building" has been used in section 5(1)(iii) and the word "property" has been used in section 5(1)(i) of the Act. In common parlance, "house" means a dwelling place where people live. However, a residential building or house can also be used for commercial purposes. Hence, a hotel could not be considered to be house so as to qualify for the exemption under section 5(1)(iv) of the Act.

2

ASSESSMENT PROCEDURE

1. Whether penalty can be levied under Wealth-tax Act, against legal representative after the death of the assessee?

   ACIT v. Late Shrimant F. P. Gaekwad (2009) 313 ITR 192 (Guj.)

   Relevant Section: 15B

   The assessee furnished the returns of wealth declaring his net wealth for the various assessment years. At the time of assessment penalty proceedings were initiated under sections 18(1)(a), 18(1)(c) and 15B of the Wealth-tax Act, 1957. The assessee expired in 1988 before the penalty proceedings could be completed and the estate of the assessee devolved upon his mother who also passed away and thereafter it devolved upon the sister of the assessee. The Assessing Officer passed penalty orders under sections 18(1)(a) and 18(1)(c) and 15B of the Act. The legal heir of the assessee challenged the penalty and the Commissioner (Appeals) deleted the penalty for all the years. The Tribunal confirmed the order of the Commissioner (Appeals).

   The High court held that no penalty order was passed during the life time of the deceased. To make the legal representative liable for penalty under section 19(1) it was not enough that the penalty proceedings should be initiated during the life time of the deceased. It was also necessary that such penalty proceedings must result in penalty orders during his life time. Therefore, neither section 19(1) nor section 19(3) cast any obligation on the executor, administrator or other legal representative to pay the amount of penalty as they were not liable to face any such penalty proceedings for which they had committed any default. The default, if any, was committed by the assessee and the assessee was not alive when the penalty proceedings culminated in penalty orders.