DIRECT TAXES CASE STUDY

FOR

CA FINAL MAY 2012

COMPILED BY

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MUMBAI (INDIA)

Source / Journals Referred:

- ≈ **Itatonline.org**
- ≈ **Income tax Review: Monthly journal of The Chamber of Tax Consultants.**
- ≈ **BCAJ (Bombay Chartered Accountant Society) Monthly journal**
- ≈ **Taxmann.com**
- ≈ **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 Nov 2010 to NOV 2011 specifically applicable for CA FINAL May 2012 term.

❖ Section 2(22)(e) : A partnership firm is a shareholder for applicability of section 2(22)(e), even though shares held in names of individual partners : [CIT vs. M/s National Travel Services (Delhi HC)(**Very Important**)]

The assessee was a partnership firm consisting of three partners being Naresh Goyal, Surinder Goyal and Jet Enterprises Pvt. Ltd. The assessee was the "beneficial owner" of 48.18% of the share capital of Jet Air Pvt. Ltd which were held in the name of its partners Naresh Goyal and Surinder Goyal. The assessee took a loan of Rs. 28.52 crores from Jet Air Pvt Ltd. The AO held that the said loan was assessable as "deemed dividend" u/s 2(22)(e) in the hands of the assessee which was reversed by the Tribunal, but High court had decided the same in favour of the department by giving the said principle:

The first limb of s. 2(22)(e) is attracted if the payment is made by a company by way of advance or loan "to a shareholder, being a person who is the beneficial owner of shares". ***While it is correct that the person to whom the payment is made should not only be a registered shareholder but a beneficial share holder, the argument that a firm cannot be treated as a "shareholder" only because the shares are held in the names of its partners is not acceptable.*** ***If this contention is accepted, in no case a partnership firm can come within the mischief of s. 2 (22)(e) because the shares would always be held in the names of the partners and never in the name of the firm.*** *This would frustrate the object of s. 2(22)(e) and lead to absurd results. Accordingly,* ***for s. 2(22)(e), a firm has to be treated as the "shareholder" even though it is not the "registered shareholder"***.

❖ Section 4 : 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.

❖ Section 4: 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.

❖ Section 4: Compensation received on premature termination of JV agreement : [ION Exchange (India) Ltd. (Mum ITAT)

Consideration received for premature termination of the joint venture agreement is a revenue receipt.

❖ Section 4 / section 28: 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.

❖ Section 10(23C) : Coaching Activity by ICAI is not falling under the category of business and hence exemption u/s 10(23c) can not be denied. [DIT vs. ICAI (Delhi HC)]

The CBDT, since the assessment year 1996-97, has been approving the ICAI under sub-clause (iv) of section 10(23C). For the assessment year 2005-06, the institute filed its return declaring its income as NIL, which was accepted by the assessment order under section 143(3). Subsequently, the DIT (Exemption) passed an order under section 263 on two grounds, namely, coaching activity was undertaken by the institute and the said activity was 'business' and not a charitable activity. In those circumstances, the institute was required to maintain separate books of account and, thus, there was violation of section 11(4A). Secondly, it was held that the institute had incurred expenses on overseas activities including travelling, membership of foreign professional bodies, etc., without permission from the CBDT as required under section 11(1)(c) and, thus, income of the institute was not entitled to exemption as a charitable institution. On appeal, the Tribunal held that the power under section 263 was wrongly exercised and the DIT was not justified in giving the directions on the two grounds relied upon by him. On appeal, the revenue questioned the findings of the Tribunal on the first ground, i.e., in respect of coaching classes, whether the same amounted to business and whether separate books of account were required to be maintained by the institute.

Decision

The purpose and object to do business is normally to earn and is carried out with a profit motive; in some cases the absence of profit motive may not be determinative. The DIT has given no such finding as far as the activities of the institute are concerned. He, without examining the concept of business, has held that the institute was carrying on business as coaching and programmes were held by them and a fee was being charged for the same. On the basis of the findings recorded in the order under section 263, it is not sufficient to hold that the institute is carrying on business. In these circumstances, the order passed by the DIT under section 263 cannot be sustained and was, therefore, rightly upset and set aside by the Tribunal.

❖ Section 11: 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.

