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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?

Saurashtra Cement Ltd (SC)

Facts of the case:

- 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 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. **[Revenue Receipt]**
- However, the Appellate Tribunal held that the amount was a **Capital Receipt** and the **High Court concurred with this view.**

Supreme Court's Decision:
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 as compensation is not in the ordinary course of business, hence it is a capital receipt in the hands of the assessee.

2. Can capital contribution of the individual partners credited to their accounts in the books of the firm be taxed as cash credit *IN THE HANDS OF THE FIRM,* where the partners have admitted their capital contribution but failed to explain satisfactorily the source of receipt in their individual hands?

M. Venkateswara Rao (HC)

Facts of the case:

- The controversy was in relation to the capital contribution of 10 partners aggregating to 76.57 lakhs. The assessee-firm's explained that the partners have paid various amounts towards contribution of their share in the capital but this explanation was not accepted since the source of income for the partners was not explained.
- The Commissioner(Appeals) observed that the amounts credited in the names of 4 partners were valid and that cash credits in the accounts of 6 other partners in the books of the firm were to be considered afresh by the AO

Issue under consideration: The issue before the High Court was whether the AO was justified in treating the capital contribution of partners as income of the firm by invoking section 68?

High Court's Opinion:

- **"*Section 68 directs that if an assessee fails to explain the nature and source of credit entered in the books of account of any previous year, the same can be treated as income.***
- In this case, the amount sought to be treated as income of the firm is the contribution made by the partners to the capital. In a way, the **amount so contributed constitutes the very foundation for the business of the firm** and it is difficult to treat the pooling of such capital as Income (credit).
- Where the firm explains that the partners have contributed capital, section 68 cannot be pressed into service. At the most, the Assessing **Officer can make an enquiry against the individual partners and not the firm** when the partners have also admitted their capital contribution in the firm.

High Court's Decision:
The High Court, accordingly, held that the view taken by the Assessing Officer that the partnership firm has to explain the source of income of the partners as regards the amount contributed by them towards capital of the firm, in the absence of which the same would be treated as the income of the firm, was not tenable.

RESIDENTIAL STATUS AND SCOPE OF TOTAL INCOME

1. Can consideration for supply of software embedded in hardware tantamount to 'royalty' u/s 9(1)(vi)?

Alcatel Lucent Canada (HC)

Facts of the case:

- The **Assessee** was engaged in manufacture, trade and supply of equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India.
- The **AO** contended that the consideration for supply of **software embedded in hardware** is **'royalty'** u/s 9(1)(vi).

Appellate Authorities' Views:

The **Commissioner (Appeals) and Tribunal** held that the consideration for supply of **embedded software** (which is part of the hardware supplied to the assessee customers) **did not constitute royalty** and therefore, section 9(1)(vi) was not attracted.

High Court's Observations:

1. The High Court noted that Tribunal had relied upon the case of ***Ericsson A.B,*** where the High Court observed that what was sold by the assessee to its Indian customers was a GSM which **consisted of both hardware and software.**
2. The High Court observed that -
   (i) the software that was loaded on the hardware **did not have any independent existence**;
   (ii) the software supply is an **integral part of GSM mobile telephone system** and is used by the cellular operators for providing cellular services to its customers;
   (iii) **There could not be any independent use of such software**;
   (iv) This software **merely facilitates the functioning of the equipment** and is an **integral part of the hardware.**

High Court's Decision:
The High Court **concurred with the decision of the Tribunal h**olding that where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, **no amount could be attributed as 'royalty'** for software in terms of section 9(1)(vi).

INCOME WHICH DO NOT FORM PART OF TOTAL INCOME

1. Where an institution engaged in imparting education incidentally makes profit, would it lead to an conclusion that it ceases to exist solely for educational purposes?

Queen's Educational Society (SC)

Facts of the case:

- The assessee, an educational institution, showed a net surplus of 6.59 lakhs and 7.83 lakhs, respectively. Since it was established with the sole object of imparting education, it claimed exemption under section 10(23C)(iiiad).
- The AO rejected the claim of exemption on the ground that the assessee has made profits and did not exist solely for educational purposes.

Supreme Court's Observations:

"The Supreme Court observed that the provisions of section 10(23C) (iiiad) provide for 3 requirements namely,

- the education institution **must exist solely for educational purposes**;
- it **should not be for purposes of profit**; and
- the **aggregate annual receipts of such institution should not exceed 1 crore"**

The Apex Court, after analyzing the legal provisions and precedents, summed up the law common to section 10(23C)(iiiad)/(vi):

(a) Where an educational institution carries on the activity of education primarily for educating persons, the **fact that it makes a surplus does not lead to the conclusion that it ceases to exist solely for educational purposes** and becomes an institution for the purpose of making profit;

(b) The **main object test must be applied** – the purpose of education should not be submerged by a profit making motive;

(c) A **distinction must be drawn between the making of surplus and an institution being carried on "for profit".** Merely because imparting of education results in making a profit, it cannot be inferred that it becomes an activity for profit;

(d) If after meeting expenditure, surplus arises incidentally from the activity carried on by the educational institution, it will not cease to be existing solely for educational purposes..

Apex Court's Decision:
Based on the above principles and tests, the **Apex Court concluded** that the assessee was engaged in imparting education and the profit was only incidental to the main object of spreading education.
Hence, it satisfies the conditions laid down in section 10(23C)(iiiad) for claim of exemption thereunder.

2. Whether section 14A (Exemption) is applicable in respect of deductions, which are permissible and allowed under Chapter VI-A?

Kribhco (HC)

High Court's Observations:

- The High Court observed that section 14A (Exemption), is not applicable for deductions under Chapter VIA.
- Section 14A (Exemption) is applicable only if an income is EXEMPT as per the provisions of Chapter III of the IT Act, 1961.
- Deductions under Chapter VIA are different from the exclusions/exemptions provided under Chapter III.
- The words "do not form part of the total income under this Act" used in section 14A are significant and important. Income which qualifies for deductions U/S 80C to 80U has to be first included in the total income and then allowed as a deduction.
- However, income referred to in Chapter III do not form part of the total income and therefore, as per section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income..

High Court's Decision:
The Delhi High Court, therefore, held that no disallowance can be made under section 14A in respect of income included in total income in respect of which deduction is allowable under section 80C to 80U.

3. In a case where the application for registration of a charitable trust is not disposed of within the period of 6 months as required under section 12AA(2), can the trust be deemed to have been registered as per provisions of section 12AA?

Karimangalam Onriya Pengal Semipu Amaipu Ltd

<u>High Court's Observations</u>:

Legal Provisions - As per the provisions of section 12AA(2), every order granting or refusing registration under section 12AA(1)(b), shall be passed by the registering authority **before the expiry of six months from the end of the month in which the application was received** under section 12A(1)(a) or section 12A(1)(aa).

Observations of High Court :

- The Madras High Court observed the decision of the Orissa High Court, in *Srikhetra, A.C. Bhakti-Vedanta Swami Charitable Trust,* wherein it was held that the **period of six months as provided under section 12AA(2) is not mandatory**.
- The nature of the statutory provision, whether **mandatory or directory**, has to be ascertained not only from the wording of the statute, but also from the nature and design of the statute and the purpose sought to be achieved.
- Further, since the consequence for non-adherence of the time limit of six months is not spelt out in the statute, it cannot be said that passing the order within such time limit is mandatory in nature i.e the period of six months provided thereunder is not mandatory but directory in nature.

<u>High Court's Decision</u>:
Accordingly, in the present case, the Madras High Court held that the time frame mentioned in section 12AA(2) is **only directory in nature** and non- consideration of the registration application within the said time frame of six months would not amount to "deemed registration".

Note - Similar ruling was pronounced by the Madras High Court in the case of CIT v. Sheela Christian Charitable Trust (2013) 354 ITR 478, holding that there is no automatic or deemed registration if the application filed under section 12AA was not disposed of within the stipulated period of six months.

4. Where a charitable trust applied for issuance of registration under section 12A within a short time span (nine months, in this case) after its formation, can registration be denied by the concerned authority on the ground that no charitable activity has been commenced by the trust?

Meenakshi Amma Endowment Trust

<u>High Court's Observations</u>:

- On this issue, the Karnataka High Court opined that an application U/S 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in case the registration is sought much later after formation of the trust.
- The High Court further observed that, in this case, When the application for registration was made, the trust, did not have sufficient funds for commencement of its activities and the corpus fund included contributions made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities.

<u>High Court's Decision</u>:

- The High Court observed that, **with the money available with the trust, it cannot be expected to carry out activity of charity immediately**. Consequently, in such a case, it cannot be concluded that the trust has not intended to do any activity of charity. In such a situation, the **objects of the trust as mentioned in the trust deed have to be taken into consideration** by the authorities for satisfying themselves about the genuineness of the trust and not the activities carried on by it.
- Later on, if it is found from the subsequent returns filed by the trust, that it is not carrying on any charitable activity, it would be open to the concerned authorities to withdraw the registration granted or cancel the registration as per the provisions of section 12AA(3).

5. In a case where properties bequeathed (donated) to a trust could not be transferred to it due to ongoing court litigation and pendency of probate proceedings, can violation of the provisions of section 11(5) be attracted?

Khetri Trust (HC)

Facts of the case:

ISSUE 1- As per the 'will' of Late Raja Bahadur Sardar Singh, the entire property, including immovable property and shares in foreign companies, were bequeathed (donated) to the trust.
However, the properties could not be transferred to or acquired by the trust because of ongoing litigation in the Court. In the probate proceedings, the validity of the 'will' was challenged and the probate proceedings are still pending.

ISSUE 2- In the meantime, the trustees paid 1,10,000 for raising a memorial for late Raja Bahadur Sardar Singh and the said amount was given to a business entity for this purpose, but due to the ongoing dispute, such project was not completed. The business entity, however, paid interest on the said amount.

The AO denied the benefit of exemption U/S 11, on the ground that the **asset held in the form of shares of foreign company and the advance given to business entity were contrary to the mandate of section 11(5)** and thus, the condition specified in section 13(1)(d) has been violated.

Appellate Authorities' views:

- The Commissioner (Appeals) observed that the **validity of the will has been challenged** in the probate proceedings; therefore, **till the 'will' is probated and affirmed as genuine, the trust would not acquire the legal right on the property for the purpose of Income-tax Act, 1961**.
- The **shares in foreign company** were still in the name of the donor, Late Raja Bahadur Sardar Singh, and its acquisition by the trust is dependent upon the adjudication of the probate.
- Further, with regard to the advance given to the business entity, the Commissioner (Appeals) found that the said **amount cannot be treated as an investment which was covered and regulated by section 11(5)**, since the intent and purpose behind the payment was not investment

High Court's Decision:
Based on the above factual findings the High Court held that there was no violation of section 11(5) in this case.

6. Is the approval of Civil Court mandatory for amendment of trust deed, even in a case where the settler has given power to the trustees to alter the trust deed?

Ramoji Foundation (HC)

Facts of the case:

The settler gave power to the trustees to amend, alter, change or modify the objects of the trust deed with the approval of two-third majority. Such additional or altered object, however, must be of charitable nature falling within the definition thereof under the relevant provisions of the Income-tax Act, 1961

High Court's Observations:

The High Court observed that the power has been given by the settler to the trustees to amend the trust deed without approaching the Civil Court, provided all the conditions laid down by the settler are fulfilled.

The sanction of Civil Court is required only when there is no such power. When the power has been specifically given to the trustees by the settler, no further power from the Civil Court is required.

High Court's Decision:
Accordingly, in this case, the High Court held that the Tribunal has correctly dealt with the matter and the trust deed amended by the trustees can be relied upon by the Revenue authorities for the purpose of granting registration under section 12AA.

INCOME FROM SALARIES

1. **Can notional interest on security deposit given to the landlord in respect of residential premises taken on rent by the employer and provided to the employee, be included in the perquisite value of rent-free accommodation given to the employee?**

   Shankar Krishnan

   Facts of the case:
   The assessee, a salaried employee, was provided with rent-free accommodation, being a flat in Mumbai, by his employer company. The monthly rent paid by the employer in respect of the said flat was 10,000 per month. The employer had given an interest-free refundable security deposit of 30 lacs to the landlord for renting out the said premises. The assessee-employee computed the perquisite value on the basis of rent of 10,000 paid by his employer to the landlord, since the same was lower than 10% ***(now, 15%)*** of salary.

   AO's contention:
   The AO however, contended that since the employer had given interest-free deposit of 30,00,000 to the landlord, interest @12% on the said deposit is required to be taken into consideration for estimating the fair rental value of the flat given to the assessee and accordingly, he enhanced the perquisite value of the residential accommodation provided to the employee by such notional interest.

   Tribunal's Observations:
   The Tribunal observed that, as per Rule 3 of the Income-tax Rules, 1962, the perquisite value of the residential accommodation provided by the employer to the employee shall be the **"actual amount of lease rent paid or payable by the employer or 10% (now, 15%) of salary, whichever is lower, as reduced by the rent, if any, actually paid by the employee.** The Tribunal, therefore, held that there is no concept of determination of the fair rental value for the purpose of ascertaining the perquisite value of the rent-free accommodation provided to the employees.

   High Court's Decision:
   On appeal by the Revenue, the Bombay High Court held that the **AO is not right in adding the notional interest on the security deposit given by the employer to the landlord in valuing the perquisite of rent-free accomodation**, since the perquisite value has to be computed as per Rule 3 and Rule 3 does not require addition of such notional interest.

   Thus, the perquisite value of the residential accommodation provided by the employer would be **the actual amount of lease rental paid or payable by the employer, since the same was lower than 10% (now 15%) of salary**.

2. **Can the limit of 1,000 per month per child be allowed as standard deduction, while computing the perquisite value of free or concessional education facility provided to the employee by the employer?**

   Director, Delhi Public School (HC)

   Legal Provision - "As per the provisions of Rule 3(5) of the Income-tax Rules, 1962, in case an educational institution is **maintained and owned by the employer** and free or concessional education facility is provided to the employees' household in such institution, **then, the cost of education in a similar institution in or near the locality shall be taken to be the value of perquisite in the hands of the employee**.
   In case the cost of such education or the value of benefit does not exceed 1,000 per month per child, the perquisite value shall be taken to be Nil.

   Assessee's contention:
   In the present case, the cost of education was more than 1,000 per month per child, therefore, while determining the perquisite value on the above basis, the assessee claimed a deduction of 1,000 per month per child.

High Court's Decision:
The Punjab and Haryana High Court, in the above case, held that on a plain reading of Rule 3(5),
- it shows that, in case the value of perquisite for free/concessional educational facility arising to an employee exceeds 1,000 per month per child, the whole perquisite shall be taxable in the hands of the employee and no standard deduction of 1,000 per month per child can be provided from the same.
- It is only in case the perquisite value is less than 1,000 per month per child, the perquisite value shall be nil.

Therefore 1,000 per month per child is not a standard deduction to be provided while calculating such a perquisite.

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INCOME FROM HOUSE PROPERTY

1. **Would income from letting out of properties by a company, whose main object as per its memorandum of association is to acquire and let out properties, be taxable as its business income or income from house property, considering the fact that the entire income of the company as per its return of income was only from letting out of properties?**

Chennai Properties and Investments Ltd. (SC)

Facts of the Case:

The assessee-company's main objective, as stated in the memorandum of association, is to **acquire properties in the city of Madras and let out those properties**. The company had rented out such properties and the rental income was shown as its business income in the return filed by the assessee.

The AO, however, assessed the rental income under the head "Income from house property".

On appeal, the Commissioner (Appeals) & Appellate Tribunal both concurred with the assessee's view that the rental income, in this case, was the company's business income.

High Court's Opinion: The High Court allowed the Department's appeal holding that income derived from letting out of properties has to be assessed as income from house property.

Supreme Court's Observations:

- The Supreme Court observed that the High Court had pronounced its ruling on the basis of the decision of the Apex Court in *East India Housing and Land Development Trust Ltd.'s* case, wherein the letting out of property was not the object of the company at all.
- The Supreme Court further observed the case of *Karanpura Development Co. Ltd,* In that case leasing out of the coal fields to the collieries and other companies was the business of the assessee. The income which was received from letting out of those mining leases was shown as business income. Department took the position that the same was to be treated as income from the house property. Thus, in similar circumstances, an identical issue arose before the Apex Court. The Apex Court pointed out that the deciding factor as to under which head income was to be assessed is **not the ownership of land or leases but the nature of the activity of the assessee** and the **nature of the operations in relation to them**. It was highlighted and stressed that the **objects of the company must also be kept in view** to interpret the activities
- After applying the aforesaid principle to the facts, the Apex Court had arrived at the conclusion that such income had to be treated as income from business and not as income from house property.

Supreme Court's Decision:
The Supreme Court opined that the aforesaid judgment in *Karanpura Development Co. Ltd.'s* case squarely applied to the facts of the present case, where **letting of the properties is in fact the business of the assessee**.
The **main objective of the company as per its memorandum of association is to acquire and hold properties in Chennai and let out these properties.** Therefore, holding of the properties and earning income by letting out these properties is the main objective of the company.
Further, in the return of income filed by the company and accepted by the Assessing Officer, the entire income of the company comprised of income from letting out of such properties. The Supreme Court, accordingly, held that the assessee had rightly disclosed the income derived from letting out of such properties under the head "Profits and gains of business or profession".

2. **Whether the rental income derived from the unsold flats which are shown as stock- in-trade in the books of the assessee would be taxable under the head 'Profits and gains from business or profession' or under the head 'Income from house property', in a case where the actual rent receipts formed the basis of computation of income?**

New Delhi Hotels Ltd. (HC)

High Court's Observations:

- ***Ansal Housing Finance and Leasing Co. Ltd*** - Income from unsold flats held as stock-in-trade, the Delhi High Court held that such rent was taxable under the head **"Income from house property".**
- Further, in ***Discovery Estates Pvt. Ltd.*** & ***Discovery Holding Pvt. Ltd*** - Income from unsold flats held as stock-in-trade. In that case also, the Delhi High Court held that the income was taxable under the head **"Income from house property".**

High Court's Decision:
In this case, the Delhi High Court followed its own decision in the case of ***Discovery Estates Pvt. Ltd***. & ***Discovery Holding Pvt. Ltd***., wherein it was held that rental income derived from unsold flats which were shown as stock-in-trade in the books of the assessee should be assessed under the head "**Income from house property"** and not under the head "Profits and gains from business or profession".

Note – In effect, irrespective of whether it is the deemed rent or actual rent which forms the basis of computing income from unsold flats held as stock-in-trade, the head under which the income is taxable would be "Income from house property".

3. Under what head of income should income from Letting Out Of Godowns and Providing Warehousing Services be subject to tax - "Income from house property" or "profits and gains of business or profession"?

NDR Warehousing P Ltd (HC)

Facts of the case:

The assessee engaged in the business of warehousing, handling and transport business claimed income from letting out of buildings and godowns as **business income.**

The Assessing Officer assessed such income as "**Income from house property".**

Appellate Authorities' Observations:

The Commissioner (Appeals) observed that the :

- **assessee's activity was not merely letting out of warehouses but storage of goods with provision of several auxiliary services** such as pest control, rodent control and fumigation service to prevent the goods stored from being affected by vagaries of moisture and temperature.
- Further, **service of security and protection was also provided to the goods stored**. Therefore there is no dispute that the assessee carries on the activity in an organised manner. These activities are more than mere letting out of the godown for tenancy i.e. Business
- The Tribunal noted that the **objects clause of the memorandum of association of the company clearly shows that the assessee-company was incorporated with the object of carrying on the business of warehousing and letting/renting of godowns** and providing facilities for storage of articles or things and descriptions whatsoever.
- The **profit and loss account of the assessee-company** shows that its main source of income is storage charges and maintenance or user charges. Even **substantial part of the expenses** also relate to the salaries of employees engaged in the maintenance and upkeep of the godowns and warehouses.

Based on these facts, **Tribunal concurred with the findings of the Commissioner (Appeals)** and held that the income of the assessee from letting out of warehouses and godowns is chargeable under the head "Profits and gains of business or profession" and not "Income from house property".

Accordingly, the High Court held that the income earned by the assessee from letting out of godowns and provision of warehousing services is chargeable to tax under the head "Profits and gains of business or profession" and not under the head "Income from house property".

High Court's Decision:
The High Court observed that the Commissioner (Appeals) as well as the Tribunal had not only gone into the objects clause of the memorandum of the assessee but also individual aspects of the business to come to the conclusion that it was a case of warehousing business, and, therefore, the income would fall under the head "Profits and gains of business or profession".

4. Can benefit of self-occupation of house property under section 23(2) be denied to a HUF on the ground that it, being a fictional entity, cannot occupy a house property?

Hariprasad Bhojnagarwala (HC)

Facts of the case:

- The assessee, being a Hindu Undivided Family (HUF), claimed the benefit of self occupation of a house property under section 23(2).
- However, AO did not accept the said claim and denied the benefit of self occupation of house property to the HUF contending that **such benefit is available only to the owner who can reside in his own residence** i.e., only an individual assessee, who is a natural person, and not to an imaginary assessable entity being HUF or a firm etc.

High Court's Observations & Decision:

- On the above mentioned issue, the Gujarat High Court observed that a firm, which is a fictional entity, cannot physically reside in a house property and therefore a firm cannot claim the benefit of this provision, which is available to an individual owner who can actually occupy the house.
- However, the **HUF is a group of individuals related to each other i.e., a family comprising of a group of natural persons.** The said family can reside in the house, which belongs to the HUF.
- Since a HUF cannot consist of artificial persons, it cannot be said to be a fictional entity.
- Therefore, the Court held that the HUF is entitled to claim benefit of self-occupation of house property under section 23(2).

5. 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?

Asian Hotels Ltd (HC)

Facts of the case:

- The assessee had received interest-free deposit in respect of shops given on rent.
- The AO added to the assessee's income notional interest on the interest free deposit at the rate of 18 % simple interest p.a. 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).

High Court's Observations & Decision:

The High Court observed 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 otherwise than by way of cash.

In the instant case, the **AO has determined the monetary value** of the benefit stated to have accrued to the assessee by adding a sum that constituted 18% simple interest on the deposit. Hence, **section 28(iv) is not applicable**.

Section 23(1) deals with the determination of the expected rent of a let out property for computing the income from house property. It provides that the expected rent is deemed to be the sum for which the property might reasonably be expected to be let out 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 neither assessable as business income nor as income from house property.

PROFITS AND GAINS OF BUSINESS OR PROFESSION

1. **Under which head of income is franchise fee received by an assessee in tourism business, against special rights given to franchisees to undertake hotel business in assessee's property, taxable?**

Tamil Nadu Tourism Development Corporation Ltd (HC)

Facts of the case:

The assessee-company, a wholly owned Government Undertaking, was engaged in the business of development of tourism in the State. It leased some of its loss making hotel units to various franchisees for a consideration with a condition that the franchisees would display its(TTDCL) name above the name of the franchisee in the name board. Also the assessee offered franchise fee as **"Income from house property"** and claimed deduction at 30% of NAV u/s 24.

Appellate Authorities' Views:

The Commissioner (Appeals) **upheld the contention of the assessee** that such income is taxable under the head "Income from house property".

The Tribunal, however, observed that the assessee had not left the business of carrying on tourism activities and it was only to earn more profits from its loss making units that it has let out the properties including business to franchisees. Thus, it held that the income arising from letting out of such properties is chargeable to tax as **income from business**. It therefore rejected the claim for deduction of 30% of NAV made by the assessee.

The issue before the High Court is whether the income by way of franchisee fee is taxable as income from business or as income from house property?

High Court's Opinion:

The High Court looked into the **Contract** between the assessee and the franchisees which **contained various conditions** ranging from obtaining of permits, licenses, maintenance of rooms, common area, garden maintenance, catering, Bar etc with 33 clauses. **The assessee had not simply leased the land and building but had imposed further conditions as to how the business of franchisees should be conducted** with regard to the hotels given on lease.

The **special conditions** stipulated in the contract clearly indicated that the **name of the assessee should be prominently indicated in the name board and that the name of the franchisee should be below the name of the assessee**, thereby, making it clear that the assessee continued to operate the business through the franchisees.
Thus, these special conditions were a clear indicator that the assessee continued to be in the business of tourism activities, though not directly but through the franchisees, and received income as franchisee fee. The assessee received franchisee fee for giving a special right or privilege to the franchisees to undertake tourism business in the property.

High Court's Decision:
The High Court, accordingly, held that the income earned by the assessee by way of franchisee fee is in the nature of business income and not income from house property.

2. **When would the interest income earned on share application money deposited with a bank for a specified period in accordance with the statutory requirement become taxable?**

Henkel Spic India Ltd (SC)

Facts of the case:

- The assessee came out with a public issue of shares on January 29, 1992 **(P.Y.1991-92).** The share application money collected from the applicants were deposited in the bank for 46 days in accordance with the requirement of law. On this deposit, assessee earned **interest of 183.32 lakhs.**
- The **shares were ultimately allotted in June 1992 (P.Y.1992-93).** The applicants who were not allotted the shares got their application money refunded along with the interest.
- However, the AO taxed the **entire interest income** in the year of public issue i.e., **P.Y.1991-92** and ignored the subsequent event viz. **allotment of shares** in the **P.Y.1992-93.**

Assessee's Contention:

The assessee contended that interest on deposit **would only accrue in the PY 1992-93**, **being the year of allotment**, since shares were allotted in June 1992. Before that time, the amount was kept in trust by the assessee and belonged to the applicants who wanted to subscribe for the shares. The assessee also contended that **after certain amounts were refunded back to the unsuccessful applicants**, the balance amount of interest which was left became the income and, therefore, this income accrued only in the year 1993-94.

High Court's Observations:

- The High Court noted that the company is required to keep the money in a bank account which yields interest. The **interest so earned cannot be regarded as an amount which is fully available to the assessee for its own use**, since interest amount which accrued on a fund was held in trust until the allotment of shares got completed and moneys were returned to those to whom shares were not allotted.
- The High Court also observed that **no part of this fund, i.e., neither the principal nor the interest, can be utilized by the company until the allotment process is completed**. **When the amount is repaid in cases of non-allotment of shares, it has to be repaid with such interest.**
- **It is only after the allotment process is completed and all moneys which are refundable are refunded with interest, the balance remaining application money can be regarded as belonging to the company.**
- Therefore the **interest on balance application money (in respect of which shares have been allotted) amount would accrue to the company only after completion of allotment.**

Supreme Court Decision:

The Apex Court, therefore, **upheld the decision of the High Court holding that the interest income accrues to the company only in the assessment year in which the allotment is completed**

3. Is interest income on margin money deposited with bank for obtaining bank guarantee to carry on business, taxable as business income?

