# DIRECT TAXES CASE STUDY

## FOR

# CA FINAL NOV 2013

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# Source / Journals Referred:

≈ **Itatonline.org, Income tax Review: Monthly journal of The Chamber of Tax Consultants, BCAJ (Bombay Chartered Accountant Society) Monthly journal, AIFTP: All India federation of Tax Practioner Journal , Taxmann.com, Taxman : The tax law weekly, SOT : Selected Orders of ITAT, ITD : Income Tax tribunal decisions, DTR : Direct Tax Reporter, ITR : Income Tax Reporter, 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 July 2012 to June 2013 specifically applicable for CA FINAL NOV 2013 term.**

❖ Section 4 : Compensation on Loss of referral work is a capital receipt [Khanna & Annadhanam vs. CIT – Delhi HC]

The assessee, a firm of Chartered Accountants, was one of the associate members of Deloitte Haskins & Sells for 13 years pursuant to which it was entitled to practice in that name. Deloitte desired to merge all the associate members into one firm. As this was not acceptable to the assessee, it withdrew from the membership and received consideration of ₹ 1.15 crores from Deloitte. The said amount was credited to the partners' capital accounts & while filing the return of income, claimed it as a capital receipt. Department had treated this receipt as a revenue receipt. The matter ultimately travelled to HC. Hon'ble HC held that if the receipt represents compensation for the loss of a source of income, it would be capital and it matters little that the assessee continues to be in receipt of income from its other similar operations. When that source was unexpectedly terminated, it amounted to the impairment of the profit-making structure or apparatus of the assessee. It is for that loss of the source of income that the compensation was calculated and paid to the assessee. The compensation was thus a substitute for the source and hence is a capital receipt.

❖ Section 9/ 40(a)(i) : Advertisement charges paid to Google & Yahoo is not taxable in India [ITO vs. Right Florist (p) Ltd. – ITAT Kolkata]

The assessee, a florist, paid a sum of ₹ 30.44 lakhs to Google Ireland Ltd and Yahoo USA for online advertising. The AO held that the assessee ought to have deducted TDS and that as there was a failure, the expenditure was not allowable u/s 40(a)(i). This was deleted by the CIT(A) on the ground that Google and Yahoo did not have a PE in India. On appeal by the department to the Tribunal, ITAT dismissed the departmental appeal by stating that :

A website does not constitute a 'permanent establishment' unless the servers on which websites are hosted are also located in the same jurisdiction. As the servers of Google and Yahoo are not located in India, there is no PE in India. Section 9(1)(i) does not apply as there is no "business connection" in India nor are the online advertising revenues generated in India serviced by any entity based in India. As regards s. 9(1)(vi), it is held that the advertising revenues are not assessable as "royalty". As regards s. 9(1)(vii), the services are not "managerial" or "consultancy" in nature as both these words involve a human element. On facts, the service rendered by Google & Yahoo is generation of certain text on the search engine result page. This is a wholly automated process. In the services rendered by the search engines, which provide these advertising opportunities, there is no human touch at all. The results are completely automated. Consequently, the whole process of actual advertising service provided by Google & Yahoo, even if it be a technical service, is not covered by the limited scope of s. 9(1)(vii). Consequently, the receipts in respect of online advertising on Google and Yahoo cannot be brought to tax in India under the provisions of the Act or the India US and India Ireland tax treaty.

- Section 10A : Return of income should be filed in time [M/s Saffire Garments vs. ITO – ITAT Rajkot]

For AY 2006-07, the assessee filed a ROI on 31.1.2007 when the due date was 31.12.2006. The assessee claimed deduction u/s 10A. The AO & CIT(A) rejected the claim by relying on the Proviso to s. 10A(1A). The matter ultimately referred to Special Bench of ITAT. SB held that the Proviso to s. 10A(1A) provides that "no deduction under this section shall be allowed to an assessee who does not furnish a return of his income on or before the due date specified u/s 139(1)". The assessee's argument that the said Proviso is merely directory and not mandatory is not acceptable. The Proviso is one of the several consequences (such as interest u/s 234A) that befall an assessee if he fails to file a ROI on the due date. As the other consequences for not filing the ROI on the due date are mandatory the consequence in the Proviso cannot be held to be directory.

- Section 14A : Not applicable in stock in trade [Ethio Plastics (p) Ltd vs. DCIT – ITAT Ahmadabad]

The assessee received ₹ 59 lakhs as tax-free dividend. It claimed that no disallowance u/s 14A could be made as it was a dealer in shares and the shares were held as stock-in-trade. Department held that section 14A applied also to shares held as stock-in-trade and made a disallowance of ₹ 37 lakhs.

In assessee's appeal, Hon'ble ITAT held that as the assessee is engaged in the business of dealing in shares and the shares were held as stock-in-trade, the intention of the assessee was not to earn dividend income. As the dividend received was incidental to the business of sale of shares, no notional expenditure could be disallowed by invoking s. 14A.

