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A Word About “Select Cases”

Direct Tax Laws and Indirect Tax Laws are the core competency areas of the Chartered Accountancy course. The level of knowledge prescribed at the final level for these subjects is ‘advanced knowledge’. For attaining such a level of knowledge, the students have to be thorough not only with the basic provisions of the relevant laws but also constantly update their knowledge on the statutory developments and judicial decisions. The Board of Studies has been bringing out publications in the area of direct and indirect tax laws to help the students update their knowledge on a continuous basis. “Select Cases in Direct and Indirect Tax Laws – An essential reading for Final Course” is one such publication which helps the students in understanding the process of judicial decisions.

The select significant judicial decisions reported during the years 2010 to 2016 (upto April 2016) are summarized and compiled in this edition of the publication. This, read in conjunction with the Study Material, will enable the students to appreciate the significant issues involved in interpreting and applying the provisions of direct and indirect tax laws to practical situations. It will also help them to develop knowledge and expertise in legal interpretation.

Happy Reading and Best Wishes for the forthcoming examinations!
INDEX

(Students may note that the Chapter numbers and headings hereunder correspond with the Chapter numbers and headings in the Study Materials of Direct Tax Laws and Indirect Tax Laws)

<table>
<thead>
<tr>
<th>Chapter No.</th>
<th>Chapter Heading</th>
<th>Page No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Basic Concepts</td>
<td>1 – 2</td>
</tr>
<tr>
<td>2.</td>
<td>Residential Status and Scope of Total Income</td>
<td>3 – 4</td>
</tr>
<tr>
<td>3.</td>
<td>Income which do not form part of Total Income</td>
<td>5 – 10</td>
</tr>
<tr>
<td>4.</td>
<td>Income from Salaries</td>
<td>11 – 12</td>
</tr>
<tr>
<td>5.</td>
<td>Income from House Property</td>
<td>13 – 17</td>
</tr>
<tr>
<td>6.</td>
<td>Profits and Gains of Business or Profession</td>
<td>18 – 40</td>
</tr>
<tr>
<td>7.</td>
<td>Capital Gains</td>
<td>41 – 56</td>
</tr>
<tr>
<td>8.</td>
<td>Income from Other Sources</td>
<td>57 – 60</td>
</tr>
<tr>
<td>10.</td>
<td>Set-off and Carry Forward of Losses</td>
<td>61 – 62</td>
</tr>
<tr>
<td>11.</td>
<td>Deductions from Gross Total Income</td>
<td>63 – 68</td>
</tr>
<tr>
<td>13.</td>
<td>Assessment of Various Entities</td>
<td>69 – 76</td>
</tr>
<tr>
<td>20.</td>
<td>Income-tax Authorities</td>
<td>77 – 79</td>
</tr>
<tr>
<td>21.</td>
<td>Assessment Procedure</td>
<td>80 – 95</td>
</tr>
<tr>
<td>23.</td>
<td>Advance Rulings</td>
<td>96 – 97</td>
</tr>
<tr>
<td>24.</td>
<td>Appeals and Revision</td>
<td>98 – 109</td>
</tr>
<tr>
<td>25.</td>
<td>Penalties</td>
<td>110 – 113</td>
</tr>
<tr>
<td>26.</td>
<td>Offences and Prosecution</td>
<td>114</td>
</tr>
<tr>
<td>Section</td>
<td>Description</td>
<td>Page(s)</td>
</tr>
<tr>
<td>---------</td>
<td>-------------</td>
<td>---------</td>
</tr>
<tr>
<td>27.</td>
<td>Miscellaneous Provisions</td>
<td>115</td>
</tr>
<tr>
<td><strong>INDIRECT TAX LAWS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Central Excise</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td>Basic Concepts</td>
<td>117 – 126</td>
</tr>
<tr>
<td>2.</td>
<td>Classification of Excisable Goods</td>
<td>127 – 133</td>
</tr>
<tr>
<td>3.</td>
<td>Valuation of Excisable Goods</td>
<td>134 – 141</td>
</tr>
<tr>
<td>4.</td>
<td>CENVAT Credit</td>
<td>142 – 151</td>
</tr>
<tr>
<td>6.</td>
<td>Export Procedures</td>
<td>152 – 156</td>
</tr>
<tr>
<td>8.</td>
<td>Demand, Adjudication and Offences</td>
<td>157 – 161</td>
</tr>
<tr>
<td>9.</td>
<td>Refund</td>
<td>162</td>
</tr>
<tr>
<td>10.</td>
<td>Appeals</td>
<td>163 – 167</td>
</tr>
<tr>
<td>11.</td>
<td>Remission of Duty and Destruction of Goods</td>
<td>168</td>
</tr>
<tr>
<td>13.</td>
<td>Exemption Based on Value of Clearances (SSI)</td>
<td>169 – 173</td>
</tr>
<tr>
<td>14.</td>
<td>Notification, Departmental Clarifications and Trade Notices</td>
<td>174 – 175</td>
</tr>
<tr>
<td>18.</td>
<td>Settlement Commission</td>
<td>176 – 177</td>
</tr>
<tr>
<td><strong>Service Tax</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td>Basic Concepts of Service Tax</td>
<td>178 – 185</td>
</tr>
<tr>
<td>2.</td>
<td>Place of Provision of Service</td>
<td>186 – 187</td>
</tr>
<tr>
<td>5.</td>
<td>Exemptions and Abatements</td>
<td>188 – 189</td>
</tr>
<tr>
<td>6.</td>
<td>Service Tax Procedures</td>
<td>190</td>
</tr>
<tr>
<td>7.</td>
<td>Demand, Adjudication and Offences</td>
<td>191 – 200</td>
</tr>
<tr>
<td>8.</td>
<td>Other Provisions</td>
<td>201 – 204</td>
</tr>
<tr>
<td></td>
<td>Customs and Foreign Trade Policy</td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>-------------------------------------------------------------------------------------------------</td>
<td>---</td>
</tr>
<tr>
<td>1</td>
<td>Basic Concepts</td>
<td>205</td>
</tr>
<tr>
<td>2</td>
<td>Levy of and Exemptions from Customs Duty</td>
<td>206 – 208</td>
</tr>
<tr>
<td>4</td>
<td>Classification of Goods</td>
<td>209 – 211</td>
</tr>
<tr>
<td>5</td>
<td>Valuation under the Customs Act, 1962</td>
<td>212</td>
</tr>
<tr>
<td>7</td>
<td>Importation, Exportation and Transportation of Goods</td>
<td>213</td>
</tr>
<tr>
<td>9</td>
<td>Demand and Appeals</td>
<td>214 – 220</td>
</tr>
<tr>
<td>10</td>
<td>Refund</td>
<td>221 – 223</td>
</tr>
<tr>
<td>13</td>
<td>Settlement Commission</td>
<td>235 – 237</td>
</tr>
<tr>
<td>15</td>
<td>Miscellaneous Provisions</td>
<td>238 – 241</td>
</tr>
</tbody>
</table>
INCOME TAX
1. What is the nature of liquidated damages received by a company from the supplier of plant for failure to supply machinery to the company within the stipulated time – a capital receipt or a revenue receipt?

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

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

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

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


**Facts of the case:** The assessee-firm was constituted in the year 1982 and its return for the assessment year 1993-94 was selected for scrutiny under section 143(3). The controversy was in relation to the capital contribution of ten partners aggregating to `76.57 lakhs. The assessee-firm's explanation that the partners have paid various amounts towards contribution of their share in the capital was not accepted since the source of income for the partners was not explained. The Commissioner (Appeals)
observed that the amounts credited in the names of four partners were valid and that cash credits in the accounts of six other partners in the books of the firm were to be considered afresh by the Assessing Officer.

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

**High Court’s Opinion:** Section 68 directs that if an assessee fails to explain the nature and source of credit entered in the books of account of any previous year, the same can be treated as income. In this case, the amount sought to be treated as income of the firm is the contribution made by the partners to the capital. In a way, the amount so contributed constitutes the very substratum for the business of the firm and it is difficult to treat the pooling of such capital as credit. It is only when the entries are made during the course of business, they can be subjected to scrutiny under section 68.

Where the firm explains that the partners have contributed capital, section 68 cannot be pressed into service. At the most, the Assessing Officer can make an enquiry against the individual partners and not the firm when the partners have also admitted their capital contribution in the firm. The High Court made reference to decision in the case of CIT v. Anupam Udyog 142 ITR 130 (Patna) where it was held if there are cash credits in the books of the firm in the accounts of the individual partners and it is found as a fact that cash was received by the firm from its partner, then, in the absence of any material to indicate that they are the profits of the firm, the cash credits cannot be assessed in the hands of the firm, though they may be assessed in the hands of individual partners.

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

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

CIT v. Alcatel Lucent Canada (2015) 372 ITR 476 (Del)

Facts of the case: The assessee, a company incorporated in France, was engaged in manufacture, trade and supply equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India. Software licensed by the assessee embodied the process which is required to control and manage the specific set of activities involved in the business use of its customers. Software also made available the process to its customers, who used it to carry out their business activities. The Assessing Officer contended that the consideration for supply of software embedded in hardware is 'royalty' under section 9(1)(vi).

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

High Court’s Observations: The High Court, at the outset, noted that the Tribunal had relied upon the precedent in the case of DIT v. Ericsson A.B. (2012) 343 ITR 470 (Del), where the High Court observed that what was sold by the assessee to its Indian customers was a GSM which consisted of both hardware and software. The High Court had also observed that -

(i) the software that was loaded on the hardware did not have any independent existence;
(ii) the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers;
(iii) the software is embedded in the system and there could not be any independent use of such software;
(iv) this software merely facilitates the functioning of the equipment and is an integral part of the hardware.
Further, the High Court had also referred the decision of the Apex Court in *Tata Consultancy Services v. State of Andhra Pradesh* (2004) 271 ITR 401, wherein it was held that software incorporated on a media would be goods liable to sales tax.

**High Court's Decision:** The High Court concurred with the decision of the Tribunal holding that where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as ‘royalty’ for software in terms of section 9(1)(vi).
1. Where an institution engaged in imparting education incidentally makes profit, would it lead to an inference that it ceases to exist solely for educational purposes?

*Queen’s Educational Society v. CIT (2015) 372 ITR 699 (SC)*

**Facts of the case:** The assessee, an educational institution, showed a net surplus of ₹ 6.59 lakhs and ₹ 7.83 lakhs, respectively, for the assessment years 2000-01 and 2001-02. Since it was established with the sole object of imparting education, it claimed exemption under section 10(23C)(iiiad). The Assessing Officer rejected the claim of exemption on the ground that the assessee has made profits and did not exist solely for educational purposes. The Commissioner (Appeals) allowed the assessee’s claim and the Tribunal dismissed the Revenue’s appeal holding that the assessee was engaged undoubtedly in imparting education and the profit was only incidental to the main object of spreading education. However, the High Court restored the order of the Assessing Officer on the reasoning that the institution made profit, year on year, and hence, was not eligible for tax exemption.

**Supreme Court’s Observations:** The Supreme Court observed that the provisions of section 10(23C)(iiiad) provide for three requirements, namely,

(i) the education institution must exist solely for educational purposes;

(ii) it should not be for purposes of profit; and

(iii) the aggregate annual receipts of such institution should not exceed the amount as may be prescribed. Such monetary limit is ₹ 1 crore as per Rule 2BC.

The Supreme Court concurred with the Tribunal’s reasoning that profit is only incidental to the main object of spreading education. If there is no surplus arising out of the difference between receipts and outgoings, the trust will not be able to achieve the objectives. Any education institution cannot be run in rented premises for all the times and without necessary equipment and without paying to the staff engaged in imparting education. The assessee is not getting any financial aid/assistance from the Government or other philanthropic agency and, therefore, to achieve the objective, it has to raise its
own funds. However, such surplus would not come within the ambit of denying exemption under section 10(23C)(iiiad).

Further, the Apex Court made reference to the tests culled out in its own decisions in the case of Addl. CIT v. Surat Art Silk Cloth Manufacturers Association [1980] 121 ITR 1, Aditanar Educational Institution v. Addl. CIT [1997] 224 ITR 310 and American Hotel and Lodging Association Educational Institute v. CBDT [2008] 301 ITR 86, which would apply for determining whether an educational institution exists solely for education purposes and not for purposes of profit.

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

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

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

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

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

(e) The ultimate test is whether on an overall view of the matter in the concerned assessment year, the object is to make profit as opposed to educating persons.

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

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

*CIT v. Kribhco (2012) 349 ITR 0618 (Delhi)*

**Facts of the case:** In the present case, the assessee is a co-operative society engaged in marketing of fertilizers and purchase and processing of seeds. The assessee had claimed deduction under section 80P(2)(d) on dividend income received from NAFED and co-operative bank and also on interest on deposits made with co-operative banks.
The Assessing Officer, relying upon section 14A, contended that the aforesaid income were not included in the total income of the assessee and therefore, expenditure with respect to such income should be disallowed.

**High Court's Observations:** The High Court observed that section 14A is not applicable for deductions, which are permissible and allowed under Chapter VIA. Section 14A is applicable only if an income is not included in the total income as per the provisions of Chapter III of the Income-tax Act, 1961. Deductions under Chapter VIA are different from the exclusions/exemptions provided under Chapter III.

The words “do not form part of the total income under this Act” used in section 14A are significant and important. Income which qualifies for deductions under section 80C to 80U has to be first included in the total income of the assessee and then allowed as a deduction. However, income referred to in Chapter III do not form part of the total income and therefore, as per section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income.

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

**Note** – The Department's Special Leave Petition against the above Delhi High Court judgement was dismissed on 15/2/2013.

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

**CIT v. Karimangalam Onriya Pengal Semipu Amaipu Ltd. (2013) 354 ITR 483 (Mad)**

**High Court's Observations:** On this issue, the Madras High Court observed that as per the provisions of section 12AA(2), every order granting or refusing registration under section 12AA(1)(b), shall be passed by the registering authority before the expiry of six months from the end of the month in which the application was received under section 12A(1)(a) or section 12A(1)(aa).

The Madras High Court observed the decision of the Orissa High Court, in Srikhetra, A.C. Bhakti-Vedanta Swami Charitable Trust v. ACIT (2006) (II) OLR 75, wherein it was held that the period of six months as provided under section 12AA(2) is not mandatory. In that case, the Orissa High Court observed that in order to ascertain whether a provision is mandatory or not, the expression 'shall' is not always decisive. The nature of the statutory provision, whether mandatory or directory, has to be ascertained not only from the wording of the statute, but also from the nature and design of the statute and the purpose sought to be achieved. Further, since the consequence for non-adherence of the time limit of six months is not spelt out in the statute, it cannot be said that passing the order within such time limit is mandatory in nature. The Orissa High Court also
opined that in the absence of any clear statutory intent to the contrary, when public duty is to be performed by the public authorities, the time-limit which is granted by the statute is normally directory and not mandatory. Hence, though the word 'shall' has been used in section 12AA(2), the period of six months provided thereunder is not mandatory but directory in nature.

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

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

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

**DIT (Exemptions) v. Meenakshi Amma Endowment Trust (2013) 354 ITR 219 (Kar.)**

**Facts of the case**: In the present case, the assessee, being a trust, made an application under section 12A for issuance of registration within nine months of its formation. The registration authority issued a show cause notice to the assessee-trust to furnish its audited accounts as also material indicating the actual activities undertaken by the trust. In response to the said notice, the assessee-trust furnished the details, wherein it indicated that it has not yet commenced any charitable activity. The concerned registration authority, not being satisfied with the reply, refused to grant registration to the trust on the ground that it has not commenced any charitable activity.

**Issue**: The issue under consideration is whether registration under section 12AA can be denied on the ground of non-commencement of charitable activity, where an application for registration has been made within a short-time span after the formation of the trust.

**High Court's Observations**: On this issue, the Karnataka High Court opined that an application under section 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in case the registration is sought much later after formation of the trust.

The High Court further observed that, in this case, the corpus fund included contribution made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities. Also, it was not the Revenue's contention that the assessee-trust had collected lots of donations for the activities of the trust, by the time its application came up for
consideration before them. When the application for registration was made, the trust, therefore, did not have sufficient funds for commencement of its activities.

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

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

*DIT (Exemption) v. Khetri Trust* (2014) 367 ITR 723 (Del)

**Facts of the case:** As per the ‘will’ of Late Raja Bahadur Sardar Singh, the entire property, including immovable property and shares in foreign companies, were bequeathed to the trust. However, the properties could not be transferred to or acquired by the trust because of ongoing litigation in the Court. In the probate proceedings, the ‘will’ was challenged and the probate proceedings are still pending.

The trustees paid ₹ 1,10,000 for raising a memorial for late Raja Bahadur Sardar Singh and the said amount was given to a business entity for this purpose, but due to the ongoing dispute, such project was not completed. The business entity, however, paid interest on the said amount. The Assessing Officer denied the benefit of exemption under section 11, on the ground that the asset held in the form of shares of foreign company and the advance given to business entity were contrary to the mandate of section 11(5) and thus, the condition specified in section 13(1)(d) has been violated.

**Appellate Authorities' views:** The Commissioner (Appeals) observed that the validity of the will has been challenged in the probate proceedings; therefore, till the ‘will’ is probated and affirmed as genuine, the trust would not acquire the legal right on the property for the purpose of Income-tax Act, 1961. In case the probate is denied, the properties would not devolve on the trust. The shares in foreign company were still in the name of the donor, Late Raja Bahadur Sardar Singh, and its acquisition by the trust is dependent upon the adjudication of the probate.

Further, with regard to the advance given to the business entity, the Commissioner (Appeals) found that the said amount cannot be treated as an investment which was covered and regulated by section 11(5), since the intent and purpose behind the payment was not investment.
These views of the Commissioner (Appeals) were confirmed by the Tribunal.

**High Court’s Decision:** Based on the above factual findings, elucidated and affirmed by the Commissioner (Appeals) and the Tribunal, the High Court held that there was no violation of section 11(5) in this case.

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

*DIT (Exemptions) v. Ramoji Foundation (2014) 364 ITR 85 (AP)*

**Facts of the case:** The settler gave power to the trustees to amend, alter, change or modify the objects of the trust deed with the approval of two-third majority. Such additional or altered object, however, must be of charitable nature falling within the definition thereof under the relevant provisions of the Income-tax Act, 1961. Based on these provisions of the trust deed and referring to the Supreme Court decision in *CIT v. Kamla Town Trust (1996) 217 ITR 699*, the Tribunal held that the trust deed can be amended without approaching the Civil Court. Therefore, the Tribunal directed the DIT (Exemptions) to grant registration to the assessee-trust under section 12AA on the basis of the amended trust deed.

**Issue:** The issue under consideration before the High Court is whether the Tribunal was correct in holding that the amendment to the trust deed can be made without approaching the Civil Court, on the basis of the decision in the case of *Kamla Town Trust (Supra)*.

**High Court’s Observations:** The High Court observed that the power has been given to the trustees by the settler to amend the trust deed without approaching the Civil Court, provided all the conditions laid down by the settler are fulfilled. The sanction of Civil Court is required only when there is no such power. When the power has been specifically given to the trustees by the settler, no further power from the Civil Court is required.

The High Court made reference to the *Kamla Town Trust’s* case and observed that it has not been stated anywhere in the Supreme Court’s decision that in spite of the power given to them by settler to amend the trust deed, the trustees have to approach the Civil Court to get the trust deed rectified.

**High Court’s Decision:** Accordingly, in this case, the High Court held that the Tribunal has correctly dealt with the matter and the trust deed amended by the trustees can be relied upon by the Revenue authorities for the purpose of granting registration under section 12AA.
1. Can notional interest on security deposit given to the landlord in respect of residential premises taken on rent by the employer and provided to the employee, be included in the perquisite value of rent-free accommodation given to the employee?

_CIT v. Shankar Krishnan (2012) 349 ITR 0685 (Bom.)_

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

**Assessing Officer’s contention:** The Assessing Officer, however, contended that since the employer had given interest-free deposit of ₹ 30,00,000 to the landlord, interest @12% on the said deposit is required to be taken into consideration for estimating the fair rental value of the flat given to the assessees and accordingly, he enhanced the perquisite value of the residential accommodation provided to the employee by such notional interest. The Commissioner (Appeals) upheld the decision of the Assessing Officer.

**Tribunal’s Observations:** The Tribunal observed that, as per Rule 3 of the Income-tax Rules, 1962, the perquisite value of the residential accommodation provided by the employer shall be the actual amount of lease rent paid or payable by the employer or 10% (now, 15%) of salary, whichever is lower, as reduced by the rent, if any, actually paid by the employee. The Tribunal, therefore, held that there is no concept of determination of the fair rental value for the purpose of ascertaining the perquisite value of the rent-free accommodation provided to the employees.
High Court's Decision: On appeal by the Revenue, the Bombay High Court held that the Assessing Officer is not right in adding the notional interest on the security deposit given by the employer to the landlord in valuing the perquisite of rent-free accommodation, since the perquisite value has to be computed as per Rule 3 and Rule 3 does not require addition of such notional interest. Thus, the perquisite value of the residential accommodation provided by the employer would be the actual amount of lease rental paid or payable by the employer, since the same was lower than 10% (now 15%) of salary.

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

CIT (TDS) v. Director, Delhi Public School (2011) 202 Taxman 318 (Punj. & Har.)

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

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

High Court's Decision: The Punjab and Haryana High Court, in the above case, held that on a plain reading of Rule 3(5), it flows that, in case the value of perquisite for free/concessional educational facility arising to an employee exceeds ₹ 1,000 per month per child, the whole perquisite shall be taxable in the hands of the employee and no standard deduction of ₹ 1,000 per month per child can be provided from the same. It is only in case the perquisite value is less than ₹ 1,000 per month per child, the perquisite value shall be nil. Therefore, ₹ 1,000 per month per child is not a standard deduction to be provided while calculating such a perquisite.
1. **Would income from letting out of properties by a company, whose main object as per its memorandum of association is to acquire and let out properties, be taxable as its business income or income from house property, considering the fact that the entire income of the company as per its return of income was only from letting out of properties?**

**Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673 (SC)**

**Facts of the Case:** The assessee-company was incorporated under the Companies Act, 1956. Its main objective, as stated in the memorandum of association, is to acquire properties in the city of Madras and let out those properties. The company had rented out such properties and the rental income was shown as its business income in the return filed by the assessee.

The Assessing Officer, however, assessed the rental income under the head “Income from house property”. On appeal, the Commissioner (Appeals) concurred with the assessee’s view that the rental income, in this case, was the company’s business income. The Appellate Tribunal also supported the view of the Commissioner (Appeals).

**High Court’s Opinion:** The High Court allowed the Department’s appeal holding that income derived from letting out of properties has to be assessed as income from house property. It held so on the basis of the Supreme Court ruling in *East India Housing and Land Development Trust Ltd. v. CIT (1961) 42 ITR 9*, wherein it was decided that income from letting out of shops and stalls was to be assessed as income from house property, in the case of a company whose main object of was buying and developing landed properties and promoting and developing markets.

**Supreme Court’s Observations:** The Supreme Court observed that the High Court had pronounced its ruling on the basis of the decision of the Apex Court in *East India Housing and Land Development Trust Ltd.*’s case, wherein the letting out of property was not the object of the company at all. Therefore, in that case, the Apex Court was of the opinion that the character of the income which was from house property had not changed merely because it was received by the company formed with the object of developing and setting up properties.

The Supreme Court further observed the law laid down authoritatively and succinctly by it in *Karanpura Development Co. Ltd. v. CIT [1962] 44 ITR 362*. In that case, the
assessee-company was formed with the object of, *inter alia*, acquiring and disposing of the underground coal mining rights in certain coal fields and it had restricted its activities to acquiring coal mining leases over large areas, developing them as coal fields and then sub-leasing them to collieries and other companies. Thus, in that case, the leasing out of the coal fields to the collieries and other companies was the business of the assessee. The income which was received from letting out of those mining leases was shown as business income. Department took the position that the same was to be treated as income from the house property. Thus, in similar circumstances, an identical issue arose before the Apex Court. The Apex Court pointed out that the deciding factor as to the head under which the income was to be assessed is not the ownership of land or leases but the nature of the activity of the assessee and the nature of the operations in relation to them. It was highlighted and stressed that the objects of the company must also be kept in view to interpret the activities. In support of the aforesaid proposition, a number of judgments of other jurisdictions, i.e., Privy Council, House of Lords in England and the US Courts were taken note of.

After applying the aforesaid principle to the facts, the Apex Court had arrived at the conclusion that such income had to be treated as income from business and not as income from house property.

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

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

*New Delhi Hotels Ltd. v. ACIT (2014) 360 ITR 0187 (Delhi)*

### High Court’s Observations:
On this issue, in *CIT v. Ansal Housing Finance and Leasing Co. Ltd.* (2013) 354 ITR 180, where the deemed rent (i.e., Expected Rent) formed the basis of computation of income from unsold flats held as stock-in-trade, the Delhi High Court held that such rent was taxable under the head “Income from house property”.
property". Further, in CIT v. Discovery Estates Pvt. Ltd. and CIT v. Discovery Holding Pvt. Ltd. (2013) 356 ITR 159, the same issue emerged when the actual rent formed the basis of computation of income from unsold flats held as stock-in-trade. In that case also, the Delhi High Court held that the income was taxable under the head "Income from house property".

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

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

3. Under what head of income should income from letting out of godowns and provision of warehousing services be subject to tax - "Income from house property" or "profits and gains of business or profession"?

**CIT v. NDR Warehousing P Ltd (2015) 372 ITR 690 (Mad)**

**Facts of the case:** The assessee engaged in the business of warehousing, handling and transport business claimed income from letting out of buildings and godowns as business income. The Assessing Officer assessed such income as "Income from house property".

**Appellate Authorities' Observations:** The Commissioner (Appeals) observed that the assessee's activity was not merely letting out of warehouses but storage of goods with provision of several auxiliary services such as pest control, rodent control and fumigation service to prevent the goods stored from being affected by vagaries of moisture and temperature. Further, service of security and protection was also provided to the goods stored. There is, therefore, no dispute that the assessee carries on the activity in an organised manner. These activities are more than mere letting out of the godown for tenancy.

