1

BASIC CONCEPTS

1. **What is the nature of liquidated damages received by a company from the supplier of plant for failure to supply machinery to the company within the stipulated time – a capital receipt or a revenue receipt?**

   CIT v. Saurashtra Cement Ltd. (2010) 325 ITR 422 (SC)

   The assessee, a cement manufacturing company, entered into an agreement with a supplier for purchase of additional cement plant. One of the conditions in the agreement was that if the supplier failed to supply the machinery within the stipulated time, the assessee would be compensated at 5% of the price of the respective portion of the machinery without proof of actual loss. The assessee received Rs.8.50 lakhs from the supplier by way of liquidated damages on account of his failure to supply the machinery within the stipulated time. The Department assessed the amount of liquidated damages to income-tax. However, the Appellate Tribunal held that the amount was a capital receipt and the High Court concurred with this view.

   The Apex Court affirmed the decision of the High Court holding that **the damages were directly and intimately linked with the procurement of a capital asset i.e., the cement plant, which lead to delay in coming into existence of the profit-making apparatus. It was not a receipt in the course of profit earning process.** Therefore, the amount received by the assessee towards compensation for sterilization of the profit earning source, not in the ordinary course of business, is a capital receipt in the hands of the assessee.

2. **What is the nature of incentive received under the scheme formulated by the Central Government for recoupment of capital employed and repayment of loans taken for setting up/expansion of a sugar factory – Capital or Revenue?**

   CIT v. Kisan Sahkari Chini Mills Ltd. (2010) 328 ITR 27 (All.)

   The assessee, engaged in the business of manufacture and sale of sugar, claimed that the incentive received under the Scheme formulated by the Central Government for recoupment of capital employed and repayment of loans taken from a financial institution for setting up/ expansion of a new sugar factory is a capital receipt. The Assessing Officer, however, treated it as a revenue receipt.

On this issue, the High Court followed the ruling of the Apex Court in *CIT v. Ponni Sugars and Chemicals Ltd. (2008) 306 ITR 392*, wherein a similar scheme was under consideration. In that case, the Apex Court had held that the main eligibility condition for the scheme was that the incentive had to be utilized for the repayment of loans taken by the assessee to set up a new unit or substantial expansion of an existing unit. The subsidy receipt by the assessee was, therefore, not in the course of a trade and hence, was of capital nature.

3. **Where the hotel industry was established based on subsidy announced by the State Government, can such subsidy be treated as a revenue receipt solely due to the reason that the same was received by the assessee after completion of the hotel projects and commencement of the business?**

CIT v. Udupi Builders P. Ltd. (2009) 319 ITR 440 (Kar.)

The assessee-company treated the amount of subsidy received from the State Government, as a capital investment. The subsidy was granted by the State Government to encourage the hotel industry. The Assessing Officer opined that the same was a revenue receipt. The Commissioner (Appeals) held that the subsidy had been granted to the assessee by the State Government as per the package of incentives and concessions and that it was towards investment and not a revenue receipt. The Tribunal confirmed the order passed by the Commissioner (Appeals).

The Revenue filed an appeal to the High Court contending that since the subsidy is received by the assessee after completion of the hotel project and commencing of the business, such receipt has to be taken as a revenue receipt and not a capital investment.

The High Court held that the hotel industry was established based on the subsidy announced by the State Government to encourage tourism and the State Government was in the habit of releasing the subsidy amount depending upon the budgetary allocation in each year. In several cases, the State Government had released the subsidy amount even after ten years of the commencement of the project. Therefore, the subsidy received has to be treated as a capital receipt and would not be liable to tax.

4. **Would the provisions of deemed dividend under section 2(22)(e) be attracted in respect of financial transactions entered into in the normal course of business?**

CIT v. Ambassador Travels (P) Ltd. (2009) 318 ITR 376 (Del.)

Relevant section: 2(22)(e)

Under section 2(22)(e), loans and advances made out of accumulated profits of a company in which public are not substantially interested to a beneficial owner of shares holding not less than 10% of the voting power or to a concern in which such shareholder has substantial interest is deemed as dividend. However, **this provision would not apply in the case of advance made in the course of the assessee's business as a trading transaction.**

The assessee, a travel agency, has regular business dealings with two concerns in the tourism industry dealing with holiday resorts. The High Court observed that the assessee was involved in booking of resorts for the customers of these companies and entered into normal business transactions as a part of its day-to-day business activities. The High Court held that such financial transactions cannot under any circumstances be treated as loans or advances received by the assessee from these concerns for the purpose of application of section 2(22)(e).

2

INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME

1. **Can exemption under section 10(10C) be availed by a retiring employee of Reserve Bank of India opting for the Optional Early Retirement Scheme?**

   Chandra Ranganathan v. CIT (2010) 326 ITR 49 (SC)

   Relevant section : 10(10C)

   On this issue, the Supreme Court held that the amounts received by employees retiring from the Reserve Bank of India opting for the Optional Early Retirement Scheme are eligible for exemption under section 10(10C).

2. **Would the provisions of section 14A get attracted to disallow set-off of loss on sale of units of a mutual fund (short-term capital loss), income from which is exempt under section 10(35)? Can such loss be disallowed by treating the said transaction as a sham since the assessee was getting tax-free dividend and at the same time claiming loss on sale of the units?**

   CIT v. Walfort Share and Stock Brokers (P) Ltd. (2010) 326 ITR 1

   Relevant sections : 10(35), 14A & 94(7)

   The assessee earned income, mainly from share trading and brokerage. It purchased some units of a mutual fund before the record date, as a result of which it became entitled to receive dividend on the units. As a result of declaration of dividend, the value of the unit reduced and the assessee sold all the units within 3 days at a loss. The assessee claimed exemption of dividend income and also set-off the short-term capital loss incurred on sale of the units. The Department, however, contended that the loss on purchasing the cum-dividend units and selling the ex-dividend units will be an expenditure attributable towards earning tax free dividend income, which is not allowable under section 14A. Therefore, the Department disallowed the set-off claimed.

   The Apex Court held that the assessee had received income which was exempt under section 10(35) [erstwhile section 10(33)] and there has been a sale of units, which resulted in a short-term capital loss. The assessee had taken advantage of the provisions of law and earned tax free income, which is not an abuse of law. Even if the transaction was pre-planned, it does not impeach the genuineness of the transaction. The provisions of section 94(7) relating to dividend stripping will apply to this case and not section 14A. In such a case, loss to the extent of dividend income will be ignored and not the entire loss. Losses over and above the dividend received would be allowed to be set-off, which makes it clear that the dividend stripping transaction is not a sham or bogus transaction.

Note – *In this case, it was observed that section 14A and 94(7) operate in two different fields. Section 14A would apply to cases where the assessee incurs expenditure to earn tax-free income. This section was introduced to apportion expenditure between taxable and non-taxable income and disallow the portion of expenditure incurred to earn non-taxable income. The basic principle of section 14A is to tax net income i.e., gross income less expenditure. However, section 94(7) would be attracted where there is an acquisition of securities or unit and the loss arises subsequently at the time of sale of such securities or unit, after receipt of exempt income. Therefore, section 14A comes into play when there is a claim for deduction of an expenditure, whereas section 94(7) would apply when there is a claim for allowance of loss.*

3

INCOME FROM HOUSE PROPERTY

1. Can notional interest on interest free deposit received by an assessee in respect of a shop let out on rent be brought to tax as "Business income" or "Income from house property"?

CIT v. Asian Hotels Ltd. (2010) 323 ITR 0490 (Del.)

The assessee had received interest free deposit in respect of shops given on rent. The Assessing Officer added to the assessee's income notional interest on the interest free deposit at the rate of 18 per cent simple interest per annum on the ground that by accepting the interest free deposit, a benefit had accrued to the assessee which was chargeable to tax under section 28(iv).