### ❖ Section 32 : Depreciation on Website Expenditure [Make Mytrip (India) (p) Ltd vs. DCIT - Delhi ITAT]

The assessee was engaged in the business of tour and travel and for the purpose of its business, had developed a website on which information about its business was available. The assessee claimed depreciation on website development expenses under the block of intangible assets. During the assessment proceedings it was submitted by the assessee that website was an intangible asset similar in nature to know-how, patents, copyrights, trade mark, licence and franchise. The website was owned by the assessee and was used for the purpose of business or profession. Therefore, depreciation at the rate of software was applicable. AO had disallowed the depreciation claim of the assessee by treating it as capital in nature. CIT (A) held that depreciation @ 25% is permissible, which was also affirmed by ITAT.

### ❖ Section 36(1)(va) : Contribution to EPF [CIT vs. Kichha Sugar Company – Uttarakhand HC]

The assessee collected employees' Provident Fund contribution for payment to the provident fund authorities. However, the amount was not paid to the provident fund authorities within the "due date" specified in the Provident Fund Act though it was paid before the due date of filing the return of income. The AO assessed the amounts received as income u/s 2(24)(x) but refused to allow a deduction u/s 36(1)(va) on the ground that the amounts were not paid within the prescribed "due date". The matter ultimately comes in HC. Hon'ble HC held that the "due date" referred to in s. 36(1)(va) must be read in conjunction with s. 43B(b) to mean the "*due date*" of filing the ROI. The AO wrongly proceeded on the basis that the "due date" in s. 36(1)(va) is the due date fixed by the Provident Fund authority, whereas read in the context of s. 43B(b) it is the "due date" fixed for filing the ROI.

### ❖ Section 36(1)(v) : Payment to LIC Group gratuity scheme is allowable expenditure. [CIT vs. Textool Co. Ltd. – SC]

The assessee set up a gratuity fund which was duly approved by the CIT. However, instead of making payment to the fund directly, the assessee paid an amount of ₹ 50 lakhs as initial contribution and an amount of ₹ 5 lakhs as annual premium to the LIC pursuant to the group Life Assurance Scheme framed by the LIC for the benefit of the employees of the assessee. The AO disallowed the claim for deduction on the ground that payment towards the gratuity fund was not made to an approved gratuity fund and was not allowable u/s 36(1)(v). The CIT(A), Tribunal and High Court upheld the assessee's claim on the basis that the payment to LIC under the Group Life Assurance Scheme was for the exclusive benefit of the employees of the assessee under the policy issued by it and that the conditions stipulated in s. 36(1)(v) had not been violated. On further appeal by the department, Hon'ble Supreme Court dismissed the appeal and held that from a bare reading of s. 36(1)(v), it is manifest that the real intention behind the provision is that the employer should not have any control over the funds of the irrevocable trust created exclusively for the benefit of the employees. On facts, it is evident that the assessee had absolutely no control over the fund created by the LIC for the benefit of the employees of the assessee and further all the contribution made by the assessee in the said fund ultimately came back to the Employees Gratuity Fund, approved by the CIT.

- **Section 37(1) : Illegal payments [CIT vs. Rajarani Exports – Calcutta HC]**

The assessee exported tea to Iraq under the 'Oil for Food Program', as sanctioned by the United Nations. It paid commission of ₹ 1.28 crores to one Jordanian company. The Volcker Committee, which was set up to expose the 'Oil for Food scam' found that this company was a front company for the Iraqi regime, meant to receive illegal kickbacks, and did not render any services. The Department acting on the report, held that the commission paid by the assessee was "*illegal*" and not allowable under the Explanation to s. 37(1). The matter travelled to HC. Hon'ble HC had dismissed the departmental appeal by stating that the "purpose" of the expenditure has to be seen and if the payment is for bonafide business purposes, the fact that they end up being used as illegal kickbacks, will not attract Explanation to s. 37(1).

- **Section 37(1) : No disallowance for penalty / violation of procedural law [CIT vs. The stock and bond trading company – Bombay HC]**

The assessee paid penalty/fine to BSE/NSE for infringement of procedural rules such as failure to maintain margins, trading beyond exposure limits, late submission of margin certificates, delay in making payment & deliveries etc. The AO disallowed the claim for deduction on the ground that there was an infringement of statutory law laid down by SEBI and the Explanation to s. 37(1) was attracted. High Court held as the payments made by the assessee to the Stock Exchange for violation of their regulation was not on account of an offence which is prohibited by law and accordingly the invocation of the Explanation to s. 37 of the Act was not justified.

- **Section 37 : Education Expenses of Director [Natco Exports (p) Ltd vs. CIT Delhi HC]**

Assessee-company incurred expenditure on education of one of its directors who had undergone a course at UK, and claimed deduction of same as business expenditure. She had not executed any bond that she would work for assessee after completing her studies at abroad and on failure shall return money spent. She had completed her graduation course in year 2005 and even prior to completing her graduation course she applied for further studies. HC held that education expenses of director cannot be treated as wholly & exclusively incurred for the purpose of business and hence is not allowable.