The Tribunal noted that the objects clause of the memorandum of association of the company clearly shows that the assessee-company was incorporated with the object of carrying on the business of warehousing and letting/renting of godowns and providing facilities for storage of articles or things and descriptions whatsoever. The profit and loss account of the assessee-company shows that its main source of income is storage charges and maintenance or user charges. Even substantial part of the expenses also relate to the salaries of employees engaged in the maintenance and upkeep of the godowns and warehouses. Based on these facts, Tribunal concurred with the findings of the Commissioner (Appeals) and held that the income of the assessee from letting out of
warehouses and godowns is chargeable under the head “Profits and gains of business or profession” and not “Income from house property”.

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

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

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

CIT v. Hariprasad Bhojnagarwala (2012) 342 ITR 69 (Guj.) (Full Bench)

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

High Court’s Observations & Decision: On the above mentioned issue, the Gujarat High Court observed that a firm, which is a fictional entity, cannot physically reside in a house property and therefore a firm cannot claim the benefit of this provision, which is available to an individual owner who can actually occupy the house. However, the HUF is a group of individuals related to each other i.e., a family comprising of a group of natural persons. The said family can reside in the house, which belongs to the HUF. Since a HUF cannot consist of artificial persons, it cannot be said to be a fictional entity. Also, it was observed that since singular includes plural, the word "owner" would include "owners" and the words "his own" used in section 23(2) would include "their own".

Therefore, the Court held that the HUF is entitled to claim benefit of self-occupation of house property under section 23(2).

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

CIT v. Asian Hotels Ltd. (2010) 323 ITR 490 (Del.)

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

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

Section 23(1) deals with the determination of the expected rent of a let out property for computing the income from house property. It provides that the expected rent is deemed to be the sum for which the property might reasonably be expected to be let out from year to year. This contemplates the possible rent that the property might fetch and certainly not the interest on fixed deposit that may be placed by the tenant with the landlord in connection with the letting out of such property. Thus, the notional interest is neither assessable as business income nor as income from house property.
1. Under which head of income is franchise fee received by an assessee in tourism business, against special rights given to franchisees to undertake hotel business in assessee’s property, taxable?

_Tamil Nadu Tourism Development Corporation Ltd v. Dy. CIT (2014) 368 ITR 533 (Mad)_

**Facts of the case:** The assessee-company, a wholly owned Government of Tamil Nadu Undertaking, was engaged in the business of development of tourism in the State. It leased some of its loss making hotel units to various franchisees for a consideration. The agreement envisaged leasing of hotels with attendant conditions including display of its name above the name of the franchisee in the name board, quality of food supplied, maintenance of rooms and buildings etc. to be followed by the franchisee. The assessee offered franchise fee as “Income from house property” and claimed deduction at 30% of Net Annual Value (NAV) under section 24, which was negatived in the assessment.

**Appellate Authorities' Views:** The Commissioner (Appeals) observed that the assessee was not engaged in any commercial or business activity to earn business income and thus, upheld the contention of the assessee that such income is taxable under the head “Income from house property”. The Tribunal, however, observed that the assessee had not withdrawn from the business of carrying on tourism activities and it was only to earn more profits from its loss making units that it has let out the properties including business to franchisees. Thus, it held that the income arising from letting out of such properties is chargeable to tax as income from business. It negatived the claim for deduction of 30% of NAV made by the assessee.

**High Court’s Opinion:** The issue before the High Court is whether the income by way of franchisee fee is taxable as income from business or as income from house property.

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

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

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

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

*CIT v. Henkel Spic India Ltd (2015) 379 ITR 322 (SC)*

Facts of the case: The assessee came out with a public issue of shares on January 29, 1992. The date of closure is February 3, 1992 (A.Y.1992-93). The share application money collected from the applicants were deposited in the bank for 46 days in accordance with the requirement of law. On this deposit, assessee earned interest of ₹183.32 lakhs. The shares were ultimately allotted in June 1992 (A.Y.1993-94). The applicants who were not allotted the shares got their application money refunded along with the interest. However, the Assessing Officer taxed the entire interest income in the year of public issue i.e., A.Y.1992-93 and ignored the subsequent event viz. allotment of shares in the A.Y.1993-94.

Assessee’s Contention: The assessee contended that interest on deposit would only accrue in the assessment year 1993-94, being the year of allotment, since shares were allotted in June 1992. Before that time, the amount was kept in trust by the assessee and belonged to the applicants who wanted to subscribe for the shares. The assessee also contended that after certain amounts were refunded, which included interest to those whose application money was returned, the actual amount of interest which was left became the income and, therefore, this income accrued only in the year 1993-94.

High Court’s Observations: The High Court noted that the company is required to keep the money in a bank account which yields interest. The interest so earned cannot be regarded as an amount which is fully available to the assessee for its own use, since interest is an amount which accrued on a fund which was held in trust until the allotment of shares got completed and moneys are returned to those to whom shares are not allotted.
The High Court also observed that no part of this fund, i.e., neither the principal nor the interest, can be utilized by the company until the allotment process is completed. When the amount is repaid in cases of non-allotment of shares, it has to be repaid with such interest as may be prescribed having regard to the length of time or period of delay in returning the money to them. It is only after the allotment process is completed and all moneys which are refundable are refunded with interest, wherever interest becomes payable, the balance remaining application money can be regarded as belonging to the company. The application money as also interest earned remain in trust in favour of the general body of the applicants until the process of allotment is completed in all respects.

As the amount of interest in the bank account includes interest payable to the applicants to whom the shares are not allotted, the trust would terminate only after allotment. The interest on balance application money (in respect of which shares have been allotted) amount would accrue to the company only after completion of allotment.

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

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

*CIT v. K and Co. (2014) 364 ITR 93 (Del)*

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

**Issue:** The issue under consideration is whether such interest income would be taxable under the head ‘Profits and Gains from Business or Profession’ or under the head ‘Income from other sources’.

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

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

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

_CIT v. TVS Motors Ltd (2014) 364 ITR 1 (Mad)_

**Facts of the case:** The assessee company, engaged in manufacture of motor cycles and spares, filed its return of income for the relevant assessment year. It later filed a revised return in which it claimed deduction under section 31 in respect of expenditure incurred on replacement of dies and moulds in the place of worn out dies and moulds. The claim was rejected by the Assessing Officer on the ground that the assessee had claimed depreciation in respect of such expenditure in the earlier years.

**Assessee’s contention:** The assessee contended that dies and moulds are not plant and machinery but are attachments to make plant and machinery function as per the requirements of the business. The assessee relied on the Madras High Court decision in the case of _Super Spinning Mill Ltd v. Asstt.CIT (2013) 357 ITR 720_, where expenditure on replacement of machinery parts was allowed as revenue expenditure.

**High Court’s Observations:** The High Court referred to the Supreme Court ruling in _CIT v. Mahalakshmi Textile Mills Ltd. (1967) 66 ITR 710_ and observed that as long as there was no change in the performance of the machinery and the parts that were replaced were performing precisely the same function, the expenditure has to be considered as current repairs of plant and machinery. In that case, the Supreme Court also observed that if grant of relief to an assessee is justified on another ground, the Revenue is bound to consider such claim of granting the relief. Accordingly, in this case, even though the assessee has claimed depreciation in the earlier years, the claim of the assessee for deduction of expenditure on replacement of moulds and dies as ‘current repairs’ is justified on the ground that there was no change in the performance of the machinery on account of such replacement.

The High Court also referred to its decision in the case of _CIT v. Machado Sons (2014) 2 ITR – OL 385_ holding that when the object of the expenditure was not for bringing into existence a new asset or to obtain a new advantage, the said expenditure qualifies as ‘current repairs’ under section 31.

**High Court’s Decision:** Applying the rationale of above decisions, the High Court held that “moulds & dies” are not independent of plant and machinery but are parts of plant and machinery. Once the dies are worn out, they had to be replaced so that the machine can produce the product according to business specifications. Thus, the expenditure incurred by the assessee towards replacement of parts of machinery to ensure its performance without bringing any new asset or advantage, is eligible for deduction as ‘current repairs’ under section 31.
5. Can depreciation on leased vehicles be denied to the lessor on the ground that the vehicles are registered in the name of the lessee and that the lessor is not the actual user of the vehicles?

_I.C.D.S. Ltd. v. CIT (2013) 350 ITR 527 (SC)_

**Facts of the case:** The assessee is a non-banking finance company engaged, _inter alia_, in the business of leasing and hire purchase. The assessee purchased vehicles directly from the manufacturers and as a part of its business, leased out these vehicles to its customers, after which the physical possession of the vehicles was with the lessee. Further, the lessees were registered as the owners of the vehicles in the certificate of registration issued under the Motor Vehicles Act, 1988. The assessee-lessee claimed depreciation on such vehicles.

The Assessing Officer disallowed the depreciation claim on the ground that the assessee’s use of these vehicles was only by way of leasing out the vehicles to others and not as actual user of the vehicles in the business of running them on hire and secondly, the vehicles were registered in the name of the lessee and not the assessee-lessee. Therefore, according to the Assessing Officer, the assessee had merely financed the purchase of these assets and was neither the owner nor the user of these assets.

**High Court’s view:** The High Court was also of the view that the assessee could not be treated as the owner of the vehicles, since the vehicles were not registered in the name of the assessee and the assessee had only financed the transaction. Therefore, the High Court held that the assessee was not entitled to claim depreciation.

**Supreme Court’s Observations:** The Supreme Court observed that section 32 imposes a twin requirement of “ownership” and “usage for business” as conditions for claim of depreciation thereunder. The Apex Court further observed that as far as usage of the asset is concerned, the section requires that the asset must be used in the course of business. It does not mandate actual usage by the assessee itself. In this case, the assessee did use the vehicles in the course of its leasing business. Hence, this requirement of section 32 has been fulfilled, notwithstanding the fact that the assessee was not the actual user of the vehicles.

The Supreme Court further noted that section 2(30) of the Motor Vehicle Act, 1988, is a deeming provision which creates a legal fiction of ownership in favour of the lessee only for that Act, not for the purpose of law in general. No inference could be drawn from the registration certificate as to ownership of the legal title of the vehicles, since registration in the name of the lessee during the period of lease is mandatory as per the Motor Vehicles Act, 1988. If the lessee was in fact the legal owner, he would have claimed depreciation on the vehicles which was not the case.

The Apex Court observed that as long as the assessee-lessee has a right to retain the legal title against the rest of the world, he would be the owner of the asset in the eyes of law. In this regard, the following provisions of the lease agreement are noteworthy –

- The assessee is the exclusive owner of the vehicle at all points of time;
• The assessee is empowered to repossess the vehicle, in case the lessee committed a default;
• At the end of the lease period, the lessee was obliged to return the vehicle to the assessee;
• The assessee had a right of inspection of the vehicle at all times.

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

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

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

*CIT v. BSES Yamuna Powers Ltd (2013) 358 ITR 47 (Delhi)*

**Assessee’s contention vis-a-vis Department’s contention:** The assessee claimed depreciation on computer accessories and peripherals at the rate of 60%, being the eligible rate of depreciation on computers including computer software. However, the Revenue contended that computer accessories and peripherals cannot be treated at par with computers and computer software, and hence were eligible for depreciation at the general rate applicable to plant and machinery, i.e., 15%.

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

**Note** - The Delhi High Court, in *CIT v. Orient Ceramics and Industries Ltd. [2013] 358 ITR 0049*, following its own judgment in the above case, held that depreciation on UPS is allowable @ 60%, being the eligible rate of depreciation on computers including computer software, and not at the general rate of 15% applicable to plant and machinery.

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

*Areva T and D India Ltd. v. DCIT (2012) 345 ITR 421 (Delhi)*

**Facts of the case:** In the present case, a transferor under a transfer by way of slump sale, transferred its ongoing business unit to the assessee company. On perusal of the sale consideration, it was found that some part of it was attributable to the tangible...
assets and the balance payment was made by the assessee company for acquisition of various business and commercial rights categorized under the separate head, namely, "goodwill" in the books of account of the assessee. These business and commercial rights comprised the following: business claims, business information, business records, contracts, skilled employees, know-how. The assessee company claimed depreciation under section 32 on the excess amount paid which was classified as "goodwill" under the category of intangible assets.

**Assessing Officer's contention vis-a-vis Assessee's contention:** The Assessing Officer accepted the allocation of the slump sale between tangible and intangible assets (described as Goodwill). However, he claimed that depreciation in terms of section 32(1)(ii) is not allowable on goodwill. He further contended that the assessee has failed to prove that such payment can be categorized under "other business or commercial right of similar nature" as mentioned in section 32(1)(ii) to qualify for depreciation.

The assessee argued that any right which is obtained for carrying on the business effectively, is likely to come within the sweep of the meaning of intangible asset. Therefore, the present case shall qualify for claiming depreciation since business claims, business information, etc, are in the nature of "any other business or commercial rights". However, the Revenue argued that, the business or commercial rights acquired by the assessee would not fall within the definition of intangible assets under section 32.

**High Court's Observations:** The Delhi High Court observed that the principle of *ejusdem generis* provides that where there are general words following particular and specific words, the meaning of the latter words shall be confined to things of the same kind. The Court applied this principle for interpreting the expression "business or commercial rights of similar nature" specified in section 32(1)(ii). It is seen that such rights need not be the same as the description of "know-how, patents, trademarks, licenses or franchises" but must be of similar nature as that of specified assets. The use of these general words after the specified intangible assets in section 32(1)(ii) clearly demonstrates that the Legislature did not intend to provide for depreciation only in respect of specified intangible assets but also to other categories of intangible assets, which were neither feasible nor possible to exhaustively enumerate.

Further, it was observed that the above mentioned intangible assets are invaluable assets, which are required for carrying on the business acquired by the assessee without any interruption. In the absence of the aforesaid intangible assets, the assessee would have had to commence business from scratch and go through the gestation period whereas by acquiring the aforesaid business rights along with the tangible assets, the assessee has got a running business. The aforesaid intangible assets are, therefore, comparable to a license to carry on the existing business of the transferor.

**High Court's Decision:** The High Court, therefore, held that the specified intangible assets acquired under the slump sale agreement by the assessee are in the nature of intangible asset under the category "other business or commercial rights of similar nature" specified in section 32(1)(ii) and are accordingly eligible for depreciation under section 32(1)(ii).
8. Is the assessee entitled to depreciation on the value of goodwill considering it as an asset within the meaning of Explanation 3(b) to Section 32(1)?

*CIT v. Smifs Securities Ltd. (2012) 348 ITR 302 (SC)*

**Facts of the case:** In this case, the assessee has paid an excess consideration over the value of net assets of the amalgamating company acquired by it, which is treated as goodwill, since the extra consideration was paid towards the reputation which the amalgamating company was enjoying in order to retain its existing clientele. The assessee had claimed depreciation on the said goodwill. However, the Assessing Officer contended that the goodwill is not an asset falling under Explanation 3 to section 32(1) and therefore, is not eligible for depreciation.

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

**Supreme Court’s Decision:** A reading of the words ‘any other business or commercial rights of similar nature’ in Explanation 3(b) indicates that goodwill would fall under the said expression. In the process of amalgamation, the amalgamated company had acquired a capital right in the form of goodwill because of which the market worth of the amalgamated company stood increased.

Therefore, it was held that ‘Goodwill’ is an asset under Explanation 3(b) to section 32(1) and depreciation thereon is allowable under the said section.

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

*Federal Bank Ltd. v. ACIT (2011) 332 ITR 319 (Kerala)*

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

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

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

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

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

**High Court's Observations:** The High Court observed that in the context of the Income-tax Act, 1961, having regard to the ground realities and further having regard to the object of the Act i.e., to tax the income, the owner is a person who is entitled to receive income from the property in his own right. The Supreme Court, in *CIT v. Podar Cement P Ltd.* (1997) 226 ITR 625, observed that the owner need not necessarily be the lawful owner entitled to pass on the title of the property to another.

**High Court's Decision:** Since, in this case, the assessee has made available all the documents relating to the business and also established before the authorities that she is the beneficial owner, the High Court held that she was entitled to claim depreciation even though she was not the legal owner of the buses.

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

**CIT v. Gujarat State Road Transport Corp. (2014) 366 ITR 170 (Guj)**

**Facts of the case:** The assessee collected employees' contribution to Provident Fund and ESI which were remitted, after the due date under the relevant Acts but before the 'due date' for filing the return specified in section 139(1). The assessing authority held that the amount collected by way of employees' contribution to PF and ESI are income under section 2(24)(x) and their remittance is governed by section 36(1)(va). The time limit prescribed for remitting the contribution is the 'due date' prescribed under the Provident Funds Act, Employees' State Insurance Act, rule, order or notification issued thereunder or under any standing order, award, contract or service or otherwise.

**Issue:** The issue under consideration is whether extended time limit upto the due date of filing the return contained in section 43B would be available in respect of remittances which are governed by section 36(1)(va).

**High Court's Observations:** The High Court noted that section 43B(b) pertaining to employer's contribution cannot be applied with respect to employees' contribution which is governed by section 36(1)(va). So far as the employee's contribution is concerned, the *Explanation* to section 36(1)(va) continues to remain in the statute and there is no provision...
for applying the extended time limit provided under section 43B for remittance of employee's contribution. The amount of employee's contribution to PF and ESI is an income upon recovery from salary and its remittance within the 'due date' as specified in Explanation to section 36(1)(va) makes it eligible for deduction. Employees' contribution recovered by the employer is not eligible for extended time limit up to the due date of filing of return, which is available under section 43B in the case of employer's own contribution.

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

**Note:** A contrary view was expressed by Uttrakhand High Court in the case of CIT v. Kichha Sugar Co. Ltd. (2013) 356 ITR 351 holding that the employees' contribution to provident fund, deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer-assessee with the provident fund authority on or before the due date of filing the return for the relevant previous year.

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

Shyam Burlap Co Ltd v. CIT (2016) 380 ITR 151 (Cal)

**Facts of the case:** The assessee company acquired premises and raised two new constructions on the said premises. It sold one of the new constructions and the profit and loss arising therefrom was assessed under the head 'Profits and Gains from Business or Profession'. The ground floor of the second new construction was given on lease. The lease rent was to be revised every five years. However, the lessee refused to increase the lease rent on the ground of business difficulties after the expiry of the said period. The said lessee offered to vacate the premises provided the assessee paid adequate compensation. The assessee company agreed to pay ₹ 50 lakhs as compensation. There was another tenant who also agreed to vacate the premises against a compensation of ₹ 3.50 lakhs. The assessee paid the compensation to both the tenants and obtained the possession.

The aggregate amount of compensation of ₹ 53.50 lakhs claimed as business expenditure treating it as revenue in nature. However, the Assessing Officer disallowed the claim of the assessee by treating the amount of compensation as capital expenditure on the ground that such payment was made for acquiring a benefit of enduring nature.

**Appellate Authorities’ views:** After examination of the object clause of the Memorandum of Association (MOA) of the assessee company, the Commissioner (Appeals) found that 85
percent of the income of the assessee is from rent and lease rentals. Based on this fact, it held that the income from rent constituted the assessee’s business income and that the compensation of ₹ 53.50 lakhs was expenditure laid out wholly and exclusively for the purposes of business on grounds of commercial expediency. Thus, it is a revenue expenditure allowable as deduction from business income.

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

**High Court’s Observations:** The High Court referred to the decision of the Apex Court in the case of *Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673*, wherein it was laid down that the objects of the company must also be kept in mind while interpreting the nature of rental income and the head under which the same is taxable. In that case, it was held that since the main object of the company was to earn rental income by letting out of properties, such income constituted its business income and not income from house property.

Accordingly, the High Court, in this case, took note of the objects clause of the MOA of the assessee which permitted the assessee to carry on the business of letting out premises. Also 85% of the assessee’s income was by way of deriving rent and lease rentals. The compensation paid was to obtain possession from the lessee / tenant so as to earn a higher rental income. Thus, the payment of compensation had arisen out of business necessity and commercial expediency.

As the compensation was not for acquiring a property, it cannot be said that the payment made was for having a benefit of enduring nature. The compensation, in fact, was paid to the existing tenants to have their portions vacated to have new tenants with higher rent and, thus, to earn higher rental income which was a business activity permitted by the memorandum.

The assessee, being the owner of the property, was carrying on business by letting out of properties and the compensation paid to the existing tenants was for deriving higher rent by re-letting out the properties which was in line with the MOA of the company.

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

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

*Taparia Tools Ltd v. Joint CIT (2015) 372 ITR 605 (SC)*

**Facts of the case:** The assessee issued non-convertible debentures and gave two options as regards payment of interest to the subscribers / debenture holders. They
could either receive interest periodically (i.e. half-yearly) at 18% per annum, over a period of 5 years or opt for one time upfront payment of ₹ 55 per debenture. In the second option, ₹ 55 per debenture was to be paid immediately upfront on account of interest. At the end of the debenture period of five years, the debentures were to be redeemed at the face value of ₹ 100. The said upfront payments of interest on debentures were shown by the assessee as deferred revenue expenditure in the books of accounts to be written off over a period of five years. Notwithstanding this accounting treatment given to the payment qua interest, assessee claimed such expenditure as fully deductible expenditure in the first year, being the year of payment. The Assessing Officer, however, treated the expenditure as “deferred revenue expenditure” to be allowed over the tenure of debentures and hence, allowed only one-fifth of the payment made and disallowed the balance of claim.

**Supreme Court’s Observations:** The Supreme Court observed that while examining the allowability of deduction, the Assessing Officer has to consider the genuineness of borrowing. Under section 36(1)(iii), any amount paid on account of interest is an admissible deduction, if the capital was borrowed by the assessee and the borrowing was for the purpose of business or profession. The Supreme Court opined that once the genuineness was proved and the conditions of section 36(1)(iii) read with section 43(2) were satisfied, the benefit of deduction in the year in which the amount of interest was actually paid or incurred cannot be denied. In the present case, the Assessing Officer has not disputed the issue of debentures and use of funds for business purposes.

Moreover, the Supreme Court also noted that there is no concept of deferred revenue expenditure in the Income-tax Act, 1961 except under specified sections such as section 35D meant for amortization over a period of time. Normally, revenue expenditure is deductible in the year in which it is incurred. However, if the assessee wants to spread the expenditure over a period of ensuing years, it can be allowed only if the principle of ‘matching concept’ is satisfied. Entries in the books of account are not conclusive and the matter has to be examined on the touchstone of the provisions contained in the Act.

The Supreme Court took note that the assessee had issued debentures with two options for payment of interest and if the interest is allowed by spread over it would amount to treating both the methods of interest payment at par, which was clearly unsustainable. By discharging the liability in the first year itself, the assessee had benefitted by making payment of a lesser amount of interest in comparison to the interest which was payable under the first option over a period of five years. When the assessee did not seek spread over of expenditure and had claimed the entire expenditure in the same year and a return was filed in that manner, the Assessing Officer was bound to carry out the assessment by applying the provisions of the Act and not to go beyond the said return. The statute enables and entitles the assessee to claim the entire upfront interest paid in the year of payment.

**Supreme Court’s Decision:** The Supreme Court, accordingly, held that the assessee would be entitled to deduction of the entire upfront interest paid in the same year in which the amount was actually paid.
14. Is expenditure incurred for construction of transmission lines by the assessee for supply of power to UPPCL by the assessee deductible as revenue expenditure?

*Addtl. CIT v. Dhampur Sugar Mill (P) Ltd (2015) 370 ITR 194 (All)*

**Facts of the case:** The assessee was engaged in the business of manufacture and sale of sugar, chemicals and power and had a distillery. It paid ₹ 8.48 crores to Uttar Pradesh Power Corporation Ltd (UPPCL) for construction of transmission line and other supporting work for supply of power to UPPCL. The assessee generated power which was sold to UPPCL, its only customer. The agreement between the assessee and UPPCL stipulated that the entire expenditure for erection and installation of power transmission lines, towers and ancillaries from the point of power generation to sub-grid station would be incurred by the assessee. The UPPCL is to ensure quality control of the equipment and material and the work has to be carried out under its supervision and prior approval. The agreement stipulated that the entire power transmission line including towers and erection would be property of UPPCL which would provide for the subsequent supervision and maintenance. The assessee claimed the entire expenditure as a deduction under section 37(1). The claim of the assessee was disallowed by the Assessing Officer. However, the Commissioner (Appeals) deleted the disallowance by holding that by incurring the expenditure the assessee acquired right to make use of the asset for facilitating efficient conduct of its business and making it more profitable but without getting any advantage of enduring benefit to itself. The assessee did not acquire any asset to get covered by section 32 and hence, the expenditure incurred was revenue in nature. The Tribunal, too, confirmed the order of the Commissioner (Appeals).

**High Court's Opinion:** The High Court made reference to *Empire Jute Co Ltd v. CIT* (1980) 124 ITR 1, where the Supreme Court held that the true test is to consider the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowed. If the advantage consists in merely facilitating its trading operations or conducting its business while leaving the capital field untouched, the expenditure would be on revenue account.

A similar precedent in *CIT v. Gujarat Mineral Development Corpn. Ltd (1981) 132 ITR 377 (Guj)* was also cited to hold that the expenditure incurred in the laying of transmission lines was on revenue account.

The Allahabad High Court also made reference to the Rajasthan High Court ruling in *CIT v. Hindustan Zinc Ltd. (2009) 221 CTR (Raj) 637*, wherein it was observed that the erection of power lines by the assessee was for facilitating its routine operations and for smooth functioning of its business. The power lines remained the property of the Electricity Board. The High Court, therefore, held that the assessee had not acquired a capital asset or any enduring benefit or advantage.
High Court’s Decision: Following the principle of law laid down by the Supreme Court in Empire Jute Mills’ case, the Allahabad High Court, in this case, held that the expenditure which was incurred by the assessee in the laying of transmission lines was clearly on the revenue account. The transmission lines, upon erection, vested absolutely in UPPCL. The expenditure which was incurred by the assessee was for aiding efficient conduct of its business since the assessee had to supply electricity to its sole consumer UPPCL. This was not an advantage of a capital nature.

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

_CIT v. IBM Global Services India P Ltd (2014) 366 ITR 293 (Karn)_

Facts of the case: The assessee-company came into existence on the bifurcation of a joint venture company floated earlier by two other companies. The assessee-company paid ₹ 530 lakhs for use of domestic customer database to the joint venture company, which gave information about various customers who patronized the company in the past and who continued to have service maintenance contract. This enabled the assessee to provide maintenance support services and effectively run its software business. Also, certain skilled and trained employees of the joint venture company were transferred to the assessee-company for which it made a payment of ₹ 938.58 lakhs to the joint venture company. The assessee claimed both the payments viz. payment for use of domestic customer database and absorption of trained employees, as revenue expenditure. The claim of the assessee was disallowed by the Assessing Officer.

