

DIRECT TAXES CASE STUDY

FOR

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COMPILED BY

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MUMBAI (INDIA)

Source / Journals Referred:

- ≈ Income tax Review : Monthly journal of The Chamber of Tax Consultants.
- ≈ BCAJ (Bombay Chartered Accountant Society) Monthly journal
- ≈ The Chartered Accountant Journal by ICAI.
- ≈ Taxmann.com
- ≈ Itatonline.org
- ≈ Taxman : The tax law weekly
- ≈ SOT : Selected Orders of ITAT
- ≈ ITD : Income Tax tribunal decisions.
- ≈ DTR : Direct Tax Reporter.
- ≈ ITR : Income Tax Reports.
- ≈ CTR Encyclopedia of Income Tax Law.

All the case decisions compiled below were pronounced between the period December 2009 to Nov 2010 specifically applicable for May 2011 term.

Citation of the Case decisions as well as full text of the decision will be provided as per requirement of the readers.

❖ **Measurement of Agricultural land : Section 2(14)(iii) : Satinder Pal Singh (P & H)**

Distance of the agricultural land belonging to the assessee within the meaning of S. 2(14)(iii)(b) has to be measured in terms of the approach by road and not by a straight line distance on horizontal plane or as per crow's flight.

❖ **Forfeiture of deposit amount will not be treated as capital loss set to be setoff against capital gain : Dinesh Babula Thakkar (Ahd.)**

Assessee entered into an agreement with power attorney holder of land owners and paid certain amount as advance. Sale deed was required to be executed within six months from the date of agreement. As the assessee could not manage fund within the prescribed period, agreement was cancelled and amount paid by assessee was forfeited. Assessee claimed that amount forfeited represented short term capital loss which could be set off against long term capital gains. The Tribunal held that essential requirement for charging capital gains (or allowing capital loss) is that a transfer of capital asset should be effected in the relevant previous year. In the instant case, by paying advance money assessee did not get any right which could be termed as capital asset within meaning of section 2 (14), and which was transferred within the meaning of section 2(47), therefore the assessee claim was not allowable.

❖ Non Compete fees Constitutes Revenue receipts : Tata Coffee Ltd. (Kar.)

Non-compete fee received by assessee for refraining from manufacturing and selling timepieces for a period of ten years after the sale of one unit while it was continuing with its other business activities constituted revenue receipt.

❖ Compensation received on Breach of contract is capital receipt : S Zoraster & Co. (Rajasthan)

The assessee firm entered into an agreement for sale of a cinema building along with land. The agreement failed and as per terms of agreement the firm became entitled to compensation. It was held that compensation amount received on breach of contract was a capital receipt.

❖ Excess cash received from customer cannot be treated as Income : Bank of Rajasthan (Bom)

Excess cash received at the cash counters of the bank represents the liability to pay to the customers as and when they may demand payment, therefore such excess cash collection cannot be considered as the income of the assessee.

❖ Non-filing of audit report with ROI not fatal to s. 11 exemption: ITO vs. Sir Kikabhai Premchand Trust (ITAT Mumbai)

The assessee, a charitable trust, filed a return claiming exemption u/s 11 in respect inter alia of a receipt of Rs. 35.70 crores on sale of property. **The audit report in Form 10B was not filed with the return.** During the assessment proceedings, the assessee's trustee gave a statement u/s 131 to the AO in which he stated that no audit report u/s 10B was obtained. Subsequently, the said statement was retracted on the ground that the trustee was not a tax expert and had no knowledge of the audit report. It was claimed that the audit report had been obtained but was omitted to be filed with the return. **The audit report was thereafter filed during the assessment proceedings.** The AO took the view that u/s 12A(1)(b) the requirement of the accounts being audited and the audit report being filed with the return was **mandatory** and the failure to do so dis-entitled the assessee to exemption u/s 11. The AO also rejected the retraction as an after-thought. However, the CIT (A) allowed the claim on the ground that the filing of the report during assessment proceedings was sufficient compliance with s. 12A(1)(b). On appeal by the department, HELD dismissing the appeal.

Though s. 12A (1)(b) provides that the exemption u/s 11 will be available only if the accounts are audited and audit report "furnished along with the return", the same is **not mandatory** but is **directory**. The audit report in Form 10B affirms the statements contained in the balance sheet and income-expenditure statement and is intended to enable the AO to allow the exemption by relying on the audit report and without having to ask the assessee to furnish supporting documents in support of the claim. Such a procedural provision cannot be construed as mandatory because the defect can be cured at a subsequent stage. **It is not the intention of the Legislature that the exemption u/s 11 should be denied merely because the audit report was not filed with the return.**

❖ For charitable purpose, application of income need not be in india : Nasscom (Del)

Application of income should result and should be for the purpose of charitable purposes in India and application need not be in India. Expenditure incurred at an event at Hannover, Germany is eligible for exemption.

❖ S. 14A disallowance can be made with regard to partner's share of profits. { Dharmasingh Popat vs. ACIT (ITAT Mumbai) }

The assessee, a partner in a firm, received 'share of profit' and 'salary' from the firm. While the 'share of profit' was exempt u/s 10(2A), the 'salary' was taxable as business income u/s 28 (v). The assessee claimed deduction for business expenditure incurred by him. The AO held that as the assessee had exempt income, s. 14A applied and a part of the expenditure had to be disallowed. This was confirmed by the CIT (A). Before the Tribunal, the assessee argued that as a partnership firm was merely a compendium of partners having no independent legal personality, **the share of profit was not an exempt income in the hands of partner** as the firm had paid tax thereon. HELD decided against the assessee.

Though in general law, a firm and its partners are not distinct, this is subject to statutory exceptions. Under the scheme of assessment of firms applicable from AY. 1993-94 a firm is treated as an independent entity and the expenditure by way of remuneration, interest, commission etc. paid to partners is allowable to it as a deduction subject to ceilings and such interest, salary etc is taxable in the hands of the partners. **A firm and its partners are consequently separate entities under the Act.** Accordingly, **the fact that the profits are charged to tax in the hands of the firm does not mean that the share of such profits is non – exempt in the hands of the partner. The profits being exempt in the hands of the partner, s. 14-A does apply in computing his total income.**

❖ S. 14A applies where shares are held as investment and the only benefit derived is dividend. S. 36(1)(iii) deduction allowable if shares held as stock-in-trade. : CIT vs. Leena Ramachandran (Kerala High Court)

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

The only benefit derived by the assessee from the investment in shares was the dividend income and no other benefit was derived from the company for the business carried on by it. As dividend is exempt u/s 10(33), the disallowance u/s 14A would apply. The Tribunal was not correct in estimating the s. 14A disallowance to a lesser figure than the interest paid on the borrowing when the whole of the borrowed funds were utilized by the assessee for purchase of shares.