- **Section 40(a)(ia) : Short deduction of TDS [CIT vs. S. K. Tekriwal – Calcutta HC]**

The assessee paid machinery hire charges on which it deducted TDS at 1% u/s 194C. The AO claimed that the amount was in the nature of "rent" and TDS at 10% ought to have deducted u/s 194-I. A proportionate disallowance u/s 40(a)(ia) was made on the ground that there was a "failure" to deduct TDS on the payment. The Tribunal upheld the assessee's plea that s. 40(a)(ia) disallowance could not be made when there was a shortfall in TDS deduction. On departmental appeal in HC, High Court held that S. 40(a)(ia) can be invoked only when the two conditions, namely, that tax is deductible at source and such tax has not been deducted is satisfied. Where tax is deducted by the assessee under a wrong provisions of TDS and there is a shortfall, s. 40(a)(ia) disallowance cannot be made.

- ## Section 43(5) : loss on currency forward contract is a hedging loss [CIT vs. Friends Shipping (p) Ltd. – Gujarat HC]

The assessee, an exporter, entered into forward contracts with Banks to hedge against any loss arising out of fluctuation in foreign currency. The forward contract provided that the assessee would buy some quantity of dollars at a particular rate to cover export bill payment. The contract gave delivery option dates and the assessee had the option to cancel the contract and pay the loss to the Bank. The assessee suffered a loss of ₹ 15 lakhs on such cancellation. Department treated the loss as "*speculation loss*" u/s 43(5) and denied the deduction.

Hon,ble HC held that the transactions in foreign exchanges were incidental to the assessee's regular course of business and the loss was thus not a speculative loss u/s 43(5) but was incidental to the assessee's business and allowable as such. The fact that there may have been no direct co-relation between the exchange document and the precise export contract cannot be seen in isolation if there are in fact several separate contracts with the bankers. Accordingly the loss is allowable for calculating PGBP.

- ## Section 44BB: For Calculating deemed Income u/s 44BB, service tax should be excluded from 'Gross Receipts'. DCIT vs. Mitchell Drilling International [Delhi ITAT]

The assessee offered income on gross receipts [excluding Service Tax] u/s 44BB and 10% of the same was offered for taxation. AO had rejected the contention of the assessee and added the amount of service tax in gross receipts for calculating total income. Matter travelled to ITAT.

ITAT held that, section 44BB is a special provision, treating 10% of the aggregate amount specified in sub-s. (2) of s. 44BB as deemed profits and gains of the non-resident. Service-tax is a statutory liability like custom duty and reimbursement of custom duty & service-tax paid by the assessee cannot form part of amount for the purpose of deemed profits u/s 44BB as it does not involve any element of profit. Accordingly, it cannot be included in the total receipts for determining the presumptive income. Accordingly department appeal was dismissed.

### ❖ Section 48: Interest paid on borrowing for acquiring house deductible u/s 24(b) & 48 [ACIT vs. C. Ramabrahmam (ITAT Chennai)]

The assessee borrowed funds for purchasing a house. The interest paid on the said loan was claimed as a deduction u/s 24(b). When the house was sold, the interest paid on the said loan was treated as "cost of acquisition" and claimed as a deduction u/s 48 in computing the capital gains. AO held that as the interest had been allowed as a deduction u/s 24(b), it could not allow again in computing capital gains. The matter travelled to ITAT and ITAT allowed the appeal in favour of the assessee by stating that deduction u/s 24(b) and computation of capital gains u/s 48 are altogether covered by different heads of income i.e., income from 'house property' and 'capital gains'. Neither of them excludes the other. A deduction u/s 24(b) is claimed when the assessee computes income from 'house property', whereas, the cost of the same asset is taken into consideration when it is sold and capital gains are computed under section 48. There is no doubt that the interest in question is an expenditure in acquiring the asset. Since both provisions are altogether different, the assessee is entitled to include the interest at the time of computing capital gains u/s 48.

### ❖ Section 50C : Not applicable on transfer of FSI & TDR [ITO vs. Prem Ratan Gupta – ITAT Mumbai]

The assessee owned a plot of land, out of which certain portion was acquired by the Municipality for development purposes. The assessee was entitled to receive TDR/ FSI in lieu of the land acquired. The assessee sold the development rights to the said property for ₹ 20 lakhs and computed capital gains on that basis. However, for purposes of stamp duty, the property was valued at ₹ 1.19 crores. The AO held that the value of the property as adopted by the stamp duty authorities had to be taken as the consideration u/s 50C for purposes of capital gains. This was reversed by the CIT(A). In departmental appeal, ITAT held that section 50C applies only to the transfer of "land or building" and not to the transfer of all "immovable property". Accordingly, though FSI and TDR is "immovable property" it is not "land or building" and so cannot be the subject matter of s. 50C.

### ❖ Section 54 : Exchange of old flat with new one [Jatinder Kumar Mohan vs. ITO - Mum ITAT]

Assessee had exchanged old flat with new flat to be constructed by builder under development agreement. It claimed exemption u/s 54 in respect of capital gain on account of transfer of old flat. AO disallowed assessee's claim holding that assessee had neither purchased nor constructed house property within period prescribed u/s 54. The question rose before ITAT was (i) whether acquisition of new flat under a development agreement in exchange of old flat amounts to construction of new flat for purpose of claiming deduction u/s 54 (ii) Whether, therefore, assessee would be entitled to exemption if new flat had been constructed within a period of 3 years from date of transfer. ITAT had decided both issues in favour of the assessee.

