THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

SELECT CASES IN DIRECT AND INDIRECT TAXES

[2006]

An Essential Reading for the Final Course

BOARD OF STUDIES

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

INDEX

(Students may note that the Chapter headings correspond with the similar headings in the Direct and Indirect Taxes study materials)

INCOME TAX

1

BASIC CONCEPTS

1. Is mere credit of an amount to the profit and loss account sufficient to constitute income under section 2(24)?

   CIT v. Industrial Credit and Development Syndicate Ltd. (2006) 285 ITR 310 (Karn)

   Relevant section: 2(24)

   The assessee, a finance company, issued redeemable debentures of Rs.10 each at par. During the period of redemption, the assessee-company purchased some of these debentures through a nominee at a price less than the face value and credited the difference between the face value and the cost thereof in its books as surplus arising on redemption of debentures. The assessee had advanced a loan to the nominee for purchase of debentures. Thereafter, on the due dates, the assessee redeemed these debentures. Although the assessee had credited the surplus to the profit and loss account, it claimed deduction of the same on the ground that they did not form part of income. The High Court held that merely because the amount was shown as surplus in the profit and loss account, it would not constitute income under section 2(24), since the assessee did not actually receive any income.

   The High Court held that the definition of income in section 2(24), though inclusive, should be construed as including only such things which are income according to the natural import of the term. It is income which has really accrued or arisen to the assessee that is taxable. Where there is neither accrual nor receipt of income by the assessee in reality, an entry to that effect in the books of account would not constitute income for the purpose of levy of tax.

2. Is section 68 attracted where cash gifts are made out of love and gratitude and routed through proper banking channels and credited in the books of the recipient?

   A. Rajendran v. Asst. Commissioner, Special Investigation, Circle III, Coimbatore (2006) 155 Taxman 364 (Mad.)

   Relevant section: 68

   In this case, it has been held that where cash gifts are made out of love and gratitude and routed through proper banking channels and credited in the books of accounts of the recipient, the genuineness of the transaction cannot be doubted and the receipt cannot be taxed under section 68. The assessee had received gifts from an NRI-industrialist in UK through normal banking channels and had credited the same in his books of account. The donor had made the gift out of love and gratitude since the assessee had earlier helped the donor's father in bad times. The donor had also confirmed the same in his declaration that it was due to the help rendered by assessee to his father in difficult times, he was able to come up in life and reach such a high position. Further, the donor had also appeared pursuant to the notice issued by the income-tax authorities and affirmed his gifts.

The High Court noted the decision of the Guwahati High Court in Nemi Chand Kothari v. CIT (2003) 264 ITR 254, where it was held that in order to avoid the applicability of section 68, the burden is on the assessee to establish (1) the identity of the creditor, (2) the genuineness of the transaction and (3) the creditworthiness of the creditor. Once this was established, then the assessee had discharged his burden.

The High Court held that in this case, the assessee had established all the above requirements and therefore, the gifted sum was not liable to be assessed under section 68.

3. What is the nature of subsidy given by the State Government to the assessee after commencement of business for the purpose of running the business?

Sundaram Exhibitions (P.) Ltd. v. CIT (2006) 154 Taxman 132 (MP)

The State Government of Madhya Pradesh had granted a subsidy to the assessee engaged in the business of running a cinema house. The High Court observed that the subsidy was not given to the assessee for establishment of business i.e., it was not meant to be used prior to commencement of commercial business so as to partake the nature of capital subsidy in the form of fixed assets. The subsidy was given to the assessee after commencement of business for the purpose of running the business. The Court observed that if any subsidy is given for running a business, such subsidy is a revenue receipt and can never be regarded as capital.

4. Can the Assessing Officer make a separate addition on account of unexplained cash and unexplained payments for purchases where he has applied the net profit rate on contract receipts for estimating income from contract work?

CIT, Jalandhar-II v. Aggarwal Engg. Co. (Jal.) (2006) 156 Taxman 40 (P & H)

Relevant sections: 68 & 69B

The assessee who was a civil contractor filed his return of income for the relevant assessment year. The assessment was made but was cancelled under section 263. Thereafter, the Assessing Officer made a best judgment assessment under section 144 applying the net profit rate on contract receipts to estimate the income from contract work. Further, he made separate addition on account of introduction of unexplained cash and unexplained payments for purchases outside the books of account. These additions were deleted by the CIT(A) and Tribunal. The High Court justified the views of the CIT(A) and Tribunal holding that once the net profit rate was applied, no further addition was called for in respect of purchases and introduction of cash.

2

RESIDENCE AND SCOPE OF TOTAL INCOME

1. Should a person be unemployed while leaving India for employment outside India to qualify as a non-resident as per Explanation (a) to section 6(1)?

   British Gas India (P.) Ltd. In re.(2006) 285 ITR 218 (AAR)

   Relevant section: 6(1)

   The applicant, a private company in India, was a part of the BG group, a leading international energy company. One Mr. Gupta, who was employed with the applicant company since February 2002, was deputed to BG, U.K. for 2 years w.e.f. 1.7.2005. During the previous year 2005-06, Mr. Gupta worked in India only for 88 days. The applicant sought the ruling of the AAR on whether Mr. Gupta would be a non-resident for the previous year 2005-06.

   The AAR observed that since Mr. Gupta's stay in India was for less than 182 days during the previous year 2005-06, he became a non-resident by virtue of the Explanation (a) to section 6(1). The issue in this case is whether a person should be unemployed while leaving India for employment outside India. The AAR observed that the condition of Explanation (a) was not "leaving India for employment" but "leaving India for employment outside India". Therefore, to satisfy this condition, the individual need not be an unemployed person who leaves India for employment outside India. The condition is satisfied even if the individual is employed in India and leaves India for employment outside India. Therefore, it is neither material nor relevant that Mr. Gupta was already employed at the time of leaving India.

   Note – Where the language of the section is clear and unambiguous, it cannot be interpreted otherwise to deny the benefit conferred therein to the assessee.

3

INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME

1. Can exemption under section 10(23C)(iiiad) be denied to a society on the ground that it was formed to earn profit and utilized its surplus in acquiring assets?

   Jhunjhunu Academy Sammittee v. Income-tax Officer, Jhunjhunu (2006) 155 Taxman 125 (ITAT Jaipur Bench)

   Relevant section: 10(23C)(iiiad)

   The assessee-society was running an educational institute with hostel facility. It had received donations from students during the relevant assessment years and had declared surplus. The assessee claimed exemption under section 10(23C)(iiiad). The Assessing Officer denied exemption on the ground that the society was formed to earn profit and the surplus was utilized in acquiring assets. Further, from the minutes of the meeting, it was observed that there was no mention about the donations being charged and there was no such clause in the objects of the society permitting collection of donation from the students. The Commissioner (Appeals) also confirmed the denial of exemption under section 10(23C)(iiiad).

   The Tribunal observed that the assessee was not registered under section 12AA and, therefore, the conditions under sections 11 and 13, as referred in section 12(1), had not been fulfilled by the assessee. These conditions have to be fulfilled for claiming an institution to be a charitable institution or an institution not for the purpose of profit. The Tribunal, thus, held that viewed from any angle, the donations received by the assessee were income from other sources and only the expenses incurred to earn such income would be allowable as deduction against such donations. Therefore, the Assessing Officer was justified in denying exemption to the assessee under section 10(23C)(iiiad).

   Note – Exemption under section 10(23C)(iiiad) is available in respect of any income of an educational institution existing solely for educational purposes and not for the purposes of profit if its aggregate annual receipts do not exceed Rs.1 crore. Therefore, donations will qualify for deduction only if the educational institution is formed solely for educational purposes and not for the purposes of profit.

2. Is U.P. State Road Transport Corporation entitled to exemption of its income from house property, capital gains and income from the business of supply of goods and services?

U.P. State Road Transport Corporation v. CIT (2006) 286 ITR 350 (All.)

Relevant section: 10(20)

The High Court held that the U.P. State Road Transport Corporation is not a local authority within the meaning of section 10(20). Therefore, its income from house property, capital gains and income from the business of supply of goods and services is not exempt to the extent provided in section 10(20).

Note – It may be noted that for the purpose of availing exemption under section 10(20), local authority means a panchayat or municipality as referred to in articles 243 and 243P of the Constitution or a Municipal Committee and District Board or a Cantonment Board. U.P. State Road Transport Corporation does not fall under any of the above categories and is, therefore, not a local authority.

3. Can an assessee claiming exemption under section 10B in respect of its export profits, adjust unabsorbed depreciation against its income from other sources instead of adjusting the same against its export income?

CIT v. Himatasingike Seide Ltd. (2006) 156 Taxman 151 (Kar.)

Relevant section: 10B & 32(2)

The assessee was a 100% export oriented industrial unit eligible for exemption under section 10B. The assessee filed its return of income claiming exemption under section 10B. It set-off brought forward unabsorbed depreciation from an earlier assessment year against income from other sources, thereby reducing the income from other sources to Nil. The Assessing Officer accepted the claim of the assessee and assessed the total income at Nil. However, the Commissioner issued a notice under section 263 holding that exemption under section 10B was allowed on an inflated amount without deducting unabsorbed depreciation and therefore, the order passed by the Assessing Officer was erroneous and prejudicial to the interests of revenue. He contended that unabsorbed depreciation should be adjusted against the export income and total income should be recomputed. However, the Tribunal allowed the assessee's appeal.

The High Court observed that the argument of the assessee that exemption under section 10B could also be on commercial basis and not necessarily in terms of the calculation could not be accepted. Section 10B cannot be read in isolation of other provisions. It is only an exemption provision. Exemption cannot be fanciful and it has some rationale with the other provisions of the Act. From a combined reading of the definition of exemption, total income, tax liability, deductibility etc. it can be inferred that calculation has to be, as far as possible, in terms of the Act. The intention of the Legislature is only to provide 100% exemption for export income and not for other income. The assessee, by dividing depreciation contrary to section 32, has virtually claimed exemption from payment of tax even on other income, which could not be allowed. Calculation cannot be at the whims and fancies of an assessee for the purpose of tax exemption. It has to be in accordance with the provisions of the Act. The High Court held that the Commissioner was fully justified in holding that the assessee was not justified in showing Nil return.

Note – This case relates to A.Y.1994-95 and the brought forward depreciation related to A.Y.1988-89. Section 32(2), as amended by the Finance Act, 2001 w.e.f. 1.4.2002, provides that brought forward unabsorbed depreciation should be added to the current year depreciation allowance and be deemed to be part of that allowance. The moot point is whether, as per amended section 32(2), it is possible to set-off brought forward unabsorbed depreciation in respect of export business (eligible for exemption under section 10B) against income from other sources, instead of export business income.

4

CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS

1. Can registration be denied to the assessee under section 12AA on the ground that the activities of the assessee were purely commercial in nature?

   Sanjeevamma Hanumanthe Gowda Charitable Trust v. Director of Income-tax (Exemptions) (2006) 285 ITR 327 (Karn.)

   Relevant section: 12AA

   The issue under consideration in this case is whether the authorities were justified in denying registration to the assessee under section 12AA, on the ground that the activities of the assessee were purely commercial in nature. The Director of Income-tax (Exemptions) rejected the application of the assessee for registration as a charitable trust on the ground that it was carrying on the activity of letting out its marriage hall on hire. The Tribunal also was of the opinion that the letting out of the marriage hall was not for attainment of other objects, but seemed to be the main object pursued by the appellant. The Tribunal, therefore opined that the trust was not established wholly for charitable purposes. The High Court observed that for the purpose of registration under section 12AA, it is necessary for the authorities to satisfy themselves that the activities of the trust or institution are genuine and that the income derived from the trust property is applied to charitable or religious purpose. It is not necessary to go into the nature of the activity by which the income was derived by the trust. This is because section 12AA(3) provides sufficient safeguard against misuse of beneficial provisions by empowering the Commissioner to cancel the registration already granted to the trust if it is satisfied, inter-alia, that the activities of such trust or institution are not genuine.

   Note – This case has gone into the distinction between the objects and activities of the trust. If the objects are religious or charitable in nature, then, registration cannot be denied to the trust on the basis of the nature of activity carried on by the trust to derive income.

2. Can an assessee-trust, whose objects were not only to promote a particular religion but also to promote other charitable goals, claim exemption under section 11?

   CIT v. Chandra Charitable Trust (2006) 156 Taxman 19 (Guj)

Relevant sections: 11 & 13(1)(b)

There are two issues in this case, namely,

(i) Is Jainism not only a simple philosophy or a life-style, but a religion in itself?

(ii) Is exemption under section 11 available to a trust promoting Jainism in addition to other charitable goals?

The High Court placed reliance on the judgement of the Apex Court in Bal Patil v. Union of India AIR 2005 SC 3172 in contending that Jainism is not a simple philosophy or a life-style but is in fact a religion in itself. Therefore, if a trust is formed only to promote Jainism, section 13(1)(b) would be attracted and the assessee would not be entitled to exemption under section 11.

However, in this case, from the covenants of the Trust Deed, it was evident that there were other charitable objects in addition to promoting Jainism. In such a case, the Trust would become a Charitable and Religious Trust and section 13(1)(b) would not be applicable. This was observed by this High Court in CIT v. Barkate Saifiyah Society (1995) 213 ITR 492, where it was held that in such cases, the assessee would be entitled to exemption under section 11.

3. Can exemption under section 11 be denied solely on the ground that there had been a delay in filing the report of the chartered accountant?

CIT v. Andhra Pradesh State Road Transport Corporation (2006) 285 ITR 147 (AP)

Relevant sections: 11 & 12A

The Supreme Court in CIT v. Andhra Pradesh State Road Transport Corporation (APSRTC) (1986) 159 ITR 1, has affirmed that the assessee, a State owned transport corporation, was a charitable institution.

The Revenue's case was that the assessee had not furnished a certificate of the chartered accountant along with the return of income of the relevant assessment years and had not submitted the report of the accountant in the prescribed form duly signed and therefore, the assessee was not entitled to exemption under section 11. However, the assessee contended that since he had furnished the said report before completion of assessment, he was entitled to exemption under section 11. The Andhra Pradesh High Court observed that as per Instruction No.1/1148 dated 9.2.1978, issued by the CBDT, exemption under section 11 should not be denied only on the ground that there had been delay in filing the report of the accountant in terms of section 12A(b). Further, the Supreme Court has, in Paper Products Ltd. v. CCE (2001) 247 ITR 128, laid down that the Department has no right to challenge a circular issued by the CBDT on any ground whatsoever including the ground that it was inconsistent with the statutory provision. Therefore, the Department is bound by the above circular and the assessee is entitled to exemption under section 11.

5

INCOME FROM SALARIES

1. Can an employee claim that there is no concession in the matter of accommodation provided to him by his employer and therefore, section 17(2)(ii) is not applicable in his case?

   Arun Kumar v. Union of India (2006) 155 Taxman 659 (SC)

   Relevant section: 17(2)(ii) read with Rule 3

   The Apex Court held that Rule 3 is not arbitrary, discriminatory or ultra vires article 14 of the Constitution or inconsistent with section 17(2)(ii). It is in the nature of 'machinery-provision' and applies only to the cases of 'concession' in the matter of rent in respect of any accommodation provided to the employee by the employer. Since there is no deeming provision in the Act, it is open to the employee to claim that there is no concession in the matter of accommodation provided by his employer and therefore, his case is not covered by section 17(2)(ii).

2. Can the scholarship granted by an employer to the employee's child be treated as a perquisite in the hands of the employee?

   CIT, Meerut v. B.L. Garg (2006) 155 Taxman 189 (All.)

   Relevant sections: 10(16) & 17(2)

   The assessee claimed exemption under section 10(16) in respect of the payment made by his employer to his child as scholarship. The Assessing Officer disallowed the assessee's claim, on the ground that the amount given by the employer to the assessee's son as scholarship was a perquisite and liable to be taxed under the head "Salary" under section 17. The Tribunal, however, allowed the assessee's claim holding that payment was made by the employer to the children of the assessee as scholarship and as such, the amount was eligible for exemption under section 10(16).

   The High Court observed that from a plain reading of section 10(16), scholarship granted to meet the cost of education is not includible in the total income of the previous year of any person. It was further observed that the Bombay High Court, in CIT v. M.N. Nad Karni (1986) 161 ITR 544, has held that when scholarship was paid entirely gratuitously by the company and in its sole discretion and payment of scholarship amount was never received by the employee but the children concerned, the scholarship amount cannot be treated as a perquisite received by the assessee as contemplated under section 17(2)(iii)(c).

Note – It may be noted that with effect from A.Y.2006-07, fringe benefit tax is payable by the employer on the expenditure incurred or payment made for the purposes of scholarship, irrespective of whether the recipient is an employee or his relative or any other person.

6

INCOME FROM HOUSE PROPERTY

1. Under what head is income from temporary letting out of property, used normally for business purposes, taxable?

   CIT v. Kohinoor Tobacco Products (P.) Ltd. (2006) 283 ITR 162 (M.P.)

   Relevant sections: 22 & 28

   The assessee-company, carrying on bidi manufacturing business, acquired properties (factory buildings, godowns, officer/staff quarters) for its business. However, owing to labour problems and other factors, the assessee had to temporarily reduce its scale of activities and consequently, let out some of the properties which were not immediately required by it for its business purposes. The assessee showed the rental income from such properties as business income. However, the Assessing Officer treated the same as income from house property. The Tribunal held that such income was to be treated as business income.

   The High Court observed that the Tribunal had recorded a finding of fact that the properties were let out to keep them in good condition so that they could be used and exploited again for the purposes of assessee's bidi manufacturing business. The assessee's intention was to increase its business again gradually and not to close down its business. Therefore, the rental income was taxable as business income.

   Note – As per section 22, the annual value of a property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner shall be chargeable under the head "Income from house property". The only exception is a property occupied by him for the purposes of any business or profession carried on by him. In this case, however, income from letting out of property during the period when they were not immediately required by the assessee for its business purposes (due to temporary scaling down of the business activities of the assessee) has been treated as business income.

7

PROFITS AND GAINS OF BUSINESS OR PROFESSION

1. Are expenditure incurred by a company on account of stamp duty and registration fees for the issue of bonus shares allowable as revenue expenditure?

   CIT, Mumbai v. General Insurance Corporation (2006) 286 ITR 232(SC)

   Relevant section: 37(1)

   On this issue, the Supreme Court observed that there is no inflow of fresh funds or increase in capital employed on account of issue of bonus shares. There is merely a reallocation of company's fund on account of issue of bonus shares by capitalization of reserves. Therefore, the company has not acquired a benefit or advantage of enduring nature. The total funds available with the company will remain the same and there is no change in the capital structure of the company consequent to the bonus issue. Thus, issue of bonus shares does not result in the expansion of capital base of the company. Therefore, the expenditure incurred by the company on account of stamp duty and registration fees for the issue of bonus shares is allowable as revenue expenditure.

   Note - While arriving at this decision, the Supreme Court has considered the effect of issue of bonus shares on the capital employed i.e. share capital plus reserves and not merely on capital alone. It may be noted that though bonus issue increases the capital of the company, the capital employed is left intact. This decision of the Apex Court has settled the long-standing dispute amongst the High Courts regarding the allowability of expenses on issue of bonus shares.

2. Are refund of liquidated damages made, not voluntarily but solely to comply with the directions of an authority, allowable as deduction?

   Mahanagar Telephone Nigam Ltd. In re (2006) 286 ITR 211 (AAR)

   Relevant section: 37(1) and 57(iii)

   MTNL, a notified resident-applicant, entered into an agreement with one ITI for purchase of plant and machinery. The agreement provided that MTNL would be entitled to liquidated damages in case of failure by ITI to deliver the equipment within the stipulated time. The amount recovered by MTNL towards liquidated damages was adjusted against the cost of the assets in some years and shown as income in some years. ITI sent representations to MTNL for waiver of liquidated damages stating that the delay was due to reasons beyond its control. Thereafter, MTNL received a direction from the Telecom Commission to waive the liquidated damages. Accordingly, the Board of Directors of MTNL decided to waive the liquidated damages and refunded certain amounts to ITI during the relevant assessment year. The issue under consideration is whether the amount refunded by the applicant on account of waiver of liquidated damages would be allowable as deduction from business income.

The AAR observed that MTNL had reluctantly agreed to refund a part of the charges only to comply with the directions of the Telecom Commission and not voluntarily for business purpose. Since the equipments supplied by ITI were capital assets, damages recovered on account of supply of capital assets were capital in nature and were not allowable as a revenue expenditure. Such expenditure was outside the purview of both section 37(1) and 57(iii).

Note – The question as to whether refund of liquidated damages can be allowed as deduction would also depend on the method of accounting followed by the assessee in respect of accounting for liquidated damages. If the liquidated damages were treated as a revenue receipt and credited to the profit and loss account, then it is possible to treat refund of the same as a revenue expenditure, if such refund was wholly and exclusively for the purpose of its business.

3. Can the value of bus donated by the assessee-employer to a school where the employees' children were receiving education be allowed as deduction?

CIT v. Rajasthan Spinning and Weaving Mills Ltd. (2006) 281 ITR 408 (Raj.)

Relevant section: 37

The assessee-company donated a bus to a school where the employee's children were studying and debited the same to the Workmen and Staff Welfare Account. It claimed the expenditure as deduction on the ground that it was incurred wholly and exclusively for the purpose of the assessee's business. The Assessing Officer rejected the claim of the assessee. However, the Commissioner (Appeals) and the Tribunal allowed it. The assessee contended that such expenses were incurred for the welfare of the children of staff/workmen of the company as part of the employee welfare expenses for the purpose of securing efficient services of such employees. The High Court observed that the contention of the assessee was true. Since the assessee had not acquired any asset, it was not a capital expenditure. Therefore, the expenditure was deductible.

Note – This case is a forerunner in allowing donation of a capital asset as revenue expenditure on the ground that the same was for employee welfare.

4. What is the nature of expenditure incurred by an assessee on payment of one-time fee for membership of OTCEI?

   Neset Holdings (P) Ltd. v. CIT (2006) 151 Taxman 309 (Delhi)

   Relevant section: 37(1)

   In this case, it was held that expenditure incurred by an assessee on payment of one-time non-refundable fee for membership of OTC Exchange of India is a revenue expenditure allowable as deduction under section 37(1).

5. Can expenditure incurred on account of stamp duty, interest etc. in respect of leased premises, in which the assessee-firm carries on the business of exhibiting films, be allowed as revenue expenditure?

   CIT v. Laxmi Talkies (2006) 151 Taxman 99 (Guj.) / (2005) 275 ITR 0125 (Guj)

   The assessee, a registered firm carrying on the business of exhibiting films, incurred expenditure on account of stamp duty, interest etc. in addition to expenditure on renovation and repairs of leased cinema hall and claimed such expenditure as revenue expenditure. The High Court held that since the expenditure would help the firm to increase its revenue by attracting more customers to cinema hall without bringing into existence any new asset or benefit of enduring nature, the expenditure incurred was a revenue expenditure.

6. A dealer carrying on its business in leasehold premises incurs expenditure in constructing ground floor above the basement, according to the specifications given by the manufacturer to all its dealers. Can such expenditure be allowed as a revenue expenditure?

   CIT v. Hari Vignesh Motors P. Ltd. (2006) 282 ITR 0338 (Mad.)

   The assessee was a dealer in two-wheelers manufactured by TVS Suzuki Ltd. It was carrying on its business in leasehold premises. The assessee constructed a ground floor above the existing basement floor according to the specifications given by TVS Suzuki Ltd. to all its dealers. The assessee claimed the expenses incurred for construction as revenue expenditure for the relevant assessment year. The High Court observed that the assessee had undertaken the construction in view of the requirements of the business. The assessee did not acquire any capital asset by incurring the expenditure. As per the stipulation in the lease deed, reimbursement of such expenditure from the owner of the premises was also not possible. The High Court, therefore, held that the expenditure was revenue in nature and can be allowed as deduction.