Deduction of interest u/s 36(1)(iii) on borrowed funds utilized for the acquisition of shares is admissible only if shares are held as stock in trade and the assessee is engaged in trading in shares. So far as acquisition of shares in the form of investment is concerned and where the only benefit derived is dividend income which is not assessable under the Act, disallowance u/s 14A is squarely attracted.

❖ Even under Rule 8D of S. 14A, disallowance can be made only if there is actual nexus between tax-free income and expenditure.{ CIT vs. Hero Cycles (P & H High Court) } (Important)

The assessee earned dividend income on shares which was exempt from tax. The AO took the view that the investment in shares was made out of borrowed funds on which interest expenditure was incurred and consequently made a disallowance u/s 14A. This was partly upheld by the CIT (A). On further appeal by the assessee, the Tribunal deleted the disallowance by noting that **the assessee had proved that the investment in shares was made out of non-interest bearing funds. It held that unless there was evidence to show that the interest – bearing funds had been invested in the tax – free investments and the nexus was established by the Revenue, s. 14A could not be applied on mere presumption.** The Revenue appealed to the High Court and claimed that in view of **s. 14A (2) and Rule 8D (1) (b), a disallowance could be made even if the assessee claimed that no expenditure had been incurred in respect of the tax – free income.** HELD, dismissing the appeal of the department by stating that

*“ If the investment in the shares is out of the non-interest bearing funds, disallowance u/s 14A is not sustainable. The contention of the revenue that directly or indirectly some expenditure is always incurred which must be disallowed u/s 14A cannot be accepted. **Disallowance u/s 14A requires a finding of incurring of expenditure. If it is found that for earning exempted income no expenditure has been incurred, disallowance u/s 14A cannot stand.** The contention of the revenue even if the assessee has made investments in shares out of its own funds, the said own funds are merged with the borrowed funds in a common kitty and, therefore, disallowance u/s 14A can be made is also not justified “*

❖ Compensation for Infringement of copyright is Business Income : Eastern Book Company (Allahabad)

Amount received as compensation for infringement of copy right assessable as business income.

❖ Even Single Transaction constitutes Business Income : Cherukuri Ramesh (Vishakhapattnam)

Assessee, his wife and son jointly purchased land on 2nd March, 1997, and soon thereafter applied for converting the same into housing plots though sanction was given by the concerned development authority in 2001. They sold all the eight plots during the financial year 2004-05. Co-owners of the assessee have no record of carrying on of agricultural operations. Two of the three coowners are engaged in the business of automobile spare parts. Even though the conversion of land materialized in the year 2001 only, in the absence of any evidence to show that the land was used for some other purpose prior to seeking approval of the layout plan, the intention of purchase of land cannot be

automatically inferred as an investment. Thus, the attendant circumstances of the case lead to the conclusion that the land was purchased with the intention to sell the same at a profit. Therefore, though an isolated transaction, it was an adventure in the nature of trade and the income there from has to be treated as business income.

❖ BSE Card is an “intangible asset” and eligible for depreciation u/s 32(1)(ii) : Techno Shares & Stocks vs. CIT (Supreme Court)

S. 32 (1), as amended w.e.f. 1.4.1998 allows depreciation on “intangible assets” being, inter alia, “licenses ... or any other business or commercial rights of similar nature”. The Tribunal took the view that a BSE card was an “intangible asset” eligible for depreciation. On appeal by the Revenue, the HC reversed the Tribunal on the ground that it was not a “license” and the words “business or commercial rights” relate to intellectual properties and not all categories of business or commercial rights. On appeal by the assessee, HELD reversing the High Court.

Under Rule 5 of the BSE Rules, membership is a personal permission from the Exchange which is nothing but a “licence” which enables the member to exercise rights and privileges attached thereto. It is this licence which enables the member to trade on the floor of the Exchange and to participate in the trading session on the floor of the Exchange. It is this licence which enables the member to access the market. Therefore, **the right of membership, which includes right of nomination, is a “licence” or “akin to a licence” which is one of the items which falls in s. 32(1)(ii).** The right to participate in the market has an **economic and money value**. It is an expense incurred by the assessee which satisfies the test of being a “licence” or “any other business or commercial right of similar nature” in terms of s. 32(1)(ii).

On the analysis of the Rules of BSE, it is clear that the right of membership allows the non-defaulting member to participate in the trading session on the floor of the Exchange. Thus, **the said membership right is a “business or commercial right” conferred by the Rules of BSE on the non-defaulting continuing member.** Rules and Bye-laws permit the member to participate in the trading session on the floor of the Exchange; to deal with other members of the Exchange and to nominate. Moreover, under Explanation 3 to s. 32(1)(ii) commercial or business right which is similar to a “licence” or “franchise” is declared to be an intangible asset.

❖ Under “block of assets” even a closed unit is eligible for depreciation.{ Swati Synthetics vs. ITO (ITAT Mumbai) }

The assessee had two divisions, one at Dombivili and the other at Surat. **The division at Surat was closed since two/three years.** The assessee claimed depreciation on the assets of the said Surat division which was rejected by the AO and the CIT (A) on the ground that the assets were not “used” and depreciation could not be allowed. On appeal by the assessee, HELD allowing the appeal of the assessee.

The concept of allowing depreciation on block of assets was introduced w.e.f. 01.04.1988 with the object of avoiding separate book keeping. **A harmonious reading of the expression ‘used for the purposes of the business’, would show that it only means that the assessee has used the machinery for the purposes of the**

business in earlier years. The doubt as to how depreciation can be allowed on assets which are not used for the purpose of business is answered by the legislative scheme that though the profit of that year is reduced, the WDV is reduced and the gain is taxed u/s 50 when the asset is sold and block ceases to exist;

The “use” of an individual asset can be examined only in the first year when the asset is purchased. In subsequent years the use of block of assets is to be examined. The existence of an individual asset in block of asset itself amounts to use for the purpose of business. This is supported by the proviso to s. 32 which provides half depreciation for assets acquired in the year and held for less than 180 days. Once an asset is included in the block of assets it remains there and can only be removed when it is sold, discarded etc u/s 43(6)(c)(i)(B) or used for non-business purposes u/s 38 (2) or where the entire block ceases to exist.