❖ Section 28, 47: Principle Tests to determine whether shares gains assessable as STCG or business profits: [CIT vs. Gopal Purohit (SC)]

The Supreme Court had affirmed Bombay HC principle that whether share gains assessable as STCG or Business Profit, where it was held that: (a) it was open to an assessee to maintain two separate portfolios, one relating to investment and another relating to business of dealing in shares, (b) that a finding of fact had been arrived at by the Tribunal as regards the two distinct types of transactions namely, those by way of investment and those for the purposes of business, (c) that there should be uniformity in treatment and consistency when facts and circumstances are identical particularly in the case of the assessee and (d) that entries in books of account alone are not conclusive in determining the nature of income though they have a bearing.

❖ Section 32 : Assets in the name of Managing Director: CIT vs. Metalman Auto (p) Ltd. CIT (P & H HC)

Depreciation under section 32 was allowable to the assessee company on the assets which were purchased in the name of the managing director of the assessee company and his wife but, used exclusively for the assessee's business.

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

❖ Section 32: 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 by stating that 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.

- Section 32 : 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 department in HC, HELD affirming the Tribunal's order and dismissed the departmental appeal.

- Section 32: "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 on merits as well as on technical grounds by stating that 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.

- Section 36: 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.

❖ Section 36 : ERP Software Package Allowable As Revenue Expenditure : [CIT vs. Raychem RPG Ltd (Bom HC)]

The assessee, engaged in manufacturing of telecommunication and power cable accessories incurred expenditure of Rs. 23 lakhs on purchase of "Enterprises Resources Planning (ERP) package". The AO treated the expenditure as capital in nature. The Tribunal applied the functional test and held that the expenditure was allowable as a deduction on the basis that the **software facilitated the assessee's trading operations or enabling the management to conduct the assessee's business more efficiently or more profitably but it is not in the nature of profit making apparatus**. The department filed an appeal before the High Court, which has been dismissed.

❖ Section 37 : Personal use by company. CIT vs. Nuchem Ltd. (P & H HC)

In case of Company there cannot be disallowance of car expense for personal use of car.

❖ Section 37 : Litigation expenses for criminal proceedings against Film star in his individual capacity. DCIT vs. Salman Khan (Mumbai ITAT)

The assessee an actor incurred expenditure in defending himself against criminal proceedings which arose out of the shooting of the film 'Hum Saath Saath Hai' at Rajasthan. The Tribunal held that the criminal proceedings were filed against the individual; this has nothing to do with the assessee's profession. The expenditure was purely of a personnel nature and not allowable.

❖ Section 37 / Section 31 : While kidnapping is an offense, paying ransom is not for denying deduction : CIT vs. M/s Khemchand Motilal Jain (MP HC)

The assessee, engaged in manufacture and sale of bidis, sent its whole-time director to a forest area for purchase of tendu leaves. There, the director was kidnapped by dacoits and the assessee paid ransom of Rs. 5.50 lakhs to secure his release. The AO disallowed the claim for deduction of the said amount u/s 37(1) though the CIT (A) and Tribunal upheld the claim on the ground of commercial expediency. Before the High Court, the department relied on the Explanation to s. 37(1) and argued that expenditure incurred for any purpose which is an offence or which is prohibited by law is not allowable as a deduction. HC had dismissed the departmental appeal by stating that while kidnapping for ransom is an offence u/s 364 A of the IPC, **the payment of ransom to secure the release of a kidnapped person is not an offense. The payment of ransom is not prohibited by law**. Accordingly, the Explanation of to s. 37 (1) is not applicable and the ransom is deductible as business expenditure.

❖ Section 37(1)/ section 31 : Professional's heart surgery expense not deductible: [Shanti Bhushan vs. CIT (Delhi HC)]

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 of the assessee by stating that " *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. 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."*

❖ Section 40(a)(ia) : Disallowance u/s 40(a)(ia) cannot be made for short-deduction of TDS : [DCIT vs. M/s. S. K. Tekriwal (ITAT Kolkata)]

The assessee paid Rs. 3.37 crores as "machine hire charges" on which it deducted TDS u/s 194C at 1%. The AO held that the payment was "rent" and TDS ought to have been deducted at 10% u/s 194-I. He disallowed the expenditure u/s 40(a)(ia). This was reversed by the CIT (A). On appeal by the department, HELD dismissing the appeal by stating that section 40(a)(ia) provides for a disallowance if amounts towards rent etc have been paid without deducting tax at source. **It does not apply to a case of short-deduction of tax at source**.

