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**
- ≈ **Tax India Online.**
- ≈ **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 are selected on the basis of their practical applications in the Income Tax proceedings. These cases are pronounced between the periods May 2010 to April 2011 specifically applicable for CA FINAL Nov 2011 term.

❖ S. 2(22)(e) "deemed dividend" not assessable if recipient not shareholder : CIT vs. Ankitech Pvt Ltd (Delhi High Court)

The assessee, a company, received advances of Rs. 6.32 crores by way of book entry from Jacksons Generators Pvt. Ltd, a closely held company. The shareholders having substantial interest in the assessee company were also having 10% of the voting power in Jacksons Generators. The AO & CIT(A) held that as the shareholders who held substantial interest in Jacksons Generators also had substantial interest in the assessee company, for purposes of s. 2(22)(e), the amount received by the assessee from Jacksons constituted "advances and loans" and was assessable as deemed dividend. On appeal, the Tribunal, deleted the addition on the ground that though the amount received by the assessee by way of book entry was "deemed dividend" u/s 2(22)(e), it was not assessable in the hands of assessee company as it was not a shareholder of Jacksons Generators. On appeal by the department to the High Court, dismissing the appeal by stating that u/s 2(22)(e), any payment by a closely-held company by way of advance or loan to a concern in which a substantial shareholder is a member holding a substantial interest is deemed to be "dividend" on the presumption that the loans or advances would ultimately be made available to the shareholders of the company giving the loan or advance. **The legal fiction in s. 2(22)(e) enlarges the definition of dividend but does not extend to, or broaden the concept of, a "shareholder". As the assessee was not a shareholder of the paying company, the "dividend" was not assessable in its hands.**

- S. 2(22)(e) applicable only to loans given in the year. S. 2(22)(e) not applicable if lending is substantial part of business CIT vs. Parle Plastics Ltd (Bombay High Court)

The assessee availed of loans and advances of Rs. 2.18 crores from a closely held company ("AMPL") of which Rs. 11.68 lakhs was received during the year. As the shareholders holding majority of the share capital in the assessee also held the majority of the shareholding in AMPL, the AO took the view that the said loan / advance was assessable as "deemed dividend" u/s 2(22)(e) in the hands of the assessee. The CIT (A) confirmed the view of the AO though he held that only the loan / advance received during the year was assessable as "deemed dividend" and not the brought forward balance. On appeal by the assessee, the Tribunal deleted the addition on the ground that the granting of loans was a substantial part of the business of AMPL and so the loan could not be treated as "deemed income" in the hands of the assessee. On appeal by the department, HELD dismissing the appeal:

(i) **S. 2(22)(e) covers only the amount received during the previous year by way of loans / advances and not amounts received in an earlier year**. Further, increase in the outstanding on account of provision for interest is not covered;

(ii) S. 2(22)(ii) excludes loans and advances where (a) the loan or advance was made by the lending-company in the ordinary course of its business and (ii) lending of money is a "substantial part" of the business of the lending-company. The first condition was satisfied as the **business of the assessee was complimentary to the business of AMPL**. As regards the second condition, **the expression "substantial part" does not connote an idea of being the "major part" or the part that constitutes majority of the whole**. **Any business which the company does not regard as small, trivial, or inconsequential as compared to the whole of the business is substantial business**. Various factors and circumstances such as turnover, profit, employees, capital employed etc are required to be looked into while considering whether a part of the business of a company is a "substantial part of its business";

(iii) On facts, as about 40% of the total assets of AMPL were deployed by way of loans and advances, and its interest income was substantial compared to the total income, lending of money was a "substantial part of its business" and the money given by it by way of loan / advance was excluded from the definition of "dividend" under s. 2(22)(ii).

- Refund of Excise Duty under subsidy scheme is a capital receipt & not taxable M/s Shree Balaji Alloys vs. CIT (J&K High Court)

The assessee, pursuant to the New Industrial Policy announced for the State of J&K, received excise refund and interest subsidy, etc which it claimed to be a capital receipt. In the alternative, it was claimed that the same was eligible for deduction u/s 80-IB. The AO, CIT (A) and Tribunal rejected the claim and held the receipts to be revenue on the ground that the subsidy (i) was for established industry and not to set up a new one, (ii) it was available after commercial production, (iii) it was recurring in nature, (iv) it was not for purchasing capital assets and (v) it was for running the business profitably. On appeal by the assessee, decided in favour of the assessee.

(i) The ratio to determine whether incentives & subsidies are revenue or capital receipts, the purpose underlying the incentives is the determinative test. **If the object of the subsidy scheme is to enable the assessee to run the business more profitably then the receipt is on revenue account. On the other hand, if the object of the**

subsidy scheme is to enable the assessee to set up a new unit or to expand the existing unit then the receipt of the subsidy was on capital account. It is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy. **The form or the mechanism through which the subsidy is given is irrelevant**;

(ii) On facts, the object of the subsidy scheme was (a) to accelerate industrial development in J&K and (b) generate employment in J&K. **Such incentives, designed to achieve a public purpose, cannot, by any stretch of reasoning, be construed as production or operational incentives for the benefit of assesses alone**. It cannot be construed as **mere production and trade Incentives**. The fact that the **incentives were available only after commencement of commercial production cannot be viewed in isolation**. The other factors which weighed with the Tribunal are also not decisive to determine the character of the incentive subsidies in view of the stated objects of the subsidy scheme;

❖ 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.

❖ S. 10(23C)(vi) exemption cannot be rejected merely because there is a surplus from the activities : St. Lawrence Educational Society vs. CIT (Delhi High Court)

The assessee, a society running a school, applied for exemption u/s 10(23C)(vi) on the ground that it was existing "solely for the purpose of education and not for the purpose of profit". The CCIT rejected the application on the ground that as the assessee had made a surplus from its activities; it did not exist "solely" for educational purposes. On a Writ Petition to challenge the rejection, High Court had allowed the appeal. To decide whether the institution exists solely for education and not to earn profit **the test of predominant object of the activity** has to be seen to decide. The purpose does not lose its character merely because some profit arises from the activity. **It is not possible to carry on educational activity in such a way that the expenditure exactly balances the income and there is no resultant profit, for, to achieve this, would not only be difficult of practical realization but would reflect**

unsound principles of management. In order to ascertain whether the institute is carried on with the object of making profit or not it is duty of the prescribed authority to ascertain whether the balance of income is applied wholly and exclusively to the objects for which the applicant is established.