❖ Under “block of assets”, use of individual assets is not required.{ CIT vs. Bharat Aluminium (Delhi High Court) }

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

The rationale and purpose for which the concept of block asset was introduced, as reflected in the CBDT’s Circular dated 23.09.1988 is that **once the various assets are clubbed together and become ‘block asset’ within the meaning of s. 2(11), it becomes one asset.** Every time, a new asset is acquired, it is to be thrown into the common hotchpotch, i.e., block asset on meeting the requirement of depreciation being allowable at the same rate. **Individual assets lose their identity and become an inseparable part of block asset insofar as calculation of depreciation is concerned;**

❖ Depreciation allowable even if asset not used at all for entire year. { CIT vs. G. R. Shipping (Bombay High Court) }

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

squarely covered in favour of the assessee by its earlier judgements in **Whittle Anderson** 79 ITR 613 and **G. N. Agrawal** 217 ITR 250.

❖ Depreciation is mandatory for Chapter VI-A deduction. { Plastiblends vs. ACIT (Bombay High Court Full Bench) }

The Assessee had disclaimed the depreciation for the purposes of regular assessment. High Court stated that though the assessee may have an option to disclaim current depreciation in computing total income under Ch. IV does not mean that the quantum of deduction allowable u/s 80 – IA is dependent upon the assessee claiming or not claiming current depreciation. Ch. VI-A is a Code by itself and the special deduction granted therein has to be computed on the gross total income determined after deducting all deductions allowable under ss. 30 to 43D and any device adopted to reduce or inflate the profits of eligible business has got to be rejected. **By not claiming current depreciation, the assessee seeks to inflate the profit linked incentives provided u/s 80-IA which is not permissible.**

❖ For Claiming depreciation, ownership is not compulsory : A Sivakami (Mad)

Owner is a person who is entitled to receive income from the property in his own right. In order to claim benefit of sec. 32 it is not necessary that the assessee should be a complete owner. The buses on which the assessee had claimed depreciation were not registered in her name, however the assessee produced all the documents relating to loans obtained, insurance etc. relating to the business to establish that she was beneficial owner and received income. It was held she was entitled to depreciation.

❖ For s. 36(1)(vii) Bad Debt, write off of individual debtor's a/c is not necessary { Vijaya Bank vs. CIT (Supreme Court) } (Very Important)

The assessee made a provision for bad debts by debiting the P & L A/c and crediting the Provision for Bad debts A/c. Thereafter, the provision account was debited and the loans and advances a/c was credited. The AO denied the claim for bad debts u/s 36(1)(vii) on the ground that **the individual account of the debtor had not been written off**. The CIT (A) and Tribunal allowed the assessee's claim though the High Court reversed it. On appeal by the assessee, HELD reversing the High Court. Pursuant to the Explanation inserted w.r.e.f. 1.4.1989 **a mere provision for bad debt is not entitled to deduction u/s 36(1)(vii)**. However, in the present case, besides debiting the P&L A/c and creating a provision for bad debts, **the assessee had also obliterated the said provision by reducing the corresponding amount from the debtors account** in the Balance Sheet. Consequently, the figure in the loans and advances in the Balance Sheet was shown net of the provision for bad debts.

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

❖ **Bad debts need not be proven to be irrecoverable u/s 36(1)(vii). It is sufficient if they are written off { TRF Limited vs. CIT (Supreme Court) } (Very Important)**

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

❖ **If brokerage offered to tax, the principal debt qualifies as a "bad debt" u/s 36(1)(vii) r.w.s. 36(2). DCIT vs. Shreyas S. Morakhia (ITAT Mumbai Special Bench)**

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

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

❖ **Interest on NPA not assessable on "accrual" basis : CIT vs. Vasisth Chay Vyapar (Delhi High Court)**

The assessee, a NBFC, advanced Inter Corporate Deposits (ICD) to Shaw Wallace. As the interest was not received by the assessee for more than six months in view of the adverse financial position of the borrower, the assessee treated the ICD as a Non Performing Asset (NPA) in terms of the directions of the RBI and did not account for the interest. However, the AO held that as the assessee was following the mercantile system of accounting, the interest had "accrued" even if it was

not actually realized. This was confirmed by the CIT (A) though reversed by the Tribunal. On appeal by the department, HELD dismissing the appeal:

U/s 45Q of the RBI Act read with the NBFCs Prudential Norms (Reserve Bank) Directions 1998, **it was mandatory on the part of the assessee not to recognize the interest on the ICD as it had become a NPA.** The assessee was bound to compute income having regard to the recognized accounting principles set out in Accounting Standard AS-9. **AS-9 provides that if there are uncertainties as to recognition of revenue, the revenue should not be recognized.** Accordingly, the argument of the revenue that the interest on the NPA can be said to have accrued despite it being a NPA is not acceptable.

❖ Foreign Exchange fluctuation losses are allowable on accrual basis. { CIT vs. Woodward Governor India p. Limited.(Supreme Court) **Very Important** }.

Assessee had debited to its Profit & Loss Account a sum of Rs. 41 lakh, out of which a sum of Rs.29 lakh was the unrealized loss due to foreign exchange fluctuation on the last date of the accounting year. The Assessing Officer held that the liability as on the last date of the previous year under consideration was a contingent liability, it was not an ascertained liability and consequently it had to be added back to the total income of the assessee. Accordingly, he added back Rs. 29 lakh being the unrealized loss due to foreign exchange fluctuation. In other words, the debit to the P&L account was disallowed.

Supreme Court in his order stated that where the assessee carrying on the mercantile system of accounting then the additional liability arising on account of fluctuation in the rate of exchange in respect of loans taken for revenue purposes was allowable as deduction u/s 37(1) in the year of fluctuation in the rate of exchange and not in the year of repayment of such loans. The actual cost of imported assets acquired in foreign currency is entitled to be adjusted u/s 43A (prior to the amendment by the FA 2002) on account of fluctuation in the rate of exchange at each balance sheet date, pending actual payment of the varied liability.