K and Co. (HC)

Facts of the case:

- The assessee running a lottery, deposited certain funds with a bank in order to obtain bank guarantee to be furnished to the State Government of Sikkim.
- Such guarantee enabled the assessee to carry on the business of printing lottery tickets and for conducting lotteries on behalf of the State Government of Sikkim. The funds which were held as margin money, earned some interest.

Issue: whether such interest income would be taxable under the head PGBP or IFOS.

High Court's Observations:

- The High Court noted that the interest income from the deposits made by the assessee is undoubtedly linked to the business of the assessee and such income, therefore, cannot be treated as income under the head **IFOS**.
- The margin money requirement was an essential element for obtaining the bank guarantee which was necessary for the contract between the State Government of Sikkim and the assessee. If the assessee had not furnished bank guarantee, it would not have got the contract for running the said lottery

High Court Decision:

The High Court, accordingly, held that the interest income received on funds kept as margin money for obtaining the bank guarantee would be taxable under the head "Profits and gains of business or profession".

4. **Is the expenditure on replacement of dies and moulds, being parts of plant and machinery, deductible as current repairs?**

TVS Motors Ltd (HC)

Facts of the case: The assessee company, engaged in manufacture of motor cycles & spares, claimed **deduction U/S 31** in respect of expenditure incurred on replacement of dies & moulds in the place of worn out dies and moulds. (REVENUE)

The claim was rejected by the AO on the ground that the assessee had claimed **depreciation in respect of such expenditure in the earlier years**. (CAPITAL)

Assessee's contention: The assessee contended that dies and moulds are not P & M but are attachments to make P & M function as per the requirements of the business. The assessee relied on the Madras High Court decision in the case of *Super Spinning Mill Ltd,* where expenditure on replacement of machinery parts was allowed as Revenue Expenditure.

High Court's Observations:

- The High Court referred to the Supreme Court ruling in Mahalakshmi Textile Mills Ltd and observed that
- The parts that were replaced were **performing precisely the same function** & **there was no change in the performance of the machinery on account of such replacement** hence the expenditure has to be considered as current repairs of plant and machinery.
- In the above case, the Supreme Court also observed even though the assessee has claimed depreciation in the earlier years, the claim of the assessee for deduction of expenditure on replacement of moulds and dies as 'current repairs" is justified on the ground that **there was no change in the performance of the machinery on account of such replacement.**
- The High Court also referred to its decision in the case of *Machado Sons* holding that **when the object of the expenditure was not for bringing into existence a new asset or to obtain a new advantage, the said expenditure qualifies as 'current repairs' u/s 31.**

High Court's Decision:

Applying the rationale of above decisions, the High Court held that "moulds & dies" are not independent of P & M but are parts of P & M. Once the dies are worn out, they had to be replaced so that the machine can produce the product according to business specifications. Thus, the expenditure incurred by the assessee towards replacement of parts of machinery to ensure its performance without bringing any new asset or advantage, is eligible for deduction as 'current repairs' under section 31.

5. **Can depreciation on leased vehicles be denied to the lessor on the ground that the vehicles are registered in the name of the lessee and that the lessor is not the actual user of the vehicles?**

I.C.D.S. Ltd. (SC)

Facts of the case:

The assessee(Lessor) is in the business of leasing and hire purchase. The assessee purchased vehicles directly from the manufacturers and leased out these vehicles to its customers, after which the physical possession of the vehicles was with the lessee. Further, **the lessees were registered as the owners of the vehicles** in the certificate of registration. The assessee-lessor claimed depreciation on such vehicles.

The AO disallowed the depreciation claim on the ground that the assessee's was only leasing out the vehicles to others and not the actual user and secondly, the vehicles were registered in the name of the lessee and not the assessee-lessor.

High Court's view: The High Court was also of the view that the assessee could not be treated as the owner of the vehicles, since the vehicles were not registered in the name of the assessee and the assessee had only financed the transaction.

Supreme Court's Observations:

- The Supreme Court observed that **Section 32** imposes a twin requirement of "**ownership" and "usage for business**" as conditions for claim of depreciation there under.
- The Apex Court further observed that as far as usage of the asset is concerned, the section requires that the **asset must be used in the course of business**. It does not mandate actual usage by the assessee itself. In

this case, the **assessee did use the vehicles in the course of its leasing business**. Hence, this requirement of section 32 has been fulfilled.

- The Apex Court observed that as long as the assessee-lessor has a right to retain the legal title against the rest of the world, he would be the owner of the asset in the eyes of law. In this regard, the following provisions of the lease agreement are noteworthy –
  - The assessee is the **exclusive owner** of the vehicle at all points of time;
  - The assessee is **empowered to repossess the vehicle**, in case the lessee committed a default;
  - The assessee had a **right of inspection of the vehicle** at all times.
  - At the end of the lease period, the **lessee was obliged to return the vehicle to the assessee**;

It can be seen that the proof of ownership lies in the lease agreement itself, which clearly points in favour of the assessee.

<u>Supreme Court's Decision</u>:
The Supreme Court, therefore, held that assessee was **entitled to claim depreciation in respect of vehicles leased out** since it has satisfied both the requirements of section 32, namely, **ownership of the vehicles and its usage in the course of business.**

6. What is the eligible rate of depreciation in respect of computer accessories and peripherals under the Income-tax Act, 1961?

BSES Yamuna Powers Ltd (HC)

<u>Assessee's contention *v/s* Department's contention</u>:

The assessee claimed depreciation on **computer accessories and peripherals** at the rate of **60%,** being the eligible rate of depreciation on computers including computer software.

However, the Revenue contended that computer accessories and peripherals cannot be treated at par with computers and computer software, and hence were eligible for depreciation at the general rate applicable to **plant and machinery, i.e., 15%.**

<u>High Court's Decision</u>:
The High Court observed that **computer accessories and peripherals such as printers, scanners and server etc. form an integral part of the computer system and they cannot be used without the computer.**
Consequently, the High Court held that since **they are part of the computer system**, they would be eligible for depreciation at the higher rate of 60% applicable to computers including computer software.

7. Can business contracts, business information, etc., acquired by the assessee as part of the slump sale and described as 'goodwill', be classified as an intangible asset to be entitled for depreciation under section 32(1)(ii)?

Areva T and D India Ltd. (HC)

<u>Facts of the case</u>:

In the present case, a transferor transfers its ongoing business unit to the assessee company by way of slump sale. In the amount of sale consideration, some part of it was attributable to the **tangible assets** and the balance payment was made for **acquisition of various business and commercial rights** categorized under the separate head, namely, **"goodwill"** in the books of account of the assessee. The assessee company claimed depreciation U/S 32 on the **excess amount paid which was classified as "goodwill" under the category of intangible assets.**

<u>Assessing Officer's contention</u>

The AO Denied Depreciation & Disallowed Goodwill.

<u>High Court's Observations</u>:

- The Delhi High Court observed that the observed that the above mentioned **intangible assets are invaluable assets**, which are required for carrying on the business acquired by the assessee without any interruption.
- The assets purchased under the slump sale agreement by the assessee is in the nature of **Intangible Asset** under the category **"Other business or commercial rights of similar nature"** because In the absence of the aforesaid intangible assets, the assessee would have had to commence business from scratch and go through the gestation period whereas by acquiring the aforesaid business rights along with the tangible assets, the assessee has got a running business.

High Court's Decision:
The High Court, therefore, held that the specified intangible assets acquired under the slump sale agreement by the assessee are in the nature of intangible asset under the category "other business or commercial rights of similar nature" specified in section 32(1)(ii) and are accordingly eligible for depreciation under section 32(1)(ii).

8. Is the assessee entitled to depreciation on the value of goodwill considering it as an asset within the meaning of *Explanation 3(b)* to Section 32(1)?

Smifs Securities Ltd. (SC)

Facts of the case: In this case, the assessee has paid an excess consideration over the value of net assets of the amalgamating company acquired by it, which is treated as **Goodwill,** since the extra consideration was paid towards the reputation which the amalgamating company was enjoying in order to retain its existing clientele. The assessee hence claimed depreciation on the said goodwill.

However, the AO contended that the goodwill is not an asset falling under *Explanation 3* to section 32(1) and therefore, is not eligible for depreciation.

Supreme Court's Observations: On this issue, the Supreme Court observed that *Explanation 3* to section 32(1) states that the expression 'asset' shall mean an **intangible asset, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.**

Supreme Court's Decision:
A reading of the words **'any other business or commercial rights of similar nature'** in *Explanation 3(b)* indicates that goodwill would fall under the said expression. In the process of amalgamation, the amalgamated company had acquired a capital right in the form of goodwill because of which the market value of the amalgamated company stood increased.
Therefore, it was held that 'Goodwill' is an asset under *Explanation 3(b)* to section 32(1) & depreciation thereon is allowable under the said section.

9. Can EPABX and mobile phones be treated as computers to be entitled to higher depreciation at 60%?

Federal Bank Ltd. (HC)

High Court's Decision:
On this issue, the High Court held that the rate of depreciation of 60% is available to computers and **there is no ground to treat the communication equipment as computers**. Hence, EPABX and mobile phones are not computers and therefore, are not entitled to higher depreciation at 60%.

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

Smt. A. Sivakami and Another (HC)

Facts of the case:

- The assessee Purchased 3 buses on loan and leased it to customers by registering the vehicles in their respective names & claimed depreciation on such 3 buses, even though she was not the registered owner of the same.
- 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 & expenditure from the buses was shown. The buses in dispute were also shown as assets in the **balance sheet** of the proprietary concern.
- Hence the assessee claimed depreciation on these buses.
- The AO rejected the claim of the assessee on the ground that the assessee was not the legal owner of the 3 buses and the basic condition under section 32(1) to claim depreciation is that the assessee should be the **owner of the asset**.

- **<u>High Court's Observations</u>:** The High Court observed that having regard to the Income- tax Act, 1961, the owner need not necessarily be the legal owner entitled to pass on the title of the property to another.

> **<u>High Court's Decision</u>:**
> 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, the High Court held that **she was entitled to claim depreciation** even though she was not the legal owner of the buses.

11. Can employees contribution to Provident Fund and Employee's State Insurance be allowed as deduction where the assessee-employer had not remitted the same on or before the "due date" under the relevant Act but remitted the same on or before the due date for filing of return of income under section 139(1)?

Gujarat State Road Transport Corpn (HC)

<u>Facts of the case:</u>

- The assessee (GSRTC) collected employees' **contribution to Provident Fund & ESI** which were remitted **after the due date** under the relevant Acts **but before the** 'due date' for filing the return specified in section 139(1).
- The AO held that
    - The amount collected by way of employees' contribution to PF and ESI are **Income** U/S 2(24)(x) and their remittance is governed by section 36(1)(va).
    - The **time limit prescribed** for remitting the contribution is the 'due date' prescribed under the Provident Funds Act, Employees' State Insurance Act, rule, order or notification issued thereunder.
- LAW – **SEC 43B** – Meant for Employers PF Contribution
  SEC 36(1)(va) – Meant for Employees PF Contribution

<u>High Court's Observations:</u>

- The High Court noted that section 43B(b) pertaining to employer's contribution cannot be applied with respect to employees' contribution which is governed by section 36(1)(va).
- So far as the employee's contribution is concerned, the *Explanation* to section 36(1)(va) continues to remain in the statute and there is no provision for applying the extended time limit provided U/S 43B for remittance of employee's contribution.

> **<u>High Court's Decision:</u>**
> The High Court, accordingly, held that the delayed remittance of employees' contribution beyond the 'due date' prescribed in section 36(1)(va), is **NOT DEDUCTIBLE** while computing the business income, even though such remittance has been made before the due date of filing of return of income under section 139(1).

12. Can compensation paid by the assessee-company to its tenants for vacating the premises in order to earn higher rent by re-letting out the same, be allowed as revenue expenditure incurred for the business, if the main object of the assessee- company as per its Memorandum of Association is to acquire and develop properties and to deal with the same by way of sale, lease, letting out etc.?

Shyam Burlap Co Ltd (HC)

<u>Facts of the case</u>:

The assessee paid the compensation of 53.50 lakhs to the tenants and obtained the possession & claimed i t as business expenditure treating it as **revenue in nature.**

However, the AO disallowed the claim of the assessee by treating the amount of compensation as **capital expenditure** on the ground that such payment was made for acquiring a benefit of enduring nature.

<u>Appellate Authorities' views</u>:

After examination of the object clause of the MOA of the assessee company, the **Commissioner (Appeals) held that it is a revenue expenditure** allowable as deduction from business income.

However, the **Tribunal supported the view of the AO** that such expenditure was capital in nature and disallowed the claim of the assessee.

<u>High Court's Observations</u>:

The High Court referred to the decision of the Apex Court in the case of *Chennai Properties and Investments Ltd,* wherein it observed that

- **The objects of the company must also be kept in mind** while interpreting the nature of rental income and the head under which the same is taxable. Accordingly, the High Court, in this case, took note of the **objects clause of the MOA** of the assessee which permitted the assessee to carry on the business of letting out premises. Also 85% of the assessee's income was by way of deriving rent and lease rentals. Hence it was held that since the main object of the company was to earn rental income by letting out of properties, such income constituted its business income and not income from house property.

  Thus, the payment of compensation had arisen out of business necessity and commercial expediency.
- As the **compensation was not for acquiring a property**, it cannot be said that the payment made was for having a benefit of enduring nature. The compensation, in fact, was paid to the existing tenants to have their portions vacated to have new tenants with higher rent and, thus, to earn higher rental income which was a business activity permitted by the memorandum.
- The assessee, being the owner of the property, was carrying on business by letting out of properties and the compensation paid to the existing tenants was for deriving higher rent by re-letting out the properties which was in line with the MOA of the company.

High Court's Decision:
The High Court, accordingly, held that when **income from letting out of premises is treated as income from business** based on the facts and circumstances of the case and the rationale of the Supreme Court ruling in *Chennai Properties'* case, **the compensation paid to tenants for vacating the premises to facilitate the assessee to derive higher rent by re-letting out the premises, is deductible as revenue expenditure**.

13. Can interest paid upfront to the debenture holders be allowed as deduction in the first year itself or should the same be spread over the life of the debentures, being 5 years in this case, when such interest is shown as deferred revenue expenditure in the books of account?

Taparia Tools Ltd (SC)

Facts of the case:

The assessee issued non-convertible debentures and gave two options as regards payment of interest to debenture holders. They could either receive interest periodically (i.e. half-yearly) at 18%PA , over a period of 5 years or opt for one time upfront payment of 55 per debenture.

In the second option, 55 per debenture was to be paid immediately upfront on account of interest. At the end of the debenture period of 5 years, the debentures were to be redeemed at the face value of 100. The said upfront payments of interest on debentures were shown by the assessee as **deferred revenue expenditure** in the books of accounts to be written off over a period of 5 years.

But assessee **claimed such expenditure as fully deductible expenditure in the first year only**, being the year of payment.

The AO, however, treated the expenditure as **"deferred revenue expenditure"** to be allowed over the tenure of debentures and hence, **allowed only one-fifth of the payment made and disallowed the balance of claim.**

Supreme Court's Observations:

The Supreme Court observed that while examining the allowability of deduction, the AO has to consider the genuineness of borrowing.

- U/S 36(1)(iii), **any amount paid on account of interest is an admissible deduction**, if the capital was borrowed by the assessee and the borrowing was for the purpose of business or profession. The Supreme Court opined that **once the genuineness was proved and the conditions of section 36(1)(iii) read with section 43(2) were satisfied, the benefit of deduction in the year in which the amount of interest was actually paid or incurred cannot be denied**. In the present case, the AO has not disputed the issue of debentures and use of funds for business purposes.
- Moreover, the Supreme Court also noted that **there is no concept of deferred revenue expenditure in the Income-tax Act, 1961** except under specified sections such as section 35D meant for amortization over a period of time.
- Normally, **revenue expenditure is deductible in the year in which it is incurred**. However, if the assessee wants to spread the expenditure over a period of ensuing years, it can be allowed only if the principle of 'matching concept' is satisfied.

- The Supreme Court took note that by discharging the liability in the first year itself, the assessee had benefitted by making payment of a lesser amount of interest in comparison to the interest which was payable under the first option over a period of 5 years. When the assessee did not seek spread over of expenditure and had claimed the entire expenditure in the same year and a return was filed in that manner, the Assessing Officer was bound to carry out the assessment by applying the provisions of the Act and not to go beyond the said return.
- **The statute enables & entitles the assessee to claim entire upfront interest paid in the year of payment.**

Supreme Court's Decision:
The Supreme Court, accordingly, held that the assessee would be entitled to deduction of the entire upfront interest paid in the same year in which the amount was actually paid.

14. Is expenditure incurred for construction of transmission lines by the assessee for supply of power to UPPCL by the assessee deductible as revenue expenditure?

Dharmpur Sugar Mill (P) Ltd (HC)

Facts of the case:

The assessee used to generate power which was later sold to UPPCL being its only customer.

The assessee paid 8.48 crores to UPPCL for construction of transmission line and other supporting work for supply of power to UPPCL.
The agreement between the assessee & UPPCL stipulated that the entire expenditure for erection and installation of power transmission lines would be incurred by the assessee & UPPCL would own such entire power transmission lines.
The assessee claimed the entire expenditure as a deduction under section 37(1). Treating it as a revenue expenditure.
The claim of the assessee was disallowed by the AO holding that the assessee acquired a capital asset & hence it's a capital expenditure.
But the Commissioner (Appeals) disagreed with AO & stated that incurring the expenditure the assessee acquired right to make use of the asset for facilitating efficient conduct of its business and making it more profitable without getting any advantage of enduring benefit to itself. The assessee did not acquire any capital asset to get covered by section 32 and hence, the expenditure incurred was revenue in nature.
The Tribunal, too, confirmed the order of the Commissioner (Appeals).

High Court's Opinion:

- The High Court made reference to ***Empire Jute Co Ltd****,* where the Supreme Court held that the true test is to **consider the nature of the advantage in a commercial sense** and if the advantage is in the capital field that the expenditure would be disallowed. If the advantage consists in merely facilitating its trading operations or conducting its business while leaving the capital field untouched, the expenditure would be on revenue account.
- A similar precedent in *Gujarat Mineral Development Corpn. Ltd* was also cited to hold that the expenditure incurred in the laying of transmission lines was on revenue account.
- The Allahabad High Court also made reference to the Rajasthan High Court ruling in *Hindustan Zinc Ltd.* wherein it was observed that the erection of power lines by the assessee was for facilitating its routine operations and for smooth functioning of its business. The power lines remained the property of the Electricity Board.
- The High Court, therefore, held that the assessee had not acquired a capital asset or any enduring benefit or advantage.

High Court's Decision:
Following the principle of law laid down by the Supreme Court in *Empire Jute Mills'* case, the Allahabad High Court, in this case, held that the expenditure which was incurred by the assessee in the laying of transmission lines was clearly on the revenue account.
The transmission lines, upon erection, vested absolutely in UPPCL. The expenditure which was incurred by the assessee was for aiding efficient conduct of its business since the assessee had to supply electricity to its sole consumer UPPCL.
This was not an advantage of a capital nature.

15. Where the assessee-company came into existence on bifurcation of a Joint Venture Company (JVC), can the amount paid by it to the JVC for use of customer database and transfer of trained personnel be claimed as revenue expenditure?

IBM Global Services India P Ltd (HC)

Facts of the case:

- The assessee-company came into existence on the bifurcation of a **JVC** floated earlier by two other companies. The assessee-company paid 530 lakhs for use of domestic customer database to the joint venture company Also certain skilled and trained employees of the **JVC** were transferred to the assessee-company for which it made a payment of 938.58 lakhs to the **JVC**.
- The assessee claimed both the payments as revenue expenditure.
- AO disallowed by the claim of the assessee and held that both the payments are of capital in nature since an enduring benefit to the assessee was provided.

AO contended that **domestic customer database is a capital asset** which provides an enduring advantage or benefit to the assessee, since by utilizing the same, the assessee can successfully run its business activities over a considerable period of time.

The Assessing Officer also contended that compensation paid by the assessee to the **JVC** for **transfer of human skill is a capital expenditure**, since the expenditure incurred on recruitment and training of transferred personnel would provide an enduring benefit.

High Court's Observations and Decision:

The High Court observed that the

Expenditure incurred for use of customer database :

- Expenditure incurred for use of customer database **did not result in acquisition of any capital asset.**
- The **expenditure incurred was for use of data base and not for acquisition of such data base** and, hence, is deductible as **revenue expenditure.**

Payment for obtaining trained and skilled employees

- As regards payment for obtaining trained and skilled employees, it was held that the **JVC** spent a lot of money to give training to employees who were transferred to the assessee-company. They have opted for employment with the assessee, and for their past services with the **JVC**, expenditure has been incurred.
- In effect, the payment made by the assessee-company was **towards expenditure incurred for their training and recruitment.** Such expenditure was in the revenue field, and therefore, the payment made by the assessee-company as per agreement to save such expenditure was also revenue in nature.
- Therefore, the expenditure incurred for obtaining trained and skilled employees cannot be termed as capital expenditure though the benefit may be of enduring nature.

The High Court, thus, held that **both the expenditures claimed were allowable as revenue expenditure.**

16. What is the nature of expenditure incurred on glow-sign boards displayed at dealer outlets - capital or revenue?

Orient Ceramics and Industries Ltd. (HC)

High Court's Observations: On this issue, the Delhi High Court noted the following observations of the Punjab and Haryana High Court in ***Liberty Group Marketing Division***, while holding that **such expenditure was revenue in nature -**

(i) The expenditure incurred **Did not bring into existence any asset or**

(ii) The expenditure incurred did **Not Bring Any Enduring Benefit Or Advantage** to the business.

(iii) The glow sign board is **Not An Asset Of Permanent Nature**. It has a short life.

(iv) The **materials used in the glow sign boards requires frequent replacement** since it decays with the effect of weather. Therefore, Consequently the assessee has to incur expenditure on glow sign boards regularly in almost each year.

(v) The assessee incurred expenditure on the glow sign boards with the **object of facilitating the business operation and not with the object of acquiring asset of enduring nature**.

High Court's Decision:

The Delhi High Court concurred with the above observations of the P & H High Court and held that **such expenditure on glow sign boards displayed at dealer outlets was revenue in nature.**

17. Would the expenditure incurred on issue and collection of convertible debentures be treated as revenue expenditure or capital expenditure?

ITC Hotels Ltd. (HC)

High Court's Decision:
On this issue, the Karnataka High Court held that the expenditure incurred on the issue and collection of debentures shall be treated as **revenue expenditure** even in case of convertible debentures, i.e., the debentures which had to be converted into shares at a later date.

18. Would expenditure incurred on feasibility study conducted for examining proposals for technological advancement relating to the existing business be classified as a revenue expenditure, where the project was abandoned without creating a new asset?

Priya Village Roadshows Ltd. (HC)

Facts of the case:

In this case, the assessee, engaged in the business of running cinemas, incurred expenditure towards architect fee for examining the technical viability of the proposal for takeover of cinema theatre for conversion into a multiplex/ four-screen cinema complexes. The project was, however, dropped due to lack of financial and technical viability. The issue under consideration is whether such expenses can be treated as **revenue in nature**, since no new asset has been created.

High Court's Observations:

On this issue, the High Court observed that, in such cases, **whether or not a new business/asset comes into existence would become a relevant factor. If there is no creation of a new asset, then the expenditure incurred would be of revenue nature.**

High Court's Decision:
The High Court held that, since the feasibility studies were conducted by the assessee for the existing business with a common administration and common fund and the studies were abandoned without creating a new asset, the expenses were of **revenue nature.**

19. 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?

Hindustan Zinc Ltd. (HC)

Facts of the case:

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 U/S 37 (revenue expenditure)

AO disallowed such expenditure on the ground that it was of capital nature.

Tribunal view:

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,**

Hence the expenditure is revenue in nature and hence, allowable as deduction.

High Court's Observations & Decision:
The High Court observed that the expenditure incurred by the assessee for commercial convenience 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.**

20. Is *Circular No. 5/2012 dated 01.08.2012* disallowing the expenditure incurred on freebies provided by pharmaceutical companies to medical practitioners, in line with *Explanation* to section 37(1), which disallows expenditure which is prohibited by law?

Confederation of Indian Pharmaceutical Industry (SSI) (HC)

High Court's Observations:

On this issue, the Himachal Pradesh High Court observed that **as per Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, every medical practitioner and his or her professional associate is prohibited from accepting any gift, travel facility, hospitality, cash or monetary grant from any pharmaceutical and allied health sector industries.**

This is a **salutary regulation in the interest of the patients and the public**, considering the increase in complaints against the medical practitioners prescribing branded medicines instead of generic medicines, solely in lieu of gifts and other freebies granted to them by some particular pharmaceutical industries.

The CBDT, considering the fact that the **claim of any expense incurred in providing freebies to medical practitioners is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations clarified that the expenditure so incurred shall be inadmissible U/S 37(1).**

The disallowance shall be made in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebies and claimed it as a deductible expense in its accounts against income.

High Court's Decision:
The High Court referred to section 37(1).
As per *Explanation* to section 37(1), it is clear that **any expenditure incurred by an assessee for any purpose which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession**.

However, if the assessee satisfies the assessing authority that the expenditure incurred is not in violation of the regulations framed by the Medical Council then it may legitimately claim a deduction, but for that assessee will have to satisfy the AO that the expenses incurred are not in violation of the Medical Council Regulations.

21. Can the commission paid to doctors by a diagnostic centre for referring patients for diagnosis be allowed as a business expenditure U/S 37 or

would it be treated as illegal and against public policy to attract disallowance?