- 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 cannot be made for "depreciation" Hoshang D Nanavati vs. ACIT (ITAT Mumbai)

The assessee, a partner in a firm of solicitors, received Rs 14 lakhs towards remuneration as a working partner and Rs 46 lakhs towards share of profit in the partnership. The question arose whether, given that the remuneration was taxable as business profits, disallowance u/s 14A could be made in respect of (a) depreciation and (b) deduction u/s 80D in respect of health insurance premium. HELD by the Tribunal that **S. 14A permits a disallowance of "expenditure incurred by the assessee" and not of "allowance admissible" to him**. There is a distinction between "expenditure" and "allowance". The expression "expenditure" does not include allowances such as depreciation allowance. Accordingly, **depreciation cannot be the subject matter of disallowance u/s 14A.** Similarly, the **deduction u/s 80D is not expenditure for earning tax-free income** but is a permissible deduction from gross total income under Chapter VIA.

- 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.

- 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.

- Single Transaction also 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 deprecation 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**;

- "Goodwill" is an "intangible asset" u/s 32(1)(ii) & eligible for depreciation CIT vs. Hindustan Coca Cola Beverages Pvt Ltd (Delhi High Court)

The assessee engaged in manufacture of non-alcoholic beverages claimed **depreciation** u/s 32 on "**goodwill**" being the amounts paid to bottlers for marketing and trading reputation, trading style and name, territory know-how etc. The AO, after due inquiry, allowed the assessee's claim u/s 143(3). The CIT revised the assessment u/s 263 on the ground that **goodwill was not an "intangible asset"** as defined in s. 32(1)(ii) and directed the AO to withdraw depreciation. On appeal by the assessee, the Tribunal allowed the appeal of the assessee which is subsequently upheld by the High Court also.

(i) S. 263 cannot be invoked to correct each and every type of mistake or error committed by the AO if it is not "prejudicial to the interests of the revenue". **Every loss of revenue as a consequence of the AO's order cannot be treated as prejudicial to the interests of the Revenue**. E.g. when the AO adopted one of the courses permissible in law and it has resulted in loss of Revenue; or **where two views are possible and the AO has taken one view with which the CIT does not agree**, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue, unless the view taken by the AO is unsustainable in law. On facts, as the assessee had made full disclosure of the facts of the claim and the AO had examined the claim and taken a view, the assessment order cannot be termed "erroneous & prejudicial to the interests of the revenue.

On merits, s. 32(1)(ii) allows depreciation in respect of know-how, patent, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature. **The term "commercial rights" are such rights which are obtained for effectively carrying on business and commerce**. "Commerce" is a wide term which encompasses many a facet. Accordingly, **any right obtained for carrying on business with effectiveness comes within the sweep of meaning of "intangible asset"**. **Goodwill, being the positive reputation built by a person over a period of time is of "similar nature" as the other items enumerated in the definition of "intangible assets**.

❖ Despite non-user of asset, depreciation admissible if it is part of "block of assets" : CIT vs. Oswal Agro Mills Ltd (Delhi High Court) (Very Important)

The assessee claimed depreciation u/s 32 in respect of the assets of its Bhopal unit which was **closed for 6 years**. The claim was on the basis that (i) despite closure of the unit there was a "**passive user**" of the assets and that (ii) even assuming there was no user, as the assets were part of the "**block of assets**", deprecation could not be disallowed. The AO & CIT (A) rejected the claim though the Tribunal upheld it. On appeal by the department, HC dismissing the appeal.

The argument of the assessee that despite closure of the unit for 6 years there should be deemed to be "passive user" is **not acceptable** as then the words "used for the purpose of business" will lose their sanctity and become superfluous. The fact that the assessee is striving to make the unit viable does not provide justification to claim depreciation when actual non-user remained for number of years. However, pursuant to the insertion of the concept of "block of assets" w.e.f. 1.04.1988, depreciation is allowable on the WDV of the "block of assets" and **individual assets lose their identity** upon introduction into the block. The department's argument that user of each and every asset is essential is not acceptable because it would mean that the assessee has to maintain the details of each asset separately and this would frustrate the very purpose for which the amendment was brought about. The Revenue is not put to any loss by adopting such method because when the asset is sold, it results in taxable STCG.

❖ 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 producer 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 not "Bad Debt", claim for "Business loss" maintainable. Website development expense is not capital expenditure : DCIT vs. Edelweiss Capital Ltd (ITAT Mumbai)

The assessee, engaged in investment activities, advanced Rs. 27.97 lakhs for development of a website. As the advance was not recoverable, the assessee wrote off the amount and claimed it as a "bad debt" even though the conditions of s. 36(1)(vii) & 36(2) were not satisfied. The AO rejected the claim though the CIT (A) allowed it. On appeal by the department to the Tribunal, dismissed the appeal of the department.

(i) **Though the claim as a 'bad debt' is not allowable, the assessee is entitled under Rule 27 to support the CIT (A)'s order on the ground that the amount should be allowed as a 'business loss'**. The subject-matter of an appeal should be understood not in a narrow and unrealistic manner but should be so comprehended as to encompass the entire controversy between the parties which is to be adjudicated upon by the Tribunal. Such a claim can be considered provided no new facts are needed. On merits, the department's argument that the amounts paid for development of websites cannot be allowed as business loss because if the websites had been successfully put up, the expenditure would have been capital expenditure is not acceptable. because (a) as **the expenditure was abortive, no capital asset has in fact been acquired** and (b) even if the website had materialized, **it does not result in an advantage of an enduring nature or in the capital field as it is only for the day-to-day running of the business and provision of information**.

- If "bad debt" not allowable u/s 36(1)(vii), claim for deduction u/s 37(1) can be raised for first time even before High Court Mohan Meakin Limited vs. CIT (Delhi High Court)

The assessee advanced sums to a supplier in order to obtain regular supplies. As the supplier failed to deliver the goods or to refund the advance, the assessee claimed the loss as a bad debt u/s 36(1)(vii). The AO rejected the claim though the CIT (A) allowed it. On appeal by the department, the Tribunal upheld the stand of the AO on the ground that the conditions of s. 36(2) were not satisfied. In the High Court, the assessee conceded that s. 36(1)(vii) was not applicable but pleaded for the first time that the loss should be allowed u/s 37(1) as a business loss and allowed the appeal of the assessee.