The term “expenditure” in s. 37 covers an amount which is a “loss” even though the said amount has not gone out from the pocket of the assessee. The “loss” suffered by the assessee on account of the exchange difference as on the date of the balance sheet is an item of expenditure u/s 37(1). Profits and gains are required to be computed in accordance with **commercial principles** and accounting standards (AS-11). Accounts and the accounting method followed by an assessee continuously for a given period of time **needs to be presumed to be correct** till the AO comes to the conclusion for reasons to be given that the system does not reflect true and correct profits. The fact that the department taxed the gains on fluctuation on the basis of accrual while disallowing the loss is important and indicates the **double standards adopted by the Department**;

❖ Roll-over charges for foreign currency contracts have to be capitalized u/s 43A { ACIT vs. Elecon Engineering (Supreme Court) (**Important**) }

The assessee procured a foreign currency loan for expansion of its existing business. To ensure availability of foreign currency, the assessee booked forward contracts with a bank. The contract was for the entire amount and delivery of

foreign currency was obtained from the bank for the installment due from time to time. The balance value of the contract was rolled over for a further period up to the date of the next installment. The assessee paid “roll over premium charges” for the same. The AO disallowed the said charges on the ground that as it were incurred for purchase of plant & machinery, it was capital expenditure. The matter ultimately went to Supreme Court.

Apex Court reversing the High Court by stating that **Exchange differences are required to be capitalized if the liabilities are incurred for acquiring fixed assets like plant and machinery. It is the purpose for which the loan is raised that is of prime significance. Whether the purpose of the loan is to finance the fixed asset or working capital is the question which one needs to answer.** It cannot be said that roll over charge has nothing to do with the fluctuation in the rate of exchange. Roll over charges represent the difference arising on account of change in foreign exchange rates. **Roll over charges paid/ received in respect of liabilities relating to the acquisition of fixed assets should be debited/ credited to the asset in respect of which liability was incurred.** However, roll over charges not relating to fixed assets should be charged to the Profit & Loss Account.

❖ Exchange Fluctuation loss on pending forward contracts is an “accrued” loss : DCIT vs. Bank of Bahrain & Kuwait (ITAT Mumbai Special Bench)

The assessee, a foreign bank carrying on business in India, entered into forward contracts with its clients to buy or sell foreign exchange at an agreed price on a future date. On the date of maturity, the contract was executed which resulted in either profits or losses to the assessee. There was no dispute that the loss was on revenue account and that loss arising on execution of the contracts in the same year were allowable as a deduction. With respect to contracts where the date of maturity fell beyond the accounting period, the assessee valued the forward contracts on the last day of the accounting period on the basis of rate of foreign exchange prevailing on that date and accounted for the loss or profit, as the case may be. The AO taxed the profits on such contracts though he disallowed the losses on the ground that they were “notional”. The Special Bench had to consider whether the loss was a “notional” or “contingent” loss or whether it was an “accrued” loss. HELD deciding in favour of the assessee:

The Act allows a deduction in respect of crystallized liabilities. While as per commercial principles of policy of prudence, all anticipated liabilities have to be accounted for, as per the Act only “accrued” liabilities are allowable. **While anticipated liabilities which are contingent in nature are not allowable, an anticipated liability coupled with a present obligation can be said to be a crystallized liability.** A contingent liability depends purely on the happening or not happening of an event whereas **if an event has already taken place, such as the entering into the contract and undertaking of an obligation to meet the liability**, and only consequential effect of the same is to be determined, then, **the liability is not a contingent liability.** Accounting Standard -11 (AS-11) issued by the ICAI is mandatory and provides that if foreign exchange transactions are not settled in the same accounting period, the effect of exchange difference has to be recorded on 31st March;

❖ Estimated expenditure towards warranty is allowable u/s 37 (1). { Rotork Controls vs. CIT (Supreme Court) Important }

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

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

❖ Explanation to s. 37 (1) does not apply to “penalty” which is not of the nature of illegal / unlawful expenditure. { Western Coalfields vs. ACIT (ITAT Nagpur) }

The assessee became liable to pay “**penalty**” for overloading wagons under the rules of the Railways. The question arose whether the said “penalty” was disallowable under the **Explanation to s. 37 (1)** which provides that “expenditure incurred for any purpose which is an offence or which is prohibited by law” shall not be allowable. Tribunal while deciding the matter stated that the substance of the matter had to be looked into and given preference over the form. **Though the amount was termed “penalty”, it was essentially of a commercial nature and incurred in the normal course of business and was consequently allowable.**

❖ Liability shown in the books of accounts cannot be treated as remission : GP International Ltd. (P & H)

Assessee having shown the amount payable by it to another company as an existing liability in its books and written back the same, it cannot be said that the aforesaid liability has ceased to exist and therefore it cannot be treated as income by invoking the provisions of section 41(1).

❖ Even employees’ contribution to PF paid before due date of filing ROI is allowable u/s 43B.{ CIT vs. AIMIL Limited (Delhi High Court) }

S. 2 (24) (x) provides that amounts received by an assessee from employees towards PF contributions etc shall be “income”. S. 36 (1) (va) provides that if such sums are contributed to the employees account in the relevant fund on or before the due date specified in the PF etc legislation, the assessee shall be entitled to a deduction. The second Proviso to

s. 43B (b) provided that any sum paid by the assessee as an employer by way of contribution to any provident etc fund shall be allowed as a deduction only if paid on or before the due date specified in 36(1)(va). After the omission of the second Proviso w.e.f 1.4.2004, the deduction is allowable under the first Proviso if the payment is made on or before the due date for furnishing the return of income. The High Court had to consider whether the benefit of s. 43B can be extended to **employees' contribution as well** which are paid after the due date under the PF law but before the due date for filing the return. HELD deciding in favour of the assessee:

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

❖ Right to subscribe for shares arises only when offer is made by the company.{ Navin Jindal vs. ACIT (Supreme Court) }

The assessee held shares in Jindal Iron and Steel Co. Pursuant to a rights issue of partly convertible debentures announced by Jindal, the assessee received an offer to subscribe to 1875 PCDs on Rights Basis. The assessee renounced his right to subscribe to PCDs and received a consideration of Rs. 56,250/- for the renunciation. Against the said sale consideration, the assessee claimed that he had suffered a diminution in the value of the original 1500 equity shares being the difference between the cum-right price per share and the ex- rights price per share aggregating Rs. 3,00,000. The difference of Rs. 2,43,750 was claimed as a short-term capital loss. The lower authorities held that **as the shares were held long-term, the said loss was also long-term**. On appeal by the assessee, HELD allowing the appeal of the assessee.