### ❖ S. 54EC : Limit of Rs. 50L applies to financial year wise [Vivek Jairazbhoy vs. DCIT (ITAT Bangalore)]

In AY 2008-09, the assessee sold land on 14.12.2007 and computed capital gains of ₹ 1.57 crores. He invested ₹ 50 lakhs on 3.3.2008 (FY 2007-08) in REC Bonds and ₹ 50 lakhs on 4.6.2008 (FY 2008-09) in NHAI Bonds and claimed a deduction of ₹ 1 crore u/s 54EC. The NHAI Bonds were allotted on 30.6.2008. The AO & CIT(A) restricted the assessee's claim to ₹ 50 lakhs on the ground that (i) the Proviso to s. 54EC imposed a ceiling of ₹ 50 lakhs for the investment and (ii) the allotment of the NHAI Bonds was made beyond 6 months of the date of transfer.

ITAT had allowed the assessee by stating that s. 54EC merely restricted the investment that can be made in one FY to ₹ 50 Lakhs but it did not restrict the exemption to ₹ 50 lakhs. CBDT Circular no.3/2008 dated 12.3.2008 makes it clear that the proviso only intended to restrict the investment in a particular FY and did not intend to restrict the maximum amount of exemption permissible u/s 54EC. The fact that the Proviso uses the words "in a financial year" fortifies this interpretation. Accordingly, it has to be held that the assessee is entitled to total deduction of ₹ 1 crores in respect of the investment of ₹ 50 lakhs made in each financial year. Further ITAT held cheque was issued to NHAI before the expiry of 6 months from the date of transfer and hence compliance was duly made.

### ❖ Section 54EC: Non availability of eligible bonds will give extra time to assessee for compliances : CIT vs. Cello Plast (Bombay High Court)

The assessee sold factory building on 22.3.2006 and earned LTCG of ₹49.36 lakhs. The LTCG was invested "REC Bonds" on 31.1.2007, *beyond the period of 6 months* (21.9.2006) specified in s. 54EC. The assessee claimed that the delay was due to the fact that for the period from 4.8.2006 to 22.1.2007, the *bonds were not available* and the investment was made when available. The matter ultimately travelled to High Court.

Before the High Court, the department argued that (a) even if the bonds were not available for a part of the period, they were *available* for some time in the period after the transfer (1.7.2006 to 3.8.2006) and the assessee ought to have invested then & (b) the s. 54EC bonds issued by *National Highway Authority* (NHAI) were available and the assessee could have invested in them. High Court had rejected departmental appeal by stating that contention of the department is not well founded. The assessee was entitled to wait till the last date (21.9.2006) to invest in the bonds. As of that date, the bonds were not available. The fact that they were available in an earlier period after the transfer makes no difference because the assessee right to buy the bonds upto the last date cannot be prejudiced. The department's contention that the assessee ought to have purchased the alternative s. 54EC NHAI bonds is also not well founded because if s. 54EC confers a choice investing either in the REC bonds or the NHAI bonds, the department cannot insist that the assessee ought to have invested in the NHAI bonds.

### ❖ Section 54 / 54F : Exemption [CIT vs. Syed Ali – Andhra Pradesh HC]

The assessee offered long term capital gains on sale of property and claimed s. 54 deductions on the ground that he had purchase two adjacent residential flats. The AO held that the deduction could not be given for both flats on the ground that they were independent units, separated by a strong wall. The CIT(A) and Tribunal allowed the claim on the basis that s. 54 deduction was available for purchase of multiple flats, even if the flats were on different floors. On subsequent appeal HC had dismissed the departmental appeal by stating that the expression "*a residential house*" in s. 54 (1) has to be understood in the sense that the building should be of residential nature and "*a*" should not be understood to indicate a singular number. Where an assessee had purchased two residential flats, he is entitled to exemption u/s 54 in respect of capital gains on sale of its property on purchase of both the flats, despite the fact that the flats were purchased by separate sale deeds. Deduction is allowable even if the flats are on different floors.

### ❖ Section 54F : Deposit in capital gain scheme [CIT vs. Jagtar Singh Chawla – P & H HC]

The assessee sold property on 20.06.2006 (AY 2007-08) for a consideration of ₹ 2.24 crores. The said amount was not invested in the capital gains account scheme by the due date of filing the return u/s 139(1) (31.07.2007) and was instead used to purchase a new residential house on 31.3.2008. The assessee claimed exemption u/s 54F which was denied by the department on the basis that u/s 54F(4) the amount of the consideration which is not appropriated for purchase of the new asset before the date of furnishing the return of income u/s 139 had to be deposited in the "*capital gains account scheme*" before the due date for filing the return of income u/s 139(1). Matter travelled to HC wherein departmental appeal was dismissed. Hon'ble Court held that section 139(4) provides that a person who has not furnished a return within the time allowed to him under s. 139(1) may furnish the return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment whichever is earlier. For AY 2007-08, the last date for filing the return u/s 139(4) is 31.3.2009. This extended time limit is available for making deposit in the capital gains account scheme. As the assessee had invested the consideration in purchase of a new house before that date, the exemption has to be allowed.