The High Court held that section 28(iv) is concerned with business income and brings to tax the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession. Section 28(iv) can be invoked only where the benefit or amenity or perquisite is other than cash. In the instant case, the Assessing Officer has determined the monetary value of the benefit stated to have accrued to the assessee by adding a sum that constituted 18 per cent simple interest on the deposit. Hence, section 28(iv) is not applicable.

Section 23(1)(a) deals with the determination of the annual letting value of such property for computing the income from house property. It provides that the annual letting value is deemed to be the sum for which the property might reasonably be expected to be let from year to year. This contemplates the possible rent that the property might fetch and certainly not the interest on fixed deposit that may be placed by the tenant with the landlord in connection with the letting out of such property.

Thus, the notional interest is not assessable either as business income or as income from house property.

4

PROFITS AND GAINS OF BUSINESS OR PROFESSION

1. Would beneficial ownership of assets suffice for claim of depreciation on such assets?

CIT v. Smt. A. Sivakami and Another (2010) 322 ITR 64

Relevant section: 32(1)

The assessee, running a proprietary concern, claimed depreciation on three buses, even though she was not the registered owner of the same. However, in order to establish that she was the beneficial owner, she furnished documents relating to loans obtained for the purchase of buses, repayment of such loans out of collections from the buses, road tax and insurance paid by her. She had also obtained an undertaking from the persons who hold the legal title to the vehicles as well as the permits, for plying buses in the name of her proprietary concern. Further, in the income and expenditure account of the proprietary concern, the entire collections and expenditure (by way of diesel, driver's salary, spares, R.T.O. tax etc.) from the buses was shown. The buses in dispute were also shown as assets in the balance sheet of the proprietary concern.

The assessee claimed depreciation on these buses. The Assessing Officer rejected the claim of the assessee on the ground that the assessee was not the owner of the three buses and the basic condition under section 32(1) to claim depreciation is that the assessee should be the owner of the asset. The Assessing Officer was of the view that mere admission of the income cannot *per se* permit the assessee to claim depreciation.

The High Court observed that in the context of the Income-tax Act, 1961, having regard to the ground realities and further having regard to the object of the Act i.e., to tax the income, the owner is a person who is entitled to receive income from the property in his own right. The Supreme Court, in *CIT v. Podar Cement P Ltd. (1997) 226 ITR 625*, observed that the owner need not necessarily be the lawful owner entitled to pass on the title of the property to another. Since, in this case, the assessee has made available all the documents relating to the business and also established before the authorities that she is the beneficial owner, she is entitled to claim depreciation even though she is not the legal owner of the buses.

2. **Can an assessee manufacturing textile goods claim additional depreciation under section 32(1)(iia) on setting up of a windmill?**

CIT v. VTM Limited (2009) 319 ITR 336 (Mad.)

Relevant section: 32(1)(iia)

The assessee is a company engaged in the business of manufacture of textile goods. It claimed additional depreciation on the setting up of wind mills for generation of power. The Revenue contended that the setting up of a windmill for generation of power had absolutely no connection with the business of the company i.e. for the manufacture of textile goods, and, therefore, the company was not entitled to claim the additional depreciation under section 32(1)(iia).

The High Court held that in order to claim the benefit of section 32(1)(iia), what is required to be satisfied is that the new machinery or plant should have been acquired and installed after March 31, 2002 *(March, 31, 2005, as per the amended provisions)*, by an assessee, who was already engaged in the business of manufacture or production of any article or thing. The provision does not state that the setting up of a new machinery or plant should have any operational connectivity to the article or thing that is already being manufactured by the assessee. Hence, it was held that the assessee is entitled to additional depreciation on setting up of a wind mill.

3. **Are expenses incurred on purchase of software components in the nature of capital expenditure or revenue expenditure?**

CIT v. Sundaram Clayton Ltd. (2010) 321 ITR 69 (Mad.)

Relevant section: 37(1)

The Delhi High Court observed that this issue is covered by its decision in the case of *CIT v. Southern Roadways Ltd. (2007) 288 ITR 15*. In that case, it was held that the upgradation of computers by changing certain parts thereby enhancing the configuration of the computers for improving their efficiency, but without making any structural alterations is not a change of an enduring nature.

Therefore, applying the ratio of the above decision in this case, the Madras High Court held that the expenditure incurred on purchase of software components has to be treated as a revenue expenditure.

4. **Can the expenditure incurred for purchase of second hand medical equipment for use as spare parts for existing equipment be claimed as revenue expenditure?**

Dr. Aswath N. Rao v. ACIT (2010) 326 ITR 188 (Karn)

Relevant section: 37(1)

The assessee, a cardiologist, following cash system of accounting claimed deduction of expenditure incurred for purchase of second hand medical equipment from USA on 31st March of the relevant previous year. However, the said equipment reached India only in August (i.e., the next previous year). The second-hand machinery was purchased for the purpose of dismantling the same and using its parts as spare parts to the existing machinery.

The assessee contended that as the existing machines were old, they went out of order quite often, and spare parts were not readily available in India. Therefore, as and when he visited USA on professional work, he purchased second hand machinery which he brought to India and used the spare parts after dismantling the machinery. Therefore, he claimed deduction of expenditure incurred for purchase of such machinery.

The Department rejected the claim of the assessee on the ground that such expenditure was a capital expenditure. Further, since the machines had reached India only in the next year, any claim for deduction could be considered only in the next year.

On these issues, the High Court held that since the second hand machinery purchased by the assessee is for use as spare parts for the existing old machinery, the same had to be allowed as revenue expenditure. Since the entire sale consideration was paid on 31st March of the relevant previous year and the machinery was also dispatched by the vendor from USA, the sale transaction was complete on that date. The title to the goods had passed on to him on that date and he became the owner of the machinery even though the goods reached India only in August next year. Therefore, the assessee was eligible to claim deduction of expenditure in the relevant previous year ended 31st March.

***Note** – In this case, since the machinery was purchased with the intention of using its parts as spare parts for existing machinery, the same has been allowed as revenue expenditure and the date of its purchase is material for determining the year in which the expenditure is allowable as deduction. However, if the intention was to use such machinery on a standalone basis, then the expenditure would be treated as a capital expenditure and the date on which it is put to use would determine its eligibility for depreciation in that year as also the quantum of depreciation (100% or 50%, depending on whether it is put to use for more than 180 days or less in that year).*

5. Is the amount paid by a construction company as regularization fee for violating building bye-laws allowable as deduction?

Millennia Developers (P) Ltd. v. DCIT (2010) 322 ITR 401 (Karn.)

Relevant section: 37(1)

The assessee, a private limited company carrying on business activity as a developer and builder, claimed the amount paid by way of regularization fee for the deviations made while constructing a structure and for violating the plan sanctioned in terms of the building bye-laws, approved by the municipal authorities as per the provisions of the Karnataka Municipal Corporations Act, 1976. The assessee's claim was disallowed by the Assessing Officer and the disallowance was confirmed by the Tribunal.

The High Court observed that as per the provisions of the Karnataka Municipal Corporations Act, 1976, the amount paid to compound an offence is obviously a penalty and hence, does not qualify for deduction under section 37. Merely describing the payment as a compounding fee would not alter the character of the payment.

Note – *In this case, it is the actual character of the payment and not its nomenclature that has determined the disallowance of such expenditure as deduction. The principle of substance over form has been applied in disallowing an expenditure in the nature of penalty, though the same has been described as regularization fee/compounding fee.*

6. Can expenditure incurred on alteration of a dam to ensure adequate supply of water for the smelter plant owned by the assessee be allowed as revenue expenditure?

CIT v. Hindustan Zinc Ltd. (2010) 322 ITR 478 (Raj.)

Relevant section: 37(1)

The assessee company owned a super smelter plant which requires large quantity of water for its day-to-day operation, in the absence of which it would not be able to function. The assessee, therefore, incurred expenditure for alteration of the dam (constructed by the State Government) to ensure sharing of the water with the State Government without having any right or ownership in the dam or water. The assessee's share of water is also determined by the State Government. The assessee claimed the expenditure as deduction under section 37, which was disallowed by the Assessing Officer on the ground that it was of capital nature. The Tribunal, however, was of the view that since the object and effect of the expenditure incurred by the assessee is to facilitate its trade operation and enable the management to conduct business more efficiently and profitably, the expenditure is revenue in nature and hence, allowable as deduction.