The right to subscribe for additional offer of shares/debentures on Rights basis, on the strength of existing shareholding in the Company, **comes into existence when the Company decides to come out with the Rights Offer**. Prior to that, such right, though embedded in the original shareholding, remains inchoate. The same crystallizes only when the Rights Offer is announced by the Company. **Therefore, in order to determine the nature of the gains/loss on renunciation of right to subscribe for additional shares/debentures, the crucial date is the date on which such right to subscribe for additional shares/debentures comes into existence and the date of transfer [renunciation] of such right. The said right to subscribe for additional shares/debentures is a distinct, independent and separate right, capable of being transferred independently of the existing shareholding, on the strength of which such Rights are offered.**

For the purposes of s. 48 an important principle that must be borne in mind is that **chargeability and computation go hand in hand**. Computation is an integral part of chargeability under the Act. Accordingly, the right to subscribe for additional offer of shares/debentures comes into existence only when the Company decides to come out with the Rights Offer and it is only when that event takes place, that diminution in the value of the original shares held by the assessee

takes place. One has to give weightage to the diminution in the value of the original shares which takes place when the Company decides to come out with the Rights Offer.

❖ S. 54 relief allowable even if new house purchased from borrowed funds. { CIT vs. Dr. P. S. Pasricha (Bombay High Court) }

S. 54 provides that if an assessee has LTCG on transfer of a residential house and he purchases or constructs a residential house within the specified period then the amount appropriated towards the new house shall be deducted from the LTCG. The assessee sold a house and **used the sale proceeds to buy commercial property**. Subsequently (but within the specified period) **he borrowed funds and purchased a new house**. The AO denied deduction u/s 54 on the ground that the new house had been purchased out of borrowed funds and not out of the consideration received for the old house. On appeal, the Tribunal and High Court upheld the claim on the ground that **s. 54 merely required the purchase of the new house to be within the specified period. The source of funds for the purchase was irrelevant.**

❖ Legal Authenticity of Gifts : Padma Singh Chauhan (Raj)

There is no legal basis to assume that to recognize the gift to be genuine, there should be any blood relationship, or any close relation-ship, between the donor and the donee. When assessee produced the affidavit, gift deed in the absence of anything to show that the gift was by way of money laundering addition under section 68 as cash credit not justified.

❖ Speculation loss can be set off against delivery based profits. { CIT vs. Lokmat Newspapers (Bombay High Court) }

The assessee earned a profit on sale of shares held as stock-in-trade. This profit was offered as profit from a 'speculation business' and was set off against a 'speculation loss' brought forward from an earlier assessment year. The AO took the view that the profit from sale of shares was not from a 'speculation business' on the ground that **the assessee had settled its transaction of sale and purchase of shares through physical delivery**. Consequently, the claim for set off against the speculation loss was denied. This was confirmed by the CIT (A) though reversed by the Tribunal on the ground that the profit earned from sale of shares fell within the purview of the Explanation to s. 73 and could be set off against speculation losses. On appeal by the Revenue, HELD affirming the Tribunal's order and dismissed the revenue's appeal.

The Explanation to s. 73 creates a deeming fiction that where the assessee is a company and any part of its business consists of the purchase and sale of shares of other companies, the assessee is deemed to be carrying on a speculation business, to the extent to which the business consists of the purchase and sale of shares. A business postulates a systematic course of activity or dealing. Unless the business of a Company consists of the sale and purchase of shares, the deeming fiction would not apply. However, once the requirements of the Explanation are satisfied the assessee is deemed to be carrying on a "speculation business". **There is no justification**

to exclude a business involving actual delivery of shares. Once an assessee is deemed to be carrying on a speculation business for the purpose of s. 73, any loss computed in respect of that speculation business, can be set off only against the profits and gains of another speculation business.

❖ Copying software onto blank discs is "manufacture" for s. 80-IA. {CIT vs. Oracle Software India (Supreme Court) **Very Important** }

The assessee imported Master Media of software from Oracle Corporation which was duplicated on blank discs, packed and sold in the market. The question arose whether the activity of copying the discs amounted to manufacture or processing of goods for purposes of s. 80IA. HELD, deciding in favour of the assessee:

The term "manufacture" implies a change, but, every change is not a manufacture, despite the fact that every change in an article is the result of a treatment of labour and manipulation. However, this test of manufacture needs to be seen in the context of the process adopted by the assessee for duplication of software. **If an operation/ process renders a commodity or article fit for use for which it is otherwise not fit, the operation/ process falls within the meaning of the word "manufacture"**. Applying this test, as the assessee has undertaken an operation which renders a blank CD fit for use for which it was otherwise not fit, the duplicating process constitutes 'manufacture' u/s 80IA(12)(b).

The argument of the revenue that **since the software on the Master Media and the software on the pre-recorded media is the same, there is no manufacture because the end product is not different from the original product is over-simplified and does not take into account the ground realities of business in modern times.**

❖ Benefit of lower tax rate under Proviso to s. 112 available to bonus shares despite no indexation. { CIT vs. Anuj A. Sheth HUF (Bombay High Court) }

The proviso to s. 112(1) provides that "where the tax payable in respect of any income arising from the transfer of a long-term capital asset, being listed securities ... exceeds ten per cent of the amount of capital gains **before giving effect to the provisions of the second proviso to section 48** (i.e. indexation), then, such excess shall be ignored for the purpose of computing the tax payable by the assessee". The assessee sold bonus shares of Infosys for Rs. 6.13 crores. As there was no cost of acquisition of bonus shares and no indexation, the long-term capital gains were computed at Rs. 6.13 crores. The assessee sold other shares and computed a long-term capital loss of Rs. 2.68 crores after indexation, which was claimed as a set off against the LTCG of Rs. 6.13 crores. On the balance of Rs. 3.45 crores (comprising of gains on the bonus shares), the assessee paid tax at 10% as per the Proviso to s. 112. The AO took the view that as the assessee was not eligible to claim indexation benefits in respect of the bonus shares, it was not entitled to the option given by the Proviso to s. 112 and tax was payable on the entire gains at the rate of 20%. The AO's stand was upheld by the CIT (A) though reversed by the Tribunal. On appeal by the revenue, HELD dismissing the appeal:

In the case of bonus shares, the question of indexation does not arise because the cost of acquisition is taken to be nil. What the proviso to s. 112 essentially requires is that where the tax payable in respect of a listed

security (being LTCG) exceeds 10% of the capital gains before indexation, such excess beyond 10% is liable to be ignored. The proviso to s. 112 requires a comparison to be made between the tax payable at 20% after indexation with the tax payable at 10% before indexation. **If the shares were acquired at a cost, it becomes necessary for purposes of the proviso to s. 112(1) to compute capital gains before giving effect to indexation. However, that does not arise in respect of bonus shares.** There is nothing in the s. 112 to suggest that the assessee would be entitled to a set off of the loss u/s 70 but without the benefit of indexation;

❖ Banks are not liable to pay S. 115JB MAT on "book profits": Krung Thai Bank PCL vs. JDIT (ITAT Mumbai)

The assessee, a foreign bank operating in India through a branch office, filed a return offering Nil income as per the normal provisions of the Act. Though the assessee had a net profit of Rs. 78.32 lakhs in the P&L A/c it did not compute "book profits" u/s 115JB. The AO accepted the return u/s 143(3) though he subsequently made a reassessment u/s 147 in which he assessed the "book profits" u/s 115JB. The assessee challenged the reopening on the ground that s. 115JB did not apply to banking companies. HELD upholding the challenge.

S. 115 JB can only come into play when the assessee is required to prepare its profit and loss account in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act. The starting point of computation of minimum alternate tax u/s 115 JB is the result shown by such a profit and loss account. **In the case of banking companies, however, the provisions of Schedule VI are not applicable in view of exemption set out under proviso to S. 211 (2) of the Companies Act.** The final accounts of banking companies are required to be prepared in accordance with the provisions of the Banking Regulation Act. **Consequently, s. 115 JB cannot be applied to a banking company.** As s. 115 JB did not apply to the assessee, no income had escaped assessment and consequently the very initiation of reassessment proceedings u/s 147 was bad in law.

❖ Even exempt income is taxable under MAT / s.115JB Rain Commodities vs. DCIT (ITAT Hyderabad Special Bench)

The assessee credited its P&L A/c with an amount of Rs. 149.77 crores being the profit on sale of assets to its wholly owned subsidiary. **As the said profits were not chargeable to tax u/s 47(iv), the assessee took the view that the same had also to be reduced from the "book profits" u/s 115JB.** The Special Bench had to consider whether exempt income could be excluded from the computation of "book profits" u/s 115JB. HELD deciding against the assessee.

The AO can alter the "book profit" only in two circumstances (a) if the P&L A/c is not drawn up in accordance with Parts II & III of Schedule VI to the Companies Act or (b) If accounting policies & standards, method & rate of depreciation have been incorrectly adopted for preparation of the P & L A/c. Except for the said two cases, the AO has no power to alter the net profit shown in the P&L A/c. Under (a), the AO cannot disturb the Net Profit shown by the assessee where

there are no allegations of fraud or misrepresentation but only a difference of opinion as to whether a particular amount should be properly shown in the P&L A/c or Balance sheet;

Parts II & III of Schedule VI to the Companies Act do not permit the exclusion of capital gain from the P & L A/c. The P & L A/c is required to disclose every material feature including credits or receipts and debits or expenses in respect of non-recurring transactions or transactions of an exceptional nature including capital profits. Items referred to in the Notes are a part of the P&L A/c. The assessee had included the said capital gains in the P & L A/c and it was not its' case that same was not includible. **The fact that the capital gains was exempt u/s 47(iv) does not mean it can be excluded from the "book profit" because no such exclusion was permitted under the Explanation to s. 115JB.** The taxability of capital gain is relevant only for the purpose of computation of income under the normal provisions and has nothing to do with the computation of "book profits".

The argument that as s. 115JB (4) provides that "save as otherwise provided in this section all other provisions of the Act shall apply" does not mean that the exemption provisions of s. 47(iv) can be read into s. 115JB. This only means that while the computation has to be as per s. 115JB, anything over and above that will be subject to other provisions of the Act.. Accordingly, in the absence of any provision for exclusion of exempted capital gain in the computation of book profit u/s 115JB, the assessee is not entitled to the exclusion claimed.

❖ **Reasons for search action u/s 132 need not be given to the Assessee. { Genom Biotech vs. DIT (Bombay High Court) }**

Search & seizure action u/s 132 was undertaken at the assessee's premises. Thereafter an order of provisional attachment u/s 281B was passed. The assessee filed a writ petition challenging the validity of the search and the provisional attachment. HELD dismissing the Petition by stating that Search action u/s 132 can be initiated only if the designated authority forms a reasonable belief on the basis of information that one of the three conditions of s. 132 exist. **However, it is not the mandate of s. 132 that the reasonable belief recorded by the designated authority must be disclosed to the assessee.**

❖ **Confession made during survey is not conclusive & can be retracted : CIT vs. Dhingra Metal Works (Delhi High Court)**

A survey u/s 133A was conducted in the premises of the assessee during which certain discrepancies were found in stock & cash-in-hand. The assessee surrendered an amount of Rs. 99 lakhs and offered the same to tax. The offer included a sum of Rs. 45 lakhs on account of excess stock found during the survey. Subsequently, the assessee **retracted the offer** of Rs. 45 lakhs in respect of the stock on the ground that the discrepancy noticed during the survey had been reconciled. The AO rejected the retraction on the ground that it was an **after-thought** though the CIT (A) and Tribunal upheld the assessee's claim on the basis that the AO had not made any independent investigation and had made the addition on the addition solely on the basis of the survey statement. On appeal by the department, HELD dismissing the appeal.

S. 133A does not mandate that any statement recorded under that section would have evidentiary value.

It merely enables the authority to record the statement of any person which may be useful for, or relevant to, any proceeding under the Act. For a statement to have evidentiary value, the survey officer should have been authorised to administer oath and to record sworn statement as under s.132 (4). While s. 132(4) specifically authorizes an officer to examine a person on oath, s. 133A does not permit the same. In any event though an admission is extremely important piece of evidence, it is not conclusive and it is open to the person who has made the admission to show that it is incorrect.