U/s 28 r.w.s. 29, computation of income has to be in accordance with the provisions contained in s. 30 to 43 which includes s. 37(1). **If a loss of a debt does not come within s. 36(1)(vii), a claim can be made u/s 37(1)**. There is a clear distinction between business expenditure and a business loss, the former is indicative of volition but in loss it comes upon him so to speak as ab extra. Non-capital expenditure incurred for the purpose of business can be deducted u/s 37(1). The advances made by the assessee were not capital in nature and were of a type which would be within the contemplation of the words "laid out or expended wholly and exclusively for the purposes of the business". **S. 37 (1) is a residuary section extending the allowance to items of business expenditure and not of business losses which are deductible on the ordinary principles of commercial accounting.** Merely because the claim was made under one provision of the Act and not under another provision does not debar the assessee from claiming deduction u/s 37(1) even if it was not raised before the lower authorities.

- Professional's heart surgery expense not deductible u/s 31 or 37(1) : Shanti Bhushan vs. CIT (Delhi High Court)

The assessee, a lawyer, claimed that his professional work had led to a heart attack and that the expenditure incurred by him on a heart operation was deductible u/s 31 on the ground that the heart was "plant" and the expenditure was incurred on "current repairs". It was also claimed that as his professional receipts increased substantially after the operation, the expenditure was "wholly & exclusively" for profession and deductible u/s 37(1). The AO, CIT (A) & Tribunal rejected the assessee's claim. On appeal to the High Court, HELD dismissing the appeal. Hon'ble court held that the claim for deduction u/s 31 is not acceptable because

(a) if the heart were to be considered a "plant", it would necessarily mean **that it is an asset which should have found a mention in the assessee's balance sheet**. This was not done and cannot be done as the "cost of acquisition" of such an asset cannot be determined and

(b) Even if the widest meaning to the word "plant" is given the heart does not satisfy the **"functionality" test** because while the heart is necessary for survival, it does not mean it is used as a "tool" of trade or professional activity;

The claim u/s 37(1) is also not acceptable because the expenditure is not incurred wholly and exclusively for the purposes of the assessee's profession. There is **no direct or immediate nexus between the expenses incurred by the assessee on the coronary surgery and his efficiency in the professional** field per se.

- Interest on NPA not assessable on "accrual" basis CIT vs. Vasisth Chay Vyapar (Delhi High Court) (very important)

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, High court dismissed 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**;

- CBDT Circular which specifies that for s. 40(b)(v), the partnership deed should specify the remuneration, is invalid : M/s Durga Dass Devki Nandan vs. ITO (HP High Court)

The assessee, a firm, provided by the partnership deed that its partners would be "working partners within the meaning of s. 40(b)" and "be paid a monthly salary as per the income-tax provisions". The AO relied **CBDT Circular No. 739 dated 25.3.1996** and held that because the deed did not specify the **amount of remuneration** payable to the partner or lay down the **manner of quantifying such remuneration**, the deduction was not admissible. This was reversed by the CIT (A). However, the Tribunal upheld the AO on the ground that the agreement did not meet with the requirements of the circular and so deduction of salary paid to the partners was not admissible. On appeal by the assessee, HELD allowing the appeal:

S. 40(b)(v) allows a deduction of payment of remuneration to a working partner if it authorized by the partnership deed and not in excess of the limits. **S. 40(b)(v) does not lay-down any condition that the partnership deed should fix the remuneration or the method of quantifying remuneration**. Accordingly, **CBDT circular No. 739 dated 25.3.1996** which requires that either the amount of remuneration payable to each individual should be fixed in the agreement or the partnership agreement deed should lay down the manner of quantifying such remuneration **goes beyond s. 40(b)(v)**. The CBDT cannot issue a circular which goes against the provisions of the Act. The CBDT can only clarify issues but cannot insert terms and conditions which are not part of the main statute. **A partnership deed which provides that the remuneration would be as per the provisions of the Act meaning thereby that the remuneration would not exceed the maximum remuneration provided in the Act is valid and deduction is admissible**.

❖ Capital asset treated as stock-in-trade of proprietary business has to be valued at market value Madhu Rani Mehra vs. CIT (Delhi High Court)

The assessee, a partner of a firm, received stock-in-trade on dissolution of the firm. The stock was used by the assessee to start a proprietorship business. In the assessment of the firm, the Tribunal held, that the option to value stock at the lower of cost or market was available only to a going concern and as the firm had dissolved, the stock had to be valued at the market value. However, in the assessment of the assessee's proprietorship business, it was held that as the proprietorship concern had acquired the stock from the dissolved firm and continued the same business, the opening stock could not be valued at a price higher than the book value as the assessee had not paid anything in excess of the said amount. On appeal to the High Court, HELD allowing the appeal:

When a partnership firm is dissolved and the erstwhile partner receives stock, it is a capital asset in his hands. When that asset is introduced into a business as stock, it gets converted into stock-in-trade. **The value of this stock will have to be the market value on the date of introduction**. The Tribunal's reasoning that the assessee cannot value the stock introduced in the business at market value because that was not the price she paid for it is flawed because if the assessee on having received her distributed share of stock of jewellery from the dissolved firm had sold it, and thereafter commenced her proprietorship business of jewellery again; within short span; by buying the jewellery from the market from the proceeds of stock sold on dissolution of the erstwhile firms, the stock of the proprietorship concern would without doubt be valued at market value. **The same principle would apply if the assessee used her share of the stock obtained from the dissolved firm in the new business**.

❖ 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.

❖ 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."

❖ Retrenchment Compensation paid for Suspension of Manufacturing Activity is allowable as business expenditure u/s 37(1) KJS India (P) Ltd. vs. Dy. CIT(DEL)

Assessee having suspended only its manufacturing activity and not closed down its trading activity, it is not a case of closure of business and therefore, expenses incurred by it towards severance cost of employees is allowable as revenue expenditure.