Kap Scan and Diagnostic Centre P. Ltd. (HC)

High Court's Observations:

- ✓ On the above mentioned issue, the Punjab and Haryana High Court observed that the argument of the assessee that giving commission to the private doctors for referring the patients for various medical tests was a trade practice which should not be termed as illegal and therefore, the same cannot be disallowed U/S 37(1), is not acceptable.
- ✓ As per *Explanation* to section 37(1), it is clear that **any expenditure incurred by an assessee for any purpose which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession**.
- ✓ Applying section 37(1), the assessee would not be entitled to deduction of payments made in contravention of law. Similarly, **payments which are opposed to public policy being in the nature of unlawful consideration cannot also be claimed as deduction.**
- ✓ The assessee cannot take a plea that businessmen are entitled to conduct their business even contrary to law and claim deduction of certain payments as business expenditure, notwithstanding that such payments are illegal or opposed to public policy or have harmful consequences to the society as a whole.
- ✓ As per the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, **no physician shall give, solicit, receive, or offer to give, solicit or receive, any gift, gratuity, commission or bonus in consideration of a return for referring any patient for medical treatment**.

High Court's Decision:
The demanding as well as paying of such commission is bad in law.
It is **not a fair practice and is opposed to public policy and should be discouraged**.
Thus, the High Court held that commission paid to doctors for referring patients for diagnosis is **not allowable as a business expenditure.**

22. Can expenditure incurred by a company on higher studies of the director's son abroad be claimed as business expenditure U/S 37 on the contention that he was appointed as a trainee in the company under "apprentice training scheme", where there was no proof of existence of such scheme?

Echjay Forgings Ltd. (HC)

High Court's Observations: On this issue, it was observed that

- **There was no evidence on record** to show that any other person at any point of time was appointed as trainee or sent abroad for higher education.
- Further, **the appointment letter to the director's son, neither had any reference number nor was it backed by any previous application by him**.
- No details were produced in relation to the appointment letter referring as "apprentice training scheme" with the company
- There was **no evidence that he was recruited as trainee by some open competitive exam or regular selection process.**

High Court's Decision:
The High Court, thus, held that **there was no nexus between the education expenditure incurred** abroad for the director's son and the business of the assessee company. Therefore, the aforesaid expenditure was not deductible.

23. Can the expenditure incurred on heart surgery of an assessee, being a lawyer by profession, be allowed as business expenditure U/S 31, by treating it as current repairs considering heart as plant and machinery, or U/S 37, by treating it as expenditure incurred wholly and exclusively for the purpose of business or profession?

Shanti Bhushan (HC)

Facts of the case:

In the present case, the assessee is a lawyer by profession. The assessee argued that the repair of vital organ (i.e. the heart) had directly impacted his professional competence. He contended that the **heart should be treated as plant as it is used for the purpose of his professional work**. Hence, the expenditure on the heart surgery should be allowed as business expenditure either U/S 31 as current repairs to plant and machinery or section 37 as an expense incurred wholly and exclusively for the purpose of profession.

The department argued that the said expenditure was **personal in nature** and was **not incurred wholly and exclusively for the purpose of business or profession**, and therefore, the same should not be allowed as business expenditure.

High Court's Observations: On this issue, the Delhi High Court observed that It cannot be said that the heart is used as an exclusive tool for the purpose of professional activity by the assessee. Further, the High Court held that:-

(i) To allow the heart surgery expenditure as repair expenses to plant, **the heart should have been first included in the assessee's balance sheet as an asset in the previous year and in the earlier years**.

(ii) Also, **a value needs to be assigned for the same**. The assessee would face difficulty in arriving at the **cost of acquisition of such an asset** for showing in his books of account.

(iii) Though the definition of "plant" as per the provisions of section 43(3) is inclusive in nature, such plant must have been used as a business tool which is not true in case of heart. Therefore, the heart cannot be said to be plant for the business or profession of the assessee. Therefore, the expenditure on heart surgery is not allowable as repairs to plant under section 31.

(iv) According to the provisions of section 37, *inter alia,* the said expenditure must be incurred **wholly and exclusively** for the purposes of the assessee's profession. As mentioned above, a healthy heart will increase the efficiency of human being in every field including its professional work.

High Court's Decision:
There is, therefore, no **direct nexus** between the expenses incurred by the assessee on the heart surgery and his efficiency in the professional field. Therefore, the claim for allowing the said expenditure under section 37 is also not tenable. Hence, the heart surgery expenses shall not be allowed as a business expenditure of the assessee under the Income-tax Act, 1961.

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

Neelavathi & Others (HC)

Facts of the case:

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 AO.

High Court's Observations:

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."

High Court's Decision:

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**.

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

Millennia Developers (P) Ltd. (HC)

Facts of the case: 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 AO and the disallowance was confirmed by the Tribunal.

High Court's Observations and Decision:

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 U/S 37**. Merely describing the payment as a compounding fee would not alter the character of the payment.

26. Can remuneration paid to working partners as per the partnership deed be considered as unreasonable and excessive for attracting disallowance U/S 40A(2)(a) even though the same is within the statutory limit prescribed under section 40(b)(v)?

Great City Manufacturing Co (HC)

Facts of the case:

In this case, the AO contended that the remuneration paid by the firm to its working partners was highly excessive and unreasonable, on the ground that the remuneration to partners (39.31 lakh) was many times more than the total payment of salary to all the employees (4.87 lakh). Therefore, he disallowed the excessive portion of the remuneration to partners by invoking the provisions of section 40A(2)(a).

High Court's Observations:

On this issue, the High Court observed that section 40(b)(v) prescribes the limit of remuneration to working partners, and deduction is allowable up to such limit while computing the business income. If the remuneration paid is within the ceiling limit provided under section 40(b)(v), then, recourse to provisions of section 40A(2)(a) cannot be taken.

The AO is only required to ensure that the

- ✓ Whether remuneration is paid to the working partners as mentioned in the partnership deed,
- ✓ Does The terms and conditions of the partnership deed provide for payment of remuneration to the working partners and
- ✓ Is The remuneration within the limits prescribed U/S 40(b)(v).

If these conditions are complied with, then the AO cannot disallow any part of the remuneration on the ground that it is excessive.

High Court's Decision: The Allahabad High Court, therefore, held that the **question of disallowance of remuneration under section 40A(2)(a) does not arise in this case**, since the Tribunal has found that **all the three conditions mentioned above have been satisfied**. Hence, the remuneration paid to working partners within the limits specified under section 40(b)(v) cannot be disallowed by invoking the provisions of section 40A(2)(a).

27. Where the lump sum amount paid as One Time Settlement (OTS), without bifurcation of interest and principal, has been offered to tax U/S 41(1), can the assesseee claim benefit of deduction of interest (interest paid plus interest waived) U/S 43B?

KLN Agrotechs (P) Ltd (HC)

Facts of the case:

The assessee company had taken working capital loan from Canara Bank aggregating to **441.30 lakhs**. Due to default in repayment of loan, the bank declared the account as NPA. The total outstanding payable by the company was **635.26 lakhs** which included **principal amount of 441.30** & **interest amount of 193.96 lakhs.**

During the assessment year in question, the assessee arrived at **One Time Settlement (OTS) scheme** with the bank. As per the OTS, the assessee **paid 378.72 lakhs** (against the total outstanding of 635.26 lakhs) to the bank.

In the return filed, the assessee offered as income **256.54 lakhs** being the difference between the amount outstanding (635.26 lakhs) and the actual amount paid (378.72 lakhs). The assessee also claimed the interest of 193.96 lakhs as deduction under section 43B.

The Revenue

- ✓ **Rejected the claim of deduction U/S 43B in respect of 193.96 lakhs** and
- ✓ **Charged to tax the entire amount of 256.54 lakhs** considering the actual amount paid as the amount adjusted towards the principal outstanding amount.

Appellate Tribunal's view:

The Appellate Tribunal, however, **allowed the claim of the assessee** holding that **the assessee cannot be subjected to double jeopardy** i.e., it could not be subjected to tax on the entire waived amount as well as subjected to disallowance of interest under section 43B, as the said two effects are mutually exclusive and cannot co-exist.

High Court's Observations & Decision :

The High Court concurred with the Tribunal's view that if out of the total sum of 256.54 lakhs which has been offered and subjected to tax by the assessee in its return, the amount of unpaid interest of 193.96 lakhs is deducted then the waived principal sum would come to 62.58 lakhs (i.e., 441.30 lakhs - 378.72 lakhs), which is the amount which ought to have been taxed under section 41(1).

Based on the above reasoning, the High Court held that either the interest amount has to be allowed as deduction under section 43B or the sum offered for tax (as waived by the bank) has to be reduced by the amount of interest. In either case, the effective amount which is subjected to tax, would come to the same.

28. Can Unpaid Electricity Charges be treated as "fees" to attract disallowance under section 43B?

Andhra Ferro Alloys P. Ltd. (HC)

Assessing Officer's view *v/s* Tribunal's view:

On this issue, the AO was of the view that electricity charges come within the ambit of section 43B and therefore, could be allowed as deduction only on payment basis. Therefore, he disallowed the unpaid electricity charges. The Tribunal, however allowed such expenses.

High Court's Observations and Decision: The Andhra Pradesh HC observed that the prov of sec 43B do not include electricity charges. Therefore, non-payment of electricity charges would not attract disallowance U/S 43B since such charges cannot be termed as "fees". Hence they will still be allowed & such charges cannot be termed as fees.

7

CAPITAL GAINS

1. **Whether, for the purpose of computing the period of holding of the property, the date of allotment letter issued by the builder of the flat or the date of registration of the property has to be considered for determining the nature of capital asset – long-term or short-term?**

S.R.Jeyashankar (HC)

Facts of the case: In the present case, the assessee had entered into an agreement with M/s Vishranthi Homes Pvt. Ltd.(VHPL) for purchase of a piece of land as well as for construction of a flat *vide*

- ✓ **Agreement dated February 22, 2005**.
- ✓ **Payments were made & the transaction was concluded with registration of land on August 4, 2005.**
- ✓ **Sold the entire unit by a sale deed dated April 10, 2008,** well after 36 months from the date of agreement i.e., February 22, 2005, and
- ✓ claimed the difference between the **SC** and **ICOA** as **LTCG**

The Assessing Officer, however, took a view that **land was registered on August 4, 2005**, and since the **property was purchased in August, 2005**, and **sold in April, 2008**, the capital gains arising from sale will be assessed as **short-term capital gains** only and, accordingly, the Assessing Officer denied benefit of section 2(29A) and made addition.

Appellate Authorities' Views: The Commissioner (Appeals) allowed the claim of the assessee. The Tribunal, held that the date of allotment of the flat has to be adopted as date of acquisition of the immovable property when it comes to acquiring a flat from the promoter of the flat by way of executing construction agreement and not the date of the sale deed for purchase of the undivided share in land.

Accordingly, the Tribunal confirmed the order of the Commissioner (Appeals).

High Court's Observations:

The Madras High Court noted that the Tribunal had relied on the decision of the Punjab and Haryana High Court in *Mrs. Madhu Kaul's case,* where it was held that **the date of allotment under a scheme framed by the DDA is to be taken as the date of acquisition and the mere fact that the actual possession was delivered later does not distract the fact that the allottee was conferred a right to hold the property on issuance of allotment letter**

The payment of balance installments, identification of a particular flat and delivery of possession are **consequential acts** that relate back & hence are not the deciding factor.

In effect, the **Punjab & Haryana High Court** held that the **allottee gets the title to the property on issuance of allotment letter and payment in installments is only a consequential act** upon which delivery of possession to the property flows.

In this case, the **Madras High Court observed that the right to the property flows from the date of agreement with the builder i.e., from February, 2005**.

High Court's Decision:
Accordingly, the Madras High Court held that the **assessee had rightly claimed the benefit of LTCG**, since the holding period exceeded 36 months (i.e., from 22.02.2005, being the date of agreement, to 10.04.2008, being the date of sale of property).

2. **Where a leasehold property is purchased and subsequently converted into freehold property and then sold, should the period of holding be reckoned from the date of purchase or from the date of conversion for determining whether the resultant capital gains is short-term or long-term?**

Smt. Rama Rani Kalia (HC)

Facts of the case:

- ✓ The assessee purchased a leasehold property in 1984.
- ✓ Such leasehold property was converted into freehold rights on March 29, 2004.
- ✓ She sold the property on March 31, 2004 and declared **LTCG** on the transfer.

The **AO** opined that since the property was acquired by converting the leasehold right into freehold right on March 29, 2004, and **was sold within 3 days** on March 31, 2004, the resultant capital gains would be **STCG**

Appellate Authorities' views:

The Commissioner (Appeals) opined that the **conversion of leasehold property into freehold property was nothing but improvement of the title over the property, as the assessee was the owner prior to conversion & after conversion also**.

The **Tribunal affirmed this view of the Commissioner (Appeals)** and **held that the gains were LTCG, as the assessee was the owner of the property even prior to conversion**.

High Court's Observations:

The High Court observed that **the difference between "short-term capital asset" and "long-term capital asset" is the period over which the property has been held by the assessee and not the nature of title over the property**. The lessee of the property has rights as the owner of the property subject to the covenants of the lease deed. Accordingly, the lessee may, subject to covenants of the lease deed, transfer the leasehold rights of the property with the consent of the lessor.

High Court's Decision:
The High Court, therefore, concurred with the views of the Tribunal that **conversion of the rights of the lessee from leasehold to freehold is only by way of improvement of her rights over the property, which she enjoyed. It would not have any effect on the taxability of gain from such property,** which is related to the period over which the property is held. **Since, in this case, the period of holding is more than 36 months, the resultant capital gains would be long-term.**

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3. **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 (HC)

Facts of the case:

- ✓ 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 & the land within 3 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 **LTCG**.

High Court's Decision:
The High Court held that the benefit of including the period of holding of the previous owner U/S 2(42A) 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, in this case, the **period of holding of the asset received by the assessee- partner on dissolution of the firm has to be reckoned only from the date of dissolution of the firm**. Since the assessee-partner has sold the property within three days of acquiring the same, the gains have to be treated as **STCG**

4. **What would be the period of holding to determine whether the capital gains on renunciation of right to subscribe for additional shares are short-term or long-term?**
Navin Jindal (SC)

Supreme Court's Observations:
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

Supreme Court's Decision:
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.**

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5. Whether indexation benefit in respect of the gifted asset shall apply from the year in which the asset was first held by the assessee or from the year in which the same was first acquired by the previous owner?

Manjula J. Shah (HC)

"In case the capital asset becomes the property of the assessee by way of gift by the previous owner, then for determining the nature of the capital asset, the aggregate period for which the capital asset is held by the assessee and the previous owner shall be considered."

As per the provisions of section 48, the profit and gains arising on transfer of a LTCA shall be computed by reducing the ICOA from the NSC. The ICOA meant the amount which bears to the cost of acquisition the same proportion as Cost Inflation Index (CII) for the year in which the asset is transferred bears to the CII for the year **in which the asset was first held by the assessee transferring it i.e., the year in which the asset was gifted to the assessee in case of transfer by the previous owner by way of gift.**

Facts of the case:

In the present case, the assessee had acquired a capital asset by way of gift from the previous owner. The said asset when transferred was a **LTCA** considering the period of holding by the assessee as well as the previous owner. The assessee computed the **LTCA** considering the CII of the year in which the asset was first held by the previous owner.

The AO raised an objection mentioning that as per meaning assigned to the Indexed cost of acquisition, the CII of the year in which the asset is first held by the assessee need to be considered and not the CII of the year in which the asset was first held by the previous owner.

High Court's Observations: In the present case, the Bombay High Court observed that the assessee is deemed to have held the capital asset from the year the asset was held by the previous owner and accordingly the asset is a **LTCA** in the hands of the assessee.

Therefore, for determining the **ICOA** U/S 48, the assessee must be treated to have held the asset from the year the asset was first held by the previous owner and accordingly the CII for the year the asset was first held by the previous owner would be considered for determining the **ICOA**

High Court's Decision: Hence, the indexed cost of acquisition in case of gifted asset has to be computed with reference to the **year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset.**

6. Where a building, comprising of several floors, has been developed and re- constructed, would exemption under section 54/54F be available in respect of the cost of construction of -

(i) the new residential house (i.e., all independent floors handed over to the assessee); or

(ii) a single residential unit (i.e., only one independent floor)?

Gita Duggal (HC)

Facts of the case:

In the present case, the assessee was the owner of property comprising the basement, ground floor, first floor and second floor. In the year 2006, she entered into a agreement with a builder for developing the property. According to the terms of the agreement, the builder was to demolish the existing structure on the plot of land and develop, construct, and/or put up a building consisting of basement, ground floor, first floor, second floor and third floor with terrace at its own costs and expenses.

The assessee handed over to the builder, the physical possession of the entire property, **along with 22.5% undivided interest over the land**. The handing over of the entire property was, however, only for the limited purpose of development. **The builder was to get the third floor plus the undivided interest in the land to the extent of 22.5% for his exclusive enjoyment**. In addition to the cost of construction incurred by the builder on development of the property, a further **amount of 4 crores was payable by the builder to the assessee as consideration against the rights of the assessee.**

Assessee's contention *v/s* Assessing Officer's contention:

The assessee, in her ROI, showed only **4 crores as sales consideration.**

The AO, however, took the view that the **sale consideration for the transfer should include not only the amount of 4 crores received by the assessee in cash, but also the cost of construction amounting to 3.44 crore incurred by the developer in respect of the other floors, which were handed over to the assessee**.

The assessee contended that if the cost of construction incurred by the builder is to be added to the sale price, then, the same should also correspondingly be considered as re- investment in the residential house for exemption U/S 54.

However, the AO rejected the claim for exemption U/S 54 on the ground that the floors obtained by the assessee contained **separate residential units** having separate entrances and cannot qualify as a single residential unit. He contended that deduction U/S 54F was allowable, and that too only in respect of cost of construction incurred in respect of one unit i.e., one floor.

High Court's Observations:

The High Court observed that **sections 54 and 54F use the expression "residential house" and not "residential unit" and it is the AO who has introduced a new concept of "residential unit" into these sections**.

Sections 54 & 54F require the assessee to acquire a "residential house" and so long as the assessee acquires a building, which may be constructed, for the sake of convenience, in such a manner as to consist of several units which can be conveniently and independently used as an independent residence, the requirement of the section should be taken to have been satisfied.

There is nothing in these sections which requires the residential house to be constructed in a particular manner. The only requirement is that it should be for residential use and not for commercial use.

High Court's Decision:
- The High Court held that **the fact that the residential house consists of several independent units cannot be permitted to act as an barrier to the allowance of the deduction U/S 54 or 54F**.
- **It is neither expressly nor by necessary implication prohibited**.
- Therefore, the **assessee is entitled to exemption of capital gains in respect of investment in the residential house, comprising of independent residential units handed over to the assessee.**

7. **Would an assessee be entitled to exemption U/S 54 in respect of *Purchase Of Two Flats*, adjacent to each other and having a common meeting point?**

Syed Ali Adil (HC)

Facts of the case:

The assessee-individual, sold a inherited ancestral house property during the relevant previous year. **Out of the sale consideration, he purchased two adjacent residential flats.** The assessee claimed exemption U/S 54 in respect of investment in both residential flats, in view of the decision of the Karnataka High Court in ***Ananda Basappa****,* wherein investment in two adjacent flats were considered eligible for exemption U/S 54.

Assessing Officer's contention:

The AO, however, **restricted the exemption U/S 54 only in respect of investment in one residential flat** (including stamp duty paid for registration of the flat), contending that –

(i) the two residential units were separated by a strong wall;

(ii) the two flats were purchased from two different vendors under two separate sale deeds.

Appellate Authorities' views: The Commissioner (Appeals) observed that assessee was entitled to exemption U/S 54 in respect of investment in both the flats, since the two flats had adjacent (NEARBY) kitchens and toilets and also had a common meeting point.
The Tribunal also concurred with the view of the Commissioner (Appeals).

High Court's Observations: On appeal by the Revenue, **the High Court referred to the Karnataka High Court decision in *Ananda Basappa,* wherein it was observed that where the flats are situated side by side and the *builder had effected the necessary modification to make it as one unit,* the assessee would be entitled to exemption U/S 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds.**

The above ruling was also followed by the Karnataka High Court in *K.G. Rukminiamma* , wherein it was held that **where a residential house was transferred and 4 flats in a single residential complex were purchased by the assessee, all the 4 residential flats constituted "a residential house" for the purpose of section 54.**

High Court's Decision:

The Andhra Pradesh High Court, on the basis of the above rulings of the Karnataka High Court, held that **in this case, the assessee was entitled to investment in both the flats purchased by him, since they were adjacent to each other and had a common meeting point, thus, making it a single residential unit.**

8. **Can exemption U/S 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?**

Gurnam Singh (HC)

Facts of the case:

The assessee claimed deduction U/S 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 AO on the ground that the land was registered in the name of the assessee's son.**

Tribunal's Observation:

- 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**.
- The **only objection raised by the Revenue was that the land was registered in the name of his son**. Therefore, it can be said that the capital gains were not in any way misused for any other purpose contrary to the provisions of law.

High Court's Decision:

- 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.

9. **Can exemption U/S 54F be denied solely on the ground that the new residential house is purchased by the assessee exclusively in the name of his wife?**

Kamal Wahal (HC)

Facts of the case:

The assessee sold a capital asset and invested the sale proceeds in purchase of a new house in the name of his wife. He claimed deduction U/S 54F in respect of the new residential house purchased by him in the name of his wife.

However, the same was denied by the AO on the ground that, **in order to avail the benefit under section 54F, the investment in the residential house should be made by the assessee in his own name**.

The **Tribunal, however, accepted the assessee's contention** observing that since section 54F is a beneficial provision enacted for encouraging investment in residential houses, the said provision has to be interpreted liberally.

High Court's Observations:

The Delhi High Court **concurred with the Tribunal's view and observed that, for the purpose of section 54F, a new residential house need not necessarily be purchased by the assessee in his own name nor is it necessary that it should be purchased exclusively in his name.**

A similar view was upheld by this Court in *Ravinder Kumar Arora,* **where the new residential house was acquired in the joint names of the assessee and his wife and the Court had held that the assessee was entitled for 100% exemption under section 54F.** In that case, it was further observed that **section 54F does not require purchase of new residential house property in the name of the assessee himself. It only requires the assessee to purchase or construct a residential house.**

Further, in this case, the Delhi High Court observed that **the assessee had not purchased the new house in the name of a stranger or somebody who is unconnected with him, but had purchased it in the name of his wife.** The entire investment for purchase of new residential house had come out of the sale proceeds of the capital asset (of the assessee) and there was no contribution from his wife.

High Court's Decision:

Hence, the Delhi High Court, held that the **assessee is entitled to claim exemption U/S 54F in respect of utilization of sale proceeds of capital asset for investment in residential house property in the name of his wife**.

10. In case of a house property registered in joint names, whether the exemption U/S 54F can be allowed fully to the co-owner who has paid whole of the purchase consideration of the house property or will it be restricted to his share in the house property?

Ravinder Kumar Arora (HC)

Facts of the case:

- In the present case, the assessee filed ROI showing LTCG on sale of plot of land. The assessee claimed exemption U/S 54F from such LTCG on account of **purchase of new residential house property** within the stipulated time period as mentioned in SEC 54F hence he claimed exemption U/S 54F taking into consideration the whole of purchase price of the residential house property.
- However, after going through the purchase deed of the house property, the AO found that the said house property was purchased in joint names of assessee and his wife. Therefore, the AO allowed 50% of the exemption claimed U/S 54F, being the share of the assessee in the property purchased in joint names.
- The assessee submitted that the **inclusion of his wife's name in the sale deed was just to avoid any litigation after his death**.
- **He further explained that all the funds invested in the said house were provided by him, including the stamp duty and corporation tax paid at the time of the registration** of the sale deed of the said house. **This fact was also clearly evident from the bank statement of the assessee.**
- The assessee claimed that the **exemption U/S 54F is to be allowed with reference to the full amount of purchase consideration paid by him for the aforesaid residential house and is not to be restricted to 50%.**
- **The AO did not deny the fact that the whole amount of purchases of the house was contributed by the assessee and nothing was contributed by his wife.**
- However, the AO opined that exemption U/S 54F shall be allowed only to the extent of assessee's right in the new residential house property purchased jointly with his wife, i.e. 50%.

High Court's Decision:

Considering the above mentioned facts, the **Delhi High Court held that the assessee was the real owner of the residential house in question and mere inclusion of his wife's name in the sale deed would not make any difference.**

The High Court also observed that **section 54F mandates that the house should be purchased by the assessee but it does not stipulate that the house should be purchased only in the name of the assessee**.

In this case, the house was purchased by the assessee in his name and his wife's name was also included additionally. Therefore, **the conditions stipulated in section 54F stand fulfilled and the entire exemption claimed in respect of the purchase price of the house property shall be allowed to the assessee.**

11. Can exemption U/S 54F be denied to an assessee in respect of investment made in construction of a residential house, on the ground that the construction was not completed within 3 years after the date on which transfer took place, on account of pendency of certain finishing work like flooring, electrical fittings, fittings of door shutter, etc?

Sambandam Udaykumar (HC)

Facts of the case:

- In this case, the assessee has claimed benefit of exemption U/S 54F in respect of capital gain arising on sale of shares of a company by investing the amount in construction of a house property.
- However, the AO contended that no exemption U/S 54F would be available in this case, as the construction of a residential house was not completed on account of pendency of certain work like flooring, electrical fittings, fittings of door shutter, etc., even after lapse of 3 years from the date of transfer of the shares.

High Court's Observations:

- The Karnataka High Court observed that the **condition mentioned for claiming the benefit U/S 54F is that the capital gains realized from sale of capital asset should have been invested either in purchasing a residential house or in constructing a residential house within the stipulated period**.
- If he has invested the money in the construction of a residential house, merely because the construction was not completed in all respects and possession could not be taken within the stipulated period, would not disentitle the assessee from claiming exemption under section 54F.
- In fact, in this case, the assessee has taken the possession of the residential building and is living in the said premises despite the pendency of flooring work, electricity work, fitting of door and window shutters.

High Court's Decision:

The Court held that in this case the **assessee would be entitled to exemption U/S 54F in respect of the amount invested in construction within the prescribed period.**

12. **Can the assessee claim exemption U/S 54F, on account of capital gain arising on transfer of depreciable assets held for more than 36 months i.e., a LTCA , though the same is deemed as capital gain arising on transfer of short-term capital asset by virtue of section 50?**

Rajiv Shukla (HC)

Facts of the case:

In the above mentioned case, the assessee had claimed benefit of exemption U/S 54F in respect of capital gain arising on the sale of property, being a depreciable asset held for more than 36 months i.e. long-term capital asset.

However, the department contended that **no exemption U/S 54F is available in this case, as the said exemption is granted in respect of the capital gain arising from the transfer of a LTCA whereas the capital gain arising on transfer of depreciable asset is deemed to be capital gain arising from transfer of STCA** by virtue of provisions of section 50.