The High Court observed that the expenditure incurred by the assessee for commercial expediency relates to carrying on of business. The expenditure is of such nature which a prudent businessman may incur for the purpose of his business. The operational expenses incurred by the assessee solely intended for the furtherance of the enterprise can by no means be treated as expenditure of capital nature.

7. **Is admission fee paid by a company towards corporate membership of a club allowable as a revenue expenditure?**

   CIT v. Samtel Color Ltd. (2010) 326 ITR 425 (Delhi)

   Relevant section: 37(1)

   The issue in this case relates to the admissibility of corporate membership fee paid to a club (viz., Indian Habitat Centre and Sports and Cultural Club).

   The Assessing Officer disallowed the same on the ground that the expenditure resulted in benefit of an enduring nature hence, was on capital account.

   The Commissioner (Appeals) opined that though the membership of the club provided the assessee a benefit which fulfills the business purpose test, it also resulted in benefits to directors and executives in their personal capacity. Accordingly, it directed the Assessing Officer to disallow 20% of the expenditure and allow the balance amount as revenue expenditure on the ground that the entire expenditure was not incurred for business purposes.

   The Tribunal, however, observed that corporate membership itself was meant for the benefit of the company and not for any particular employee as it was the company which had a right to nominate and substitute an employee at any point of time. It further observed that since membership allowed the employees to interact with its customers, the expenses were for business purposes and, therefore, there was no reason to disallow the expenditure either wholly or in part.

   The High Court upheld the decision of the Tribunal observing that the expenditure incurred towards admission fee for corporate membership was for the benefit of the company. The "business purpose" basis adopted for eligibility of expenditure under section 37 was the right approach and this was further strengthened by the Tribunal's findings that it was the assessee-company which nominated the employees who would be eligible to avail the benefit of the corporate membership. The High Court further observed that an expenditure which gives enduring benefit is by itself not conclusive as regards the nature of the expenditure. The true test for qualification of expenditure under section 37 is that it should be incurred wholly and exclusively for the purposes of business and the expenditure should not be towards capital account. **In the instant case, the admission fee paid towards corporate membership is an expenditure incurred wholly and exclusively for the purposes of business and not towards capital account as it only facilitates smooth and efficient running of a business enterprise and does not add to the profit-earning apparatus of the business enterprise.**

8. **Can payment to police personnel and gundas to keep away from the cinema theatres run by the assessee be allowed as deduction?**

CIT v. Neelavathi & Others (2010) 322 ITR 643 (Karn)

Relevant section: 37(1)

The assessee running cinema theatres claimed deduction of the sum paid to the local police and local gundas towards maintenance of the theatre. The same was disallowed by the Assessing Officer.

On this issue, the High Court observed that if any payment is made towards the security of the business of the assessee, such amount is allowable as deduction, as the amount is spent for maintenance of peace and law and order in the business premises of the assessee i.e., cinema theatres in this case. However, the amount claimed by the assessee, in the instant case, was towards payment made to the police and gundas. **Any payment made to the police illegally amounts to bribe and such illegal gratification cannot be considered as an allowable deduction. Similarly, any payment to a gunda as a precautionary measure so that he shall not cause any disturbance in the theatre run by the assessee is an illegal payment for which no deduction is allowable under the Act.**

If the assessee had incurred expenditure for the purpose of security, the same would have been allowed as deduction. However, in the instant case, since the payment has been made to the police and gundas to keep them away from the business premises, such a payment is illegal and hence, not allowable as deduction.

9. **Can the amount incurred by the assessee for replacing the old mono sound system in its cinema theatre with a new Dolby stereo system be treated as revenue expenditure?**

CIT v. Sagar Talkies (2010) 325 ITR 133 (Karn.)

On this issue, the High Court observed held that the assessee had provided certain amenities to its customers by replacing the old system with a better sound system and by introducing such system, the assessee had not increased its income in any way. The assessee installed dolby stereo system instead of repairing the existing old stereo system. **This had not benefited the assessee in any way with regard to the total income since there was no change in the seating capacity of the theatre or increase in the tariff rate of the ticket. In such a case, the expenditure on such change of sound system could not be considered capital in nature.**

10. **For claiming deduction of bad debts, is it necessary for the assessee to establish that the debt had, in fact, become irrecoverable?**

T.R.F. Ltd. v. CIT (2010) 323 ITR 397 (SC)

Relevant section : 36(1)(vii)

On this issue, the Apex Court held that in order to obtain deduction in relation to bad debts under section 36(1)(vii), it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable. It is enough if the bad debts is written off as irrecoverable in the accounts of the assessee for the relevant previous year.

Note *– Prior to 1st April, 1989, the condition to be satisfied for claim of deduction under section 36(1)(vii) was that the debt should have been established to have become a bad debt in the relevant previous year. However, w.e.f. 1st April, 1989, the condition for claim of deduction under section 36(1)(vii) is that the bad debts should be written off as irrecoverable in the accounts of the assessee for the previous year. Therefore, there is presently no requirement to prove that the debt has actually become irrecoverable.*

11. **Is the expenditure incurred on payment of retrenchment compensation and interest on money borrowed for payment of retrenchment compensation on closure of one of the textile manufacturing units of the assessee-company revenue in nature?**

CIT v. DCM Ltd. (2010) 320 ITR 307 (Delhi)

The assessee-company had four textile units, out of which one unit had to be closed down as it was located in a non-conforming area, while the other three units continued to carry on business. The company claimed deduction of retrenchment compensation paid to employees of the unit which had been closed down and interest on money borrowed for payment of retrenchment compensation. The Revenue contended that the textile unit was a separate business maintaining separate books of account and engaging separate workers, and hence, with the closure of the unit, the assessee should not be allowed deduction of the aforementioned expenses.

The issue under consideration was whether closure of one textile mill unit would amount to closure of the business as contended by the Revenue. The Tribunal observed that there was no closure of business since the textile mill unit was only a part of the textile manufacturing operations, which continued even after closure of the textile mill unit, as the assessee-company continued in the business of manufacturing of textiles in the remaining three units. The assessee prepared a consolidated profit and loss account and balance sheet of all its manufacturing units taken together; the control and management of the assessee was centralized in the head office and also all important policy decisions were taken at the head office. Also, the head office provided funds required for various units and there were common marketing facilities for all the textile units.

The Tribunal applied the tests laid down by the Apex Court in *CIT v. Prithvi Insurance Co. (1967) 63 ITR 632* and arrived at the conclusion that there was interconnection, interlacing and unity of control and management, common decision making mechanism and use of common funds in respect of all the four units.

The High Court concurred with these findings of the Tribunal and accordingly, held that deduction was allowable in respect of expenditure on payment of retrenchment compensation and interest on money borrowed for payment of retrenchment compensation.

Note *– In this case, the payment of compensation to workers on closure of a textile mill unit is treated as a revenue expenditure since after closure of the unit, the remaining business continued and there was inter-connection in the functioning of the different units. Therefore, it follows that if compensation is paid to workers on closure of the entire business, the same would be a capital expenditure.*

12. Can the expenditure incurred by the assessee on techno-economic feasibility report for the manufacture of a new product be eligible for deduction under section 35D?

CIT v. Tamil Nadu Road Development Co. Ltd. (2009) 316 ITR 380 (Mad.)

Relevant section: 35D

The assessee-company engaged in the business of implementation of the industrial policy and creation of infrastructure facilities in the State of Tamil Nadu on a commercial framework claimed deduction in respect of the expenditure incurred on account of techno-economic feasibility report for the manufacture of new products. The Assessing Officer disallowed the deduction treating it as a capital expenditure. The Commissioner (Appeals) allowed the assessee's claim on the finding that the expenses incurred were covered under section 35D of the Income-tax Act, 1961, as the expenses were incurred to find out new ideas by conducting test studies and pilot studies for improving the existing business and, therefore, could not be treated as capital expenditure. This was confirmed by the Tribunal and the High Court.