7. Can loss incurred by an assessee engaged in smuggling business on account of confiscation of foreign currency be allowed as a business loss?

   CIT v. Anil M. Gehi (2006) 284 ITR 338 (Bom.)

   The assessee was engaged in smuggling business. Foreign currency equivalent to Rs.4,56,980 seized from his custody was the amount involved in the smuggling activity. The High Court observed that confiscation of the amount was, therefore, business loss suffered by the assessee in conducting his business of smuggling. It was not the case of assessee carrying on some other business for which foreign currency was illegally transported out of India. The confiscation of foreign currency equivalent to Rs.4,56,980 was a loss of stock-in-trade of the assessee. When such amount is brought to tax as income of the assessee under section 69A, he is entitled to the benefit of treating the amount confiscated from him as a business loss.

8. Are expenses in connection with issue of shares allowable as business expenditure?

   CIT, Karnataka-I, Bangalore v. Amco Batteries (2006) 155 Taxman 167 (Kar.)

   The issue under consideration is whether expenditure in connection with the issue of shares is allowable as a business expenditure. The High Court followed the judgment of the Supreme Court in the case of Brooke Bond India Ltd. v. CIT (1997) 225 ITR 798, where it was held that expenditure in connection with issue of shares, with a view to increase its share capital, is directly related to the expansion of the capital base of the company and is a capital expenditure. Hence, expenditure in connection with the issue of shares is not allowable as a business expenditure.

9. Is expenditure incurred on lease of plant and machinery, technical know-how from a sister-concern allowable as deduction where the same is given on lease by the assessee to another sister-concern at a much lower price?

   CIT v. Mysore Wine Products Ltd. (2006) 285 ITR 381 (Karn.)

   Relevant section: 37(1)

   The assessee-company is a wholly owned subsidiary of M/s. Consolidated Investments Ltd. (CIL), which again is a wholly owned subsidiary of M/s. United Breweries Ltd (UBL). It carries on the business of trading in liquor. It entered into agreements with another group company, M/s. McDowell and Co. Ltd. (MDL), for taking on hire certain plant and machinery and for obtaining know how and technical advice on payment of Rs.8 lakhs per month. The assessee transferred to MWP, another wholly owned subsidiary of UBL, the plant and machinery taken by it on hire from MDL alongwith the technical know-how and other information. MWP had to pay a sum of Rs.2 lakhs per month to the assessee for use of the facilities. The said expenditure was disallowed by the Assessing Officer on the ground that it was not incurred wholly and exclusively for business purposes. The Assessing Officer was of the view that the arrangement for paying higher amount to MDL and charging a much lower amount from MWP was with a view to reduce the tax liability of the group as a whole.

The High Court observed that the three companies were sister concerns. The payment made by the assessee to MDL was reflected in the books of the assessee, and when the payments were not made, interest was charged and the same was also reflected in the books. MDL had accounted for the charges of Rs.8 lakhs per month in its accounts and paid income-tax. The receipt of Rs.2 lakhs by the assessee was also not disputed. The tripartite agreement was beneficial to the assessee from the point of payment of sales tax. MWP supplied liquor manufactured by it at a lower price to the assessee than at which it sold to third parties. Further, 90% of the production of MWP was supplied to the assessee. If payment of Rs.8 lakhs was made by MWP to the assessee, it would not have been able to make profits and there would have been no tax liability. Also, the said amount of Rs.8 lakhs was taxed in the hands of MDL and consequently, there was no avoidance of tax by the sister concerns.

The High Court, therefore, held that the Commissioner (Appeals) and the Tribunal were right in holding that the arrangement was not sham. The High Court also held that interest charged by MDL (for default in payment of such sums legally payable by the assessee) was also a genuine business expenditure deductible under section 37(1).

10. Can the expenditure incurred by a businessman in providing wooden partition, glass work etc. in the premises taken on lease for business purposes be treated as revenue in nature?

CIT v. Escorts Finance Ltd. (2006) 155 Taxman 559 (Delhi)

The assessee-company had incurred certain expenditure for providing wooden partition, painting, glass work and other petty repairs in its leased premises. It claimed such expenditure as revenue expenditure. The Assessing Officer disallowed the claim of the assessee, treating the said expenditure as capital expenditure. However, Commissioner (Appeals) and the Tribunal allowed the assessee's claim, treating the expenditure as revenue expenditure.

The High Court observed that the expenditure of the above nature incurred by the assessee to make the premises workable has to be considered as revenue expenditure. The manner in which the leased premises is to be maintained and the extent of repair work to be done is to be decided by the businessman. The Court held that all such expenditure incurred on painting, polishing the floor, providing wooden partition, glass work etc. has to be considered as revenue expenditure. The nature of such repairs was not of enduring character so as to characterize the same as capital expenditure.

11. Can the interest paid by the assessee for delay in making payment for shares purchased through share brokers be claimed as business expenditure?

    CIT v. Raghav Behl (2006) 286 ITR 134 (Delhi)

    Relevant section: 37

    The assessee had purchased shares through two share brokers. The assessee could not make payment for the shares on time due to shortage of funds. Therefore, he had to pay interest till the date when he made payment and took delivery of shares. He claimed such interest as deduction. The High Court held that charge of interest for delayed payment was customary in the trade of share transactions, and therefore, interest paid to brokers was an allowable business expenditure.

12. A firm entered into an agreement with its partners to pay a portion of the net profits of the succeeding years on their disassociation from the firm. Accordingly, the firm paid the amounts to the partners in the subsequent years. Can such payments be allowed as business expenditure?

    CIT v. Mandovi Hotel (P.) Ltd. (2006) 152 Taxman 361 (Bom.)

    The assessee, along with two other entities, was a partner in a firm which was engaged in hotel business. A memorandum of understanding was executed by which it was decided that the other partners would disassociate from the firm and the assessee would continue the business of the firm. Accordingly, a dissolution deed was executed by which it was agreed that the assessee would take over all the assets of the firm and in consideration, the assessee would pay to the retiring partners, 30% of the net profits of the business, subject to a minimum amount of Rs.60,000 for a period of 7 years. During the relevant previous year, as per the terms of dissolution deed, the assessee paid the said sum to the retired partners and claimed deduction of such sum as business expenditure. The Assessing Officer disallowed the amount paid by the assessee to the retired partners on the ground that the payment was capital in nature.

    The Bombay High Court observed that the payment of 30% of net profits was related to annual profits that flowed from the business activities of the assessee-company and not to the capital value of the assets. Further, the dissolution deed did not specify any capital sum payable to the retiring partners. The payment so made was also not related to or tied up in any way to any fixed sum agreed between the parties as part of the consideration payable to the retiring partners for disassociating from the firm. Hence, the expenditure cannot be construed as a capital expenditure.

    Note – If the principle of substance over form is applied, then such expenditure would be treated as capital expenditure, since in effect it represents payment of capital sum to retired partners.

13. Can it be inferred that, in the absence of one of the parameters, the entire section 44C becomes non-workable?

CIT v. Deutshe Bank A.G. (2006) 284 ITR 463 (Bom.)

Relevant sections: 37(1) & 44C

Section 44C restricts allowance of deduction for head office expenditure to the least of the three (now, two) parameters stated therein. The assessee, a foreign bank, claimed the full amount of head office expenses as deduction on the ground that section 44C was not applicable as one of the parameters was not attracted. The High Court concurred with the assessee's view and held that in the absence of one of the parameters, the entire section 44C stood ruled out. Therefore, the entire head office expenditure was allowable under section 37(1), as section 44C was not applicable to the case of the assessee, since, in the absence of one of the parameters, the entire section becomes non-workable.

Note – The moot point is whether the residuary section 37 can be called in aid in the absence of any one of the parameters under any section providing for deduction of specified expenditure from business income.

14. Can deduction of business loss be denied on the ground that the same was attributable to the negligence of the banker to check whether the shipping documents were genuine?

CIT v. Mahendra N. Shah (2006) 155 Taxman 49 (Guj.)

The assessee entered into a contract for importing dates from an establishment in Dubai. For this purpose, it opened a letter of credit with the bank. The Dubai establishment presented false documents and collected money without loading and dispatching the corresponding quantity of dates. The assessee took efforts to recover the money from the said establishment. It traced the Dubai party through an intermediary, who forwarded two post-dated cheques to the assessee. However, the cheques were not honoured. Therefore, the assessee claimed a sum of Rs.3,45,000 as business loss. The Assessing Officer disallowed the same on the ground that the official of the bank, through whom the transactions had been effected, should have been careful to check whether the shipping documents were correct and genuine before releasing the amount in favour of the Dubai party.

The Tribunal recorded a finding that there was evidence in the form of telegrams, correspondence and the assessee's efforts to recover the money through Consulate General of India, though such efforts were not successful. All these prima facie established incurring of a loss by the assessee. The Assessing Officer had placed undue emphasis on the lapse committed by the bank official which cannot, however, wipe out the loss incurred by the assessee. The High Court held that the Tribunal was right in holding that the assessee was entitled to deduction of the sum of Rs.3,45,000 as business loss.

15. Can unabsorbed depreciation, not determined in pursuance of a return filed under section 139, be carried forward?

CIT, Lucknow v. Brigadier Paramanand (2006) 152 Taxman 123 (All.)

Relevant section: 32(2), 80 read with section 139

In this case, it was held that the assessee is entitled to carry forward and set-off unabsorbed depreciation under section 32(2), even though it was not been determined in pursuance of a return filed under section 139, since section 80 which stipulates filing a return of loss as per section 139 is not applicable to unabsorbed depreciation allowed to be carried forward under section 32(2).

16. Is it necessary to adjust unabsorbed depreciation (relating to earlier years) of the amalgamating company for computing the written down value of assets transferred to the amalgamated company?

CIT v. Kothari Industrial Corporation Ltd. (2006) 156 Taxman 240 (Mad.)

Relevant section: 43(6)

The Tribunal directed the Assessing Officer to adopt the written down value of the assets transferred to the assessee-amalgamated company by the amalgamating company without reducing therefrom the unabsorbed depreciation of the earlier years. The High Court noted the observation of the Bombay High Court in CIT v. Hindustan Petroleum Corporation Ltd. (1991) 187 ITR 1, where it was held that the written down value of assets would be the actual cost of the assets to the assessee less depreciation actually allowed to the company. Any unabsorbed depreciation which was not set-off cannot be taken into account.

The High Court, therefore, held that the Tribunal was right in law in holding that the written down value of the assets transferred from the amalgamating company should be worked out without reducing therefrom the unabsorbed depreciation relating to earlier years.

17. Is the company entitled to claim depreciation in respect of an asset owned by its director in his personal capacity?

M.M. Fisheries (P) Ltd. v. CIT (2006) 152 Taxman 247 (Del.) / (2005) 277 ITR 0204 (Del)

Relevant section: 32

Where an asset is owned by the director of a company in his personal capacity, then such asset cannot be deemed to be in the vested ownership or beneficial utility of the company. The director of the company was the registered owner of the vehicle and the as per the findings recorded by the Tribunal, even the beneficial ownership did not vest with the assessee company. The company had no dominion over the vehicle nor was the vehicle provided as a perk to the director of the company. Therefore, the High Court held that the company is not entitled to claim depreciation under section 32 in respect of such vehicle.

Note – The dual conditions of ownership by the assessee and use for the purposes of business or profession have to be satisfied for claiming depreciation. However, ownership by the director cannot be considered as ownership by the company for availing the benefit of depreciation.

18. Can a donation by a spinning mill to a pediatrics institution for organizing a conference relating to pediatrics qualify for deduction under section 35?

    Nahar Spinning Mills Ltd. v. CIT (2006) 155 Taxman 562 (P&H)

    Relevant section: 35(1)

    The assessee-spinning mill gave donation to a pediatrics institution for organising a conference relating to pediatrics and claimed the same as deduction under section 35. The assessee's claim was rejected by the Tribunal on the ground that donation given by the assessee was not allowable as deduction under section 35 since the said section pertains to expenditure on scientific research.

    The High Court observed that from the perusal of section 35, it can be seen that deduction under that section is allowable in case the scientific research is related to the business of the assessee. However, in the instant case, the donation was not related to the assessee's business. Therefore, the High Court held that the Tribunal was right in rejecting the assessee's claim.

    Note – In this case, deduction under section 35 has been denied on the ground that the donation was for scientific research not related to the assessee's business. However, for claiming deduction in respect of donation for scientific research, section 35(1)(ii) is relevant, which does not stipulate any condition that the scientific research should be related to the assessee's business. The moot point in this case is whether donation for the purpose of organising a conference can be considered as donation for scientific research.

19. Can employer's contribution to unapproved gratuity fund and superannuation fund qualify for deduction from business income?

    Sony India P. Ltd. v. CIT (2006) 285 ITR 213 (Delhi)

    Relevant sections: 36(1)(iv) and 36(1)(v)

    The issue under consideration in this case is whether contributions towards gratuity and superannuation funds, which are not approved, qualify for deduction. The High Court observed that from a plain reading of sections 36(1)(iv) and 36(1)(v), which provides for deduction in respect of contributions to approved superannuation fund and approved gratuity fund, it is clear that deductions under those sections are admissible only if the employer makes the contributions towards an approved superannuation fund or an approved gratuity fund. The provisions of a taxing statute have to be interpreted strictly applying the rule of literal interpretation. Nothing can be added or substituted by implication or intendment. If Parliament has allowed deductions towards provident fund, superannuation fund or gratuity fund only in cases where such funds are approved, granting deduction of amounts paid to unapproved funds under the cover of section 37 may defeat the legislative intent and frustrate the very purpose underlying the specific provisions made thereunder.

Therefore, contributions made to such unapproved funds will not qualify for deduction under section 36(1). Since the deductions claimed by the assessee were of the nature described in section 36(1)(iv) and (v), therefore, section 37 cannot come to the aid of the assessee.

Note – Payments of the above nature specifically attract disallowance under section 40A(9), which provides that no deduction shall be allowed to the assessee-employer, inter-alia, towards contribution to any fund, trust etc. except where such sum is so paid, for the purposes and to the extent provided under clauses (iv) and (v) of section 36(1).

20. Can interest on borrowed capital be allowed as deduction where such borrowings have been diverted as interest-free loans by the assessee to its sister concern for non-business purposes?

CIT v. Abhishek Industries Ltd. (2006) 286 ITR 1 (P & H)

Relevant sections: 36(1)(iii)

Under section 36(1)(iii), deduction is allowed for interest on loan raised for business purposes. Where the assessee claims such deduction, the onus lies on him to satisfy the Assessing Officer that such loan has been used for the purposes of business. Where in the process of examining the genuineness of the claim, it comes to light that the assessee had made interest-free loans or advances to its sister concerns, the onus would be on the assessee to justify such payment for non-business purposes in spite of pending interest-bearing term loans and working capital loans.

The assessee contended that such interest-free advances to its sister concerns for non-business purposes were made out of its own funds i.e. capital introduced in the business. This contention was not acceptable since the assessee's plea at the time of raising loan was that the capital was introduced by it as a margin for loans being raised. Subsequently, the assessee diverted substantial amounts to sister concerns for non-business purposes without interest and took the plea that the amount was advanced out of its capital. Such a plea might have been acceptable if the assessee had not raised any loan at the time of diversion of funds. This was not so in the instant case.

The High Court held that where the assessee had borrowed certain funds on which there was a liability to pay interest and had diverted amounts to its sister concern for non-business purposes without interest, then the interest to the extent of such interest-free advance made cannot be allowed as deduction under section 36(1)(iii).

21. What is the method of valuation of stock to be adopted on conversion of sole proprietary concern into a partnership firm?

CIT v. M. Kathiresan (2006) 285 ITR 206 (Mad.)

The issue raised in this case relates to the method of valuation of stock to be adopted where a sole proprietary concern is converted into a partnership firm. The assessee claimed the loss incurred in the sole proprietary concern as a business loss, on conversion of the same into a partnership firm. Though the Assessing Officer accepted the loss, the Commissioner (Appeals) set aside the assessment order on the ground that the Assessing Officer had not revalued the stock according to market price on conversion of the proprietary business into a partnership business. The Tribunal, however, set aside the order the Commissioner (Appeals).

The High Court observed that it is an established rule of commercial practice and accountancy that where there was no discontinuance of business, the closing stock is to be valued at cost or market price, whichever is lower. It is only when the business is closed forever, that the question of valuing the stock at the market price will arise. The High Court, therefore, held that the Tribunal was justified in coming to the conclusion that the closing stock should not be valued at market price.

22. Whether disallowance under section 40(b) is attracted in respect of gross interest payment by the firm to the partner or net interest payment?

CIT (Central) Kanpur, v. Juggilal Kamlapat Bankers (2006) 155 Taxman 321 (All.)

Relevant section: 40(b)

In this case, the High Court held that, in view of the Supreme Court decision in Keshavji Ravji & Co. v. CIT (1990) 183 ITR 1, the Tribunal was justified in holding that only the net amount paid by the firm to the partner after adjusting the interest paid by the partner to the firm attracts disallowance under section 40(b).

Note – Since section 40(b) stipulates the condition that interest payment by a firm to its partner upto 12% p.a. does not attract disallowance provided the same is authorized by the partnership deed, it appears that netting of interest is possible only if interest payment by the partner to the firm is also authorized by the partnership deed.

23. Is disallowance under section 40A(3) attracted when a single payment exceeds Rs.20,000 or when the aggregate of the amounts paid to a person exceeds Rs.20,000?

CIT v. Kothari Sanitation and Tiles (P.) Ltd. (2006) 282 ITR 117 (Mds.)

Relevant section: 40A(3)

The assessee was engaged in the business of sanitary fittings and tiles. For the relevant assessment year, the Assessing Officer disallowed the claim for certain expenditure under section 40A(3) on account of the payments being made in cash and exceeding Rs.20,000. The assessee contended that no single transaction exceeded Rs.20,000 and the Commissioner (Appeals) and the Tribunal accepted his claim. The High Court observed that a perusal of the cash book revealed that cash payments were made in respect of each invoice separately and therefore, the payments could not be disallowed since no single payment exceeded Rs.20,000.

Note – It may be noted that no single payment should exceed Rs.20,000 to escape disallowance under section 40A(3). In this case, since cash payment is made for each invoice separately and each such cash payment does not exceed Rs.20,000, disallowance is not attracted. However, it is possible to escape disallowance under section 40A(3) by making separate payments of Rs.20,000 or less in respect of each invoice, where the value of the invoice exceeds Rs.20,000. Splitting up of payments in respect of a single expenditure/invoice may be resorted to by some assessees for the purpose of escaping disallowance under section 40A(3).

24. Can that portion of the amount received by the assessee towards credit note of excise duty and not refunded to its customers but credited to its profit and loss account be charged to tax?

CIT v. London Machinery Company (2006) 280 ITR 0271 (All.)

Relevant section: 41(1)

The assessee-firm had received a certain sum of money towards credit note of excise duty. Out of the said sum, the assessee did not refund a certain amount to its customers and credited the same to its profit and loss account. The amount had also been distributed amongst the partners.

The High Court observed that the provisions of section 41(1) would be attracted if the following conditions are satisfied –

(1) An allowance or deduction has been made in the assessment for any year in

respect of loss, expenditure or trading liability incurred by the asssessee.

(2) Subsequently, during any previous year, the assessee must have obtained -

(i) any amount in respect of such loss; or

(ii) any benefit in respect of such trading liability by way of remission or cessation thereof.

In case either of the events mentioned in (2) above happen, the deeming provision enacted in the closing part of sub-section (1) of section 41 comes into play. Accordingly, the amount obtained by the assessee or the value of benefit accruing to him is deemed to be the profits and gains of business or profession and it becomes chargeable to income-tax as the income of that previous year. The transfer of unpaid excise credit to the profit and loss account of the assessee falls under the first clause of section 41(1) [i.e. obtained any amount in respect of such loss or expenditure] and is, therefore, chargeable to tax as profit of the year.

25. Is the surplus amount realised by the assessee-sugar mill on sale of sugar, over and above the levy price fixed by the Government, a taxable receipt?

CIT, Lucknow v. Raza Buland Sugar Co. (2006) 156 Taxman 69 (All.)

Relevant section: 28(i)

In this case, the High Court held that the excess amount realised by the sugar mill as sale price of sugar over and above the levy price fixed by the Government did not form part of the trading receipt.

26. Whether bonus relatable to an earlier year but paid during the current year can be allowed as deduction in the current year?

CIT v. Standard Radiators (P) Ltd. (2006) 286 ITR 207 (Guj.) / 152 Taxman 210 (Guj.)

The assessee changed its method of accounting from cash to mercantile system in the assessment year under consideration. The issue involved is whether bonus relatable to an earlier year can be allowed as deduction in the relevant assessment year. It was held that since the assessee had been consistently paying bonus on cash basis in the past after the end of the accounting period and the same modality was adopted in the year under consideration, such payment cannot be considered as relating to an earlier year. Hence, bonus actually paid during the previous year is an allowable deduction.

8

CAPITAL GAINS

1. Where a holding company receives assets on voluntary liquidation of its subsidiary company by virtue of being a shareholder of the subsidiary company, would the value of assets received by the holding company on the date of distribution be liable to tax under section 46(2)?

   CIT v. Brahmi Investments (P.) Ltd. (2006) 286 ITR 66 (Guj.)/ (2006) 153 Taxman 471 (Guj.)

   Relevant sections: 46(2) & 47(v)

   In this case, the High Court held that if a holding company had received assets on voluntary liquidation of its subsidiary company by virtue of being a shareholder of the subsidiary company, the value of assets received by the holding company on the date of distribution was liable to tax under section 46(2). Section 47(v), which provides that transfer of a capital asset by a subsidiary company to its 100% holding company (being an Indian company) would not be regarded as a transfer for the purpose of charge of capital gains tax, would not be applicable in this case.

2. In a case where additional compensation awarded by the civil court had not been accepted by the State Government and it had preferred an appeal objecting to the enhancement, can the said additional compensation received by the assessee be subject to capital gains tax?

   CWT v. T.Girijammal (2006) 284 ITR 482 (Mad.)

   In this case, it was held that when additional compensation awarded by the civil court had not been accepted by the State Government and it had preferred an appeal objecting to the enhancement, the said additional compensation received could not be treated as part of the compensation received for the transfer of the land until it is finally determined by the High Court or the Supreme Court. If the appeal of the State is allowed, the assessee is bound to refund the amount and hence, the same cannot be assessed in the assessee's hands before reaching finality. Hence, when the income itself has not accrued or arisen, the question of levying wealth-tax also does not arise, as it is only consequential in nature.

3. Would exemption of capital gains under section 54F be available if there has been a mere extension of an existing building?

   CIT, Tamil Nadu-I vs. V. Pradeep Kumar (2006) 153 Taxman 138 (Mad.)

   Relevant section: 54F

   For the purpose of exemption of capital gains under section 54F, there must be construction of a residential house and such construction should be real and not symbolic. Exemption would not be available if there has been a mere extension of an existing building. Mere construction by way of extension of the old existing house would not mean constructing a residential house as contemplated under section 54F.

4. A building is leased out by the assessee through a lease deed, which was not registered under the Registration Act and Transfer of Property Act. Can such lease amount to transfer of a capital asset for attracting capital gains tax?

   CIT v. C.F. Thomas (2006) 284 ITR 557 (Ker.)

   Relevant section: 2(47)

   The assessee had leased out a commercial building, owned by it, for a period of 20 years. The lease was executed through a lease deed which was not registered. Such lease should have been compulsorily registered under the Registration Act, 1908 and Transfer of Property Act, 1882. Therefore, the assessee contended that although the transaction recorded in the said instrument is a lease, however, legally there is no transfer of a capital asset so as to attract capital gains tax.