❖ **Delay in filing ROI due to late appointment of auditor must be condoned : Bombay Mercantile Coop Bank vs. CBDT (Bombay High Court)**

The assessee, a co-op bank, filed a return for AY 2001-02 showing a loss of Rs. 15.94 crores. As the return was belated, the assessee filed an application u/s 119(2)(b) with the CBDT requesting condonation of delay and for being allowed carry forward of loss. The principal ground on which condonation was sought was that there was a delay in appointment of the statutory auditor by the Registrar and a consequent delay in preparing the s. 44AB tax audit report. The CBDT rejected the application on the ground that the reasons were general in nature and there were no exceptional circumstances beyond the control of the assessee to file the return. It was also stated that the assessee was operating for several years and was aware of its obligation to get the accounts audited and to file the return within the due date. The assessee challenged the rejection of the application. HELD upholding the challenge:

The power to appoint statutory auditors is that of the Central Registrar and that was done on 3.9.2001. The Registrar appointed Chartered Accountants to be statutory auditors in place of the Departmental Auditors. This change was made in respect of all societies. Therefore, **the assessee cannot be blamed for the delay in carrying out its audit as the same was beyond its control.** The contention of the Revenue that the departmental auditors had started the audit in the year 2000 and it was for the assessee to get the audit expedited cannot be accepted. Though the departmental auditors might have started the audit, it appears that pursuant to the said policy decision that was taken, the departmental auditors were replaced by the Chartered Accountants to be the statutory auditors. Therefore, the reason given for delay deserves to be accepted;

❖ **AO deemed to have applied his mind if facts are on record and reopening u/s 147 on change of opinion is not permissible even within 4 years. { CIT vs. Kelvinator of India (Supreme Court) }**

In **CIT vs. Kelvinator of India Ltd** the Full Bench of the Delhi High Court held that when a regular order of assessment is passed in terms of section 143 (3) of the Act, **a presumption can be raised that such an order has been passed on application of mind. It was held that if it be held that an order which has been passed purportedly without application of mind would itself confer jurisdiction upon the Assessing Officer to reopen the proceeding without anything further, the same would amount to giving premium to an authority exercising quasi-judicial function to take benefit of its own wrong. It was held that section 147**

of the Act does not postulate conferment of power upon the Assessing Officer to initiate reassessment proceedings upon a mere change of opinion. On appeal by the department to the Supreme Court, HELD dismissing the appeal:

Apex Court held that though the power to reopen under the amended s. 147 is much wider, one needs to give a schematic interpretation to the words “reason to believe” failing which s. 147 would give **arbitrary powers to the AO to re-open assessments on the basis of “mere change of opinion”, which cannot be per se reason to re-open.** One must also keep in mind the conceptual difference between power to review and power to re-assess. The AO has no power to review; he has the power to re-assess only.

❖ Assessment order is not effaced in respect of items that are not subject of reassessment. Time limit for s. 263 begins from date of original order for such items. { Ashoka Buildcon vs. ACIT (Bombay High Court) }

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

In **CIT vs. Alagendran Finance** 293 ITR. 1 (SC) it was held that the doctrine of merger does not apply where the subject matter of reassessment and original assessment is not one and the same. **Where the assessment is reopened on a specific ground and the reassessment is confined to that ground, the original assessment continues to hold the field except for those grounds on which a reassessment has been made.** Consequently, an appeal on the grounds on which the original assessment was passed and which does not form the subject of reassessment continues to subsist and does not abate. **The order of assessment is not subsumed in the order of reassessment in respect of those items which do not form part of the order of reassessment.** Consequently, the time limit for exercise of power u/s s. 263 with reference to **issues which do not form the subject of the reassessment order commences from the date of the original order** and not the reassessment order.

❖ Reopening u/s 147 not valid if there is no finding regarding failure to disclose material facts.{ Bhavesh Developers vs. AO (Bombay High Court) }

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

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

On facts, the assessee had furnished details of the claim u/s 80IB (10) including the breakup of the other income. **Even the recorded reasons showed that the inference that the income has escaped assessment was based on the disclosure made by the assessee itself. Further, there was no finding in the recorded reasons that there was a failure to disclose necessary facts.** Accordingly, the condition precedent to a valid exercise of the power to reopen the assessment was absent. An exceptional power has been conferred upon the Revenue to reopen an assessment after a lapse of four years and the conditions prescribed by the statute for the exercise of such a power must be strictly fulfilled and in their absence, the exercise of power would not be sustainable in law.

❖ **Reopening beyond 4 years on basis of Supreme Court's judgment not justified if assessee has not failed to disclose material facts. : CIT vs. Baer Shoes (Madras High Court)**

The AO passed an order u/s 143(3) r.w.s 147 in which he allowed deduction u/s 80HHC though the assessee had suffered a loss in the export business by setting off the said loss against the export incentive. After the expiry of four years from the end of the assessment year, the assessment was reopened u/s 147 on the ground that pursuant to the judgement of the Supreme Court (probably **Ipca Laboratories vs. CIT** 266 ITR 521) s. 80HHC deduction could be allowed only if there were positive profits from export operations and the assessee had been wrongly allowed deduction u/s 80HHC. The Tribunal struck down the reopening. On appeal by the department, HELD dismissing the appeal.

The assessee had claimed deduction u/s 80HHC after a **full disclosure of the material facts**. As four years had elapsed from the end of the assessment year, the assessment could not be reopened in the absence of failure to disclose the material facts. **The judgment of the Supreme Court is an expression of opinion on the interpretation of statute. Merely because a judgment has been rendered, the same cannot be a ground for reopening the assessment u/s 147 as it amounts to a change of opinion.**

❖ **If AO does not assess income for which reasons were recorded u/s 147, he cannot assess other income u/s 147 : CIT vs. Jet Airways (I) Ltd (Bombay High Court)**

In the department's appeal, the Court had to consider the question whether if the AO issues a notice u/s 148 to assess/reassess a particular item of income but does not assess/reassess that income, is it open to the AO to assess any other item of income. HELD dismissing the appeal. S. 147 provides that the AO may assess the income which has escaped assessment "**and also** any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section". Explanation 3 to s. 147 inserted by F (No. 2) Act, 2009

w.r.e.f 1.4.1989 provides that the AO “may assess or reassess the income in respect of any issue ... notwithstanding the reasons for such issue have not been included in the reasons recorded ...”