13. Is the expenditure incurred by the assessee towards commitment charges for issuing debentures deductible as business expenditure, where the borrowing is for the purposes of meeting the working capital needs of the existing business?

CIT v. Mihir Textiles Ltd. (2009) 316 ITR 403 (Guj.)

Relevant section: 36(1)

On this issue, the High Court observed that money borrowed by issue of debentures is in the nature of a loan and cannot assume the characteristic of investment. Therefore, the expenditure in the nature of commitment charges at the time of issuing such debentures would be on revenue account only. Hence, the commitment charges were allowable as deduction under section 36(1).

Note - In this case, the Gujarat High Court has followed the decision of the Supreme Court in *Deputy CIT v. Core Health Care Ltd. [2008] 298 ITR 194*.

14. Can the reimbursement of expenses towards customs duty be included for computing profits under section 44BB?

Director of Income Tax (International Taxation) v. Schlumberger Asia Services Ltd. (2009) 317 ITR 156 (Uttrakhand)

Relevant section: 44BB

In this case, the Assessing Officer noticed that the assessee, a non-resident company, had not offered for tax under section 44BB, the reimbursement of expenses, which include customs duty also. The Assessing Officer brought to tax these sums. The Commissioner (Appeals) partly allowed the appeal holding that the customs duty paid in importing the equipment for rendering services does not form part of the amount taxable under section 44BB. It was observed that for import of machinery or equipment, liability to pay the customs duty was on ONGC, who had hired the services of the assessee-company in contract and there could not be any element of profit in reimbursement of the customs duty paid by the assessee.

The High Court held that reimbursement of expenses towards the customs duty paid by the assessee, being statutory in nature, could not form part of amount for the purposes of deemed profits, unlike the other amounts received towards reimbursement. Therefore, same would not form part of the amount taxable under section 44BB.

5

CAPITAL GAINS

1. What is the cost of acquisition of additional share of property obtained on partition of HUF?

Lalitaben Hariprasad v. CIT (2010) 320 ITR 698 (Guj)

A residential property was divided as part and parcel of total partition of a HUF comprising of four members i.e., father, mother and two sons. The father and mother took one-half share each of the property. The father made payment of Rs.14,33,000 to one son for acquisition of one-fourth share of the property. The mother made similar payment to the other son for the same purpose. The father and mother claimed Rs.14,33,000 each as cost of acquisition of one-fourth share of the property from their sons. This claim was disallowed by the Assessing Officer holding that since the property was of the HUF, the only cost of acquisition which could be allowed was under the provisions of section 49 i.e., the cost of acquisition in the hands of the original owner (namely, the HUF) from whom the property had been received on partition.

On this issue, the High Court observed that the cost of acquisition of one-fourth share of the house property, being the proportion which each member is entitled to, would be governed by the provisions of section 49(1)(i) i.e., the cost of acquisition to the HUF would be the cost to the member for computation of capital gains on subsequent sale of the property. However, in respect of the additional share acquired by the members at the time of partition from other members, the amount of Rs.14,33,000 paid would be the cost of acquisition in each case. Therefore, Rs.14,33,000 can be claimed as additional cost of acquisition of the property for computation of capital gains in the hands of each of the assessees on subsequent sale of their share of the property.

2. What would be the period of holding to determine whether the capital gains on renunciation of right to subscribe for additional shares is short-term or long-term?

Navin Jindal v. ACIT (2010) 320 ITR 708 (SC)

On this issue, the Apex Court observed that the right to subscribe for additional offer of shares on rights basis, on the strength of existing shareholding in a company, comes into existence when the company decides to come out with the rights offer. Prior to that date, the right, though embedded in the original shareholding, remains inchoate. It crystallizes only when the rights offer is announced by the company. Therefore, for determining whether the capital gains on renunciation of right to subscribe for additional shares is short-term or long-term, the period of holding would be from the date on which such right to subscribe for additional shares comes into existence upto the date of renunciation of such right.

3. **Can exemption under section 54EC be denied on account of the bonds being issued after six months of the date of transfer even though the payment for the bonds was made by the assessee within the six month period?**

   Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)

   Relevant section: 54EC

   In this case, the Bombay High Court observed that in order to avail the exemption under section 54EC, the capital gains have to be invested in a long-term specified asset within a period of six months from the date of transfer. Where the assessee has made the payment within the six month period, and the same is reflected in the bank account and a receipt has been issued as on that date, the exemption under section 54EC cannot be denied merely because the bond was issued after the expiry of the six month period or the date of allotment specified therein was after the expiry of the six month period. For the purpose of the provisions of section 54EC, the date of investment by the assessee must be regarded as the date on which payment is made. The High Court, therefore, held that if such payment is within a period of six months from the date of transfer, the assessee would be eligible to claim exemption under section 54EC.

4. **In determining the period of holding of a capital asset received by a partner on dissolution of firm, can the period of holding of the capital asset by the firm be taken into account?**

   P. P. Menon v. CIT (2010) 325 ITR 122 (Ker.)

   Relevant sections : 2(42A) & 49(1)(iii)(b)

   The assessee was a partner in a firm which owned a hospital building and land. The firm was dissolved and the entire assets including the hospital building and land were taken over by the assessee. The assessee sold the hospital building and the land within three days of dissolution. He, however, claimed that the period of holding should be reckoned by including the period when he was a partner of the firm. He contended that since the total period has more than 36 months, the capital gain was to be treated as a long-term capital gain.

The High Court held that the benefit of including the period of holding of the previous owner under section 2(42A) read with section 49(1)(iii)(b) can be availed only if the dissolution of the firm had taken place at any time before April 1, 1987. In this case, the firm was dissolved on April 15, 2001 and therefore the benefit of these sections would not be available to the assessee. Therefore, the period of holding of the asset by the assessee in this case has to be reckoned from the date of dissolution of the firm. Since the assessee sold the property within three days of acquiring the same, the gains have to be treated as short-term capital gain.

5. Can the interest payable by a company on loan availed from its directors for the purchase of an asset be added to the cost of acquisition of the asset while computing long term capital gain, where the resolution to pay interest has been passed after the date of sale?

CIT v. Sri Hariram Hotels P. LTD (2010) 325 ITR 136 (Karn.)

The assessee borrowed loans from some of its directors and purchased an immovable property in order to put up a hotel building. However, the project did not materialize on account of various reasons. Ultimately, the assessee sold the property. While filing the return, it claimed the interest paid to the directors on the loan borrowed from them in order to purchase the property as cost of acquisition for computation of the capital gain. The Assessing Officer disallowed the claim made by the assessee, but the Tribunal allowed it.

The main contention of the Revenue was that it was after the sale of property that a resolution was passed by the company to pay the interest to the Directors, and as such, there was no liability for the company to pay the interest as on the date of sale.

The High Court, dismissing the appeal, held that since the property had been purchased out of the loans borrowed from the directors, any interest paid thereon had to be included while calculating the cost of acquisition of the asset.

Note - *In this case, it has been observed that the date of passing resolution for payment of interest is not relevant since interest generally starts accruing as soon as the loan is taken.*

6. Can the valuation done by any authority of the State Government for the purpose of payment of stamp duty in respect of land or building be taken as actual sale consideration received by the purchaser?

CIT v. Chandni Buchar (2010) 323 ITR 0510 (Pun.& Har.)

The Assessing Officer added the difference between purchase price disclosed in the sale deed and purchase price of the property adopted for the purpose of paying the stamp duty to the total income of the assessee as income from unexplained sources. The Commissioner of Income-tax (Appeals) deleted this addition by holding that section 50C is a deeming provision for the purpose of bringing to tax the difference as capital gain. Further, he also held that in the absence of any legally acceptable evidence, valuation done for the purpose of section 50C would not represent actual consideration passed on to the seller. The Tribunal also held that valuation done by any State agency for the purpose of stamp duty would not *ipso facto* substitute the actual sale consideration as being passed on to the seller by the purchaser in the absence of any admissible evidence. The Assessing Officer is obliged to bring on record positive evidence indicating the fact that the assessee has paid anything more than the sum disclosed in the purchase deed. In this case, the assessee has discharged the burden of proving the sale consideration as projected in the sale deed by producing the original bank statement.