### ❖ Section 68: Assessee have to prove that donors have financial capacity to give gifts : [CIT vs. P.R. Ganapathy (SC)]

Hon'ble SC in this case has explained the law related to applicability of section 68. First of all the assessee have to prove that the amount received as gift(s) from the donors is actually "gift" in the legal sense. The assessee has to show whether the donors have the financial capacity to make the gift(s) in favour of the assessees. The fact that the donor's are assessed to tax outside India does not answer the question. The assessees have to lead evidence to show that the alleged donors had adequate funds in their respective accounts to make the gift(s).

### ❖ Section 92 : Benchmarking of Business Advances [Aurionpro Solutions Ltd. vs. ACIT – ITAT Mumbai]

The assessee, an Indian company, gave loans of ₹ 15.65 crores to its Associated Enterprises in USA, Singapore and Bahrain. It claimed that the said loans were "working capital advances" given for commercial consideration to secure business and that no interest was recoverable on it. The TPO applied the CUP method and determined the ALP of the advances at LIBOR plus 3% mark up. The DRP held that only ECBs taken by the Indian entities from outside India could be benchmarked with LIBOR and that outbound loans had to be benchmarked on the interest rate prevailing in India on corporate bonds. It treated the advance as an unrated bond having very high risk and enhanced the assessment by directing the TPO to adopt 14% as the ALP rate. On appeal by the assessee, Hon'ble ITAT held that The assessee's argument that the non-charging of interest on the working capital advances to AEs from whom the assessee was getting good business was justified by commercial considerations and that no transfer pricing adjustment is warranted is not acceptable because the existence or non-existence of commercial consideration between the assessee and the AEs is not a required condition for applicability of the TP regulations. ALP should be determined on the basis of LIBOR + 2% by following other ITAT decisions.

### ❖ Section 143(3) : Validity of assessment [Crystal Phosphates Ltd. vs. JCIT – ITAT Delhi]

For AY 2006-07, the assessee filed a ROI declaring income of ₹ 3.97 crore. The case was selected for scrutiny under clause 2(v)(b) of the Scrutiny Guidelines issued by the CBDT. The said clause of the Scrutiny Guidelines provided that a case had to be selected for compulsory scrutiny if an addition/ disallowance of Rs. 5 lacs or more was pending in appeal before the CIT(A) and such identical issue also originated in the year under consideration. The assessee claimed that as this condition stipulated in the Scrutiny Guidelines was not satisfied, the AO had no jurisdiction to select the case for scrutiny. The department has rejected the assessee's claim. Hon'ble ITAT had quashed the assessment order by stating that the CBDT's instructions for assumption of jurisdiction for selection of cases of corporate assesses for scrutiny and assessment are issued u/s 119 and are binding on the AO and have to be followed by him in letter and spirit. The burden lies on the authority assuming jurisdiction to show and establish that such instructions have duly been complied and satisfied in letter and spirit. On facts, as there was no disallowance of ₹ 5 lacs or more in the earlier years and as no identical issue had arisen in the present year, the notice issued u/s 143(2) was not in terms of the CBDT's Scrutiny Guidelines and consequently the assumption of jurisdiction was illegal and the entire assessment proceedings were invalid.

### ❖ Section 143(3) : Assessment order without the signature of AO is void [M/s Vijay Corporation vs. ITO : ITAT Mumbai)

AO passed an assessment order u/s 143(3) and issued the Income-tax Computation Form (ITNS 150), Demand Notice u/s 156 and Penalty Notice u/s 271(1)(c). While all the other documents were signed by the AO, the assessment order was not signed. In reply to the assessee's contention that the assessment order was invalid, ITAT held that if the assessment order is not signed, then the fact that he has signed the tax computation form and the notice of demand is irrelevant. The omission to sign the assessment order cannot be explained by relying on s. 292B.

### ❖ Section 147 : Reopening on the basis of retrospective amendment is invalid [Ganesh Housing Corporation Ltd. vs. DCIT – Gujarat HC]

For AY 2006-07, the assessee claimed s. 80-IB (10) deduction of Rs. 11.38 crores which was accepted by the AO while passing order u/s 143(3). Subsequently, within 4 years from the end of the AY, the AO reopened the assessment u/s 148 on the ground that the assessee had not complied with s. 80-IB(10) including that after the insertion of the Explanation to s. 80-IB(10) by the FA (No. 2) Act 2009 w.r.e.f. 1.4.2000, a contractor was not eligible for deduction u/s 80-IB(10). The assessee challenged the s.148 notice by a Writ Petition. High Court by allowing the WP held that as regards the retrospective amendment, if an Explanation is added to a section for the removal of doubts, the implication is that the law was the same from the very beginning and the same is further explained by way of addition of the Explanation. <u>It is not a case of introduction of a new provision of law by retrospective operation</u>. As regards the formation of opinion, the assessee had disclosed all the material relevant for claiming s. 80-IB(10) deduction and there was no suppression of material.

### ❖ S. 147: Reopening in the absence of "fresh tangible material" is invalid [CIT vs. Amitabh Bachchan (Bombay HC)]

Assessee, a famous Bollywood Actor, filed ROI declaring income of ₹ 14.99 crores. A revised ROI was then filed claiming 30% ad-hoc expenses (₹ 6.31 crores) and offering income of ₹ 8.11 crores. When the AO asked the assessee to substantiate the expenses, he withdrew the claim. The AO passed order u/s 143(3). The AO then issued a s. 148 notice (within 4 years) to reopen the assessment on the ground that the claim for expenses (which was withdrawn) had to be assessed as "unexplained expenditure" u/s 69. The CIT (A) & Tribunal struck down the reassessment order on the ground that the material on the basis of which the assessment was sought to be reopened was always available at the time of the original proceeding and there was no new material.