❖ Market Research Expenditure is allowed as business expenditure u/s 37(1) KJS India (P) Ltd. vs. Dy. CIT(DEL)

Assessee a manufacturer of a soft drink having conducted a market research by using the services of a professional agency to determine its brand performance with price, gauge the consumer demand at the current price or a lower price and to know whether its brand can adopt a different pricing between the base flavours and the new flavours, the expenses were incurred for exploring the circumstances as to how assessee can carry on its business more potentially and not exploring the market of a new product and therefore, same is allowable as revenue expenditure.

❖ Licence to operate Tele communication services is Business Expenditure u/s 37(1) - (S. 35AB) Bharti Airtel Ltd (Mum)

Payment made by the assessee for obtaining licence for providing telecommunication services though for a period of 10 years, the licence fee was payable on yearly basis with right to licensor to terminate the licence and the licence is non-exclusive, non-transferrable and it is open to the Government of India to grant similar licenses to other persons as well and therefore, the benefit of licence fee paid during the year endures only till the end of relevant financial year and does not extend to the subsequent year and hence, the licence fee is not in the nature of capital expenditure falling under section 35ABB, but the same is revenue in nature allowable under section 37(1).

- **S. 37(1): Business expenditure-Capital or revenue- Expenditure on abandoned expansion plans. Indo Rama Synthetics India Ltd. (SC)**

The assessee had incurred expenditure on engaging services of consultants for improving operational efficiencies inextricably linked to the existing business. The project was abandoned, with no new asset to be created. The expenditure held to be revenue expenditure. SLP filed by the department had been dismissed by SC.

- **Cash Payments made by Distributor to BSNL in its card division does not warrant disallowance u/s 40A(3) S. Rahumathulla vs. ACIT (Cochin)**

During the year under consideration assessee made total purchases of India Telephone cards at Rs. 270.64 lakhs, of which Rs. 187.73 lakhs were by way of cash purchases. Assessing Officer invoked provisions of section 40A(3) and disallowed 20% of impugned expenditure. CIT(A) upheld the disallowance. The Tribunal held that on facts, it was apparent that relationship between service provider i.e. BSNL and assessee–distributor was of principal and agent and income arising to assessee was in nature of commission or remuneration against services rendered, hence, disallowance under section 40A(3) is not applicable.

- **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).

- **Whether waiver of loan is income or not depends on whether loan was used for capital or revenue purposes : Logitronics Pvt Ltd vs. CIT (Delhi High Court)**

The assessee, engaged in manufacture of electronic products, took a loan from SBI of which Rs. 4.76 crores was due towards principal and Rs. 1.90 crores was due towards interest. Owing to its inability to repay the amounts, the assessee entered into a settlement under which an amount of Rs. 1.85 crores was agreed to be paid towards the principal and the balance was waived. The whole of the interest was also waived. The assessee offered the amount of interest waived to tax though it claimed that the principal sum waived was a capital receipt. On appeal, the Tribunal held that the question whether the principal sum waived was income or not would depend on whether the loan was utilized for capital or revenue purposes and directed the AO to go into the matter. On appeal by the assessee, court had given the principle that the answer to the question **whether the waiver of a loan is taxable as income or not depends on the purpose for which the loan was taken**. If the loan was taken for acquiring a capital asset, the waiver thereof would not amount to any income exigible to tax u/s 28(iv) or 41(1). On the other hand, **if the loan was taken for a trading purpose and was treated as such from the very beginning in the books of account, its waiver would result in income** more so when it was transferred to the P&L A/c.

- Merely because shares are purchased by taking loan at high interest does not mean gains are taxable as business profits CIT vs. Niraj Amidhar Surti (Gujarat High Court)

The assessee, a CA, offered income from profession, LTCG, STCG & speculation profits. He borrowed funds @ 30% p.a. and bought a large number of shares of Home Trade Ltd at Rs. 50. The shares were pledged as security for the loan. After 14 months, the assessee repaid the loan, obtained the shares & sold them at Rs. 750 each for a profit of Rs. 1.73 crores which was offered as LTCG. The assessee invested in s. 54 EC bonds & claimed exemption. The AO held that as the assessee had borrowed at an "exorbitant" rate of interest & taken risk, the transaction was an "adventure in the nature of trade" and the profits assessable as business profits. This was reversed by the CIT (A) & Tribunal. On appeal by the department, HELD dismissing the appeal of the department.

(i) The AO held the transaction to be an "adventure in the nature of trade" and not normal investment on the basis that (a) assessee had borrowed funds at an exorbitant rate of 30% and (b) the shares were held by the lender till the entire loan was paid. However, **this reasoning loses sight of the fact that merely because the shares had been purchased from borrowed funds obtained on high rate of interest would not change the nature of the transaction from investment to one in the nature of an "adventure in the nature of trade"**. Moreover, as the shares were held for a long-period of 14 months, the intention of the assessee had always been that of making investment in shares and not dealing in shares. This is also apparent from the fact that the shares had not been treated as stock in trade by the assessee. The fact that the shares were in the physical possession of the lender was not relevant because the assessee was the owner thereof. A capital investment and resale does not lose its capital nature **merely because the resale was foreseen** and contemplated when the investment was made and the **possibility of enhanced values motivated the investment.**

- Large volume in shares not deciding factor to hold assessee as trader : Ramesh Babu Rao vs. ACIT (ITAT Mumbai) (IMP)

The assessee, a retired professor, offered gains from sale of shares as short-term capital gains (STCG). The AO assessed the gains as business profits on the ground that (a) in the earlier years, the assessee had offered similar gains as business profits and the volume of transactions was higher in the present year, (b) there were 54 scrips which were purchased and sold during the year which resulted in sales of more than Rs. 24 crores, (c) In one particular share, the assessee purchased on 54 occasions and sold on on 25 occasions within a short duration. On appeal, the CIT (A) reversed the AO. On appeal by the department, dismissing the appeal of the department. The assessee was an investor and the gains are assessable as capital gains because:

(a) The assessee was a good timer of purchase and sale of shares thereby substantially increasing his gains in the stock market;

(b) The large turnover was because of bulk purchases and sales in a scrip. There were very few transactions of purchase and sale, as the assessee was purchasing in block of a particular share in large volume. Accordingly, large volume cannot be a deciding factor to hold as a trader;