High Court's Decision:

- The Delhi High Court, in the present case held that **the deeming fiction created by section 50 that the capital gain arising on transfer of a depreciable asset shall be treated as capital gain arising on transfer of short-term capital asset is only for the purpose of sections 48 and 49 and not for the purpose of any other section.**
- **Section 54F being an independent section will not be bound by the provisions of section 50.**
- **The depreciable asset if held for more than 36 months shall be a long-term capital asset as per the provisions of section 2(29A).**
- Therefore, the exemption U/S 54F on transfer of depreciable asset held for more than 36 months **cannot be denied on account of fiction created by section 50**.

13. **Where the stamp duty value U/S 50C has been adopted as the full value of consideration, can the reinvestment made in acquiring a residential property, which is in excess of the actual net sale consideration, be considered for the purpose of computation of exemption U/S 54F, irrespective of the source of funds for such reinvestment?**

Gouli Mahadevappa (HC)

Facts of the case:

In the present case, the assessee sold a plot of land for 20 lakhs and reinvested the sale consideration of ` 20 lakhs together with agricultural income of 4 lakhs, in construction of a residential house & therefore **assessee claimed capital gains exemption U/S 54F, taking into consideration the entire investment of 24 lakhs.**

The AO, applying the provisions of section 50C, **deemed the stamp duty value of 36 lakhs as the full value of consideration** since the consideration received on transfer of capital asset (i.e. 20 lakhs) was less than the value adopted by the stamp valuation authority (i.e.,36 lakhs). **The same was not disputed by the assessee before the AO.**

Assessing Officer's contention *vis-a-vis* Assessee's contention:

- The AO allowed exemption U/S 54F to the extent of actual net consideration of **20 lakhs.**
- **He did not consider the balance amount of 4 lakhs,** invested in the construction of residential house, out of agricultural income, for computation of exemption U/S 54F, even though the sale consideration adopted for the purpose of computation of capital gains i.e., stamp duty value of 36 lakhs, was more than the amount of 24 lakhs invested in the new house.
- **The assessee contended that the entire investment of 24 lakhs made in construction of the residential house should be considered for computation of exemption U/S 54F, irrespective of the source of funds for such reinvestment.**
- Further, the assessee also contended before the High Court that the registration value adopted U/S 50C was excessive and disproportionate to the market value of the property.

High Court's Observations:

- On the issue of applicability of section 50C, the Karnataka High Court observed that section 50C(2) allows an opportunity to the assessee to contend, before the AO, the correctness of the registration value fixed by the State Government. Had he done so, the assessing authority would have invoked the power of appointing a Valuation Officer for assessing the fair market value of the property.
- The High Court held that **when the assessee had not disputed the registration value at that point of time, it is not permissible for the assessee to now contend, at this stage, that the registration value does not correspond to the market value**.
- Hence, the value of 36 lakhs adopted U/S 50C has to be deemed as the full value of consideration.

High Court's Decision:

On the issue of exemption U/S 54F, the High Court held that **when capital gain is assessed on notional basis as per the provisions of section 50C, and the higher value i.e., the stamp duty value of 36 lakhs U/S 50C has been adopted as the full value of consideration, the entire amount of 24 lakhs reinvested in the residential house within the prescribed period should be considered for the purpose of exemption U/S 54F, irrespective of the source of funds for such reinvestment.**

14. Can exemption U/S 54EC be denied on account of the bonds being issued after 6 months of the date of transfer even though the payment for the bonds was made by the assessee within 6 month period?

Hindustan Unilever Ltd. (HC)

High Court's Observations:

In this case, the Bombay High Court observed that **in order to avail the exemption U/S 54EC, the capital gains have to be invested in a long-term specified asset within a period of 6 months from the date of transfer.**

Where the assessee has made the payment within the 6 month period, and the same is reflected in the bank account and a receipt has been issued as on that date, the exemption U/S 54EC cannot be denied merely because the bond was issued after the expiry of the 6 month period or the date of allotment specified therein was after the expiry of the 6 month period.

High Court's Decision:

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 6 months from the date of transfer, the assessee would be eligible to claim exemption U/S 54EC.**

★ **15. Can advance given for purchase of land, building, plant and machinery tantamount to utilization of capital gain for purchase and acquisition of new machinery or plant and building or land, for claim of exemption under section 54G?**

Fibre Boards (P) Ltd (SC)

Facts of the case:

The assessee-company had an industrial unit in Thane, which had been declared a notified urban. The assessee, in order to **shift its industrial undertaking from an urban area to a non- urban area**, sold its land, building and p & m situated at Thane and out of the capital gains so earned, paid advances of various amounts to different persons for purchase of land, plant and machinery, construction of factory and building in the year 1991-92. The assessee claimed exemption U/S 54G of the Income-tax Act, 1961, on the capital gains earned from the sale proceeds of its previous industrial undertaking situated in Thane in view of the advances so made, which was more than the capital gains earned by it.

The AO refused to grant exemption to the assessee U/S 54G on the ground that the non-urban area had not been declared to be so by any general or special order of the Central Government and that **giving advances did not amount to utilisation of capital gains for acquiring the assets.**

Appellate Authorities' views:

The CIT (Appeals) dismissed the case of the assessee

While Appellate Tribunal allowed the appeal by stating that even an agreement to purchase is good enough.

High Court's Decision:

The High Court **denied the exemption** on the reasoning that the **notification declaring Thane to be an urban area stood cancelled with the cancellation of the section under which it was made**.

Further the expression **"purchase"** in the section 54G cannot be equated with the expression **"towards purchase**" and accordingly the advance for purchase of land, plant and machinery would not entitle the assessee to claim exemption U/S 54G.

Supreme Court's Observations:

The Apex Court observed that Section 54G gives a time limit of 3 years after the date of transfer of capital asset in the case of shifting of industrial undertaking from urban area **to any area other than urban area.**

For the purpose of availing exemption, all that was required for the assessee is **to "utilise" the amount of capital gain for purchase and acquisition of new machinery or plant and building or land.** Since the entire amount of capital gain, in this case, was utilized by the assessee by way of advance for acquisition of land, building, plant and machinery, the assessee was entitled to avail exemption/deduction U/S 54G.

Hence This case was decided in favour of the assessee by holding that payment of advance for purchase of eligible asset would tantamount to utilisation of capital gains for purchase of the said asset.

Supreme Court's Decision :
To avail exemption under section 54G in respect of capital gain arising from transfer of capital assets in the case of shifting of industrial undertaking from urban area to non-urban area, the requirement is satisfied if the capital gain is given as advance for acquisition of capital assets such as land, building and / or plant and machinery.

16. In the case of an assessee, being a dealer in shares and securities, whose portfolio comprises of shares held as stock-in-trade as well as shares held as investment, is it permissible under law to convert a portion of his stock-in-trade into investment and if so, what would be the tax treatment on subsequent sale of such investment?

Yatish Trading Co. Pvt. Ltd. (HC)

Facts of the case:

- The assessee, being a dealer in shares and securities, has a trading as well as an investment portfolio of shares and securities. The assessee meanwhile converted certain shares and securities held as stock-in-trade into investments and Sold such converted shares and securities and declared income arising on such transfer under the head "PGBP" and "Capital gains".
- The profits & gains up to the date of conversion was offered as business income (i.e., FMV as on the date of conversion - COA).
- The profits and gains arising after conversion up to the date of sale was offered as capital gains (i.e., SP - FMV as on the date of conversion).
- The Assessing Officer, however, assessed the entire income arising on transfer of such converted shares and securities as **business income.**

Appellate Authorities' findings & views:

- The CIT (Appeals) opined that the **view of the assessee was logical and reasonable**.
- The Tribunal noted that the **Department had accepted the conversion of stock-in-trade into investment** while assessing the income of A.Y.2003-04 and A.Y.2005-06.
- Further, the **books of account of the assessee showed such shares** (on which the assessee offered income as capital gains) **as investment.**
- Also, the mere fact that the assessee-company was trading in the shares & securities cannot bar it from holding certain shares as investment and offering the gains on sale of such shares to tax under the head "Capital gains". **It is open for a trader in shares to have a trading as well as an investment portfolio of shares and securities.**

High Court's Decision:
The High Court concurred with the Tribunal's ruling that the gains arising on sale of those shares held as investments by the dealer-assessee (i.e., the difference between the **SP - FMV** as on the date of conversion) were to **be assessed under the head "Capital gains" and not under the head "PGBP".**

8

INCOME FROM OTHER SOURCES

1. **What are the tests for determining "substantial part of business" of lending company for the purpose of application of exclusion provision under section 2(22)?**

Parle Plastics Ltd. (HC)

High Court's Observations:

- U/S 2(22), **"dividend" does not include any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company.**

Now what is substantial part of the business?

- Sometimes a portion which **contributes a substantial part of the turnover**, **though it contributes a relatively small portion of the profit**, would be termed as a substantial part of the business.
- Similarly, **a portion which is relatively small as compared to the total turnover, but generates a large portion, say, more than 50% of the total profit of the company** would also be a substantial part of its business.
- Percentage of turnover also the percentage of the profit, sometimes even percentage of manpower used would be required to be taken into consideration for determining the substantial part of business.
- **In this case, 42% of the total assets of the lending company were deployed by it by way of loans and advances. Further, if the income earned by way of interest is excluded, the other business had resulted in a net loss.**
- These factors were considered in concluding that **lending of money was a substantial part of the business of the company.**

High Court's Decision:
Since lending of money was a substantial part of the business of the lending company, the money given by it by way of advance or loan to the assessee could not be regarded as a dividend, as it had to be excluded from the definition of "dividend" by virtue of the specific exclusion in section 2(22).

2. **Can repair and renovation expenses incurred by a company in respect of premises leased out by a shareholder having substantial interest in the company, be treated as deemed dividend?**

Vir Vikram Vaid (HC)

Facts of the case:

- The assessee holds more than 75% of equity shares in a company and is the executive director of the company.
- In his personal capacity, he is the owner of certain premises in which he was carrying on a proprietary business.
- Subsequently, the assessee ceased to carry on the business of proprietary concern and hence, let out the premises to the company.
- The company incurred 2.51 crores towards construction and improvement of factory premises, which it continued to use otherwise than as the owner of the premises.

The AO **held that the amounts spent by the company towards repair and renovation is taxable as deemed dividend in the hands of the assessee**. In the alternative, **the said amount was to be treated as a perquisite taxable in the hands of the assessee**.

Appellate Authorities' Views:

According to the Commissioner (Appeals), **the assessee failed to substantiate his claim and also all the conditions provided U/S 2(22)(e) for deemed dividend were satisfied.**

On the other hand, the **Tribunal concluded that the payment was neither a deemed dividend nor a perquisite chargeable to tax.**

High Court's Observations:

- The challenge before the High Court by the Revenue was only with regard to applicability of section 2(22)(e) in this case.
- The High Court observed that **no money had been paid by way of advance or loan to the shareholder who has substantial interest in the company.** Further, the amount spent was towards repairs and renovation of the premises owned by the assessee **but occupied by the company as lessee**. There is no dispute that the company had taken on rent the aforesaid premises.
- The High Court observed that the **expenditure incurred by virtue of repairs & renovation on the premises cannot be brought within the definition of advance or loan given to the shareholder having substantial interest in the company,** though he is the owner of the premises.
- **It cannot be treated as payment by the company on behalf of the shareholder or for the individual benefit of such shareholder**. If held in such manner, it is a mere assumption not tenable in law.

High Court's Decision:
The High Court, accordingly, held that the repair and renovation expenses in respect of premises occupied by the company **cannot be treated as deemed dividend in the hands of shareholder being the owner of the building**.

3. **Can the loan or advance given to a shareholder by the company, in return for an advantage conferred on the company by the shareholder, be deemed as dividend under section 2(22)(e) in the hands of the shareholder?**

Pradip Kumar Malhotra (HC)

Facts of the case:

In the present case, the assessee, a shareholder holding substantial voting power in the company, **permitted his property to be mortgaged to the bank for enabling the company to take the benefit of loan**.

The shareholder requested the company to release the property from the mortgage. On failing to do so and for retaining the benefit of loan availed from bank, the company gave advance to the assessee, which was authorized by a resolution passed by its BOD.

Issue: The issue under consideration is whether the advance given by the company to the assessee-shareholder by way of security deposit for keeping his property as mortgage on behalf of company to reap the benefit of loan, can be treated as deemed dividend within the meaning of section 2(22)(e).

High Court's Observations:

In the above case, the Calcutta High Court observed that **Gratuitous** (unnecessary/unreasonable/unwarranted) loan or advance given by a company to a share holder, who is the beneficial owner of shares holding more than 10% of the voting power, would come within the purview of section 2(22)(e) **but not to the cases where the loan or advance is given in return to an advantage granted to the company by such shareholder.**

High Court's Decision:
In the present case, **the advance given to the assessee by the company was not in the nature of a gratuitous advance; instead it was given to protect the interest of the company.**
Therefore, the **said advance cannot be treated as deemed dividend in the hands of the shareholder U/S 2(22)(e).**

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

Ambassador Travels (P) Ltd. (HC)

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 more 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.

High Court's Observations & Decision:
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, therefore, 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).

5. Can winnings of prize money on unsold lottery tickets held by the distributor of lottery tickets be assessed as business income and be subject to normal rates of tax instead of the rates prescribed under section 115BB?

Manjoo and Co. (HC)

High Court's Observations:

- On the above issue, the Kerala High Court observed that all prizes from unsold tickets of the lotteries shall be the property of the organising agent. Similarly, all unclaimed prizes shall also be the property of the organising agent and shall be refunded to the organising agent.
- The High Court contended that the receipt of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be "income earned" by him in business.
- The High Court observed that the receipt of the prize money is not in his capacity as a lottery distributor but as a holder of the lottery ticket which won the prize. The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which tax is deducted at source.
- Further, winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls. Therefore, even if the argument of the assessee is accepted and the winnings from lottery is taken to be received by him in the course of his business and as such assessable as business income, the specific provision contained in section 115BB, namely, the special rate of taxi.e. 30% would apply.

High Court's Decision:
The High Court, therefore, held that **the rate of 30% prescribed U/S 115BB is applicable in respect of winnings from lottery received by the distributor.**

10

Set-Off And Carry Forward Of Losses

1. **Can the loss suffered by an erstwhile partnership firm, which was dissolved, be carried forward for set-off by the individual partner who took over the business of the firm as a sole proprietor, considering the succession as a succession by inheritance?**

Pramod Mittal

Facts of the case:

In the present case, the assessee was previously a partner in a firm. As per the dissolution deed of the partnership firm he took over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partner was paid his dues. He then ran the business as a sole proprietor with effect from that date. The assessee claimed the set-off of the losses suffered by the erstwhile partnership firm against his income earned as an individual proprietor, considering the case as inheritance of business.

However, considering that **only the person who has suffered the loss is entitled to carry forward and set-off the same, the claim of the assessee was disallowed by the Assessing Officer.**

High Court's Observations:

- The High Court observed that upon dissolution, the partnership firm ceased to exist. Also, **the partnership firm and the proprietorship concern are two separate and distinct units for the purpose of assessment**.
- Section 78(2) provides that **only the person who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. An exception provided there under is in the case of Succession By Inheritance**.
- It implies that generally set off of business loss should be claimed by the same person who has suffered loss and the only exception to this provision is when the business passes on to the **Another Person By Inheritance.**
- **Therefore it cannot be said that taking over a firm is inheritance by succession because in this case the partnership firm was dissolved & taken over by the assessee as a sole proprietorship & this is not the case of succession by inheritance.**
- **Therefore carry forward of the losses of the firm by the assessee was not allowed**

High Court's Decision:
Therefore, the loss suffered by the erstwhile partnership firm before dissolution of the firm **cannot be carried forward by the successor sole-proprietor,** since it is not a case of succession by inheritance.
The assessee sole-proprietor is, therefore, not entitled to set-off the loss of the erstwhile partnership firm against his income.

11

DEDUCTIONS FROM GROSS TOTAL INCOME

1. **Can the Commissioner reject an application for grant of approval U/S 80G(5) on the ground that the trust has failed to apply 85% of its income for charitable purposes?**

Shree Govindbhai Jethalal Nathavani Charitable Trust (HC)

Law - Section 80G(5)(i) provides that **donation to any institution or fund would qualify for deduction there under only if it is established in India for a charitable purpose and derives such income which would not be liable to inclusion in its total income under the provisions of sections 11 and 12 or section 10(23AA)/(23C).**

Facts of the case:

The assessee trust filed an application for grant of approval U/S 80G(5)[1]. It also filed copies of trust deed and registration certificate with the approving authority.

As per the trust deed, the **main objects of the trust are educational, social activities, etc**. In order to verify the facts stated in the application, the trust was asked to produce books of account, relevant vouchers, donation book and minutes in original.

On perusal of the books for financial year 2011-12, it was found that the trust had not applied 85% of its income and therefore, the Commissioner rejected the application of the assessee seeking approval under section 80G(5) and Rule 11AA of the Income-tax Rules, 1962.

Tribunal's view: On appeal, the Tribunal noted that at the time of granting approval of exemption U/S 80G, only the objects of the trust are required to be examined and the aspect of application of funds can be examined by the AO at the time of framing the assessment. Consequently, the **Tribunal held that the Commissioner has erred in refusing to grant recognition to the trust U/S 80G(5).**

High Court's Observations: The High Court was of the view that

(i) Section 80G does not relate to assessment of the trust or the institution whose income is not liable to be included in the computation of taxable income under various provisions of the Act.

(ii) Primarily, section 80G is related to giving deduction in respect of donations made by a person to such trusts and institutions.

(iii) Once a trust is registered under section 12AA, its income from property includes donation which is covered by section 11(1)(d) or under section 12. Such donations are deemed to be income from property, which are not to be included in the total income under section 11 or section 12. The enquiry U/S 80G, hence, cannot go beyond that.

(iv) The scope of enquiry cannot include an enquiry as to whether, at the close of the previous year, the donee-trust will actually be able to apply 85% of its

(v) The question of whether the trust will be able to apply 85% of its income can be determined only from the facts existing at the close of the assessment year.

High Court's Decision:
The High Court, thus, concurred with the decision of the Tribunal setting aside the order passed by the Commissioner refusing to grant registration under section 80G(5) to the assessee-trust due to the reason that it has not applied 85% of its income for charitable purposes.

2. **Can unabsorbed depreciation (UAD) of a business of an industrial undertaking eligible for deduction under section 80-IA be set off against income of another *NON-ELIGIBLE* business of the assessee?**

Swarnagiri Wire Insulations Pvt. Ltd. (HC)

Facts of the case:

- The assessee was in the business of **manufacture of wires (which is a non eligible Business)**.
- It installed a **windmill** for power generation (Eligible business).
- The assessee claimed depreciation of windmill against income from power generation, which was eligible for deduction under section 80-IA. The balance depreciation was set off against the profits from manufacturing of wires, being a non-eligible business.

Assessing Officer's contention:

The AO contended that depreciation relating to a business eligible for deduction under section 80-IA cannot be set off against non-eligible business income. Therefore, UAD was to be carried forward to the subsequent year to be set off against the eligible business income of the assessee of that year.

Tribunal's Observations: The Tribunal observed that the balance depreciation of the eligible business is required to be carried forward for set-off against eligible business income of the next year while determining the profits eligible for deduction under section 80-IA in that year

High Court's Observations and Decision:

- The High Court observed that the assessee had incurred loss in eligible business after claiming depreciation. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed. It is thereafter that section 70(1) comes into play, whereby the assessee is entitled to set off the losses from one source against income from another source under the same head of income.
- The Court, therefore, held that the **assessee was entitled to the benefit of set off of loss of eligible business against the profits of non-eligible business**.
- However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year.

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?

Kiran Enterprises (HC)

- 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.

Issue: 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.

High Court's Decision:

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.** Therefore, the freight subsidy cannot be treated as profits derived from the business for the purposes of section 80-IA.

4. Can Duty Drawback be treated as profit derived from the business of the industrial undertaking to be eligible for deduction U/S 80-IB?

Orchev Pharma P. Ltd (SC)

Supreme Court's Decision :

On this issue, the Supreme Court, following the decision in case of ***Liberty India*** held that Duty Drawback receipts **cannot be said to be profits derived from the business of industrial undertaking** for the purpose of computation of deduction under section 80-IB.

5. Would grant of transport subsidy, interest subsidy and refund of excise duty qualify for deduction U/S 80-IB?

Meghalaya Steels Ltd. (HC)

- The Supreme Court, in ***Liberty India*** observed that section 80- IB provides for deduction in respect of profits and gains "derived from the business" of the assessee.
- There should be a **direct nexus between the generation of profits & the source of profits**.

High Court's Observations:

- In this case, the High Court observed that the **Transport & Interest Subsidies** were **Revenue Receipts which were granted after setting up of the new industries and after commencement of production**.

- The transport subsidy would have the effect of reducing the inward and outward transport costs for the purposes of determining the cost of production as well as for sales. However, **Transport And Interest subsidy had no direct nexus with the profits or gains derived by the assessee from its industrial activity and the benefit to the assessee was only ancillary to its industrial activity**.
- **The Transport & Interest subsidies were not directly relatable to the industrial activity of the assessee**. **Therefore, the subsidies could not be taken into account for purposes of deduction U/S 80-IB.**

High Court's Decision:
The payment of central excise duty, however, has a direct nexus with the manufacturing activity and similarly, the refund of the central excise duty also has a direct nexus with the manufacturing activity, being a profit-linked incentive, since payment of the central excise duty would not arise in the absence of any industrial activity.
Therefore, the refund of excise duty had to be taken into account for purposes of section 80-IB.

6. Does income derived from sale of export incentive qualify for deduction under section 80-IB?

Jaswand Sons (HC)

High Court's Decision:
On this issue, the High Court held that income derived from sale of export incentive **cannot be said to be income "derived from" the industrial undertaking** and therefore, **such income is not eligible for deduction under section 80-IB.**

7. 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?

Nestor Pharmaceuticals Ltd. / Sidwal Refrigerations Ind Ltd. (HC)

Facts of the case:
- 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 (5 Years)
- whereas the AO denied deduction for A.Y.2003-04 on the ground that the 5 year period would be reckoned from A.Y.1998-99, since the trial production began in March, 1998.

Tribunal's Observations: 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.

High Court's Observations & Decision:
The High Court observed that 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 2 items in that assessment year, and hence the five year period has to be reckoned from A.Y.1998-99.

8. Can an assessee who has not claimed deduction under section 80-IB in the initial years, start claiming deduction there under for the remaining years during the period of eligibility, if the conditions are satisfied?

Praveen Soni (HC)

High Court's Decision:
On the above issue, the Delhi High Court held that **the provisions of section 80-IB nowhere stipulated a condition that the claim for deduction under this section had to be made from the first year of qualification of deduction failing which the claim will not be allowed in the remaining years of eligibility.**
Therefore, the deduction U/S 80-IB should be allowed to the assessee for the remaining years up to the period for which his entitlement would accrue, provided the conditions mentioned under section 80-IB are fulfilled.

13

ASSESSMENT OF VARIOUS ENTITIES

1. **Where land inherited by three brothers is compulsorily acquired by the State Government, whether the resultant capital gain would be assessed in the status of "Association of Persons" (AOP) or in their individual status?**

   Govindbhai Mamaiya (SC)

Facts of the case: Three brothers inherited a property consequent to demise of their father. A part of this bequeathed land was acquired by the State Government and compensation was paid for it. On appeal, compensation was enhanced and the enhanced compensation was paid with interest.

Issue: The issue under consideration is regarding the status in which capital gain arising on transfer of property would be assessed. The assessees offered income in their status as "individual" but the Revenue sought to tax the same in their status as "Association of Persons" (AOP).

High Court's Observations:

- The High Court found that the parties (3 brothers in this case) inherited the property and there was no material on record to suggest any sort of arrangement between the brothers for formation of AOP.
- Further, as per **section 4 of the Hindu Succession Act, 1956**, income from the asset inherited by a son from his father has to be assessed as income of the son individually and also as per **section 8 of the Hindu Succession Act, 1956,** the property of the father pass on to his son in his individual capacity and not as karta of HUF. Thus, it was held that the income is chargeable to tax in their individual status and not as AOP.

Supreme Court's Observations:

- The Apex Court noted that "Association of Persons" means an association in which two or more persons come together or join in for a common purpose or common action.
- The Supreme Court held that an association of persons could be formed only when two or more persons voluntarily combined together for certain purposes.
- In this case, **the property in question came to the assessees' possession through inheritance** i.e., by operation of law. It is not a case where any 'association of persons" was formed by desire of the parties.
- Further, even the income earned in the form of interest is not because of any business venture of the three assessees, but is the result of the act of the Government in compulsorily acquiring the said land.
- Thus, the basic test to be satisfied for making an assessment in the status of AOP is absent in this case.

> **Apex Court's Decision:**
> The Apex Court, accordingly, held that the income from asset inherited by the legal heirs is taxable in their individual hands and not in the status of AOP.

2. **Would the ancestral property received by the assessee after the death of his father, be considered as HUF property or as his individual property, where the assessee's father had received such property as his share when he went out of the joint family under a release deed?**

   D. L. Nandagopala Reddy (HC)

   Facts of the case: The assessee's father (Laxmaiah Reddy), took his share in the joint family property and executed a release deed in favour of the remaining members of the joint family *vide* a registered release deed and bequeathed all his properties in favour of the assessee. The assessee, in turn, distributed the property in favour of his wife and children. This was done by oral partition which was evidenced by a memorandum of partition dated August 6, 1998.

   Thereafter, a transaction was entered into by the assessee with the builder for development of the property.

   The AO treated the consideration received from the builder by the assessee and his wife as their individual income and assessed the same to tax in their individual hands i.e. The Revenue contended that it was a separate property & not a property of the HUF, consequently, the income derived therefrom is assessed to tax in the hands of the assessee as separate property.