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

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, HC has allowed the appeal by stating that **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.

❖ Section 43A: 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. 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.*

- Section 41(1) : Liability shown in the books of accounts cannot be treated as remission : GP International Ltd. (P & H HC)

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).

- 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.

- Section 48 : 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, HELD dismissing the departmental appeal by stating that 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.**

❖ Section 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) 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 by stating that 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;

❖ Section 54EC : Deduction should be given priority before set-off of brought-forward loss : [The Tata Power Co Ltd vs. ACIT (ITAT Mumbai) **(Important)]**

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.

❖ Section 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. 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)

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**.

❖ Section 56 : HUF is a "relative" for gifts exemption u/s 56(2)(v), (vi) & (vii): [Vineet kumar Raghavjibhai Bhalodia vs. ITO (ITAT Rajkot)]

The assessee received a gift of Rs. 60 lakhs from his HUF. The AO & CIT(A) held that as HUF was not covered by the definition of "relative", the gift was chargeable to tax u/s 56(2)(v). The alternate submission that gift was exempt u/s 10(2) was rejected on the basis that s. 10(2) applied only to amounts received "out of income of the estate" on partial or total partition of the HUF. On appeal by the assessee, ITAT had allowed the appeal by stating that S. 56(2)(v) exempts gifts from a "relative". **Though the definition of the term "relative" does not specifically include a Hindu Undivided Family, a 'HUF" constitutes all persons lineally descended from a common ancestor and includes their mothers, wives or widows and unmarried daughters. As all these persons fall in the definition of "relative", an HUF is 'a group of relatives'**. As a gift from a "relative" is exempt, a gift from a 'group of relatives' is also exempt since the singular will include the plural;

❖ Section 80-IA: 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. SC has decided in favour of the assessee by stating that 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).

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

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. The ITAT had decided the appeal in favour of the assessee.

- Section 115JB: 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)(Important)

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.

- Section 115JB: 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;

- Section 132: 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**.

- Section 133A : 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, HC had dismissed the appeal by stating that **S. 133A does not mandate that any statement recorded under that section would have evidentiary value**.

- Section 144C : DRP's power to "enhance" confined to issues raised in draft assessment order : [Dredging International NV vs. ADIT (ITAT Mumbai)]

The assessee, a foreign company, declared a loss of Rs. 31.22 crores in its first year of operations after claiming deduction for "Provision for future losses" of Rs. 32.86 crores. The AO passed a draft assessment order u/s 144C in which he disallowed the claim for future losses. The DRP confirmed the disallowance of future losses and also directed the AO to take 20% of the contract as having been completed during the period and to assess 8% thereof as the profit. The assessee filed an appeal claiming that the DRP had no jurisdiction to go beyond the draft assessment order and that the future losses were allowable. Hon'ble ITAT had allowed the appeal of the assessee.

- Section 145 : Despite s. 209(3) of the Co's Act, company can follow cash system for tax purposes : DCIT vs. Stup Consultants Pvt Ltd (ITAT Mumbai)

The assessee, a company, followed, in accordance with s. 209(3) of the Companies Act, 1956, the mercantile system of accounting according to which the profits were Rs. 7.48 crores. However, for income-tax purposes, it followed the cash system of accounting according to which the profits were Rs. 4.76 crores and offered that sum to tax. The AO rejected the claim on the ground that u/s 209(3) of the Co's Act, a company is obliged to follow the mercantile system and that is its' "regular method" for purposes of s. 145. However, the CIT (A) upheld the assessee's claim, which was subsequently allowed by the ITAT.