(c) the assessee was not a broker or sub-broker and did not have any office establishment;

(d) The assessee did not do any speculative activity nor indulge in any sales without delivery;

(e) The shares were shown as capital assets in the books of account;

(f) The assessee had not pledged any shares with any financial institutions, nor borrowed any funds

- As TDR has no cost of acquisition, amount received not taxable ITO vs. Hemandas J. Pariyani (ITAT Mumbai)

The assessee was a member of Rajratan Palace Co-op Hsg Society. The Society entered into an agreement with a developer for redevelopment of the building owned by the Society pursuant to which the Society and its Members received Rs. 3.02 crores "on account of sale of FSI" from the developer. While Rs. 2.99 crores was received directly by the 51 members of the society, the Society received Rs. 2.51 lakhs. The AO took the view that the entire consideration of Rs. 3.02 crores was taxable in the hands of the Society. A protective assessment was made in the hands of the Members on the ground that the "share of the assessee in the total FSI available to the CHS was a capital asset held by the assessee and that this was transferred to the developer". This was reversed by the CIT (A). On appeal by the department, ITAT dismissed the appeal.

Transferable Development Rights (TDR) granted by the Development Control Regulations for Greater Mumbai, 1991, qualifying for equivalent Floor Space Index (FSI) have **no cost of acquisition** and so sale thereof **does not give rise to taxable capital gains.**

- 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**.

- S. 54 Relief available to multiple sales & purchases of residential houses : Rajesh Keshav Pillai vs. ITO (ITAT Mumbai)

The assessee sold two separate flats and earned long-term capital gains of Rs. 1.74 crores. The assessee bought two different flats for a consideration of Rs. 1.77 crores and claimed that the LTCG of Rs. 1.74 crores was exempt u/s 54. The AO & CIT (A) followed the judgement of the Special Bench in **ITO vs. Sushila Jhaveri** 292 ITR (AT) 1 and held that the benefit of s. 54 was available in respect of only one flat and not two flats. On appeal to the Tribunal, HELD allowing the appeal of the assessee.

Though s. 54 refers to capital gains arising from "transfer of a residential house", it does not provide that the exemption is available only in relation to one house. **If an assessee has sold multiple houses, then the exemption u/s 54 is available in respect of all houses** if the other conditions are fulfilled.

There the issue was whether if one house is sold and the proceeds are invested in several houses, the exemption u/s 54 is available and it was held that the exemption was available only for one house. But, **if more than one house is sold and more than one house is bought, a corresponding exemption u/s 54 is available**. However, the exemption is **not available on an aggregate basis** but has to be computed considering **each sale and the corresponding purchase** adopting a combination beneficial to the assessee.

- S. 54EC deduction allowable before set-off of brought-forward loss : The Tata Power Co Ltd vs. ACIT (ITAT Mumbai)

The assessee earned LTCG of Rs.233 crores and claimed deduction of Rs.124 crores u/s.54EC on account of investment in specified bonds of NABARD. The assessee also had brought forward long term capital loss of Rs.111 crores. The assessee first claimed deduction u/s 54EC and then, against the balance, set-off the brought forward losses. The CIT revised the assessment u/s 263 on the ground that the long-term capital loss had to be first set-off against the LTCG and the deduction u/s 54EC was allowable only on the balance. On appeal by the assessee to the Tribunal, HELD allowing the appeal of the assessee. While s. 54EC is an exemption provision which exempts capital gains and takes them outside the purview of chargeable "capital gains", s. 74 deals with the carry forward and set off of loss under the head "capital gains". **The stage at which set off of carried forward long term capital loss is to be given is subsequent to the stage at which income under the head capital gains is computed and deduction u/s 54EC is to be given in the course of the latter**. Accordingly, **s. 54EC deduction has to be given before set-off of losses**.

- S. 54EC relief available if cheque issued within 6 months of transfer even if cheque cleared, and bonds issued, after 6 months : Kumarpal Amrutlal Doshi vs. DCIT (ITAT Mumbai) (Imp)

On 9.8.2005 (AY 2006-07) the assessee earned LTCG on sale of land. U/s 54EC, NABARD bonds were a "specified asset" till 31.3.2006 and the assessee had time till 9.2.06 (6 months) to make the investment. The assessee issued a cheque on 7.2.06 and sent it by courier to NABARD. The cheque was encashed on 13.2.2006 and the bonds were allotted on 15.2.06. The AO & CIT(A) rejected the claim on the ground that (i) NABARD bonds were not a "specified asset" as of 1.4.06 & (ii) the investment was not within 6 months of the transfer. On appeal to the Tribunal, HELD allowing the appeal of the assessee. The department's argument that for AY 2006-07 only the "specified assets" as of 1.4.06 should be considered is not acceptable. Instead, **the law as it stood on the date of transfer of the capital asset has to be applied**. When a payment is made by cheque, then the 'date of payment' is the 'date of the cheque' even though the cheque may be encashed subsequently. **As the cheque was issued within 6 months of the transfer, s. 54EC relief was available even though the cheque was encashed, and bonds were allotted, later**.

- 'Cash Credits' u/s 68 Principles of Law laid down by High Court : CIT vs. Oasis Hospitalities Pvt Ltd (Delhi High Court) (**Very Important**)

After a **comprehensive review of all the important cases on s. 68**, the following principles were laid down:

(i) S. 68 provides that if the assessee is not able to give satisfactory explanation as to the "nature and source" of a sum found credited in his books, the sum may be treated as the "undisclosed income" of the assessee. **The initial burden is on the assessee to explain the "nature and source" of the credit and to do so, the assessee is required to prove (a) Identity of the shareholder; (b) Genuineness of transaction; and (c) credit worthiness of shareholders**;

*(a) The **identity of the shareholder** can be proved by either (if individual) producing him before the AO or by way of documents, registered address, PAN etc;*

*(b) The **genuineness of the transaction** can be shown from the fact that the money has been received from the shareholder. **If the money is received by cheque and is transmitted through banking or other indisputable channels, the genuineness of transaction would be proved**. Other documents showing the genuineness of transaction could be the copies of the shareholders register, share application forms, share transfer register, etc;*