Subsequently High Court had dismissed the departmental appeal by stating that the reopening on the basis that the said adhoc expenditure constituted "unexplained expenditure" u/s 69 was based on the same material. There was no fresh tangible material before the AO to reach a reasonable belief that the income liable to tax has escaped assessment. It is a settled position of law that review under the garb of reassessment is not permissible.

### ❖ Section 148 : Reopening based solely on departmental audit objection is void [Vijay Rameshbhai Gupta vs. ACIT – Gujarat HC]

The AO passed order u/s 143(3) in which he allowed the assessee's claim for business expenses. The Revenue Audit raised an objection that as the assessee's business had ceased, the income had to assessed as "other sources" and the expenditure disallowed. The AO replied to the Audit stating that the objection was not correct and that the assessment order was correct. The Revenue Audit thereafter wrote to the CIT that the AO's stand was not correct. Based on this, the AO issued a s. 148 notice (within 4 years from the end of the AY) to reopen the assessment and disallow the expenditure. The assessee challenged the reopening on the basis that the AO was compelled by the audit party to re-open the assessment though he was of the belief that no income had escaped assessment. Hon'ble HC had upheld the writ of the assessee by stating that if the AO acts under compulsion of the audit party and not independently, the action of re-opening would be vitiated. Consequently, the s. 148 notice had to be quashed.

### ❖ Section 153C : Recording of satisfaction by AO is compulsory [Ingram Micro (India) vs. DDIT – ITAT Mumbai]

A search & seizure action u/s 132(1) was carried out in the case of Ingram Micro India Pvt. Ltd. As certain documents were found which allegedly showed that the assessee (a Singapore company) was not paying tax in India though it had a PE, an assessment u/s 153C was made to bring such profits to tax. The assessee challenged the s. 153C assessment on the ground that the AO who had conducted the search had not recorded satisfaction that any income belonged to the assessee. Hon'ble ITAT held that u/s 153A & 153C, proceedings can be initiated only after the AO comes to the satisfaction that the seized material pertains to a person other than the searched party and comes to the conclusion that proceedings are required to be initiated in the other party's case. It is well settled that the recording of satisfaction by the AO that any undisclosed income belongs to any person, other than the person searched, is a condition precedent and that a notice issued without recording satisfaction and application of mind was a nullity.

### ❖ Section 158B : Undisclosed income [ACIT vs. M/s A R Enterprises – SC]

A search u/s 132 was conducted on the premises of the assessee and it was detected that though the assessee had taxable income in the previous year, it had not filed a Return of Income and the due date had lapsed. The AO issued notice directing the assessee to file a return for the block period. The assessee claimed that as it had paid advance tax on the income for the previous year, the income could not be said to be "*undisclosed*". The AO rejected the claim. The matter ultimately travelled to SC. Hon'ble SC held that S. 158B(b) defines the expression "*undisclosed income*" to mean that income "*which has not been or would not have been disclosed for the purposes of this Act*". The only way of disclosing income on the part of an assessee is through filing of a return and therefore an "*undisclosed income*" signifies income not stated in the return filed. It cannot be said that payment of Advance

Tax by an assessee per se is tantamount to disclosure of total income. Accordingly departmental appeal was allowed.

## ❖ Section 194C : TDS not applicable to contract manufacturing [CIT vs. Silver Oak Laboratories (p) Ltd. – SC]

The assessee, a manufacturer of pharmaceutical products, entered into agreements with various manufacturers who manufactured the said items according to the specifications provided by the assessee. The AO held that the transaction between the assessee and the manufacturer was in the nature of a "*works contract*" and fell within the purview of s. 194C and that the assessee ought to have deducted TDS thereon. The assessee was held to be in default and liable to pay the tax and interest u/s 201(1) & 201(1A). The matter ultimately travelled to SC. Hon'ble SC had dismissed the departmental appeal by stating that on examining the terms and conditions, invoices, purchase orders and challans indicating payment of excise duty, there is no material on record to indicate that the transaction in question is a "*contract for carrying out works*". Hence, s. 194C is not attracted. The definition of the word "*work*" not include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person other than such customer.

## ❖ Section 195 : DTAA rate along with surcharge and education cess [ITO vs. M Far Hotels Ltd. – ITAT Cochin]

The assessee made a remittance of management fee and interest to a resident of France. The AO held that in deducting TDS thereon u/s 195, the assessee ought to have deducted surcharge and education cess. The assessee claimed that as the India-France DTAA was silent about inclusion of surcharge & education cess, it was under no obligation to do so. Matter travelled to ITAT. Hon'ble ITAT held India-France DTAA does not say anything about inclusion of surcharge and education cess for the purpose of deduction of tax at source. Therefore, there is an apparent conflict between the Income-tax Act and the DTAA between the two sovereign countries with regard to deduction of tax at source on surcharge and education cess. U/s 90(2) if the provisions of the DTAA are more beneficial to the taxpayer, the DTAA prevails over the Act. Since the DTAA is silent about the surcharge and education cess for the purpose of deduction of tax at source, the taxpayer may take advantage of that provision in the DTAA for deduction of tax.