The High Court, therefore, held that the view taken by the Tribunal while accepting the order of the Commissioner of Income-tax (Appeals) does not suffer from any legal infirmity.

7. **Can exemption under section 54B be denied solely on the ground that the new agricultural land purchased is not wholly owned by the assessee, as the assessee's son is a co-owner as per the sale deed?**

CIT v. Gurnam Singh (2010) 327 ITR 278 (P&H)

Relevant section : 54B

The assessee claimed deduction under section 54B in respect of the land purchased by him along with his son out of the sale proceeds of the agricultural land. However, the same was denied by the Assessing Officer on the ground that the land was registered in the name of the assessee's son.

The Tribunal observed that the agricultural land sold belonged to the assessee and the sale proceeds were also used for purchasing agricultural land. The possession of the said land was also taken by the assessee. It is not the case that the sale proceeds were used for other purposes or beyond the stipulated period. The only objection raised by the Revenue was that the land was registered in the name of his son. Therefore, it cannot be said that the capital gains were in any way misused for any other purpose contrary to the provisions of law.

In this case, the High Court concurred with the Tribunal's view that merely because the assessee's son was shown in the sale deed as co-owner, it did not make any difference. It was not the case of the Revenue that the land in question was exclusively used by the son. Therefore, the assessee was entitled to deduction under section 54B.

6

DEDUCTIONS FROM GROSS TOTAL INCOME

1. **Can the Duty Entitlement Passbook Scheme (DEPB) benefits and Duty Drawback be treated as profit derived from the business of the industrial undertaking to be eligible for deduction under section 80-IB?**

   Liberty India v. CIT (2009) 317 ITR 218 (SC)

   Relevant section: 80-IB

   On this issue, the Supreme Court observed that DEPB / Duty drawback are incentives which flow from the schemes framed by the Central Government or from section 75 of the Customs Act, 1962. Section 80-IB provides for the allowing of deduction in respect of profits and gains derived from eligible business. **However, incentive profits are not profits derived from eligible business under section 80-IB. They belong to the category of ancillary profits of such undertaking.** Profits derived by way of incentives such as DEPB/Duty drawback cannot be credited against the cost of manufacture of goods debited in the profit and loss account and they do not fall within the expression "profits derived from industrial undertaking" under section 80-IB. Hence, Duty drawback receipts and DEPB benefits do not form part of the profits derived from the eligible business for the purpose of the deduction under section 80-IB.

2. **Does the period of exemption under section 80-IB commence from the year of trial production or year of commercial production? Would it make a difference if sale was effected from out of the trial production?**

   CIT v. Nestor Pharmaceuticals Ltd. / Sidwal Refrigerations Ind Ltd. v. DCIT (2010) 322 ITR 631 (Delhi)

   In this case, the assessee had started trial production in March 1998 whereas commercial production started only in April, 1998. Therefore, the assessee claimed deduction under section 80-IB for the assessment years 1999-2000 to 2003-04, whereas the Assessing Officer denied deduction for A.Y.2003-04 on the ground that the five year period would be reckoned from A.Y.1998-99, since the trial production began in March, 1998.

   The Tribunal observed that not only the trial production had started in March 1998 but there was in fact sale of one water cooler and air-conditioner in the month of March 1998. The explanation of the assessee was that this was done to file the registration under the Excise Act and Sales-tax Act.

The High Court observed that with mere trial production, the manufacture for the purpose of marketing the goods had not started which starts only with commercial production, namely, when the final product to the satisfaction of the manufacturer has been brought into existence and is fit for marketing. However, in this case, since the assessee had effected sale in March 1998, it had crossed the stage of trial production and the final saleable product had been manufactured and sold. The quantum of commercial sale and the purpose of sale (namely, to obtain registration of excise / sales-tax) is not material. With the sale of those articles, marketable quality was established. Therefore, the conditions stipulated in section 80-IB were fulfilled with the commercial sale of the two items in that assessment year, and hence the five year period has to be reckoned from A.Y.1998-99.

***Note** – Though this decision was in relation to deduction under section 80-IA, as it stood prior to its substitution by the Finance Act, 1999 w.e.f. 1.4.2000, presently, it is relevant in the context of section 80-IB.*

3. Can freight subsidy arising out of the scheme of Central Government be treated as a "profit derived from the business" for the purposes of section 80-IA?

CIT v. Kiran Enterprises (2010) 327 ITR 520 (HP)

Relevant section: 80-IA

Section 80-IA provides for deduction in respect of profits and gains derived from eligible business. In this case, the Central Government had framed a scheme whereby freight/transport subsidy was provided to industries set up in remote areas where rail facilities were not available and some percentage of the transport expenses incurred to transport raw material/finished goods to or from the factory was subsidized.

The issue under consideration is whether such freight subsidy arising out of the scheme of Central Government can be treated as a "profit derived from the business" for the purposes of section 80-IA.

On appeal, the High Court held that the transport subsidy received by the assessee was not a profit derived from business since it was not an operational profit. The source was not the business of the assessee but the scheme of Central Government. The words "derived from" are narrower in connotation as compared to the words "attributable to". Therefore, the freight subsidy cannot be treated as profits derived from the business for the purposes of section 80-IA.

4. **Whether interest on fixed deposits with a bank and other interest income qualify as income for deduction under section 80-IA?**

CIT v. Jagdishprasad M. Joshi (2009) 318 ITR 420 (Bom.)

Relevant section: 80-IA

On this issue, the High Court concurred with the decision of the Tribunal holding that interest income earned by the assessee on fixed deposits with bank and other interest income were in the nature of business income and should be considered as part of business profit for the purpose of granting deduction under section 80-IA.

7

Assessment Of Various Entities

1. **Can transfer fees received by a co-operative housing society from its incoming and outgoing members be exempt on the ground of principle of mutuality?**

   Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47 (Bom)

   On this issue, the High Court observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class. The High Court, therefore, held that **transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.**

   Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

2. **Can an AOP be constituted by inheritance under will?**

   CIT v. Laxmi Pd. and Sons (2009) 316 ITR 330 (All.)

   An association of persons is a voluntary association of two or more persons who join together for a particular purpose which may not necessarily be with the object of deriving of income or profits or gains. The association should be voluntary on the part of the persons forming the same irrespective of the object of associating. Forced association of persons on account of inheriting joint property under a will or such other circumstances not being voluntary would not constitute such joint legatees as "association of persons" for the purpose of section 2(31).

3. **Is it necessary that there be a written agreement between persons to prove the status of association of persons, in a case where the accounts seized from the persons prove joint investments and sharing of profits in business?**

   CIT v. T. George and M. Syed Alavi (2009) 316 ITR 333 (Ker.)

   During the search conducted at the residential premises of two assessees it was found that the two persons were engaged in contract work for slaughter tapping and sale of rubber trees. The assessments were based on entries in the seized records and available evidence including statements recorded from the assessees. When a notice under section 147 was issued for taxing income escaping assessments in the hands of the association of persons constituting both the assessees, both of them filed individual returns denying the existence of an association of persons. The Tribunal held that there was nothing to indicate the intention of the members of the association of persons to carry on business together and no written agreement for slaughter tapping for one estate was recovered by the Department.

   The High Court observed that the accounts seized from both members of association of persons were mutually complementary and proved joint investments in slaughter tapping and receipt on sale of rubber latex and timber. The assessees had admitted that slaughter tapping of one estate was undertaken by them together as association of persons. Failure on the part of the Department to recover a written agreement in respect of the other estate would not affect the validity of the assessment because the accounts were seized from both the assessees and complementary to each other conclusively establishing that slaughter tapping was done by the assessees together in this estate. The accounts seized from the assessees proved that both undertook business together and shared the profit.