The words “**and also**” indicate that reassessment must be with respect to the income for which the AO has formed an opinion and also in respect of any other income which comes to his notice subsequently. However, **if the AO accepts the objection of the assessee and does not assess the income which was the basis of the notice, it is not open to him to assessee income under some other issue independently;**

❖ **S. 147 reopening on mechanical basis void even where s. 143(3) assessment not made : Sarthak Securities vs. ITO (Delhi High Court)**

The assessee-company allotted shares to four companies. The allottee companies were active as per the records of the ROC and were allotted PAN and assessed to income-tax. Though the assessee filed a return, **no assessment u/s 143(3) was made**. The AO subsequently received information from the ADIT (Inv) unit that the assessee had received “**bogus accommodation entries**” in the form of share application money from the said four companies. The AO accordingly issued a notice u/s 148 seeking to reopen the assessment. The assessee challenged the reopening on the ground that (i) the reasons did not disclose the basis on which the ADIT had termed the subscription money as bogus accommodation entries and (ii) the AO had assumed the information provided by the ADIT as gospel truth without verification or application of mind and (iii) as the alleged bogus shareholders were on the records of the department, they should be pursued against and not the assessee. HELD upholding the challenge.

The AO is required to form an opinion and record reasons before he proceeds to issue a notice u/s 148. **Only the reason so recorded can be looked at for sustaining or setting aside a notice issued u/s 148.** No addition, substitution or deletion is permissible nor can an inference be allowed to be drawn based on reasons not recorded. **The reasons recorded should be clear and unambiguous and not suffer from any vagueness.** The reasons cannot be supplemented by filing an affidavit or making an oral submission. **The AO cannot reopen the assessment merely on the basis of information received without applying his mind to the information and forming an opinion.** The reasons must show due application of mind to the information. He also cannot reopen merely because he has been directed to do so by a superior officer.

❖ **S. 147 reopening for rectifying s. 154 mistakes is invalid: Hindustan Unilever vs. DCIT (Bombay High Court)**

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

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

❖ Retrospective amendment after passing order does not lead to "apparent mistake. : ACIT vs. GTL Ltd (ITAT Mumbai)

Following HCL Comnet 305 ITR 409 (SC), the Tribunal took the view vide order dated **17.3.2009** that provision for bad debts debited to the P&L A/c could not be added to the "book profits" u/s 115JA. To **supercede HCL Comnet**, clause (g) was inserted in the Explanation to s. 115JA by the F. A. 2009 **w.r.e.f 1.4.1998**. The amendment received the assent of the President on **19.8.2009**, after the order of the Tribunal was passed. The department filed a MA contending that in view of the said retrospective amendment, there was a "mistake apparent from the record". HELD dismissing the application:

As per the law laid down in Sudhir Mehta 265 ITR 548 (Bom), where an order is passed as per the prevailing law, **a retrospective amendment which comes into force after the date of the passing of the order does not show any mistake in the order.**

❖ "Discount" for supply of Sim Cards is "Commission" for S. 194H TDS : Vodafone Essar Cellular vs. ACIT (Kerala High Court)

The Assessee, a mobile cellular operator, carried on business through distributors, and offered the "post paid scheme" and the "pre-paid scheme" to its customers. The assessee paid charges to the distributors for services rendered. While the charges paid in respect of the "post paid services" was treated as "commission" and liable to TDS u/s 194H, payments made for services rendered under the "prepaid scheme" were treated as a sale of Sim Card at a discounted value and not as "commission". The AO, CIT (A) & Tribunal treated the assessee as being in default u/s 201 on the ground that the so-called "discount" was "commission" u/s 194H. On appeal by the assessee, HELD dismissing the appeal.

The argument that **there is a "sale" of a Sim Card is not acceptable** because a Sim Card has no value or use for the subscriber other than to get connection to the mobile network. The **supply of the Sim Card is only for the purpose of rendering continued services** by the assessee to the subscriber of the mobile phone. Consequently, the charges collected by the assessee at the time of delivery of Sim Cards or Recharge coupons is for rendering services to ultimate

subscribers. The distributor is the middleman arranging customers or subscribers for the assessee after ensuring proper identification and documentation. Besides the discount given at the time of supply of Sim Cards and Recharge coupons, the assessee is not paying any amount to the distributors for the services rendered by them like getting the subscribers identified, doing the documentation work and enrolling them as mobile subscribers to the service provider namely, the assessee. The argument that the relationship between the assessee and the distributors is principal to principal basis is not acceptable. **The distributor is an agent and canvasses business for the assessee.** The terminology used by the assessee for payment to the distributors is **immaterial**. In substance **the discount given at the time of sale of Sim Cards or Recharge coupons by the assessee to the distributors is a payment for services rendered to the assessee and falls within s. 194H.**

❖ TDS obligation u/s 195(1) arises only if the payment is chargeable to tax in the hands of non-resident recipient : GE India Technology Centre vs. CIT (Supreme Court)

The assessee, an Indian company, made remittance to a foreign company for purchase of software. The assessee took the view that the payment was not chargeable to tax in India and did not deduct tax at source u/s 195. The AO & CIT (A) took the view that the payment constituted “royalty” and was chargeable to tax and that the assessee was liable u/s 201 for failure to deduct tax at source though this was reversed by the Tribunal. On appeal by the department, the High Court reversed the Tribunal by taking the view in CIT vs. Samsung Electronics that the assessee was not entitled to consider whether the payment was chargeable to tax in the hands of the non-resident or not and had to deduct tax u/s 195 on all payments. On appeal by the assessee, HELD reversing the High Court.

S. 195(1) uses the expression “**sum chargeable under the provisions of the Act**”. This means that a person paying interest or any other sum to a non-resident is **not liable to deduct tax if such sum is not chargeable to tax**. Also s. 195(1) uses the word ‘payer’ and not the word “assessee”. The payer is not an assessee. The payer becomes an assessee-in-default only when he fails to fulfill the statutory obligation u/s 195(1). **If the payment does not contain the element of income the payer cannot be made liable.** He cannot be declared to be an assessee-in-default.

❖ S. 271 (1) (c) penalty cannot be imposed even for making unsustainable claims { CIT vs. Reliance Petroproducts (Supreme Court) (Very Important) }

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

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

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

Note:

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Success is not the matter of being the BEST & WINNING the race: Success is a matter of HANDLING the WORST & FINISHING the Race.