High Court's Observations:

The High Court observed that the **property originally belonged to HUF.** One of the members of the family (i.e., the assessee's father) went out of the joint family under a release deed and the remaining members continued to be the members of joint family. After the death of assessee's father and mother, the assessee, being the adopted son, became the sole surviving co- parcener. **When such property came to the hands of the assessee it was not his individual property; it was the property of his HUF**

High Court's Decision:
The High Court held that that **when the property came to the hands of the assessee, it was not his self-acquired property; it was property belonging to his HUF. The assessee had given a portion of the property to his wife without a registered document, which is possible only if the property is a HUF property. If such property is treated as a self-acquired property, then assessee would have been able to give the portion of the property to his wife only by registered document.**

3. **Under which head of income is rental income from plinth inherited by individual co-owners from their ancestors taxable - "Income from house property" or "Income from other sources"? Further, would such income be assessable in the hands of the individual co-owners or in the hands of the Association of Persons?**

Sudhir Nagpal (HC)

High Court's Observations for First Issue:

As regards the head of income under which rental income from plinths is assessable, the High Court referred to the judgment in *Gowardhan Das and Sons,* wherein it was observed that **it is the income from property consisting of any building or land appurtenant thereto which is assessed under section 22 and not the income from renting out of open land or some kutcha plinth only.**

High Court's Decision:
Therefore, the Court held that the income from letting out the plinths is assessable U/S 56 as "Income from other sources" and not under the head "Income from house property".

Facts of the case: In the present case, five persons of the Nagpal family were co- owners of the agricultural land "Nagpal farms" inherited from their forefathers. **The co-owners had, therefore, not purchased the land but had inherited the land**. The co-owners filed their individual returns of income disclosing their rental income and also paid tax on such income.

The AO, however, issued notice U/S 148 to all the co-owners of the property in the name of Mr. Sudhir Nagpal on the ground that there is an AOP formed by the co-owners and therefore, income had escaped assessment in the hands of AOP.

The assessee contended that **since no land was purchased, therefore, the status of the co-owners cannot be treated as AOP.**

The AO did not agree with the contention of the assessee and assessed the entire rental income from the plinths as **IFOS** in the hands of the **AOP** and determined the tax payable by applying section 167B(2).

The Commissioner (Appeals) and the Tribunal confirmed the action of the AO.

High Court's Observations on Second Issue:

On appeal, the High Court observed that in order to assess individuals as "association of persons", the **individual co-owners should have joined their resources and thereafter, acquired property in the name of association of persons and the property should have been commonly managed.** It is only in such a case that income could be assessed in the hands of "association of persons".

Mere accruing of income jointly to one or more persons would not constitute them an AOP in respect of such income. In other words, unless the associates have done some acts or performed some operations together, which have helped to produce the income in question, they cannot be termed as an AOP. Unless the members combine or join in a common purpose, it cannot be held that they have formed themselves into an AOP.

High Court's Decision:
In this case, the co-owners had inherited the property from their ancestors and there was nothing to show that they had acted as an AOP. Thus, the High Court held that the rental income from the plinths has to be assessed in the status of individual and not AOP & consequently, section 167B would not be attracted in this case.

4. **Would the interest earned on surplus funds of a club deposited with institutional members satisfy the principle of mutuality to escape taxability?**

Madras Gymkhana Club (HC)

Facts of the case: The assessee-club providing facilities like gym, library, etc, to its members earned interest from fixed deposits which it had made by investment of its surplus funds with its corporate members.

High Court's Decision:
The High Court held that interest earned from investment of surplus funds in the form of fixed deposits with institutional members **does not satisfy the principle of mutuality and hence cannot be claimed as exempt on this ground. The interest earned is, therefore, taxable.**

5. **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 (HC)

High Court's Observations: 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.

High Court's Decision: 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 foul 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.**

6. **Would Non-Resident Match Referees And Umpires in the games played in India fall within the meaning of "sportsmen" to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer?**

Indcom v Commissioner of Income-tax (TDS)

High Court's Observations:

- On this issue, the Calcutta High Court observed that, **in order to attract the provisions of the section 194E, the person should be a Non-Resident Sportsperson or Non-Resident Sports Association Or Institution whose income is taxable as per the provisions of section 115BBA.**
- **The Umpires & The Match Referees can be described as professionals or technical persons** who **render professional or technical services**, **but they cannot be said to be either non-resident sportsmen (including an athlete) or non-resident sports association or institution** so as to attract the provisions of section 115BBA and **consequently, the provisions of TDS U/S194E are also not attracted in this case**.
- Though for the purpose of section 194J, match referees and umpires are considered as professionals, the tax deduction provisions thereunder are attracted only in case where the deductee is a resident individual, which is not so in the present case.

High Court's Decision:
Therefore, although the payments made to non-resident umpires and the match referees are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the **assessee is not liable to deduct tax under section 194E**.

7. **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?**

Anil Hardware Store (HC)

Facts of the case:

- The partnership deed of the assessee-firm provided that in case the book profits of the firm are up to ` 75,000, then the partners would be entitled to remuneration up to 50,000 or 90% of the book profits, whichever is more.
- In respect of the next 75,000, it is 60% and for the balance book profits, it is 40%.
- 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.

High Court's Decision:

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 ventures 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. **Therefore the assessee-firm is entitled to deduct the remuneration paid to the partners under section 40(b)(v).**

8. **Can interest under sections 234B and 234C be levied where a company is assessed on the basis of book profits under section 115JB?**

Rolta India Ltd (SC)

Supreme Court's Observations:

- On this issue, the Supreme Court observed that **there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section.**
- Section 115JB is a **self-contained code pertaining to MAT**, and by virtue of sub- section (5) thereof, the liability for payment of advance tax would be attracted. Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C.

Supreme Court's Decision:

The Supreme Court, therefore, held that interest U/S 234B & 234C shall be payable on failure of the company to pay advance tax in respect of tax payable under section 115JB.

9. **Can LTCG exempted by virtue of section 54EC be included in the book profit computed U/S 115JB?**

N. J. Jose and Co. (HC)

Facts of the case:

The assessee claimed exemption U/S 54E on the income from LTCG by depositing amounts in specified assets in terms of the said provision. In the computation of book profit U/S 115J, the assessee claimed exclusion of capital gains because of exemption available on it by virtue of section 54E.

The AO reckoned the book profits including long-term capital gains for the purpose of assessment U/S 115J.

High Court's Decision:

The High Court held that once the AO found that total income as computed under the provisions of the Act was **< 30** % of the **Book Profit**, he had to make the assessment U/S 115J which does not provide for any deduction in terms of section 54E.

As long as LTCG 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).

INCOME-TAX AUTHORITIES

1. Can the assessee's application, for adjustment of tax liability on income surrendered during search by sale of seized gold bars, be entertained where assessment has not been completed?

Hemant Kumar Sindhi & Another (HC)

Facts of the case:

- Consequent to a search in the premises of the assessee, some gold bars were seized from the locker. The assessee voluntarily disclosed some income during the course of search. The assessee filed an application for sale of the gold bars and adjustment of tax liability on undisclosed income out of the sale proceeds.
- The AO dismissed the application on the reasoning that **only when the assessment is completed and tax demand is crystallized, can recovery be initiated by the sale of gold bars.**
- The assessee filed a writ contesting the dismissal of application by the AO

High Court's Observations:

- The High Court observed that section 132B(1)(i) uses the expression **"the amount of any existing liability"** and "**the amount of the liability determined".**
- The words **"existing liability"** postulates a liability that is crystallized by adjudication; likewise, **"a liability is determined"** only on completion of the assessment.
- **Until the assessment is complete, it cannot be postulated that a liability has been crystallized.**
- As per the first proviso to section 132B(1)(i), the assessee may make an application to the AO for release of the assets seized. However, he has to explain the nature and source of acquisition of the asset to the satisfaction of the AO. It is not the *ipse dixit* of the assessee but the satisfaction of the AO on the basis of the explanation tendered by the assessee which is material.

High Court's Decision:
The High Court, accordingly, held that the **AO was justified in his conclusion that it is only when the liability is determined on the completion of assessment that it would stand crystallized and in pursuance of which a demand can be raised and recovery can be initiated**. Therefore, in the present case, the first proviso to section 132B(1)(i) would not be attracted. **The High Court, thus, dismissed the writ petition.**

2. Where no proceeding is pending against a person, can the AO call for information U/S 133(6), which is useful or relevant to any enquiry, with the permission of Director or Commissioner?

Kathiroor Service Co-operative Bank Ltd. (SC)

Facts of the case:

- The AO, with the prior approval of the Commissioner, issued notice under section 133(6) to the assessee, a co-operative society engaged in banking business, calling for general information regarding details of all persons (whether resident or non-resident) who had made (a) cash transactions of 1 lakh & above in any account, and/or (b) time deposits of 1 lakh or above, for the period of 3 years between April 1, 2005, and March 31, 2008, expressly stating therein that failure to furnish the information would attract penal consequences.
- The assessee objected to the said notice, *inter alia*, on the ground that such notice seeking for information which is unrelated to any existing or pending proceeding against the assessee could not be issued under the provisions of the Act.

Supreme Court's Observations:

- The Supreme Court observed that the AO has been empowered to requisition information which will be useful for or relevant to **any enquiry** or proceeding under the Income-tax Act, 1961 in the case of any person.
- However, **an income-tax authority below the rank of the Director/Commissioner can exercise this power in respect of an enquiry in a case where no proceeding is pending, only with the prior approval of the Director or the Commissioner.**

Supreme Court's Decision:
The Supreme Court held that **information of general nature could be called for from banks**. In this case, since **notices have been issued after obtaining approval of the Commissioner**, the assessing authority had not erred in issuing the notices to assessees requiring them to furnish information regarding account holders with cash transactions or deposits of more than 1 lakh. The Supreme Court, therefore, held that for such enquiry under section 133(6), the notices could be validly issued by the assessing authority.

3. Is the requirement to grant a reasonable opportunity of being heard, stipulated U/S 127(1), mandatory in nature?

Sahara Hospitality Ltd. (HC)

<u>High Court's Observations</u>:

On this issue, the Bombay High Court observed that the provisions of section 127(1) stipulate, *inter alia,* that **the income tax authority mentioned therein MAY GIVE AN OPPORTUNITY of being heard to the assessee, wherever it is possible to do so, and after recording his reasons for doing so, transfer any case from 1 or more AO subordinate to him to any other AO or officers subordinate to him.**

<u>High Court's Decision</u>:
The Bombay High Court held that the **word "may" used in this section should be read as "shall" and such income-tax authority has to mandatorily give a reasonable OOBH to the assessee, wherever possible to do so, and thereafter, record the reasons for taking any action under the said section.**
"Reasonable opportunity" can only be denied in a case where it is not possible to provide such opportunity. In such a case also, the authority should record its reasons for making the transfer, even though no opportunity was given to the assessee. The discretion of the authority is only to consider as to what is a reasonable opportunity in a given case and whether it is possible to give such an opportunity to the assessee or not.
The authority cannot deny a reasonable opportunity of being heard to the assessee, wherever it is possible

4. Does the CBDT have the power U/S 119(2)(b) to condone the delay in filing ROI ?

Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue

<u>Facts of the case</u>:

- The assessee filed his ROI, which contains a claim for carry forward of losses, **a day after the due date**.
- The delay of 1 day in filing the ROI 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.
- The Above circumstances were recorded in the letter along with the ROI 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 ROI U/S 119.

<u>Issue</u>: The issue under consideration is whether the CBDT has the power U/S 119(2)(b) to condone the delay in filing ROI

<u>High Court's Decision</u>:
The High Court held that the **CBDT 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.

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ASSESSMENT PROCEDURE

1. **Can UAD be allowed to be carried forward in case the ROI is not filed within the due date?**

   Govind Nagar Sugar Ltd. (HC)

   High Court's Observations: On this issue, the Delhi High Court observed that, the **provisions of section 80 and section 139(3), requiring the ROI claiming loss to be filed within the due date, applies to, *inter alia,* carry forward of business loss and not for the carrying forward of unabsorbed depreciation.**

   As per the provisions of section 32(2), the UAD becomes part of next year's depreciation allowance and is allowed to be set-off as per the provisions of the Income-tax Act, 1961, irrespective of whether the return of earlier year was filed within due date or not.

High Court's Decision:
Therefore, in the present case, the High Court held that the UAD will be allowed to be carried forward to subsequent year even though the ROI of the current AY was not filed within the due date.

2. **Can an assessee revise the particulars filed in the original ROI by filing a REVISED STATEMENT OF INCOME?**

   Orissa Rural Housing Development Corpn. Ltd. (HC)

High Court's Decision:
On this issue, the Orissa High Court held that :

- **The assessee can make a fresh claim before the AO or**
- **Make a change in the originally filed ROI only by filing revised ROI U/S 139(5).**

There is no provision under the Income-tax Act, 1961 to enable an assessee to revise his income by **filling a revised statement of income**.
Therefore, filling of revised statement of income is of no value and will not be considered by the AO for assessment purposes.
The High Court, relying on the judgement of the Supreme Court in ***Goetze (India) Ltd****,* held that the AO has no power to entertain a fresh claim made by the assessee after filing of the original return except by way of filing a revised return.

3. **Is a person having income below taxable limit, required to furnish his PAN to the deductor as per the provisions of section 206AA, even though he is not required to hold a PAN as per the provisions of section 139A?**

   Smt. A. Kowsalya Bai (HC)

- **As per the provisions of section 139A**, *inter alia,* a person whose total income does not exceed the maximum amount not chargeable to income-tax is not required to apply to the AO for the allotment of a PAN
- **However, as per the provisions of section 206AA,** notwithstanding anything contained in any other provision of this Act, any person who is entitled to receive any sum or income or amount on which tax is deductible i.e., the deductee, shall furnish his PAN to the deductor, otherwise tax shall be deducted as per the provisions section 206AA, which is normally higher. It is mandatory for an assessee to furnish his PAN, despite filing Form 15G as required U/S 197A, to seek exemption from deduction of tax.
- **The provisions of section 139A are contradictory to section 197A**, due to the fact that assessees whose income was less than the maximum amount not chargeable to income-tax, were not required to hold PAN, whereas their declaration furnished under section 197A was not accepted by the bank or financial institution unless PAN was communicated as per the provisions of section 206AA.
- **The provisions of section 206AA creates inconvenience to small investors**, who invest their savings from earnings as security for their future, since, in the absence of PAN, tax was deducted at source at a higher rate.

High Court's Decision:
In order to avoid undue hardship caused to such persons, the Karnataka High Court, in the present case, held that it may not be necessary for such persons whose income is below the maximum amount not chargeable to income-tax to obtain PAN and in view of the specific provision of section 139A, section 206AA is not applicable to such persons. Therefore, the banking and financial institutions shall not insist upon such persons to furnish PAN while filing declaration under section 197A. However, section 206AA would continue to be applicable to persons whose income is above the maximum amount not chargeable to income-tax.

4. Can the AO reopen an assessment on the basis of merely a change of opinion?

Aventis Pharma Ltd. (HC)

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 (Proof of document) is essential to safeguard against an arbitrary exercise of this power.

High Court's Observations and Decision:
In this case, the High Court observed that there was no tangible material before the AO 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.

5. Is it permissible U/S 147 to reopen the assessment of the assessee on the ground that income has escaped assessment, after a change of opinion as to a loss being a speculative loss and not a normal business loss, consequent to a mere re-look of accounts which were earlier furnished by the assessee during assessment U/S 143(3)?

ICICI Securities Primary Dealership Ltd. (SC)

Facts of the case:

In the above case, the AO had completed the assessment of assessee U/S 143(3) after taking into consideration the accounts furnished by assessee.

After the lapse of 4 years from relevant AY, the AO had reopened the assessment of assessee U/S 147 on the ground that after re-look of the accounts of the relevant PY, it was noticed that the assessee company had incurred a loss in trading in share, which was a speculative one. Therefore, such loss can only be set off against speculative income. Consequently, the loss represents income which has escaped assessment. Accordingly, the AO came to a conclusion that income had escaped assessment & passed an order U/S 147.

Supreme Court's Decision:

- The Supreme Court observed that the **assessee had disclosed full details in the ROI in the matter of its dealing in stocks & shares.**
- **There was no failure on the part of assessee to disclose material facts** as mentioned in proviso to section 147.
- Further, **there is nothing new which has come to the notice of the AO**.
- **The accounts had been furnished by the assessee when called upon**.
- Therefore, re-opening of the assessment by the AO is clearly a change of opinion and therefore, the order of re-opening the assessment is not valid.

6. Can a notice U/S 148 for a particular AY be issued solely on the ground that survey U/S 133A was carried on at the business premises of the assessee, where nothing had been found therein which would indicate escapement of income chargeable to tax for the said AY?

Hemant Traders

Facts of the case:

- In the present case, the assessee is a partnership firm filed a ROI which was processed and intimation U/S 143(1) was issued on 20.02.2012, seeking clarification.
- No assessment order was passed.
- The assessee claimed that the profit as per the ROI was accepted.
- Meanwhile, a survey U/S 133A was carried out at the business premises of the assessee. However, the survey party did not find any discrepancy in the books of account. In March 2014, the assessee was issued a notice U/S 148 for the A.Y.2010-11 based on the said survey.
- The assessee preferred a writ challenging the issue of notice on the reasoning that no satisfaction was recorded of the escapement of income in the survey report or in any other relevant material. *Ex-facie,* the reassessment was bad in law.

High Court's Observations:

- The High Court examined the survey report which recorded that the survey was conducted based on the allegations that the Assessee party were resorting to hoarding of potatoes and making huge profits by fluctuating the day-to-day price of potatoes in the market.

- During survey, the assessee's books of account, cash balance & stocks were physically verified and inventory prepared. The report revealed **cash difference of 5,020** and the explanation given was that the same pertained to the day-to-day and miscellaneous expenditure incurred on the day of survey.
- The report also revealed **physical stock difference of 672 bags of potatoes**. The explanation for such difference was recorded.
- Neither the survey report nor any other material indicated escapement of income chargeable to tax for A.Y.2010-11.
- The AO had nothing before him to record his belief or satisfaction that escapement of income had taken place.
- **Merely because survey had taken place cannot be a ground for reopening the assessment without valid material or evidence at the time of issue of notice**. Whenever there was shortage of potatoes in the market, such powers of survey were invoked.
- **Where nothing has been found during the survey operations to indicate that income chargeable to tax has escaped assessment, then the survey report ought not to be the basis for reopening of assessment. Something more was required in law for the AO to exercise his powers.**

<u>High Court Decision:</u>
The High Court, accordingly, held that since **there is absolutely no material to indicate escapement of income for the relevant assessment year, the issue of notice to initiate reassessment proceedings under section 148 on the basis of survey which had taken place is not valid.**
Therefore, the proceedings initiated U/S 148 are quashed at the threshold itself.

7. Will the subsequent amendment of law with Retrospective Effect validate a reassessment notice issued on a different ground Before The Retrospective Amendment was made?

Godrej Industries Ltd (HC)

<u>Facts of the case</u>:

- The assessee-company filed its ROI for the AY 2000-01 declaring total income as 'Nil' and a book profit of 52.70 crores. This resulted in 'book profit' being assessed to income-tax.
- Later, the AO issued notice U/S 148 for the reason that income chargeable to tax had escaped assessment on the ground that the PROVISION FOR DOUBTFUL DEBTS AND PROVISION FOR DEPLETION OF LONG-TERM INVESTMENT debited to the profit and loss account were **unascertained liabilities (Under MAT)** and, hence they were to be added back to the net profit for arriving at the book profits as per MAT provisions
- The assessee preferred a writ challenging the maintainability of the notice issued U/S 148.

<u>High Court's Observations</u>:

- The High Court observed that in this case, it is clear that the reasons stated for reopening the assessment are that **PROVISION FOR DOUBTFUL DEBTS AND DEPLETION IN VALUE OF INVESTMENTS are both amounts set aside for meeting liabilities other than ascertained liabilities and hence, constitute income escaping assessment.** Therefore the reasons recorded are not valid as the said items were not related to liabilities as perceived by the AO. These provisions are made to take care of the likely fall in the value of assets.
- The High Court observed that **it is the AO'S belief at the time of issuing the reassessment notice that determines the validity of the notice**.
- In this case, he wanted to apply clause (c) of section 115JA i.e PROVISION FOR CONTINGENT LIABILITIES and whereas the issues got covered by subsequent amendment by means of insertion of clause (g) i.e PROVISION FOR DIMINUTION IN THE VALUE OF THE ASSETS to the *Explanation* to section115JA by the Finance (No.2) Act, 2009 with retrospective effect from 1.4.1998. The subsequent event could not put life into the Assessing Officer's reason that income chargeable to tax had escaped assessment when the reasons as originally recorded are still born.

<u>High Court's Decision</u>:
The position of law on the date of issue of notice U/S 148 must be looked into and the retrospective amendment subsequent to issue of notice could not validate a notice issued earlier. It could only amount to change of opinion and the notice for reopening of assessment would become unsustainable.

The High Court, accordingly, allowed the writ and held that the reason for reopening the assessment cannot get validated by the retrospective amendment of law.

***Note** – It may be noted that section 115JA levying MAT was applicable from A.Y.1997-98 to A.Y.2000-01. From A.Y.2001-02, MAT is attracted under section 115JB. Clause (c) of Explanation 1 to section 115JB requires addition of amount set aside to provisions made for meeting liabilities, other than ascertained liabilities, to the net profit for arriving at the book profit for levy of MAT. Clause (i) was inserted by the Finance (No.2) Act, 2009 retrospectively with effect from 1st April, 2001 providing for addition of amount set aside as provision for diminution in the value of any asset, to the net profit for arriving at the book profit for levy of MAT. The rationale of the above ruling would, therefore, also apply in the context of examining the validity of notice issued for reopening an assessment on the basis of clause (c) of Explanation 1 to section 115JB, consequent to subsequent retrospective insertion of clause (i) in Explanation 1 to section 115JB.*

8. Can the AO reassess issues other than the issues in respect of which proceedings were initiated U/S 147 when the original "reason to believe" on the basis of which the notice was issued ceased to exist?

A. Ranbaxy Laboratories Ltd. (HC)

Issue: The issue under consideration is whether the Assessing Officer can make an assessment on the basis of an issue which came to his notice during the course of assessment, where the issues, which originally formed the basis of issue of notice under section 148, were dropped in its entirety.

High Court's Observations:

As per section 147, the AO may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice in the course of proceedings under this section. The Delhi High Court observed that the words "and also" used in section 147 are of wide amplitude.

It is significant to note that Parliament has not used the word 'or' but has used the word 'and' together and in conjuction with the word 'also'. The words *'such income'* in the first part of the sentence refer to the income chargeable to tax which has escaped assessment and in respect of which the AO has formed a reason to believe for issue of the notice under section 148. **Hence, the language used by the Parliament is indicative of the position that the assessment or reassessment must be in respect of the income, in respect of which the has formed a reason to believe that the same has escaped assessment and also in respect of any other income which comes to his notice subsequently during the course of the proceedings as having escaped assessment.**

High Court's Decision: If the income, the escapement of which was the basis of the formation of the "reason to believe" is not assessed or reassessed, it would not be open to the Assessing Officer to independently assess only that income which comes to his notice subsequently in the course of the proceedings under the section as having escaped assessment. If he intends to do so, a fresh notice under section 148 would be necessary.

B. Mehak Finvest P Ltd (HC)

Facts of the case:

In the present case, reassessment proceedings were initiated against the assessee on the reason that various finance companies managed and controlled by certain persons were engaged in accommodation entries and the assessee-company was one among them.

However, during the reassessment proceedings, the AO noticed that fresh share application money amounting to 47 lakhs could not be explained by the assessee and hence invoked section 68 to bring to tax such sum. There was no addition on the basis of the original reason for which reassessment proceedings were initiated.

Issue: The issue under consideration is whether an addition can be made in reassessment when the original reasons on the basis of which notice for reassessment was issued did not survive.

High Court's Observations:

The High Court noted that *Explanation 3 to section 147* nowhere postulates or contemplates that the AO cannot make any additions on any other ground unless some addition is made on the basis of the original ground for which reassessment proceeding was initiated

High Court's Decision: The High Court, accordingly, held that even though no addition is made on the original grounds which formed the basis of initiation of reassessment proceedings, **the AO is empowered to make additions on another ground for which reassessment notice might not have been issued but which came to his notice subsequently during the course of proceedings for reassessment.**

C. N. Govindaraju (HC)

Issue under consideration: One of the issues under consideration before the High Court was whether the reassessment based on fresh grounds would be valid when the original reason which prompted the reassessment, does not survive.

Assessee's contention *vis-s-vis* Revenue's contention:

- The assessee contended that the reason for which notice was issued has to survive and it is only thereafter that "any other income" which is found to have escaped assessment can also be assessed or reassessed in such proceeding.
- On the other hand, the Revenue claimed that section 147 is in two parts which have to be read independently; the phrase "such income" in the first part is with regard to reasons which have been recorded and the phrase "any other income" is with regard to cases where no reasons are recorded in the notice but they come to the notice of the AO during the course of reassessment proceeding. Both being independent, **once the satisfaction in the notice is found sufficient, addition can be made on all grounds i.e., for reasons which have been recorded and also for items for which no reasons were recorded**. All that is necessary is that, during the course of the proceedings U/S 147, income chargeable to tax must have escaped assessment.

High Court's Observations:

The High Court reiterated that once the proceedings have been initiated on a valid notice, it becomes the duty of the AO to levy tax on the entire income (including "any other income") which may have escaped assessment and comes to his notice during the course of the proceedings initiated under section 147.

High Court's Decision: The High Court held that, in effect, once satisfaction of reasons for the notice is found sufficient i.e. if the notice under section 148(2) is found to be valid, then, the Assessing Officer may do reassessment in respect of any other item of income which may have escaped assessment, even though the original reason for issue of notice under section 148 does not survive.

This decision has dissented from the decisions in the case of *CIT v. Jet Airways (I) Ltd (2011) 331 ITR 236 (Bom); Ranbaxy Laboratories Ltd v. CIT (2011) 336 ITR 136 (Del).*

Note – In this case, the reassessment on the basis of reasons, which did not form the original reasons to believe, but were subsequently discovered by the Assessing Officer, was held to be valid, even though the original reasons did not survive.

9. **Would the reassessment proceedings initiated U/S 147 against the legal heirs of the deceased assessee be valid if notice of reassessment was sent to the legal heirs after the limitation period, though a notice addressed to the deceased assessee was sent prior to the limitation period?**

Vipin Walia (HC)

Facts of the case:

- A notice U/S 148 dated 27th March, 2015 was addressed to the assessee for the AY 2008-09. The notice got returned unserved with the postal authorities endorsing on it the remarks "addressee expired".
- Later, the **AO issued a letter dated 15.06.2015** to the petitioner seeking details of legal heirs/successors of the deceased (assessee) to complete the proceedings for the AY 2008-09.
- The assessee, being one of the legal representatives of the deceased, wrote to the AO pointing out that the proceedings initiated U/S 148 were barred by limitation.
- The AO proceeded to make the assessment U/S 147 which the assessee challenged by means of a writ.