   The High Court held that the status of association of persons need not be proved through an agreement. The business carried on by the members together was proved through accounts recovered on search, which justifies the assessment of the assessees in that status.

4. **Can long-term capital gain exempted by virtue of erstwhile section 54E be included in the book profit computed under erstwhile section 115J?**

   N. J. Jose and Co. (P.) Ltd. v. ACIT (2010) 321 ITR 0132 (Ker.)

   The assessee claimed exemption under section 54E on the income from long-term capital gains by depositing amounts in specified assets in terms of the said provision. In the computation of book profit under section 115J, the assessee claimed exclusion of capital gains because of exemption available on it by virtue of section 54E. The Assessing Officer reckoned the book profits including long-term capital gains for the purpose of assessment under section 115J.

The High Court held that once the Assessing Officer found that total income as computed under the provisions of the Act was less than 30 per cent of the book profit, he had to make the assessment under section 115J which does not provide for any deduction in terms of section 54E. As long as long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956, capital gains cannot be excluded unless provided under the Explanation to section 115J(1A).

Note – *It may be noted that the rationale of this decision would apply even where minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18% of book profits. If an assessee has claimed exemption under section 54EC by investing in bonds of NHAI/ RECL, within the prescribed time, the long term capital gains so exempt would be taken into account for computing book profits under section 115JB for levy of minimum alternate tax (MAT), since Explanation 1 to section 115JB does not provide for such deduction. Further, it may be noted that even the long term capital gain exempt under section 10(38) is included for computation of book profit under section 115JB.*

5. In a case where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, would the assessee-firm be entitled to deduction in respect of remuneration paid to partners?

CIT v. Anil Hardware Store (2010) 323 ITR 0368 (HP)

The partnership deed of the assessee firm provided that in case the book profits of the firm are up to Rs. 75,000, then the partners would be entitled to remuneration up to Rs. 50,000 or 90 per cent of the book profits, whichever is more. In respect of the next Rs. 75,000, it is 60 per cent and for the balance book profits, it is 40 per cent. Thereafter, it is further clarified that the book profits shall be computed as defined in section 40(b) of the Income-tax Act, 1961, or any other provision of law as may be applicable for the assessment of the partnership firm. It has also been clarified that in case there is any loss in a particular year, the partners shall not be entitled to any remuneration. Clause 7 of the partnership deed laid down that the remuneration payable to the partners should be credited to the respective accounts at the time of closing the accounting year and clause 5 stated that the partners shall be entitled to equal remuneration.

The High Court held that the manner of fixing the remuneration of the partners has been specified in the partnership deed. In a given year, the partners may decide to invest certain amounts of the profits into other venture and receive less remuneration than that which is permissible under the partnership deed, but there is nothing which debars them from claiming the maximum amount of remuneration payable in terms of the partnership deed. The method of remuneration having been laid down, the assessee-firm is entitled to deduct the remuneration paid to the partners under section 40(b)(v) of the Income-tax Act.

Note -

(1) Payment of remuneration to working partners is allowed as deduction if it is authorized by the partnership deed and is subject to the overall ceiling limits specified in section 40(b)(v). The limits for partners' remuneration under section 40(b)(v) has revised upwards and the differential limits for partners' remuneration paid by professional firms and non-professional firms have been removed. On the first Rs.3 lakh of book profit or in case of loss, the limit would be the higher of Rs.1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

(2) The CBDT had, vide Circular No. 739 dated 25-3-1996, clarified that no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.

In this case, since the partnership deed lays down the manner of quantifying such remuneration, the same would be allowed as deduction subject to the limits specified in section 40(b)(v).

8

INCOME-TAX AUTHORITIES

1. **Can extension of the maximum period of retention of 15 days of books of accounts and documents impounded be granted indefinitely?**

   Subha and Prabha Builders P Ltd. vs. ITO (2009) 318 ITR 29 (Karn).

   Relevant section: 131

   On this issue, the High Court observed that section 131 confers on the income-tax authorities the power to impound and retain books of account or other documents for a maximum period of 15 days, after recording of reason for doing so. Extension can be granted with the prior approval of the higher authority for a reasonable period and not for an indefinite period.

   The High Court held that the extension can only be a one time exercise and supplementing the outer limit of 15 days for few more days depending on the circumstances. Since the outer limit is specified in days, the period can be extended only in days and not in months or years.

2. **Does the Central Board of Direct Taxes (CBDT) have the power under section 119(2)(b) to condone the delay in filing return of income?**

   Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441 (Del.)

   Relevant section: 119(2)(b)

   The assessee filed his return of income, which contains a claim for carry forward of losses, a day after the due date. The delay of one day in filing the return of income was due to the fact that the assessee had not reached the Central Revenue Building on time because he was sent from one room to the other and by the time he reached the room where his return was to be accepted, it was already 6.00 p.m. and he was told that the return would not be accepted because the counter had been closed. These circumstances were recorded in the letter along with the return of income delivered to the office of the Deputy Commissioner of Income-tax on the very next day. Later on, the CBDT, by a non-speaking order, rejected the request of the assessee for condonation of delay in filing the return of income under section 119.

The issue under consideration is whether the CBDT has the power under section 119(2)(b) to condone the delay in filing return of income.

The High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown sufficient reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the petitioner. Therefore, the Court held that the delay of one day in filing of the return has to be condoned.

Note *– Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or* ***any other relief under the Act*** *after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of a loss return is relatable to a claim arising under the category of any other relief available under the Act. Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.*

9

ASSESSMENT PROCEDURE

1. **Would the doctrine of merger apply for calculating the period of limitation under section 154(7)?**

   CIT v. Tony Electronics Limited (2010) 320 ITR 378 (Del.)

   Relevant section: 154(7)

   The issue under consideration is whether the time limit of 4 years as per section 154(7) would apply from the date of original assessment order or the order of the Appellate Authority.

   The High Court held that once an appeal against the order passed by an authority is preferred and is decided by the appellate authority, the order of the Assessing Officer merges with the order of the appellate authority. After merger, the order of the original authority ceases to exist and the order of the appellate authority prevails. Thus, the period of limitation of 4 years for the purpose of section 154(7) has to be counted from the date of the order of the Appellate Authority.

   Note - *In this case, the Delhi High Court has followed the decision of the Supreme Court in case of Hind Wire Industries v. CIT (1995) 212 ITR 639.*

2. **Can the Assessing Officer reopen an assessment on the basis of merely a change of opinion?**

   Aventis Pharma Ltd. v. ACIT (2010) 323 ITR 0570 (Bom.)

   Relevant section: 147

   The power to reopen an assessment is conditional on the formation of a reason to believe that income chargeable to tax has escaped assessment. The existence of tangible material is essential to safeguard against an arbitrary exercise of this power.

   In this case, the High Court observed that there was no tangible material before the Assessing Officer to hold that income had escaped assessment within the meaning of section 147 and the reasons recorded for reopening the assessment constituted a mere change of opinion. Therefore, the reassessment was not valid.

10

APPEALS AND REVISION

1. **Does the Appellate Tribunal have the power to recall its own order under section 254(2)?**

   CIT v. Earnest Exports Ltd. (2010) 323 ITR 577 (Bom.)

   Relevant section: 254(2)

   In this case, the High Court observed that the power under section 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters. **Section 254(2) is not a carte blanche for the Tribunal to change its own view by substituting a view which it believes should have been taken in the first instance.** Section 254(2) is not a mandate to unsettle decisions taken after due reflection.

   In this case, the Tribunal, while dealing with the application under section 245(2), virtually reconsidered the entire matter and came to a different conclusion. This amounted to a reappreciation of the correctness of the earlier decision on merits, which is beyond the scope of the power conferred under section 254(2).