   The High Court observed that the instrument in question i.e. the lease deed was a transaction by way of arrangement having the effect of enabling the enjoyment of immovable property. Such a transaction was clearly a transfer of a capital asset and any profit or gain arising out of such transfer would definitely generate capital gains. The High Court held that merely because the instrument was compulsorily registrable under the Registration Act, 1908 and Transfer of Property Act, 1882, such transaction had not become anything other than a lease transaction.

5. Can distribution at the time of dissolution of the firm to the ex-partners of the firm, who had retired much earlier, be subject to capital gains?

   Gandamal and Sons v. ACIT (2006) 285 ITR (AT) 163 (Pune)

   Relevant section: 45(4)

   The assessee-firm was the owner of certain land, which was distributed in connection with the dissolution of the firm. Such a transfer was covered under section 45(4). The assessee-firm had four partners who had retired much before the dissolution. These ex-partners had 38% share in such land. The firm contended that this portion of the value of land should not be taken into account for computing the capital gains, since this portion (i.e. 38%) of the actual distribution which was made on the date of dissolution was to ex-partners and not partners. The Tribunal held that distribution of assets to outsiders for satisfaction of their debts, representing their capital on the date of retirement, was not caught within the mischief of section 45(4). Hence, only 62% of the value of the land should be considered for the purpose of computing capital gains.

6. Is capital gains attracted where a firm is dissolved and the business, along with assets and liabilities, are taken over by a partner?

   Suvardhan v. CIT (2006) 156 Taxman 229 (Kar.)

   Relevant section: 45(4) read with section 2(47)

   The assessee-firm had been dissolved and the business, along with the assets and liabilities, are taken over by a partner. Pursuant to a notice, the assessee-firm filed a nil return for the said assessment year. The Assessing Officer held that the assessee-firm was liable to capital gains under section 45(4) in respect of assets transferred by the firm to the partner on dissolution. The Commissioner (Appeals) and the Tribunal upheld the order of the Assessing Officer.

   As per section 45(4), the profits or gains arising from transfer of capital assets by way of distribution of capital assets on dissolution of a firm shall be chargeable to tax as income of the firm. This is because there has been a transfer in terms of section 2(47). Section 47 provides for transactions not regarded as transfer. Erstwhile clause (ii) of section 47 provided that distribution of capital assets on dissolution of firm, body of individuals or other association of persons is not regarded as a transfer. However, this clause was omitted by the Finance Act, 1987 w.e.f. 1.4.1988. Therefore, any transaction resulting in distribution of assets on dissolution of a firm is a transfer as per section 2(47). This was also held by the Bombay High Court in the case of CIT v. A.N. Naik Associates (2004) 265 ITR 346, where it was observed that the Finance Act, 1987 had omitted clause (ii) of section 47, instead of amending section 2(47), the effect of which is that distribution of capital assets on dissolution of a firm would be regarded as transfer.

   The High Court held that the assessee-firm was liable to capital gains under section 45(4) since there was a transfer on distribution of capital assets to a partner on dissolution of the firm.

9

INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

1. Are clubbing provisions attracted in respect of agricultural income of a minor son?

   Suresh Chand Talera v. Union of India (2006) 152 Taxman 348 (MP) / (2006) 282 ITR 0341(MP)

   Relevant section: 64(2)

   In this case, the High Court observed that the definition of income under section 2(24) is inclusive and not exhaustive. Hence, the fact that agricultural income has not been specified as one of the items in section 2(24) does not mean that agricultural income is not included in the word "income" wherever the word "income" has been used in the Act. Section 10 of the Act provides that in computing the income of the previous year of a person, any income falling in any of the clauses mentioned therein shall not be included. The first clause mentioned therein is "agricultural income". Thus, section 10, on which great reliance has been placed by the assessee, makes it clear that agricultural income is income but by express provision therein, agricultural income has been excluded from the total income of an assessee for the purpose of levy of income-tax. Section 4(1), which is the charging section, provides that while the total income of a person is to be determined in accordance with the provisions of the Income-tax Act, the rate or rates at which such income-tax will be paid on such income for any assessment year will be stipulated in the relevant Finance Act. The Annual Finance Act provides under Chapter II section 2 that the net agricultural income shall be taken into account in the manner provided therein for the purpose of determining the rates of income-tax applicable to the income of the assessee. Therefore, in view of the above provisions, the High Court held that agricultural income of the minor son of the assessee has to be included in the income of the assessee for the purpose of determining the rate of income-tax applicable to the income of the assessee.

2. Are clubbing provisions attracted where the husband is a partner of the firm in his capacity as karta of HUF and the wife is a partner of the same firm in her individual capacity?

   CIT, Meerut v. S.N. Anand (2006) 155 Taxman 390 (All.)

Relevant section: 64(1)

The assessee was a partner of a firm in the capacity of karta of his HUF. The assessee's wife was also a partner of the same firm in her individual capacity. The assessee did not disclose the income of his spouse in his return of income. The original assessment was completed under section 143(1). Thereafter, reassessment proceedings were initiated for all the years on the ground that the assessee had not disclosed the share income of his wife in accordance with the provisions of erstwhile section 64(1)(i). The Income-tax Officer (now, Assessing Officer) added the share income of the wife to the assessee's total income.

The High Court followed the judgment of the Apex Court in CIT v. Om Prakash (1996) 217 ITR 785 and held that the income of the wife could not be included in the income of the assessee-HUF. Therefore, it was not obligatory on the part of the husband, who is karta of the HUF, to disclose the share income of his wife from the partnership firm.

Note – This case relates to assessment years 1978-79 and 1980-01 to 1983-84. Share income of a partner is now exempt and therefore clubbing provisions are not relevant. However, the ratio of decision in this case may also be extended to salary, interest and other remuneration of partner i.e., where the assessee is a partner in the capacity as karta of HUF and has substantial interest in the firm and his wife is a partner in her individual capacity, then, salary, interest etc. of wife from the firm need not be clubbed in the hands of the husband. In such a case, clubbing provisions under section 64(1)(ii) would not be attracted.

3. Are clubbing provisions attracted in a case where income is only to be credited to the minor's account in the trust and to remain there till the minor attains majority?

CIT v. K.J. Ramaswamy (2006) 286 ITR 77 (Mad.) [FB]

Relevant section: 64

The assessee was a founder of the trust of which his minor children were beneficiaries. The assessee was a partner in a firm in a representative capacity, as trustee of the trust. The issue under consideration was whether the income derived by the trustee in his representative capacity from the firm, which ultimately accrues to the beneficiaries, would be included in the income of the respective parent of the beneficiaries under the erstwhile section 64(1)(iii) read with Explanation 2A thereto.

The High Court observed that in order to attract clubbing provisions, the income generated from transferred assets should be available for the benefit of the minor child i.e. the income must be readily available for the use of the minor. Where the income is only credited to the minor's account in the trust to remain there till he attains majority, then, such income is not for the immediate use of the minor. It was held that so long as the beneficiary – minor child receives his share income only on attaining majority, clubbing provisions are not attracted.

Note – Clubbing of minor's income is now covered under section 64(1A) which provides for clubbing of "all such income as arises or accrues" to a minor child. The issue in the current context is whether such income credited to a minor's account to be available for his use when he attains majority would fall outside the ambit of "all such income as arises or accrues" to a minor child under section 64(1A) also.

10

DEDUCTIONS FROM GROSS TOTAL INCOME

1. Should deduction under section 80-IA be allowed on the gross total income in a case where the assessee has been allowed deduction under section 80HHC?

   CIT v. Rochi Ram & Sons (2006) 153 Taxman 338 (Raj.)

   Relevant section: 80-IA

   The assessee-firm, an exporter, claimed deduction under section 80-IA and 80HHC. The issue involved is whether once deduction under section 80HHC was allowed, can deduction under section 80-IA be allowed on the same gross total income. The High Court observed that there is no provision or intention of the Legislature to allow deduction under section 80-IA only on the balance amount remaining after deduction under section 80HHC. In the absence of such an intention, deduction under section 80-IA should be allowed on the gross total income, since the words used in sub-section (1) of section 80-IA, for the purpose of allowing deduction are "gross total income" and not on the balance after making deduction under any section.

   Note – It may be noted that deduction under section 80HHC is not available w.e.f. A.Y.2005-06. Though the issue in this case relates to the amount eligible for deduction under section 80-IA, where a deduction has been claimed under section 80HHC, still this decision is relevant in the current context since the High Court has held that deduction under section 80-IA should be allowed on gross total income and not on the balance after making deduction under any section (and not only section 80HHC).

2. Do the operations of lamination of printed sheets, punching of laminated sheets, and pasting the same with glue for the purpose of making cartons tantamount to a manufacturing process for availing deduction under section 80-IB?

   CIT v. Supreme Graphics Creations (P.) Ltd. (2005) 148 Taxman 67 (Bom)

   Relevant section: 80-IB

   The assessee-company was engaged in the manufacture of printed, laminated and waxed cartons. As part of the process of making cartons, the printed sheets were brought to the factory of the company and laminated to make the surface of the sheets smooth and attractive. Then, the laminated sheets were punched and the punched paper was pasted with glue to convert into a carton. The company claimed deduction under section 80-IB. The Assessing Officer, however, disallowed the deduction opining that such operations do not constitute 'manufacture' and the assessee was not engaged in any manufacturing operations in order to be eligible to claim deduction under section 80-IB. The Tribunal, however, held that the characteristics of the finished goods were totally changed after laminating, corrugating, printing, punching and pasting. Therefore, the assessee was carrying out a manufacturing process for making the laminated cartons. The High Court held that the view taken by the Tribunal was correct and the assessee was entitled to deduction under section 80-IB.

3. Does blending of different qualities of tea, possessing different chemical and physical composition, to produce a specific blend of tea constitute manufacture?

   D.D. Shah & Bros. v. Union of India (2006) 283 ITR 486 (Raj.)

   Relevant section: 80-IB

   The High Court observed that blending of different qualities of tea possessing different chemical and physical composition so as to produce a specific blend of tea does not involve an act of manufacture. The assessee is not a grower of tea and so he cannot be called the producer of tea. Nor is he engaged in manufacture of potable tea from green leaves. Therefore, the assessee is only a trader in tea and not a producer or manufacturer. The High Court held that the expression 'manufactures or produces any article or thing' under section 80-IB(2)(iii) has been used in a generic sense. It does not include any processing of goods, which does not bring out a new or commercially distinct commodity. Blending of different teas by a dealer amounts to processing of tea but falls short of a manufacturing process. Therefore, it does not amount to manufacturing or producing any article or thing within the meaning of section 80-IB.

4. Can income from cold storage be exempt u/s 80P(2)(e), by considering the cold storage as a warehouse or godown where goods are stored?

   CIT v. District Co-operative Federation (2006) 155 Taxman 420 (All.)

   Relevant section: 80P(2)(e)

   On this issue, the High Court observed that the identical question of law appeared in respect of the same assessee relating to an earlier assessment year and the High Court had observed that the terms 'godowns' and 'warehouses' are synonymous and interchangeable. The common parlance meaning which can be attributed to godowns or warehouses is that they must be used for the purpose of storage of goods even for a temporary period.

The High Court had further observed that in a cold storage, vegetables, fruits and several other articles are stored. This can be established from the dictionary meaning of the term "cold storage" as well as from the following decisions -

1. Calcutta High Court in CIT v. Radha Nagar Cold Storage (P.) Ltd. (1980) 4 Taxman 351.
2. Apex Court in Delhi Cold Storage (P.) Ltd. v. CIT (1991) 59 Taxman 144

Thus, by giving a liberal interpretation to the provisions of section 80P(2)(e), cold storage can be treated as a warehouse or godown where fixed temperature is maintained. Therefore, cold storage can be said to be a warehouse or godown where goods are stored, and hence, income from cold storage would be exempt.

11

INCOME-TAX AUTHORITIES

1. Is it necessary that a "proceeding" should be pending against a particular or specified individual for an income-tax authority to exercise the power under section 131(3) to impound and retain any documents produced before it?

   Suman Sehgal v. Union of India (2006) 154 Taxman 195 (Delhi)

   Relevant sections: 131(1)/(1A)/(3)

   On this issue, the High Court observed that section 131(3) which talks of specific power of impounding is expressly subject to the rules framed under section 131(1) or 131(1A). Section 131(1) makes a specific reference to four situations – discovery, production of evidence, issuing commissions etc. Section 131(1A) makes a specific reference to investigation and enquiry. The subsequent specific power of impounding under section 131(3) is expressly subject to the rules framed under section 131(1) or 131(1A). Therefore, the Parliament intended the power to impound to be adjunct and concomitant to the express powers indicated in sections 131(1) and 131(1A). Hence, there should be no distinction drawn between investigation and proceeding. The High Court also observed that, from another perspective of viewing, even an investigation or enquiry is, in broad terms, a proceeding.

   Therefore, the High Court held that for exercise of power under section 131(3) by the income-tax authorities to impound and retain documents, it is not necessary that a "proceeding" should be pending against a particular or specified individual. Such power can be exercised even in case of investigation and enquiry.

2. Does assessee have the choice of asking for a particular officer or a particular place for assessment to be made when power under section 127(2) is to be exercised?

   Sahara Airlines Ltd. v. D.G.I.T (Inv.) North (2006) 152 Taxman 522 (All.)

   Relevant section: 127

   This case is regarding exercise of power under section 127 to transfer a case from one Assessing Officer to another Assessing Officer. In this case, there are several assessees in a group, having their business activities and offices at different places throughout the country, and there is an element of interlacing of funds and intermixing of activities amongst the various entities of the group. In such cases, for proper and just assessment of tax, it is necessary to get the assessment proceedings transferred at any one place under one officer, as found appropriate by the income-tax authorities. The choice of place where the cases are to be transferred is fully within the domain of the transferring authority. The assessee does not have the choice of asking for a particular officer or a particular place for assessment to be made when power under section 127(2) is to be exercised. It is sufficient that the place where the cases are being transferred has sufficient links with the business activities of the group.

12

ASSESSMENT PROCEDURE

1. Can the Assessing Officer infer that income has escaped assessment for the relevant previous year on the basis of defects found in the books of account for the next year?

   Dass Friends Builders (P.) Ltd. v. Dy. CIT (2006) 280 ITR 0077(All.)

   Relevant section: 147

   The Assessing Officer found defects in the books of accounts of the assessee company for the A.Y.1996-97 and made a best judgement assessment by taking 10% of the gross receipts as profit for the P.Y.1995-96. On account of the defects in the books of accounts for the A.Y.1996-97, the Assessing Officer proceeded to reopen the assessment for the A.Y.1995-96 and initiated proceedings under section 147. Accordingly, the Assessing Officer estimated the net profit at the rate of 10% of gross receipts for the P.Y.1994-95 as against the loss shown by the company in its return of income.

   The Allahabad High Court observed that under section 147, the words used are 'has reason to believe' and not 'has reason to suspect'. The material should be relating to the particular year for which the assessment is sought to be reopened. In this case, the escaped income for the relevant year was inferred on the basis of the income of the next year which was determined by way of best judgement assessment due to defects found in the books of account relating to that year. There was no material that some profit was earned in the relevant previous year or that the loss shown in the return was incorrect. The High Court held that in such circumstances, there was no material relating to the assessment year under consideration to show that income has escaped assessment. The basis for reopening of the case is only a presumption and guess work, which does not constitute material to reopen the case.

   Note – This case distinguishes between "reason to believe" and "reason to suspect". "Reason to suspect" may not be on account of sufficient material/information that income has escaped assessment whereas "reason to believe" should be supported by sufficient material (which should relate to the assessment year under consideration) that income has escaped assessment and such reason should be recorded in writing.

2. Is it necessary for the Assessing Officer to actually record the reasons in writing for initiation of proceedings under section 148?

ABP Ltd. v. JCIT (2006) 151 Taxman 161 (Cal.) / (2005) 278 ITR 0627 (Cal.)

Relevant section: 148

The Assessing Officer cannot initiate proceedings under section 148 by simply stating that he had reasons to believe that income has escaped assessment. The exercise of power in this manner would be an abuse of power. It is necessary that the Assessing Officer should actually record the reasons in writing for initiation of proceedings under section 148.

3. Can an assessee claim a particular deduction, which he has failed to claim in his original return of income, otherwise than by filing a revised return?

Goetze (India) Ltd. v. CIT (2006) 284 ITR 323 (SC)

The assessee filed its return of income for the relevant assessment year without claiming a particular deduction. Later on, it sought to claim the deduction by way of a letter addressed to the Assessing Officer. The deduction was disallowed by the Assessing Officer on the ground that there was no provision under the Act to make amendment in the return of income by making an application at the assessment stage without revising the return.

The assessee had relied upon the decision of the Apex court in National Thermal Power Company Ltd. v. CIT (1998) 229 ITR 383, to contend that it was open to the assessee to raise the points of law even before the Appellate Tribunal. In that case, it was held that the Tribunal had jurisdiction to examine a question of law (raised for the first time), which arose from the facts as found by the income-tax authorities and which have a bearing on the tax liability of the assessee.

The Supreme Court held that this decision does not in any way relate to the power of the Assessing Officer to entertain a claim for deduction otherwise than by filing a revised return. Therefore, the assessee can claim deduction only by filing a revised return. The Supreme Court further clarified that the issue in this case is limited to the power of the assessing authority and does not impinge on the power of the Income-tax Appellate Tribunal under section 254.

4. Can a mistake in the application of rate of depreciation be an error apparent on the face of record?

CIT (Central) Kanpur v. J.K. Cotton Spg. & Wvg. Mills Ltd. (2006) 154 Taxman 142 (All.)

Relevant section: 154

In this case, it has been held that the correct rate of admissibility of depreciation is a debatable issue. Such mistake cannot be the subject-matter of rectification proceedings under section 154 and it cannot be said that there was an error apparent on the face of record on this issue in the original assessment order.

5. Does noting in a diary seized constitute sufficient information to form a prima facie opinion that income has escaped assessment?

Ramilaben Ratilal Shah v. CIT (2006) 282 ITR 0176 (Guj)

In this case, the High Court held that noting in a diary seized constitutes sufficient information for the assessing authority to form a prima facie opinion that income has escaped assessment. Reassessment proceedings can, therefore, be initiated on this basis. The High Court also held that excess of the value of property as per the noting in the seized diary, over the value as per books of account is deemed to be the undisclosed income of the assessee, where the explanation given by the assessee was not found to be satisfactory by the assessing authority.

6. Where a method of accounting has been regularly followed by the assessee and accepted by the Tribunal over the years, can the Tribunal change its stand later on, when circumstances remain unchanged?

Lakshmi Vilas Bank Ltd. v. CIT (2006) 154 Taxman 301 (Mad.)

The assessee-bank was dealing with the purchase and sale of Government securities. It had always been treating Government securities as its stock-in-trade and accordingly the profit and loss on sale of Government securities had been assessed as its business income/loss. Further, any depreciation/appreciation in the value of securities at the end of each accounting year, was claimed as deduction/offered as income of the relevant year. This method of accounting was regularly employed by the assessee and accepted by the Department. The Tribunal had also decided the case in favour of the assessee in the earlier years. The High Court observed that in such a case, the Tribunal was not correct in now holding, on identical facts, that the Government securities were held by the assessee as investments/capital assets. Where a method of accounting has been regularly followed by the assessee and accepted by the Tribunal over the years, the Tribunal cannot change its stand later on, when circumstances remain unchanged. The High Court, therefore, held that the bank was entitled to claim deduction on account of fall in the market value of Government securities, which was held by it as stock-in-trade.

13

APPEALS AND REVISION

1. Can failure to initiate penalty proceedings for not obtaining audit report within the specified time render the order of the assessing authority erroneous and prejudicial to the interests of revenue?

   CIT v. Ganeshi Lal Ram Krishna (2006) 154 Taxman 238 (All.)

   Relevant section: 263

   The respondent-firm engaged in execution of civil contract work failed to get its accounts audited and obtain audit report in terms of section 44AB within the specified time. The Income-tax Officer (now, Assessing Officer) completed the assessment but failed to initiate penalty proceedings under section 271B for the firm's failure to obtain audit report within the specified time. The High Court held that failure to initiate penalty proceedings renders the order of the assessing authority erroneous and prejudicial to the interest of revenue. Therefore, notice under section 263 can be issued in such a case.

2. The National Tax Tribunal Act, 2005 has been enacted by the Parliament in pursuance of Article 323B of the Constitution. It came into force with effect from December 28th, 2005. The notified date of establishment of the National Tax Tribunal (NTT) by the Central Government is 6th January, 2006. What is the current status of NTT?

   P.C. Joshi v. Union of India (2006) 282 ITR 39 (Bom.)

   The High Court passed an ad interim order restraining the constitution of the NTT since the contentions raised by the petitioner, an advocate and senior income-tax practitioner, concerned the basic structure of the judicial framework and the Constitution and the same required examination. Interim relief was granted since transferring the pending cases to the NTT and then deciding the validity of the statute would result in unnecessary shifting of the cases back.

14

PENALTIES

1. Where penalty has been imposed for not deducting tax at source, can penalty also be imposed again for non-issuance of TDS certificate or non-filing of TDS return?

   CIT-II v. Sri Ram Memorial Education Promotion Society (2006) 152 Taxman 257 (All.)

   The assessee did not deduct the tax at source in respect of the salary paid to the principal of the school. The Assessing Officer imposed penalty under section 272A(2)(c) and (g). The High Court held that once penalty under section 271C has been imposed on the assessee for not deducting the tax at source, penalty cannot be imposed under section 272A(c) and (g) for non-compliance of the provisions of sections 203 and 206. This is because, in a case where tax has not been deducted at source, the question of issuing the certificate of tax under section 203 or that of filing of return under section 206 would not arise at all.

2. In a case where the Assessing Officer has levied penalty under section 271C for failure to deduct tax at source, is he justified in also levying penalty under section 272A(2)(c) for failure to furnish return under section 206 and under section 272A(2)(g) for failure to furnish certificate of tax deducted at source as per the requirement of section 203?

   CIT vs. Sahara Airlines Ltd (2006) 152 Taxman 646(All.)

   In this case, the High Court held that the provisions of sections 203 and 206 would be applicable only if tax has been deducted at source by the person concerned and he commits default in complying with any of the provisions of section 203 or 206. However, in a case where no tax has been deducted at source, the aforesaid provisions would not be attracted. For failure of the assessee in deducting tax at source, penalty can be imposed upon him under section 271C. Once a person concerned has been subjected to a penalty under section 271C for not deducting tax at source, there would not arise any occasion for levying penalty under section 272A(2)(c) and 272A(2)(g) for non-compliance of the provisions of sections 206 and 203. In other words, in case the tax has not been deducted at source, the question of issuing the certificate of tax deducted under section 203 and that of filing of return under section 206 would not arise at all. Therefore, the question of imposing penalty for violation of the provisions of section 203 and 206 would also not arise.

Note - The principle established in both the above cases is that penalty can be imposed only once in respect of a particular offence. Once such penalty has been imposed, then penalty cannot be imposed again for failure to comply with other provisions consequent to and arising out of such offence in respect of which penalty has already been imposed.

3. Is penalty under section 271B attracted in a case where the audit report is filed after the due date for filing the return of income but before issuance of notice by the Assessing Officer under section 142(1)(i)?

CIT v. K.K. Spun Pipe (2006) 284 ITR 0301 (P&H)

Relevant section: 44AB & 271B

The assessee filed its return after the specified due date for the relevant assessment years under section 139(4). It filed its returns along with the audit reports under section 44AB. The Assessing Officer levied penalty under section 271B for failure on the part of the assessee to file audit reports along with the return of income within the due date for filing return under section 139(1). However, the Tribunal deleted the penalties. The High Court observed that penalty under section 271B was not attracted in this case since the audit report under section 44AB had been obtained on or before the specified date and it was filed along with the return of income under section 139(4) and no notice had been issued to the assessee by the Assessing Officer under section 142(1)(i). Therefore, penalty under section 271B is not attracted in a case where audit report is filed after the due date for filing return of income but before issue of notice by the Assessing Officer under section 142(1)(i).