Assessing Officer’s Contentions: The Assessing Officer contended that domestic customer database is a capital asset which provides an enduring advantage or benefit to the assessee, since by utilizing the same, the assessee can successfully run its business activities over a considerable period of time. Hence, he treated the payment made for acquisition of domestic customer database as the payment made towards acquisition of capital asset. The Assessing Officer also contended that compensation paid by the assessee to the joint venture company for transfer of human skill is a capital expenditure, since the expenditure incurred on recruitment and training of transferred personnel would provide an enduring benefit.

High Court’s Observations and Decision: The High Court observed that the expenditure incurred for use of customer database did not result in acquisition of any capital asset. The assessee got the right to use the database and the company which provided the database was not precluded from using such database. Therefore, the expenditure incurred was for use of data base and not for acquisition of such data base and, hence, is deductible as revenue expenditure.
As regards payment for obtaining trained and skilled employees, it was held that the joint venture company spent a lot of money to give training to employees who were transferred to the assessee-company. They were trained in the field of software. They have opted for employment with the assessee, and for their past services with the joint venture company, expenditure has been incurred. In effect, the payment made by the assessee-company was towards expenditure incurred for their training and recruitment. Such expenditure was in the revenue field, and therefore, the payment made by the assessee-company as per agreement to save such expenditure was also revenue in nature. Therefore, the expenditure incurred for obtaining trained and skilled employees cannot be termed as capital expenditure though the benefit may be of enduring nature. The High Court, thus, held that both the expenditures claimed were allowable as revenue expenditure.

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

_CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR 49 (Delhi)_

**High Court’s Observations**: On this issue, the Delhi High Court noted the following observations of the Punjab and Haryana High Court in _CIT v. Liberty Group Marketing Division [2009] 315 ITR 125_, while holding that such expenditure was revenue in nature -

(i) The expenditure incurred by the assessee on glow sign boards does not bring into existence an asset or advantage for the enduring benefit of the business, which is attributable to the capital.

(ii) The glow sign board is not an asset of permanent nature. It has a short life.

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

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

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

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

_CIT v. ITC Hotels Ltd. (2011) 334 ITR 109 (Kar.)_
High Court's Decision: On this issue, the Karnataka High Court held that the expenditure incurred on the issue and collection of debentures shall be treated as revenue expenditure even in case of convertible debentures, i.e., the debentures which had to be converted into shares at a later date.

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

CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594 (Delhi)

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

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

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

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

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

Facts of the case: The assessee company owned a super smelter plant which requires large quantity of water for its day-to-day operation, in the absence of which it would not be able to function. The assessee, therefore, incurred expenditure for alteration of the dam (constructed by the State Government) to ensure sharing of the water with the State Government without having any right or ownership in the dam or water. The assessee's share of water is also determined by the State Government. The assessee claimed the expenditure as deduction under section 37, which was disallowed by the Assessing Officer on the ground that it was of capital nature.

Tribunal view: The Tribunal, however, was of the view that since the object and effect of the expenditure incurred by the assessee is to facilitate its trade operation and enable the management to conduct business more efficiently and profitably, the expenditure is revenue in nature and hence, allowable as deduction.
**High Court’s Observations & Decision:** The High Court observed that the expenditure incurred by the assessee for commercial expediency relates to carrying on of business. The expenditure is of such nature which a prudent businessman may incur for the purpose of his business. The operational expenses incurred by the assessee solely intended for the furtherance of the enterprise can by no means be treated as expenditure of capital nature.

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

**Confederation of Indian Pharmaceutical Industry (SSI) v. CBDT (2013) 353 ITR 388 (H.P.)**

**High Court’s Observations:** On this issue, the Himachal Pradesh High Court observed that as per Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, every medical practitioner and his or her professional associate is prohibited from accepting any gift, travel facility, hospitality, cash or monetary grant from any pharmaceutical and allied health sector industries. This is a salutary regulation in the interest of the patients and the public, considering the increase in complaints against the medical practitioners prescribing branded medicines instead of generic medicines, solely in lieu of gifts and other freebies granted to them by some particular pharmaceutical industries.

The CBDT, considering the fact that the claim of any expense incurred in providing freebies to medical practitioners is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, has, vide Circular No.5/2012 dated 1.8.2012, clarified that the expenditure so incurred shall be inadmissible under section 37(1). The disallowance shall be made in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebies and claimed it as a deductible expense in its accounts against income.

**High Court’s Decision:** The High Court opined that the contention of the assessee that the above mentioned Circular goes beyond section 37(1) was not acceptable. As per Explanation to section 37(1), it is clear that any expenditure incurred by an assessee for any purpose which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession. The sum and substance of the circular is also the same. Therefore, the circular is totally in line with the Explanation to section 37(1).

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

21. Can the commission paid to doctors by a diagnostic centre for referring patients for diagnosis be allowed as a business expenditure under section 37 or would it be treated as illegal and against public policy to attract disallowance?

**CIT v. Kap Scan and Diagnostic Centre P. Ltd. (2012) 344 ITR 476 (P&H)**
High Court's Observations: On the above mentioned issue, the Punjab and Haryana High Court observed that the argument of the assessee that giving commission to the private doctors for referring the patients for various medical tests was a trade practice which could not be termed to be illegal and therefore, the same cannot be disallowed under section 37(1), is not acceptable. Applying the rationale and considering the purpose of Explanation to section 37(1), the assessee would not be entitled to deduction of payments made in contravention of law. Similarly, payments which are opposed to public policy being in the nature of unlawful consideration cannot also be claimed as deduction. The assessee cannot take a plea that businessmen are entitled to conduct their business even contrary to law and claim deduction of certain payments as business expenditure, notwithstanding that such payments are illegal or opposed to public policy or have pernicious consequences to the society as a whole.

As per the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, no physician shall give, solicit, receive, or offer to give, solicit or receive, any gift, gratuity, commission or bonus in consideration of a return for referring any patient for medical treatment.

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

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

Echjay Forgings Ltd. v. ACIT (2010) 328 ITR 286 (Bom.)

High Court's Observations: On this issue, it was observed that there was no evidence on record to show that any other person at any point of time was appointed as trainee or sent abroad for higher education. Further, the appointment letter to the director’s son, neither had any reference number nor was it backed by any previous application by him. The appointment letter referred to “apprentice training scheme” with the company in respect of which no details were produced. There was no evidence that he was recruited as trainee by some open competitive exam or regular selection process.

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

23. Can the expenditure incurred on heart surgery of an assessee, being a lawyer by profession, be allowed as business expenditure under section 31, by treating it as current repairs considering heart as plant and machinery, or under section 37, by

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treat ing it as expenditure incurred wholly and exclusively for the purpose of business or profession?

*Shanti Bhushan v. CIT (2011) 336 ITR 26 (Delhi)*

**Facts of the case:** In the present case, the assessee is a lawyer by profession. The assessee argued that the repair of vital organ (i.e. the heart) had directly impacted his professional competence. He contended that the heart should be treated as plant as it is used for the purpose of his professional work. He substantiated his contention by stating that after his heart surgery, his gross receipts from profession increased manifold. Hence, the expenditure on the heart surgery should be allowed as business expenditure either under section 31 as current repairs to plant and machinery or section 37 as an expense incurred wholly and exclusively for the purpose of profession. The department argued that the said expenditure was personal in nature and was not incurred wholly and exclusively for the purpose of business or profession, and therefore, the same should not be allowed as business expenditure.

**High Court’s Observations:** On this issue, the Delhi High Court observed that a healthy and functional human heart is necessary for a human being irrespective of the vocation or profession he is attached with. Expenses incurred to repair an impaired heart would thus add to the longevity and efficiency of a human being which would be reflected in every activity he does, including professional activity. It cannot be said that the heart is used as an exclusive tool for the purpose of professional activity by the assessee. Further, the High Court held that:

(i) To allow the heart surgery expenditure as repair expenses to plant, the heart should have been first included in the assessee’s balance sheet as an asset in the previous year and in the earlier years. Also, a value needs to be assigned for the same. The assessee would face difficulty in arriving at the cost of acquisition of such an asset for showing in his books of account.

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

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

**High Court’s Decision:** There is, therefore, no *direct nexus* between the expenses incurred by the assessee on the heart surgery and his efficiency in the professional field. Therefore, the claim for allowing the said expenditure under section 37 is also not tenable. Hence, the heart surgery expenses shall not be allowed as a business expenditure of the assessee under the Income-tax Act, 1961.
24. Can payment to police personnel and gundas to keep away from the cinema theatres run by the assessee be allowed as deduction?

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

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

**High Court’s Observations:** On this issue, the High Court observed that if any payment is made towards the security of the business of the assessee, such amount is allowable as deduction, as the amount is spent for maintenance of peace and law and order in the business premises of the assessee i.e., cinema theatres in this case. However, the amount claimed by the assessee, in the instant case, was towards payment made to the police and gundas.

Any payment made to the police illegally amounts to bribe and such illegal gratification cannot be considered as an allowable deduction. Similarly, any payment to a gunda as a precautionary measure so that he shall not cause any disturbance in the theatre run by the assessee is an illegal payment for which no deduction is allowable under the Act.

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

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

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

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

**High Court’s Observations and Decision:** The High Court observed that as per the provisions of the Karnataka Municipal Corporations Act, 1976, the amount paid to compound an offence is obviously a penalty and hence, does not qualify for deduction under section 37. Merely describing the payment as a compounding fee would not alter the character of the payment.
Note – In this case, it is the actual character of the payment and not its nomenclature that has determined the disallowance of such expenditure as deduction. The principle of substance over form has been applied in disallowing an expenditure in the nature of penalty, though the same has been described as regularization fee/compounding fee.

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

CIT v. Great City Manufacturing Co. (2013) 351 ITR 156 (All)

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

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

The Assessing Officer is only required to ensure that the remuneration is paid to the working partners mentioned in the partnership deed, the terms and conditions of the partnership deed provide for payment of remuneration to the working partners and the remuneration is within the limits prescribed under section 40(b)(v). If these conditions are complied with, then the Assessing Officer cannot disallow any part of the remuneration on the ground that it is excessive.

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

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

CIT v. KLN Agrotechs (P) Ltd (2015) 375 ITR 301 (Kar.)

Facts of the case: The assessee company is engaged in the business of manufacture and trading of refined edible oil. It had taken working capital loan from Canara Bank
aggregating to ₹ 441.30 lakhs. Due to default in repayment of loan, the bank declared the account as NPA. The total outstanding payable by the company was ₹ 635.26 lakhs which included principal amount of ₹ 441.30 and interest amount of ₹ 193.96 lakhs. During the assessment year in question, the assessee arrived at One Time Settlement (OTS) scheme with the bank. As per the OTS, the assessee paid ₹ 378.72 lakhs (against the total outstanding of ₹ 635.26 lakhs) to the bank.

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

The Revenue rejected the claim of deduction under section 43B in respect of ₹ 193.96 lakhs and charged to tax the entire amount of ₹ 256.54 lakhs considering the actual amount paid as the amount adjusted towards the principal outstanding amount.

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

**Note:** The rationale of the Karnataka High Court ruling in the above case can be explained with the help of a simple example:

The following are particulars of OTS scheme of A Ltd. with ABC Bank -

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Principal ₹ in lakhs</th>
<th>Interest ₹ in lakhs</th>
<th>Total ₹ in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Amount Outstanding (Working Capital loan)</td>
<td>400</td>
<td>150</td>
<td>550</td>
</tr>
<tr>
<td>(2) Payment under OTS scheme with bank</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Option 1</td>
<td>150</td>
<td>150</td>
<td>300</td>
</tr>
<tr>
<td>Option 2</td>
<td>300</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Option 3</td>
<td>200</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>
Waiver [(1) – (2)]

<table>
<thead>
<tr>
<th>Option</th>
<th>250</th>
<th>-</th>
</tr>
</thead>
<tbody>
<tr>
<td>Option 2</td>
<td>100</td>
<td>150</td>
</tr>
<tr>
<td>Option 3</td>
<td>200</td>
<td>50</td>
</tr>
</tbody>
</table>

In all three cases above, let us assume that A Ltd. has offered ₹ 250 lakhs (i.e., ₹ 550 lakhs - ₹ 300 lakhs) as income under section 41(1) and claimed the interest paid/waived as deduction under section 43B.

In **Option 1**, A Ltd. has rightly offered ₹ 250 lakhs, being waiver of principal amount, as income under section 41(1). In this case, the interest of ₹ 150 lakhs actually paid would be deductible under section 43B on payment basis.

In **Option 2**, A Ltd. should have offered only ₹ 100 lakhs, being waiver of principal amount, as income under section 41(1). However, it has offered the entire amount of ₹ 250 lakhs waived, as income under section 41(1). Therefore, A Ltd.’s claim of ₹ 150 lakhs, being interest waiver, as deduction under section 43B would result in effectively bringing to tax the principal waiver of ₹ 100 lakhs.

In **Option 3**, A Ltd. should have offered only ₹ 200 lakhs, being waiver of principal amount, as income under section 41(1) and claimed interest of ₹ 100 lakhs paid as deduction under section 43B. However, A Ltd. has offered the entire amount of ₹ 250 lakhs waived, as income under section 41(1). Therefore, A Ltd. claim for deduction of ₹ 150 lakhs [₹ 100 lakhs, being interest paid + ₹ 50 lakhs, being interest waived] under section 43B would effectively bring to tax the principal waiver of ₹ 200 lakhs.

This, in effect, is the rationale of the court ruling, i.e., where the entire amount waived has been offered as income under section 41(1), the claim of interest waived and interest paid as deduction under section 43B would effectively bring to tax, the principal amount waived.

28. Can unpaid electricity charges be treated as “fees” to attract disallowance under section 43B?


**Assessing Officer’s view vis-a-vis Tribunal’s view:** On this issue, the Assessing Officer was of the view that electricity charges come within the ambit of section 43B and therefore, could be allowed as deduction only on payment basis. Therefore, he disallowed the unpaid electricity charges. The Tribunal, however, set aside the disallowance.

**High Court’s Observations and Decision:** The Andhra Pradesh High Court observed that the provisions of section 43B do not incorporate electricity charges. Therefore, non-payment of electricity charges would not attract disallowance under section 43B since such charges cannot be termed as “fees”.

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

_CIT v. S.R. Jeyashankar (2015) 373 ITR 120 (Mad)_

**Facts of the case:** In the present case, the assessee had entered into an agreement
with M/s Vishranthi Homes Pvt. Ltd. (VHPL) for purchase of undivided share in a piece of
land as well as for construction of a flat under a project promoted by the said builder vide
agreement dated February 22, 2005. Over a period of time, the payments were made and
the transaction was concluded with registration of undivided share of land on August 4,
2005. Thereafter, the assessee sold the entire unit by a sale deed dated April 10, 2008,
well after 36 months from the date of agreement i.e., February 22, 2005, and claimed the
difference between the sale consideration and the indexed cost of acquisition as long-
term capital gains. The Assessing Officer, however, took a view that the undivided share
of land was registered on August 4, 2005, and since the property was purchased in
August, 2005, and sold in April, 2008, the capital gains arising from sale will be assessed
as short-term capital gains only and, accordingly, the Assessing Officer denied benefit of
section 2(29A) and made addition.

**Appellate Authorities' Views:** The Commissioner (Appeals) placed reliance on Circular
No.471 dated 15.10.1986 and allowed the claim of the assessee. The Tribunal, after
taking into consideration the decisions of the Punjab and Haryana High Court, in the
cases of Mrs. Madhu Kaul v. CIT [2014] 363 ITR 54 and Vinod Kumar Jain v. CIT [2012]
344 ITR 501 and Circular No. 471, dated 15.10.1986, held that the date of allotment of
the flat has to be adopted as date of acquisition of the immovable property when it comes
to acquiring a flat from the promoter of the flat by way of executing construction
agreement and not the date of the sale deed for purchase of the undivided share in land.
Accordingly, the Tribunal confirmed the order of the Commissioner (Appeals).

**High Court's Observations:** The Madras High Court noted that the Tribunal had relied
on the decision of the Punjab and Haryana High Court in Mrs. Madhu Kaul's case, where
it was held that the date of allotment under a scheme framed by the DDA is to be taken
as the date of acquisition and the mere fact that the actual possession was delivered
later does not distract the fact that the allottee was conferred a right to hold the property on issuance of allotment letter and the payment of balance installments, identification of a particular flat and delivery of possession are consequential acts that relate back to and arise from the date rights were conferred by the allotment letter. In effect, the Punjab & Haryana High Court held that the allottee gets the title to the property on issuance of allotment letter and payment in installments is only a consequential act upon which delivery of possession to the property flows. The Madras High Court also noted that the Punjab & Haryana High Court had taken a similar view in Vinod Kumar Jain’s case.

In this case, the Madras High Court observed that the right to the property flows from the date of agreement with the builder i.e., from February, 2005. Over a period of time, payments were made and the transaction was concluded in accordance with the terms of the agreement by registering the undivided share in land and handing over of the flat subsequently.

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

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

**CIT v. Smt. Rama Rani Kalia (2013) 358 ITR 0499 (All.)**

**Facts of the case:** The assessee purchased a leasehold property on July 7, 1984. Such leasehold rights in the property were converted into freehold rights on March 29, 2004. She sold the property on March 31, 2004 and declared long-term capital gains on the transfer. The Assessing Officer opined that since the property was acquired by converting the leasehold right into freehold right on March 29, 2004, and was sold within three days on March 31, 2004, the resultant capital gains would be short-term.

**Appellate Authorities' views:** The Commissioner (Appeals) opined that the conversion of leasehold property into freehold property was nothing but improvement of the title over the property, as the assessee was the owner prior to conversion. The Tribunal affirmed this view of the Commissioner (Appeals) and held that the gains were long-term capital gains, as the assessee was the owner of the property even prior to conversion.

**High Court's Observations:** The High Court observed that the difference between “short-term capital asset” and “long-term capital asset” is the period over which the property has been held by the assessee and not the nature of title over the property. The lessee of the property has rights as the owner of the property subject to the covenants of the lease deed. Accordingly, the lessee may, subject to covenants of the lease deed, transfer the leasehold rights of the property with the consent of the lessor.
High Court's Decision: The High Court, therefore, concurred with the views of the Tribunal that conversion of the rights of the lessee from leasehold to freehold is only by way of improvement of her rights over the property, which she enjoyed. It would not have any effect on the taxability of gain from such property, which is related to the period over which the property is held. Since, in this case, the period of holding is more than 36 months, the resultant capital gains would be long-term.

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

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

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

High Court's Decision: The High Court held that the benefit of including the period of holding of the previous owner under section 2(42A) read with section 49(1)(iii)(b) can be availed only if the dissolution of the firm had taken place at any time before April 1, 1987. In this case, the firm was dissolved on April 15, 2001 and therefore the benefit of these sections would not be available to the assessee.

Therefore, in this case, the period of holding of the asset received by the assessee-partner on dissolution of the firm has to be reckoned only from the date of dissolution of the firm. Since the assessee-partner has sold the property within three days of acquiring the same, the gains have to be treated as short-term capital gain.

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

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

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

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

*CIT v. Manjula J. Shah (2013) 355 ITR 474 (Bom.)*

As per Explanation 1 to section 2(42A), in case the capital asset becomes the property of the assessee in the circumstances mentioned in section 49(1), inter alia, by way of gift by the previous owner, then for determining the nature of the capital asset, the aggregate period for which the capital asset is held by the assessee and the previous owner shall be considered.

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

**Facts of the case:** In the present case, the assessee had acquired a capital asset by way of gift from the previous owner. The said asset when transferred was a long-term capital asset considering the period of holding by the assessee as well as the previous owner. The assessee computed the long-term capital gain considering the CII of the year in which the asset was transferred. The Assessing Officer raised an objection mentioning that as per meaning assigned to the Indexed cost of acquisition, the CII of the year in which the asset is first held by the assessee needs to be considered and not the CII of the year in which the asset was first held by the previous owner.

**High Court's Observations:** In the present case, the Bombay High Court observed that by way of ‘deemed holding period fiction’ created by the statute, the assessee is deemed to have held the capital asset from the year the asset was held by the previous owner and accordingly the asset is a long term capital asset in the hands of the assessee. Therefore, for determining the indexed cost of acquisition under Section 48, the assessee must be treated to have held the asset from the year the asset was first held by the previous owner and accordingly the CII for the year the asset was first held by the previous owner would be considered for determining the indexed cost of acquisition.
High Court’s Decision: Hence, the indexed cost of acquisition in case of gifted asset has to be computed with reference to the year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset.

Note - The Delhi High Court, in the case of Arun Shungloo Trust v. CIT (2012) 205 Taxman 456 (Delhi) has also given the similar view on the said issue. The Court observed that as per Explanation (iii) to section 48, the expression ‘asset held by the assessee’ is not defined and therefore, in the absence of any intention to the contrary, it has to be construed in consonance with the meaning given in section 2(42A). However, the Assessing Officer contended that in cases covered under section 49, the benefit of indexed cost of acquisition will be available only from the date the capital asset was transferred and not from the date on which the asset was held by the previous owner.

The High Court observed that this will result in inconsistency because as per the provisions of Explanation to section 48, the holding of predecessor has to be accounted for the purpose of computing the cost of acquisition, the cost of improvement and indexed cost of improvement, but not for the purpose of indexed cost of acquisition.

In the present case, the Bombay High Court held that by way of ‘deemed holding period fiction’ created by the Statute, the assessee is deemed to have held the capital asset from the year the asset was held by the previous owner and accordingly, the asset is a long term capital asset in the hands of the assessee. Therefore, for determining the indexed cost of acquisition under section 48, the assessee must be treated to have held the asset from the year in which the asset was first held by the previous owner and accordingly the cost inflation index for the year the asset was first held by the previous owner would be considered for determining the indexed cost of acquisition.

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

   (i) the new residential house (i.e., all independent floors handed over to the assessee); or
   (ii) a single residential unit (i.e., only one independent floor)?

CIT v. Gita Duggal (2013) 357 ITR 153 (Delhi)

Facts of the case: In the present case, the assessee was the owner of property comprising the basement, ground floor, first floor and second floor. In the year 2006, she entered into a collaboration agreement with a builder for developing the property. According to the terms of the agreement, the builder was to demolish the existing structure on the plot of land and develop, construct, and/or put up a building consisting of basement, ground floor, first floor, second floor and third floor with terrace at its own costs and expenses. The assessee handed over to the builder, the physical possession of the entire property, along with 22.5% undivided interest over the land. The handing
over of the entire property was, however, only for the limited purpose of development. The builder was to get the third floor plus the undivided interest in the land to the extent of 22.5% for his exclusive enjoyment. In addition to the cost of construction incurred by the builder on development of the property, a further amount of ₹ 4 crores was payable by the builder to the assessee as consideration against the rights of the assessee.

**Assessee’s contention vis-à-vis Assessing Officer’s contention:** The assessee, in her return of income, showed only ₹ 4 crores as sales consideration. The Assessing Officer, however, took the view that the sale consideration for the transfer should include not only the amount of ₹ 4 crores received by the assessee in cash, but also the cost of construction amounting to ₹ 3.44 crore incurred by the developer in respect of the other floors, which were handed over to the assessee.

The assessee contended that if the cost of construction incurred by the builder is to be added to the sale price, then, the same should also correspondingly be considered as reinvestment in the residential house for exemption under section 54.

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

**Appellate Authorities’ views:** The Commissioner (Appeals), on the basis of the judgment in *CIT v. D. Ananda Basappa* [2009] 309 ITR 0329 (Kar.), took a contrary view. The Tribunal concurred with the view of the Commissioner (Appeals).

**High Court’s Observations:** The High Court observed that sections 54 and 54F use the expression “residential house” and not “residential unit” and it is the Assessing Officer who has introduced a new concept of “residential unit” into these sections. Sections 54 and 54F require the assessee to acquire a “residential house” and so long as the assessee acquires a building, which may be constructed, for the sake of convenience, in such a manner as to consist of several units which can, if the need arises, be conveniently and independently used as an independent residence, the requirement of the section should be taken to have been satisfied. There is nothing in these sections which requires the residential house to be constructed in a particular manner. The only requirement is that it should be for residential use and not for commercial use. The physical structuring of the new building, whether lateral or vertical, should not come in the way of considering the building as a residential house.

**High Court's Decision:** The High Court held that the fact that the residential house consists of several independent units cannot be permitted to act as an impediment to the allowance of the deduction under section 54 or section 54F. It is neither expressly nor by necessary implication prohibited. Therefore, the assessee is entitled to exemption of capital gains in respect of investment in the residential house, comprising of independent residential units handed over to the assessee.
Note – The Department’s Special Leave Petition against the Delhi High Court’s judgment was dismissed on 29th August, 2014.

7. Would an assessee be entitled to exemption under section 54 in respect of purchase of two flats, adjacent to each other and having a common meeting point?


_Facts of the case:_ The assessee-individual had inherited an ancestral house property, which he sold during the relevant previous year. Out of the sale consideration, he purchased two adjacent residential flats. The assessee claimed exemption under section 54 in respect of investment in both the residential flats, in view of the decision of the Karnataka High Court in _CIT v. Ananda Basappa (2009) 309 ITR 329_, wherein investment in two adjacent flats were considered eligible for exemption under section 54.

_Assessing Officer’s contention:_ The Assessing Officer, however, restricted the exemption under section 54 only in respect of investment in one residential flat (including stamp duty paid for registration of the flat), contending that –

(i) the two residential units were separated by a strong wall;
(ii) the two flats were purchased from two different vendors under two separate sale deeds.

_Appellate Authorities’ views:_ The Commissioner (Appeals), however, observed that the assessee was entitled to exemption under section 54 in respect of investment in both the flats, since the two flats had adjacent kitchens and toilets and also had a common meeting point. The Tribunal concurred with the view of the Commissioner (Appeals).

_High Court’s Observations:_ On appeal by the Revenue, the High Court referred to the Karnataka High Court decision in _CIT v. Ananda Basappa (2009) 309 ITR 329_, wherein it was observed that where the flats are situated side by side and the builder had effected the necessary modification to make it as one unit, the assessee would be entitled to exemption under section 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds.

The above ruling was also followed by the Karnataka High Court in _CIT v. K.G. Rukminiamma (2011) 331 ITR 211_, wherein it was held that where a residential house was transferred and four flats in a single residential complex were purchased by the assessee, all the four residential flats constituted “a residential house” for the purpose of section 54.