High Court's Observations:

- The High Court took note of section 159 which sets out the procedure to be adopted when the assessment is made on the legal representatives. **Section 159(2)(a) states that any proceeding already taken against an assessee 'before his death' shall be deemed to have been taken against the legal representative**.
- As per section 159(2)(b), **any proceeding which could have been taken against the deceased if he had survived, may be taken against the legal representative of the deceased assessee, even if it had not been taken while the assessee was alive.**
- The AO initiated proceedings U/S 147 against the deceased for the AY 2008-09. **The time limit for issue of notice was 31.03.2015**. On March 27, 2015 when the notice was issued, the assessee was already dead. If the Department intended to proceed U/S 147, it could have done so prior to 31.03.2015 by issuing a notice to

the legal representatives of the deceased. Beyond that date, it could not have proceeded in the matter even by issuing notice to the legal representatives of the assessee.

High Court's Decision: The High Court, accordingly, held that issue of notice on the legal representatives beyond the limitation time would render the reassessment proceedings invalid.

10. Does the finding or direction in an appellate order that income relates to a different AY empower reopening of assessment for that AY, irrespective of the expiry of the 6 year time limit?

PP Engineering Work

Under section 149(1)(b), the time limit for issue for notice under section 148 is six years from the end of the relevant AY, where the income chargeable to tax which has escaped assessment amounts to or is likely to amount to 1 lakh or more for that year.

Section 150(1) states that notwithstanding anything contained in section 149, notice U/S 148 may be issued at any time for the purpose of making an assessment or reassessment or recomputation in consequence of or to give effect to any finding or direction contained in an appellate or revisionary order.

High Court's Opinion: The High Court made reference to section 150 which overrides the time limitation specified in section 149. Also, *Explanation 2* to section 153 makes it clear that when an order in appeal, revision or reference is made whereby any income is excluded from the total income of an assessee for an AY, an assessment of such income for another AY shall be deemed to be one made in consequence of or to give effect to any finding or direction contained in the said order for the purposes of section 150 and section 153.

High Court's Decision:
The High Court observed that in view of the order of the Tribunal that the credit entries related to the earlier AY i.e., A.Y.2000-01, the AO initiated reassessment proceedings U/S 147 by issue of notice U/S 148 for the year and passed an order dated 29/12/2009 making an addition of 32 lakhs. The High Court held that by virtue of section 150 read with *Explanation 2* to section 153, **the said order was not barred by limitation**.

11. Is initiation of reassessment beyond a period of 4 years on the basis of subsequent Tribunal and High Court ruling valid, if there is no failure on the part of the assessee to disclose fully and truly all materials facts?

Allanasons Ltd (HC)

High Court's Opinion:

The High Court observed that it is well settled in terms of the proviso to section 147, that where any assessment is sought to be opened beyond a period of 4 years from the end of the relevant assessment year, two conditions have to be fulfilled cumulatively.

The 1ST condition is that **there must be reason to believe that income chargeable to tax has escaped assessment.**

The 2ND condition is that **such escapement of income should have arisen due to failure on the assessee's part to fully and truly disclose all material facts required for the assessment.**

Thus, escapement of income prompting reopening of assessment beyond the period of 4 years from the end of the AY is not possible unless it is due to the failure of the assessee to disclose fully and truly all material facts necessary for assessment.

Even a subsequent change of law cannot be taken as income escaping assessment for triggering reassessment provisions beyond 4 years from the end of the assessment year unless there was a failure on the part of the assessee to disclose fully and truly all material facts necessary for assessment.

The High Court observed that in this case, the reasons did not indicate even remotely any failure on the part of the assessee to disclose fully and truly any material fact necessary for assessment.

High Court's Decision:
The High Court, accordingly, held that **a subsequent decision of Tribunal or High Court by itself is not adequate for reopening the assessment completed earlier under section 143(3) unless there is a failure on the part of the assessee to disclose complete facts.**

12. Is recording of satisfaction and quantification of escaped income a pre-condition for issuing notice U/S 148 after 4 years from the end of the relevant AY?

Amarnath Agrawal (HC)

Facts of the case:

- The assessee along with four others had obtained a lease of land and was in possession of the same from 1953. Subsequently, the State Government introduced a policy for conversion of lease-hold to free-hold. The assessee applied for conversion before the District Magistrate in 1997 and a sale deed was executed. The assessee deposited the necessary charges as demanded by the State Government and a freehold sale deed dated 25th March, 1998 was executed. The assessee sold a portion of the land during the F.Y. 1999-2000 and admitted the same as LTCG taking into account the lease hold period also.
- In the assessment, the admission of income as LTCG was accepted.
- However, after the expiry of 4 years from the end of the relevant AY, proceeding for reassessment of such income as STCG was resorted to by the Revenue on the ground that assessee had computed LTCG tax liability, whereas he was liable to pay STCG tax, since he had sold a portion of the property within 3 years from the date of conversion of leasehold land into a freehold land.
- The assessee filed a writ challenging the validity of notice issued U/S 148 stating that the requirements of section 149 read with section151 were not considered by the Revenue.

High Court's Opinion and Decision:

The High Court observed that two distinct conditions must be satisfied for assuming jurisdiction to issue a notice under section 148 after a period of 4 years viz.

1. escapement of income; and
2. omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment.

Under section 149(1)(b), **it is imperative for the Assessing Officer, in his reasons, to state that the escaped income is likely to be 1 lakh or more. This is an essential ingredient for seeking approval** from the competent authority U/S 151. **If the condition in order to substantiate the satisfaction of escapement of income is not made, the issuance of notice would be invalid.**

In this case, since no reasons were recorded that the escaped income is likely to be 1 lakh or more so that the Chief Commissioner or Commissioner may record his satisfaction U/S151, the initiation of reassessment proceedings after four years was barred by time.

High Court's Decision:

- **The High Court observed that the property was held for more than 3 years and the conversion from leasehold to freehold being an improvement of the title did not have any effect on the taxability of profits. The reasons recorded by the Assessing Officer did not indicate any failure on the part of the assessee to disclose fully and truly all material facts at the time of assessment;**
- **it also did not indicate that the quantum of escapement of income exceeds 1 lakh.**
- **Accordingly, the High Court held that, in this case, the issue of notice under section 148 after the four year time period was not valid.**

13. Can the successor AO initiate reassessment proceedings on the ground of change of opinion in relation to an issue, which the predecessor AO who framed the original assessment had already applied his mind and come to a conclusion?

H. K. Buildcon Ltd. (HC)

High Court's Observations:

On this issue, the Gujarat High Court referred to the ruling of the Apex Court in *Kelvinator of India Ltd.* wherein it was held that the **AO has the power only to reassess and not to review**.

The Apex Court laid down that one must treat the concept of change of opinion as an in-built test to check abuse of power by the AO.

The Apex Court concluded that if the phrase "reason to believe" is omitted, the same would give arbitrary powers to the Assessing Officer to reopen the past assessment on mere change of opinion and this is not permissible even as per legislative intent.

High Court's Decision:
The Gujarat High Court, applying the rationale of the Apex Court ruling, observed that **in the entire reasons recorded in this case, there was nothing on record to show that income had escaped assessment in respect of which the successor AO received information subsequently, from an external source**. The reasons recorded themselves indicated that the successor AO had merely recorded a different opinion in relation to an issue to which the AO, who had framed the original assessment, had already applied his mind and come to a conclusion. **The notice of reassessment was, therefore, not valid.**

14. Can the AO issue notice U/S 154 to rectify a mistake apparent from record in the intimation U/S 143(1), after issue of a valid notice U/S 143(2)?

Haryana State Handloom and Handicrafts Corporation Ltd. (HC)

High Court's Observations:

On this issue, the Punjab and Haryana High Court referred to the Delhi High Court ruling in. *Punjab National Bank,* where it was held that **rectification of an intimation cannot be made after issuance of notice U/S 143(2) and during the pendency of proceedings U/S 143(3)**.

It was held that if any change was permitted to be effected, the same can be done in the assessment U/S 143(3) and not by exercising the power U/S 154 to rectify the intimation issued U/S 143(1)

High Court's Decision:
In the present case, the Punjab and Haryana High Court relying, *inter alia,* on the said decision held that the scope of proceedings U/S 143(2) is wider than the power of rectification of mistake apparent from record U/S 154. The notice under section 143(2) is issued to ensure that the assessee has not understated the income or has not computed excessive loss or underpaid the tax. It is only on consideration of the matter and on being satisfied that it is necessary or expedient to do so that the AO issues the notice under section 143(2). Therefore, the AO has to proceed U/S 143(3) and issue an assessment order. If issue of notice U/S 154 is permitted to rectify the intimation issued U/S 143(1), then it would lead to duplication of work and wastage of time.

Therefore, it was concluded that proceedings U/S 154 for rectification of intimation U/S 143(1) cannot be initiated after issuance of notice U/S 143(2) by the AO to the assessee.

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

Tony Electronics Limited (HC)

Issue : 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.

High Court's Decision: 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.*

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ADVANCE RULINGS

1. **Can AAR reject an application for advance ruling on the ground that proceedings are already pending before the Income-tax authority, where notice U/S 143(2) in printed format has been served on the applicant-assessee before the date of filing the said application for advance ruling?**
What would be the position if notice U/S 142(1) along with detailed questionnaire has also been issued to the applicant assessee before the date of filing of the said application for Advance Ruling?

Hyosung Corporation (HC)

Facts of the case:

The assessee-company incorporated in South Korea was engaged in several projects in India and has been regularly assessed to income-tax from AY 2008-09 onwards. It filed an application for advance ruling for the AY 2008-09, 2009-10 and 2010-11.

For the AY 2008-09 and 2009-10, notices U/S 143(2) were issued and subsequently, **before the date of filing applications with AAR**, notice U/S 142(1) along with a questionnaire was issued.

For the assessment year 2010-11, notice U/S 143(2) was issued before the date of filing of application with the AAR and notice U/S 142(1) along with a questionnaire was served on the assessee after the date of filing of application with the AAR.

The applications for all the assessment years were objected by the Revenue on the reasoning that the proceedings were already pending before the AO & hence it could not entertain the applications. Accordingly, the AAR rejected the applications of the assessee for all the assessment years.

High Court's Observations:

The High Court observed that the assessee received notices U/S 143(2) in a standard pre-printed format and also received notices U/S 142(1) accompanied by questionnaire for all the assessment years.

The High Court noted that mere issue of notice under section 143(2) in pre-printed format will not amount to 'already pending' proceedings for the purpose of applying proviso to section 245R(2).

However, issue of notices under section 142(1) accompanied by a questionnaire which raised the question of supply contracts which were executed overseas would nevertheless make the proceedings pending. This is more so when such notices were issued before filing of the applications by the assessee with the AAR.

High Court's Decision:

- The High Court, accordingly, held that **rejection of application filed by the assessee for the assessment years 2008-09 and 2009-10 was not erroneous and did not call for any interference, since the notice U/S 142(1) along with questionnaire were issued before the date of making an application for advance ruling.**
- However, **notice U/S 142(1) issued for the AY 2010-11 after the date of filing of application will not result in the proceedings being 'already pending' before an IT authority for the purpose of applying proviso to section 245R(2).**
- **Thus, the application for the assessment year 2010-11 cannot be rejected by the AAR**.
- However, for the assessment years 2008-09 and 2009-10, the rejection of the application by AAR is tenable in law, since notice under section 142(1) along with detailed questionnaire was issued before the date of filing of such application.

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APPEALS AND REVISION

1. Can mere non-mention or non-discussion of enquiry made by the AO in the assessment order justify invoking revisionary jurisdiction U/S 263?

Krishna Capbox (P) Ltd (HC)

Facts of the case:

- The assessee filed its ROI declaring total income of 8.15 lakhs. The return was processed U/S 143(1) and later, the case was selected for scrutiny and statutory notice U/S 143(2) was issued. During the course of scrutiny, the AO raised certain queries which were answered by the assessee.
- The AO, after being satisfied with the replies given, completed the assessment by accepting the declared income.
- Subsequently, the Commissioner invoked revisionary jurisdiction U/S 263 by holding that the AO had not made enquiry on certain aspects, such as -
  - (i) Non-verification of source of investment in respect of addition in fixed assets;
  - (ii) Non-confirmation of sundry creditors by the assessee;
  - (iii) Non-enquiry of unsecured loan by the AO
  - (iv) Not obtaining the copy of bank statements;
  - (v) Non-verification of genuineness of shareholders;
  - (vi) Deduction of freight paid without deduction of tax at source.

Assessee's contention *vis-a-vis* Revenue's Contention:

The assessee contended that all the aspects contested by the Commissioner were enquired by the AO. The Revenue took the defence that no enquiry was made by the AO in respect of the issues set out in the notice issued U/S 263 and hence, revisionary jurisdiction was correctly assumed.

Tribunal's view:

Once enquiry was made, mere non- discussion or non-mention in the assessment order cannot lead to the assumption that the AO did not apply his mind or that he had not made any enquiry on the subject for invoking section 263.

High Court's Observations:

The High Court noted the Bombay's High Court's view in ***Cellular Ltd.*** that if a query is raised during the assessment proceedings and responded to by the assessee, the mere fact that it is not dealt with in the assessment order would not lead to a conclusion that no mind had been applied to it.

High Court's Decision:
The High Court concurred with the decision of the Tribunal and held that **since the relevant enquiries and replies are available on 'record' (i.e., the paper book), the Commissioner cannot invoke revisionary jurisdiction merely because there was no mention of such enquiry and verification in the assessment order**.

2. Can the Commissioner invoke revisionary jurisdiction U/S 263, when the subject matter of revision (i.e., whether the manner of allocation of revenue amongst the members of AOP would affect the allowability and/or quantum of deduction U/S 80-IB) has been decided by the Commissioner (Appeals) and the same is pending before the Tribunal?

Fortaleza Developers (HC)

Facts of the case:

The assessee, an Association of Person filed its return of income for the assessment year 2007-08 declaring total income of 4.14 lakhs after claiming deduction U/S 80-IB(10) of 1454.47 lakhs. The assessment was completed U/S 143(3) disallowing fully the claim of deduction under section 80- IB(10).

The assessee preferred an appeal before Commissioner (Appeals) who held that the assessee had fulfilled all the conditions laid down in section 80-IB(10) and hence, directed the Assessing Officer to allow the deduction.

The order of Commissioner (Appeals) was challenged before the Tribunal by the Revenue. During the pendency of the appeal before the Tribunal, the Commissioner issued a notice U/S 263 asking the assessee to show cause as to why the assessment order should not be set aside. The notice U/S 263 specified that the method of allocation of revenue gave the assessee undue benefit by way of a higher claim of deduction under section 80-IB(10) contrary to clause (7) of the AOP agreement.

Appellate Authorities' Views:

The Tribunal observed that the **quantum of deduction U/S 80-IB(10) will depend upon the income earned from the project in question & not on the mode of distribution of shares amongst members of the AOP as income of AOP is taxable at the maximum marginal rate**.

The Tribunal further held that the Commissioner cannot exercise jurisdiction U/S 263 in respect of deduction U/S 80- IB, which was the subject matter of appeal.

High Court's Views:

The High Court took note of all the facts and sequence of events with regard to the matter in appeal. The Court was of the view that the contract between the two parties was self-explanatory and the interpretation placed by the assessee on clause (7) and claiming deduction under section 80-IB(10) is in order.

High Court's Decision :

When the order of the first appellate authority is complete and the appeal is pending before the Tribunal, the Commissioner is precluded from invoking section 263 for revision of the very same matter decided by the first appellate authority since clause (c) of the Explanation 1 to section 263 debars the same.

Accordingly, the **High Court held that the order passed by the AO got merged with the order of the first appellate authority. The very same issue cannot be revised by invoking revisionary jurisdiction U/S 263.**

3. Can an assessee, objecting to the reassessment notice issued U/S 148, directly approach the High Court in the normal course contending that such reassessment proceedings are apparently unjustified and illegal?

Samsung India Electronics P. Ltd. (HC)

Facts of the case:

- In the present case, Samsung Electronics Co. Ltd., the Korean Company was subjected to regular assessment for the assessment year 2006-07. The assessment order was passed however For the same assessment year, i.e., A.Y.2006-07, assessee was issued a reassessment notice U/S 148.
- Against this reassessment notice, assessee filed a writ petition before the High Court.

High Court's Observations:

- The High Court observed the Apex court ruling in the case of *GKN Driveshafts (India) Ltd*, wherein, it was laid down that "**when a notice under section 148 is issued, the proper course of action for the noticee is to file a return and if he so desires, to seek reasons for issuing notices. The AO is bound to furnish reasons within a reasonable time. On receipt of the reasons, the noticee is entitled to file objections to issuance of notice and the AO is bound to dispose of the objections by passing a speaking order.**
- The High Court noted that the **in this case the assessee has not filed objections before the AO and has directly approached the court by way of the writ petition**.
- On this issue, the assessee contended that they were justified in approaching the High Court directly as the reassessment proceedings *ex facie* were unjustified and illegal.

High Court's Decision:

The High Court, thus, held that **it will not be appropriate and proper in the facts of the present case to permit and allow the petitioner to bypass and forgo the procedure laid down by the Supreme Court** in ***GKN Driveshafts (India) Ltd.*** *(supra),* since the said procedure has been almost universally followed and has helped cut down litigation and crystallise the issues, if and when the question comes up before the Court.

4. Should time limit U/S 263 to be reckoned with reference to the date of assessment order or the date of reassessment order, where the revision is in relation to an item which was not the subject matter of reassessment?

I Lark Chemicals Ltd

Facts of the case: The assessee-company, for the AY 2002-03, filed its ROI declaring a total income of 30.98 lakhs. This was accepted and the return was processed U/S 143(1).

Subsequently, it was reopened by issue of notice U/S 148 and the order of reassessment was passed in June, 2006. The Commissioner assumed jurisdiction for revision of order by invoking section 263 in March, 2009. The subject matter of revision, however, was not related to any of the issues dealt with in the reassessment.

Tribunal's view:

The Tribunal opined that jurisdiction U/S 263 cannot be exercised in respect of those issues which were not the subject matter of consideration while passing the order of reassessment but were a part of the original assessment, the time limit for which had since expired.

High Court's Opinion:

The High Court observed that if the revision happened to be in relation to issues dealt with in the reassessment proceedings, then, it would not be barred by limitation as the time limit would expire only on 31st March, 2009 i.e., two years from the end of the financial year in which the order sought to be revised U/S 263, was passed. However, in this case, the revision proposed U/S 263 was in respect of issues, other than the issues dealt with in the order of reassessment. The issues on which the Commissioner sought to exercise jurisdiction U/S 263 were concluded by virtue of intimation issued U/S 143(1). The time period for revision U/S 263 is two years from the end of the financial year in which order sought to be revised was passed [i.e., two years from the end of the financial year in which the intimation was issued U/S 143(1)] and that time period has expired long ago.

High Court's Decision:
The High Court, thus, held that the jurisdiction U/S 263 could not be assumed on issues which were not the subject matter of issues dealt with in the order of reassessment but were part of the original assessment, for which the period of limitation expired long ago.

II ICICI Bank Ltd. (HC)

Facts of the case:

- In the present case, an order of assessment was passed U/S 143(3) allowing the deduction U/S 36(1)(vii), 36(1)(viia) and foreign exchange rate difference. Further, two notices of reassessment were issued U/S 148 and an order of reassessment was passed U/S 147 which did not deal with the above deductions.
- Later, the Commissioner passed an order U/S 263 for disallowing the deduction U/S 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference which have not been taken up in the reassessment proceedings U/S 147 but which was decided in the original order of assessment passed U/S 143(3).

Assessee's contention *vis-à-vis* Revenue's contention:

- The assessee claimed that the order passed by the Commissioner U/S 263 is barred by limitation since the period of 2 years from the end of the financial year in which the order sought to be revised was passed, had lapsed.
- However, the Revenue gave a plea that period of limitation shall be reckoned from the date of order U/S 147 and not from the date of the original assessment order U/S 143(3), applying the doctrine of merger.
- The Revenue pointed out that as per the provisions of *Explanation 3* to section 147, the AO is entitled to assess or reassess the income in respect of any issue which has escaped assessment though the reasons in respect of such issue have not been included in the reasons recorded U/S 148(2).

High Court's Decision:
Considering the above mentioned facts, the Bombay High Court held that the order of assessment U/S 143(3) allowed deduction U/S 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference. The order of reassessment, however, had not dealt with these issues. Therefore, the doctrine of merger cannot be applied in this case. The order U/S 143(3) cannot stand merged with the order of reassessment in respect of those issues which did not form the subject matter of the reassessment.
Therefore, the period of limitation in respect of the order of the Commissioner U/S 263 with regard to a matter which does not form the subject matter of reassessment shall be reckoned from the date of the original order U/S 143(3) and not from the date of the reassessment order U/S 147.

5. Can the original assessment order U/S 143(3), which was subsequently modified to give effect to the revision order U/S 264, be later on subjected to revision U/S 263?

New Mangalore Port Trust (HC)

Facts of the case:

- The assessee-trust, a government undertaking carrying on commercial activities in one of the major ports was enjoying exemption U/S 10(20) since its inception. On March 27, 2006, the assessee applied for registration U/S 12A.
- However, the said application for registration was rejected by the Commissioner.
- On appeal before the Appellate Tribunal, the Commissioner was directed to grant registration U/S 12AA to the assessee w.e.f. 1 April, 2003. The Commissioner granted registration on July 27, 2009.
- Subsequent to the registration, an assessment order was passed by the AO U/S 143(3) on December 27, 2009. The assessee filed a revision petition U/S 264 which was allowed and the matter was remanded to the AO to compute the income of the assessee in terms of the order of revision U/S 264.
- The AO gave effect to the revision order vide order dated May 27, 2011. Thereafter, the original order passed U/S 143(3), dated December 27, 2009 was revised by the Commissioner U/S 263 on March 22, 2012.
- The revision order U/S 263 passed by Commissioner was challenged by the assessee before the Appellate Tribunal.
- The Tribunal set aside the revision order of the Commissioner passed U/S 263.

High Court's Observations:

The High Court took note of the sequence of events and undisputed facts that the assessment order dated 27 December 2009 passed by the AO was no longer in existence.

The High Court concluded that the Tribunal arrived at the conclusion only after considering the factual position that Commissioner had no jurisdiction to revise the order which was not in existence.

High Court's Decision: The High Court, accordingly, held that **the order passed by the Commissioner U/S 263, revising the non-existing order is void ab initio and is a nullity in the eyes of law**

6. Can an assessee file a revision petition U/S 264, if the revised return to correct an inadvertent error apparent from record in the original return, is filed after the time limit specified U/S 139(5) on account of the error coming to the notice of the assessee after the specified time limit?

Sanchit Software and Solutions Pvt. Ltd (HC)

Facts of the case:

- The assessee-company had electronically filed its ROI. It committed a mistake by including dividend income [exempt U/S 10(34)] and LTCG on sale of shares [exempt U/S 10(38)] in its ROI, though the same was correctly disclosed in the Schedule containing details of exempt income.
- The return was processed U/S 143(1) denying the exemptions U/S 10(38) and 10(34) and therefore, intimation U/S 143(1) was served on the assessee raising a demand of tax.
- The assessee, on receiving the intimation, noticed the error committed and filed a revised return rectifying the error.
- However, the revised return was not sustainable as the same was filed beyond the period of limitation as provided U/S 139(5). Later, the assessee filed an application for rectification U/S 154 and also a revision petition U/S 264.

Commissioner's contention:

The Commissioner of income-tax, while considering the revision petition, contended that the intimation U/S 143(1) was based on the return of the assessee, in which the claims U/S 10(34) and U/S 10(38) were not made by the assessee. Hence, it cannot be said that the intimation U/S 143(1) was erroneous, since the same was squarely based on the return filed by the assessee.

Secondly, the power of Commissioner U/S 264 is only restricted to the record available before the AO which can be examined by the Commissioner. In the circumstances, the other evidence sought to be brought on record to establish the mistake committed by the assessee cannot be considered by the Commissioner U/S 264. The revision petition U/S 264 was rejected by the Commissioner on the above grounds.

High Court's Observations:

The High Court observed that the entire object of administration of tax is to secure the revenue for the development of the country and not to charge the assessee more tax than which is due and payable by the assessee. In this context, the High Court referred to the CBDT Circular issued as far back as 11th April, 1955 directing the AO not to take advantage of the assessee's mistake.The High Court opined that the said Circular should always be borne in mind by the officers of the Revenue while administering the Act.

The High Court observed that, in this case, the Commissioner of income-tax had committed a fundamental error in proceeding on the basis that no deduction on account of dividend income and LTCG U/S 10 was claimed from the total income, without considering that the assessee had specifically sought to exclude the same as is evident from the entries in the relevant Schedule. Therefore, this was an error on the face of the order and hence, the same was not sustainable.

High Court's Decision:

The High Court, accordingly, **set aside the order of Commissioner and remanded the matter for fresh consideration.**

The High Court further directed the AO to consider the rectification application filed by the assessee U/S 154 as a fresh application received on the date of service of this order and dispose of the rectification application on its own merits, without awaiting the result of the revision proceedings before the Commissioner of Income-tax on remand, at the earliest.

7. Can an assessee make an additional/new claim before an appellate authority, which was not claimed by the assessee in the ROI (though he was legally entitled to), otherwise than by way of filing a revised ROI?

Pruthvi Brokers & Shareholders (HC)

High Court's Observations:

- While considering the above mentioned issue, the Bombay High Court observed the decision of the Supreme Court, in the case of ***Jute Corporation of India Ltd.*** and ***National Thermal Power Corporation. Ltd***, that **an assessee is entitled to raise additional claims before the appellate authorities. The appellate authorities have jurisdiction to permit additional claims before them, however, the exercise of such jurisdiction is entirely the authorities' discretion.**
- Also, the High Court considered the decision of the Apex Court in the case of ***Gurjargravures (P.) Ltd***, wherein it was held that **in case an additional ground was raised before the appellate authority which could not have been raised at the stage when the return was filed or when the assessment order was made, or the ground became available on account of change of circumstances or law, the appellate authority can allow the same.**
- The Supreme Court, in the case of ***Goetze (India) Ltd*** held that the **assessee cannot make a claim before the AO otherwise than by filing an application for the same. The additional claim before the AO can be made only by way of filing revised return of income.**
- The decision in the above mentioned case, however, does not apply in this case, since the AO is not an Appellate Authority.