Note – This case relates to A.Y. 1989-90 and A.Y.1990-91. Section 44AB, as it stood at that time, required the assessee to obtain the tax audit report before the specified date i.e. 31st October. It did not stipulate filing of tax audit report before the specified date. Section 44AB has been amended w.e.f. 1.7.95 requiring the assessee to furnish the tax audit report by 31st October of the relevant assessment year. Penalty under section 271B is attracted for failure to get the accounts audited or furnish tax audit report as required under section 44AB. Therefore, it appears that, in the current context, penalty would be attracted under section 271B if the tax audit report is not furnished before 31st October of the assessment year. However, the Assessing Officer can condone the delay if sufficient cause is shown.

4. Can the Assessing Officer condone the delay in filing of audit report under section 44AB and grant relief to the assessee from payment of penalty under section 271B?

Staywell Hotels (P.) Ltd. v. CIT, Indore (2006) 155 Taxman 603 (M.P.)

Relevant section: 271B

The Assessing Officer issued notice on the assessee imposing penalty under section 271B for late filing of audit report in Form 3CD. There was a delay of two months in filing the said audit report. The assessee offered reason for the delay and claimed that the delay was not intentional.

The High Court observed that compliance of section 44AB is mandatory and its non-compliance within time would attract rigour of penalty under section 271B. However, the expression 'may' used in section 271B confers discretion on the Assessing Officer to impose penalty for non-compliance of section 44AB. If sufficient cause is shown, the Assessing Officer can condone the delay and relieve the assessee from payment of penalty. In the opinion of the High Court, the assessee's explanation in this case was sufficient and ought to have been accepted. The delay in filing the report was not inordinate and explanation was offered for such delay. Thus, there was no deliberate intention on the part of the assessee to delay the filing of report nor was there any intention to evade payment of tax. The non-compliance was merely a technical breach. Therefore, from the facts of the instant case, no case for penalty under section 271B was made out.

5. Is it necessary to file the return of income within the specified due date to avail the benefit of Explanation 5 of section 271(1)(c)?

Surender Paul v. CIT, Chandigarh (2006) 155 Taxman 385 (P&H)

Relevant section: 271(1)(c) – Explanation 5

The search and seizure operation under section 132 was carried out at the premises of the assessee's family and cash, jewellery and other valuables were seized besides other incriminating materials. The assessee made a disclosure under section 132(4) during the course of search. The return of income of the relevant assessment year in question was filed after the due date and tax due to be paid with the return was also not paid. The Assessing Officer completed the assessment of the assessee taking into account the surrendered income and initiated penalty proceedings under section 271(1)(c). The assessee, relying upon Explanation 5 to section 271(1)(c), contended that no penalty was leviable under section 271(1)(c). The Commissioner (Appeals) and the Tribunal upheld the levy of penalty under section 271(1)(c) upon the assessee on the ground that the return of income should have been filed by the assessee within the due date specified under section 139 for the purpose of availing the benefit of Explanation 5 of section 271(1)(c).

The High Court observed that the assessee's case was not covered by any of the two exceptions spelt out in the Explanation 5. The income which was surrendered by the assessee was not disclosed by him in his return of income before the search took place. The return of income for the relevant assessment year in question was not filed within the due date and the tax due thereon was also not paid by the assessee along with the return filed belatedly. Therefore, the levy of penalty under section 271(1)(c) was justified.

6. Are penal provisions under section 271D attracted in a case where a private limited company had accepted a cash loan from its sister-concern, whose proprietor was one of the directors of the company?

CIT v. Idhayam Publications Ltd. (2006) 285 ITR 221 (Mad.)

Relevant sections: 269SS & 271D

The assessee, a private limited company engaged in publication of books, had accepted a cash loan of Rs.2,94,000 from its sister concern. The Assessing Officer was of the opinion that the assessee had violated the provisions of section 269SS. On the basis of this information, the Deputy Commissioner initiated penalty proceedings under section 271D. The assessee contended that there was no loan or deposit. However, the contention was rejected and penalty was imposed. The Tribunal, however, deleted the penalty on finding that the proprietor of the sister concern was one of the directors of the company and there was a running account in his name.

The High Court observed that in order to impose penalty under section 271D, the Revenue has to establish that the transaction was a loan or deposit within the meaning of section 269SS. Under the Companies (Acceptance of Deposits) Rules, 1975, deposit does not include any amount received from a director or a shareholder of a private limited company. The High Court, therefore, held that since the transaction between the assessee and the director-cum-shareholder was not a loan or deposit transaction but was only a current account in nature and no interest was being charged for the said transaction, the Tribunal was justified in deleting the penalty.

7. Can penalty be imposed under section 271(1)(c), where the assessee has surrendered its full income, though at a later stage?

CIT v. S.V. Electricals (P.) Ltd. (2006) 155 Taxman 158 (MP)

Relevant section: 271(1)(c)

In this case, the High Court held that where the assessee has surrendered its full income, though at a later stage, there was no deliberate intention to evade payment of lawful tax by indulging in concealment of true income. When the disclosure was total, even though at a later stage, there was no question of any concealment of income and therefore, no penalty was imposable under section 271(1)(c).

8. Where the Assessing Officer adopted certain income, on the basis of books of account seized from the assessee, can he entertain assessee's request for waiver of penalty under section 271(1)(c)?

   CIT, Trivandrum v. R. Kesavan Nair (2006) 156 Taxman 172 (Ker.)

   Relevant section: 271(1)(c)

   The assessee had declared income of Rs.40,000 from liquor business during the course of search operations. The Assessing Officer adopted income of Rs.3,45,643 on the basis of books of accounts seized and sent a proposal to the assessee requiring him to file objections. The assessee initially raised objections but later on withdrew the objections and agreed for adoption of Rs.3,45,643 as income from liquor business. The assessee also requested that no penalty should be levied. However, the Assessing Officer imposed penalty under section 271(1)(c). The Commissioner (Appeals) confirmed the same while the Tribunal set aside the imposition of penalty.

   The High Court observed that penalty can be imposed once concealment of income is noticed and unearthed. Imposition of penalty does not depend upon the consent or otherwise of the assessee. Therefore, the Assessing Officer was correct in levying penalty.

9. Can penalty be levied where a belated return is filed under section 139(4)?

   Amin Chand Payarelal v. Inspecting Assistant Commissioner, Income-tax (2006) 155 Taxman 633 (SC)

   The issue under consideration is whether penalty can be levied on a belated return filed under section 139(4). The High Court observed that the question as to whether penalty under the erstwhile section 271(1)(a) could be levied on a return filed under section 139(4) was raised before the Supreme Court in Pradip Lamps Works v. CIT (2001) 249 ITR 797. The Supreme Court had held, in that case, that merely because section 139(4) enables the assessee to file his return at any time before the assessment is made, it does not mean that his liability to pay penalty under section 139(4) is removed. In view of the law laid down in Pradip Lamps Works case, the Supreme Court held that penalty could be levied in the instant case under the erstwhile section 271(1)(a).

   Note – Now, penalty is attracted under section 271F for failure to furnish return of income as required under section 139(1) before the end of the relevant assessment year. The time allowed for filing a belated return is upto one year from the end of the relevant assessment year or before the completion of assessment, whichever is earlier. If the belated return under section 139(4) is filed before the end of the relevant assessment year, penalty under section 271F is not attracted. However, if the same is filed after the end of the relevant assessment year, penalty under section 271F is attracted.

15

OFFENCES AND PROSECUTION

1. Can the Department launch prosecution in a case where they have accepted the revised return filed by the assessee, rectifying a mistake in the original return of income?

   K.E. Sunil Babu, Asst. CIT v. Steel Processors and Others (2006) 286 ITR 315 (Karn)

   Relevant sections: 139(5), 276C, 277 & 278

   The return of income filed by respondents Nos.1 to 3 disclosed a sum of Rs.1 lakh as loan taken from the 4th respondent. However, this did not correspond to the entries recorded in the accounts of the 4th respondent. The 4th respondent contended that the entry made by the respondents Nos.1 to 3 was false. The respondents Nos.1 to 3 filed revised returns under section 139(5) on receipt of notice for submitting false returns. The revised returns were accepted by the Department. Thereafter, the Department launched prosecution under sections 276C, 277 and 278. However, the respondents were found not guilty by the Special Court for Economic Offences.

   The High Court observed that since the Department had accepted the revised returns filed under section 139(5), it was clear that there was a bona fide mistake in the original return and there was no element of mens rea. Therefore, the Department cannot launch prosecution under sections 276C, 277 and 278.

16

DEDUCTION, COLLECTION AND RECOVERY OF TAX

1. Can stamp vendors be treated as agents of the Government for marketing stamp papers? If yes, can tax be deducted under section 194H in respect of discount given on sale of stamps by the Treasury to the stamp vendor?

   Kerala State Stamp Vendors Association v. Office of the Accountant-General (2006) 282 ITR 0007 (Ker.)

   Relevant section: 194H

   In this case, the High Court held that stamp vendors cannot be treated as agents of the Government for marketing stamp papers. The discount given on sale of stamps by the Treasury to the stamp vendor is outside the scope of TDS provisions under section 194H.

   The High Court observed that only commission and brokerage are subject to tax deduction under section 194H. Commission or brokerage is paid for services rendered in the course of sale. This implies services rendered by third parties like brokers or agents. It cannot mean services rendered by a buyer because a buyer is not rendering any service except buying. A price discount given by the seller to the buyer cannot be treated as commission or brokerage for services rendered in the course of buying and selling of goods. This is because the act of buying does not constitute rendering of any service. Therefore, stamp vendors cannot be treated as agents of the Government for marketing stamp papers and consequently, TDS provisions under section 194H are not attracted.

2. Would hiring of ships by the assessee, for the purpose of use in its business, amount to a contract for carrying out any work as contemplated in section 194C?

   CIT v. Poompuhar Shipping Corpn. Ltd. (2006) 282 ITR 0003 (Mad.)

   Relevant section: 194C

   The assessee-company was carrying on the business of transporting coal. It entered into a contract with the State Electricity Board for transporting coal from various ports. Since the ships owned by the company were not sufficient for executing the contracts, the company hired ships from other shipping companies and paid hire charges for use of ships. The company did not deduct tax at source under section 194C from payment of hire charges to the shipping companies. Therefore, the

Assessing Officer treated the company as an "assessee-in-default". The High Court held that the hiring of ships for the purpose of using the same in assessee's business would not amount to a contract for carrying out any work as contemplated in section 194C and therefore, payment of hire charges would not attract tax deduction under section 194C.

3. Are TDS provisions attracted in respect of supply of corrugated boxes with some labels printed on them?

   CIT v. Dabur India Ltd. (2006) 283 ITR 197 (Delhi)

   Relevant section: 194C

   The issue under consideration is whether the supply of corrugated boxes with some labels printed on them was a contract for sale and therefore outside the purview of section 194C. The High Court held that printing of the labels on corrugated boxes did not require any special skill or involve any confidence or secrecy. In such circumstances, the predominant object underlying the contract was the sale of goods which took the contract outside the purview of section 194C of the Act.

4. Are tax deduction provisions under section 195 attracted only where the amount paid wholly bears the character of income?

   Headstart Business Solutions (P.) Ltd., In re. (2006) 155 Taxman 639 (AAR – New Delhi)

   Relevant section: 195(1)

   Microsoft Regional Sales Corporation (MRSC), Singapore is a non-resident company having its registered office at Singapore. MRSC entered into a solution provider agreement with the applicant, an Indian company, for supplying packaged business software solutions to it. The product is delivered in physical form through a compact disc accompanied by a software license key which is delivered electronically through e-mail. In this regard, the applicant filed an application under section 245Q(1) to know whether it has any legal obligation to withhold taxes while making payment for the software purchased from MRSC.

   The AAR observed that, on perusal of section 195(1), any person responsible for paying to a foreign company (i) any interest or (ii) any other sum chargeable under the provisions of the Act is required to deduct income-tax at the time of credit to the account of the payee or at the time of actual payment thereof, whichever is earlier. The expression 'any other sum chargeable under the provisions of this Act' would mean a sum on which income-tax is leviable. The provisions of tax deduction at source would apply not only to the amount paid which wholly bears the character of income but would also apply to gross revenue receipts, where the whole sum may not be income or profits of the recipient. This principle was laid down by the Supreme Court in Transmission Corporation A.P. Ltd. v. CIT (1999) 239 ITR 587. Therefore, in view of the provisions of section 195(1), there is a legal obligation on the part of the applicant to withhold taxes while making payment for the software purchased from MRSC.

Note - In this case, the AAR has taken a view that "any other sum chargeable under the provisions of this Act" used in section 195(1) would apply not only to income but also to gross revenue receipts. However, from the words "shall, at the time of credit of such income to the account of the payee" following the above phrase in section 195(1), it appears that the TDS provisions are attracted only in respect of income and not gross receipts.

5. Section 206C casts responsibility on the seller to collect tax at source, inter alia, on sale of alcoholic liquor for human consumption at the rate of 1% of "such amount" received from the buyer in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier. Whether collection of tax at source under section 206C would be on the price of liquor, including excise duty paid for purchase of liquor?

Vinod Rathore vs. Union of India (2005) 146 Taxman 32 (M.P.)

Relevant section: 206C

The question for consideration before the High Court was whether the collection of tax at source under section 206C on the price of liquor shall include the excise duty paid for purchase of liquor. The High Court held that the purchase price would include the excise duty paid by the buyer and collection of tax at source under section 206C on the price of liquor shall include the excise duty paid for purchase of liquor.

6. Are State Government undertakings engaged in manufacturing arrack liable to deduct tax at source in respect of sale of arrack to contractors/buyers for retail vending of arrack in their respective assigned areas?

Excise Commissioner v. Mysore Sales International Ltd. (2006) 286 ITR 136 (Karn.)

Relevant section: 206C

The appellants were State Government undertakings engaged in manufacturing arrack. They conducted public auctions for granting leasehold rights upon contractors/buyers for retail vending of arrack in different areas in the State. The winning bidders in whose favour contracts were awarded were entitled to purchase arrack from the manufacturers and bottling units for sale in retail trade at the rate fixed by the State Government. The appellants submitted that they were not required to collect tax at source as the Excise Commissioner had issued a circular stating that they were not required to collect tax at source from contractors. The High Court held that collection of tax at source from contractors in respect of purchases of liquor was mandatory and the Excise Commissioner was not the competent authority for issuing such circulars. However, relief can be given to the extent tax has been paid by the contractors directly to the Government.

7. Is it necessary that the Assessing Officer should record his reasons in writing for exercising the power to reduce the period for making the payment specified in the notice of demand?

   Agricultural Produce Marketing Committee v. Union of India (2006) 155 Taxman 186 (Delhi)

   Relevant section: 220

   The High Court observed that the legal position regarding the competence of the Assessing Officer to reduce the period for payment of the outstanding dues is clearly stated in section 220. A plain reading of the proviso to section 220(1) makes it clear that while the assessing authority has the power to reduce the period for making the payment specified in the notice of demand under section 156, such reduction must be supported by valid reasons to be recorded in writing. Therefore, whenever the competent authority invokes its powers of reducing the period stipulated under section 220, it must take care not only to pass a proper order but also to support the same by cogent reasons.

   Note – The High Court has built in the principles of natural justice into the provisions of section 220(1), by interpreting that the "reason to believe" as required by the proviso to section 220(1), implies that such reasons should be cogent and should be recorded in writing.

8. Which is the date on which the refund is granted for the purpose of payment of interest under section 244A?

   Rajasthan State Electricity Board v. CIT (2006) 281 ITR 274 (Raj.)

   Relevant section: 244A

   The issue under consideration is whether the expression "the date on which the refund is granted" means the date of service of the refund order. The High Court observed that the words used in clause (a) of section 244A(1) is "refund is granted". Refund is granted the moment the concerned officer has signed the order regarding payment of the interest under section 244A. Interest should be granted till the date when the order regarding payment of interest has been signed.

17

ASSESSMENT OF VARIOUS ENTITIES

1. Can interest be levied under sections 234B and 234C, in the case of assessment of a company on the basis of book profits under section 115JB?

   CIT v. Kwality Biscuits Ltd. (2006) 284 ITR 434 (SC)

   Relevant section: 115JB

   The Supreme Court upheld the decision of the Karnataka High Court that interest is not leviable under sections 234B and 234C, in the case of assessment of a company on the basis of book profits under section 115J (now, section 115JB). This is because the entire exercise of computing income under section 115J can only be done at the end of the financial year, and the provisions of sections 207, 208, 209 and 210 cannot be made applicable until and unless the accounts are audited and the balance-sheet is prepared.

   Note – It may be noted that estimation of profits is required even where income is computed as per the normal provisions of the Income-tax Act. In such a case also, the income is finally determined only after the close of the financial year. When interest under sections 234B and 234C are attracted for default in payment of advance tax and for deferment of advance tax, respectively, where income is computed as per the normal provisions of the Act, it appears that such provisions would be applicable even where the company is assessed on the basis of book profits, since estimation is required in both cases.

2. Would the principle of mutuality apply in a case where an assessee-club rents out the marriage hall owned by it to non-members by making them temporary members only for the purpose of letting out the marriage hall?

   CIT v. Trivandrum Club (2006) 153 Taxman 481 (Ker.)

   The assessee was a private club which provided entertainment to its members by offering accommodation, library, reading room etc. The assessee also earned income by letting out its marriage hall to non-members by making them as temporary members. The assessee contended that the "doctrine of mutuality" would apply in such a case and hence, its income would not be taxable. The High Court observed that the marriage hall was being rented out to non-members by making them temporary members only for the purpose of letting out the marriage hall and the amounts received from the non-members formed part of the income of the assessee-club. The principle of mutuality, therefore, would not apply in such a case.

Note - The concept of mutuality means that the contributors and the beneficiaries are identical. Since one cannot make a profit by dealing with oneself, there is no taxable profit involved wherever such concept applies. In this case, however, the principle of mutuality does not apply since non-members are made temporary members only for the purpose of letting out the marriage hall.

3. Are two separate assessments required where there has been a change in the constitution of the firm during the previous year?

CIT, Lucknow v. Shyam Medical Agencies (2006) 155 Taxman 632 (All.)

Relevant section: 187(2)

In this case, there was a change in the constitution of the firm in October of the relevant previous year on account of retirement of one partner and admission of another. The assessee-firm filed two returns – one for the period from 1st April to October and the other for the period thereafter up to 31st March. The assessee claimed that two assessments should be made. The Assessing Officer took the view that there should be only one assessment in case of change in constitution of the firm and rejected the claim. The Deputy Commissioner (Appeals) and the Tribunal confirmed the view of the Assessing Officer.

Section 187 deals with the change in constitution of the firm. The High Court observed that as per section 187(2), there is a change in the constitution of a firm if one or more of the partners cease to be the partners or new partners are admitted in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners of the firm after the change. Therefore, in view of section 187(2), no new firm is constituted in the instant case and it was a case of change in the constitution of the firm. Hence, there was no need for two separate assessments.

18

INCOME-TAX ON FRINGE BENEFITS

1. Is an employer liable to pay fringe benefit tax even if the income of the employer is not chargeable to income-tax in India?

   Population Council, Inc., In re. (2006) 156 Taxman 125 (AAR-New Delhi)

   Relevant section: 115WA

   The applicant, a non-resident, is a non-profit international organization based in USA. It has regional and country offices in India and is engaged in charitable, scientific and educational activities. The applicant incurs expenses in India, which include fringe benefits provided to the employees, falling under the heads traveling, conference, entertainment, hospitality etc. These expenses are met by remittances from the head office. The applicant contended that it is not liable to pay fringe benefit tax (FBT) under section 115WA since its income is not chargeable to tax in India. The question on which the applicant sought advance ruling of the Authority is whether it is liable to pay FBT under section 115WA on the fringe benefits provided to its employees working in India.

   The AAR observed that section 115WA provides that FBT is in addition to income-tax and it is to be charged to tax even when no income-tax is payable by an employer on his total income computed in accordance with the provisions of the Act. Therefore, it is pointless to contend that no FBT would be payable by the employer, if its income is not chargeable to tax in India. Such an interpretation would be contrary not only to the intention of the Parliament but also to the plain language of the provision and the basic principles of interpretation. The AAR, therefore, ruled that the applicant is liable to pay fringe benefit tax.

WEALTH TAX

1

LEVY OF WEALTH-TAX

1. Can cinema building be treated as a house for the purpose of claiming exemption under section 5(vi)?

   CWT v. Dinesh Kumar (2006) 282 ITR 0271 (All.)

   Relevant section: 5(vi)

   The assessee was a partner in a firm which owned a cinema building. The assessee claimed exemption under section 5(vi) of the Wealth-tax Act, 1957 in respect of his share in the value of the cinema building. The High Court held that cinema building is not a dwelling place and cannot be treated as a house. Exemption under section 5(vi) is available only in respect of a house and not a cinema building.

2. Is a trust created for an unborn child a valid trust?

   CWT (Central), Kanpur v. Rakesh Mohan (2006) 155 Taxman 419 (All.)

   The assessee created a trust for the first son of one Mr. Pankaj Mohan and transferred certain shares to the trust. The Wealth-tax Officer (now, Assessing Officer) included the value of the shares transferred to the trust while making the assessment on the ground that the department found the trust to be invalid since the sole beneficiary was not in existence. The CWT (Appeals) and the Tribunal upheld the validity of the trust and deleted the addition. The High Court observed that the Delhi High Court has held, in CIT v. Brig. Kapil Mohan (2001) 252 ITR 830, that a trust can be created for unborn child also and such a trust is a valid trust. Therefore, the High Court held that the Tribunal was justified in deleting the addition made in respect of the value of the shares transferred to the trust.

2

ASSESSMENT PROCEDURE

1. Can the Assessing Officer refer valuation of assets to the Departmental Valuation Officer for the purpose of making an assessment in a case where no return of wealth has been filed by the assessee?

   CWT v. Anil Tayal (HUF)(2006) 285 ITR 243 (P & H)

   Relevant section: 16A

   The issue in this case is whether the Assessing Officer has the power to refer valuation of assets to the Departmental Valuation Officer for the purpose of making an assessment in a case where no return of wealth has been filed by the assessee. The High Court observed that the object of section 16A of the Wealth-tax Act, 1957 is to enable the Wealth-tax Officer (now, Assessing Officer) to refer the issue relating to the value of any asset to a Valuation Officer for the purpose of making assessment. The expression "in any other case" in clause (b) of section 16A(1) is wide enough to include a case where no return has been filed by the assessee. If a narrow view is taken that a reference under section 16A(1) can be made only where the return has been filed, then the expression "in any other case" in clause (b) of section 16A(1) and the expression "where no such return has been made" in sub-section (4) of section 16A would become redundant. Therefore, a reference under section 16A(1) could be made even where no return has been filed by the assessee under section 14 or section 15.

CENTRAL EXCISE

1

BASIC CONCEPTS

1. Whether cutting/slitting of jumbo rolls of toilet/tissue paper constitutes manufacture when the end product and the jumbo rolls fall in different tariff headings?

   CCEx. New Delhi – I v. S.R. Tissues Pvt. Ltd. 2005 (186) ELT 385 (SC)

   The assessee was engaged in the activity of cutting/slitting of jumbo rolls of toilet/tissue paper of a width exceeding 36 cms. The jumbo rolls were purchased on payment of excise duty from various suppliers. The process undertaken by the assessee reduced the width of the jumbo rolls to less than 36 cms. The rolls with width exceeding 36 cms and with width less than 36 cms were covered under different tariff headings. The excise department contended that such reduction of width resulted in manufacture. The excise department assessed and demanded duty from the assessee on the basis of the heading covering jumbo rolls of width less than 36 cms.