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

_Note_ – Sections 54 and 54F have been amended by the Finance (No.2) Act, 2014 to clarify that the exemption available thereunder would be in respect of investment in one residential house in India. In this case as well as in Ananda Basappa’s case, the
assessee had invested in two adjacent flats and necessary modification was effected so that the flats can be used as a single residence. The respective High Courts had held that the assesses were entitled to exemption under section 54 in respect of investment in both the residential flats, since they were intended to be used as a single residence and necessary modification had also been effected so that the two flats located side by side can be used as a single residence. It appears that even after the amendment by the Finance (No.2) Act, 2014, the above rulings will continue to hold good, since the restriction is regarding investment being made in one residential house, and not in one unit of a residential house.

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

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

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

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

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

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

_CIT v. Kamal Wahal (2013) 351 ITR 4 (Delhi)_

_Facts of the case:_ The assessee sold a capital asset and invested the sale proceeds in purchase of a new house in the name of his wife. He claimed deduction under section 54F in respect of the new residential house purchased by him in the name of his wife. However, the same was denied by the Assessing Officer on the ground that, in order to avail the benefit under section 54F, the investment in the residential house should be made by the assessee in his own name.
The Tribunal, however, accepted the assessee’s contention observing that since section 54F is a beneficial provision enacted for encouraging investment in residential houses, the said provision has to be interpreted liberally.

**High Court's Observations:** The Delhi High Court concurred with the Tribunal’s view and observed that, for the purpose of section 54F, a new residential house need not necessarily be purchased by the assessee in his own name nor is it necessary that it should be purchased exclusively in his name. A similar view was upheld by this Court in CIT v. Ravinder Kumar Arora (2012) 342 ITR 38, where the new residential house was acquired in the joint names of the assessee and his wife and the Court had held that the assessee was entitled for 100% exemption under section 54F. In that case, it was further observed that section 54F does not require purchase of new residential house property in the name of the assessee himself. It only requires the assessee to purchase or construct a residential house.

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

**High Court’s Decision:** Hence, the Delhi High Court, having regard to the rule of purposive construction and the object of enactment of section 54F, held that the assessee is entitled to claim exemption under section 54F in respect of utilization of sale proceeds of capital asset for investment in residential house property in the name of his wife.

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

*CIT v. Ravinder Kumar Arora (2012) 342 ITR 38 (Delhi)*

**Facts of the case:** In the present case, the assessee filed the return of income showing long-term capital gain on sale of plot of land. The assessee claimed exemption under section 54F from such long-term capital gain on account of purchase of new residential house property within the stipulated time period as mentioned in the aforesaid section. He claimed exemption under section 54F taking into consideration the whole of purchase price of the residential house property. However, after going through the purchase deed of the house property, the Assessing Officer found that the said house property was purchased in joint names of assessee and his wife. Therefore, the Assessing Officer allowed 50% of the exemption claimed under section 54F, being the share of the assessee in the property purchased in joint names.

The assessee submitted that the inclusion of his wife’s name in the sale deed was just to avoid any litigation after his death. He further explained that all the funds invested in the
said house were provided by him, including the stamp duty and corporation tax paid at the time of the registration of the sale deed of the said house. This fact was also clearly evident from the bank statement of the assessee. The assessee claimed that the exemption under section 54F is to be allowed with reference to the full amount of purchase consideration paid by him for the aforesaid residential house and is not to be restricted to 50%. The Assessing Officer did not deny the fact that the whole amount of purchases of the house was contributed by the assessee and nothing was contributed by his wife. However, the Assessing Officer opined that exemption under section 54F shall be allowed only to the extent of assessee's right in the new residential house property purchased jointly with his wife, i.e. 50%.

**High Court's Decision:** Considering the above mentioned facts, the Delhi High Court held that the assessee was the real owner of the residential house in question and mere inclusion of his wife’s name in the sale deed would not make any difference. The High Court also observed that section 54F mandates that the house should be purchased by the assessee but it does not stipulate that the house should be purchased only in the name of the assessee. In this case, the house was purchased by the assessee in his name and his wife's name was also included additionally. Therefore, the conditions stipulated in section 54F stand fulfilled and the entire exemption claimed in respect of the purchase price of the house property shall be allowed to the assessee.

**Note** - A similar view was taken by the Karnataka High Court in the case of **DIT (IT) v. Mrs. Jennifer Bhide (2011) 203 Taxman 208**, in the context of deductions under section 54 and 54EC, wherein the assessee had sold a residential house property. The assessee, in order to claim exemption of the long-term capital gain, made the investment in the residential house property and bonds jointly in her name and in the name of her husband. The Karnataka High Court, in this case, observed that it was clear from the facts of this case that the entire investment was done by the assessee and no contribution was made by her husband. Therefore, in the present case, it was, held that section 54 and 54EC only stipulate that the capital gain arising on a sale of property is to be invested in a residential house property or in the long-term specified asset i.e., bonds. It is not mandatory in those sections that the investment is to be made in the name of the assessee only. The name of the assessee's husband is shown in the sale deed as well as in the bonds, as a joint owner. However, since the consideration for acquisition flows entirely from the assessee's funds, the assessee is entitled to claim deduction under section 54 and 54EC in respect of the full amount invested. Therefore, in the present case, the exemption under section 54 and 54EC shall not be restricted to 50%, being the share of the assessee in the ownership of the house property and the bonds. The assessee is entitled to 100% exemption of the long-term capital gain so invested in the residential house property and in the bonds.
11. Can exemption under section 54F be denied to an assessee in respect of investment made in construction of a residential house, on the ground that the construction was not completed within three years after the date on which transfer took place, on account of pendency of certain finishing work like flooring, electrical fittings, fittings of door shutter, etc?

*CIT v. Sambandam Udaykumar (2012) 345 ITR 389 (Kar.)*

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

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

**High Court's Decision:** The Court held that in this case the assessee would be entitled to exemption under section 54F in respect of the amount invested in construction within the prescribed period.

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

*CIT v. Rajiv Shukla (2011) 334 ITR 138 (Delhi)*

**Facts of the case:** In the above mentioned case, the assessee had claimed benefit of exemption under section 54F in respect of capital gain arising on the sale of property, being a depreciable asset held for more than 36 months i.e. long-term capital asset. However, the department contended that no exemption under section 54F is available in this case, as the said exemption is granted in respect of the capital gain arising from the transfer of a long-term capital asset whereas the capital gain arising on transfer of depreciable asset is deemed to be capital gain arising from transfer of short-term capital asset by virtue of provisions of section 50.
High Court's Decision: The Delhi High Court, in the present case, relying on the decision of the Bombay High Court in the case of CIT v. Ace Builders P. Ltd. (2006) 281 ITR 210 and the decision pronounced by Gauhati High Court in CIT v. Assam Petroleum Industries P. Ltd. [2003] 262 ITR 587, in relation to erstwhile section 54E, held that the deeming fiction created by section 50 that the capital gain arising on transfer of a depreciable asset shall be treated as capital gain arising on transfer of short-term capital asset is only for the purpose of sections 48 and 49 and not for the purpose of any other section. Section 54F being an independent section will not be bound by the provisions of section 50. The depreciable asset if held for more than 36 months shall be a long-term capital asset as per the provisions of section 2(29A).

Therefore, the exemption under section 54F on transfer of depreciable asset held for more than 36 months cannot be denied on account of fiction created by section 50.

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

Gouli Mahadevappa v. ITO (2013) 356 ITR 90 (Kar.)

Facts of the case: In the present case, the assessee sold a plot of land for ` 20 lakhs and reinvested the sale consideration of ` 20 lakhs together with agricultural income of ` 4 lakhs, in construction of a residential house. The assessee claimed capital gains exemption under section 54F, taking into consideration the entire investment of ` 24 lakhs. The Assessing Officer, applying the provisions of section 50C, deemed the stamp duty value of ` 36 lakhs as the full value of consideration since the consideration received or accruing as a result of transfer of capital asset (i.e. ` 20 lakhs) was less than the value adopted by the stamp valuation authority (i.e., ` 36 lakhs). The same was not disputed by the assessee before the Assessing Officer.

Assessing Officer's contention vis-a-vis Assessee's contention: The Assessing Officer allowed exemption under section 54F, taking into consideration investment in construction of residential house, to the extent of actual net consideration of ` 20 lakhs. He did not consider the balance amount of ` 4 lakhs, invested in the construction of residential house, out of agricultural income, for computation of exemption under section 54F, even though the sale consideration adopted for the purpose of computation of capital gains i.e., stamp duty value of ` 36 lakhs, was more than the amount of ` 24 lakhs invested in the new house.

The assessee contended that the entire investment of ` 24 lakhs made in construction of the residential house should be considered for computation of exemption under section 54F, irrespective of the source of funds for such reinvestment. Further, the assessee also contended before the High Court that the registration value adopted under section 50C was excessive and disproportionate to the market value of the property.
**High Court's Observations:** On the issue of applicability of section 50C, the Karnataka High Court observed that section 50C(2) allows an opportunity to the assessee to contend, before the Assessing Officer, the correctness of the registration value fixed by the State Government. Had he done so, the assessing authority would have invoked the power of appointing a Valuation Officer for assessing the fair market value of the property. The High Court held that when the assessee had not disputed the registration value at that point of time, it is not permissible for the assessee to now contend, at this stage, that the registration value does not correspond to the market value. Hence, the value of ₹ 36 lakhs adopted under section 50C has to be deemed as the full value of consideration.

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

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

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

**High Court's Observations:** In this case, the Bombay High Court observed that in order to avail the exemption under section 54EC, the capital gains have to be invested in a long-term specified asset within a period of six months from the date of transfer. Where the assessee has made the payment within the six month period, and the same is reflected in the bank account and a receipt has been issued as on that date, the exemption under section 54EC cannot be denied merely because the bond was issued after the expiry of the six month period or the date of allotment specified therein was after the expiry of the six month period.

**High Court's Decision:** For the purpose of the provisions of section 54EC, the date of investment by the assessee must be regarded as the date on which payment is made. The High Court, therefore, held that if such payment is within a period of six months from the date of transfer, the assessee would be eligible to claim exemption under section 54EC.

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

   *Fibre Boards (P) Ltd v. CIT (2015) 376 ITR 596 (SC)*

**Facts of the case:** The assessee-company had an industrial unit in Thane, which had been declared a notified urban area by notification dated September 22, 1967, issued
under section 280Y(d) of the Income-tax Act, 1961 vide Notification dated 22.09.1967. The assessee, in order to shift its industrial undertaking from an urban area to a non-urban area, sold its land, building and plant and machinery situated at Thane and out of the capital gains so earned, paid advances of various amounts to different persons for purchase of land, plant and machinery, construction of factory and building in the year 1991-92. The assessee claimed exemption under section 54G of the Income-tax Act, 1961, on the capital gains earned from the sale proceeds of its erstwhile industrial undertaking situated in Thane in view of the advances so made, which was more than the capital gains earned by it. The Assessing Officer refused to grant exemption to the assessee under section 54G on the ground that the non-urban area had not been declared to be so by any general or special order of the Central Government and that giving advances did not amount to utilisation of capital gains for acquiring the assets.

Appellate Authorities' views: The CIT (Appeals) dismissed the case of the assessee while the Appellate Tribunal allowed the appeal by stating that even an agreement to purchase is good enough and that Explanation to section 54G is declaratory in nature and would be retrospectively applicable.

High Court's Decision: The High Court reversed the order of the Appellate Tribunal and denied the exemption on the reasoning that the notification declaring Thane to be an urban area stood repealed with the repeal of the section under which it was made. Further, the expression “purchase” in the section 54G cannot be equated with the expression “towards purchase” and accordingly the advance for purchase of land, plant and machinery would not entitle the assessee to claim exemption under section 54G.

Supreme Court's Observations: The Apex Court observed that, on a conjoint reading of the Speech of the Finance Minister introducing the Finance Bill, 1987, and the Notes on Clauses and Memorandum explaining the provisions of the Finance Bill of 1987, it becomes clear that the idea of omitting section 280ZA of the Income-tax Act, 1961 and introducing section 54G on the same date was to do away with the tax credit certificates scheme together with the prior approval required by the Board and to substitute the repealed provision with the new scheme contained in section 54G. Once section 280ZA was omitted from the statute book, section 280Y(d) having no independent existence would for all practical purposes also cease to exist. Section 280Y(d) which was a definition section defining “urban area” for the purpose of section 280ZA alone was also omitted subsequently by the Finance Act, 1990. Apart from this, section 54G(1) by its Explanation introduces the very definition contained in section 280Y(d) in the same terms. It is obvious that both provisions are not expected to be applied simultaneously and it is clear that the Explanation to section 54G(1) repeals, by implication, section 280Y(d).

Unlike section 6 of the General Clauses Act, 1897 which saves certain rights, section 24 merely continues notifications, orders, schemes, rules, etc., that are made under a Central Act which is repealed and re-enacted with or without modification. The idea of section 24 of the 1897 Act is, as its marginal note shows, to continue uninterrupted
subordinate legislation that may be made under a Central Act that is repealed and re-enacted with or without modification.

Section 54G gives a time limit of 3 years after the date of transfer of capital asset in the case of shifting of industrial undertaking from urban area to any area other than urban area. The expression used in section 54G(2) is that the amount “which is not utilized by him for all or any of the purposes aforesaid has to be deposited in the capital gain account scheme”.

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

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

**Note** – In this case, two issues have been touched upon, namely, whether notification of an area as an urban area under a repealed provision would hold good under the re-enacted provision and whether advance given for purchase of an eligible asset would tantamount to utilisation of capital gains for purchase of the said asset for availing exemption under section 54G. The former issue was decided taking support from section 24 of the General Clauses Act, 1897, which provides for uninterrupted subordinate legislation in case of repeal and re-enactment, with or without modification. The latter issue was also decided in favour of the assessee by holding that payment of advance for purchase of eligible asset would tantamount to utilisation of capital gains for purchase of the said asset.

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

*CIT v. Yatish Trading Co. Pvt. Ltd. (2013) 359 ITR 320 (Bom.)*

**Facts of the case:** The assessee, being a dealer in shares and securities, has a trading as well as an investment portfolio of shares and securities. On 1st April 2002 and 1st October 2004, the assessee converted certain shares and securities held as stock-in-trade into investments and thereafter, in the A.Y.2006-07, it transferred such converted shares and securities and declared income arising on such transfer under the head "Profits and gains of business or profession" and "Capital gains". The profits and gains up to the date of
conversion was offered as business income (i.e., fair market value on the date of conversion minus the cost of acquisition). The profits and gains arising after conversion up to the date of sale was offered as capital gains (i.e., sale price minus the fair market value on the date of conversion). The Assessing Officer, however, assessed the entire income arising on transfer of such converted shares and securities as business income.

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

High Court’s Decision: The High Court concurred with the Tribunal’s ruling that the gains arising on sale of those shares held as investments by the dealer-assessee (i.e., the difference between the sale price and the fair market value on the date of conversion) were to be assessed under the head “Capital gains” and not under the head “Profits and gains of business or profession”.

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INCOME FROM OTHER SOURCES

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

*CIT v. Parle Plastics Ltd. (2011) 332 ITR 63 (Bom.)*

**High Court's Observations:** Under section 2(22), “dividend” does not include, *inter alia,* any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company. The expression used in the exclusion provision of section 2(22) is "substantial part of the business". Sometimes a portion which contributes a substantial part of the turnover, though it contributes a relatively small portion of the profit, would be termed as a substantial part of the business. Similarly, a portion which is relatively small as compared to the total turnover, but generates a large portion, say, more than 50% of the total profit of the company would also be a substantial part of its business. Percentage of turnover in relation to the whole and also the percentage of the profit in relation to the whole and sometimes even percentage of manpower used for a particular part of the business in relation to the total manpower or work force of the company would be required to be taken into consideration for determining the substantial part of business. The capital employed for a specific division of a company in comparison to total capital employed would also be relevant to determine whether the part of the business constitutes a substantial part.

In this case, 42% of the total assets of the lending company were deployed by it by way of loans and advances. Further, if the income earned by way of interest is excluded, the other business had resulted in a net loss. These factors were considered in concluding that lending of money was a substantial part of the business of the company.

**High Court's Decision:** Since lending of money was a substantial part of the business of the lending company, the money given by it by way of advance or loan to the assessee could not be regarded as a dividend, as it had to be excluded from the definition of "dividend" by virtue of the specific exclusion in section 2(22).
2. Can repair and renovation expenses incurred by a company in respect of premises leased out by a shareholder having substantial interest in the company, be treated as deemed dividend?

_CIT v. Vir Vikram Vaid (2014) 367 ITR 365 (Bom)_

**Facts of the case:** The assessee holds more than 75% of equity shares in a company and is the executive director of the company. In his personal capacity, he is the owner of certain premises in which he was carrying on a proprietary business. Subsequently, the assessee ceased to carry on the business of proprietary concern and hence, let out the premises to the company. The company incurred ₹ 2.51 crores towards construction and improvement of factory premises, which it continued to use otherwise than as the owner of the premises. The Assessing Officer held that the amounts spent by the company towards repair and renovation is taxable as deemed dividend in the hands of the assessee. In the alternative, the said amount was to be treated as a perquisite taxable in the hands of the assessee.

**Appellate Authorities' Views:** The Commissioner (Appeals) noted the assessee's submission that he had leased out the said premises for a rent lower than the prevailing market rate with an understanding that all expenditure for its upkeep and maintenance would be spent by the company on account of the assessee having stopped business activities. According to the Commissioner (Appeals), the assessee failed to substantiate his claim. The Commissioner (Appeals) was of the view that all the conditions provided under section 2(22)(e) for deemed dividend were satisfied. On the other hand, the Tribunal concluded that the payment was neither a deemed dividend nor a perquisite chargeable to tax.

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

**High Court's Decision:** The High Court, accordingly, held that the repair and renovation expenses in respect of premises occupied by the company cannot be treated as deemed dividend in the hands of shareholder being the owner of the building.
Can the loan or advance given to a shareholder by the company, in return for an advantage conferred on the company by the shareholder, be deemed as dividend under section 2(22)(e) in the hands of the shareholder?

**Pradip Kumar Malhotra v. CIT (2011) 338 ITR 538 (Cal.)**

**Facts of the case:** In the present case, the assessee, a shareholder holding substantial voting power in the company, permitted his property to be mortgaged to the bank for enabling the company to take the benefit of loan. The shareholder requested the company to release the property from the mortgage. On failing to do so and for retaining the benefit of loan availed from bank, the company gave advance to the assessee, which was authorized by a resolution passed by its Board of Directors.

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

**High Court’s Observations:** In the above case, the Calcutta High Court observed that, the phrase “by way of advance or loan” appearing in section 2(22)(e) must be construed to mean those advances or loans which a shareholder enjoys simply on account of being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power. In case such loan or advance is given to such shareholder as a consequence of any further consideration which is beneficial to the company received from such a shareholder, such advance or loan cannot be said to a deemed dividend within the meaning of the Act. Thus, gratuitous loan or advance given by a company to a shareholder, who is the beneficial owner of shares holding not less than 10% of the voting power, would come within the purview of section 2(22)(e) but not to the cases where the loan or advance is given in return to an advantage conferred upon the company by such shareholder.

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

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

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

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

**High Court’s Observations & Decision:** The High Court observed that the assessee was involved in booking of resorts for the customers of these companies and entered into normal business transactions as a part of its day-to-day business activities. The High Court, therefore, held that such financial transactions cannot under any circumstances be treated as loans or advances received by the assessee from these concerns for the purpose of application of section 2(22)(e).

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

*CIT v. Manjoo and Co. (2011) 335 ITR 527 (Kerala)*

**High Court’s Observations:** On the above issue, the Kerala High Court observed that winnings from lottery is included in the definition of income by virtue of section 2(24)(ix). Further, in practice, all prizes from unsold tickets of the lotteries shall be the property of the organising agent. Similarly, all unclaimed prizes shall also be the property of the organising agent and shall be refunded to the organising agent.

The High Court contended that the receipt of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be “income earned” by him in business. The said view was taken on the basis that the unsold lottery tickets cease to be stock-in-trade of the distributor because, after the draw, those tickets are unsaleable and have no value except waste paper value and the distributor will get nothing on sale of the same except any prize winning ticket if held by him, which, if produced will entitle him for the prize money. Hence, the receipt of the prize money is not in his capacity as a lottery distributor but as a holder of the lottery ticket which won the prize. The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which tax is deducted at source.

Further, winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls. Therefore, even if the argument of the assessee is accepted and the winnings from lottery is taken to be received by him in the course of his business and as such assessable as business income, the specific provision contained in section 115BB, namely, the special rate of tax i.e. 30% would apply.

**High Court’s Decision:** The High Court, therefore, held that the rate of 30% prescribed under section 115BB is applicable in respect of winnings from lottery received by the distributor.
1. Can the loss suffered by an erstwhile partnership firm, which was dissolved, be carried forward for set-off by the individual partner who took over the business of the firm as a sole proprietor, considering the succession as a succession by inheritance?

Pramod Mittal v. CIT (2013) 356 ITR 456 (Delhi)

Facts of the case: In the present case, the assessee was previously a partner in a firm. As per the dissolution deed of the partnership firm, with effect from 18th September, 2004, he took over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partner was paid his dues. He then ran the business as a sole proprietor with effect from that date. The assessee, relying upon section 78(2) and the decisions of the Supreme Court in CIT v. Madhukant M. Mehta (2001) 247 ITR 805 (SC) and Saroj Aggarwal v. CIT (1985) 156 ITR 497 (SC), claimed the set-off of the losses suffered by the erstwhile partnership firm against his income earned as an individual proprietor, considering the case as inheritance of business.

However, considering that only the person who has suffered the loss is entitled to carry forward and set-off the same, the claim of the assessee was disallowed by the Assessing Officer. The Tribunal concurred with the Assessing Officer's view.

High Court’s Observations: The High Court observed that upon dissolution, the partnership firm ceased to exist. Also, the partnership firm and the proprietorship concern are two separate and distinct units for the purpose of assessment. As per section 170(1), the partnership firm shall be assessed as such from 1st April of the previous year till the date of dissolution (i.e., 18th September, 2004). Thereafter, the income of the sole-proprietorship shall be taxable in the hands of the assessee as an individual. Thus, section 170(1) provides as to who will be assessable in respect of the income of the previous year from business, when there is a change in the person carrying on business by succession.

Section 78(2), however, deals with carry forward of losses in case of succession of business. It provides that only the person who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. An exception provided thereunder is in the case of succession by inheritance.
Therefore, section 170(1) providing the person in whose hands income is assessable in case of succession and section 78(2) providing for carry forward of losses in case of succession of business, deal with different situations and resultantly, there is no contradiction between these sections.

The income earned by the sole proprietor would include his share of loss as an individual but not the loss suffered by the erstwhile partnership firm in which he was a partner. The exception given in section 78(2), permitting carry forward of losses by the successor in case of inheritance, is not applicable in the present case since the partnership firm was dissolved and ceased to continue. Taking over of business by a partner cannot be considered as a case of inheritance due to death as per the law of succession. The High Court opined that the decision in Madhukant M. Mehta’s case and Saroj Aggarwal’s case cannot be applied since this is not a case of succession by inheritance.

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

**Note -** In Madhukant M. Mehta’s case, the sole proprietor had expired and after his death the heirs succeeded the business as a partnership concern. Therefore, the losses suffered by the deceased proprietor was allowed to be set-off by the partnership firm since the case falls within the exception mentioned under section 78(2), i.e., a case of succession by inheritance.

Also, in Saroj Aggarwal’s case, upon death of a partner, his legal heirs were inducted as partners in the partnership firm. The partnership firm was not dissolved on the death of the partner. The partnership firm which suffered the losses continued with induction of the legal heirs of the deceased partner. This, being a case of succession by inheritance, the benefit of carry forward of losses was given to the re-constituted partnership firm.

In the present case, however, the partnership firm was dissolved and the take over of the running business of the firm by the erstwhile partner as a sole proprietor was not a case of succession by inheritance. Hence, the carry forward of losses of the firm by the sole proprietor was not allowed in this case.
DEDUCTIONS FROM GROSS TOTAL INCOME

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

*CIT v. Shree Govindbhai Jethalal Nathavani Charitable Trust (2015) 373 ITR 619 (Guj)*

**Facts of the case:** The assessee trust filed an application in Form 10G for grant of approval under section 80G(5). It also filed copies of trust deed and registration certificate dated 18th August, 2011 with the approving authority. As per the trust deed, the main objects of the trust are educational, social activities, etc. In order to verify the facts stated in the application, the trust was asked to produce books of account, relevant vouchers, donation book and minutes in original. On perusal of the books for financial year 2011-12, it was found that the trust had not applied 85% of its income and therefore, the Commissioner rejected the application of the assessee seeking approval under section 80G(5) and Rule 11AA of the Income-tax Rules, 1962.

**Tribunal's view:** On appeal, the Tribunal noted the decision of Punjab and Haryana High Court in the case of *CIT v. O.P. Jindal Global University (2013) 38 Taxmann 366*, in which it was held that at the time of granting approval of exemption under section 80G, only the objects of the trust are required to be examined and the aspect of application of funds can be examined by the Assessing Officer at the time of framing the assessment. Consequently, the Tribunal held that the Commissioner has erred in refusing to grant recognition to the trust under section 80G(5).

**High Court's Observations:** The High Court was of the view that the issue in the present case is now not *res integra* in view of the decision of the Division Bench of this Court in the case of *N.N. Desai Charitable Trust v. CIT (2000) 246 ITR 452 (Guj)*. In that case, the Division Bench observed that, while considering the application for the purpose of section 80G, the authority cannot act as an assessing authority and the enquiry should be confined to finding out if the institution satisfies the prescribed conditions. The Division Bench also made the following observations:

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1 Section 80G(5)(i) provides that donation to any institution or fund would qualify for deduction thereunder only if it is established in India for a charitable purpose and derives such income which would not be liable to inclusion in its total income under the provisions of sections 11 and 12 or section 10(23AA)/(23C).
(i) Section 80G does not relate to assessment of the trust or the institution whose income is not liable to be included in the computation of taxable income under various provisions of the Act. Primarily, section 80G is related to giving deduction in respect of donations made by a person to such trusts and institutions.

(ii) There are two distinct concepts. The first is whether an institution or fund is such whose income is not liable to be included in the computation of total income, has to be determined on the basis of its status or character. The second is the actual assessment of income, which necessarily takes place in future after donation is received by the donee, on fulfilment of other conditions about application of income by the eligible trusts, which in the very nature of things can operate only after receipt of income. The two are different concepts.