*(c) The **creditworthiness or financial strength** of the creditor/subscriber can be proved by producing the bank statement of the creditors/subscribers showing that it had sufficient balance in its accounts to enable it to subscribe to the share capital. **Once these documents are produced, the assessee would have satisfactorily discharge the onus cast upon him**. The AO can discredit the documents produced by the assessee with cogent reasons and materials but not on the realm of suspicion;*

(ii) If the assessee has produced documents like PAN Card, bank account details or details from the bankers the onus shifts upon the AO and it is for him to reach the shareholders and **the AO cannot burden the assessee merely on the ground that summons issued to the investors were returned back with the endorsement "not traceable"**;

(iii) The initial burden on an assessee which is a pvt ltd company is somewhat heavy because the shareholders are family friends/close acquaintances etc and the assessee cannot feign ignorance about the status of these parties;

(v) There is an additional burden on the Department to show that even if share applicants did not have the means to make investment, **the investment made by them actually emanated from the coffers of the assessee** so as to enable it to be treated as the undisclosed income of the assessee. **In the absence of such finding, addition cannot be made u/s 68 in the hands the assessee**.

❖ Under Expl to s. 73 even delivery-based loss on shares is "speculation" loss : Paharpur Cooling Towers Ltd vs. CIT (Calcutta High Court)

The assessee, a company, was engaged in the business of purchase & sale of shares. It suffered a loss of Rs. 1.41 crores and claimed that this could not be treated as "speculation loss" under the Explanation to s. 73 on the ground that (i) the assessee had taken/given delivery of the shares and they were not "speculative transactions" as defined in s. 43 (5), (ii) the object of the Explanation to s. 73 (as per CBDT Circular dated 24.7.1976) was to curb "manipulation" and artificial loss and it had to be confined to only such cases & (iii) the loss was only on account of fall in value of shares held as closing stock and not on account of purchase and sale of shares. Appeal of the assessee is dismissed by the High Court.
The Explanation to s.73 **creates a fiction** that the loss suffered by certain companies from the business of purchase & sale of shares shall be **deemed to be speculation loss**. The Explanation is not inconsistent with the object of introduction. The CBDT Circular dated 24.7.1976 cannot be treated as guide for interpretation of s. 73 when the provision is very clear and free from any ambiguity;

❖ 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) }

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**.

- For s. 80-IA (8), tariff fixed by MERC for sale of power does not reflect "market value" Reliance Infrastructure Ltd vs. ACIT (ITAT Mumbai)

The assessee was engaged in the business of distribution of electricity by purchasing it from Tata Power. The assessee set up a plant for generation of electricity, 100% of whose profits were eligible for deduction u/s 80IA (4). The said electricity was transferred by the assessee to its other business of distribution of electricity {which was not eligible for deduction u/s 80IA (4)}. The AO held that as the eligible business had transferred goods to the non-eligible business, **the "market value" of the same had to be determined u/s 80IA (8) and he did that by adopting the purchase price paid by the assessee to Tata Power**. In AY 2005-06, the Maharashtra Electricity Regulatory Authority (MERC) for the first time fixed a tariff for the assessee to charge its customers and determined the profits of generation and distribution business in Mumbai suburb at Rs.210 Crores. The AO held that pursuant to the MERC order, the old basis of determining the "market value" of the electricity was not valid and that the profits relatable to the generation activity had to be determined on the basis of the MERC tariff at Rs. 110 crores and not at Rs. 489 crores as claimed. This was reversed by the CIT (A) on the ground that the tariff fixed by MERC for the purpose of determining the price to be charged by the assessee to its customers could not change the method of calculation of profits for the purpose of deduction u/s 80IA and that the price paid by the assessee for purchase of electricity from outside party was the appropriate yardstick for computing "market value" u/s 80-IA (8). On appeal by the department, HELD dismissing the appeal of the department.

(i) U/s 80-IA (8), the transfer of goods from an eligible business to a non-eligible business is required to be taken at "market value". **The tariff determined by MERC is based on the concepts of 'clear profits' and 'reasonable return' and does not reflect the "market value" of the electricity**. While the 'clear profits' are determined by considering the streams of income, the 'reasonable return' is determined on the capital base. If the 'clear profits' are more than the 'reasonable return', the excess is considered while fixing tariffs for the subsequent year and the exercise of adjusting the gap between the reasonable return and clear profits is an on-going process. The tariff is either increased or reduced to adjust the gap between the two. Further, **the tariff is fixed for both activities of generation and distribution of power and may not reflect the true rates with regard to only the activity of generation**;

(ii) Accordingly, even after the fixation of tariff by MERC, **the profits from the business of generation of power has to be worked out on the basis of the price paid to the outside party for purchase of power**.

❖ If Transfer Pricing difference is less than 5%, actual price should be taken as ALP DCIT vs. BASF India Limited (ITAT Mumbai)

In respect of AY 2002-03 the assessee purchased goods from its associated enterprises. The difference between the price paid by the assessee and the arms' length price determined by the AO was 4%. The assessee argued that **by virtue of the second Proviso to s. 92C (2), no adjustment could be made**. HELD accepting the assessee's claim. The second Proviso to s. 92C (2) (as substituted by F (No. 2) Act, 2009 w.e.f. 1.10.09) clearly shows that **if the difference is less than 5% then the actual price paid should be considered as arm's length price**. The TPO as well as CIT (A) have clearly observed that difference in respect of these two items is 4% and, therefore, same has to be reckoned in terms of second proviso.

❖ 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 appeal of assessee.

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.

- Company liable to pay tax u/s 115J / 115JA i.e. Book Profit Cos liable for advance-tax & s. 234B interest JCIT vs. Rolta India Ltd (Supreme Court)

The Supreme Court had to consider whether advance tax was payable on book profits u/s 115JA and whether for default interest u/s 234B could be charged on the tax calculated on book profits u/s 115JA. SC held that S. 115J/115JA are special provisions. For purposes of advance tax the evaluation of current income and the determination of the assessed income had to be made in terms of the statutory scheme comprising s. 115J/115JA. **Hence, levying of interest was inescapable**. **The assessee was bound to pay advance tax under the scheme of the Act. S. 234B is clear that it applies to all companies**. There is no exclusion of s. 115J/115JA in the levy of interest u/s 234B.