   The Supreme Court held that slitting/cutting of jumbo rolls of plain toilet/tissue paper into smaller size would not amount to manufacture as its character and end-use viz., household purposes, have not undergone any change on account of winding, cutting/slitting and packing. Further, slitting and cutting of toilet paper could not be termed as deemed manufacture as the said process has not been treated as manufacture by the legislature under any of the Section/Chapter Notes of the Central Excise Tariff.

   The Apex Court elaborated that mere mention of a product in a tariff heading would not necessarily imply that said product has been obtained by process of manufacture. Just because raw material and finished product come under two different headings, it could not be presumed that process of obtaining finished product from such raw material automatically constitutes manufacture. Therefore, slitting/cutting of jumbo rolls of toilet/tissue paper into various shapes and sizes would not amount to manufacture merely because toilet/tissue paper in jumbo roll of size exceeding 36 cms. fall in one entry and toilet/tissue roll of a width not exceeding 36 cms. fall in a different entry. The Supreme Court further explained that value addition on account of transport charges, sales tax, distribution and selling expenses and trading margin without any change in name, character or end-use by mere cutting/slitting of jumbo rolls could not constitute the criteria to decide what is "manufacture".

2. Does printing/decorating of duty paid plain glazed ceramic tiles amount to manufacture?

CCEx. & Cus. Gujarat v. Pan Pipes Resplendents Ltd. 2006 (193) ELT 129 (SC)

It was held by the Apex Court that printing/decorating of duty paid plain glazed ceramic tiles would not amount to manufacture as it does not change the basic character of glazed tiles.

The Supreme Court stated that manufacture implies a change but every change is not a manufacture yet every change in an article is a result of some treatment, labour and manipulation. Therefore, for manufacture, there must be transformation and a new article must be produced having a distinct name, character or use.

3. Does polishing of tiles result in the manufacture of glazed tiles?

CCEx. & Cus. , Mumbai v. Bell Granito Ceramica Ltd. 2006 (198) ELT 161 (SC)

Polishing of tiles would not amount to manufacture of glazed tiles as glazed tiles are normally not polished at all. Glazed tiles are produced when a coating of melted glass is applied on the surface of the body of tiles. Thus, mere fact of polishing would not lead to the conclusion that the tiles are glazed.

The Supreme Court also explained the difference between vitrification and glazing in this case. Vitrification is a process to which ceramic body is subjected before it is made, while glazing is a process to which said body is subjected after being made.

4. Does mere packing of excisable goods (so as to make them marketable) amount to manufacture for the purpose of Note 5 to Chapter 30 of the Central Excise Tariff?

CCEx., Mumbai v. Johnson & Johnson Ltd. 2005 (188) ELT 467 (SC)

The assessee imported medicines in pallets with one big box containing assorted medicines in smaller units. These smaller units were then repacked in thermocole boxes of different sizes which were again put into cardboard boxes. The cardboard boxes were then taken to the assessee’s warehouses where stickers were affixed to them containing information like names and addresses of importers, maximum retail price, net weight etc. The department relying upon Note 5 to Chapter 30, claimed that the activities as aforesaid i.e., bulk packs to retail packs resulted in manufacture.

The Supreme Court held that merely packing for being marketed would not amount to manufacture for the purpose of Note 5 to Chapter 30 of the Central Excise Tariff. The products would have to be repacked from bulk packs to retail packs so as to make them marketable to the consumer for the activity to be termed as ‘manufacture’. The Apex Court stated that the medicines were imported as ready to market retail packs which were then affixed with stickers containing certain information. In the opinion of the Supreme Court, there was no evidence of assessee indulging in any further activity which required packing or repacking of bulk packs into retail packs within the extended meaning of the manufacture.

Note: Note 5 to Chapter 30 reads as follows:

"In relation to products of Heading No. 30.03, conversion of powder into tablets or capsules, labelling or relabelling of containers intended for consumers and repacking from bulk packs to retail packs or the adoption of any other treatment to render the product marketable to the consumer, shall amount to 'manufacture'.

5. Whether the process of printing of cotton bed sheets, pillow covers and bed covers be considered as an integral part of the manufacture of such bed sheets etc.?

Impression Prints v. CCEx., Delhi-I 2005 (187) ELT 170 (SC)

Notification No. 65/87-C.E. grants exemption to "made-up textile articles" only "if they are made without aid of power". Bed sheets, bed covers and pillow cases were manufactured by the assessee from cotton fabrics without the use of power. However, for printing such bed sheets, bed covers and pillow cases, colours were mixed with help of colour mixing machine which was operated with the aid of power. The issue under consideration was that whether in such a case the manufacture could be considered to have taken place without the aid of power.

The Supreme Court observed that to decide that whether any particular process/activity would be covered under the expression "made with the aid of power", it is to be seen that whether the activity is so integrally connected to the production of ultimate goods that without undertaking that process, the manufacture would be impossible or commercially inexpedient. The Apex Court stated that the activity of printing and colouring is so integrally connected to the production of ultimate goods that but for this activity, manufacture of printed bed sheets, bed covers would not be possible. Therefore, the Apex Court held that the benefit of notification would not be available to the assessee.

The Supreme Court further elaborated that the words "if made without aid of power" in Notification No. 65/87-CE have the same meaning as "in the manufacture of which no power is used".

6. Does doubling or multifolding of single ply yarn amount to manufacture?

New Shorrock Mills v. CCEx. and Cus., Vadodara 2006 (202) ELT 192 (Tri.-LB)

The Large Bench of the Tribunal held that doubling or multifolding of duty paid single yarn would not amount to manufacture. The Large Bench of the Tribunal relied upon the decision of the Apex Court in the case of Banswara Syntex Ltd. 1996 (88)ELT 645 wherein it was held that a single ply yarn was first manufactured and thereafter it was doubled or multifolded, depending upon the type of fabric to be woven. The liability to pay excise duty arose on the manufacture of the single ply yarn and not after the same had been doubled or multifolded. The stage of levy of excise duty in such cases was the single yarn stage.

As regards the fact that doubled or multifolded yarn were completely exempt from the payment of duty vide an exemption notification, the Large Bench of the Tribunal held that mere mention of an item in the notification was not determinative of its excisability.

7. Whether PSC girders are marketable goods?

Asian Techs Ltd. v. CCEx., Pune –II 2005 (189) ELT 420 (Tri-LB)

The issue under consideration was that whether PSC girders manufactured at site by the appellants for the construction of bridge were marketable goods attracting excise duty and whether they were exempt under Notification No. 59/90-C.E., dated 20.03.1990 when the notification referred to buildings and not bridges.

The Large Bench of the Tribunal observed that the PSC girders were not manufactured at site but in casting yard and were then removed from there for being launched on sub-structure i.e. piers which showed that PSC girders were capable of being transported from one place to another and hence, capable of being marketed.

As regards the exemption, the Tribunal held that buildings and bridges were different from each other and thus, benefit of exemption under Notification No. 59/90-CE dated 20.03.1990 would not be available to PSC girders as they were not manufactured at the site of construction of buildings.

8. (a) Whether structures and parts of structures of the types illustrated in Heading 73.08 are liable to excise duty if they are fixed permanently in immovable iron and steel structures?

(b) Whether plates, rods, angles, shapes, sections, tubes etc. prepared for use in structures of iron or steel are liable to excise duty?

Mahindra & Mahindra Ltd. v CCEx. 2005 (190) ELT 301 (Tri-LB)

The Large Bench of the Tribunal held that:

(i) The immovable iron and steel structures not being goods would not fall under the Heading 73.08 of the Excise Tariff.

(ii) The structures or parts thereof mentioned in the Heading 73.08 like bridges and bridges-sections, lock-gates, towers, trusses, column frames etc. and the like articles in their movable state would be subject to excise duty under the Heading 73.08, notwithstanding their getting permanently fixed in the iron and steel structures.

(iii) The plates, rods, angles, shapes, sections, tubes, and the like prepared for use in the structures of the types covered under the Heading 73.08, as aforesaid, would also be excisable goods subject to duty in their pre-assembled or disassembled state.

Note: The Tariff Heading 73.08 reads as under:

"73.08		Structures (excluding prefabricated buildings of Heading No. 94.06) and parts of structures (for example, bridges and bridge sections, lock-gates, towers, lattice masts, roofs, roofing, frameworks, doors and windows and their frames and thresholds for doors, shutters, balustrades, pillars and columns) of iron or steel; plates, rods, angles, shapes, sections, tubes and the like, prepared for use in structures, of iron or steel.
7308.10	–	Bridges and bridge-sections
7308.20	–	Towers and lattice masts
7308.30	–	Doors, windows and their frames and thresholds for doors
7308.40	–	Props and similar equipment or scaffolding, shuttering or pit-propping
7308.90	–	Other"

9. Packing material in which inputs are received is not a manufacturing waste and thus, would not be liable to excise duty. [Apollo Tyres Ltd. v. CCEx., Vadodara 2005 (185) ELT 183 (Tri.-Del.)]

Note: The Central Excise Tariff Act, 1985 has now been amended by the Central Excise Tariff (Amendment) Act, 2004 which came into force from 28.2.2005 vide Notification No. 6/2005-Central Excise (N.T.) dated February 24, 2005. It is now aligned with the 8 digit Customs Tariff. It should be kept in mind that case no. 4 and 8 reported above relate to the period prior to such amendment. Therefore, it may be possible that the Headings, Entries and Notes cited in the said cases may not co-relate with the Headings, Entries and Notes in the present Tariff.

2

CLASSIFICATION OF EXCISABLE GOODS

1. How will the rubberised coir mattresses be classified: as a product of rubber industry or as a product of coir industry?

   CCEx., Chandigarh v. Regal Industries Ltd. 2006 (200) ELT 513 (SC)

   Rubberised coir mattresses and cushion would be treated as products of the coir industry. To run a coir or rubber industry, a licence has to be taken from the Coir Board or the Rubber Board, as the case may be. The Apex Court held that since the assessee was functioning under a licence granted by the coir board and its coir mattresses contained more than 50% (in this case 55.5%) coir, it would be deemed to be a coir industry.

2. How should the fan regulators cleared as such be classified: as parts/accessories of fan or as fans?

   North West Switchgear Ltd. v CCEx., New Delhi 2006 (195) ELT 134 (SC)

   Fan regulators which are not cleared with electric fan but are cleared as such would be classifiable as parts/accessories of fan under sub-heading 8414.99 of the Central Excise Tariff and not under sub-heading 8414.20 ibid covering fans. The Supreme Court held that if regulators have to be classified under 'electric fans' whether sold with fan or separately, then no part or accessory would be covered under sub-heading 8414.99 ibid.

   Note: The Central Excise Tariff Act, 1985 has now been amended by the Central Excise Tariff (Amendment) Act, 2004 which came into force from 28.2.2005 vide Notification No. 6/2005-Central Excise (N.T.) dated February 24, 2005. It is now aligned with the 8 digit Customs Tariff. It should be kept in mind that the case reported above relates to the period prior to such amendment. Therefore, it may be possible that the sub-heading cited in the above case may not co-relate with the sub-heading in the present Tariff.

3

VALUATION OF EXCISABLE GOODS

1. Can advertising expenses incurred by an agency of the bottlers to advertise aerated products manufactured by them be included in the assessable value of the concentrates (of such aerated products) manufactured by the assessee?

   CCEx., Mumbai-I v. Parle International Ltd. 2006 (198) ELT 486 (SC)

   The assessee manufactured concentrates of non-alcoholic beverages and sold it to various bottlers. The bottlers after processing the concentrate, bottled the outcome and sold the same. Under the agreement between the bottlers and the assessee, the assessee was required to advertise the finished products. However, subsequently 'Soft Drinks and Advertising Marketing Services Pvt. Ltd.' (SAMS) was set up by the bottlers as a centralized agency for advertising finished products of the bottlers. The shareholders of SAMS were the representatives of the bottlers and its Directors were also representatives of the bottlers.

   The Apex Court held that advertisement expenses incurred by 'Soft Drinks and Advertising Marketing Services Pvt. Ltd.' to advertise aerated products manufactured by third party bottlers would not be includible in the assessable value of concentrates manufactured by the assessee, as only the advertisement and sales expenses incurred for the goods under assessment (here concentrate) could be added to the assessable value.

2. Whether the cost of bought out items viz. sockets, which are fitted to m.s./g.i. pipes before their removal from the factory gate, is includible in the assessable value of the pipes?

   Siddhartha Tubes Ltd. v. CCEx., Indore (M.P.) 2006 (193) ELT 3 (SC)

   The Apex Court held that the cost of bought out items viz. sockets which are fitted to m.s./g.i. pipes before their removal from the factory gate would be includible in the assessable value of the pipes. The reason for the inclusion being the essentiality of the sockets for the functioning of the pipes as these sockets join the pipes to each other. Further, the Apex Court stated that the service charges paid to the selling agent (here Madhya Pradesh Laghu Udyog Nigam Ltd.) for supplying the pipes to various buyers (here departments of the State Government) would also be includible in the assessable value because they are not in the nature of trade discount. The Apex Court explained that trade discount would be admissible as a deduction only if it is given to a customer or the trader.

3. Whether the cost of galvanization should be included in the assessable value of the

galvanized pipes?

Siddhartha Tubes Ltd. v. CCus. & CEx., Indore (M.P.) 2006 (193) ELT 6 (SC)

The Supreme Court held that galvanization cost would be includible in the assessable value of m.s. galvanized pipes even though galvanization does not amount to manufacture as the concept of valuation is different from the concept of manufacture. In the instant case, the process of galvanization took place before product was cleared from the place of removal. Galvanization added to the quality of the product and increased the value of pipes. The Apex Court held that the cost of the process of galvanization, being incidental to the manufacture of pipes would therefore, be includible in the assessable value of the pipes.

4. When should the valuation rules be resorted to?

CCEx.-II, Chennai v. Beacon Neyrpic Ltd. 2006 (193) ELT 16 (SC)

The Apex Court held that the assessee being related to its subsidiary company, by itself would not be sufficient to invoke Valuation Rules. The Department has to go further and show that relationship has introduced an element other than purely commercial consideration in effecting the sale by the assessee to the subsidiary company.

5. Whether the benefit derived from the surrendering of an advance license by the buyer in favour of the seller can be treated as additional consideration?

CCEx. Bhubaneshwar-II v IFGL Refractories Ltd. 2005 (186) ELT 529 (SC)

The assessee sold refractories to Visakhapatnam Steel Plant (VSP) under a contract at a particular price. For the supply of refractories, the assessee availed the duty exemption scheme contained in the Export and Import Policy. In order to enable the assessee to avail the duty exemption scheme, VSP surrendered the advance licences held by them for import of refractories.

Against such surrender, advance intermediate licences for import of inputs were issued to the assessee. Consequently, the assessee imported the inputs without payment of customs duty as well as got them at a lower price than what they would have paid, had they purchased the same in India. The excise department claimed that the benefit derived by the assessee under the advance intermediate licence, issued to them as a result of surrender of licence by VSP, was additional consideration towards the value of the refractories and that this additional consideration formed part of the price of the refractories for purposes of excise duty.

The Supreme Court observed that surrendering of licences by the buyer and consequent acquiring of the licences by the assessee had nothing to do with any Import and Export policy. This was directly a matter of contract between two parties which had resulted in additional consideration by way of “advance intermediate licence” flowing from buyer to the assessee. The Apex Court stated that had the seller procured the advance intermediate licence on its own i.e. without the buyer having to surrender its licence for the purposes of the contract, then there would have been no additional consideration. However, since the licence was obtained in pursuance of the contract of sale, there was directly a flow of additional consideration from the buyer to seller. Thus, the Supreme Court held that the value thereof had to be added to the price of the refractories.

The Apex Court further clarified that where parties take advantage of policies of Government and benefits flow therefrom, then such benefit could be treated as additional consideration.

6. When can the advertisement expenses (that are born by the buyers) be included in the assessable value?

   Alembic Glass Industries Ltd. v. CCEx. 2006 (201) ELT 161 (SC)

   On account of a prolonged strike in the factory of the appellant, it was decided to cut down expenditure incurred on labour, packing, inventory advertising etc. One of the bulk buyers of the appellant's products started advertising the products purchased from the appellant in order to boost its sales. The department contended that the appellant had gradually transferred the expenditure on sales promotion/advertisement of its products to the said buyer and thus, such expenditure should be treated as additional consideration and should be included in the assessable value of the appellant's products.

   The Supreme Court observed that where advertisement cost is incurred by the manufacturers/customers compulsorily or mandatorily and where manufacturer has enforceable right against the customers to insist on incurring of such advertisement expenditure by the customers, the advertisement cost would be includible in the assessable value. The Apex Court stated that in the instant case there was no finding recorded by the CEGAT that the appellant had any enforceable legal right. However, circumstances under which the buyer gave an assurance of bulk purchase and commenced advertising the appellant's product indicated that it was a package outlay for the revival of the appellant's factory arrived at between them as a part of cost reduction exercise of the appellant. There was no material before that CEGAT to conclude that there was any tacit understanding between the appellant and the buyer. The factual position showed that the transaction was on principal to principal basis. Hence, the Supreme Court held that there was no scope for making any addition in the assessable value.

7. Whether the value of price support incentives received from the raw material supplier should be included in the assessable value of the final products?

   CCEx., Meerut-I Bisleri International Pvt. Ltd. 2005 (186) ELT 257 (SC)

   The assessee manufactured aerated waters and sold the same to the wholesale dealers. The rent equivalent to interest was collected by the assessee on account of delay in returning of empty crates/bottles from some wholesale dealers. Further, it received price support incentive in the form of credit notes from the raw material supplier. The department contended that the assessee had undervalued the assessable value of the aerated water by excluding the rent on containers (ROC) and the value of price support incentive and thus, they should be included in the assessable value of the aerated water.

The Supreme Court observed that as per the department, the actual price was lower on account of the incentives given by the raw material supplier. However, the adjudicating authority as well as the Tribunal found that the prices had to be reduced by the assessee on account of competition in the market. The Apex Court stated that there was no evidence of flow back of any additional consideration from the buyers of aerated water to the assessee. The evidence on record indicated that the price uniformity was maintained. No favour for extra commercial reasons was shown to any of the buyers of the aerated water. There was no evidence of any concession to any of the buyers or existence of any favoured buyers. Thus, the Supreme Court held that the value of the price support incentives would not be includible in the assessable value of the aerated water.

As regards the ROC, the Apex Court observed that the purpose of charging interest was to get back empty bottles/crates immediately as otherwise the assessee was required to make additional investment towards stock inventory on crates/empty bottles. Further, the said levy did not form part of the price of the aerated water and, therefore, ROC was not includible in the assessable value.

8. Whether subsidy received from the buyer as per the policy of the Government is includible in the assessable value as additional consideration?

CCEx., Bangalore v. Mazagaon Dock Ltd. 2005 (187) ELT 3 (SC)

The assessee received 20% subsidy from the Government and 10% subsidy from the buyer of its products as per the policy of the Government. It was contended by the Revenue that the value of these subsidies should be included in the assessable value of the final product.

The Supreme Court observed that where price was not the sole consideration, the amount in money value of any additional consideration was includible in the value of the excisable goods. However, the additional consideration must flow directly or indirectly from the buyer to the assessee. The Apex Court stated that the subsidy of 20% from the Government could not be said to be additional consideration as it was not received from the buyer either directly or indirectly. Therefore, that would not be includible in the price of the goods for the purposes of excise. However, the 10% subsidy received by the assessee from the buyer was additional consideration. The fact that it was received under a policy of the Government did not detract from the above position.

9. Whether the principle of valuation enunciated in the case of Ujagar Prints can be applied in the case of related job worker too?

CCEx., Indore v. S. Kumars Ltd. 2005 (190) ELT 145 (SC)

The assessee used to process grey fabric on its own account as well as the grey fabrics that were received from others (the merchant manufacturers) on job charge basis. The excise duty on grey fabrics processed by its own account was paid on the value at which the merchant manufacturer was selling the processed goods. For paying excise duty on the grey fabrics received from the merchant manufacturers, the assessee used to value the processed goods on the basis of the cost of grey fabrics plus the processing charges as well as its manufacturing expenses and profits. In other words, the price at which the merchant manufacturer was selling the processed goods was not taken. This was done relying upon the Supreme Court's decision in Ujagar Prints 1989 (39) ELT 493 (S.C.).

A duty demand was raised against the assessee on the ground that the assessee and the merchant manufacturers were all firms and companies having a common management and control. Some of these group firms or companies sold grey fabric to the assessee who, after processing the fabrics, sold the same to some of the other group firms or companies. The latter ultimately sold the processed fabrics to independent dealers. The department claimed that the price charged by the trader firms or companies from the independent dealers should be the assessable value of the processed fabrics.

The Supreme Court observed that 'deemed price' principle of Ujagar Prints 1989 (39) ELT 493 (S.C.) does not apply to processor who is not independent. In other words, it applies only in cases where job work is done for an unrelated raw material supplier. In this case, the merchant manufacturers and the purchasing traders were merely extensions of the processor (assessee). The processor was not a mere processor but also a merchant manufacturer who purchased/manufactured the raw material, processed it and sold it himself in the wholesale market. In such a situation, the profit was not that of a processor but of a merchant manufacturer and a trader.

Thus, where the raw material supplier and the job worker are 'related persons' as defined in section 4, then valuation of the processed goods would be made on the basis of the price at which the raw material supplier sells the processed goods (after receiving them from the job-worker) to the unrelated buyer.

Note: Though this judgement is on the basis of erstwhile section 4 and valuation rules thereof, the principle of this judgement may apply to new section 4 also.

10. Will administrative charges collected from the buyer and paid to the Government be included in the assessable value?

CCEx., Lucknow v. Chhata Sugar Co. Ltd. 2004 (165) ELT 369 (SC)

The assessee collected administrative charges from the buyer for selling the molasses as per the State Government Act. The amount collected was paid over to the Government. The Supreme Court held that such charges were in the nature of a tax and hence, would not be includible in the assessable value.

11. In a case where significant sales are made to unrelated persons at the same price at which goods are sold to a related person, can that price be considered for the purpose of valuation?

    CCEx., Mumbai v. Universal Luggage Mfg. Co. Ltd. 2005 (190) ELT 3 (SC)

    When significant sales are made to unrelated persons at same price at which goods are sold to related person, no special consideration to related person could have been involved and thus, that price could form basis of valuation.

12. Should the pre-delivery inspection and after-sale service charges received by a dealer be included in the assessable value of the automobiles produced by the manufacturer?

    Maruti Udyog Ltd. v CCEx. Delhi-III 2004 (170) ELT 245 (Tri.-Del.)

    The appellant M/s. Maruti Udyog Limited (MUL) manufactured automobiles. They sold the automobiles produced by them to dealers at ex-factory prices. They had also fixed maximum selling price for re-sale of the products in retail to customers. The dealers could not exceed those maximum selling prices while selling the automobiles to retail buyers. The dealership agreement stipulated that the dealer should provide pre-delivery inspection (PDI) and after-sale service to vehicles. The dealers' commission included charges for PDI and after-sale service.

    The Tribunal observed that the money value of any additional consideration flowing directly or indirectly from the buyer to the assessee should be added to the transaction value to find out the aggregate value of the goods. The Tribunal held that since pre-delivery inspection and after-sale service charges were received by the dealers from the buyers of cars and were not paid/payable to the manufacturer or any person on his behalf, they would not be includible in the assessable value of the automobiles.