High Court's Decision:

Therefore, in the present case, the Bombay High Court, considering the above mentioned decisions, held that additional grounds can be raised before the Appellate Authority even otherwise than by way of filing return of income. However, in case the claim has to be made before the Assessing Officer, the same can only be made by way of filing a revised return of income.

8. Does the Appellate Tribunal have the power to review or re-appreciate the correctness of its earlier decision U/S 254(2)?

Earnest Exports Ltd. (HC)

High Court's Observations:

- In this case, the High Court observed that **the power U/S 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.**

High Court's Decision:

In this case, the Tribunal, while dealing with the application U/S 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 U/S 254(2).

9. Can the Tribunal exercise its power of rectification U/S 254(2) to recall its order in entirety, where there is a mistake apparent from record?

Lachman Dass Bhatia Hingwala (P) Ltd. (HC)

High Court's Observations:

- On this issue, the Delhi High Court referred to the case of Apex Court in ***Honda Siel Power Products Ltd***, dealing with the Tribunal's power U/S 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order.
- Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review.
- It is a well settled provision of law that the **Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.**
- The Apex Court in relation to *Honda Siel Power Products Ltd.,* observed that When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then it is the duty of the Tribunal to set it right. The Apex Court took note of the fact that the Tribunal committed a mistake in not considering material which was already on record and the Tribunal acknowledged its mistake and accordingly, rectified its order.

High Court's Decision:

Applying the above-mentioned decision of the Apex Court to this case, the Delhi High Court observed that **the Tribunal, while exercising the power of rectification U/S 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.**

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

Meghalaya Steels Ltd. (SC)

Facts of the case:

In this case, the High Court had considered whether deduction is allowable U/S 80-IB on **transport subsidy** and **interest subsidy** and on the **central excise duty refund** received by it.

Revenue's contention *v/s* Assessee's contention:

- The Revenue contended that the High Court would have no jurisdiction U/S 260A to review such judgment since as per section 260A(7), only those provisions of the Civil Procedure Code could be looked into for the purposes of section 260A as were relevant to the disposal of appeals.
- The assessee- petitioner, however, contended that High Courts being courts of record under article 215 of the Constitution of India, the power of review would in fact bestowed in them.

Supreme Court's Observations:

- The Supreme Court concurred with the assessee's submission that High Courts being courts of record under article 215 of the Constitution of India, the power of review would bestowed in them.
- Further, it noted that in another case the Supreme Court had observed that there is nothing in article 226 of the Constitution to preclude a High Court from exercising the power of review to prevent miscarriage of justice or to correct grave and palpable errors committed by it.

Supreme Court's Decision:

The Supreme Court observed that **it is clear on reading of section 260A(7), that it does not claim in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure.**

Section 260A(7) only states that all the provisions that would apply in the Code of Civil Procedure would apply to appeals U/S 260A. That does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.

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PENALTIES

1. Is penalty under section 271D imposable for cash loans/deposits received from partners?

Muthoot Financiers (HC)

Facts of the case:

- The assessee-firm, engaged in business of banking and money lending, had received huge amounts from the partners in the assessment years 1996-97 and 1998-99 by way of cash.
- The AO levied penalty U/S 271D. The Commissioner (Appeals) upheld the levy of penalty.
- The Tribunal observed that the advance made to the firm by the partners cannot be regarded as loan accepted by the firm. It held that the amount advanced and accepted is capital of the firm and not loans which cannot be subjected to penalty U/S 271D.
- The Revenue filed an appeal before High Court.
- The assessee contended before the High Court that the amount advanced by the partners cannot be regarded as loan but is a capital of the firm. As the partnership firm has no separate legal entity, nor is there a separate identification between the firm and the partners, there is no violation of section 269SS in this case.

High Court's Opinion & Decision:

- The High Court referred to the case *R.M. Chidambaram Pillai*, where the Apex Court was of the view that the **firm is not a legal person even though it has some of the attributes of a personality**.
- It also referred to ***Sivakumar. V*** where the High Court upheld the conclusion of the Tribunal to hold that there is no separate legal entity for the partnership firm and the partner is entitled to use the funds of the firm.
- In ***Lokhpat Film Exchange (Cinema)***, it was held that **a partnership firm not being a juristic person, the *inter se* transaction between the firm and partners are not governed by the provisions of sections 269SS and 269T.**
- The High Court also noted the different view expressed by the Supreme Court in ***A.W. Figgies & Co***. where it was held that **the partners of the firm are distinct as civil entities while the firm as such is a separate and distinct unit for the purpose of assessment.**
- The High Court observed that the position that emerges is that **there are three different Courts, which have held that section 269SS would not be violative when money is exchanged *inter se* between the partners and the firm.**

- The High Court further observed that, in this case, there was no dispute as regards the money brought in by the partners of the assessee-firm.
- The source of money was also not doubted.
- The transaction was bona fide and not aimed to avoid any tax liability.
- The credit worthiness of the partners and genuineness of the transactions coupled with relationship between the 'two persons' and two different legal interpretations put forward, could constitute a reasonable cause in a given case for not invoking sections 271D /271E read with section 273B.

The High Court held that the issue being a debatable one, there was reasonable cause for not levying penalty.

2. Can loan, exceeding the specified limit, advanced by a partnership firm to the sole- proprietorship concern of its partner be viewed as a violation of section 269SS to attract levy of penalty?

V. Sivakumar (HC)

Facts of the case:

- In the present case, the assessee was a partner in 4 firms and also had a sole-proprietary business.
- In the relevant PY, the partnership firms had advanced loan to the assessee in cash exceeding the specified amount mentioned in section 269SS.
- The AO initiated penalty proceedings U/S 271D in view of violation of section 269SS.

Assessee's contention:

The assessee contended that the amount is taken in the capacity of the partner and it cannot be taken as an independent transaction and therefore, there is no violation of section 269SS.

Also, the assessee contended that the partnership firm has no separate legal entity and there is no separate identification between the firm and the partner.

Tribunal's view:

The Tribunal, relying upon the various court decisions, confirmed the finding of the Commissioner (Appeals) that partnership firm is not a juristic person and there is no separate identity for the firm and the partners; Being a partner, the assessee had withdrawn amounts from the firms and there were no reasons to doubt the genuineness of the transactions.

Consequently, the transactions between the firm and the partner cannot be brought within the meaning of section 269SS.

High Court's Decision:

- The High Court, relying upon the various court decisions, upheld the decision of the Tribunal holding that **there is no separate identity for the partnership firm and that the partner is entitled to use the funds of the firm**.
- In the present case, the assessee has acted *bona fide* and that there was a reasonable cause within the meaning of section 273B.
- Therefore, the transaction cannot be said to be in violation of section 269SS and no penalty is attracted in this case.

3. Where an assessee repays a loan merely by passing adjustment entries in its books of account, can such repayment of loan by the assessee be taken as a contravention of the provisions of section 269T to attract penalty U/S 271E?

Triumph International Finance (I.) Ltd.

Assessing Officer's contentions:

The Assessing Officer passed the assessment order levying penalty U/S 271E for the contravention of the provisions of section 269T on the argument that since section 269T put an obligation on the assessee to pay loan only by way of an account payee cheque or an account payee draft, the settlement of a portion of the loan by passing journal entry would be a mode otherwise than by way of an account payee cheque or an account payee draft and therefore, the penal provisions under section 271E shall be attracted.

Assessee's contentions:

- The assessee argued that the transaction of repayment of loan or deposit by way of adjustment through book entries was carried out in the ordinary course of business and the genuineness of the assessee's transaction with the Investment Trust of India was also accepted by the Tribunal. It is a bonafide transaction.
- The assessee further contended that section 269T mentions that in a case where the loan or deposit is repaid by an outflow of funds, the same has to be by an account payee cheque or an account payee demand draft. However, in case the discharge of loan or deposit is in a manner otherwise than by an outflow of funds, as is the situation in the present case, the provisions of section 269T would not apply.

High Court's Observations:

- Considering the above mentioned facts and arguments, the Bombay High Court observed that, the obligation to repay the loan or deposit by account payee cheque/bank draft as specified in section 269T is mandatory in nature. The contravention of the said section will attract penalty U/S 271E.
- The argument of the assessee cannot be accepted since section 269T does not require the fulfillment of the condition mentioned therein only in case where there is outflow of funds. It merely puts a condition that in case a loan or deposit is repaid, it should be by way of an account payee cheque/draft. Therefore, in the present case the assessee has repaid a portion of loan in contravention of provisions of section 269T.
- However, the cause shown by the assessee for repayment of the loan otherwise than by account payee cheque/bank draft was that the assessee was liable to receive amount towards the sale price of the shares sold by the assessee to the person from whom loan was received by the assessee. It would have been mere formality to repay the loan amount by account payee cheque/draft and receive back almost the same amount towards the sale price of the shares.

- Also, neither the genuineness of the receipt of loan nor the transaction of repayment of loan by way of adjustment through book entries carried out in the ordinary course of business has been doubted in the regular assessment.
- Therefore, there is nothing on record to suggest that the amounts advanced by Investment Trust of India to the assessee represented the unaccounted money of the Investment Trust of India or the assessee and also it cannot be said that the whole transaction was entered into to avoid tax. This is accepted as a reasonable cause U/S 273B.

High Court's Decision:

In effect, the assessee has violated the provisions of section269T by repaying the loan amount by way of passing book entries and therefore, penalty U/S 271E is applicable.

However, since the transaction is bona fide in nature being a normal business transaction and has not been made with a view to avoid tax, it was held that the assessee has shown reasonable cause for the failure U/S 269T, and therefore, as per the provisions of section 273B, no penalty U/S 271E could be imposed on the assessee for contravening the provisions of section 269T.

26

OFFENCES AND PROSECUTION

1. Would prosecution proceedings U/S 276CC be attracted where the failure to furnish return in time was not willful?

Bhavecha Machinery and Others (HC)

High Court's Observation and Decision:

- 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 ROI and such delay was not willful.
- Therefore, prosecution proceedings U/S 276CC are not attracted in such a case.

27

MISCELLANEOUS PROVISIONS

1. Can the AO *suo moto* assume jurisdiction to declare sale of property as void U/S 281?

Dr. Manoj Kabra (HC)

Facts of the case:

- The assessee acquired a property for 7 lakhs though the stamp duty was paid in accordance with the circle rate which was 12 lakhs.
- Pursuant to the sale deed, the assessee took possession of the property.
- Prior to the sale, the income tax assessment of seller had been completed and a certain demand was raised against him in respect of the assessment year when the sale of the property was effected.
- The AO issued a notice U/S 281 to show cause as to why the sale deed executed in his favour (assessee-buyer) should not be treated as a void document.
- The assessee-buyer contended that he was a *bona fide* purchaser for adequate consideration and no notice of pendency of proceedings was to known him nor was it brought to his knowledge by the seller.
- The assessee placed reliance on the decision of Supreme Court in the case of ***Gangadhar Vishwanath Ranade*** where it was held that section 281 of the Income-tax Act, 1961 is only a declaratory provision and not an adjudicatory provision entitling the income-tax authority to declare a document as a void document.

High Court's Observation:

- The High Court observed that the issue in this case was squarely covered by above Apex Court decision which held that the **legislature had no intention to confer any exclusive power or jurisdiction upon the income-tax authority to decide any question arising U/S 281.**
- The Income-tax Act, 1961, does not prescribe any adjudicatory machinery for deciding any question which may arise U/S 281.
- In order to declare a transfer as fraudulent U/S 281, an appropriate proceeding in accordance with law was required to be taken U/S 53 of the Transfer of Property Act, 1882. The AO is required to file a suit for declaration to the effect that the transaction of transfer was void U/S 281 of the Income-tax Act; but he himself cannot assume jurisdiction to declare the sale deed as void.

High Court's Decision:

Applying the rationale of the Apex Court ruling, the High Court held that the **AO has no jurisdiction U/S 281 to *suo moto* declare the sale as void.**

28

DEDUCTION, COLLECTION AND RECOVERY OF TAX

1. **Do the tips collected by hotel and disbursed to employees constitute salary to attract the provisions for tax deduction at source U/S 192?**

   ITC Ltd. *(HC)*

   Facts of the case:

- The assessee-company was engaged in the business of owning, operating and managing hotels. The assessee-company allowed the employees to receive tips from the customers, by virtue of the employment, and in case the employer himself collected tips, those were also disbursed by the employer to the employees.
- Once the tips were paid by the customers either in cash directly to the employees or by way of charge to the credit cards in the bills, the employees gained additional income, which was by virtue of their employment. When the tips were received by the employees directly in cash, the employer hardly had any role and it may not even know the amounts of tips collected by the employees. That would be out of the purview of responsibility of the employer U/S 192.
- However, when the tips were charged to the bill either by way of a fixed percentage, say 10% or so on the total bill, or where no percentage was specified and the amount was indicated by the customer on the bill as a tip, the tip went into the receipt of the employer and was subsequently disbursed to the employees. As soon as such amounts were received by the employer, there was an obligation on the part of the employer to disburse them to the rightful persons, namely, the employees. Simultaneously, a right accrued to the employees to claim the tips from the employer. By virtue of the employer-employee relationship, a vested right accrued to the employee to claim the tips.

High Court's Decision:

- The High Court, therefore, **held that the tips would constitute income within the meaning of section 2(24) and thus, taxable U/S 15.**
- **It was obligatory upon the company to deduct tax at source from such payments U/S 192**.
- In this case, the assessee-company had not deducted tax at source on tips under a *bona fide* belief that tax was not deductible. This practice had been accepted by the Revenue by accepting the assessments in the form of annual returns of the assessees in the past.
- The High Court held that since no dishonest intention could be attributed to the assessees, they could not be made liable for levy of penalty as envisaged U/S 201.
- The High Court, however, observed that payment of interest U/S 201(1A) is mandatory. The payment of interest under that provision is not penal. There was, therefore, no question of waiver of such interest on the basis that the default was not intentional or on any other basis.

2. **Is section 194A applicable in respect of interest on fixed deposits in the name of Registrar General of High Court?**

   UCO Bank (HC)

   Facts of the case:

- The assessee-bank accepted 707.46 lakhs as fixed deposit in the name of Registrar General of the High Court and issued a fixed deposit receipt in compliance with a direction passed by the court in relation to certain proceedings.
- Subsequently, the Assistant Commissioner of Income-tax issued a SCN to the bank for not deducting tax at source on the interest accrued and to show cause as to why it should not be treated as an assessee-in-default U/S 201(1)/201(1A).
- The bank replied that the FDRs in the name of **Registrar General of the Court was as a custodian because the actual beneficiary was unknown** as the matter was sub judice **and tax at source would be deducted when the payment is made to beneficiary as and when it is decided by the court**.

- The Assistant Commissioner, however, passed an order treating the bank as assessee-in-default and raised a demand of 40.33 lakhs and 14.20 lakhs U/S 201(1) and 201(1A), respectively. Further, he initiated penalty proceedings U/S 271C.
- The assessee preferred a writ challenging the order passed imposing penal interest and initiation of penalty proceedings.

<u>High Court's Opinion and Decision</u>:

- The High Court opined that in the normal course, the bank is obliged to deduct tax at source in respect of any credit or payment of interest on deposits made with it.
- However, in this case, the actual payee is not ascertainable and the person in whose name the interest is credited is not a person liable to pay tax under the Act. The deposits kept with the bank under the orders of the court were, essentially, funds which were in custodia legis, that is, funds in the custody of the court.
- The interest on that account – although credited in the name of the Registrar General – was also part of funds under the custody of the Court. The Registrar General is not the recipient of the income represented by interest that accrues on the deposits made in his name. The credit of interest is not a credit to the account of a person who is liable to be assessed to tax.
- The person to whom the funds would be paid ultimately is determined by the court order and at that stage, tax would be required to be deducted at source to the credit of the recipient. However, the litigant who deposits the funds cannot be stated to be the recipient of income.
- The High Court allowed the writ and set aside the orders passed by the tax authorities

The High Court observed that in the absence of a payee, the machinery provisions for deduction of tax to his credit are ineffective. The expression "payee" U/S 194A would mean the recipient of income whose account is maintained by the person paying interest. The Registrar General is neither recipient of the amount credited to his account nor to interest accruing thereon. Therefore, he cannot be considered as a 'payee' for the purposes of section 194A.
The credit by the bank in the name of the Registrar General would, thus, not attract the provisions of section 194A.

3. Whether chit dividend paid to subscribers of chit fund is in the nature of 'interest' in terms of section 2(28A) to attract deduction of tax at source U/S 194A?

Avenue Super Chits (P) Ltd (HC)

<u>Facts of the case</u>: The assessee-company engaged in chit fund business had several chit groups which consisted of 25 to 40 customers each. Each subscriber has to subscribe an equal amount based on the value of chit. There are two types of chit. One is the lottery system and other is auction system. Under the auction system, during each instalment of the chit, the highest bidder got the chit amount. The unsuccessful members would earn dividend.

<u>Revenue's Contentions</u>: The Revenue contended that when the successful bidder in an auction took the prize money earlier to the period to which he is entitled, he is liable to pay an amount to others who contributed to take the prize money, the amount so paid is nothing but interest which is liable for tax deduction U/S 194A. The assessee had failed to do so, and therefore, he is treated as an assessee-in-default U/S 201 and is liable to pay interest U/S 201(1A).

<u>Appellate Authorities Views</u>: The Commissioner (Appeals) held that the amount paid by way of dividend could not be called as 'interest' in terms of section 2(28A) of the Income- tax Act, 1961 and hence, there was no liability on the part of the assessee to deduct tax at source. The Tribunal affirmed the findings of Commissioner (Appeals).

<u>High Court's Observations</u>: The High Court noted the decision of ***Sahib Chits (Delhi) (P) Ltd*** wherein section 2(28A) was referred to decide that chit dividend cannot be treated as interest. Further, section 194A has no application to such (chit) dividend and therefore, there is no obligation on the part of the assessee to make any deduction U/S 194A before such dividend is paid to the subscribers of the chit.

<u>High Court's Decision</u>:
The High Court held that the above judgment squarely applies to the facts of this case. Therefore, auction chit dividend paid to subscribers of the chit is not 'interest' as defined in section 2(28A) of the Income-tax Act, 1961 and therefore, tax deduction in terms of section 194A is not attracted.

3. Where the assessee fails to deduct tax at source U/S 194B in respect of the winnings, WHICH ARE WHOLLY IN KIND, can he be deemed as an assessee-in- default U/S 201?

Hindustan Lever Ltd. (HC)

Facts of the case:

In the present case, the assessee is a FMCG company, During the previous years relevant to A.Y.2001-02 and A.Y.2002-03, it had conducted certain sales promotion schemes. The assessee advertised the schemes wherein coupons were inserted in packs/containers of their products. Some of those coupons indicated that on purchase of the packs/ containers, they would get prizes, as indicated in coupons. The prizes that were offered were Santro car, Maruti car, gold chains, gold coins, gold tablas, silver coins, emblems, etc.

The AO, having received the information about the schemes, sought clarification and also conducted survey of the assessee's business premises U/S 133A. The AO, thereafter, passed an order U/S 201(1) and 201(1A) for the A.Y.2001-02 and treated the assessee as an assessee-in-default of its obligation in terms of section 194B. Similar order was passed for the A.Y.2002-03.

According to the AO, the assessee was obliged to ensure that the tax in respect of the winnings, wholly in kind, was remitted before the winnings were released. Having failed to do so, the proceedings U/S 201(1) were initiated.

The AO held that although the customers did not pay anything extra to receive the prize, nevertheless, they had participated in the scheme by purchasing the products advertised to take a chance at winning the prize. It was further held that what has been paid as prize-in-kind in various schemes conducted by the assessee is a lottery on which the tax was deductible U/S 194B. As the assessee neither deducted the tax nor ensured payment thereof before the winnings were released, he treated the assessee as an assessee-in-default. He passed similar order dated 28.3.2002 for the A.Y.2002-03.

Appellate Tribunal's view:

The Tribunal held that the schemes conducted by the assessee were not a lottery, as the said expression was understood up to the A.Y.2001-02. The Tribunal observed that the customers did not pay any excess amount for getting coupons indicating winnings in the packs/containers of products they purchased, and, therefore, nothing was paid by them for participating in the scheme. Accordingly, the Tribunal concluded that although there was an element of chance but as no consideration or payment was made by the customers for the purpose of participation in the lottery with the object of winning the prizes, the schemes conducted by the assessee would not fall within the ambit of section 194B.

High Court's view:

- From a bare perusal of section 194B, it is clear that **the person responsible for paying to any person any income by way of winnings from any lottery in an amount exceeding 10,000 shall, at the time of payment thereof, deduct income-tax thereon at the rates in force.** A combined reading of sections 194B and 201 shows that if any such person fails to "deduct" the whole or any part of the tax or after deducting, fails to pay the tax as required by or under the Act, then such person shall be deemed to be an assessee in default in respect of such tax.
- **The provisions contained in these sections do not cast any duty to deduct tax at source where the winnings are wholly in kind. If the winnings are wholly in kind, as a matter of fact, there cannot be any deduction of tax at source. The word "deduction" employed in this provision postulates a reduction or subtraction of an amount from a gross sum to be paid and payment of the net amount thereafter. Where the winnings are wholly in kind the question of deduction of any sum there from does not arise and in that eventuality, the only responsibility, as cast under section 194B, is to ensure that tax is paid by the winner of the prize before the prize or winnings is or are released in his favour.**

High Court's Decision:

- The High Court observed that if the assessee fails to ensure that tax is paid before the winnings are released in favour of the winner, then, section 271C empowers the Joint Commissioner to levy penalty equivalent to the amount of tax not paid, and
- U/S 276B, such non-payment of tax is an offence attracting rigorous imprisonment for a term which shall not be less than 3 months but which may extend to 7 years and with fine.
- However, the High Court held that proceedings U/S 201 cannot be initiated against the assessee.

5. **Can the Transmission, Wheeling and SLDC charges paid by a company engaged in distribution and supply of electricity, under a service contract, to the transmission company be treated as fees for technical services so as to attract TDS provisions U/S 194J or in the alternative, under 194C?**

Ajmer Vidyut Vitran Nigam Ltd. (AAR)

Applicant's contention: The applicant contended that the above charges were not in the nature of fees for technical services to attract TDS provisions U/S 194J, on the following grounds –

(i) The **transmission does not involve rendering of any technical services nor were technically qualified staff of the transmission company involved in the transmission of electrical energy**;

(ii) The **SLDC charges were also mere statutory charges and does not involve rendering of technical services;**

(iii) The payment of **Transmission, Wheeling And SLDC** charges **were in the nature of reimbursement of actual cost and hence, do not generate any income in the hands of the transmission company.**

Revenue's contention: The Revenue, on the other hand, was of the view that the **Transmission Of Electrical energy** from the point of generation to the point of distribution of the applicant involves rendering of technical services and consequently, the applicant was bound to withhold tax. The Revenue supported its view on the basis of the following contentions –

(i) **Transmission of electrical energy is a technical service and requires constant involvement of a technical system consisting of sophisticated instruments, constant monitoring and supervision by persons with a technical ability and knowledge to operate and manage the system** so as to ensure regular and consistent supply of electricity at the grid voltage at the distribution point of the applicant.

(ii) **As regards SLDC charges, the services rendered require the technical support and services of technically qualified staff and therefore they were technical services** within the meaning of section 194J.

(iii) The fact that the contract between both the parties is backed by a statutory obligation cannot alter the nature of services rendered.

AAR's Observations:

- The **AAR did not agree with the applicant's contention regarding transmission and wheeling charges** not constituting fees for technical services on the ground that no rendering of technical services was involved for maintaining proper and regular transmission of electrical energy.
- **It was also not in agreement with the applicant's argument that the services of technical personnel were not needed for ensuring due and proper transmission of electrical energy from the generation point to the distribution point.**
- **The AAR concurred with the Revenue's view that the personnel of the transmission company had to ensure regular and consistent transmission of electrical energy** at the grid voltage at the distribution point of the applicant.

AAR's Decision:
The AAR, considering the definition of fees for technical services U/S 9(1)(vii) held that **Transmission And Wheeling Charges** paid by the applicant to the transmission company are in the nature of fees for technical services, in respect of which the applicant has to withhold tax thereon U/S 194J.

As regards **SLDC charges**, the AAR opined that the main duty of the SLDC is to ensure integrated operation of the power system in the State for optimum scheduling and dispatch of electricity within the State. The SLDC charges paid appeared to be more of a supervisory charge with a duty to ensure just and proper generation and distribution in the State as a whole. Therefore, such services were not in the nature of technical service to the applicant; Resultantly, it does not attract TDS provisions under section 194J or under section 194C.

6. **Can discount given to stamp vendors on purchase of stamp papers by the state governments be treated as 'commission or brokerage' to attract the provisions for tax deduction U/S 194H?**

Ahmedabad Stamp Vendors Association (SC)

Issue: The principal issue in this case is whether stamp vendors are agents of the State Government who are being paid commission or brokerage or whether the sale of stamp papers by the Government to the licensed vendors is on "principal-to-principal" basis involving a "contract of sale".

High Court's Observations:

High Court held that the given transaction is a sale and the discount given to stamp vendors for purchasing stamps in bulk quantity is in the nature of cash discount and consequently, section 194H has no application in this case.

On this issue, the Gujarat High Court had in, ***Ahmedabad Stamp Vendors Association*** *v. Union of India* observed that the crucial question is **whether the ownership in the stamp papers passes to the stamp vendor when the treasury officer delivers stamp papers on payment of price less discount.**

If the **licensed stamp vendors were mere agents of the State Government, no sales tax would have been leviable when the stamp vendors sell the stamp papers to the customers**, because it would have been sale by the Government "**through**" stamp vendors.

The question of levy of sales tax arises only because the licensed vendors themselves sell the stamp papers on their own and not as agents of the State Government. Had they been treated as agents of the State Government, there would be no question of levy of sales tax on sale of stamp papers by them, and consequently, there would have been no necessity for any exemption provision in this regard.