2. **Does the High Court have an inherent power under the Income-tax Act, 1961 to review an earlier order passed on merits?**

   Deepak Kumar Garg v. CIT (2010) 327 ITR 448 (MP)

   Relevant section: 260A(7)

   The power to review is not an inherent power and must be conferred by law specifically by express provision or by necessary implication. The appellate jurisdiction of the High Court carries with it statutory limitations under the statute, unlike the extraordinary powers which are enjoyed by the Court under article 226 of the Constitution of India.

   It was observed that, keeping in view the provisions of section 260A(7), the power of re-admission/restoration of the appeal is always enjoyed by the High Court. However, such power to restore the appeal cannot be treated to be a power to review the earlier order passed on merits.

11

PENALTIES

1. **Would making an incorrect claim in the return of income *per se* amount to concealment of particulars or furnishing inaccurate particulars for attracting the penal provisions under section 271(1)(c), when no information given in the return is found to be incorrect?**

   CIT v. Reliance Petro Products Pvt. Ltd. (2010) 322 ITR 158 (SC)

   Relevant section: 271(1)(c)

   In this case, the Supreme Court observed that in order to attract the penal provisions of section 271(1)(c), there has to be concealment of the particulars of income or furnishing inaccurate particulars of income. Where no information given in the return is found to be incorrect or inaccurate, the assessee cannot be held guilty of furnishing inaccurate particulars. Making an incorrect claim (i.e. a claim which has been disallowed) would not, by itself, tantamount to furnishing inaccurate particulars.

   The Apex Court, therefore, held that where there is no finding that any details supplied by the assessee in its return are incorrect or erroneous or false, there is no question of imposing penalty under section 271(1)(c). A mere making of a claim, which is not sustainable in law, by itself, will not amount to furnishing inaccurate particulars regarding the income of the assessee.

2. **Can the penalty under section 271(1)(c) be imposed where the assessment is made by estimating the net profit at a higher percentage applying the provisions of section 145?**

   CIT v. Vijay Kumar Jain (2010) 325 ITR 0378 (Chhattisgarh)

   Relevant section: 271(1)(c)

   In this case, the Assessing Officer levied penalty under section 271(1)(c) on the basis of addition made on account of application of higher rate of net profit by applying the provisions of section 145, consequent to rejection of book results by him.

On this issue, the High Court held that the particulars furnished by the assessee regarding receipts in the relevant financial year had not been found inaccurate and it was also not the case of revenue that the assessee concealed any income in his return. Thus, penalty could not be imposed.

The High Court placed reliance on the ruling of the Supreme Court in *CIT v. Reliance Petroproducts P. Ltd. (2010) 322 ITR 158,* while considering the applicability of section 271(1)(c). In that case, the Apex Court had held that in order to impose a penalty under the section, there has to be concealment of particulars of income of the assessee or the assessee must have furnished inaccurate particulars of his income. Where no information given in the return is found to be incorrect or inaccurate, the assessee cannot be held guilty of furnishing inaccurate particulars.

12

OFFENCES AND PROSECUTION

1. **Would prosecution proceedings under section 276CC be attracted where the failure to furnish return in time was not willful?**

   Union of India v. Bhavecha Machinery and Others (2010) 320 ITR 263 (MP)

   Relevant section: 276CC

   In this case, the High Court observed that for the provisions of section 276CC to get attracted, there should be a willful delay in filing return and not merely a failure to file return in time. There should be clear, cogent and reliable evidence that the failure to file return in time was 'willful' and there should be no possible doubt of its being 'wilful'. The failure must be intentional, deliberate, calculated and conscious with complete knowledge of legal consequences flowing from them.

   In this case, it was observed that there were sufficient grounds for delay in filing the return of income and such delay was not willful. Therefore, prosecution proceedings under section 276CC are not attracted in such a case.

13

DEDUCTION, COLLECTION AND RECOVERY OF TAX

1. Would the payments made by the assessee company to MTNL / other companies for the services provided through interconnect / port / access / toll attract TDS provisions under section 194J?

CIT v. Bharti Cellular Ltd. (2009) 319 ITR 139 (Del.)

Relevant sections: 194J & 9(1)(vii)

The assessee-companies engaged in providing cellular telephone facilities to their subscribers, had been granted licences by the Department of Telecommunication for operating in specified circles. The licences stipulated that the Department of Telecommunication/MTNL/BSNL would continue to operate in the service areas in respect of which licences were issued. Where calls were to be made by subscribers of one network to another network, such calls were to be routed through MTNL/BSNL through interconnection points known as ports. For providing interconnection, the assessees entered into agreements with MTNL/BSNL, which were regulated by the Telecom Regulatory Authority of India. Under the agreement, the assessees had to pay interconnection, access charges and port charges to the interconnection providers. The Department was of the view that interconnect/port access charges were liable for tax deduction at source in view of the provisions of section 194J on the understanding that these charges were in the nature of fee for technical services.

The High Court held that the services rendered relating to interconnection, port access did not involve any human interface and, therefore, the services could not be regarded as "technical services" as contemplated under section 194J. The interconnect/port access facility was only a facility to use the gateway and the network of MTNL/other companies. MTNL or other companies did not provide any assistance to the assessees in managing, operating, setting up their infrastructure and networks. Even though the facility of interconnection and port access provided by MTNL/other companies was "technical" in the sense that it involved sophisticated technology, the expression "technical service" is not to be construed in the abstract and general sense but in the narrower sense as circumscribed by the expressions "managerial service" and "consultancy service" under Explanation 2 to section 9(1)(vii). **The expression "technical service" would have reference to only technical service rendered by a human.** It would not include any service provided by machines or robots. The interconnect charges/port access charges could not, therefore, be regarded as fees for technical services, and hence TDS provisions under section 194J are not attracted.

2. **Does payment of charter fee to a non-resident (for chartering fishing vessels), by way of percentage of fish catch done outside the territorial waters of India but brought to an Indian port for verification and valuation before dispatch of the same to the non-resident, attract the provisions of tax deduction at source under section 195?**

Kanchanganga Sea Foods Ltd. v. CIT & ITO (2010) 325 ITR 540 (SC)

Relevant sections: 5(2) & 195

An Indian company engaged in the sale and export of sea foods entered into an agreement with a non-resident for chartering two fishing vessels (trawlers) for an all-inclusive charter fee of US $ 6,00,000 per vessel per annum. The charter fee was payable out of earnings from the sale of fish and for this purpose, 85% of the gross earnings from the sale of fish was to be paid to the non-resident company.

The trawlers were delivered to the Indian company. The actual fishing operations were done outside the territorial waters of India but within the exclusive economic zone. The voyage commenced and concluded at the Chennai Port. The catch made at high seas were brought to Chennai where the surveyor of the Fishery Department verified the log books and assessed the value of the catch over which local taxes were levied and paid. The Indian company paid the dues and arranged for customs clearance for the export of fish. The trawlers, which were used for fishing, carried the fish to the destination chosen by the non-resident company. The trawlers reported back to the Chennai Port after delivering fishes to the destination and thereafter, commenced a fresh voyage.

The Indian company did not deduct tax at source from the payments to the non-resident and therefore, notice under section 201(1) of the Income-tax Act, 1961 was issued deeming the company as an assessee-in-default for failure to deduct tax at source under section 195. The Indian company, however, contended that it was not required to deduct tax at source since –

(i) no income accrued to the non-resident company in India since it did not carry on activities in India.

(ii) even if bringing the catch to the Chennai Port for customs appraisal and export to the non-resident results in an operation, it was an operation for mere purchase of goods and therefore, there is no assessable income.

(iii) even if 85% of the catch is considered as charter fee to the non-resident company, it was paid outside India.

The Apex Court observed that the chartered vessels with the entire catch were brought to the Indian Port, the catch were certified for human consumption, valued, and after customs and port clearance, the non-resident company received 85% of the catch. As long as the catch was not apportioned, the entire catch was the property of the Indian company and not of the non-resident company as the latter did not have any control over the catch. The control came into the hands of the non-resident only after it was given its share of 85% of the catch.