13. Excess collection of insurance charges on account of collection on average basis would not be taxable as value of goods. [Rama Vision Ltd. v. CCEx., Meerut 2005 (185) ELT 296 (Tri.-Del.)]

14. In cases where price is reduced due to non-completion of contract within contracted time, the assessable value would be computed according to the reduced rates as delivery is made in terms subsequently agreed upon. [Jaiswal Equipments and Holdings Pvt. Ltd. v CCEx., Raipur 2005 (185) E.L.T. 306 (Tri. - Del.)]

15. Transportation charges collected in excess of that agreed upon would not be additional consideration if the contract for the same is separate. [PSL Ltd. v. CCEx., Daman 2005 (185) ELT 59 (Tri. – Mumbai]

4

CENVAT CREDIT RULES, 2004

1. Whether a ropeway which connects the mines with the factory is entitled to CENVAT/MODAVT credit?

   CCEx., Nagpur v. Manikgarh Cement Ltd. 2005 (190) ELT 7 (SC)

   Relying upon its decision in the case of Birla Corpn. Ltd. v. Commissioner 2005 (186) ELT 266 (S.C.) wherein it was held that spares of ropeway used for transporting crushed limestone from mines located 4.2 kms away to factory were entitled to MODAVT credit, the Supreme Court allowed the MODVAT credit on the ropeway.

2. Is it necessary for availing credit that the inputs be used within the factory?

   Vikram Cement v. CCEx., Indore 2006 (194) ELT 3 (SC)

   The Supreme Court held that CENVAT credit on inputs being explosives used for blasting mines to produce limestone for use in manufacture of cement/clinkers in factory situated at some distance away from mines could not be denied on the ground that they were not used as inputs within the factory.

   Note: The above-mentioned decision overrules the contrary opinion of the Supreme Court in the case of J.K. Udaipur Udyog Ltd. 2004 (171) E.L.T. 289 (SC). In this case, the credit on explosives used for blasting mines was disallowed on the ground that the same were not used within the factory but in a mine which could not qualify to be a factory.

   Further, it may be noted that in Vikram Cement v. CCE 2006 (197) ELT 145 (SC), it has been held that CENVAT credit is available only when mines are captive mines i.e. they constitute one integrated unit with the main cement factory. Credit would not be available if the supplies from the mine are made to various cement factories of different assessees.

3. Whether assimilation or actual consumption of capital goods into final products is necessary for claiming credit?

   CCEx., Pune v. Indian Seamless Steels & Alloys Ltd. 2005 (190) ELT 12 (Bom.)

   Pipes and tubes used to carry water for cooling inert sphere in a plant would be entitled to MODVAT credit as capital goods, as they are used in the manufacture of final products. The High Court held that only user test would be required to be satisfied to find out that whether a particular goods could be treated as capital goods. Assimilation of or actual consumption of capital goods into final product would not be warranted.

4. Can the unutilised credit be refunded in the event of closure of the factory?

Union of India v. Slovak India Trading Co. Pvt. Ltd. 2006 (201) ELT 559 (Kar.)

The assessee stopped production due to the closure of its factory and thus came out of the MODVAT scheme. The assessee filed a refund claim in respect of the unutilised MODVAT credit.

The High Court allowed the refund claim on the premise that erstwhile rule 5 of the CENVAT Credit Rules, 2002 did not expressly prohibit refund of unutilised credit where there was no manufacture in the light of closure of the factory. Moreover, the High Court stated that the erstwhile rule 5 could not be used in this case as it referred to a "manufacturer" and there was no "manufacturer" here as there had been no manufacture on account of the closure of the factory. Further, the assessee had also come out of the MODVAT scheme.

Note: The principle pronounced in this judgement may hold good in the new scheme of the CENVAT Credit Rules, 2004 as well.

5. Can the excise duty debited in the CENVAT account be refunded in cash, when the refund becomes otherwise due?

Gauri Plasticulture (P) Ltd. v. CCEx., Indore 2006 (202) ELT 199 (Tri.-LB)

Where on account of objection raised by the department or actions taken by them by way of initiation of proceedings, the CENVAT credit could not be utilized (it has been debited) and the duty has to be paid in cash or out of PLA or duty has to be paid out of CENVAT account at the department's insistence, such credit should be reinstated in the CENVAT account for future clearances, on the dispute being ultimately settled in the assessee's favour.

The Large Bench of the Tribunal pointed out that in such a case the refund is not of the unutilised credit, but the credit which has been used for payment of duty at the insistence of the revenue or has been reversed because of the department's view that the same is not available for utilisation.

However, if the assessee is not able to utilize such credit on account of any reasons e.g. closure of his factory or final products being exempted etc., the refund of the same would be admissible in cash to the extent of payment of duty in cash during that period. The Large bench of the Tribunal stated that there is no bar in the credit rules for allowing refund of such credit in cash. However, if no cash payments towards duty were made through PLA and the credit would have remained unutilized in account books, such refund of credit could not be allowed by way of cash.

Note: It may be noted that the judgement in case no. 4 has been given in respect of an entity which had closed its operations. However, the decision in the present case is in respect of a going concern.

6. Should the credit be reversed when capital goods are cleared after use?

Madura Coats (P) Ltd. v CCEx., Tirunelveli 2005 (190) ELT 450 (Tri.-Bang.)

The Tribunal held that erstwhile rule 3(4) of CENVAT Credit Rules, 2002 [rule 3(5) of CENVAT Credit Rules, 2004] applied only to capital goods removed as such. It did not apply to removal of capital goods after use. Hence, duty was required to be paid when used machinery was sold.

Rule 3(5) of CENVAT Credit Rules, 2004 inter alia lays down that when inputs or capital goods, on which CENVAT credit has been taken, are removed as such from the factory, or premises of the provider of output service, the manufacturer of the final products or provider of output service, as the case may be, shall pay an amount equal to the credit availed in respect of such inputs or capital goods and such removal shall be made under the cover of an invoice referred to in rule 9.

Note: As per rule 3(5A) of CENVAT Credit Rules, 2004, if capital goods are removed as waste and scarp the manufacturer has to pay an amount equal to the duty leviable on transaction value.

5

DEMAND, ADJUDICATION AND OFFENCES

1. Whether the failure to declare the particulars amounts to misdeclaration or willful suppression under section 11A?

   Pahwa Chemicals Private Ltd. v. CCEx., Delhi 2005 (189) ELT 257 (SC)

   The issue involved in the case was that whether the department was entitled to invoke the extended period of limitation under section 11A. The assessee used to label its products with a foreign brand name and claimed exemption under a notification. The classification list of the assessee was approved by the department after carrying out verification and all returns were regularly filed. The invoices containing description of goods were also regularly approved by the department. The department denied the benefit of exemption to the assessee by invoking extended period of limitation under section 11A on the ground that it failed to declare the particulars regarding affixing of labels.

   The Supreme Court held that mere failure to declare the particulars would not amount to misdeclaration or wilful suppression. Some positive act on the part of the assessee to establish either wilful misdeclaration or wilful suppression is must. The Apex Court held that there was no wilful misdeclaration or wilful suppression as all the facts were within the knowledge of the department and the assessee did not make the declaration on the belief that affixing of a label made no difference. The Apex Court stated that since all the facts were within the knowledge of department, hence extended period of limitation was not invokable.

2. Who will be given preference while recovering the dues: central excise department or secured creditors?

   CCEx., Pondicherry v. Indian Bank 2006 (198) ELT 334 (Mad.)

   In view of the law laid down by the Apex Court in Dena Bank v. Bhikhabhai Prabhudas Parekh & Co. (2000) 5 SCC 694, while recovering the dues, the central excise department would have precedence over the secured creditors.

3. Can the advocates or legal advisers be penalized for clandestine removal of goods by their client company?

   Jayantilal Thakkar & Company v. Union of India 2006 (195) ELT 9 (Bom.)

   Advocates or legal advisers or auditors of company could not be alleged or presumed to handle muchless deal with excisable goods as contemplated under section 9(1)(bbb) of the Central Excise Act (or erstwhile Rule 209A of the Central Excise Rules, 2001) while discharging their professional duties. Thus, the High Court held that they would not be liable to penalty for clandestine removal of goods by their client company.

4. A refund has been granted to the assessee by an appellate authority. Can a notice under section 11A be issued demanding the amount of refund on the ground that such a refund is erroneous?

   Dynamatic Technologies Ltd. v. Union of India 2005 (186) ELT 277 (Kar.)

   Section 11A(1) inter alia provides that when any duty of excise has been short-levied or short-paid or erroneously refunded, whether or not such non-levy or non-payment, short-levy or short payment or erroneous refund, as the case may be, was on the basis of any approval, acceptance or assessment relating to the rate of duty on or valuation of excisable goods under any other provisions of this Act or the rules made thereunder, a Central Excise Officer may, within one year from the relevant date, serve notice on the person chargeable with the duty which has not been levied or paid or which has been short-levied or short-paid or to whom the refund has erroneously been made, requiring him to show cause why he should not pay the amount specified in the notice.

   The High Court observed that when the refund arises only as a consequence of an order/direction issued by the Appellate Authority, as a quasi-judicial functionary, any recovery of amount could only be made if the order is again modified further in the appeal proceedings and not otherwise. It was made clear by the High Court that even in such an event, the amount could be recovered as a consequential action and not independently. The High Court thus, held that the show cause notice was unnecessary and not within the scope of the power under section 11A of the Central Excise Act.

   Note: This case establishes that the scope of the words “whether or not” in section 11A do not extend to the case of short levy/non levy or erroneous refund granted as a result of appellate proceedings.

6

REFUND

1. Will interest be payable by the Revenue to the assessee when interest payment on delayed payment of refund is also delayed?

   Sandvik Asia Ltd. v. CIT 2006 (196) ELT 257 (SC)

   The Supreme Court has held that tax can only be collected in accordance with the law. Hence, the Revenue must compensate the assessee where excess collection of tax has been made or some amount has been wrongfully withheld from the assessee without the authority of law. This compensation should include interest on interest wrongfully withheld, irrespective of absence of any statutory provisions granting the same. In this case the interest due to the assessee was withheld by the department for 17 long years.

   Note: Though this judgement has been rendered in respect of income-tax laws, the principle enunciated in this judgement may also squarely apply in central excise and customs cases.

2. Can the department withhold a refund on the ground that it has filed an appeal against the order giving the refund, in a case where it has not obtained a stay order?

   Atul Limited v. CCEx., Surat-II 2005 (188) ELT 21 (Guj.)

   The amount of pre-deposit was not refunded to the assessee when its appeal was allowed by the Commissioner (Appeals). Subsequently, when the Revenue filed an appeal before the Tribunal against such order of Commissioner (Appeals), no stay was granted.

   The High Court observed that the officers of the Revenue had been informed by the Board that no refund/rebate claim should be withheld on the ground that an appeal has been filed against the order giving the relief, unless stay order has been obtained. Thus, the High Court directed that the amount of pre-deposit should be refunded to the petitioner with interest within a fortnight.

3. Whether the principle of unjust enrichment applies to the State Undertakings?

   CCEx. Bangalore-II v. Karnataka State Agro Corn Products Ltd. 2006 (202) ELT 47 (Kar.)

` The Karnataka State Agro Corn Products Limited (assessee) manufactured food products and was fully owned by the State Government. The food products were supplied to the various Government departments on payment of excise duty. However, subsequently, it was noticed that the assessee was not liable to pay excise duty and thus, a refund claim was filed. The department rejected the refund claim on the ground of unjust enrichment. It was contended that the duty burden had been passed on by the Karnataka State Agro Corn Products Limited (State Undertaking) and since a State Undertaking was different from the State Government, a refund to the State Undertaking would result in unjust enrichment of the same.

The High Court observed that the State Government controlled the Government undertakings in the matter of management, finance, administration etc. State Government had an effective control over these Undertakings as the policies or programmes of these Undertakings were also, to a certain extent, evolved by the State Government. The High Court held that unless the department was able to show that the Government undertakings were totally different from all angles, it would not be possible to accept the argument of unjust enrichment on the part of the State undertakings. A refund granted to the State Undertaking would ultimately go to the State's exchequer.

4. Price remaining same prior and during the period in question would not be conclusive to prove that burden of duty has not been passed on. [Auro Lab v. CCEx., Madurai 2005 (185) ELT 88 (Tri.- Chennai)]

7

APPEALS

1. Does failure to take into consideration the material evidence, which is present on record, amount to mistake apparent on the face of the record?

   CCEx., Mumbai v. Bharat Bijlee Ltd. 2006 (198) ELT 489 (SC)

   The Supreme Court held that failure to take in to consideration the material evidence, which is present on record, would amount to mistake apparent on the face of the record and the Tribunal has jurisdiction to correct such mistake in exercise of its powers under section 35C(2) of the Central Excise Act, 1944.

   Section 35C(2) lays down that the Appellate Tribunal may, at any time within six months from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it and shall make such amendments if the mistake is brought to its notice by the Commissioner of Central Excise or the other party to the appeal.

2. When should the aspect of financial hardship be considered by the authority hearing an application for stay?

   Toppan Plywood Pvt. Ltd. v. Union of India 2006 (198) ELT 495 (Guj.)

   The High Court held that an authority hearing an application for stay should in the first instance consider that whether the applicant has a prima facie case in appeal. Only after considering this aspect, should the aspect of financial hardship be delved upon by such authority.

3. Can a Commissioner recall an order which is passed in violation of natural justice?

   Gujarat Ambuja Exports Ltd. v. Union of India 2006 (199) ELT 798 (Guj.)

   It has been held by the High Court that a Commissioner is competent to recall an order which is passed in violation of principles of natural justice and can grant opportunity of hearing to a petitioner before passing an order.

4. Does non-consideration of a decision of the Apex Court which is rendered after the order of the Tribunal, constitute an error apparent from the face of the record on the part of the Tribunal?

   Hindustan Lever Ltd. v. CCEx., Mumbai-I 2006 (202) ELT 177 (Tri.-LB)

   When a decision rendered by the Apex Court is not considered, non-consideration of such binding precedent constitutes an error apparent on the face of the record, by the applicability of the doctrine of per incuriam. In cases where due to inadvertence or oversight, Court or Tribunal fails to notice the statutory provision or a binding authority, the principle of per incuriam applies.

The Large Bench of the Tribunal observed that though in context of the decisions of the Apex Court and the jurisdictional High Courts which are rendered after the order of the Tribunal, the doctrine of per incuriam could not be invoked, yet there would be error apparent from the record of such order on the reasoning that the superior court declared the law as it always was, and therefore, the question whether there was error apparent from the record of the order, (which could not have taken into consideration, such subsequent binding decision), would still arise.

The Large Bench of the Tribunal held that the binding decision of the Apex Court that declared the law as it always was, would cover even the prior period from the inception of such law, during which the orders contrary to such ratio of the subsequent binding decision were passed, thus giving rise to error apparent on the face of the record.

The Large Bench of the Tribunal relied upon the Madras High Court's decision in V. Guard Industries Ltd. v. Commercial Tax Officer 2003 (158) ELT 806. In this case, the High Court has held that when Supreme Court pronounces on true position of law, any decision rendered by any other authority contrary to that, is required to be regarded as an error which is apparent on record and rectification of such an error within the period permissible under law and in accordance with provisions of the statue is required to be effected.

Note: The Latin expression per incuriam or per ignoratium means 'thorough inadvertence'. 'Incuria' means 'carelessness'. Giving a decision per incuriam means giving a decision when a case or a statute has not been brought to the attention of the Court and they have given the decision in ignorance or forgetfulness of the existence of that case or that statute.

8

REMISSION OF DUTY AND DESTRUCTION OF GOODS

1. Whether remission of duty can be granted for handling losses?

   J.K. Sugar Ltd. v. CCEx., Meerut 2005 (185) ELT 300 (Tri.-Del.)

   The CESTAT held that even though rule 21 of the Central Excise Rules, 2002 does not specifically mention handling, remission of duty would be permissible for handling losses as the reference in the rule to “unavoidable accident at any time before removal” would cover handling.

9

EXEMPTION BASED ON VALUE OF CLEARANCES (SSI)

1. Can it be presumed that a manufacturer producing exempted goods is a small scale industry?

   Super Delicacies (P) Ltd. v. CCEx., New Delhi 2006 (199) ELT 387 (SC)

   Notification No. 175/86-CE grants exemption from excise duty to small scale industries provided they do not use the brand name of another person who is not entitled to exemption under that notification. The appellant were using the brand name of the person who was not paying excise duty as his goods were exempt and was not registered with the excise department during the disputed period. The appellant contended that they were eligible for the small scale exemption under Notification No.175/86 as they were using the brand name of the person who, according to the appellant, was also entitled to the small scale exemption under the said notification.

   The Supreme Court held that merely because the owner of the brand name manufactured goods which were exempt from excise duty, it did not mean that such owner was a small scale industry entitled to the benefit of the notification. Further, it could not be presumed that just because the owner of the brand name was not registered during the disputed period, it was a small scale industry during the period in question.

2. Small scale exemption is not available if brand name of another person is used on the final products. Will the situation be different if the brand name is used on the goods meant for captive consumption?

   Kohinoor Elastics Pvt. Ltd. v. CCEx., Indore 2005 (188) ELT 3 (SC)

   The assessee manufactured elastics with the brand name of one “X Ltd.” who in turn used these elastics in the manufacture of undergarments. These elastics were never sold in the open market. The general public only received the manufactured undergarments.

   The asssessee claimed SSI exemption under Notification No. 1/93-C.E on the ground that he did not use the brand name on the final products; the brand name was used only in respect of the goods meant for captive consumption. The assessee contended that the words “so as to indicate a connection in the course of trade” in Explanation IX of the notification made it clear that the brand/trade name must be used on goods which ultimately reach a customer. It was submitted that the ultimate customers did not associate the brand/trade names (used by the assessee) with the elastics (which never reached the market) but with the undergarments manufactured by "X Ltd." The use of brand/trade names on elastics, which were not sold in the open market, did not convey to the ultimate customer that the elastics had any connection with the owner of the brand/trade name. The ultimate customer only got the final product i.e. the undergarments and thus, he only associated the brand/trade name with the undergarment and not with the elastics.

The Supreme Court observed that as per clause 4 of the Notification No. 1/93-C.E small scale exemption is available only to those goods which do not bear a brand/trade name of another person. The Notification does not provide that exemption shall be lost only for those goods (bearing the brand name of other person) which are sold in the market or those goods which reach the customers without any change in form, i.e. the Notification does not provide that exemption will not be lost if goods (here elastic) are only used as inputs in manufacture of other goods. The Notification also does not provide that exemption is not lost if goods (elastic) are manufactured as per the orders of a customer (here X Ltd.) and for use only by that customer.

The Supreme Court opined that the words "course of trade" in Explanation IX refers to the course of trade of manufacturer (assessee) and not general course of trade. Even if a manufacturer only manufactures as per orders of customer and delivers only to that customer, the course of trade, for him would be such manufacture and sale.

Therefore, the Apex Court held that goods manufactured for captive consumption would not be any exception and the exemption would not be available if brand name of another person is used on them. The Supreme Court elaborated that if use of brand/trade names is permitted on goods manufactured as per orders of customers or which are captively consumed then, manufacturers, who are otherwise not entitled to exemption, would get their goods or some inputs manufactured on job work basis or through some small party, freely use their brand/trade name on the goods and avail of the exemption. It is to foreclose such a thing that clause (4) provides, in unambiguous terms, that the exemption is lost if the "goods" bear a brand/trade name of another person.

Note: Explanation IX of Notification No. 1/93-CE defines brand name as under:

"Brand name" or "trade name" shall mean a brand name or trade name, whether registered or not, that is to say a name or a mark, code number, design number, drawing number, symbol, monogram, label, signature or invented word or writing which is used in relation to such specified goods for the purpose of indicating, or so as to indicate a connection in the course of trade between such specified goods and some person using such name or mark with or without any indication of the identity of that person.

10

NOTIFICATIONS, DEPARTMENTAL CLARIFICATIONS AND TRADE NOTICES

1. Will a thermal power plant located within a refinery be covered within the definition of refinery for the purpose of claiming exemption under Notification No. 75/84-CE.?

   Indian Oil Corporation Ltd. v. Collector of CEx., Baroda 2006 (202) ELT 37 (SC)

   Notification No. 75/84-CE read with the clarificatory Circular exempts Low Sulphur Heavy Stock (LSHS) or Reduced Crude Oil (RCO) consumed captively in a refinery for generation of electricity, which in turn is used in the process of manufacture of petroleum products. The Supreme Court has held that the exemption would not be denied if LSHS/RCO is consumed in a thermal power plant located within the refinery area. However, the exemption would not be available if RCO/LSHS is used in the generation of electricity which is not used in the manufacture of petroleum products within the refinery area.

   In the instant case, the Apex Court elaborated upon one more point regarding the finality of orders due to non-filing of appeal. It has been held that the department is not entitled to raise same point in other cases when no appeal has been preferred against the order (involving that point) passed by the appellate authority, as the same becomes final. The Supreme Court held that the Revenue having accepted the principle laid down in an identical case could not be permitted to take a different stand in another appeal.

   Note: This case highlights that finality of orders due to non-filing of appeal affects other cases too.

2. How should an exemption notification be interpreted?

   Compack Pvt. Ltd. v. CCEx., Vadodara 2005 (189) ELT 3 (SC)

   The assessee manufactured cardboard containers out of base paper or paperboard having three layers, in respect of which no credit was availed of. However, the outer layer of the container consisted of LDPE coated paper in respect of which MODVAT credit of duty paid was availed. The cardboard containers were exempt from payment of duty under Notification No. 67/82-C.E. subject to the condition that appropriate duty of excise or additional duty had been paid in respect of base paper used in the manufacture of the said cardboard containers. Explanation to notification raised a legal fiction that base paper or a paperboard, if purchased from market would be deemed to be duty paid.

However, the exemption was denied to the assessee on the ground that the plastic coated paper was different from the base paper and on a true construction of the notification, it would be evident that exemption from payment of excise duty was to be granted only to those manufacturers who used only the base paper for manufacturing containers. As per the department, the exemption notification must be construed strictly.

The Supreme Court observed that the eligibility clause contained in the notification was confined to the use of base paper or paperboard in the manufacture of the printed cartons, boxes, containers and cases. The container could have consisted of inputs other than base paper or paperboard for which MODVAT facility had been availed of. The Apex Court categorically stated that once eligibility criteria of the notification was satisfied by the assessee, conditions thereof had to be construed liberally. The Supreme Court rejected the finding of the Tribunal that container must be manufactured only from the base paper. However, the exemption was available only to the extent for which excise duty had been paid and credit not availed i.e. on paperboard.

The Supreme Court held that while interpreting an exemption notification, the eligibility criteria would deserve a strict construction although construction of a condition thereof may be given a liberal meaning.

Note: The same view regarding the interpretation of an exemption notification was adopted by the Supreme Court in the case of CCus. (Imports) Mumbai v. Tullow India Operations Ltd. 2005 (189) ELT 401 (SC).

3. Whether the amendment made in section 5A vide the Finance Act, 2005 has any retrospective effect?

CCEx., Pune v. Pudumjee Pulp & Paper Mills Ltd. 2006 (198) ELT 330 (SC)

The Supreme Court has held that clause (1A) of section 5A introduced by the Finance Act, 2005 does not have any retrospective effect. Section 5A empowers the Central Government to grant exemption from duty of excise. Clause (1A) clarifies that when any excisable goods is exempted from the duty of excise absolutely, the manufacturer of such excisable goods shall not pay the duty of excise on such goods.

4. Can a workshop, which is used to facilitate repair of mining machinery and equipments used in adjacent coal mines and other collieries, be treated as a mine for the purpose of exemption under Notification No. 63/95-CE, dated 16.03.1995?