(iii) The liability to assessment is neither affected on account of grant of recognition under section 80G nor on whether the donor ultimately gets deduction in respect of such donation. Once a trust is registered under section 12AA, its income from property includes donation which is covered by section 11(1)(d) or under section 12. Such donations are deemed to be income from property, which are not to be included in the total income under section 11 or section 12. The enquiry under section 80G, hence, cannot go beyond that.

(iv) The scope of enquiry cannot include an enquiry as to whether, at the close of the previous year, the donee-trust will actually be able to apply 85% of its income because non-fulfilment of some conditions by the donee-trust as regards application or accumulation cannot be ascertained in praesenti, when the donation is made. The question of whether the trust will be able to apply 85% of its income can be determined only from the facts existing at the close of the assessment year.

The High Court also noted that similar views were expressed by the Punjab and Haryana High Court in the case of CIT v. O. P. Jindal Global University (2013) 38 Taxmann.com 366.

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

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


**Facts of the case:** The assessee was in the business of manufacture of wires. It installed a windmill for power generation. The assessee claimed depreciation on windmill against income from power generation, which was eligible for deduction under section 80-IA. The balance depreciation was set off against the profits from manufacturing of wires, being a non-eligible business.
**Assessing Officer's contention:** The Assessing Officer contended that depreciation relating to a business eligible for deduction under section 80-IA cannot be set off against non-eligible business income. Therefore, unabsorbed depreciation was to be carried forward to the subsequent year to be set off against the eligible business income of the assessee of that year.

**Tribunal's Observations:** The Tribunal observed that the balance depreciation of the eligible business is required to be carried forward for set-off against eligible business income of the next year while determining the profits eligible for deduction under section 80-IA in that year. However, the Tribunal noted that section 80-IA is a beneficial section permitting certain deduction in respect of certain income under Chapter VI-A. A provision granting tax incentive for economic growth should be construed liberally and any restriction placed should also be construed in a reasonable and purposive manner to advance the objects of the provision.

**High Court's Observations and Decision:** The High Court observed that it is a generally accepted principle that deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1). The assessee had incurred loss in eligible business after claiming depreciation. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed. It is thereafter that section 70(1) comes into play, whereby the assessee is entitled to set off the losses from one source against income from another source under the same head of income. The Court, therefore, held that the assessee was entitled to the benefit of set off of loss of eligible business against the profits of non-eligible business. However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year.

**Note** – The crux of the above decision can be explained with a simple example. Let us consider a company, X Ltd., having two units, Unit A and Unit B. If Unit A engaged in eligible business (say, power generation) has a profit of ₹100 lacs in A.Y.2017-18, before claiming depreciation of ₹120 lacs and Unit B engaged in non-eligible business (say, manufacture of wires) has a profit of ₹70 lacs, then, as per the above decision, the loss of ₹20 lacs (representing balance depreciation not set-off) pertaining to Unit A can be set-off against profit of ₹70 lacs of Unit B carrying on non-eligible business. Therefore, the net profit of ₹50 lacs would be taxable in the A.Y.2017-18. If in the next year, i.e., A.Y.2018-19, the net profits of Unit A and Unit B are ₹200 lacs and ₹80 lacs, respectively, then the eligible deduction under section 80-IA for that year would be ₹180 lacs (i.e., ₹200 lacs minus ₹20 lacs, being loss (representing balance depreciation) set-off in the A.Y.2017-18 against other income).
3. Can freight subsidy arising out of the scheme of Central Government be treated as a “profit derived from the business” for the purposes of section 80-IA?


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

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

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

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

**CIT v. Orchev Pharma P. Ltd. (2013) 354 ITR 227 (SC)**

**Supreme Court's Decision:** On this issue, the Supreme Court, following the decision in case of *Liberty India v. CIT (2009) 317 ITR 218 (SC)* held that Duty Drawback receipts cannot be said to be profits derived from the business of industrial undertaking for the purpose of computation of deduction under section 80-IB.

**Note** - In the case of Liberty India v. CIT (2009) 317 ITR 218 (SC), the Supreme Court observed that DEPB / Duty drawback are incentives which flow from the schemes framed by the Central Government or from section 75 of the Customs Act, 1962. Section 80-IB provides for the allowing of deduction in respect of profits and gains derived from eligible business. **However, incentive profits are not profits derived from eligible business under section 80-IB. They belong to the category of ancillary profits of such undertaking.** Profits derived by way of incentives such as DEPB/Duty drawback cannot be credited against the cost of manufacture of goods debited in the profit and loss account and they do not fall within the expression “profits derived from industrial undertaking” under section 80-IB. Hence, Duty drawback receipts and DEPB benefits do not form part of the profits derived from the eligible business for the purpose of the deduction under section 80-IB.
5. Would grant of transport subsidy, interest subsidy and refund of excise duty qualify for deduction under section 80-IB?

_CIT v. Meghalaya Steels Ltd. (2011) 332 ITR 91 (Gauhati)_

The Supreme Court, in _Liberty India v. CIT [2009] 317 ITR 218_, observed that section 80-IB provides for deduction in respect of profits and gains “derived from the business” of the assessee and accordingly, the Parliament intended to cover sources of profits and gains not beyond the first degree. There should be a direct nexus between the generation of profits and gains and the source of profits and gains, the latter being directly relatable to the business of the assessee. Any other source, not falling within the first degree, can only be considered as ancillary to the business of the assessee.

_High Court's Observations:_ In this case, the High Court observed that the transport and interest subsidies were revenue receipts which were granted after setting up of the new industries and after commencement of production. The transport subsidy would have the effect of reducing the inward and outward transport costs for the purposes of determining the cost of production as well as for sales. However, the subsidy had no direct nexus with the profits or gains derived by the assessee from its industrial activity and the benefit to the assessee was only ancillary to its industrial activity. The subsidies were not directly relatable to the industrial activity of the assessee, and hence they did not fall within the first degree contemplated by the Act. Therefore, the subsidies could not be taken into account for purposes of deduction under section 80-IB.

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

_Note - Similar ruling was pronounced by the Himachal Pradesh High Court in CIT v. Gheria Oil Gramudtyog Workers Welfare Association (2011) 330 ITR 117, wherein it was held that interest subsidy received from the State Government cannot be treated as “profit derived from industrial undertaking” and hence, was not eligible for deduction under section 80-IB._

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

_CIT v. Jaswand Sons (2010) 328 ITR 442 (P&H)_

_High Court's Decision:_ On this issue, the High Court held that income derived from sale of export incentive cannot be said to be income “derived from” the industrial undertaking and therefore, such income is not eligible for deduction under section 80-IB.
7. Does the period of exemption under section 80-IB commence from the year of trial production or year of commercial production? Would it make a difference if sale was effected from out of the trial production?

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

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

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

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

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

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

_Praveen Soni v. CIT (2011) 333 ITR 324 (Delhi)_

**High Court’s Decision:** On the above issue, the Delhi High Court held that the provisions of section 80-IB nowhere stipulated a condition that the claim for deduction under this section had to be made from the first year of qualification of deduction failing which the claim will not be allowed in the remaining years of eligibility. Therefore, the deduction under section 80-IB should be allowed to the assessee for the remaining years up to the period for which his entitlement would accrue, provided the conditions mentioned under section 80-IB are fulfilled.
1. Where land inherited by three brothers is compulsorily acquired by the State Government, whether the resultant capital gain would be assessed in the status of “Association of Persons” (AOP) or in their individual status?

*CIT v. Govindbhai Mamaiya (2014) 367 ITR 498 (SC)*

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

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

**High Court’s Observations:** The High Court found that the parties inherited the property and there was no material on record to suggest consensus *ad idem* between the brothers for formation of AOP. It referred to *CWT v. Chander Sen (1986) 161 ITR 370 (SC)* to hold that as per section 4 of the Hindu Succession Act, 1956, income from the asset inherited by a son from his father has to be assessed as income of the son individually. Further, as per section 8 of the Hindu Succession Act, 1956, the property of the father devolves on his son in his individual capacity and not as karta of HUF. Thus, it was held that the income is chargeable to tax in their individual status and not as AOP.

**Supreme Court’s Observations:** The Supreme Court referred to its earlier decision in the case of *Meera & Co v. CIT (1997) 224 ITR 635* in which the earlier precedent in the case of *CIT v. Indira Balakrishna (1960) 39 ITR 546 (SC)* was followed. The Apex Court noted that “Association of Persons” means an association in which two or more persons join in a common purpose or common action.

The Supreme Court also referred to its judgment in *G. Murugesan & Bros. v. CIT (1973) 4 SCC 211*. In that case, it was held that an association of persons could be formed only when two or more persons voluntarily combined together for certain purposes.

In this case, the property in question came to the assessee's possession through inheritance i.e., by operation of law. It is not a case where any “association of persons” was formed by volition of the parties. Further, even the income earned in the form of
interest is not because of any business venture of the three assessees, but is the result of the act of the Government in compulsorily acquiring the said land. Thus, the basic test to be satisfied for making an assessment in the status of AOP is absent in this case.

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

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


**Facts of the case:** In the present case, Laxmaiah Reddy had no sons and therefore, he adopted the assessee vide a registered adoption deed dated June 25, 1956. The property, which is the subject matter of the suit, originally belonged to Venkateshwaraiah (assessee’s grandfather). The assessee’s father (Laxmaiah Reddy), took his share in the joint family property and executed a release deed in favour of the remaining members of the joint family vide a registered release deed dated November 23, 1927 and bequeathed all his properties in favour of the assessee. The assessee, in turn, distributed the property in favour of his wife and children. This was done by oral partition which was evidenced by a memorandum of partition dated August 6, 1998.

Thereafter, a transaction was entered into by the assessee with the builder for development of the property. The Assessing Officer treated the consideration received from the builder by the assessee and his wife as their individual income and assessed the same to tax in their individual hands.

**Assessing Officer's contention:** The Revenue contended that when assessee’s father got the property under a release deed, it ceased to be the joint family property. Since that property was bequeathed in favour of the assessee, he became its owner after the death of his father. Therefore, it was a separate property and, consequently, the income derived therefrom is assessed to tax in the hands of the assessee as separate property.

**High Court's Observations:** The High Court observed that the property originally belonged to Hindu Undivided Family (HUF). One of the members of the family (i.e., the assessee’s father) went out of the joint family under a release deed and the remaining members continued to be the members of joint family. After the death of assessee’s father and mother, the assessee, being the adopted son, became the sole surviving co-parcener. When such property came to the hands of the assessee it was not his individual property; it was the property of his Hindu Undivided Family.
3. Under which head of income is rental income from plinths inherited by individual co-owners from their ancestors taxable - “Income from house property” or “Income from other sources”? Further, would such income be assessable in the hands of the individual co-owners or in the hands of the Association of Persons?

_Sudhir Nagpal v. Income-tax Officer (2012) 349 ITR 0636 (P & H)_

**First Issue:** The first issue relates to the head of income under which rental income from plinths, inherited by individual co-owners from their ancestors, is taxable – whether “Income from house property” or “Income from other sources”?.

**High Court’s Observations:** As regards the head of income under which rental income from plinths is assessable, the High Court referred to the Division Bench judgment in _Gowardhan Das and Sons v. CIT (2007) 288 ITR 481_, wherein it was observed that it is the income from property consisting of any building or land appurtenant thereto which is assessed under section 22 and not the income from renting out of open land or some kutcha plinth only.

**High Court’s Decision:** Therefore, the Court held that the income from letting out the plinths is assessable under section 56 as “Income from other sources” and not under the head “Income from house property”.

**Second Issue:** The second issue relates to whether such rental income is assessable in the hands of the individual co-owners or in the hands of the Association of Persons. To appreciate this issue, it is necessary to understand the complete facts of the case.

**Facts of the case:** In the present case, five persons of the Nagpal family were co-owners of the agricultural land “Nagpal farms” inherited from their forefathers. The co-owners executed a power of attorney in favour of Mr. Sudhir Nagpal, one of the co-owners, appointing him to construct plinths on the agricultural land and to further lease out such open plinths to any party on their behalf. The co-owners had, therefore, not purchased the land for the said purpose but had inherited the land. They were owners not in their joint capacity but in their individual capacity with a definite/defined proportion of share. The co-owners filed their individual returns of income disclosing their rental income and also paid tax on such income.

The Assessing Officer, however, issued notice under section 148 to all the co-owners of the property in the name of Mr. Sudhir Nagpal on the ground that there is an association
of persons formed by the co-owners and therefore, income had escaped assessment in the hands of association of persons.

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

The Assessing Officer did not agree with the contention of the assessee and assessed the entire rental income from the plinths as income from other sources in the hands of the association of persons and determined the tax payable by applying section 167B(2). The Commissioner (Appeals) and the Tribunal confirmed the action of the Assessing Officer.

**High Court's Observations:** On appeal, the High Court observed that in order to assess individuals as "association of persons", the individual co-owners should have joined their resources and thereafter, acquired property in the name of association of persons and the property should have been commonly managed. It is only in such a case that income could be assessed in the hands of “association of persons”. Mere accruing of income jointly to more persons than one would not constitute them an association of persons in respect of such income. In other words, unless the associates have done some acts or performed some operations together, which have helped to produce the income in question, they cannot be termed as an association of persons. Unless the members combine or join in a common purpose, it cannot be held that they have formed themselves into an association of persons.

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

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

**Madras Gymkhana Club v. DCIT (2010) 328 ITR 348 (Mad.)**

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

**High Court’s Decision:** The High Court held that interest earned from investment of surplus funds in the form of fixed deposits with institutional members does not satisfy the principle of mutuality and hence cannot be claimed as exempt on this ground. The interest earned is, therefore, taxable.
5. Can transfer fees received by a co-operative housing society from its incoming and outgoing members be exempt on the ground of principle of mutuality?

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

**High Court’s Observations:** On this issue, the High Court observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

**High Court’s Decision:** The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

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

6. Would non-resident match referees and umpires in the games played in India fall within the meaning of “sportsmen” to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer?

*Indcom v. Commissioner of Income-tax (TDS) (2011) 335 ITR 485 (Cal.)*

**High Court’s Observations:** On this issue, the Calcutta High Court observed that, in order to attract the provisions of the section 194E, the person should be a non-resident sportsperson or non-resident sports association or institution whose income is taxable as per the provisions of section 115BBA.

The umpires and the match referees can be described as professionals or technical persons who render professional or technical services, but they cannot be said to be either non-resident sportsmen (including an athlete) or non-resident sports association or institution so as to attract the provisions of section 115BBA and consequently, the provisions of tax deduction at source under section 194E are also not attracted in this case. Though for the purpose of section 194J, match referees and umpires are considered as professionals, the tax deduction provisions thereunder are attracted only in case where the deductee is a resident individual, which is not so in the present case.

**High Court’s Decision:** Therefore, although the payments made to non-resident umpires and the match referees are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the assessee is not liable to deduct tax under section 194E.
Note - It may be noted that since income has accrued and arisen in India to the non-resident umpires and match referees, the TDS provisions under section 195 would be attracted and tax would be deductible at the rates in force.

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

**CIT v. Anil Hardware Store (2010) 323 ITR 368 (HP)**

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

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

**Notes:**

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

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

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

*Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470 (SC)*

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

**Supreme Court's Decision:** The Supreme Court, therefore, held that interest under sections 234B and 234C shall be payable on failure of the company to pay advance tax in respect of tax payable under section 115JB.

**Note** – According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year. Under section 115JB(1), where the tax payable on total income is less than 18.5% of “book profit” of a company, the “book profit” would be deemed to be the total income and tax would be payable at the rate of 18.5%. Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.

9. Can long-term capital gain exempted by virtue of section 54EC be included in the book profit computed under section 115JB?

*N. J. Jose and Co. (P.) Ltd. v. ACIT (2010) 321 ITR 132 (Ker.)*

**Facts of the case:** The assessee claimed exemption under section 54E on the income from long-term capital gains by depositing amounts in specified assets in terms of the said provision. In the computation of book profit under section 115J, the assessee claimed exclusion of capital gains because of exemption available on it by virtue of section 54E. The Assessing Officer reckoned the book profits including long-term capital gains for the purpose of assessment under section 115J.
**High Court’s Decision:** The High Court held that once the Assessing Officer found that total income as computed under the provisions of the Act was less than 30 per cent of the book profit, he had to make the assessment under section 115J which does not provide for any deduction in terms of section 54E. As long as long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956 (now, Statement of Profit and Loss prepared in accordance with Part II of Schedule III to the Companies Act, 2013), capital gains cannot be excluded unless provided under the Explanation to section 115J(1A).

**Note** – It may be noted that the rationale of this decision would apply even where minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18.5% of book profits. If an assessee has claimed exemption under section 54EC by investing in bonds of NHAI/ RECL, within the prescribed time, the long term capital gains so exempt would be taken into account for computing book profits under section 115JB for levy of minimum alternate tax (MAT), since Explanation 1 to section 115JB does not provide for such deduction. Further, it may be noted that even the long term capital gain exempt under section 10(38) is included for computation of book profit under section 115JB.
1. Can the assessee's application, for adjustment of tax liability on income surrendered during search by sale of seized gold bars, be entertained where assessment has not been completed?

_Hemant Kumar Sindhi & Another v. CIT (2014) 364 ITR 555 (All)_

**Facts of the case:** Consequent to a search in the premises of the assessee, some gold bars were seized from the locker. The assessee voluntarily disclosed some income during the course of search. The assessee filed an application for sale of the gold bars and adjustment of tax liability on undisclosed income out of the sale proceeds. This would obviate his liability to pay interest under sections 234B and 234C. The Assessing Officer dismissed the application on the reasoning that only when the assessment is completed and tax demand is crystallized, can recovery be initiated by the sale of gold bars. The assessee filed a writ contesting the dismissal of application by the Assessing Officer.

**High Court's Observations:** The High Court observed that section 132B(1)(i) uses the expression “the amount of any existing liability” and “the amount of the liability determined”. The words “existing liability” postulates a liability that is crystallized by adjudication; Likewise, “a liability is determined” only on completion of the assessment. **Until the assessment is complete, it cannot be postulated that a liability has been crystallized.**

As per the first proviso to section 132B(1)(i), the assessee may make an application to the Assessing Officer for release of the assets seized. However, he has to explain the nature and source of acquisition of the asset to the satisfaction of the Assessing Officer. It is not the _ipse dixit_ of the assessee but the satisfaction of the Assessing Officer on the basis of the explanation tendered by the assessee which is material.

**High Court's Decision:** The High Court, accordingly, held that the Assessing Officer was justified in his conclusion that it is only when the liability is determined on the completion of assessment that it would stand crystallized and in pursuance of which a demand can be raised and recovery can be initiated. Therefore, in the present case, the first proviso to section 132B(1)(i) would not be attracted. The High Court, thus, dismissed the writ petition.
2. Where no proceeding is pending against a person, can the Assessing Officer call for information under section 133(6), which is useful or relevant to any enquiry, with the permission of Director or Commissioner?

*Kathiroor Service Co-operative Bank Ltd. v. CIT (CIB) (2014) 360 ITR 0243 (SC)*

**Facts of the case:** The Assessing Officer, with the prior approval of the Commissioner, issued notice under section 133(6) to the assessee, a co-operative society engaged in banking business, calling for general information regarding details of all persons (whether resident or non-resident) who had made (a) cash transactions of ₹ 1 lakh and above in any account, and/or (b) time deposits of ₹ 1 lakh or above, for the period of three years between April 1, 2005, and March 31, 2008, expressly stating therein that failure to furnish the information would attract penal consequences.

The assessee objected to the said notice, *inter alia*, on the ground that such notice seeking for information which is unrelated to any existing or pending proceeding against the assessee could not be issued under the provisions of the Act.

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

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

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

*Sahara Hospitality Ltd. v. CIT (2013) 352 ITR 38 (Bom.)*

**High Court's Observations:** On this issue, the Bombay High Court observed that the provisions of section 127(1) stipulate, *inter alia*, that the income tax authority mentioned therein *may* give an opportunity of being heard to the assessee, wherever it is possible to do so, and after recording his reasons for doing so, transfer any case from one or more Assessing Officers subordinate to him to any other Assessing Officer or officers subordinate to him.
High Court's Decision: The Bombay High Court held that the word “may” used in this section should be read as “shall” and such income-tax authority has to mandatorily give a reasonable opportunity of being heard to the assessee, wherever possible to do so, and thereafter, record the reasons for taking any action under the said section. “Reasonable opportunity” can only be dispensed with in a case where it is not possible to provide such opportunity. In such a case also, the authority should record its reasons for making the transfer, even though no opportunity was given to the assessee. The discretion of the authority is only to consider as to what is a reasonable opportunity in a given case and whether it is possible to give such an opportunity to the assessee or not. The authority cannot deny a reasonable opportunity of being heard to the assessee, wherever it is possible to do so.

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

Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 441 (Del.)

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

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

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

Note – Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or any other relief under the Act after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of a loss return is relatable to a claim arising under the category of any other relief available under the Act. Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.
1. Can unabsorbed depreciation be allowed to be carried forward in case the return of income is not filed within the due date?

_CIT v. Govind Nagar Sugar Ltd. (2011) 334 ITR 13 (Delhi)_

**High Court’s Observations:** On this issue, the Delhi High Court observed that, the provisions of section 80 and section 139(3), requiring the return of income claiming loss to be filed within the due date, applies to, _inter alia_, carry forward of business loss and not for the carrying forward of unabsorbed depreciation. As per the provisions of section 32(2), the unabsorbed depreciation becomes part of next year’s depreciation allowance and is allowed to be set-off as per the provisions of the Income-tax Act, 1961, irrespective of whether the return of earlier year was filed within due date or not.

**High Court’s Decision:** Therefore, in the present case, the High Court held that the unabsorbed depreciation will be allowed to be carried forward to subsequent year even though the return of income of the current assessment year was not filed within the due date.

2. Can an assessee revise the particulars filed in the original return of income by filing a revised statement of income?

_Orissa Rural Housing Development Corpn. Ltd. v. ACIT (2012) 343 ITR 316 (Orissa)_

**High Court’s Decision:** On this issue, the Orissa High Court held that the assessee can make a fresh claim before the Assessing Officer or make a change in the originally filed return of income only by filing revised return of income under section 139(5). There is no provision under the Income-tax Act, 1961 to enable an assessee to revise his income by filling a revised statement of income. Therefore, filing of revised statement of income is of no value and will not be considered by the Assessing Officer for assessment purposes.

The High Court, relying on the judgement of the Supreme Court in _Goetze (India) Ltd. v. CIT (2006) ITR 323_, held that the Assessing Officer has no power to entertain a fresh claim made by the assessee after filing of the original return except by way of filing a revised return.
3. Is a person having income below taxable limit, required to furnish his PAN to the deductor as per the provisions of section 206AA, even though he is not required to hold a PAN as per the provisions of section 139A?

_Smt. A. Kowsalya Bai v. UOI (2012) 346 ITR 156 (Kar.)_

As per the provisions of section 139A, _inter alia_, a person whose total income does not exceed the maximum amount not chargeable to income-tax is not required to apply to the Assessing Officer for the allotment of a permanent account number (PAN).

However, as per the provisions of section 206AA, notwithstanding anything contained in any other provision of this Act, any person who is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, i.e., the deductee, shall furnish his PAN to the deductor, otherwise tax shall be deducted as per the provisions section 206AA, which is normally higher. It is mandatory for an assessee to furnish his PAN, despite filing Form 15G as required under section 197A, to seek exemption from deduction of tax.

The provisions of section 139A are contradictory to section 197A, due to the fact that assessees whose income was less than the maximum amount not chargeable to income-tax, were not required to hold PAN, whereas their declaration furnished under section 197A was not accepted by the bank or financial institution unless PAN was communicated as per the provisions of section 206AA. The provisions of section 206AA creates inconvenience to small investors, who invest their savings from earnings as security for their future, since, in the absence of PAN, tax was deducted at source at a higher rate.

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

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

_Aventis Pharma Ltd. v. ACIT (2010) 323 ITR 570 (Bom.)_

The power to reopen an assessment is conditional on the formation of a reason to believe that income chargeable to tax has escaped assessment. The existence of tangible material is essential to safeguard against an arbitrary exercise of this power.
High Court's Observations and Decision: In this case, the High Court observed that there was no tangible material before the Assessing Officer to hold that income had escaped assessment within the meaning of section 147 and the reasons recorded for reopening the assessment constituted a mere change of opinion. Therefore, the reassessment was not valid.

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

\textit{ACIT v. ICICI Securities Primary Dealership Ltd. (2012) 348 ITR 299 (SC)}

Facts of the case: In the above case, the Assessing Officer had completed the assessment of assessee under section 143(3) after taking into consideration the accounts furnished by assessee. After the lapse of four years from relevant assessment year, the Assessing Officer had reopened the assessment of assessee under section 147 on the ground that after re-look of the accounts of the relevant previous year, it was noticed that the assessee company had incurred a loss in trading in share, which was a speculative one. Therefore, such loss can only be set off against speculative income. Consequently, the loss represents income which has escaped assessment. Accordingly, the Assessing Officer came to a conclusion that income had escaped assessment and passed an order under section 147.

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

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

\textit{Hemant Traders v. ITO (2015) 375 ITR 167 (Bom)}

Facts of the case: In the present case, the assessee is a partnership firm and registered as a Commission agent of the onion potato market under the Agricultural Produce Market Committee, Navi Mumbai. The firm is regularly assessed to income-tax. The firm filed a return of income for A.Y.2010-11 on October 14, 2010 along with audit report, audited Balance Sheet and Profit & Loss Account for the year ended 31.3.2010. The return was
processed and intimation under section 143(1) was issued on 20.02.2012, seeking clarification. No assessment order was passed. The assessee claimed that the profit as per the return of income was accepted. Meanwhile, a survey under section 133A was carried out at the business premises of the assessee on 7th January 2011 pertaining to A.Y.2011-12. However, the survey party did not find any discrepancy in the books of account. Further, the survey report did not contain any reference to any transactions for A.Y.2010-11. In March 2014, the assessee was issued a notice under section 148 for the A.Y.2010-11 based on the said survey.

The assessee preferred a writ challenging the issue of notice on the reasoning that no satisfaction was recorded of the escapement of income in the survey report or in any other relevant material. Ex-facie, the reassessment was bad in law.