- Amount withdrawn from revaluation reserve & credited to P&L A/c cannot be reduced from book profit even if in year of creation of reserve, the P&L A/c was not debited : Indo Rama Synthetics (I) Ltd vs. CIT (Supreme Court)

In AY 2000-01 the assessee revalued its fixed assets by Rs. 288.58 crores and credited the said sum to the revaluation reserve. In AY 2001-02, the assessee debited Rs.127.57 crores towards depreciation and in accordance with Accounting Standard AS-10 & AS-6 transferred Rs. 26.11 crores from revaluation reserve & set it off against the depreciation resulting in a net depreciation charge of Rs.101.45 crores. In computing the book profits u/s 115JB, the assessee claimed that the amount of Rs. 26.11 crores transferred from the reserves had to be excluded and the depreciation charge had to be considered at Rs. 127.57 crores. The AO, CIT (A), Tribunal & High Court rejected the claim of the assessee. On appeal to the Supreme Court, SC also dismissed the appeal.

(i) The assessee's argument that as the creation of the revaluation reserve was not debited to the P&L A/c, the withdrawal from the reserve should be excluded from the P&L A/c in terms of clause (i) of the Explanation to s. 115JB(2) read with the Proviso is not acceptable because had the assessee deducted the full depreciation from the profit before depreciation in AY 2001-02 it would have shown a loss and could not have paid the dividends. Therefore, the assessee credited the amount to the extent of the additional depreciation from the revaluation reserve to present a more healthy balance sheet to its shareholders enabling the assessee possibly to pay out a good dividend. **It is precisely to tax these kinds of companies that MAT provisions had been introduced. The object of MAT provisions is to bring out the real profit of the companies. The thrust is to find out the real working results of the company**. (ii) Further, clause (i) of the Explanation to s. 115JB(2) permits the net profit to be reduced by the amount withdrawn from reserves only if in the year of creation of the reserves, the book profits had been increased. **As in the year of creation of the reserves (AY 2000-01), the amount of Rs.288.58 crores or Rs.26.11 crores had not gone to increase the book profits there is no question of reducing the amount transferred from such revaluation reserves to the P & L Account**.

- S. 115JAA MAT credit to be set off before computing advance-tax shortfall and liability for s. 234B/C interest: CIT vs. Tulsyan NEC (Supreme Court) (**IMPORTANT**)

S. 115JAA inserted by FA 1997 w.e.f. 1.4.1997 provides that when tax is paid u/s 115JA or 115JB, a tax credit being the difference of the tax paid u/s 115JA/115JB and the tax payable under the normal provisions of the Act shall be allowed as set-off in the subsequent year when tax becomes payable under the normal provisions of the Act. The AO, in computing the tax under the normal provisions of the Act, took the view that though MAT credit was available, the same could not be deducted whilst computing the liability to pay advance tax and interest u/s 234B & 234C. The High Court disagreed with the view of the AO. On appeal by the department, SC had dismissed the appeal.

Hon'ble court had given the principle that the scheme of s. 115JA (1) and 115JAA shows that **right to set-off the tax credit follows as a matter of course** once the conditions of s. 115JAA are fulfilled. The **grant of credit is not dependent upon determination by the AO** except that the ultimate amount of tax credit to be allowed depends upon the determination of total income for the first assessment year. Accordingly, **the assessee is entitled to take into account the set off while estimating its liability to pay advance tax**. If this interpretation is not given, there will be absurdity;

- 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.

- 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 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.

❖ S. 148. Reassessment- Service of notice- Service of notice u/s 148 for reassessment to chartered accountant is not as per law and assessment on that basis is void ab initio. Harsingar Gutkha (P) Ltd v DCIT (lucknow) (Trib).

Service of notice under section 148 on a chartered accountant who was not empowered to receive such notice on behalf of the assessee company or any other person who was not authorised to receive was not a valid service of notice on the assessee , more so when it was not shown that the assessee was keeping out of way for the purpose of avoiding service of notice or that there was any other reason that the notice could not be served on the assessee in the ordinary way and therefore , assessment completed pursuant to said notice was bad 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) (Imp)

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 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) **(Very Important)**

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.

- While interest u/s 234A to 234C are applicable to settlement commission proceedings, it is payable only up to the s. 245D(1) order and cannot be levied u/s 154 : Brij Lal vs. CIT (Supreme Court – 5 Judge Bench)

A reference was made to the Full Bench of the Supreme Court to answer the questions (i) whether ss. 234A, 234B & 234C were applicable to Settlement Commission proceedings, (ii) whether such interest is payable up to the date of the s. 245D(1) order or up to the date of the s. 245D (4) order and (iii) whether the Settlement Commission can re-open its concluded proceedings by having recourse to s. 154 so as to levy interest u/s 234B, if it was not done in the original proceedings?

Hon'ble Court had decided as under:

(i) Though Chapter XIX- A is a self-contained Code, the procedure to be followed by the Settlement Commission u/s 245C and 245D is nothing but assessment or computation of total income which takes place at the s. 245D(1) stage. In that computation, provisions dealing with a regular assessment, self-assessment and levy and computation of interest for default in payment of advance tax, etc. are engrafted. Accordingly, **ss. 234A to 234C are applicable**;

(ii) **Interest under ss. 234A to 234C is payable only up to the date of the s. 245D (1) order and not up to the date of the s. 245D (4) order**. In a case where 90% of the assessed tax is paid but on the basis of the Commission's order u/s 245D(4) the advance tax paid turns out to be less than 90% of the assessed tax as defined in the Explanation to s. 234B(1), no interest is payable for shortfall. **The Legislature has not contemplated levy of interest between the s. 245D (1) stage and the s. 245D (4) stage**. Interest u/s 234B is chargeable only till the order of the Settlement Commission u/s 245D(1), i.e., admission of the case;

(iii) In view of s. 245I which provides that the order of the Settlement Commission shall be final and conclusive and also in view of the controversy as to liability for interest, **the Settlement Commission cannot re-open concluded proceedings by having recourse to s. 154 to levy interest u/s 234B if it was not done in the original proceedings**.