## ❖ Section 206AA : Not applicable to assessee having no taxable income [A Kowsalya Bai vs. UOI – Kar HC]

The assessee, whose income was below taxable limit, filed Form 15G and requested that no TDS be deducted on the interest on fixed deposit. However, she was informed that in view of s. 206AA inserted by FA 2009, TDS would have to be deducted in the absence of PAN. The assessee filed a writ petition to challenge s. 206AA as being arbitrary and unconstitutional to the extent that it compelled persons with no taxable income to obtain a PAN.

High Court held - "U/s 139A, only persons whose income is chargeable to tax are required to obtain a PAN. However, s. 206AA compels even persons without a taxable income to obtain a PAN to avoid TDS. This creates difficulty for poor and illiterate persons who make small investments and discourages them to invest money. S. 206AA runs counter to s. 139A and is discriminatory. Accordingly, s.206AA is read down as being inapplicable to persons whose income is less than the taxable limit."

- Section u/s 234A /234B / 234C : Interest is mandatory & can be levied even if assessment order is silent [Karanvir Singh Gossal vs. CIT (SC)

Supreme Court in this case explains that interest u/s 234A/234B/ 234C is mandatory in nature and there is no need for the AO to specifically recite in the assessment order that the said interest shall be levied.

- Section 245 : Mere filing of Return of Income makes an advance ruling application void: [Netapp BV vs. The AAR (Delhi High Court)]

For AY 2009-10, the assessee filed a return on income u/s 139(1) on 31.3.2010. On 17.06.2010, it filed an application before the AAR seeking a ruling in respect of the transactions that had been entered into in that year. The AAR rejected the application on the ground that as the assessee had filed a ROI, the questions raised in the application were "already pending" before an income-tax authority and so the application was not maintainable. The assessee filed a Writ petition contending that (a) the mere filing of a ROI did not mean that all possible questions were "pending" if the AO had not raised the issue and (b) as the AAR had in the past admitted applications even though ROIs were filed, it could not change its stand.

High Court had dismissed the Petition by stating that the crux of s. 245R(2) is that if the applicant wishes to plan its affairs and transactions in advance, it is free to do but once it proceeds to file a return, the AAR's jurisdiction to entertain the application for advance ruling is taken away, because the AO would then be seized of the matter, and would possess a multitude of statutory powers to examine and rule on the return. The fact that in the past the AAR followed a different practice in the past is irrelevant because there is no estoppel against a statute.

- Section 253 : Delay in filing the appeal due to fault of CA [Y P Trivedi vs. JCIT – ITAT Mumbai]

The assessee filed an appeal before the Tribunal which was delayed by 496 days. In the application for condonation of delay, the assessee claimed that he had handed over the papers to his Chartered Accountant and that the latter had mixed up the papers with other papers in his office which led to the delay. The department opposed the application on the ground that there was "*gross negligence*" on the part of the assessee and that sufficient cause for the delay was not explained. Hon'ble ITAT held that the facts do not suggest that the assessee has acted in a mala fide manner or that the reasons explained are only a device to cover an ulterior purpose. On facts, the reasons explained by the assessee show that due to bonafide mistake and inadvertence, the appeal could not be filed within the period of limitation. Accordingly, the delay of 496 days has to be condoned.

### ❖ Section u/s 271(1)(c): Penalty cannot be imposed for a "bona fide human error" [PWC vs. CIT (SC)] **Imp.**

The assessee filed a ROI together with the Tax Audit Report. In the Tax Audit Report, it was *disclosed* that an amount of ₹ 23 lakhs towards provision for gratuity was *not allowable* u/s 40A(7). However, in the computation of income, the said amount was not disallowed. The AO also overlooked the item and omitted to make a disallowance. Subsequently, he reopened the assessment u/s 147, disallowed the expenditure and levied penalty u/s 271(1)(c). The assessee explained that the omission to make a disallowance had occurred because it had a separate accounts department and there was "*some confusion*" and that the return was prepared by a *non-CA* and was signed a director who proceeded on the basis that the return was correctly drawn up. The CIT (A), Tribunal and High Court affirmed the levy of penalty on the ground that since the assessee was a well known and reputed Chartered Accountant firm and a tax consultant, it was not expected to make such a mistake and that there had been a failure to discharge the strict liability to furnish true and correct particulars of income.

On appeal, Supreme Court deleted the penalty by observing that though the assessee is undoubtedly a reputed firm and has great expertise available with it, it is possible that even the assessee could make a "silly" mistake. All that happened in the present case is that through a bona fide and inadvertent error failed to add the provision for gratuity to its total income. This can only be described as a human error which we are all prone to make. The calibre and expertise of the assessee has little or nothing to do with the inadvertent error. Consequently, given the peculiar facts of this case, the imposition of penalty on the assessee is not justified.