- Section 147 : Despite "Wrong Claim", s. 147 reopening invalid if failure to disclose not alleged by AO : [Titanor Components Limited vs. ACIT (Bombay HC)]

The AO reopened the assessment after the end of 4 years from the assessment year on the ground that the assessee had "wrongly claimed deduction u/s 80IA" and that "long term capital gains had been wrongly set-off". There was no allegation in the recorded reasons that there was any failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment. The assessee filed a Writ Petition to challenge the reopening before the HC, which was allowed by giving reason that

There is a well known difference between ***"a wrong claim made by an assessee after disclosing all the true and material facts" and "a wrong claim made by the assessee by withholding the material facts**." It is only in the latter case that the AO is entitled to proceed u/s 147. The power conferred by s. 147* ***does not provide a fresh opportunity to the AO to correct an incorrect assessment*** *made earlier unless the mistake in the assessment so made is the result of a failure of the assessee to fully and truly disclose all material facts necessary for assessment. Further, it is necessary for the AO to first state that there is a failure to disclose fully and truly all material facts.* ***If he does not record such a failure he would not be entitled to proceed u/s 147**.*

- Section 148 : 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 vs. DCIT (ITAT Lucknow)].

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.

- Section 147: 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 HC)]

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 by stating that "*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.*"

- Section 147: Reopening for rectifying s. 154 mistakes is invalid: [Hindustan Unilever vs. DCIT (Bombay HC)]

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. HC had struck down the reopening proceedings by stating that *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.*

- Section 147 : Retrospective amendment does not mean failure to disclose material facts: [CIT vs. M/s K. Mohan & Co. (Bombay HC)

After the expiry of four years from the end of the assessment year, the AO reopened the assessment u/s 147 by relying on the retrospective amendment to s. 80HHC by the Taxation Laws (Amendment) Act, 2005 w.e.f. 1.4.1998. The CIT (A) and Tribunal truck down the reopening. On appeal by the department, High Court dismissed the appeal by stating that " *If the legislature amends the provisions of the Act with retrospective effect, it cannot be said that there was failure on the part of the assessee to disclose fully and truly all material facts relevant for the purpose of assessment.*"

- Section 194J : Transaction charges" paid to BSE is "fees for technical services" u/s 194-J: [CIT vs. Kotak Securities Limited (Bombay HC)]

The assessee paid Rs.5.17 crores to the Bombay Stock Exchange towards "transaction charges" for getting access to the "BOLT" trading system. The AO held that the payment constituted 'fees for technical services' u/s 194J and that as there was a failure to deduct TDS u/s 194-J, the amount was disallowable u/s 40(a)(i). This was upheld by the CIT (A) though reversed by the Tribunal on the ground that the stock exchange did not render any managerial or technical services. On appeal by the department, High court had decided the appeal in favour of the department by stating that " *In the case of a stock exchange, there is direct linkage between the managerial services rendered and the transaction charges levied by the stock exchange. The BOLT system provided by the BSE is a complete platform for trading in securities. A stock exchange manages the entire trading activity carried on by its members and accordingly renders "managerial services". Consequently, the transaction charges constituted "fees for technical services" u/s 194-J and the assessee ought to have deducted TDS*".

- Section 195(1) : 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, SC reversed the High Court decision by giving the principle that

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**.

- Section 271(1)(c): High Court has power to review its judgement u/s 260A: [VIP Industries Ltd vs. CCE (Bombay High Court) (Important)]

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.

- 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. 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.*

- Section 271(1)(c): Despite detection in survey, No s. 271(1)(c) penalty if income offered in Return of Income: CIT vs. SAS Pharmaceuticals (Delhi High Court) **(Very Important)**

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.

- Section 271(1)(c): 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 by stating that 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.

- Section 271(1)(c) : 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, allowing the appeal of the assessee by saying that 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.

- Section 271(1)(c) : Dispute regarding choosing APL for Transfer pricing adjustments [DCIT vs. RBS Equities Ltd (MUM ITAT)

The assessee adopted the TNMM to determine the ALP in respect of the broking transactions entered into with its Affiliates. The AO & TPO held that the assessee ought to have adopted the CUP method and made an adjustment of Rs. 1.10 crores. This was accepted by the assessee. The AO levied penalty under Explanation 1 to s. 271(1)(c) on the ground that the assessee had filed inaccurate particulars of income. This was deleted by the CIT (A). On appeal by the department to the Tribunal, the Tribunal dismissing the appeal by stating that explanation to section 271(1)(c) does not apply to transfer pricing adjustments.

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