Since the first receipt of 85% of the fish catch was in India, the non-resident effectively received the charter fee in the shape of 85% of the fish catch in India. The sale of fish and the realization of the sale consideration of fish by the non-resident outside India does not mean that there was no receipt in India. **When 85% of the catch is received after valuation by the non-resident in India, in sum and substance, it amounts to receipt of the value of money.** Had it not been so, the value of the catch ought to have been the price for which the non-resident sold the fish catch at the chosen destination.

In light of the above, the income earned by the non-resident was chargeable to tax under section 5(2) of the Income-tax Act, 1961. The Indian company was, therefore, liable to deduct tax under section 195 on the payment made to the non-resident company. Since it had failed to deduct tax at source, it was an assessee-in-default under section 201.

Note *– It may be noted that TDS provisions under section 195 are attracted even if the charter fees is payable in kind, for example, as a percentage of fish catch, as in this case.*

3. **What is the nature of landing and parking charges paid by an airline company to the Airports Authority of India and is tax required to be deducted at source in respect thereof?**

   CIT v. Japan Airlines Co. Ltd. (2010) 325 ITR 298 (Del.)

   Relevant section: 194-I

   On this issue, the Delhi High Court referred to the case of *United Airlines v. CIT (2006) 287 ITR 281*, wherein the issue arose as to whether landing and parking charges could be deemed as rent under section 194-I. The Court observed that rent as defined in the said provision had a wider meaning than "rent" in common parlance. It included any agreement or arrangement for use of land. The Court further observed that **when the wheels of the aircraft coming into an airport touch the surface of the airfield, use of the land of the airport immediately begins. Similarly, for parking the aircraft in that airport, again, there is use of the land. Therefore, the landing and parking fee were definitely "rent" within the meaning of the provisions of section 194-I as they were payments for the use of the land of the airport.**

4. **Whether retention of a percentage of advertising charges collected from customers by the advertising agencies for payment to Doordarshan for telecasting advertisements would attract the provisions of tax deduction at source under section 194H?**

   CIT v. Director, Prasar Bharti (2010) 325 ITR 205 (Ker)

   Relevant section: 194H

   Prasar Bharti is a fully owned Government of India undertaking engaged in telecast of news, sports, entertainment, cinema and other programmes. The major source of its revenue is from advertisements, which were canvassed through agents appointed by Doordarshan under the agreement with them. The advertisement charges were recovered from the customers by the advertisement agencies in accordance with the tariff prescribed by Doordarshan and incorporated in the agreement between the parties. There was a provision in the agreement permitting advertising agencies to retain 15% of the advertising charges payable by them to Doordarshan towards commission from out of the charges received for advertising services from customers.

The issue under consideration is whether retention of 15% of advertising charges by the advertising agency is in the nature of commission to attract the provisions of tax deduction at source under section 194H. It was contended that the agreement between Prasar Bharti and the advertising agency is not an agency but is a "principal to principal" agreement of sharing advertisement charges and therefore, the provisions for deduction of tax at source under section 194H would not get attracted in this case.

In this context attention was invited to a clause of the agreement between the parties which reads as follows –

"Agency agrees to pay the TDS/income-tax liability as applicable under the income-tax law on the discount retained by him. For this purpose, the agency agrees to make payment to Doordarshan Commercial Service by means of cheque/demand draft for the TDS on 15% discount retained by them. This cheque/demand draft will be drawn separately and should not be included in the telecast fees/advertisement charges".

The above provision makes it clear that the advertising agency clearly understood the agreement as an agency agreement and the commission payable by Prasar Bharati to such agency is subject to tax deduction at source under the Income-tax Act, 1961. **The permission granted by Doordarshan under the agreement to the agencies to retain 15% out of the advertisement charges collected by them from the customers amounts to payment of commission by Doordarshan to agents, which is subject to deduction of tax at source under section 194H.**

It is clear from section 194H that tax has to be deducted at the time of credit of such sum to the account of the payee or at the time of payment of such income in cash or by the issue of cheque or draft or any other mode, whichever is earlier. **When the agent pays 85% of the advertisement charges collected from the customer, the agent simultaneously gets paid commission of 15%, which he is free to appropriate as his income. TDS on commission charges of 15% has to be paid to the Income-tax Department with reference to the date on which 85% of the advertisement charges are received from the agent.**

5. **Can services rendered by a hotel to its customers in providing hotel room with various facilities / amenities (like house keeping, bank counter, beauty saloon, car rental, health club etc.) amount to "carrying out any work" to attract the provisions of section 194C?**

   East India Hotels Ltd. v. CBDT (2010) 320 ITR 0526 (Bom.)

   Relevant section: 194C

   On this issue, the High Court observed that the words "carrying out any work" in section 194C are limited to any work which on being carried out culminates in a product or result. "Work" in the context of this section, has to be understood in a limited sense and would extend only to the service contracts specifically included in section 194C by way of clause (iv) of the Explanation* below sub-section(7).

   The provisions of tax deduction at source under section 194C would be attracted in respect of payments for carrying out the work like construction of dams, laying of roads and air fields, erection or installation of plant and machinery etc. In these contracts, the execution of the contract by a contractor or sub-contractor results in production of the desired object or accomplishing the task under the contract.

   However, facilities or amenities made available by a hotel to its customers do not fall within the meaning of work under section 194C, and therefore provisions of TDS under this section are not attracted.

6. **Would there be an obligation to deduct tax at source under section 195 in respect of payments to non-residents if such payments do not give rise to income chargeable under the provisions of the Income-tax Act, 1961?**

   GE India technology Centre P. Ltd. v. CIT and Another (2010) 327 ITR 456 (SC)

   Relevant section: 195

   The Apex Court observed that the expression "chargeable under the provisions of the Act" in section 195(1) shows that the remittance has got to be a trading receipt, the whole or a part of which is liable to tax in India. If the tax is not so assessable, there is no question of tax at source being deducted. 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 under the Act.

   ***Note** – In this case, the Apex Court remitted the case to the High Court to decide whether or not the amount paid by the appellant to the foreign software suppliers constituted "royalty". Only if the amount is in the nature of royalty which is deemed to accrue or arise in India, then, tax is liable to be deducted at source under section 195.*

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* erstwhile Explanation III

7. **Can the interest under sections 234B and 234C, be levied on the basis of interest calculation given in the computation sheet annexed to the assessment order, though the direction to charge such interest is not mentioned in the assessment order?**

   CIT v. Assam Mineral Development Corporation Ltd. (2010) 320 ITR 149 (Gau.)

   The Assessing Officer determined the total income of the assessee for the year in question and issued an order. No specific order levying interest was recorded by the Assessing officer. However, in the computation sheet annexed to the assessment order, interest under 234B and 234C was computed while determining the total sum payable by the assessee. On appeal the Commissioner of Income-tax (Appeals) deleted the interest charged under sections 234B and 234C.

   The High Court held that, as per the judgment of the Supreme Court in case of *CIT v. Anjum M. H. Ghaswala (2001) 252 ITR 1,* the interest leviable under sections 234B and 234C is mandatory in nature. The computation sheet in the form prescribed, signed or initialed by the Assessing Officer, is an order in writing determining the tax payable within the meaning of section 143(3). It is an integral part of the assessment order. Hence, the levy of interest and the basis for arriving at the quantum thereof have been explicitly indicated in the computation sheet and therefore, such interest has to be paid.

8. **Is an employee liable to pay interest under sections 234A, 234B and 234C, where the employer has failed to deduct tax at source, but has later paid such tax with interest under section 201(1A)?**

   CIT v. Emilio Ruiz Berdejo (2010) 320 ITR 190 (Bom.)

   The High Court held that the person who fails to deduct tax is liable to pay interest under section 201(1A). Sections 234A, 234B and 234C cast liability on the assessee to pay interest for the default committed by him in the circumstances mentioned in the sections. Interest charged under sections 234A, 234B and 234C are compensatory and not in the nature of penalty.

   Therefore, where the deductor had already discharged tax liability with interest payable under section 201(1A), no further interest could be claimed by the Revenue from the deductee-employee either under section 234A or section 234B or section 234C.