High Court's Observations: The High Court perused the survey report which recorded that there was a group of assessees who were engaged in wholesale trading of potato on commission basis. The survey was conducted based on the allegations that these parties were resorting to hoarding of potatoes and making huge profits by fluctuating the day-to-day price of potatoes in the market. During survey, the assessee’s books of account, cash balance and stocks were physically verified and inventory prepared. The report revealed cash difference of ₹ 5,020 and the explanation given was that the same pertain to the day-to-day and miscellaneous expenditure incurred on the day of survey. The report also revealed physical stock difference of 672 bags of potatoes. The explanation for such difference was recorded.

Neither the survey report nor any other material indicated escapement of income chargeable to tax for A.Y.2010-11. The Assessing Officer had nothing before him to record his belief or satisfaction that escapement of income had taken place.

Merely because survey had taken place cannot be a ground for reopening the assessment without valid material or evidence at the time of issue of notice. Whenever there was shortage of potatoes in the market, such powers of survey were invoked. Where nothing has been found during the survey operations to indicate that income chargeable to tax has escaped assessment, then the survey report ought not to be the basis for reopening of assessment. Something more was required in law for the Assessing Officer to exercise his powers.

High Court Decision: The High Court, accordingly, held that since there is absolutely no material to indicate escapement of income for the relevant assessment year, the issue of notice to initiate reassessment proceedings under section 148 on the basis of survey which had taken place is not valid. Therefore, the proceedings initiated under section 148 are quashed at the threshold itself.
7. Will the subsequent amendment of law with retrospective effect validate a reassessment notice issued on a different ground before the retrospective amendment was made?

Godrej Industries Ltd v. B.S. Singh Dy.CIT (2015) 377 ITR 1 (Bom)

**Facts of the case:** The assessee-company filed its return of income for the assessment year 2000-01 declaring total income as 'Nil' and a book profit of ₹ 52.70 crores. This resulted in 'book profit' being assessed to income-tax. Later, the Assessing Officer issued notice under section 148 for the reason that income chargeable to tax had escaped assessment on the ground that the provision for doubtful debts and provision for depletion of long-term investment debited to the profit and loss account were unascertained liabilities and, hence, in terms of clause (c) of the *Explanation* to section 115JA, i.e., they were to be added back to the net profit for arriving at the book profits.

The assessee preferred a writ challenging the maintainability of the notice issued under section 148.

**Revenue’s Contention:** The Revenue contended that at the time of issuing the impugned notice on March 29, 2007, the position was not clear. The position became clear only when Parliament introduced/added clause (g) to the *Explanation* to section 115JA of the Act with retrospective effect from April 1, 1998, and which reads as under:

"(g) the amount or amounts set aside as provision for diminution in the value of any asset."

Thus, the Revenue submitted that the impugned notice is sustainable on the basis of above clause (g) of the *Explanation* to section 115JA, inserted by the Finance (No.2) Act, 2009 retrospectively with effect from 1st April, 1998.

**High Court’s Observations:** The High Court observed that an identical issue had come up in *Rallis India Ltd. v. Asst. CIT* [2010] 323 ITR 54 (Bom) wherein a reopening notice was, *inter alia*, issued on the ground that the book profits have to be increased by the provision made for doubtful debts and for diminution in the value of investment in view of clause (c) of the *Explanation* to section 115JB. In the said case, the High Court recorded the fact that the Apex Court had, in *CIT v. HCL Comnet Systems and Services Ltd.* [2008] 305 ITR 409, held that the provision for doubtful debts is a provision made for diminution in the value of assets and is not a liability. Thus, it would not fall under clause (c) of the *Explanation* to section 115JA of the Act. Consequent to the aforesaid decision of the Apex Court, the Parliament has amended the *Explanation* both under section 115JA as well as section 115JB of the Act in 2009 by adding clause (g) and clause (i) with retrospective effect from April 1, 1998, and April 1, 2001, respectively. The Court held that though the amendment was made with the retrospective effect, the critical date is the date on which the Assessing Officer exercises jurisdiction under section 148 of the Act and the subsequent amendment could not have been and is in fact not a ground on which the Assessing Officer sought to reopen the assessment. It was held that the
validity of a reopening notice of Assessing Officer is to be determined with reference to the reasons which are recorded in support of thereof and nothing else.

In this case also, it is clear that the reasons stated for reopening the assessment are that provision for doubtful debts and depletion in value of investments are both amounts set aside for meeting liabilities other than ascertained liabilities and hence, constitute income escaping assessment. The reasons recorded are not valid as the said items were not related to liabilities as perceived by the Assessing Officer. These provisions are made to take care of the likely fall in the value of assets.

The High Court observed that it is the Assessing Officer’s belief at the time of issuing the reassessment notice that determines the validity of the notice. In this case, he wanted to apply clause (c) of the Explanation to section 115JA and whereas the issues got covered by subsequent amendment by means of insertion of clause (g) to the Explanation to section 115JA by the Finance (No.2) Act, 2009 with retrospective effect from 1.4.1998. The subsequent event could not put life into the Assessing Officer's reason that income chargeable to tax had escaped assessment when the reasons as originally recorded are still born.

**High Court’s Decision:** The position of law on the date of issue of notice under section 148 must be looked into and the retrospective amendment subsequent to issue of notice could not validate a notice issued earlier. It could only amount to change of opinion and the notice for reopening of assessment would become unsustainable.

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

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

8. Can the Assessing Officer reassess issues other than the issues in respect of which proceedings were initiated under section 147 when the original “reason to believe” on the basis of which the notice was issued ceased to exist?

* Delhi High Court ruling in Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136:
**Facts of the case:** In the present case, the assessee company was engaged in the business of manufacture and trading of pharmaceutical products. The Assessing Officer accepted the returned income filed by the assessee but initiated reassessment proceedings under section 147 in respect of the addition to be made on account of club fees, gifts and presents and provision for leave encashment. It was observed that the Assessing Officer had reason to believe that income has escaped assessment due to claim and allowance of such expenses and accordingly, he issued notice under section 148. However, after sufficient enquiries were made during reassessment proceedings, the Assessing Officer came to the conclusion that no additions are required to be made on account of these expenses. Therefore, while completing the reassessment he did not make additions on account of these items but instead made additions on the basis of other issues which were not the original “reason to believe” for the issue of notice under section 148. The Assessing Officer made such additions on the basis of Explanation 3 to section 147 as per which the Assessing Officer may assess the income which has escaped assessment and which comes to his notice subsequently in the course of proceedings under section 147 even though the said issue did not find mention in the reasons recorded in the notice issued under section 148.

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

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

The correct interpretation of the Parliament would be to regard the words ‘and also’ as being “conjunctive and cumulative with” and not “in alternative to” the first part of the sentence, namely, “the Assessing Officer may assess and reassess such income”. It is significant to note that Parliament has not used the word ‘or’ but has used the word ‘and’ together and in conjunction with the word ‘also’. The words ‘such income’ in the first part of the sentence refer to the income chargeable to tax which has escaped assessment and in respect of which the Assessing Officer has formed a reason to believe for issue of the notice under section 148. Hence, the language used by the Parliament is indicative of the position that the assessment or reassessment must be in respect of the income, in respect of which the Assessing Officer has formed a reason to believe that the same has escaped assessment and also in respect of any other income which comes to his notice subsequently during the course of the proceedings as having escaped assessment.
**High Court's Decision:** If the income, the escapement of which was the basis of the formation of the "reason to believe" is not assessed or reassessed, it would not be open to the Assessing Officer to independently assess only that income which comes to his notice subsequently in the course of the proceedings under the section as having escaped assessment. If he intends to do so, a fresh notice under section 148 would be necessary.

**II Punjab & Haryana High Court ruling in CIT v. Mehak Finvest P Ltd (2014) 367 ITR 769:**

**Facts of the case:** In the present case, reassessment proceedings were initiated against the assessee on the reason that various finance companies managed and controlled by certain persons were engaged in accommodation entries and the assessee-company was one among them. However, during the reassessment proceedings, the Assessing Officer noticed that fresh share application money amounting to `47 lakhs could not be explained by the assessee and hence invoked section 68 to bring to tax such sum. There was no addition on the basis of the original reason for which reassessment proceedings were initiated.

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

**Assessee's Contention vis-a-vis Revenue's Contention:** The assessee contended that when the original reason prompting the initiation of reassessment proceedings did not survive, the question of making addition on some other fresh grounds was not possible. The basis of the assessee’s contention was the Bombay High Court ruling in case of CIT v. Jet Airways (I) Ltd (2011) 331 ITR 236 and Delhi High Court ruling in Ranbaxy Laboratories Ltd v. CIT (2011) 336 ITR 136.

On the other hand, the Revenue placed reliance on the jurisdictional High Court decision in the case of Majinder Singh Kang v. CIT (2012) 344 ITR 358 holding that reassessment can be made on the basis of additional grounds, even though the original reason forming the basis of issue of notice did not survive.

**High Court's Observations:** The High Court noted that *Explanation 3 to section 147* nowhere postulates or contemplates that the Assessing Officer cannot make any additions on any other ground unless some addition is made on the basis of the original ground for which reassessment proceeding was initiated. It cited the dismissal of special leave petition (SLP) against the High Court ruling in *Majinder Singh Kang’s* case by the Supreme Court on 19.08.2011 as the binding precedent.
High Court’s Decision: The High Court, accordingly, held that even though no addition is made on the original grounds which formed the basis of initiation of reassessment proceedings, the Assessing Officer is empowered to make additions on another ground for which reassessment notice might not have been issued but which came to his notice subsequently during the course of proceedings for reassessment.

III Karnataka High Court ruling in N. Govindaraju v. ITO (2015) 377 ITR 243

Facts of the case: The assessee, an individual, deriving income from house property, transport business, capital gains and other sources filed his return of income declaring total income of ₹ 4.82 lakhs and agricultural income of ₹ 1.62 lakhs. The return was processed under section 143(1). Subsequently, a notice under section 148 was issued stating that the assessee had converted agricultural land into non-agricultural purposes, formed sites and sold the same but while arriving at the indexation benefit it was taken up to the date of sale instead of the date of conversion as per section 45(2). Thus, the reason for reassessment was the excessive indexation benefit availed by the assessee. However, in reassessment, the Assessing Officer adopted fair market value which was less than what was adopted by the assessee and also sought to disallow 50% of the expenses incurred on transfer. The original reason which prompted the reassessment was dropped and based on fresh grounds, reassessment was completed.

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

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

High Court’s Observations: The High Court observed that the controversy revolved around Explanation 3 to section 147 inserted by the Finance (No.2) Act 2009 retrospectively with effect from 1.4.1989. The Court took note of Circular No.5/2010 issued by CBDT after the amendment in Paragraph 47 with caption ‘Clarificatory
amendment in respect of reassessment proceeding under section 147. Para 47.3 reads as under:

“Therefore, to articulate the legislative intention clearly Explanation 3 has been inserted in section 147 to provide that the Assessing Officer may examine, assess or reassess any issue relevant to income which comes to his notice subsequently in the course of proceedings under this section, notwithstanding that the reason for such issue has not been included in the reasons recorded under section 148(2).”

The High Court observed that it is true that if the foundation goes, then, the structure cannot remain. Meaning thereby, if notice has no sufficient reason or is invalid, no proceedings can be initiated. However, this can be verified at the initial stage by challenging the notice. If the notice is challenged and found to be valid, or where the notice is not at all challenged, then, in either case, it cannot be said that notice is invalid. As such, if the notice is valid, then the foundation remains and the proceedings on the basis of such notice can continue. The High Court reiterated that once the proceedings have been initiated on a valid notice, it becomes the duty of the Assessing Officer to levy tax on the entire income (including “any other income”) which may have escaped assessment and comes to his notice during the course of the proceedings initiated under section 147.

Note – In this case, the reassessment on the basis of reasons for the notice is found sufficient i.e. if the notice under section 148(2) is found to be valid, then, the Assessing Officer may do reassessment in respect of any other item of income which may have escaped assessment, even though the original reason for issue of notice under section 148 does not survive.

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

Further, without assigning any reason, the Assessing Officer had disallowed 50% of the total expenditure claimed by the assessee towards transfer and brokerage charges, even when the same had been paid by cheque and the receipt for which was obtained from the broker. When the specific case of the assessee was that heavy brokerage had to be paid because the property was under litigation and that it was occupied by unauthorised persons for which payment had to be made to get it vacated, disallowance could not be made on the ground that brokerage was generally being paid at the rate of 1-2%. The
High Court opined that when the said brokerage was paid by cheque and there was sufficient reason for paying higher brokerage, the entire amount ought to have been allowed and disallowance of 50% was not justified in law.

Thus, in this case, though the High Court upheld that reassessment could be made on fresh grounds even when the original reasons recorded for reopening the assessment did not survive, additions made on the basis of such fresh grounds were turned down by the High Court, since the reasons were not justified to merit such additions.

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

**Vipin Walia v. ITO (2016) 382 ITR 19 (Del)**

**Facts of the case:** A notice under section 148 dated 27th March, 2015 was addressed to the assessee for the assessment year 2008-09. The notice got returned unserved with the postal authorities endorsing on it the remarks “addressee expired”. Later, the Assessing Officer issued a letter dated 15.06.2015 to the petitioner seeking details of legal heirs/successors of the deceased (assessee) to complete the proceedings for the assessment year 2008-09.

The assessee, being one of the legal representatives of the deceased, wrote to the Assessing Officer pointing out that the proceedings initiated under section 148 were barred by limitation. The Assessing Officer proceeded to make the assessment under section 147 which the assessee challenged by means of a writ.

**High Court’s Observations:** The High Court took note of section 159 which sets out the procedure to be adopted when the assessment is made on the legal representatives. Section 159(2)(a) states that any proceeding already taken against an assessee ‘before his death’ shall be deemed to have been taken against the legal representative. As per section 159(2)(b), any proceeding which could have been taken against the deceased if he had survived, may be taken against the legal representative of the deceased assessee, even if it had not been taken while the assessee was alive.

The Assessing Officer initiated proceedings under section 147 against the deceased for the assessment year 2008-09. The time limit for issue of notice was 31.03.2015, since the income escaping assessment exceeded ₹ 1 lakh. On March 27, 2015 when the notice was issued, the assessee was already dead. If the Department intended to proceed under section 147, it could have done so prior to 31.03.2015 by issuing a notice to the legal representatives of the deceased. Beyond that date, it could not have proceeded in the matter even by issuing notice to the legal representatives of the assessee.
10. Does the finding or direction in an appellate order that income relates to a different assessment year empower reopening of assessment for that assessment year, irrespective of the expiry of the six year time limit?

*CIT v. PP Engineering Work (2014) 369 ITR 433 (Del)*

**Facts of the case:** The Tribunal, in its order, directed that the cash credit of `32 lakhs found credited in the books of the assessee in the financial year 1999-2000 is chargeable to tax in the assessment year 2000-01 as against the assessment made by taxing the said amount in the assessment year 2001-02. In short, the Tribunal gave a finding that the cash credit under section 68 was assessable in a different assessment year than the assessment year in respect of which it heard the appeal. This prompted the Assessing Officer to issue a notice under section 148 in February, 2009 for reopening the proceedings for the A.Y. 2000-01. The issue is validity of notice issued after a lapse of 6 years from the end of the relevant assessment year.

The Commissioner (Appeals) held that the reassessment is barred by time limitation and the Tribunal also upheld the order of the Commissioner (Appeals) without making reference to section 150 read with *Explanation 2* to section 153.

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

The High Court made reference to the Delhi High Court ruling in the case of *Rural Electrification Corporation Ltd v. CIT (2013) 355 ITR 345* and opined that the findings of Commissioner (Appeals) and Tribunal on the question of limitation as legally untenable and incorrect.

**High Court's Decision:** The High Court observed that in view of the order of the Tribunal that the credit entries related to the earlier assessment year i.e., A.Y.2000-01, the Assessing Officer initiated reassessment proceedings under section 147 by issue of notice under section 148 for the year and passed an order dated 29/12/2009 making an addition of `32 lakhs. The High Court held that by virtue of section 150 read with *Explanation 2* to section 153, the said order was not barred by limitation.
Note – Under section 149(1)(b), the time limit for issue for notice under section 148 is six years from the end of the relevant assessment year, where the income chargeable to tax which has escaped assessment amounts to or is likely to amount to ₹1 lakh or more for that year.

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

Explanation 2 to section 153 provides that where by an order referred to in section 250, 254, 260, 262, 263 or 264, any income is excluded from the total income of the assessee for an assessment year, then, an assessment of such income for another assessment year shall, for the purposes of section 150 and section 153, be deemed to be one made in consequence of or to give effect to any finding or direction contained in the said order.

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

Allanasons Ltd v. Dy. CIT (2014) 369 ITR 648 (Bom)

Facts of the case: The assessee-company filed its return of income in which a claim for deduction under Chapter VI-A was made. The case was subjected to scrutiny assessment and order under section 143(3) was passed reducing the claim for deduction under Chapter VI-A. After 4 years from the end of the assessment year, a notice under section 148 was issued ascribing reasons such as subsequent tribunal and other court decisions which show that the deduction was excessively allowed in this case. The assessee challenged the reassessment proceedings by means of a writ before the court, contending that it is a settled position in law that the decision rendered by court subsequent to the assessment order does not by itself amount to failure on the part of the assessee to fully and truly disclose all material facts necessary for assessment.

High Court's Opinion: The High Court observed that it is well settled in terms of the proviso to section 147, that where any assessment is sought to be opened beyond a period of four years from the end of the relevant assessment year, two conditions have to be fulfilled cumulatively. The first condition is that there must be reason to believe that income chargeable to tax has escaped assessment. The second condition is that such escapement of income should have arisen due to failure on the part of the assessee to disclose fully and truly all material facts required for the assessment.

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

Even a subsequent change of law cannot be taken as income escaping assessment for triggering reassessment provisions beyond 4 years from the end of the assessment year unless there was a failure on the part of the assessee to disclose fully and truly all material facts necessary for assessment. The High Court observed that in this case, the reasons
recorded, when read as a whole did not indicate even remotely any failure on the part of the assessee to disclose fully and truly any material fact necessary for assessment.

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

12. Is recording of satisfaction and quantification of escaped income a pre-condition for issuing notice under section 148 after 4 years from the end of the relevant assessment year?

*Amarnath Agrawal v. CIT (2015) 371 ITR 183 (All)*

**Facts of the case:** The assessee along with four others had obtained a lease of land and was in possession of the same from 1953. Subsequently, the State Government introduced a policy for conversion of lease-hold to free-hold. The assessee applied for conversion before the District Magistrate in 1997 and a sale deed was executed. The assessee deposited the necessary charges as demanded by the State Government and a freehold sale deed dated 25th March, 1998 was executed. The assessee sold a portion of the land during the F.Y. 1999-2000 and admitted the same as long-term capital gain taking into account the lease hold period also. In the assessment, the admission of income as long-term capital gain was accepted. However, after the expiry of four years from the end of the relevant assessment year, proceeding for reassessment of such income as short-term capital gains was resorted to by the Revenue on the ground that the lease hold period should not be considered for determining the period of holding of freehold land transferred. The assessee filed a writ challenging the validity of notice issued under section 148 stating that the requirements of section 149 read with section 151 were not considered by the Revenue.

**High Court’s Opinion and Decision:** The High Court observed that two distinct conditions must be satisfied for assuming jurisdiction to issue a notice under section 148 after a period of 4 years viz. (i) escapement of income; and (ii) omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment.

Under section 149(1)(b), it is imperative for the Assessing Officer, in his reasons, to state that the escaped income is likely to be ₹ 1 lakh or more. This is an essential ingredient for seeking approval and the basis on which satisfaction is to be recorded by the competent authority under section 151. If the condition precedent to substantiate the satisfaction of escapement of income is not made, the issuance of notice would be invalid.

In this case, since no reasons were recorded that the escaped income is likely to be ₹ 1 lakh or more so that the Chief Commissioner or Commissioner may record his satisfaction under section 151, the initiation of reassessment proceedings after four years was barred by time. The reasons recorded by the Assessing Officer were that the assessee had computed long-term capital gains tax liability, whereas he was liable to pay...
short-term capital gains tax, since he had sold a portion of the property within 3 years from the date of conversion of leasehold land into a freehold land.

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

13. In case of change of incumbent of an office, can the successor Assessing Officer initiate reassessment proceedings on the ground of change of opinion in relation to an issue, which the predecessor Assessing Officer who framed the original assessment had already applied his mind and come to a conclusion?

**H. K. Buildcon Ltd. v. Income-tax Officer (2011) 339 ITR 535 (Guj.)**

**High Court’s Observations:** On this issue, the Gujarat High Court referred to the ruling of the Apex Court in *CIT v. Kelvinator of India Ltd. (2010) 320 ITR 561*, wherein it was held that the Assessing Officer has the power only to reassess and not to review. Reassessment has to be based on fulfillment of certain precondition and if the concept of change of opinion is removed, then, in the garb of reopening the assessment, review would take place. The Apex Court further laid down that one must treat the concept of change of opinion as an in-built test to check abuse of power by the Assessing Officer. The Apex Court referred to *Circular No.549 dated 31.10.1989* explaining the amendment made by the Direct Tax Laws (Amendment) Act, 1989 with effect from 1.4.1989 to reintroduce the expression “reason to believe”, and concluded that if the phrase “reason to believe” is omitted, the same would give arbitrary powers to the Assessing Officer to reopen the past assessment on mere change of opinion and this is not permissible even as per legislative intent.

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

14. Can the Assessing Officer issue notice under section 154 to rectify a mistake apparent from record in the intimation under section 143(1), after issue of a valid notice under section 143(2)?

**CIT v. Haryana State Handloom and Handicrafts Corporation Ltd. (2011) 336 ITR 699 (P&H)**
High Court's Observations: On this issue, the Punjab and Haryana High Court referred to the Delhi High Court ruling in *CIT v. Punjab National Bank* (2001) 249 ITR 763, where it was held that rectification of an intimation cannot be made after issuance of notice under section 143(2) and during the pendency of proceedings under section 143(3). It was held that if any change was permitted to be effected, the same can be done in the assessment under section 143(3) and not by exercising the power under section 154 to rectify the intimation issued under section 143(1).

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

Therefore, it was concluded that proceedings under section 154 for rectification of intimation under section 143(1) cannot be initiated after issuance of notice under section 143(2) by the Assessing Officer to the assessee.

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

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

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

High Court's Decision: The High Court held that once an appeal against the order passed by an authority is preferred and is decided by the appellate authority, the order of the Assessing Officer merges with the order of the appellate authority. After merger, the order of the original authority ceases to exist and the order of the appellate authority prevails.

Thus, the period of limitation of 4 years for the purpose of section 154(7) has to be counted from the date of the order of the Appellate Authority.

*Note* - In this case, the Delhi High Court has followed the decision of the Supreme Court in case of *Hind Wire Industries v. CIT* (1995) 212 ITR 639.
1. Can Authority for Advance Ruling (AAR) reject an application for advance ruling on the ground that proceedings are already pending before the Income-tax authority, where notice under section 143(2) in printed format has been served on the applicant-assessee before the date of filing the said application for advance ruling? What would be the position if notice under section 142(1) along with detailed questionnaire has also been issued to the applicant assessee before the date of filing of the said application for Advance Ruling?

*Hyosung Corporation v. AAR (2016) 382 ITR 371 (Del)*

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

For the assessment years 2008-09 and 2009-10, notices under section 143(2) were issued and subsequently, before the date of filing applications with AAR, notice under section 142(1) along with a questionnaire was issued. For the assessment year 2010-11, notice under section 143(2) was issued before the date of filing of application with the AAR and notice under section 142(1) along with a questionnaire was served on the assessee after the date of filing of application with the AAR.

The applications for all the assessment years were objected by the Revenue on the reasoning that the proceedings were already pending before the Assessing Officer and in view of the bar under proviso to section 245R(2), it could not entertain the applications. Accordingly, the AAR rejected the applications of the assessee for all the assessment years.

**High Court’s Observations:** The High Court observed that the assessee received notices under section 143(2) in a standard pre-printed format and also received notices under section 142(1) accompanied by questionnaire for all the assessment years. The High Court noted that mere issue of notice under section 143(2) in pre-printed format will not amount to ‘already pending’ proceedings for the purpose of applying proviso to section 245R(2).
However, issue of notices under section 142(1) accompanied by a questionnaire which raised the question of supply contracts which were executed overseas would nevertheless make the proceedings pending. This is more so when such notices were issued before filing of the applications by the assessee with the AAR.

**High Court's Decision:** The High Court, accordingly, held that rejection of application filed by the assessee for the assessment years 2008-09 and 2009-10 was not erroneous and did not call for any interference, since the notice under section 142(1) along with questionnaire were issued before the date of making an application for advance ruling.

However, notice under section 142(1) issued for the assessment year 2010-11 after the date of filing of application will not result in the proceedings being ‘already pending’ before an Income-tax authority for the purpose of applying proviso to section 245R(2).

Thus, the application for the assessment year 2010-11 cannot be rejected by the AAR. However, for the assessment years 2008-09 and 2009-10, the rejection of the application by AAR is tenable in law, since notice under section 142(1) along with detailed questionnaire was issued before the date of filing of such application.
1. Can mere non-mention or non-discussion of enquiry made by the Assessing Officer in the assessment order justify invoking revisionary jurisdiction under section 263?

*Cit v. Krishna Capbox (P) Ltd (2015) 372 ITR 310 (All)*

**Facts of the case:** The assessee filed its return of income declaring total income of ₹ 8.15 lakhs. The return was processed under section 143(1) and later, the case was selected for scrutiny and statutory notice under section 143(2) was issued. During the course of scrutiny, the Assessing Officer raised certain queries which were answered by the assessee. The Assessing Officer, after being satisfied with the replies given, completed the assessment by accepting the declared income. Subsequently, the Commissioner invoked revisionary jurisdiction under section 263 by holding that the Assessing Officer had not made enquiry on certain aspects, such as -

(i) Non-verification of source of investment in respect of addition in fixed assets;
(ii) Non-confirmation of sundry creditors by the assessee;
(iii) Non-enquiry of unsecured loan by the Assessing Officer;
(iv) Not obtaining the copy of bank statements;
(v) Non-verification of genuineness of shareholders;
(vi) Deduction of freight paid without deduction of tax at source.

**Assessee's contention vis-a-vis Revenue's Contention:** The assessee contended that all the aspects contested by the Commissioner were enquired by the Assessing Officer. The Revenue took the defence that no enquiry was made by the Assessing Officer in respect of the issues set out in the notice issued under section 263 and hence, revisionary jurisdiction was correctly assumed.