Therefore, although the Government has imposed a number of restrictions on the licensed stamp vendors regarding the manner of carrying on the business, the **stamp vendors are required to purchase the stamp papers on payment of price less discount on "principal to principal" basis** and there is no "contract of agency" at any point of time.

When the licensed stamp vendors take delivery of stamp papers on payment of full price less discount and they sell such stamp papers to the retail customers, neither of the two activities (namely, buying from the Government and selling to the customers) can be termed as service in the course of buying and selling of goods. The High Court, therefore, held that discount on purchase of stamp papers does not fall within the expression "commission or brokerage" to attract the provisions of tax deduction at source U/S 194H.

Supreme Court's Decision:
The Supreme Court affirmed the above decision of the High Court holding that the given transaction is a sale and the discount given to stamp vendors for purchasing stamps in bulk quantity is in the nature of cash discount and consequently, section 194H has no application in this case.

7. **Can incentives given to stockists and distributors by a manufacturing company be treated as "commission" to attract –**

   (i) the provisions for tax deduction at source U/S 194H; and

   (ii) consequent disallowance U/S 40(a)(ia) for failure to deduct tax at source?

Intervet India P Ltd (HC)

Facts of the case:

The assessee-company engaged in manufacture of biological vaccines and animal health care pharmaceutical products, sold the same either through consignment or commission agents or directly through distributors or stockists.

During the relevant financial year, it introduced a sales promotion scheme to boost sales by way of product discounts and product campaign. It passed on the incentives to distributors through consignment agents by way of sales credit notes.

The AO held that as the assessee was paying the stockists/distributors for the services rendered by them for buying and selling goods, on the basis of quantum of sales effected, such payment has to be considered as commission, on which tax was deductible at source **U/S** 194H. Consequently, disallowance **U/S** 40(a)(ia) was attracted for failure to deduct tax at source.

High Court's Observations:

The High Court observed that the assessee had undertaken sales promotion by way of product discount scheme under which it offered incentive to the stockists / distributors and dealers. **The relationship between the assessee and the distributors / stockists was that of principal to principal.**

The products were firstly sold to distributors / stockists who in turn resold the goods in the market. No service was offered by the assessee to them except a discount under the product discount scheme/product campaign scheme to buy the assessee's product.

High Court's Decision:

The High Court, accordingly, held that **the stockists and distributors were not acting on behalf of the assessee and most of the credit was by way of goods on meeting the sales target which could not be said to be a commission within the meaning of the *Explanation (i)* to section 194H**. Accordingly, the High Court affirmed the order of the Tribunal which held that such payment does not attract deduction of tax at source. Consequently, disallowance under section 40(a)(ia) would not be attracted.

8. Can discount given on supply of SIM cards and pre-paid cards by a telecom company to its franchisee be treated as commission to attract the TDS provisions U/S 194H?

Bharti Cellular Ltd. (HC)

High Court's Observations: On this issue, the Calcutta High Court observed the Supreme Court ruling in ***Bhopal Sugar Mills'*** *case*, wherein it was held that **the true relationship between the parties has to be gathered from the nature of the contract, its terms and conditions.** The terminology used by the parties is not decisive of the said relationship.

The High Court, on perusal of the agreement between the assessee-telecom company and the franchisees, observed that –

(1) **The property in the start-up pack and pre-paid coupons remained with the assessee-telecom company**, even after transfer and delivery to the franchisee,;

(2) **THE franchisee really acted as a facilitator** and/or instrument of providing services by the assessee-telecom company to the ultimate subscriber;

(3) **The franchisee had no free choice to sell the pre-paid coupons and sim cards** and everything including the **selling price was regulated by the assessee-telecom company**;

(4) The **rate at which the franchisee sells to the retailers is also regulated and fixed by the assessee-telecom company.**

In the real sense, the franchisee acted on behalf of the assessee-telecom company for selling start-up pack, prepaid recharge coupons to the customer. Therefore, the relationship between the assessee and the franchisee is essentially that of principal and agent, though the nomenclature used is "franchisee". The franchisees were, thus, agents of the assessee, getting a fixed percentage of commission, in the form of discount.

High Court's Decision:

Considering the above, the High Court held that there is an indirect payment of commission, in the form of discount, by the assessee-telecom company to the franchisee. Therefore, the assessee is liable to deduct tax at source on such commission as per the provisions of section 194H.

9. Can the difference between the published price and the minimum fixed commercial price be treated as additional special commission in the hands of the agents of an airline company to attract TDS provisions U/S 194H, where the airline company has no information about the exact rate at which tickets are ultimately sold by the agents?

Qatar Airways (HC)

Facts of the case:

- In this case, the airline company sold tickets to the agents at a **minimum fixed commercial price** (say 70). The agents were permitted to sell the tickets at a higher price, however, up to the **maximum of published price** (say 100). Commission at the rate of 9% of published price was payable to the agents of the airline company, on which tax was deducted U/S 194H.
- The issue under consideration is whether the difference between the published price and the minimum fixed commercial price amounts to additional special commission in the hands of the agents to attract the provisions of section 194H.

High Court's Observations:

- On this issue, the Bombay High Court observed that the difference between the published price and minimum fixed commercial price cannot be taken as additional special commission in the hands of the agents, since the published price was the maximum price and airline company had granted permission to the agents to sell the tickets at a price lower than the published price.

- In order to deduct tax at source, the exact income in the hands of the agents must necessarily be ascertainable by the airline company. However, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents, since the agents had been given discretion to sell the tickets at any rate between the minimum fixed commercial price and the published price. It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of each ticket sold.

High Court's Decision:
Thus, tax at source was not deductible on the difference between the actual sale price and the minimum fixed commercial price, even though the amount earned by the agent over and above minimum fixed commercial price would be taxable as income in his hands.

10. Are landing and parking charges paid by an airline company to Airports Authority of India in the nature of rent to attract tax deduction at source U/S 194-I?

Japan Airlines Co. Ltd. (SC)

Singapore Airlines Ltd. (SC)

Facts of the case:

The assessees in both the cases are foreign airlines. Being international airlines, they fly their aircrafts to several destinations across the world, including New Delhi. For landing the aircrafts and parking thereof at the Indira Gandhi International Airport (IGIA), New Delhi, the Airports Authority of India (AAI) levies charges on these airlines. The airlines are deducting tax **@2% U/S 194C** for payment of landing and parking charges in respect of its aircrafts to AAI and remitting the same.

However, the income-tax authorities are of the view that tax is to be deducted at the higher rate applicable U/S 194-I ***(currently, 10%)***.

Issue under consideration: The issue under consideration is whether landing and parking charges paid by the airline companies to AAI is in the nature of rent to attract tax deduction at source U/S 194-I.

Delhi High Court's view *v/s* Madras High Court's view:

On this issue, contrary views were expressed by the Delhi High Court in *Japan Airlines Co. Ltd.*'s case and the Madras High Court in *Singapore Airlines Ltd.'s* case.

The **Delhi High Court observed that** "rent" as defined in section 194-I has a widermeaning than rent in common parlance and includes any agreement or arrangement for use of land. The Delhi High 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 Delhi High Court, following its own judgment in the case of ***United Airlines*** held that landing and parking fee were "rent" within the meaning of the provisions of section 194-I, as they were payments for the use of the land of the airport.

The **Madras High Court, however, expressed** a contrary view on the above issue in ***Singapore Airlines Ltd***. The Court has observed that only if the agreement or arrangement has the characteristics of lease or sub-lease or tenancy for systematic use of the land, the charges levied would fall for consideration under the definition of 'rent' for the purpose of section 194-I.

The Madras High Court further observed that the principles guiding the levy of charges on landing and take-off show that the **charges are with reference to the number of facilities provided by the Airport Authority of India in compliance with the international protocols and the charges are not made for any specified land usage or area allotted.**

The **charges are for various facilities offered to meet the requirement of passenger safety and for safe landing and parking of the aircraft. Thus, the charges levied are, at the best, in the nature of fee for the services offered rather than in the nature of rent for the use of the land.**

Therefore, the levy of charges, which is not only for the use of land, but for maintenance of various services, including technical services involving navigation, would not automatically bring the transaction and the charges within the meaning of either lease or sub-lease or tenancy or any other agreement or arrangement in the nature of lease or tenancy so that the charges would fall within the meaning of 'rent'

Thus, the Madras High Court held that going by the nature of services offered by the AAI in respect of landing and parking charges, collected from the assessee, there is no ground to accept that the payment would fit in with the definition of "rent" as given under section 194-I.

Supreme Court's Observations:

The Apex Court After due consideration of the views of the Delhi High Court and the Madras High Court on this issue, the Supreme Court concluded that the Madras High Court's view is justified on the basis of sound rationale and reasoning.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

Supreme Court's Decision:
The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the full and larger picture in mind, it becomes very clear that the charges are not for use of the land *per se* and, therefore, it cannot be treated as "rent" within the meaning of section 194-I.
The Supreme Court, thus, concurred with the view taken by the Madras High Court in *Singapore Airlines* case and overruled the view taken by the Delhi High Court in *United Airlines/Japan Airlines* case.

11. Is payment made for Use Of Passive Infrastructure Facility such as Mobile Towers subject to tax deduction U/S 194C or section 194-I?

Indus Towers Ltd (HC)

Facts of the case:

- The assessee owned a network of telecom towers and infrastructure services which were let out to major telecom operators in the country. U/S 197,
- The assessee sought for lower tax deduction U/S **194C for the FY 2013-14 at 0.5%** and
- Whereas the AO issued a certificate **U/S 197 for lower tax deduction at 2.5%** U/S 194-I.
- The assessee filed a writ before the Delhi High Court.
- The Court directed the assessee to prefer a revision petition before the Commissioner of Income-tax.
- **The Commissioner of Income-tax rejected the contention of the assessee for applying section 194C and upheld the order of the AO applying section 194-I,** on the ground that the mobile operators had the right to install the equipment on the tower owned by the assessee, which tantamounts to use of the land or telecommunication site and the tower owned by the assessee. The assessee once again preferred a writ before the High Court.

Assessee's Contentions:

The assessee explained that its responsibility is to provide the entire passive infrastructure service with the aid of equipment belonging to it which is fully operated, controlled and managed by it. The customers do not have access, control or possession over the towers, sites or designated areas which are limited to rectification or maintenance of any defects in the equipments installed by them. The assessee, further, contended that its customers do not pay for any leasing rights but only for the services. Therefore, the provisions of section 194-I would not be attracted in this case.

High Court's Observations:

The High Court observed that it was the intention of the parties to use the technical and specialized equipment maintained by the assessee. The infrastructure was given for the use of mobile operators. The towers were the neutral platform without which the mobile operators could not operate. Each mobile operator has to carry out this activity, by necessarily renting premises and installing the same equipment. The dominant intention was the use of equipment or plant or machinery and the use of premises was only incidental.

High Court's Decision:
The High Court held that the submission of the assessee that the transaction is not "renting" is incorrect.
Also, the Revenue's contention that the transaction is primarily "renting of land" is also incorrect.
The underlying object of the arrangement was the use of machinery, plant or equipment i.e., the passive infrastructure and it is incidental that it was necessary to house the equipment in some premises.
The High Court directed that tax deduction be made at 2% as per section 194-I(a), the rate applicable for payment made for use of plant and machinery.

12. In respect of a co-owned property, would the threshold limit mentioned in section 194-I for non-deduction of tax at source apply for each co-owner separately or is it to be considered for the complete amount of rent paid to attract liability to deduct tax at source?

Senior Manager, SBI (HC)

Facts of the case:

In the present case, the assessee was paying rent for the leased premises occupied. The said premise was co-owned and the share of each co-owner was definite and ascertainable. Also, the assessee made payment to each co-owner separately by way of cheque. The assessee did not deduct tax at source U/S194-I stipulating that the payment made to each co-owner was less than the minimum threshold mentioned in the said section (now 1,80,000) and therefore, no liability to deduct tax at source on the rent so paid is attracted, though the whole rent taken together exceeds the said threshold limit.

Revenue's contentions:

The Revenue contended that since the premises let out to the assessee had not been divided/partitioned by metes and bounds, it cannot be said that any specified portion let out to the assessee was owned by a particular person. Therefore, the assessee had to deduct tax at source on the rent so paid assessing the co-owners as AOP's and the threshold limit mentioned in section 194-I was to be seen in respect of the entire rent amount. Hence, the Revenue was of the view that assessee was liable to deduct tax on the payment of rent and interest would be leviable on failure to deduct such tax U/S 201.

High Court's Decision:

Considering the above mentioned facts, the Allahabad High Court held that, since the share of each co-owner is definite and ascertainable, they cannot be assessed as an AOP as per section 26. The income from such property is to be assessed in the individual hands of the co-owners. Therefore, it is not necessary that there should be a physical division of the property by metes and bounds to attract the provisions of section 26.

Therefore, in the present case, **since the payment of rent is made to each co-owner by way of separate cheque and their share is definite, the threshold limit mentioned in section 194-I has to be seen separately for each co-owner**. Hence, the assessee would not be liable to deduct tax on the same and no interest U/S 201 is leviable.

13. Can the payment made by an assessee engaged in transportation of building material and transportation of goods to contractors for hiring dumpers, be treated as rent for machinery or equipment to attract provisions of tax deduction at source U/S 194-I?

Shree Mahalaxmi Transport Co. (HC)

Facts of the case:

- In this case, the assessee was engaged in the business of transportation of building material, salt, black trap, iron, etc. During the relevant previous year, the assessee made payment for hiring of dumpers and deducted tax at source at the rate U/S 194C applicable for sub-contracts which, according to the AO, was not correct as the assessee had taken dumpers on hire and such payments were governed U/S 194-I.
- The AO, accordingly, held that the assessee had short deducted tax at source and passed an order U/S 201(1) holding the assessee to be an assessee-in-default.

High Court's Observations:

The High Court observed that the assessee had given contracts to the parties for the transportation of goods and had not taken machinery and equipment on rent. The Court observed that the transactions being in the nature of contracts for shifting of goods from one place to another would be covered as works contracts, thereby attracting the provisions of section 194C.

High Court's Decision:

Since the assessee had given sub-contracts for transportation of goods and not for the renting out of machinery or equipment, such payments could not be termed as rent paid for the use of machinery and the provisions of section 194-I would, therefore, not be applicable.

14. Where remuneration paid to doctors is variable based on number of patients and treatment given to them, would the liability to deduct tax at source arise U/S 192 or U/S 194J?

Manipal Health Systems (P) Ltd (HC)

Facts of the case:

- The assessee-company is an institution providing health services. A survey U/S 133A was conducted on the business premises of the assessee in order to ascertain the TDS compliance. While conducting the survey, the **AO found that the assessee company has deducted tax on payment made to doctors U/S 194J**.
- The AO came to a conclusion that **there existed an employer-employee relationship between the hospital and the doctors engaged by it,** and hence, the assessee was required to deduct tax at source U/S 192. Accordingly, the AO computed the liability for short deduction of tax at source U/S 201(1) and section 201(1A).
- The assessee challenged the said demand before the Commissioner (Appeals).

Appellate Authorities' Views:

The Commissioner (Appeals) allowed the claim holding that the doctors cannot be construed as employees of the assessee-company. The Tribunal dismissed the appeal filed by the Revenue.

High Court's Observations:

- The High Court observed that to decide whether the relationship of employer-employee existed or not, the contract entered into between the parties has to be seen - whether the same is a **"contract for service"** or a **"contract of service".**
- In order to ascertain the nature of contract, multiple-factor tests have to be applied. The independence test, control test, intention test are some of the tests adopted to distinguish between 'contract for service' and 'contract of service'.
- The High Court examined the terms of the contract entered into between the asseesee- company and the doctors. As per the said terms,
  - ✓ The **remuneration paid to the doctors** depends on the treatment given to patients and on the number of patients - if the number of patients are more, remuneration would be on a higher side or if no patients, no remuneration;
  - ✓ The **timing of the doctors** is fixed; and
  - ✓ They **cannot have private practice or attend any other hospital**.
- It was observed that **mere provision of non-competition clause in the agreement shall not change the nature of contract from profession to that of employment.**
- Imposing a condition of bar to private practice is to make use of the expertise, skill of a doctor exclusively for the assessee-company, i.e., to get the attention and focus of the professional skill and expertise only to the patients of the assessee-company and to discourage doctors from transferring patients to their own clinics or any other hospital.
- The High Court also noted the Tribunal's finding that none of the doctors are entitled to gratuity, provident fund, leave travel allowance and other terminal benefits. It is also pertinent to note that the doctors have filed their ROI for the relevant AY's showing the income received from the assessee-company as professional income and the same is said to have been accepted by the Department.
- In ***Apollo Hospitals International Ltd***., the Gujarat High Court took a view that consultant doctors were not getting salary but payment to them was in the nature of professional fees liable to tax deduction at source U/S 194J.

High Court's Decision: Considering the totality of facts and terms of the agreement, the Court held that in this case, the consultancy charges paid to doctors rendering professional service would be subject to tax deduction U/S 194J and not section 192.

15. Would transaction charges paid by the members of the stock exchange for availing fully automated online trading facility, being a facility provided by the stock exchange to all its members, constitute fees for technical services to attract the provisions of tax deduction at source U/S 194J?

Kotak Securities Ltd (SC)

High Court's Decision: The Bombay High Court held that the transaction charges paid by a member of the BSE to the stock exchange to transact business of sale & purchase of shares amounts to payment of a "fee for technical services" and hence, tax is deductible at source U/S 194J.

Supreme Court's Observations: The Apex Court made the following observations:

- The **services provided by the stock exchange are available to all members** in respect of every transaction that is entered into. There is nothing special, exclusive or customized in the service that is rendered by the stock exchange.
- **A member who wants to conduct his daily business in the stock exchange has no option but to avail such services.** Each and every transaction by a member involves the use of such services provided by the stock exchange for which the member is required to pay transaction charge based on the transaction value besides charges for the membership of the stock exchange.

- Technical services like managerial and consultancy service are in the nature of specialised services made available by the service provider to cater to the special needs of the customer-user as may be felt necessary. ***It is the above feature that would distinguish or identify a service provider from a facility offered.***
- However, there is no exclusivity in the services rendered by the stock exchange and each and every member has to avail such service in the normal course of trading in securities in the stock exchange.

Supreme Court's Decision:

The Apex Court, accordingly, held that the service provided by the BSE for which transaction charges are paid failed to satisfy the test of specialized, exclusive and individual requirement of the user or the consumer who may approach the service provider for such assistance or service.

Therefore, the transaction charges paid to BSE by its members are **not for technical services but are in the nature of payments made for facilities provided by the stock exchange**.

Such payments would, therefore, not attract the provisions of tax deduction at source U/S 194J.

16. Is tax is required to be deducted U/S 195 on the demurrage charges paid to a foreign shipping company which is governed by section 172 for the purpose of levy and recovery of tax?

Dempo & Co P Ltd (HC)

Facts of the case:

- In the present case, the assessee, being a company engaged in the business of mining and export of processed iron ore as also in construction business, claimed demurrage charges paid to a foreign shipping company on which no tax was deducted at source U/S 195 as deductible expenditure.
- Since tax was not deducted at source U/S 195, the AO, in view of provisions of section 40(a)(i), **disallowed the claim of expenditure in respect of such demurrage charges paid.**

High Court's Observations:

- The High Court took note of the Tribunal's observation that section 40(a)(i) would apply only when there is an obligation to deduct tax at source.
- The Tribunal placed reliance upon the CBDT Circular No. 723 dated September 19, 1995 to support its conclusion that **there was no obligation to deduct tax at source in respect of payment made towards demurrage charges to non-resident shipping company falling within the scope of section 172**.
- The Revenue did not dispute that section 172 applied in the present case. Section 172 is a charging as well as machinery provision in respect of non-resident shipping companies. It provides for determination and collection of tax. Thus, no obligation to deduct at source U/S 195 would arise in respect of payment of demurrage charges to such companies.
- The High Court also noted that section 172 is a complete code that applies to non-resident Indians and section 195 is part of recovery provision under the Income-tax Act, 1961.The provisions of section 172 would apply **notwithstanding anything contained** in the other provision of this Act, for the purpose of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident which carries passengers, etc. shipped at a port in India.
- **Since sec 172(1) begins with a non-obstante clause, it would prevail over other provisions of the Act including sec195**. Thus, the provisions contained thereunder would take care of the manner of determination of income from shipping business of non-residents as well as the levy and recovery of tax thereon

High Court's Decision:

The High Court, accordingly, held that since section 172 dealing with shipping business of non-residents contains a non-obstante clause and applies both for the purpose of the levy and recovery of tax in the case of any ship carrying passengers etc., belonging to or chartered by a non-resident and shipping at a port in India, **there would be no obligation on the payer-assessee to deduct the tax at source U/S 195 on payment of demurrage charges to the non-resident shipping company**.

17. Is payment made to an overseas agent, who did not perform any service in India, liable for tax deduction at source?

Wizcraft International Entertainment (P) Ltd (HC)

Facts of the case:

The assessee, an event management company, engaged the services of an agent to bring artistes to India. The assessee-company

(i) paid commission to overseas agent;

(ii) reimbursed the expenses in connection with the visit of the artistes in India; and

(iii) paid fees to the artistes in India.

The assessee-company deducted tax at source on the **fees paid to the international artistes in India but did not deduct tax at source on the commission paid to the agent and on the reimbursement of expenses incurred in India by the artistes.**

Assessing Officer's view *v/s* Commissioner (Appeals) view:

- The AO contended that the payments made by the assessee including the payment made by way of **commission to the agent and payment for reimbursement of expenses** in connection with the visit of the artistes to India are liable for tax deduction at source.
- The Commissioner (Appeals) was of the view that expenses incurred and reimbursed do not constitute income derived by the artistes from their personal activities, so as to be taxable under Article 18 of the DTAA between India and UK; and hence, the same is not liable for deduction of tax at source.

Issue:

The issue under consideration before the High Court was with regard to deduction of tax on **commission paid to overseas agent** who never took part in the events organized in India and **amount paid as reimbursement of expenses incurred on travelling of artistes.**

High court's Observations:

- The High Court observed that the assessee has deducted tax on the **payments made to artistes for the services rendered in India.**
- In so far as reimbursement of expenses is concerned, it has been verified with supporting documents that it was towards their air travel on which no tax was required to be deducted.
- With regard to the payment of commission, the agent did not act as a performing artist or entertainer. He was concerned only with the services rendered outside India.
- Thus, the Tribunal had recorded the finding of fact that the income of the agent did not arise from the personal activities in the contracting status of an entertainer or artist. He only contacted the artistes and negotiated with them for performance in India in terms of the authority given by the assessee.
- Hence, the commission paid to the overseas agent was not liable to tax in India.
- Consequently, there was no obligation for deducting tax at source at the time of making payment to the overseas agent.

High Court's Decision: The High Court, therefore, affirmed the decision of the Tribunal and Commissioner (Appeals) holding that the service rendered by the agent was outside India and hence, was not chargeable to tax in India. Thus, the requirement for deducting tax at source U/S 195 on such payment does not arise.

18. Can items of finished products from ship breaking activity which are usable as such be treated as "Scrap" to attract provisions for tax collection at source U/S 206C?

Priya Blue Industries (P) Ltd (HC)

Facts of the case:

- The assessee-company, engaged in ship breaking activity, sold old and used plates, wood etc. It did not produce any document or papers to show collection of tax at source on sale of such items and payment thereof to the credit of the Central Government nor was certificate in Form No.27C produced.
- The AO observed that such items were in the nature of scrap and therefore, the assessee was under an obligation to collect tax at source from the buyers of scrap. Accordingly, he raised a demand U/S 201(1) and interest U/S 201(1A). The assessee claimed that such items are usable as such, and are hence not 'scrap' to attract the provisions for collection of tax at source.

Appellate Authorities' views:

- The Commissioner (Appeals) observed that the assessee was engaged in ship breaking activity and the products obtained from the activity were finished products which constituted sizable chunk of production done by the ship breakers.
- The Commissioner (Appeals) agreed with the assessee that such products though commercially known as 'scrap' were definitely not "waste and scrap". He further agreed with the contention of the assessee that the items in question were usable as such and, therefore, do not fall within the definition of "scrap" as given in clause (b) of *Explanation* to section 206C(1).
- The Tribunal firstly recorded a list of items sold by the assessee from the ship breaking activity. It found that the assessee collected and paid tax, for 7 items, but did not collect tax at source on certain items viz. old and used plates; non-excisable (exempted) goods like wood etc. It observed that the 'waste and scrap' must be from manufacture or mechanical working of material which is *definitely not usable as such because of breakage, cutting up, wear and other reasons.*
- Since the assessee is engaged in ship breaking activity, these items/products are finished products obtained from such activity which are usable as such and hence, are not 'waste and scrap' though commercially known as scrap. Accordingly, the Tribunal also decided the issue in favour of the assessee.

High Court's Decision: The High Court concurred with the views of the Tribunal and held that any material which is usable as such would not fall within the ambit of the expression 'scrap' as defined in clause (b) of the *Explanation* to section 206C.

19. Is levy of interest U/S 234B attracted in a case where the assessment order does not contain any specific direction for payment of interest, but is accompanied by form ITNS 150 containing a calculation of interest payable on tax assessed?

Bhagat Construction Co (P) Ltd (SC)

Facts of the case: The assessment order passed did not contain any direction for the payment of interest U/S 234B. The appellate order also simply stated that interest is payable U/S 234B, without any further substantiation. The amount of interest payable U/S 234B was contained in the Income-tax Computation Form or 'Form for Assessment of Tax/Refund (I.T.N.S 150)

Apex Court's Observations:

The Apex Court observed that the facts of the present case are squarely covered by the three judges' bench decision of this court in the case of *Kalyankumar Ray,* wherein it was held that **the Form I.T.N.S 150 is also a form for determination of tax payable and when it is signed or initialled by the AO, it is certainly an order in writing by the AO determining the tax payable within the meaning of section 143(3). The said form also contains the calculation of interest payable on the tax assessed. This form must, therefore, be treated as part of the assessment order.**

The Supreme Court further observed that the provisions of section 234B are attracted the moment an assessee liable to pay advance tax has failed to pay such tax or the advance tax paid by him is less than 90% of the assessed tax. The assessee, thus, becomes liable to pay simple interest at 1% for every month or part of the month.

Supreme Court's Decision:
The Apex Court, accordingly, held that the levy of interest U/S 234B is automatic when the conditions specified therein are satisfied and the assessment order is accompanied by the prescribed form containing the calculation of interest payable.