South Eastern Coalfields Ltd. v. CCus. & CEx., M.P. 2006 (200) ELT 357 (SC)

Notification No. 63/95-CE, dated 16.03.1995 grants exemption from excise duty to all goods manufactured in a mine. The Apex Court held that a workshop which facilitates repair of all mining machinery and equipment used in adjacent coal mines and other collieries would come within the ambit of the definition of mine for the purpose of the said notification. The fact that the mine is registered as a factory under Factories Act, 1948 shall not defeat the claim for exemption under the Central Excise Act, 1944. (As per section 2(m) of the Factories Act, a factory means any premises including the precincts thereof but does not include a mine subject to the operations of the Mines Act, 1952).

The Explanation to the said exemption notification states that “mine” has the meaning assigned to it in Section 2(j) of the Mines Act, 1952. Clause (viii) of section 2(j) of the Mines Act, 1952 defines “mine” to include “all workshops and stores situated within the precincts of a mine and under the same management and used solely for the purposes connected with the mine or a number of mines under the same management”.

5. Can a Circular issued by the Board take away the benefits granted by the status of being a 100% EOU?

CCus. & CEx., Meerut –II v. J.S.Gupta & Sons 2006 (201) ELT 174 (All.)

The assessee was granted the status of 100% Export Oriented Unit. Upon grant of such status, the unit got the right/facility to obtain raw material free of excise duty. However, the Commissioner of Central Excise drawing power from a Circular issued by the Central Board of Excise and Customs passed an order suspending the said right/facility of the assessee of procuring duty free raw material.

The Tribunal observed that the power to suspend the facility to obtain raw material free of duty was a penal action which could be initiated only under the authority of law. The Tribunal stated that in the absence of such authority of law under the Customs Act, 1962 and the Central Excise Act, 1944 facility of procuring duty free raw material could not be suspended particularly when the status of assessee as 100% EOU had not been cancelled. Since, the right of procuring duty free raw material had not been granted by the CBEC or by the Commissioner of Central Excise, neither of these two authorities could, either by circular or by order, take away that right.

Therefore, the Tribunal held that the right of procuring duty free raw material flowed, by virtue of law, to 100% EOU and that right could be taken away either by canceling the 100% EOU status or by an order authorized by the same law which had granted that right.

When the matter was brought before the High Court, the views of the Tribunal were reaffirmed by the High Court. It was held that without taking away the 100% EOU status, benefits flowing from that status could not be taken away unless there was such a power conferred by a provision in that very law, which conferred the said benefits.

CUSTOMS

1

LEVY OF AND EXEMPTIONS FROM DUTY

1. Can a sale after the act of import be treated as a sale in the course of international trade?

   Udayani Ship Breakers Ltd. v. CCus. & CEx., Rajkot 2006 (195) ELT 3 (SC)

   The Supreme Court held that a sale after the act of import would not be a sale in the course of international trade but only a sale in the course of domestic trade and only the price paid during the course of international trade should be considered for the purpose of valuation. The Apex Court categorically pointed out that the reduced price during the course of domestic trade would not be relevant under section 14(1) of the Customs Act, 1962 read with Rule 4 of the Customs (Valuation) Rule, 1988.

   Further, the Apex Court clarified one more point that the remission of duty under section 22 of the Customs Act could not be granted if the claim thereof has not been made before the Assessing Authority.

2

TYPES OF DUTY

1. If some goods are exempt from customs duty, can it be inferred that they are exempt from additional duty as well?

   Kaur Sain Traders v. Union of India 2006 (199) ELT 224 (Pat.)

   The High Court observed that exemption from customs duty would not mean exemption from additional duty. The High Court held that when goods are exempted from basic customs duty in terms of section 12 of the Customs Act, 1962, it would not mean that they are exempted from additional duty also, as basic customs duty is leviable by virtue of section 12 of the Customs Act, 1962, while additional customs duty is leviable under section 3 of the Customs Tariff Act, 1975.

3

CLASSIFICATION OF GOODS

1. Can the motion capture animation files be classified as software when they need another software to get the final results?

   CCus., Chennai v. Pentamedia Graphics Ltd. 2006 (198) ELT 164 (SC)

   Motion capture animation files are computer software recorded in a machine-readable form and capable of being manipulated by means of automatic data processing machines. It has been held by the Apex Court that these files are software and their import would be eligible for exemption under Notification No. 20/99-Cus. The fact that these motion capture animation files require another software known as 'soft image' to get the final results would not disqualify them from being software. The Apex Court clarified that programming aids are also known as software.

   Note: Notification No. 20/99 Cus. inter alia exempts information technology software.

4

VALUATION UNDER THE CUSTOMS ACT, 1962

1. A vessel is hired on a time charter basis to import goods. Should the charges payable on account of such time charter be included in the assessable value of the imported goods as the cost of transportation?

   CCus., Ahmedabad v. Essar Steel Ltd. 2005 (188) ELT 465 (SC)

   The Supreme Court observed that all charges paid on account of time charter could not be equated to freight. When the vessel is taken under a time charter, the payment is for hire and use of the vessel as a whole and such charges are referred to as ‘hire charges’ and not as ‘freight’. Freight, in the ordinary mercantile sense, is the reward payable to the carrier for the carriage and removal of the goods. Freight is defined as the cost of transport of imported goods from the place of exportation to the place of importation under Rule 9(2)(a). Thus, the Apex court held that the price payable on account of time charter would not be includible in the cost of transportation.

2. Can barge charges for transporting goods from mother ship by barge to a place approved under section 8(a) of the Customs Act, 1962 be added to the valuation of such imported goods for levy of customs duty?

   Ispat Industries Ltd. v. CCus., Mumbai 2006 (202) ELT 561 (SC)

   The mother vessel anchored at Bombay Floating Light (BFL). After obtaining the out of charge order, the cargo was discharged at BFL from the mother vessel to the barges which then ferried the cargo to the Dharamtar jetty, the place approved under section 8(a) of the Customs Act, 1962. The cargo could not be discharged directly from the mother vessel to the Dharamtar jetty due to lack of draught. In the bills of entry, the assessable value of the cargo was arrived at by including freight from the place of export to the port of discharge viz., Mumbai/JNPT/Dharamtar. However, the Assistant Commissioner of Customs included the freight incurred on barges in transporting the cargo from BFL to the Dharamtar jetty in the assessable value of the cargo by virtue of Rule 9(2)(a) of the Customs (Valuation) Rules, 1988.

   The Supreme Court observed that since the cost of transportation (from BFL to Dharamtar jetty) was already included in the price paid to the seller under CIF contract, a further addition to transport charges under Rule 9(2)(a) of the Customs Valuation Rules, 1988 was not permissible.

Section 14(1) states that the value of the imported goods shall be the deemed price at which such or like goods are ordinarily sold or offered for sale, for delivery at the time and place of importation in the course of international trade. The Apex Court asserted that section 14 creates a deeming fiction, therefore the prevailing price in the market has to be seen and not the actual price mentioned in the contract between the supplier and the importer. The Supreme Court observed that if Rule 9(2)(a) is read independently without considering it along with section 14, then the submission of the department could have been sustained. However, Rule 9(2) has to be read along with section 14 and it could not be read independently. Since, section 14 creates a legal fiction, the ordinary value of the imported goods in the course of international trade at the place and time of import should be considered. Therefore, specific cases for determining value of imported goods should be ignored.

The Apex Court asserted that Rule 9(2)(a) is subservient to section 14 of the Customs Act, 1962, and hence should be interpreted in such a way so as to make it in accordance with the main object of section 14. The object of section 14 is 'primary' whereas conditions in Rule 9(2) are 'accessories'.

Note: It may be noted that Circular No. 29/2004–Cus., dated 13.04.2004 issued by CBE&C has clarified that barging/lighterage charges borne by the importer in bringing the goods from the outer anchorage to the landmass have to be included in the assessable value as "extended cost of transportation" under Rule 9(2)(a) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988.

A reading of the judgement and the above-mentioned Circular may lead to the conclusion that where the price paid is limited to delivery at the outer anchorage by the specific terms of the CIF contract and the goods are subsequently transported and ultimately delivered at another place to make them as part of the landmass, the transportation charges therof would be includible in the assessable value.

3. Whether the transaction value between two related persons should always be rejected by the department?

CCus., New Delhi v. Prodelin India (P) Ltd. 2006 (202) ELT 13 (SC)

The assessee 'X Ltd.' entered into a joint venture with a foreign collaborator 'Y' for promotion and selling VSAT antennas, accessories and other communication equipments, assembly of equipments, testing, servicing etc. As per the joint agreement, 'Y' owned 75% of equity shares in 'X Ltd.' 'X Ltd.' had to assemble, install, test and service the components provided by 'Y'. Technical service fee was paid by 'X Ltd.' to 'Y' for various functions that were carried out in respect of manufacture of antenna system in India. It was claimed by the department that 'X Ltd.' and 'Y' were related persons in terms of Rules 2(2)(i) and 2(2)(iv) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988 (hereinafter referred to as Rules) and the technical fee paid by ‘X Ltd.’ was includible in the assessable value of the imported components in terms of Rule 9(1)(c) of the Rules.

After a perusal of the joint venture agreement, the Supreme Court observed that the department had wrongly interpreted the various clauses of the joint venture agreement and linked the price of imported parts of antenna with the technical fee paid by ‘X Ltd.’ to ‘Y’. The technical fee paid by ‘X Ltd.’ to ‘Y’ for design, drawing, fabrication etc., was in respect of the manufacture of the antenna system in India and not with regard to the imported parts of the antenna. Further, the department was not able to produce any evidence that relationship between ‘X Ltd.’ and ‘Y’ had influenced the value of the imported goods.

The Apex Court reiterated the settled law that the onus to prove that declared price does not reflect the true transaction value is always on the department. The department is bound to accept transaction value entered between two parties in the absence of any evidence that identical or similar goods are imported by other importers at a higher price. The Apex Court stated that even if it was assumed that the importer and its foreign collaborator were related persons, their transaction value had to be accepted by the department provided that the examination of the circumstances of sale of imported goods indicated that relationship did not influence price and the importer demonstrated that declared value of goods being valued, closely approximated to the value of identical or similar goods.

Note: The main point on which this case turned was the department’s inability to produce any evidence that the relationship between ‘X Ltd.’ and ‘Y’ had influenced the value of the imported goods.

Further, this case establishes that the technical fee charged in respect of post importation activities should not be included in the assessable value of the imported goods under Rule 9(1)(c) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988.

5

IMPORTATION, EXPORTATION AND TRANSPORTATION OF GOODS

1. Whether the agents of the person-in-charge of the conveyance can be made responsible in respect of commission or omission in filing the import manifest, when the same has been filed by them on behalf of the person-in-charge?

   CCEx., Delhi-III v. Machino Montell (I) Ltd. 2006 (202) ELT 398 (P & H)

   The High Court answered this question in positive. The High Court observed that the import manifest is required to be delivered to the proper officer either by the person-in-charge of the conveyance or any other person as may be specified by the Central Government by notification in the Official Gazette. Any person, who in relation to any goods does or omits to do any act which act or omission would render such goods liable to confiscation under section 111, or abets the doing or omission of such an act, is liable to penalty under section 112.

   The High Court held that the liability can be fastened upon the agent of the person-in-charge appointed under the Customs Act, 1962 or a person representing the person-in-charge, who has been accepted as such by the concerned officer for the purpose of dealing with the cargo on behalf of the person-in-charge, by virtue of section 148(2) ibid. The High Court held that the penalty could be imposed on such representatives for failure in filing accurate and complete import manifest.

   Note: Section 148 provides that where the Customs Act requires anything to be done by the person-in-charge of a conveyance, it may be done on his behalf by his agent. An agent appointed by the person-in-charge of a conveyance and any person who represents himself to any officer of customs as an agent of any such person-in-charge, and is accepted as such by that officer, shall be liable for the fulfilment in respect of the matter in question of all obligations imposed on such person-in-charge by or under this Act or any law for the time being in force, and to penalties and confiscations which may be incurred in respect of that matter.

6

WAREHOUSING

1. Is it necessary that the ownership of the goods should pass to the Project Authority in order to classify them as project import?

   CCus. Mumbai v. Toyo Engineering India Ltd. 2006 (201) ELT 513 (SC)

   The assessee imported construction equipments which were to be used in initial setting up of an industrial plant. The assessee applied for the benefits of Project Import Scheme so that the goods could be classified under Heading 98.01 of the Tariff Act. However, the benefit was denied to it on the ground that the ownership of the imported goods did not pass to the Project Authority and thus, the goods could be used for other work elsewhere after the completion of the present project.

   The Supreme Court observed that any equipment which aids or helps in setting up of an industrial plant would be covered under Heading 98.01 of Customs Tariff Act, 1975. The Apex Court held that since, the imported construction equipments were used in initial setting up of the plant, project import benefits could not be denied. The Apex Court made it clear that the mere possibility of the imported construction equipments being used subsequently for other projects would not debar the assessee from availing the facility of project import.

   Note: Project Imports are the imports of machinery, instruments, and apparatus etc., falling under different classifications required for initial set up of a unit or for substantial expansion of an existing unit. In a project several different items are required, each of which is importable at different rates of customs duties. Hence, it becomes very complicated to make assessment for such project imports. Therefore, one consolidated rate of customs duty has been made applicable for all items imported under a project irrespective of the nature of the goods and their customs classification. The items eligible for project import are specified in Heading 98.01 of the Customs Tariff Act, 1975. These include all items of machinery, spare parts within prescribed limits, components or raw materials etc. for initial setting up of a unit or for substantial expansion of the same.

2. Should the rent and demurrage charges in respect of goods sold in auction be demanded from the buyer of such goods?

   Kolkata Port Trust v. Santanu Das 2005 (185) E.L.T. 346 (Cal.)

   The High Court held that the Port trust authorities could not demand rent and demurrage charges from purchasers of auctioned goods. Once customs authorities became owner of the goods, they became owner along with all liabilities attached to the said goods. Lien of Port trust, if any, could have been realised from the sale proceeds that were received by the customs authorities after selling the said goods.

3. Will there be any interest liability in case of re-export of warehoused goods (belonging to an importer other than a 100% EOU) after the expiry of statutory time limit of warehousing?

Swil Ltd. v. Union of India 2005 (185) ELT 251 (Guj.)

As per section 61(2)(ii) of the Customs Act, 1962, if goods (belonging to an importer other than a 100% EOU) are kept in the warehouse beyond a period of 90 days, interest shall be payable @15% p.a. on the amount of duty payable at the time of clearance of the goods. The interest shall be payable after the expiry of the said 90 days till the date of payment of duty.

The High Court followed the Supreme Court's decision in the case of Pratibha Processors v. UOI 1996 (88) ELT 12 (SC), wherein the Apex Court has held that when goods at the time of removal from the warehouse are wholly exempt from payment of duty, the liability to pay interest could not be saddled on a non-existing duty. Liability to pay interest under section 61(2) of the Customs Act is solely dependant upon the exigibility or actual liability to pay duty. In case the liability to pay duty is nil, then, the interest would also be nil. Thus, the High Court held that in case of re-export of warehoused goods after prescribed time limit of warehousing, there would be no liability of interest for warehousing beyond the prescribed time as there is no liability to pay duty in such a case.

Note: Circular No. 38/2005-Customs dated 28.09.2005 clarifies that if no duty is payable on clearances from the warehouses, then no interest is payable thereon.

4. Whether the benefit of an exemption notification that is issued after the payment of duty on warehoused goods (ex-bond clearance), but before their removal therefrom, can be claimed in respect of such warehoused goods?

Secretary, Council of Science & Tech., UP v. CCus. (Port) 2006 (202) ELT 241 (Cal.)

An ex-bond bill of entry in respect of certain warehoused goods was filed by the appellants. The duty was assessed at the applicable rate and was paid accordingly by the appellants. However, the goods were not cleared or removed from the warehouse. In the meanwhile, (when the goods were still in the warehouse) an exemption notification exempting the said goods was issued. The appellants contended that they were eligible for refund of the duty being paid by them on the said goods as the notification came in to effect when the goods were still in the custody and control of the proper officer in the warehouse. On the other hand, department contested the refund claim on the ground

that the appellants had applied for warehousing in terms of section 49 of the Customs

Act.

The High Court observed that section 15 of the Customs Act, 1962 inter alia lays down that in the case of the imported goods cleared from a warehouse the relevant date for determination of rate of duty and tariff valuation is the date on which the said goods are actually removed form the warehouse. The High Court stated that inspite of the payment of duty, the customs authorities did not permit the clearance of the goods. The goods were in custody and control of the proper officer in the warehouse. Further, the department was unable to bring on record the application of the appellant seeking warehousing of goods under section 49. The High Court held that as the goods were cleared from the warehouse after the exemption notification came into force, the appellants were entitled to its benefit and were thus, eligible for the refund of duty.

Note: Section 49 provides for storage of imported goods in the warehouse pending clearance. If the imported goods (both dutiable and non-dutiable) entered for home consumption cannot be cleared within a reasonable time, such goods may, pending clearance, be permitted to be stored in a public warehouse, or in a private warehouse if facilities for deposit in a public warehouse are not available. Such a deposit will be permissible only when the importer applies for the same to the satisfaction of the Assistant/Deputy Commissioner of Customs. However, such goods are not deemed as warehoused goods for the purposes of the Customs Act and accordingly the provisions of Chapter IX do not apply to such goods.

7

DEMAND AND APPEALS

1. Can a show cause notice under section 28(1) of the Customs Act, 1962 be issued in respect of goods that are already cleared?

   Venus Enterprises v. CCus., Chennai 2006 (199) ELT 405 (Mad.)

   The High Court held that the show cause notice under section 28(1) of the Customs Act, 1962 could be issued for recovery of short levy in case of goods already assessed and cleared. The contention that when the goods were already cleared, no demand notice could be issued under section 28 without reviewing the order of assessment was rejected by the High Court.

2. What amounts to review of an order?

   CCus., Kolkata v. Sunil Ghosh 2006 (199) ELT 587 (Cal.)

   Section 129B empowers the Appellate Tribunal to rectify its own orders and amend any mistake apparent from the record if brought to its notice by any of the parties. However, this provision does not empower the Appellate Tribunal to undertake review.

   The High Court observed that passing of a fresh order by considering evidence which is alleged to have been omitted amounts to review and not rectification. A piece of evidence if alleged not to have been considered and a finding has been arrived at, in that event it would not be a mistake rectifiable under section 129B(2) of the Customs Act. This would be a case of review since the entire finding would be changed and the purpose would not be served by amending the order but by replacing the order or substituting the order as a whole.

   The High Court explained that the effect of review is of setting aside the order and passing a fresh order upon considering the materials alleged to have been omitted to be considered. The High Court made it clear that review and rectification could not be treated at par.

3. (i) Is it necessary for an exemption notification to contain a recovery provision for effecting recoveries due to non fulfilment of post importation conditions thereof?

   (ii) Is the time limit for demand of duty necessary in case of continuous obligation?

Bombay Hospital Trust v CCus., Sahar, Mumbai 2005 (188) ELT 374 (Tri.-LB)

The appellant imported medical equipment at concessional rate of customs duty. However, there were certain conditions which were to be fulfilled after their import. A duty demand was raised when the assessee failed to fulfil those conditions. The appellant contended that the exemption notification did not have any provision for demanding duty in the event of non-compliance with the conditions. It also did not provide for any bond or undertaking to enable the department to make recovery in terms of such bond or undertaking as had been prescribed under some other notifications.

The Large Bench of the Tribunal observed that when a post-importation condition in an exemption notification was not fulfilled, department had power to recover escaped duty in terms of section 12 of the Customs Act, 1962. The appellants' contention that the notification did not provide for obtaining any bond or bank guarantee for recovery of duty could not be considered as a valid plea for not paying demanded duty when post importation conditions of the exemption notification were not fulfilled. The Tribunal observed that the exemption notification issued under section 25 of the Customs Act, 1962 did not need a recovery provision when the power to recover the duty could be traced to section 12 of the Customs Act, 1962. Further, section 25 also did not provide for such a recovery provision in an exemption notification.

The Large Bench of the Tribunal further elaborated that in such a case section 28 of the Customs Act, 1962 would not be applicable since the duty demand did not relate to short levy or non levy at the time of initial assessment on importation, but had arisen subsequently on account of failure to fulfil the post-importation conditions under the said notification. The Large Bench of the Tribunal held that the instant case was that of the continuous obligation and there was no time limit for raising demand in such a case. It was also held that in such a case the demand would not be made under section 28 of the Customs Act but under charging section 12 of the Customs Act and the relevant exemption notification, even if no bond was executed at the time of import.

8

REFUND

1. Whether the principle of unjust enrichment applies in the case of captive consumption of imported capital goods?

   SRF Ltd. v. CCus. Chennai 2006 (193) ELT 186 (Tri. - LB)

   The Large Bench of the Tribunal held that the doctrine of unjust enrichment would be applicable in case of imported capital goods used captively for manufacture of excisable goods.

   The Large Bench of the Tribunal also held that uniformity in price, before and after assessment, did not lead to the inevitable conclusion that duty burden had not been passed on as such uniformity might be due to various reasons.

   Note: It may be noted that in case of Grasim Industries v. CCE 2003 (157) ELT 123 (CESTAT) it was held that question of passing of excise duty would not arise in case of capital goods used captively. However, this decision has now been overruled by the above-mentioned judgement of the Large Bench of the Tribunal.

9

DUTY DRAWBACK

1. Can drawback at All Industry Rate be claimed in a case where major input of an export product (which constitutes about 97% of total material cost) has not suffered any duty?

   Rubfila International Ltd. v CCus., Cochin 2005 (190) ELT 485 (Tri.-Bang.)

   The assessee claimed drawback in respect of its export products. 97% of the inputs (by weight) of the product were procured indigenously and were not excisable.

   The Tribunal observed that All Industry Rates were fixed taking into account incidence of customs duty on imported inputs. In this case, there was no question of any duty incidence on 97% of the inputs of the export product except the duty incidence on remaining 3% of the inputs, which was insignificant. The Tribunal stated that even though All Industry Rates were fixed for particular export products that were applicable to all exporters who exported the same, but when there was evidence that inputs of such export products had not suffered any duty, no drawback could be claimed.

   Note: Rule 3(1)(ii) of Customs and Central Excise Duties Drawback Rules, 1995 inter alia provides that no drawback shall be allowed if the exported goods are produced or manufactured, using imported materials or excisable materials in respect of which duties have not been paid.

10

PROVISIONS RELATING TO ILLEGAL IMPORT, CONFISCATION, PENALTY & ALLIED PROVISIONS

1. When can the power of search and seizure of a proper officer of customs be struck down?

   Mapsa Tapes Pvt. Ltd. v. Union of India 2006 (201) ELT 7 (P & H)

   Section 105 of the Customs Act, 1962 inter alia lays down that if the proper officer has reason to believe that any goods liable to confiscation, or any documents or things useful for or relevant to any proceeding under this Act, are secreted in any place, he may authorise any officer of customs to search or may himself search for such goods, documents or things. Section 110 of the Customs Act, 1962 inter alia lays down that if the proper officer has reason to believe that any goods are liable to confiscation under this Act, he may seize such goods.

   The High Court has held that exercise of the abovementioned powers of search and seizure would be liable to be struck down unless the "reason to believe" have been duly recorded before the action of search and seizure is taken.

2. Do the customs authorities have power to recover duty of customs on confiscated goods even when the option of redemption is not exercised?

   Bombay Hospital Trust v. CCus (ACC), Mumbai 2006 (201) ELT 555 (Bom.)

   The assessee imported certain goods and cleared them for home consumption under section 47 without payment of duty by availing the benefit of an exemption notification. However, the assessee failed to comply with the conditions set out in the notification. As a result, the goods were confiscated under section 111(O) of the Customs Act, 1962 with an option to the assessee to redeem the said goods on payment of fine and penalty. The assessee was directed to pay the customs duty payable on the said goods.