### ❖ Section 271(1)(c) : CA's opinion will not make the claim genuine [Chadha Sugars (p) Ltd vs. ACIT – ITAT Delhi)

Assessee obtained the opinion of a Chartered Accountant on whether expenditure on fees to the Registrar of Companies for increasing authorized capital can be claimed as revenue expenditure. The CA relied on judicial precedents and opined that the issue was debatable and a claim could be made on the basis that if two views were possible, the view in favour of the assessee should be taken. The assessee claimed deduction and even the tax auditor did not qualify the same. The claim of the assessee was rejected by AO and levied penalty u/s 271(1)(c), which was confirmed by CIT (A). ITAT had confirmed the penalty u/s 271(1)(c) by stating that opinion of CA's does not make claim bonafide one.

### ❖ Section 271(1)(c) : Mistake / wrong advise of CA does not attract penalty [CIT vs. Somany Evergreen – Bombay H HC]

The assessee filed a return of income in which it committed two mistakes (i) Depreciation was claimed at ₹ 1.70 crores instead of at ₹ 1.05 crores due to a mistake in calculation, (ii) the assessee sold its garment manufacturing machine and suffered a loss of ₹ 21.68 lakhs thereon. Though the loss was on capital account, it was claimed as a revenue deduction. In the course of the assessment proceedings, the assessee realized its mistake and withdrew the claim for excess depreciation and the claim for the loss. The AO levied penalty u/s 271(1)(c) on both issues which was confirmed by the CIT(A). However, the Tribunal held that both mistakes had occurred due to a mistake/ wrong advice given by the Chartered Accountant and that there was a bona fide mistake. It was also held by ITAT that the bonafide of the assessee is established from the fact that the assessee accepted the mistake and did not prefer any appeal against the order of the AO. Departmental Appeal in HC was dismissed as the bonafide mistake on the part of the assessee was not disputed by the department.

### ❖ Section 271(1)(c) : No Penalty for disallowance u/s 40(a)(ia) [ACIT vs. Mazda Ltd Ahmadabad ITAT]

AO had made certain disallowance u/s 40(a)(ia) for non deduction of Tax at source. Further, penalty u/s 271(1)(c) had been imposed. ITAT held Penalty u/s 271(1)(c) cannot be imposed on additions made by making a disallowance u/s 40(a)(ia) for non deduction of TDS.

### ❖ Section 271(1)(c) : No penalty for impact of 50C [CIT vs. Madan Theaters – Calcutta HC]

The assessee sold property for a consideration of ₹ 2.50 crore. However, for the purpose of stamp duty, the property was valued at ₹ 5.19 crore and stamp duty was paid on that value. The assessee offered capital gains on the basis that the sale consideration was ₹ 2.50 crore. The AO invoked s. 50C and held that the sale consideration had to be taken at ₹ 5.19 crore and capital gains computed on that basis. The AO imposed penalty u/s 271(1)(c) which was deleted by the appellate authorities. Department went in appeal in HC but fails as the court had confirmed the deletion of penalty by stating that it is only on the basis of the deemed consideration that the proceedings u/s 271(1)(c) started. The department has failed to produce any iota of evidence that the assessee actually received any money more than the amount shown to have been received by him.

### ❖ Section 271(1)(c) : Status of Quantum appeal [CIT vs. Liquid Investment & Trading Co – Delhi HC]

The assessee's appeal against the disallowance made u/s 14A was admitted by the High Court. The AO levied penalty u/s 271(1)(c) in respect of the said disallowance. The CIT(A) and the ITAT set aside the penalty levied u/s 271(1)(c) on the ground that the issue of deduction u/s 14A was a debatable issue. On appeal by the

Department, High Court Held that against the quantum assessment where under deduction u/s 14A of the Act was prescribed to the assessee, the assessee has preferred an appeal in this Court u/s 260A of the Act which has also been admitted and substantial question of law framed. This itself shows that the issue is debatable for which no penalty can be imposed.

❖ Section 271(1)(c) : Surrender of Income [CIT vs. MAK data Ltd. – Delhi HC]

A survey u/s 133A was conducted on the assessee's premises in the course of which certain documents belonged to certain entities who had applied for shares in the assessee company were found. The AO called upon the assessee to prove the nature and source of the monies received as share capital, the creditworthiness of the applicants and the genuineness of the transactions. The assessee offered ₹ 40.74 lakhs as income from other sources "*to avoid litigation and to buy peace*". It was made clear that in making the surrender, there was no admission of concealment. The AO completed the assessment by adding the said sum and levied penalty u/s 271(1)(c) for furnishing inaccurate particulars of income u/s 271(1)(c). Matter travelled to High Court. Hon'ble High Court had confirmed the penalty by stating that in the absence of any explanation in respect of the surrendered income, the first part of clause (A) of Explanation 1 to s. 271(1)(c) is attracted because the nature and source of the amount surrendered are facts material to the computation of total income. The absence of any explanation regarding the receipt of the money, which is in the exclusive knowledge of the assessee leads to an adverse inference against the assessee and is statutorily considered as amounting to concealment of income under the first part of clause (A) of the Explanation to s. 271(1)(c) and penalty has to be levied.

***Note: For Full texts of the decisions / citations as well as any queries, Feel free to contact us at "bikashbogi@yahoo.co.in" / or www.sbrca.in / or https://www.facebook.com/sbrca***

BEST OF LUCK

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