- Employee not liable to pay s. 234B interest for failure to pay advance tax on salary : DIT vs. Maersk Co Ltd as agent of Mr. Henning Skov (Uttarkhand High Court)

The assessee, a foreign company, entered into a contract with ONGC pursuant to which it supplied technicians. The AO treated the assessee as an agent of the technician – employees and assessed their income under the head "salaries". Interest u/s 234B was levied on the ground that the employees had not paid advance tax. The CIT (A) & Tribunal upheld the claim of the assessee that the employees were not liable to pay advance tax as the tax was "deductible" at source u/s 192. On appeal by the department, the issue was referred to a Full Bench of high court and High Court had decided the case in favour of the assessee.

U/s 208, an employee is not liable to pay advance tax on salary because u/s 192 there is an obligation on the employer to deduct tax at source. The employee cannot foresee that the tax deductible under a statutory duty imposed upon the employer would not be so deducted. The employee proceeds on the assumption that the deduction of tax at source has statutorily been made or would be made and a certificate to that effect would be issued to him. **If the**

employer fails to deduct tax at source, the employee becomes liable to pay the tax directly. However, the liability to pay interest remains upon the person responsible to deduct tax at source.

- Direct Stay Application to Tribunal maintainable. Not necessary that lower authorities must be approached first Honeywell Automation India Ltd vs. DCIT (ITAT Pune)

The assessee filed a stay application before the AO, Addl CIT & CIT but none of the authorities dealt with it. The assessee also filed a stay application before the Tribunal which was opposed by the Department on the ground that the application was not maintainable without there first being a rejection by the lower authorities. HELD dismissing the department's objection.

It is settled law that a **Direct Stay Application filed before the Tribunal is maintainable and it is not the requirement of the law that assessee should necessarily approach the CIT before approaching the Tribunal** for grant of stay. It does not make any difference whether the assessee filed any application before the Revenue and not awaited their decisions before filing application before the Tribunal or directly approached the Tribunal without even filing the applications before the Revenue authorities, when there exists threat of coercive action by the AO;

In deciding a stay application, the following aspects have to be considered: (i) liquidity of the funds of the assessee to clear the tax arrears out of own funds at the relevant point of time based on the assessee's financial status at the time of the stay petition hearing; (ii) creditworthiness of the assessee to outsource the funds to clear the departmental dues; (iii) prima facie views on the likely decision of the Tribunal on the issues raised in the appeal; (iv) departmental urgencies in matters of collection and recovery; (v) guarantees provided by the assessee to safe guard the interest of the revenue etc.

- High Court has power to review its judgement u/s 260A VIP Industries Ltd vs. CCE (Bombay High Court)

The High Court is a Court of record as envisaged in Article 215 of the Constitution and has inherent powers to correct the record. As the High Court has plenary jurisdiction, **it has inherent power of review** to prevent miscarriage of justice or to correct grave and palpable errors committed by it. In dealing with matters under a special enactment, **the practice and procedure of the ordinary Court will apply if the special enactment refers to and adopts the practice and procedure to be followed by the ordinary Court**. Accordingly, all provisions of the CPC apply to appeals under the Excise Act. One of the grounds of review is an error apparent on the face of the record. Where a statute is amended retrospectively, a judgment applying the unamended law constitutes an error apparent on the face of record and can be reviewed.

- 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.*

- Despite detection in survey, No s. 271(1)(c) penalty if income offered in ROI CIT vs. SAS Pharmaceuticals (Delhi High Court)

A survey was conducted pursuant to which certain discrepancies were found and the assessee surrendered Rs. 88.14 lakhs. In the ROI due for the financial year of survey, the assessee offered the said sum as income. The AO levied penalty u/s 271(1)(c) on the ground that the offer of income was pursuant to detection in the survey and not voluntary. The CIT(A) & Tribunal deleted the penalty. HC had also dismissed the appeal by stating that though it is possible that but for detection in the survey, the assessee might not have offered the income, penalty u/s 271(1)(c) can only be levied if "in the course of proceedings" the AO is satisfied that there is "concealment" or "furnishing of inaccurate particulars". The words "in the course of proceedings" **mean the assessment proceedings** because there is no question of the satisfaction of the AO in survey proceedings. Further, the **question whether there is "concealment" or "inaccurate particulars" has to be determined with reference to the return of income**. As the assessee had offered the detected income in the return, there was neither concealment nor the furnishing of inaccurate particulars.

- Despite concealment, no s. 271(1)(c) penalty if s. 115JB book profits assessed Ruchi Strips & Alloys Ltd vs. DCIT (ITAT Mumbai) (IMP)

Pursuant to a search u/s 132 and the detection of incriminating documents, the assessee offered additional income. The AO computed the income under the normal provisions and levied penalty u/s 271(1)(c) for concealment of income. However, as the book profits computed u/s 115JB was higher, the assessee was assessed u/s 115JB. The assessee's appeal against the levy of penalty u/s 271(1)(c) was rejected by the CIT (A). However, on appeal to the Tribunal, ITAT allowed the appeal of the assessee. **The concealment of income had its repercussions only when the assessment was done under the normal procedure**. If the assessment as per the normal procedure was not acted upon and it was the **deemed income assessed u/s 115JB which became the basis of assessment**, **the concealment had no role to play and was totally irrelevant**. The concealment did not lead to tax evasion at all.

- Mere admission of Appeal by High Court sufficient to disbar s. 271(1)(c) penalty Nayan Builders & Developers Pvt Ltd vs. ITO (ITAT Mumbai) (IMP)

In quantum proceedings, the Tribunal upheld the addition of three items of income. The assessee filed an appeal to the High Court which was admitted. The AO levied penalty u/s 271(1)(c) in respect of the said three items. The penalty was upheld by the CIT (A). On appeal to the Tribunal, HELD allowing the appeal of the assessee. **When the High Court admits substantial question of law on an addition, it becomes apparent that the addition is certainly debatable**. In such circumstances penalty cannot be levied u/s 271(1) (c). **The admission of substantial question of law by the High Court lends credence to the bona fides of the assessee in claiming deduction**. Once it turns out that the claim of the assessee could have been considered for deduction as per a person properly instructed in law and is not completely debarred at all, the mere fact of confirmation of disallowance would not per se lead to the imposition of penalty.

Note: Citation of the Case decisions as well as full text of the decision will be provided as per requirement of the readers. Feel free to mail your queries to " bikashbogi@yahoo.co.in". or contact me at **+91-9930934403 .**

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