   The assessee contended that under section 125(2) of the Customs Act, the liability to pay duty was in addition to the redemption fine and if the redemption fine was not payable, the question of paying duty did not arise at all. According to the assessee, the duty liability under section 125(2) was dependent upon the "payment" of fine in lieu of confiscation and where the option was not exercised and the fine in lieu of confiscation was not payable then the duty was also not payable.

   The High Court observed that section 125(2) provides that where any fine in lieu of confiscation of goods is imposed, the owner of such goods or where such owner is not known, the person from whose possession or custody such goods have been seized, shall, in addition, be liable to any duty and charges payable in respect of such goods. The High Court explained that the duty liability that was to be discharged under section 125(2) was on the "imposition" of fine in lieu of confiscation and not on the "payment" of fine in lieu of confiscation. Therefore, whether the fine in lieu of confiscation was paid or had become payable or not, on imposition of fine in lieu of confiscation, the duty and charges payable on the confiscated goods had to be paid. The High Court elaborated that the words 'in addition to' in section 125(2) were relatable to the "imposition" of fine in lieu of confiscation and not "payment" of fine in lieu of confiscation.

Therefore, the High Court held that customs authorities were justified in seeking to recover the duty from the assessee under section 125(2) ibid even though the assessee had not opted to redeem the goods by paying fine in lieu of confiscation.

Note: This case establishes that liability for duty in respect of confiscated goods cannot be avoided by not opting to pay the redemption fine.

3. Should the penalty under section 114A be levied when the shortfall in the duty is deposited before the issuance of the show cause notice?

Al-Falah (Exports) v CCEx., Surat-I 2006 (198) ELT 343 (Tri.-LB)

The Large Bench of the Tribunal held that the penalty under section 114A of the Customs Act, 1962 would not be levied if the duty amount that is short paid is deposited before the issue of show cause notice. However, penal consequences emerging from other provisions of Customs Act, 1962 viz. penalty leviable under sections 112, 114 or 116 could be separately attracted, on the facts of each case. The Large Bench of the CESTAT stated that the penalty under section 114A of Customs Act, 1962 is not mandatory. It is a result of an exercise of discretion vested in the assessing authority and is a liability to be imposed only in those cases where compliance is not exhibited by the liable person.

11

SETTLEMENT COMMISSION

1. Whether applications involving evasion of duty by fraudulent means and misdeclaration can be entertained by the Settlement Commission?

   Tata Teleservices (Maharashtra) Ltd. v. Union of India 2006 (201) ELT 529 (Bom.)

   The assessee had evaded duty and had applied for settlement in the Settlement Commission. The contention of the department was that the companies or the persons, who evaded the customs duty fraudulently, could not avail of the benefit of approaching the Settlement Commission. It was submitted by the department that the Settlement Commission had a limited jurisdiction of accepting only the cases of short levy on account of misclassification or otherwise and not other cases.

   The High Court observed that the Settlement Commission had wide jurisdiction to entertain all kinds of settlement claim applications, with liberty to reject the same even at preliminary stage, depending upon the nature, circumstances and complexity of a case. However, a case would be accepted by the Settlement Commission only if the mandatory requirements of:

   (i) filing Bill of Entry/Shipping Bill and issuance of a show cause notice in relation to such a Bill of Entry/Shipping Bill

   (ii) making a full and true disclosure of duty liability which was not disclosed earlier before the proper officer and the manner in which such liability had been incurred and additional amount of customs duty accepted to be payable by the assessee and

   (iii) furnishing such other particulars as may be specified by the rules including the particulars of such dutiable goods in respect of which the assessee admits short levy on account of misclassification or otherwise of goods

   have been fulfilled.

   The High Court observed that the jurisdiction of the Settlement Commission was not restricted only to cases of short levy on account of misclassification or otherwise. The object of introducing Chapter XIVA to the Customs Act, 1962 was to resolve all disputes so as to collect revenue for the department. The High Court held that if interpretation of section 127B was restricted to mean only bona fide cases, then there would be no scope of unearthing revenue. It was pointed out by the High Court that earlier part of section 127B ibid laid down the jurisdiction and only the latter part dealt with the rules whereby certain details were to be provided. Therefore, it was held by the High Court that the argument with regard to short levy due to misclassification or otherwise was purely a procedural one and there was no need to decide the same.

12

MISCELLANEOUS PROVISIONS

1. Whether the customs dues have priority over payment of dues of a secured creditor in respect of all the assets of the defaulting importer?

   KSIIDC Ltd. v. Secretary, Ministry of Commerce 2005 (187) ELT 12 (Kar.)

   With the loan taken from the petitioner corporation, the importer imported machinery as a 100% Export Oriented Unit and availed custom duty exemption subject to export obligation. However, the importer failed to meet the said obligations and thus, customs duty became payable. Subsequently, all properties of the importer including the imported machinery were brought to sale by the petitioner corporation as the importer defaulted in repayment of the loan. The issue under consideration was whether the customs dues have priority over payment of dues of petitioner corporation.

   The High Court held that the customs department could claim a priority of recovery of dues only in respect of those goods which had been imported and not in respect of other goods over which the petitioner had a claim as a secured creditor. The High Court stated that the petitioner was liable to meet customs dues as a successor of defaulting importer.

2. (a) Whether the despatch of order, decision etc. by speed post can be deemed to be a valid service under section 153(a) of the Customs Act, 1962 in the absence of proof of the actual delivery of the speed post?

   (b) Whether simultaneous affixing of the order on the notice board while despatching it by speed post is sufficient compliance of section 153(b) of the Customs Act, 1962?

   Margra Industries Ltd. v. CCus., New Delhi 2006 (202) ELT 244 (Tri.-LB)

   Section 27 of the General Clauses Act, 1897 deems an order to be served if the conditions of addressing, pre-payment and posting by registered post have been complied with. The Large Bench of the Tribunal observed that section 27 of the General Clauses Act, 1897 would apply only if other Central Act or Regulations do not contain any other clause for valid service. The Tribunal held that presumption of deemed service could not be accepted in view of sub-sections of section 153 of the Customs Act.

   Section 153 of the Customs Act provides that any order or decision passed or any summons or notice issued under this Act, shall be served -

   (a) by tendering the order, decision, summons or notice or sending it by registered post to the person for whom it is intended or to his agent; or

(b) if the order, decision, summons or notice cannot be served in the manner provided in clause (a), by affixing it on the notice board of the customs house.

The Large bench of the Tribunal stated that the delivery of order, decision, summon etc. in the post office for onward transmission to addressee by registered post would not be a sufficient proof of valid service when proof of delivery is absent. Further, simultaneous affixing of order on the notice board of the customs house would also not be sustainable, as affixing of order on the notice board would be considered only after the failure of first two modes. The Large Bench of the CESTAT elaborated that by providing for alternate service vide section 153(b) in case of failure of service by sub-section (a), the legislative intent has been made clear that order, decision etc. has to be made known.

Note: Similar provisions have been made in the Central Excise Act for valid service of order, decisions etc. vide section 37C. Therefore, the principle enunciated in this judgement may hold good for central excise law too.

SERVICE TAX

1
PRELIMINARY LEGAL PROVISIONS

1. How will the assessable value be computed when a lumpsum amount is charged for the provision of services without collecting service tax thereon?

   Rampur Engineering Co. Ltd. v. CCEx., Jaipur-I 2006 (3) STR 650 (Tri.- Del.)

   In a case where a lumpsum amount is charged for the services without collecting service tax thereon, the assessable value of the services should be fixed after deducting the tax element from the entire realization value.

   Note: The principle enunciated in the above-mentioned judgement of the Tribunal was incorporated in the erstwhile section 67 of the Finance Act, 1994 vide explanation 2 thereof. The Finance Act, 2006 has also incorporated this principle in the new section 67 of the Finance Act, 1994. Sub-section (2) of section 67 provides that where the gross amount charged by a service provider, for the service provided or to be provided is inclusive of service tax payable, the value of such taxable service shall be such amount as, with the addition of tax payable, is equal to the gross amount charged.

2. What is the taxable event in case of service tax?

   Prachar Communications Ltd. v. CCEx., Mumbai-IV 2006 (2) STR 492 (Tri.- Mumbai)

   The Tribunal held that the taxable event in case of service tax is not the time of rendering services but the realisation of payment for services so rendered. Tax liability has nexus with the realisation of payments for such services and value of such payments.

   Note: The essence of this principle is highlighted by the fact that service tax is payable even when any advance is received in respect of provision of a taxable service.

2

GAMUT AND COVERAGE OF SERVICE TAX LAWS

1. Is service tax on mandap keepers and outdoor caterers a tax on sale of goods or on hire-purchase activities?

   Tamil Nadu Kalyana Mandpam Association v. Union of India 2006 (3) STR 260 (S.C)

   Service tax on mandap keepers and outdoor caterers would be a tax on services and not a tax on sale of goods or on hire purchase activities. The nature and character of this service is evident from the fact that the transactions between a mandap-keeper and his customer are definitely not in the nature of a sale or hire purchase of goods. They are essentially that of the provision of a service. In fact, the manner of service provided assumes predominance over the providing of food in such situations which is a definite indication of the supremacy of the service aspect.

2. Whether the process of bottling and labelling of liquor is a taxable service or a part of the manufacturing process of the liquor?

   Vindhyachal Distilleries Pvt. Ltd. v. State of Madhya Pradesh 2006 (3) STR 723 (MP)

   The Tribunal observed that bottling, labelling and sealing by pilfer proof cap of glass bottles undertaken by bottlers was an independent activity and was not a part of process of manufacture of liquor as defined in section 2(f) of the Central Excise Act, 1944. The Tribunal held that it was a taxable service covered by section 65(76b) of the Finance Act, 1994. The service provider/distillers'/bottlers could pass the tax liability to the wholesale/retail contractors, though the department should recover service tax from service provider only and not from the wholesale/retail contractors.

3. Can a circular create the liability to pay service tax when the law does not provide for the same?

   Mahakaushal Builders Welfare Association v. Supdt. of Cus. & Ex., Jabalpur 2006 (3) STR 721 (MP)

   While listening to the writ petition of the builders in respect of the liability of service tax on construction of flat/building, the High Court held that a Circular could not create a liability for payment of service tax if the assessee was not liable to pay tax under the law relating to service tax.

   However, the writ petition was dismissed on the ground that the assessee had an alternate remedy before filing the writ petition. The petitioners were asked to file a reply to the show cause notice before the competent authority.

4. Is an isolated activity of freight forwarding covered under clearing and forwarding operations?

Medpro Pharma Pvt. Ltd. v. CCEx., Chennai 2006 (3) STR 355 (Tri-LB)

Isolated activity of freight forwarding would also be covered under clearing and forwarding operations and would be taxable. Clearing and forwarding operations could not be dissected into 'clearing and forwarding'. Both these activities fall under common category and any service provided in that category would attract service tax.

5. Whether persons engaged in mere procurement of orders on commission basis are covered in the definition of clearing and forwarding agent?

Larsen & Toubro Ltd. v. CCEx., Chennai 2006 (3) STR 321 (Tri-LB)

The Large Bench of the Tribunal held that the persons engaged in mere procurement of orders on commission basis would not be covered in the definition of clearing and forwarding agent as clearing and forwarding activities do not flow directly or indirectly from mere procurement of orders. Activity of procuring orders had been treated separately under business auxiliary service and was independent of clearing and forwarding operations (Services of commission agent have been included in definition of business auxiliary service with effect from 01.07.2003). Expressions 'directly or indirectly' and 'in any manner' in the definition of clearing and forwarding agent should not be isolated from activity of clearing and forwarding operation. Thus, the CESTAT held that mere booking orders for the principal by an agent on commission basis would not be taxable under clearing and forwarding agent's service.

Note :This decisions of the large bench of the Tribunal has overruled the decision of the Tribunal in the case of Prabhat Zarda Factory (Pvt.) Ltd. v. CCEx., Patna 2002 (145) E.L.T. 222 (Tri).

6. Does erection and commissioning of fire fighting equipments come within the ambit of the term “technical assistance” rendered by a consulting engineer?

CCEx., Chennai v. Agnice Fire Protection 2006 (3) STR 173 (Tri-Chennai)

The Tribunal held that erection and commissioning of fire fighting equipments involve engineering work and require professional skills, and thus, could be brought within the ambit of the term “technical assistance” rendered by a consulting engineer.

7. Whether the cost of inputs “consumed” in case of photography service is allowed as a deduction from the value of taxable service?

Laxmi Color (P) Ltd. v. CCEx., Jaipur-II 2006 (3) STR 363 (Tri-Del)

In case of photography service cost of inputs consumed would not be allowed as a deduction from the value of taxable service. The Tribunal stated that the CBEC clarification dated 07-04-2004 on Notification No. 12/2003-ST was not applicable in this case as the value of inputs sold had not been indicated in the bills. The Tribunal held that the clarification in fact, was beyond the scope of exemption Notification No. 12/2003 ST, as the said notification exempted 'value' of goods and materials sold by service provider whereas the clarification provided exclusion of inputs "consumed" while providing the taxable service.

8. Is the scope of security service wide enough to cover the services performed along with the watch and ward works?

   Maruthi Detective & Security Agency v. CCEx., Belgaum 2006 (3) STR 521 (Tri.-Bang.)

   Works like switching ON and OFF operations of pumps of water supply installations, switching ON and OFF operations of street-light control points and other petty repairs like replacement of blown off fuse wire, etc. performed along with watch and ward works would not be covered under the security service.

9. Can a society registered under the Society Registration Act be treated as a firm for the purpose of consulting engineer's services?

   Central Power Research Institute v. CCEx., Bangalore 2006 (3) STR 637 (Tri. – Bang.)

   The assessee was a society registered under the Society Registration Act functioning under the Ministry of Power, Government of India. It carried out the activity of testing various instruments and collected charges for the same. The department proceeded against it to levy service tax under the category of 'consulting engineer'. Erstwhile section 65(13) of the Finance Act, 1994 defined consulting engineer as "any professionally qualified engineer or an engineering firm who, either directly or indirectly, renders any advice, consultancy or technical assistance in any manner to a client in one or more disciplines of engineering".

   The Tribunal held that a society registered under the Society Registration Act could not be a firm and was thus, not liable to service tax under the category of consulting engineer's services. Moreover, the activity of technical testing of instruments would not be covered under consulting engineers' services but under scientific and technical consultancy services and as per Board's Circular F-B-11/1/01 TRU dated 09.07.2001 public funded research institutions receiving grants/aids from Government for conducting research/project work do not come within the ambit of service tax.

   Note: Finance Act, 2006 has amended the definition of a consulting engineer. As per the new definition, consulting engineer means "any professionally qualified engineer or any body corporate or any other firm who, either directly or indirectly, renders any advice, consultancy or technical assistance in any manner to a client in one or more disciplines of engineering".

10. Whether services of making arrangement for storage and sale of goods fall under the ambit of services of clearing and forwarding agent?

    V.S. Distributors v. CCEx., Jaipur 2006 (3) STR 649 (Tri.- Del.)

    It was held by the Tribunal that the services of an agent of making arrangement for storage and sale of goods were not that of the clearing and forwarding agent as there was no clearing and forwarding of goods involved in this type of activity.

11. Whether printing of stickers, labels and cards fall within the ambit of advertising services?

    Zodiac Advertisers v. CCEx., Cochin 200 (3) STR 538 (Tri.- Bang.)

    As per section 65(3) of the Finance Act, 1994 advertising agency means "any commercial concern engaged in providing any service connected with the making, preparation, display or exhibition of advertisement and includes an advertising consultant". The Tribunal observed that for an agency to come under advertising agency, execution of all the above-mentioned activities would be necessary. Further, making of an advertisement involves conceptualization, visualization, designing etc. and is highly creative.

    Therefore, the Tribunal held that persons undertaking printing of stickers, labels and cards as per the directions of advertisers would not come within the ambit of advertising agency as there was no creativity involved in these operations.

12. Whether the service charges recovered by a hotel from the customers as a specific percentage of the bill amount are liable to service tax?

    Hotel Mela Plaza v. CCEx., Ghaziabad 2006 (3) STR 563 (Tri.-Del.)

    The hotel charged 10% of the bill amount as service charges from its customers for mandap keeping services. The assessee (Hotel) contended that the amount @ 10% collected from its customers did not form part of its income as that amount was subsequently disbursed among the staff and hence, was not liable to service tax.

    The Tribunal observed that erstwhile section 67 of the Finance Act, 1994 provided that the value of taxable service in relation to the services provided by a mandap keeper shall be the gross amount charged by such keeper from the client for the use of mandap, including facilities provided to the clients in relation to such use and also the charges of catering, if any. Therefore, the Tribunal held that as the assessee was charging this amount from its customers for providing the service, which was taxable as above, hence, the 10% service charges would be liable to service tax.

    Note: The law laid down by the abovementioned judgement will hold good in respect of new section 67 as well.

13. Does transfer of technical know-how fall within the ambit of consulting engineer's services?

CCEx., Mangalore v. Micro Finish Valves (P) Ltd. 2006 (1) STR 283 (Tri. – Bang.)

The Tribunal held that mere transfer of technical know-how would not be covered under the consulting engineer's services.

14. Whether the service of obtaining and supplying free pharmaceutical samples from manufacturer to various doctors for advertising medicaments is covered under clearing and forwarding services?

Protec Laboratories Pvt. Ltd. v. CCEx., Mumbai 2006 (1) STR 287 (Tri. – Mum.)

Service of obtaining and supplying free pharmaceutical samples from manufacturer to various doctors for advertising medicaments would not be covered under clearing and forwarding services as neither any sale nor any clearing or forwarding of goods is involved in this case. This service would more appropriately be covered as a business auxiliary service.

15. Whether the matrimonial service provided from portals/websites are liable to service tax?

Bharat Matrimony.Com Pvt. Ltd. v. CST, Chennai 2006 (4) STR 27 (Tri.-Chennai)

Matrimonial service provided from the portals/websites would be liable to service tax. They would be charged to service tax under the category of on-line information and database access or retrieval services.

16. Whether the activity of letting out halls and stadiums built by the Municipal Corporation for social and official functions is liable to service tax?

Surat Municipal Corpn. v. CCEx., Surat 2006 (4) STR 44 (Tri.-Del.)

Activity of letting out halls and stadiums for consideration for various social and official functions, such as sports, garbas, educational programmes, cultural and religious programmes would be liable to service tax under the category of manadp keeper's services. In this case the halls and stadiums were built by the Surat Municipal Corporation. It was held that there could not be any malafide intention of evading tax in case of a statutory government body.

Note: The Bangalore Tribunal in the case of Secy., Town Hall Committee, Mysore City Corpn. v. CCEx., Mysore 2006 (4) STR 78 has held that a town hall built by Mysore City Corporation for holding public functions including cultural and political functions could not be considered as a mandap liable to service tax under mandap keeper's services.

3

SERVICE TAX PROCEDURES

1. Whether the ratio of judgement applicable in respect of penalties under the provisions of the central excise law can be made applicable under the service tax legislation?

   CCEx., Kolkata -I. v. Chandra Nath Pyne 2006 (3) STR 177 (Tri- Kolkata)

   Ratio of judgement applicable in respect of penalties under the provisions of the central excise law could not be made applicable under the service tax legislation.

2. Can a show cause notice be issued under section 74 for rectification when an appeal is not filed against finally assessed ST-3 return?

   Onkar Travels (P) Ltd. v. CCEx., Jalandhar 2006 (3) STR 164 (Tri-Del.)

   After an assessment is complete, it could not be claimed subsequently that there was an error and the appellant did not produce relevant records. When an appeal is not filed against finally assessed ST-3 return, a show cause notice could not be issued under section 74 for rectification. The Tribunal held that if an appeal has not been filed within the stipulated time under section 85 ibid, opportunity to re-open assessment could not be read into provisions of section 74 ibid.

3. Can review be ordered in respect of an order-in-original which has merged with the order-in-appeal?

   Inani Carriers v. CCEx., Jaipur 2006 (3) STR 640 (Tri.-Del.)

   The order-in-original passed by the adjudicating authority on 16.01.2003 demanding service tax and imposing penalty on the assessee was upheld by the Commissioner (Appeals) on 13.10.2004. Thereupon, service tax and penalty was paid by the assessee. However, the Commissioner, in exercise of powers vested in him under section 84 of the Finance Act, 1994, issued a show cause notice to the assessee on 12.08.2005 for review of penalty. The assessee contended that the order-in-original had already merged with the order in appeal dated 13.10.2004 and hence, on the date of issue of show cause notice there was no order-in-original which could be reviewed by the Commissioner.

   The Tribunal held that reviewing authority could have preferred an appeal against the order-in-appeal instead of resorting to review of an order that was non-existent on date of issuance of show cause notice.

4. Whether the non-receipt of the response from the department after applying for the registration can be construed as a “reasonable cause” under section 80 to escape penalty?

   Laxmi Color Pvt. Ltd. v. CCEx., Jaipur 2006 (3) STR 760 (Tri.-Del.)

   The assessee applied for service tax registration as soon as his service became exigible to service tax. However, he did not receive any response from the department. Subsequently, a penalty under section 76 and 77 of the Finance Act, 1994 for non payment of service tax and non filing of return was imposed on him. The Tribunal observed that section 80 provides that notwithstanding anything under sections 76 and 77, no penalty should be imposed on the assessee for any failure referred to in the said provisions, if assessee proved that there was a reasonable cause for the said failure.

   The Tribunal held that since the assessee had applied for service tax registration as soon as his service became taxable, there was no fault at his end if he did not receive any response from the department. The Tribunal held that in view of the provisions of section 80, the penalty would not be imposable.

5. Is a show cause notice that does not specify the period and amount of demand valid?

   Praseetha Suresh v. CCEx., Thiruvananthapuram 2006 (3) STR 777 (Tri.-Bang.)

   The Tribunal held that a show cause notice which does not specify the period of demand nor quantifies the demand would not be a valid show cause notice.

6. Can the refund be granted when the service receiver pays less than the billed amount and the service tax is paid on the billed amount?

   CCE & ST, Bangalore v. Standard Chartered Bank 2006 (3) STR 751 (Tri.-Bang.)

   In cases where customers pay less than the billed amount and service tax has been paid by the service provider on the billed amount, refund should be granted to the service provider as there would be no unjust enrichment.

7. Where will the service of supply of furniture, fixtures, lights and light fittings, PA system and other articles, without providing/supplying/erecting a pandal or shamiana, be classified?

   In Re: Kartar Singh Kochar 2005 (187) ELT 304 AAR

   The Authority for the Advance Ruling (AAR) held that as long as the supply of furniture, fixtures, lights and lighting fittings is in connection with the preparation, arrangement, erection or decoration of a pandal or shamiana as defined in sub-section (77a) of the Act, the service would be covered by the definition of ‘pandal or shamiana contractor’ given in sub-section (77b) irrespective of whether the service provider himself provides/supplies/erects the pandal or shamiana or not. Therefore, if the supply of the above items is in connection with the preparation, arrangement, erection or decoration of a pandal or shamiana, the service would be classifiable as a taxable service under clause (zzw) of section 65(105), otherwise it would not fall under that clause.

Regarding the supply of "PA system and other articles" (connected with sound system), the AAR held that since it is not covered by the definition of 'pandal or shamiana contractor', it would not come within the purview of clause (zzw) of Section 65(105) of the Act.

8. Can an advance ruling be sought on a question based on a circular issued by the Board?

Jason James Clemens 2006 (3) STR 452 (AAR)

The Authority for the Advance Ruling held that an advance ruling could not be sought on a question based on a circular issued by the Board as a circular is not a notification within the meaning of clause (d) of sub-section (2) of section 96C.