**Tribunal's view:** The Tribunal noted that all necessary enquiries were made and all the requisite documents were placed in the paper book. Once enquiry was made, mere non-discussion or non-mention in the assessment order cannot lead to the assumption that the Assessing Officer did not apply his mind or that he had not made any enquiry on the subject for invoking section 263.

**High Court’s Observations:** The High Court noted the Bombay’s High Court’s view in *Cellular Ltd. v. DCIT (2008) 301 ITR 407* that if a query is raised during the assessment
proceedings and responded to by the assessee, the mere fact that it is not dealt with in the assessment order would not lead to a conclusion that no mind had been applied to it.

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

**Note:** The Finance Act, 2015 inserted Explanation 2 to section 263(1) to clarify, inter alia, that an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if in the opinion of the Principal Commissioner or Commissioner, the order is passed without making inquiries or verification which should have been made.

The rationale of this ruling would hold good even after insertion of Explanation 2 to section 263(1), since in this case, the Tribunal has recorded a finding of fact that necessary enquiries have been made by the Assessing Officer even though the same was not specifically mentioned in the assessment order. Mere non-discussion or non-mention about the enquiry made by the Assessing Officer in the assessment order cannot be a ground for invoking revisionary jurisdiction under section 263.

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

*CIT v. Fortaleza Developers (2015) 374 ITR 510 (Bom)*

**Facts of the case:** The assessee, an Association of Person (AOP) consisting of promoters and builders, was constituted by means of an agreement dated April 29, 2003 between M/s Raviraj Kothari and Co. (RRK) and M/s Sanand Properties Pvt. Ltd. (SPPL). The AOP filed its return of income for the assessment year 2007-08 declaring total income of ₹ 4.14 lakhs after claiming deduction under section 80-IB(10) of ₹ 1454.47 lakhs. The assessment was completed under section 143(3) disallowing fully the claim of deduction under section 80-IB(10). The assessee preferred an appeal before Commissioner (Appeals) who held that the assessee had fulfilled all the conditions laid down in section 80-IB(10) and hence, directed the Assessing Officer to allow the deduction.

The order of Commissioner (Appeals) was challenged before the Tribunal by the Revenue. During the pendency of the appeal before the Tribunal, the Commissioner issued a notice under section 263 asking the assessee to show cause as to why the assessment order should not be set aside. The notice under section 263 specified that the method of allocation of revenue gave the assessee undue benefit by way of a higher claim of deduction under section 80-IB(10) contrary to clause (7) of the AOP agreement.
Clause (7) of the agreement laid down that SPPL shall be entitled to 35% of the amount received from the purchasers of the housing units. Out of the balance 65% of the said receipts, all required and relevant expenditure for the purpose of the business of the AOP shall be met with and whatever net balance remains thereafter, shall be determined as the share of income of RRK.

On perusal of clause (7) of the agreement, the Commissioner contended that share of revenue pertaining to SPPL was not eligible for deduction under section 80-IB(10). Accordingly, the Commissioner set aside the assessment order of the assessee and directed recomputing the income on the basis of the clause (7) of the AOP agreement. The assessee challenged the revision order passed by the Commissioner under section 263 before the Tribunal.

**Appellate Authorities’ Views:** The Tribunal observed that the quantum of deduction under section 80-IB(10) will depend upon the income earned from the project in question. The quantum of deduction will not depend on the mode of distribution of shares amongst members of the association of persons as income of association of persons is taxable at the maximum marginal rate. It is also observed by the Tribunal that the allowability or otherwise of deduction under section 80-IB(10) is not dependent upon the manner in which the profit has been distributed amongst the members of the AOP but is dependent upon the income earned from an eligible project and the fulfilment of the conditions laid down in the section. Also, the deduction is available to an undertaking and not to the individual constituent of an undertaking. The Tribunal further held that the Commissioner cannot exercise jurisdiction under section 263 in respect of deduction under section 80-IB, which was the subject matter of appeal.

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

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

Accordingly, the High Court held that the order passed by the Assessing Officer got merged with the order of the first appellate authority. The very same issue cannot be revised by invoking revisionary jurisdiction under section 263.
3. Can an assessee, objecting to the reassessment notice issued under section 148, directly approach the High Court in the normal course contending that such reassessment proceedings are apparently unjustified and illegal?

_Samsung India Electronics P. Ltd. v. DCIT (2014) 362 ITR 460 (Del.)_

**Facts of the case:** In the present case, Samsung Electronics Co. Ltd., the Korean Company was subjected to regular assessment for the assessment year 2006-07. The assessment order was passed, pursuant to the directions under section 144C(5) made by the Disputes Resolution Panel. For the same assessment year, i.e., A.Y.2006-07, assessee was issued a reassessment notice dated March 30, 2013 under section 148. Against this reassessment notice, assessee filed a writ petition before the High Court.

**High Court’s Observations:** The High Court observed the Apex court ruling in the case of _GKN Driveshafts (India) Ltd. v. ITO_ [2003] 259 ITR 19 (SC), wherein, it was laid down that when a notice under section 148 is issued, the proper course of action for the noticee is to file a return and if he so desires, to seek reasons for issuing notices. The Assessing Officer is bound to furnish reasons within a reasonable time. On receipt of the reasons, the noticee is entitled to file objections to issuance of notice and the Assessing Officer is bound to dispose of the objections by passing a speaking order.

The High Court noted that the assessee has not filed objections before the Assessing Officer and has directly approached the court by way of the writ petition. On this issue, the assessee contended that they were justified in approaching the High Court directly as the reassessment proceedings _ex facie_ were unjustified and illegal. The assessee relied upon the decision of the Delhi High Court in _Techspan India P. Ltd. v. ITO_ [2006] 283 ITR 212 (Delhi) in which reference was made to the decision of the Gujarat High Court in _Garden Finance Ltd. v. Asst. CIT_ [2004] 268 ITR 48 (Guj), wherein it was observed that the exercise of the powers under section 148 may be so arbitrary or _mala fide_ that the court may entertain the petition without requiring the assessee to approach the Assessing Officer, but such a case was an exception and not a rule. In _Techspan India P. Ltd._’s case, the High Court had given concurrent reasons and made observations when a writ court should interfere. However, there is no need to go into the said question and controversy in the present case, since it does not occasion or require a different treatment from the procedure followed in other cases in which re-assessment proceedings were/are initiated.

**High Court’s Decision:** The High Court, thus, held that it will not be appropriate and proper in the facts of the present case to permit and allow the petitioner to bypass and forgo the procedure laid down by the Supreme Court in _GKN Driveshafts (India) Ltd._ (supra), since the said procedure has been almost universally followed and has helped cut down litigation and crystallise the issues, if and when the question comes up before the Court.
4. Should time limit under section 263 to be reckoned with reference to the date of assessment order or the date of reassessment order, where the revision is in relation to an item which was not the subject matter of reassessment?

Bombay High Court ruling in CIT v. Lark Chemicals Ltd (2014) 368 ITR 655

Facts of the case: The assessee-company, for the assessment year 2002-03, filed its return of income declaring a total income of ₹ 30.98 lakhs. This was accepted and the return was processed under section 143(1). Subsequently, it was reopened by issue of notice under section 148 and the order of reassessment was passed in June, 2006. The Commissioner assumed jurisdiction for revision of order by invoking section 263 in March, 2009. The subject matter of revision, however, was not related to any of the issues dealt with in the reassessment.

Issue under consideration: The issue before the High Court was whether the revision under section 263 is barred by limitation in view of the fact that the issues dealt with therein were not the subject matter of reassessment.

Tribunal’s view: The Tribunal opined that jurisdiction under section 263 cannot be exercised in respect of those issues which were not the subject matter of consideration while passing the order of reassessment but were a part of the original assessment, the time limit for which had since expired. It relied on the Apex Court decision in the case of CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1, wherein it was held that in such cases, the doctrine of merger would not apply and the period of limitation would commence from the date of original assessment and not from the date of reassessment.

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

High Court’s Decision: The High Court, thus, held that the jurisdiction under section 263 could not be assumed on issues which were not the subject matter of issues dealt with in the order of reassessment but were part of the original assessment, for which the period of limitation expired long ago.
II Bombay High Court ruling in CIT v. ICICI Bank Ltd. (2012) 343 ITR 74

Facts of the case: In the present case, an order of assessment was passed under section 143(3) allowing the deduction under section 36(1)(vii), 36(1)(viia) and foreign exchange rate difference. Further, two notices of reassessment were issued under section 148 and an order of reassessment was passed under section 147 which did not deal with the above deductions.

Later, the Commissioner passed an order under section 263 for disallowing the deduction under section 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference which have not been taken up in the reassessment proceedings under section 147 but which was decided in the original order of assessment passed under section 143(3).

Assessee’s contention vis-à-vis Revenue’s contention: The assessee claimed that the order passed by the Commissioner under section 263 is barred by limitation since the period of 2 years from the end of the financial year in which the order sought to be revised was passed, had lapsed. However, the Revenue gave a plea that period of limitation shall be reckoned from the date of order under section 147 and not from the date of the original assessment order under section 143(3), applying the doctrine of merger.

The Revenue pointed out that as per the provisions of Explanation 3 to section 147, the Assessing Officer is entitled to assess or reassess the income in respect of any issue which has escaped assessment though the reasons in respect of such issue have not been included in the reasons recorded under section 148(2).

High Court’s Decision: Considering the above mentioned facts, the Bombay High Court held that the order of assessment under section 143(3) allowed deduction under section 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference. The order of reassessment, however, had not dealt with these issues. Therefore, the doctrine of merger cannot be applied in this case. The order under section 143(3) cannot stand merged with the order of reassessment in respect of those issues which did not form the subject matter of the reassessment.

Therefore, the period of limitation in respect of the order of the Commissioner under section 263 with regard to a matter which does not form the subject matter of reassessment shall be reckoned from the date of the original order under section 143(3) and not from the date of the reassessment order under section 147.

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

CIT v. New Mangalore Port Trust (2016) 382 ITR 434 (Karn)

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

The revision order under section 263 passed by Commissioner was challenged by the assessee before the Appellate Tribunal. The Tribunal set aside the revision order of the Commissioner passed under section 263.

**Assessee's Contentions:** The assessee contended before the High Court that the order passed by the Assessing Officer under section 143(3) on December 27, 2009 does not exist subsequent to the order of Commissioner passed under section 264, being given effect to by the Assessing Officer vide order dated May 27, 2011. The said order dated December 27, 2009 which no longer subsists, was revised by the Commissioner under section 263. In this case, invoking of *suo motu* revision powers by the Commissioner is not justifiable.

**High Court’s Observations:** The High Court took note of the sequence of events and undisputed facts that the assessment order dated 27 December 2009 passed by the Assessing Officer was no longer in existence. The High Court concluded that the Tribunal arrived at the conclusion only after considering the factual position that Commissioner had no jurisdiction to revise the order which was not in existence.

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

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

**Sanchit Software and Solutions Pvt. Ltd. v. CIT (2012) 349 ITR 404 (Bom.)**

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

**Commissioner's contention:** The Commissioner of income-tax, while considering the revision petition, contended that the intimation under section 143(1) was based on the return of the assessee, in which the claims under section 10(34) and under section 10(38) were not made by the assessee. Hence, it cannot be said that the intimation under section 143(1) was erroneous, since the same was squarely based on the return filed by the assessee. Secondly, the power of Commissioner under section 264 is only restricted to the record available before the Assessing Officer which can be examined by the Commissioner. In the circumstances, the other evidence sought to be brought on record to establish the mistake committed by the assessee cannot be considered by the Commissioner under section 264. The revision petition under section 264 was rejected by the Commissioner on the above grounds.

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

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

**High Court's Decision:** The High Court, accordingly, set aside the order of Commissioner and remanded the matter for fresh consideration. The High Court further directed the Assessing Officer to consider the rectification application filed by the assessee under section 154 as a fresh application received on the date of service of this order and dispose of the rectification application on its own merits, without awaiting the result of the revision proceedings before the Commissioner of Income-tax on remand, at the earliest.
7. Can an assessee make an additional/new claim before an appellate authority, which was not claimed by the assessee in the return of income (though he was legally entitled to), otherwise than by way of filing a revised return of income?

*CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336 (Bom.)*

**High Court's Observations:** While considering the above mentioned issue, the Bombay High Court observed the decision of the Supreme Court, in the case of Jute Corporation of India Ltd. v. CIT (1991) 187 ITR 688 and National Thermal Power Corporation, Ltd v. CIT (1998) 229 ITR 383, that an assessee is entitled to raise additional claims before the appellate authorities. The appellate authorities have jurisdiction to permit additional claims before them, however, the exercise of such jurisdiction is entirely the authorities' discretion.

Also, the High Court considered the decision of the Apex Court in the case of Addl. CIT v. Gurjargravures (P.) Ltd. (1978) 111 ITR 1, wherein it was held that in case an additional ground was raised before the appellate authority which could not have been raised at the stage when the return was filed or when the assessment order was made, or the ground became available on account of change of circumstances or law, the appellate authority can allow the same.

The Supreme Court, in the case of Goetze (India) Ltd v. CIT (2006) 157 Taxmann 1, held that the assessee cannot make a claim before the Assessing Officer otherwise than by filing an application for the same. The additional claim before the Assessing Officer can be made only by way of filing revised return of income.

The decision in the above mentioned case, however, does not apply in this case, since the Assessing Officer is not an Appellate Authority.

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

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

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

**High Court's Observations:** In this case, the High Court observed that the power under section 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters. **Section 254(2) is not a carte blanche for the Tribunal to change its own view by substituting a view which it believes should have been taken in the first instance.** Section 254(2) is not a mandate to unsettle decisions taken after due reflection.
High Court’s Decision: In this case, the Tribunal, while dealing with the application under section 245(2), virtually reconsidered the entire matter and came to a different conclusion. This amounted to a reappreciation of the correctness of the earlier decision on merits, which is beyond the scope of the power conferred under section 254(2).

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

Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243 (Delhi)(FB)

High Court’s Observations: On this issue, the Delhi High Court observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466, dealing with the Tribunal’s power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.

The Apex Court, while dealing with the power of the Tribunal under section 254(2) in Honda Siel Power Products Ltd., observed that one of the important reasons for giving the power of rectification to the Tribunal is to see that no prejudice is caused to either of the parties appearing before it by its decision based on a mistake apparent from the record. When prejudice results from an order attributable to the Tribunal’s mistake, error or omission, then it is the duty of the Tribunal to set it right. In that case, the Tribunal had not considered the material which was already on record while passing the judgment. The Apex Court took note of the fact that the Tribunal committed a mistake in not considering material which was already on record and the Tribunal acknowledged its mistake and accordingly, rectified its order.

The above decision of the Apex Court is an authority for the proposition that the Tribunal, in certain circumstances can recall its own order and section 254(2) does not totally prohibit so. In view of the law laid down by the Apex Court in that case, the decisions rendered by the High Courts in certain cases to the effect that the Tribunal under no circumstances can recall its order in entirety do not lay down the correct statement of law.
**High Court’s Decision:** Applying the above-mentioned decision of the Apex Court to this case, the Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.

**Note** - In deciding whether the power under section 254(2) can be exercised to recall an order in entirety, it is necessary to understand the true principle laid down in the Apex Court decision. A decision should not be mechanically applied treating the same as a precedent without appreciating the underlying principle contained therein. In this case, the Apex Court decision was applied since prejudice had resulted to the party on account of the mistake of the Tribunal apparent from record.

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


**Facts of the case:** In this case, the High Court had considered whether deduction is allowable under section 80-IB on transport subsidy and interest subsidy and on the central excise duty refund received by it. Finally, after stating that two substantial questions of law arose under section 260A, the High Court proceeded to answer the two questions. Against this judgement, the assessee filed a review petition whereupon the Division Bench of the High Court recalled its entire order for adjudication on the ground that it had not formulated the substantial questions of law before hearing of the appeal and had not invited the parties to have their say in the matter which amounted to denial of opportunity of effective hearing to the parties concerned, particularly, the review petitioners. Further, it had on an earlier occasion prior to passing the order, reserved the judgement on whether substantial questions of law in fact existed at all.

**Revenue’s contention vis-à-vis Assessee’s contention:** The Revenue contended that, by virtue of section 260A(7), only those provisions of the Civil Procedure Code could be looked into for the purposes of section 260A as were relevant to the disposal of appeals, and since the review provision contained in the Code of Civil Procedure is not so referred to, the High Court would have no jurisdiction under section 260A to review such judgment. The assessee-petitioner, however, contended that High Courts being courts of record under article 215 of the Constitution of India, the power of review would in fact inhere in them.

**Supreme Court’s Observations:** The Supreme Court concurred with the assessee’s submission that High Courts being courts of record under article 215 of the Constitution of India, the power of review would inhere in them. Further, it noted that in another case\(^2\), in a slightly different context while dealing with power of review of writ petitions filed under article 226, the Supreme Court had observed that there is nothing in article 226 of the

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Constitution to preclude a High Court from exercising the power of review which inheres in every court of plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable errors committed by it. In that case, the High Court had entertained the second petition since the interested parties were not given an effective opportunity of being heard, before passing the judgement; therefore, keeping in mind the requirement of the principles of natural justice, the High Court had exercised its inherent power of review.

**Supreme Court's Decision:** The Supreme Court went ahead to further observe that it is clear on a cursory reading of section 260A(7), that it does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals under section 260A. That does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.
1. Is penalty under section 271D imposable for cash loans/deposits received from partners?

CIT v. Muthoot Financiers (2015) 371 ITR 408 (Del)

**Facts of the case:** The assessee-firm, engaged in business of banking and money lending, had received huge amounts from the partners in the assessment years 1996-97 and 1998-99 by way of cash. The Assessing Officer levied penalty under section 271D. The Commissioner (Appeals) upheld the levy of penalty. The Tribunal observed that the advance made to the firm by the partners cannot be regarded as loan accepted by the firm. It held that the amount advanced and accepted is capital of the firm and not loans which cannot be subjected to penalty under section 271D. The Revenue filed an appeal before High Court.

The assessee contended before the High Court that the amount advanced by the partners cannot be regarded as loan but is a capital of the firm. As the partnership firm has no separate legal entity, nor is there a separate identification between the firm and the partners, there is no violation of section 269SS in this case.

**High Court's Opinion & Decision:** The High Court referred to the case CIT v. R.M. Chidambaram Pillai (1977) 106 ITR 292, where the Apex Court was of the view that the firm is not a legal person even though it has some of the attributes of a personality. It held that the ‘firm’ is a collective noun, a compendious expression to designate an entity not a person. It also referred to CIT v. Sivakumar. V (2013) 354 ITR 9 (Mad), where the High Court upheld the conclusion of the Tribunal to hold that there is no separate legal entity for the partnership firm and the partner is entitled to use the funds of the firm. In CIT v. Lokhpat Film Exchange (Cinema) (2008) 304 ITR 172 (Raj), it was held that a partnership firm not being a juristic person, the inter se transaction between the firm and partners are not governed by the provisions of sections 269SS and 269T.

The High Court also noted the different view expressed by the Supreme Court in CIT v. A.W. Figgies & Co. (1953) 24 ITR 405, where it was held that the partners of the firm are distinct as civil entities while the firm as such is a separate and distinct unit for the purpose of assessment.
The High Court observed that the position that emerges is that there are three different Courts, which have held that section 269SS would not be violative when money is exchanged *inter se* between the partners and the firm.

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

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

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

_CIT v. V. Sivakumar (2013) 354 ITR 9 (Mad.)_

**Facts of the case:** In the present case, the assessee was a partner in four firms and also had a sole-proprietorship business. In the relevant previous year, the partnership firms had advanced loan to the assessee in cash exceeding the specified amount mentioned in section 269SS. The Assessing Officer initiated penalty proceedings under section 271D in view of violation of section 269SS. The Assessing Officer recorded a factual finding that the said money had been advanced by the partnership firm as a loan and were debited to the accounts of the proprietary concern; therefore, it was evident that the assessee had taken loan from the firms in cash in the capacity of the proprietor and not as a partner. Consequently, the provisions of section 269SS had been violated.

**Assessee’s contention:** The assessee contended that the amount is taken in the capacity of the partner and it cannot be taken as an independent transaction and therefore, there is no violation of section 269SS. Also, the assessee contended that the partnership firm has no separate legal entity and there is no separate identification between the firm and the partner.

**Tribunal’s view:** The Tribunal, relying upon the various court decisions, confirmed the finding of the Commissioner (Appeals) that partnership firm is not a juristic person and there is no separate identity for the firm and the partners; Being a partner, the assessee had withdrawn amounts from the firms and there were no reasons to doubt the genuineness of the transactions. Consequently, the transactions between the firm and the partner cannot be brought within the meaning of section 269SS.
High Court's Decision: The High Court, relying upon the various court decisions, upheld the decision of the Tribunal holding that there is no separate identity for the partnership firm and that the partner is entitled to use the funds of the firm. In the present case, the assessee has acted bona fide and that there was a reasonable cause within the meaning of section 273B. Therefore, the transaction cannot be said to be in violation of section 269SS and no penalty is attracted in this case.

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


Facts of the case: In the present case, the assessee is a public limited company, registered as category-I merchant banker with SEBI, engaged in the business of stock broking, investment and trading in shares and securities. The assessee had taken a loan from the Investment Trust of India. During the previous year in question, the assessee had transferred shares of a company held by it to the Investment Trust of India. Therefore, in the current assessment year, the assessee was liable to pay the loan amount to the Investment Trust of India and had a right to receive the sale price of the shares transferred to Investment Trust of India. In order to avoid the unnecessary circular transfer of shares, both the parties agreed to set-off the amount payable and receivable by way of passing journal entries and the balance loan amount was paid by the assessee by way of an account payee cheque. The amount of loan settled by way of passing journal entries exceeds ₹ 20,000.

Assessing Officer's contentions: The Assessing Officer passed the assessment order levying penalty under section 271E for the contravention of the provisions of section 269T on the argument that since section 269T put an obligation on the assessee to pay loan only by way of an account payee cheque or an account payee draft, the settlement of a portion of the loan by passing journal entry would be a mode otherwise than by way of an account payee cheque or an account payee draft and therefore, the penal provisions under section 271E shall be attracted.

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

High Court’s Observations: Considering the above mentioned facts and arguments, the Bombay High Court observed that, the obligation to repay the loan or deposit by account
payee cheque/bank draft as specified in section 269T is mandatory in nature. The contravention of the said section will attract penalty under section 271E.

The argument of the assessee cannot be accepted since section 269T does not make a distinction between a bonafide or a non-bonafide transaction neither does it require the fulfillment of the condition mentioned therein only in case where there is outflow of funds. It merely puts a condition that in case a loan or deposit is repaid, it should be by way of an account payee cheque/draft. Therefore, in the present case the assessee has repaid a portion of loan in contravention of provisions of section 269T.

However, the cause shown by the assessee for repayment of the loan otherwise than by account payee cheque/bank draft was on account of the fact that the assessee was liable to receive amount towards the sale price of the shares sold by the assessee to the person from whom loan was received by the assessee. It would have been mere formality to repay the loan amount by account payee cheque/draft and receive back almost the same amount towards the sale price of the shares. Also, neither the genuineness of the receipt of loan nor the transaction of repayment of loan by way of adjustment through book entries carried out in the ordinary course of business has been doubted in the regular assessment. Therefore, there is nothing on record to suggest that the amounts advanced by Investment Trust of India to the assessee represented the unaccounted money of the Investment Trust of India or the assessee and also it cannot be said that the whole transaction was entered into to avoid tax. This is accepted as a reasonable cause under section 273B.

**High Court’s Decision:** In effect, the assessee has violated the provisions of section 269T by repaying the loan amount by way of passing book entries and therefore, penalty under section 271E is applicable. However, since the transaction is bona fide in nature being a normal business transaction and has not been made with a view to avoid tax, it was held that the assessee has shown reasonable cause for the failure under section 269T, and therefore, as per the provisions of section 273B, no penalty under section 271E could be imposed on the assessee for contravening the provisions of section 269T.

**Note:** In order to mitigate the hardship caused by certain penalty provisions in case of genuine business transactions, section 273B provides that no penalty under, inter alia, section 271E shall be imposed on a person for any failure referred to in the said section, if such person proves that there was reasonable cause for such failure.
1. Would prosecution proceedings under section 276CC be attracted where the failure to furnish return in time was not willful?

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

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

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

1. Can the Assessing Officer suo moto assume jurisdiction to declare sale of property as void under section 281?

_Dr. Manoj Kabra v. ITO (2014) 364 ITR 541 (All)_

**Facts of the case:** The assessee acquired a property for ₹ 7 lakhs though the stamp duty was paid in accordance with the circle rate which was ₹ 12 lakhs. Pursuant to the sale deed, the assessee took possession of the property. Prior to the sale, the income tax assessment of vendor had been completed and a certain demand was raised against him in respect of the assessment year when the sale of the property was effected. The Assessing Officer issued a notice under section 281 to show cause as to why the sale deed executed in his favour (assessee-buyer) should not be treated as a void document. The assessee-buyer contended that he was a _bona fide_ purchaser for adequate consideration and no notice of pendency of proceedings was to known him nor was it brought to his knowledge by the seller.

The assessee placed reliance on the decision of Supreme Court in the case of _TRO v. Gangadhar Vishwanath Ranade (Decd.) (1998) 234 ITR 188_, where it was held that section 281 of the Income-tax Act, 1961 is only a declaratory provision and not an adjudicatory provision entitling the income-tax authority to declare a document as a void document.

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

**High Court’s Decision:** Applying the rationale of the Apex Court ruling, the High Court held that the Assessing Officer has no jurisdiction under section 281 to suo moto declare the sale as void.
1. Do the tips collected by hotel and disbursed to employees constitute salary to attract the provisions for tax deduction at source under section 192?

_CIT (TDS) v. ITC Ltd. [2011] 338 ITR 598 (Del.)_

**Facts of the case:** The assessee-company was engaged in the business of owning, operating and managing hotels. The assessee-company allowed the employees to receive tips from the customers, by virtue of the employment, and in case the employer himself collected tips, those were also disbursed by the employer to the employees. Once the tips were paid by the customers either in cash directly to the employees or by way of charge to the credit cards in the bills, the employees gained additional income, which was by virtue of their employment. When the tips were received by the employees directly in cash, the employer hardly had any role and it may not even know the amounts of tips collected by the employees. That would be out of the purview of responsibility of the employer under section 192.

However, when the tips were charged to the bill either by way of a fixed percentage, say 10% or so on the total bill, or where no percentage was specified and the amount was indicated by the customer on the bill as a tip, the tip went into the receipt of the employer and was subsequently disbursed to the employees. As soon as such amounts were received by the employer, there was an obligation on the part of the employer to disburse them to the rightful persons, namely, the employees. Simultaneously, a right accrued to the employees to claim the tips from the employer. By virtue of the employer-employee relationship, a vested right accrued to the employee to claim the tips.

**High Court's Decision:** The High Court, therefore, held that the tips would constitute income within the meaning of section 2(24) and thus, taxable under section 15. It was obligatory upon the company to deduct tax at source from such payments under section 192.

In this case, the assessee-company had not deducted tax at source on tips under a _bona fide_ belief that tax was not deductible. This practice had been accepted by the Revenue by accepting the assessments in the form of annual returns of the assessee in the past. The High Court held that since no dishonest intention could be attributed to the assessee, they could not be made liable for levy of penalty as envisaged under section 201.
The High Court, however, observed that payment of interest under section 201(1A) is mandatory. The payment of interest under that provision is not penal. There was, therefore, no question of waiver of such interest on the basis that the default was not intentional or on any other basis.

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

*UCO Bank v. Dy. CIT (2014) 369 ITR 335 (Del)*

**Facts of the case:** The assessee-bank accepted ₹ 707.46 lakhs as fixed deposit in the name of Registrar General of the High Court and issued a fixed deposit receipt in compliance with a direction passed by the court in relation to certain proceedings. Subsequently, the Assistant Commissioner of Income-tax issued a show cause notice to the bank for not deducting tax at source on the interest accrued and to show cause as to why it should not be treated as an assessee-in-default under section 201(1)/201(1A). The bank replied that the FDRs in the name of Registrar General of the Court was as a custodian because the actual beneficiary was unknown as the matter was sub judice and tax at source would be deducted when the payment is made to beneficiary as and when it is decided by the court. The Assistant Commissioner, however, passed an order treating the bank as assessee-in-default and raised a demand of ₹ 40.33 lakhs and ₹ 14.20 lakhs under sections 201(1) and 201(1A), respectively. Further, he initiated penalty proceedings under section 271C. The assessee preferred a writ challenging the order passed imposing penal interest and initiation of penalty proceedings.

**High Court’s Opinion and Decision:** The High Court opined that in the normal course, the bank is obliged to deduct tax at source in respect of any credit or payment of interest on deposits made with it. However, in this case, the actual payee is not ascertainable and the person in whose name the interest is credited is not a person liable to pay tax under the Act. The deposits kept with the bank under the orders of the court were, essentially, funds which were in custodia legis, that is, funds in the custody of the court. The interest on that account – although credited in the name of the Registrar General – was also part of funds under the custody of the Court. The Registrar General is not the recipient of the income represented by interest that accrues on the deposits made in his name. The credit of interest is not a credit to the account of a person who is liable to be assessed to tax.

The High Court observed that in the absence of a payee, the machinery provisions for deduction of tax to his credit are ineffective. The expression “payee” under section 194A would mean the recipient of income whose account is maintained by the person paying interest. The Registrar General is neither recipient of the amount credited to his account nor to interest accruing thereon. Therefore, he cannot be considered as a ‘payee’ for the purposes of section 194A. The credit by the bank in the name of the Registrar General would, thus, not attract the provisions of section 194A.
The High Court was of the view that Circular No.8/2011 dated 14.10.2011 makes an assumption that the litigant depositing the money is the account holder with the bank or is the recipient of the income represented by the interest accruing thereon. This assumption is basically erroneous as the litigant who is asked to deposit the money in Court ceases to have any control or proprietary right over these funds. The person to whom the funds would be paid ultimately is determined by the court order and at that stage, tax would be required to be deducted at source to the credit of the recipient. However, the litigant who deposits the funds cannot be stated to be the recipient of income.

The High Court allowed the writ and set aside the orders passed by the tax authorities.

Note - The CBDT has accepted the aforesaid judgment and accordingly, vide Circular No.23/2015 dated 28.12.2015, clarified that interest on FDRs made in the name of Registrar General of the Court or the depositor of the fund on the directions of the Court, will not be subject to TDS till the matter is decided by the Court. However, once the Court decides the ownership of the money lying in the fixed deposit, the provisions of section 194A will apply to the recipient of the income.

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

CIT v. Avenue Super Chits (P) Ltd (2015) 375 ITR 76 (Kar)

Facts of the case: The assessee-company engaged in chit fund business had several chit groups which consisted of 25 to 40 customers each. Each subscriber has to subscribe an equal amount based on the value of chit. There are two types of chit. One is the lottery system and other is auction system. Under the auction system, during each installment of the chit, the highest bidder got the chit amount. The unsuccessful members would earn dividend [chit dividend as defined under section 2(h) of Chit Fund Act, 1982].

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

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

High Court’s Observations: The High Court noted the decision of CIT v. Sahib Chits (Delhi) (P) Ltd (2010) 328 ITR 342 (Del) wherein section 2(28A) was referred to decide that chit dividend cannot be treated as interest. Further, section 194A has no application to such (chit) dividend and therefore, there is no obligation on the part of the assessee to
make any deduction under section 194A before such dividend is paid to the subscribers of the chit.

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

**Notes:**

1. Meaning of certain terms:

<table>
<thead>
<tr>
<th>Term</th>
<th>Section</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend</td>
<td>2(h) of Chit Fund Act, 1982</td>
<td>The share of the subscriber in the amount of discount available under the chit agreement for rateable distribution among the subscribers at each instalment of the chit.</td>
</tr>
<tr>
<td>Discount</td>
<td>2(g) of the Chit Fund Act, 1982</td>
<td>The sum of money or the quantity of grain which a prized subscriber is, under the terms of the chit agreement, required to forego and which is set apart under the said agreement to meet the expenses of running the chit or for distribution among the subscriber or for both.</td>
</tr>
<tr>
<td>Interest</td>
<td>2(28A) of the Income-tax Act, 1961</td>
<td>Interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.</td>
</tr>
</tbody>
</table>

2. Example (to explain the concept of Chit Fund):

Let us suppose 50 persons come together to organise a chit and each of them undertake to contribute ₹ 1,000. The total chit amount would be ₹ 50,000 (₹ 1,000 × 50). Let us further suppose that the fund would operate for a period of 50 months. Thus, the member subscribers and the number of months for which the chit would operate would be the same. In this example, at the end of each month, an amount of ₹ 50,000 (₹ 1,000 × 50) would be available in the kitty of the chit fund. The said amount would be put to auction and those subscribers who are interested in drawing the money early because of their needs may participate in the auction. The successful bidder, who is normally the person who offers the highest discount, is given the chit amount.
For example, let us assume that there are three bidders offering to take the chit for ₹ 50,000. They offer ₹ 40,000, ₹ 35,000 and ₹ 33,000, respectively. The chit would be given to that subscriber who is willing to take it for ₹ 33,000, since he has offered a discount of ₹ 17,000. This leaves a balance of ₹ 17,000 in the kitty. The amount of ₹ 17,000 which represents the discount which the successful bidder has foregone becomes the dividend which is to be distributed to the subscribers.

4. Where the assessee fails to deduct tax at source under section 194B in respect of the winnings, which are wholly in kind, can he be deemed as an assessee-in-default under section 201?

*CIT v. Hindustan Lever Ltd. (2014) 361 ITR 0001 (Kar.)*

**Facts of the case:** In the present case, the assessee is a company engaged in the business of manufacture and sale of various consumer goods/products. During the previous years relevant to A.Y.2001-02 and A.Y.2002-03, it had conducted certain sales promotion schemes. The assessee advertised the schemes wherein coupons were inserted in packs/containers of their products. Some of those coupons indicated that on purchase of the packs/containers, they would get prizes, as indicated in coupons. The prizes that were offered were Santro car, Maruti car, gold chains, gold coins, gold tablas, silver coins, emblems, etc. The total amount of prizes distributed valued ₹ 6,51,238 for the A.Y.2001-02 and ₹ 54,73,643 for the A.Y.2002-03.

The Assessing Officer, having received the information about the schemes, sought clarification and also conducted survey of the assessee's business premises under section 133A. The Assessing Officer, thereafter, passed an order dated 3.1.2002, under sections 201(1) and 201(1A) for the A.Y.2001-02 and treated the assessee as an assessee-in-default of its obligation in terms of section 194B. Similar order was passed for the A.Y.2002-03. According to the Assessing Officer, the assessee was obliged to ensure that the tax in respect of the winnings, wholly in kind, was remitted before the winnings were released. Having failed to do so, the proceedings under section 201(1) were initiated. The Assessing Officer held that although the customers did not pay anything extra to receive the prize, nevertheless, they had participated in the scheme by purchasing the products advertised to take a chance at winning the prize. It was further held that what has been paid as prize-in-kind in various schemes conducted by the assessee is a lottery on which the tax was deductible under section 194B. As the assessee neither deducted the tax nor ensured payment thereof before the winnings were released, he treated the assessee as an assessee-in-default. He passed similar order dated 28.3.2002 for the A.Y.2002-03.

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

The Tribunal further held that having regard to the insertion of Explanation below section 2(24)(ix), the scheme conducted by the assessee would be a lottery for the A.Y.2002-03 but nevertheless they accepted the alternate contention that having regard to Circular No. 390, dated August 8, 1984 [See (1984) 149 ITR (St.) 5], there was no obligation on the respondent to deduct tax at source in respect of prizes paid in kind and in the absence of any such obligation, no proceedings under section 201 could be taken against the respondent.

**High Court's view:** From a bare perusal of section 194B, it is clear that the person responsible for paying to any person any income by way of winnings from any lottery in an amount exceeding ten thousand rupees shall, at the time of payment thereof, deduct income-tax thereon at the rates in force. A combined reading of sections 194B and 201 shows that if any such person fails to “deduct” the whole or any part of the tax or after deducting, fails to pay the tax as required by or under the Act, then such person shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax. **The provisions contained in these sections do not cast any duty to deduct tax at source where the winnings are wholly in kind.** If the winnings are wholly in kind, as a matter of fact, there cannot be any deduction of tax at source. The word “deduction” employed in this provision postulates a reduction or subtraction of an amount from a gross sum to be paid and payment of the net amount thereafter. Where the winnings are wholly in kind the question of deduction of any sum therefrom does not arise and in that eventuality, the only responsibility, as cast under section 194B, is to ensure that tax is paid by the winner of the prize before the prize or winnings is or are released in his favour.

**High Court's Decision:** The High Court observed that if the assessee fails to ensure that tax is paid before the winnings are released in favour of the winner, then, section 271C empowers the Joint Commissioner to levy penalty equivalent to the amount of tax not paid, and under section 276B, such non-payment of tax is an offence attracting rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine. However, the High Court held that proceedings under section 201 cannot be initiated against the assessee.
5. Can the transmission, wheeling and SLDC charges paid by a company engaged in distribution and supply of electricity, under a service contract, to the transmission company be treated as fees for technical services so as to attract TDS provisions under section 194J or in the alternative, under 194C?

Ajmer Vidyut Vitrani Nigam Ltd., In re (2013) 353 ITR 640 (AAR)

Facts of the case: In the present case, the applicant is a government company engaged in the business of distribution and supply of electricity to customers in various districts of Rajasthan. The activity of distribution is preceded by the production of electricity and its transmission from the point of production to the point of distribution. The production is by the generating company, which is another entity and transmission to the applicant is through the transmission system network of the transmission company. The transmission company carries the electrical energy to the applicant at the distribution system network of the applicant. The applicant then distributes the energy to the end customers.

The transmission of electricity from the point of generation to the point of distribution of the applicant is termed as “wheeling”. The applicant pays transmission and wheeling charges for this wheeling, which it contends are statutory charges. The transmission company also functions as a State Load Dispatch Centre (SLDC), which is responsible for the general coordination of production and transmission of electricity to ensure uniform distribution in the State. The applicant pays to the transmission company, SLDC charges, which it claims as statutory in nature, since the levy is in terms of the Electricity Act, 2003.

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

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

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

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

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

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

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

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

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

**AAR's Decision:** The AAR, considering the definition of fees for technical services under section 9(1)(vii) and the process involved in proper transmission of electrical energy, held that transmission and wheeling charges paid by the applicant to the transmission company are in the nature of fees for technical services, in respect of which the applicant has to withhold tax thereon under section 194J.

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

6. Can discount given to stamp vendors on purchase of stamp papers be treated as ‘commission or brokerage’ to attract the provisions for tax deduction under section 194H?

**CIT v. Ahmedabad Stamp Vendors Association (2012) 348 ITR 378 (SC)**

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

**High Court's Observations:** On this issue, the Gujarat High Court had in, Ahmedabad Stamp Vendors Association v. Union of India (2012) 348 ITR 378, observed that the
crucial question is whether the ownership in the stamp papers passes to the stamp vendor when the treasury officer delivers stamp papers on payment of price less discount. The Gujarat Stamp Supply and Sales Rules, 1987 contemplates that the licensed vendor, while taking delivery of the stamp papers from the Government offices, is purchasing the stamp papers. The Rules also indicate that the discount which the licensed vendor has obtained from the Government is on purchase of the stamp papers. If the licensed stamp vendors were mere agents of the State Government, no sales tax would have been leviable when the stamp vendors sell the stamp papers to the customers, because it would have been sale by the Government “through” stamp vendors. However, entry 84 in Schedule I to the Gujarat Sales Tax Act, 1969 specifically exempts sale of stamp papers by the licensed vendors from sales-tax. The very basis of the State Legislature enacting such exemption provision in respect of sale of stamp papers by the licensed vendors makes it clear that the sale of stamp papers by the licensed vendors to the customers would have, but for such exemption, been subject to sales tax levy. The question of levy of sales tax arises only because the licensed vendors themselves sell the stamp papers on their own and not as agents of the State Government. Had they been treated as agents of the State Government, there would be no question of levy of sales tax on sale of stamp papers by them, and consequently, there would have been no necessity for any exemption provision in this regard.

Therefore, although the Government has imposed a number of restrictions on the licensed stamp vendors regarding the manner of carrying on the business, the stamp vendors are required to purchase the stamp papers on payment of price less discount on “principal to principal” basis and there is no “contract of agency” at any point of time. The definition of “commission or brokerage” under clause (i) of the Explanation to section 194H indicates that the payment should be received, directly or indirectly, by a person acting on behalf of another person, inter alia, for services in the course of buying or selling goods. Therefore, the element of agency is required in case of all services and transactions contemplated by the definition of “commission or brokerage” under Explanation (i) to section 194H. When the licensed stamp vendors take delivery of stamp papers on payment of full price less discount and they sell such stamp papers to the retail customers, neither of the two activities (namely, buying from the Government and selling to the customers) can be termed as service in the course of buying and selling of goods. The High Court, therefore, held that discount on purchase of stamp papers does not fall within the expression “commission or brokerage” to attract the provisions of tax deduction at source under section 194H.

**Supreme Court's Decision:** The Supreme Court affirmed the above decision of the High Court holding that the given transaction is a sale and the discount given to stamp vendors for purchasing stamps in bulk quantity is in the nature of cash discount and consequently, section 194H has no application in this case.
7. Can incentives given to stockists and distributors by a manufacturing company be treated as “commission” to attract –

(i) the provisions for tax deduction at source under section 194H; and
(ii) consequent disallowance under section 40(a)(ia) for failure to deduct tax at source?

CiT v. Intervet India P Ltd (2014) 364 ITR 238 (Bom)

Facts of the case: The assessee-company engaged in manufacture of biological vaccines and animal health care pharmaceutical products, sold the same either through consignment or commission agents or directly through distributors or stockists. During the relevant financial year, it introduced a sales promotion scheme to boost sales by way of product discounts and product campaign. It passed on the incentives to distributors through consignment agents by way of sales credit notes. The Assessing Officer held that as the assessee was paying the stockists/distributors for the services rendered by them for buying and selling goods, on the basis of quantum of sales effected, such payment has to be considered as commission, on which tax was deductible at source under section 194H. Consequently, disallowance under section 40(a)(ia) was attracted for failure to deduct tax at source.

High Court’s Observations: The High Court observed that the assessee had undertaken sales promotion by way of product discount scheme under which it offered incentive to the stockists / distributors and dealers. The relationship between the assessee and the distributors / stockists was that of principal to principal. The products were firstly sold to distributors / stockists who in turn resold the goods in the market. No service was offered by the assessee to them except a discount under the product discount scheme/product campaign scheme to buy the assessee’s product.

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

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

Bharti Cellular Ltd. v. ACIT (2013) 354 ITR 507 (Cal.)

High Court’s Observations: On this issue, the Calcutta High Court observed the Supreme Court ruling in Bhopal Sugar Mills’ case (1977) 40 STC 42, wherein it was held that the true relationship between the parties has to be gathered from the nature of the contract, its terms and conditions. The terminology used by the parties is not decisive of the said relationship.
The High Court, on perusal of the agreement between the assessee-telecom company and the franchisees, observed that—

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

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

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

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

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

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

**Note** - Similar ruling was pronounced by the Kerala High Court in Vodafone Essar Cellular Ltd. v. ACIT (TDS) (2011) 332 ITR 255, wherein it was held that there was no sale of goods involved as claimed by the assessee-telecom company and the entire charges collected by the assessee from the distributors at the time of delivery of SIM cards or recharge coupons were only for rendering services to ultimate subscribers. The assessee was accountable to the subscribers for failure to render prompt services pursuant to connections given by the distributor. Therefore, the distributor only acted as a middleman on behalf of the assessee for procuring and retaining customers and consequently, the discount given to him was within the meaning of commission on which tax was deductible under section 194H.

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

*CIT v. Qatar Airways (2011) 332 ITR 253 (Bom.)*

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

**High Court's Observations:** On this issue, the Bombay High Court observed that the difference between the published price and minimum fixed commercial price cannot be taken as additional special commission in the hands of the agents, since the published price was the maximum price and airline company had granted permission to the agents to sell the tickets at a price lower than the published price. In order to deduct tax at source, the exact income in the hands of the agents must necessarily be ascertainable by the airline company. However, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents, since the agents had been given discretion to sell the tickets at any rate between the minimum fixed commercial price and the published price. It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of each ticket sold.

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

**Note** - It may be noted that in the case of CIT v. Singapore Airlines Ltd. (2009) 319 ITR 29, the billing analysis statement clearly indicated the extra commission in the form of special or supplementary commission that was paid to the travel agent with reference to the deal code. Therefore, in that case, the Delhi High Court, held that the supplementary commission in the hands of the agent was ascertainable by the airline company and hence the airline company was liable to deduct tax at source on the same under section 194H.

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


**Facts of the case:** The assessee in both the cases are foreign airlines. Being international airlines, they fly their aircrafts to several destinations across the world, including New Delhi. For landing the aircrafts and parking thereof at the Indira Gandhi International Airport (IGIA), New Delhi, the Airports Authority of India (AAI) levies charges on these airlines. The airlines are deducting tax @2% under section 194C for payment of landing and parking charges in respect of its aircrafts to AAI and remitting the same. However, the income-tax authorities are of the view that tax is to be deducted at the higher rate applicable under section 194-I (currently, 10%).
Issue under consideration: The issue under consideration is whether landing and parking charges paid by the airline companies to AAI is in the nature of rent to attract tax deduction at source under section 194-I.

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

The Delhi High Court observed that “rent” as defined in section 194-I has a wider meaning than rent in common parlance and includes any agreement or arrangement for use of land. The Delhi High Court further observed that when the wheels of the aircraft coming into an airport touch the surface of the airfield, use of the land of the airport immediately begins. Similarly, for parking the aircraft in that airport, again, there is use of the land. Therefore, the Delhi High Court, following its own judgment in the case of United Airlines v. CIT (2006) 287 ITR 281 held that landing and parking fee were “rent” within the meaning of the provisions of section 194-I, as they were payments for the use of the land of the airport.

The Madras High Court, however, expressed a contrary view on the above issue in CIT v. Singapore Airlines Ltd. (2012) 209 Taxman 581 (Mad.). The Court has observed that only if the agreement or arrangement has the characteristics of lease or sub-lease or tenancy for systematic use of the land, the charges levied would fall for consideration under the definition of ‘rent’ for the purpose of section 194-I.

The Madras High Court further observed that the principles guiding the levy of charges on landing and take-off show that the charges are with reference to the number of facilities provided by the Airport Authority of India in compliance with the international protocols and the charges are not made for any specified land usage or area allotted. The charges are for various facilities offered to meet the requirement of passenger safety and for safe landing and parking of the aircraft. Thus, the charges levied are, at the best, in the nature of fee for the services offered rather than in the nature of rent for the use of the land.

Therefore, the levy of charges, which is not only for the use of land, but for maintenance of various services, including technical services involving navigation, would not automatically bring the transaction and the charges within the meaning of either lease or sub-lease or tenancy or any other agreement or arrangement in the nature of lease or tenancy so that the charges would fall within the meaning of ‘rent’ as appearing in Explanation to section 194-I.

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

Supreme Court's Observations: The Apex Court considered the moot question as to whether landing and take-off facilities on the one hand and parking facility on the other hand would tantamount to use of land. After due consideration of the views of the Delhi
High Court and the Madras High Court on this issue, the Supreme Court concluded that the Madras High Court’s view is justified on the basis of sound rationale and reasoning.

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

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers’ safety as well as for safe landing and parking of the aircrafts. Therefore, it is not mere "use of the land". On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

For example, runways are not constructed like any ordinary roads. Special technology is required for the construction of these runways for smooth landing and take-off of the aircrafts. Specialised kind of orientation and dimensions are needed for these runways which are prescribed with precision and those standards are to be adhered to. Further, there has to be proper runway lighting, runway safety area, runway markings, etc. Technical specifications for such lighting, safety area and markings are stipulated which have to be provided. The technical specifications keep in mind the basic fact, namely, on landing, the aircraft is light on fuel and usually less than 5% of the weight of the aircraft touches the runway in one go. On take-off, the aircraft is heavy but as the aircraft accelerates, the weight gradually moves from the wheels to the wings. The technological aspects of these runways have been emphasized in some detail to highlight the precision in designing and engineering which goes into making these runways fool proof for safety purposes. The purpose is to show that the AAI is providing all these facilities for landing and take-off of an aircraft and in this whole process, "use of the land" pales into insignificance.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from the reality.

**Supreme Court’s Decision:** The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the full and larger picture in mind, it becomes very clear that the charges are not for use of the land *per se* and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in *Singapore Airlines* case and overruled the view taken by the Delhi High Court in *United Airlines/Japan Airlines* case.
The Supreme Court was, however, not in agreement with the Madras High Court’s view that the words “any other agreement or arrangement for the use of any land or any building” have to be read *ejusdem generis* and it should take its colour from the earlier portion of the definition, namely, “lease, sub-lease and tenancy”, thereby, limiting the ambit of the words “any other agreement or arrangement”. The Supreme Court observed that this reasoning was not correct. A bare reading of the definition of “rent” contained in *Explanation* to section 194-I would make it clear that in the first place, the payment, by whatever name called, under any lease, sub-lease, tenancy is to be treated as “rent”. This is rent as understood in the traditional sense. However, the second part is independent of the first part which gives a much wider scope to the term “rent”. Accordingly, whenever payment is made for use of any land or any building by any other agreement or arrangement, that is also to be treated as “rent”. Once such a payment is made for use of land or building under any other agreement or arrangement, such agreement or arrangement gives the definition of “rent” a very wide connotation. The Supreme Court observed that the interpretation of the Delhi High Court appears to be correct to that extent i.e., to the extent that the scope of the definition of rent under section 194-I is very wide and not limited to what is understood as rent in common parlance; though the Delhi High Court did not apply this definition correctly to the present case as it failed to notice that in substance the charges paid by these airlines are not for “use of land” but for other facilities and services wherein the use of the land was only a minor and insignificant aspect. Thus, the Supreme Court was of the considered view that the Delhi High Court did not correctly appreciate the nature of charges that are paid by the airlines as landing and parking charges, in the sense, it did not appreciate that such charges were not, in substance, for use of land but for various other facilities extended by the Airports Authority of India to the airlines.

11. Is payment made for use of passive infrastructure facility such as mobile towers subject to tax deduction under section 194C or section 194-I?

*Indus Towers Ltd v. CIT (2014) 364 ITR 114 (Del)*

**Facts of the case:** The assessee owned a network of telecom towers and infrastructure services which were let out to major telecom operators in the country. Under section 197, the assessee sought for lower tax deduction under section 194C for the financial year 2013-14 at 0.5% and whereas the Assessing Officer issued a certificate under section 197 for lower tax deduction at 2.5% under section 194-I. The assessee filed a writ before the Delhi High Court. The Court directed the assessee to prefer a revision petition before the Commissioner of Income-tax.

The Commissioner of Income-tax rejected the contention of the assessee for applying section 194C and upheld the order of the Assessing Officer applying section 194-I, on the ground that the mobile operators had the right to install the equipment on the tower owned by the assessee, which tantamounts to use of the land or telecommunication site and the tower owned by the assessee. The assessee once again preferred a writ before the High Court.
**Assessee's Contentions:** The assessee explained that its responsibility is to provide the entire passive infrastructure service with the aid of equipment belonging to it which is fully operated, controlled and managed by it. The customers do not have access, control or possession over the towers, sites or designated areas which are limited to rectification or maintenance of any defects in the equipments installed by them. The assessee, further, contended that its customers do not pay for any leasing rights but only for the services. Therefore, the provisions of section 194-I would not be attracted in this case.

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

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

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

**CIT v. Senior Manager, SBI (2012) 206 Taxman 607 (All.)**

**Facts of the case:** In the present case, the assessee was paying rent for the leased premises occupied. The said premise was co-owned and the share of each co-owner was definite and ascertainable. Also, the assessee made payment to each co-owner separately by way of cheque. The assessee did not deduct tax at source under section 194-I stipulating that the payment made to each co-owner was less than the minimum threshold mentioned in the said section (now, ₹ 1,80,000) and therefore, no liability to deduct tax at source on the rent so paid is attracted, though the whole rent taken together exceeds the said threshold limit.

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

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

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

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

CIT (TDS) v. Shree Mahalaxmi Transport Co. (2011) 339 ITR 484 (Guj.)

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

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

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

Note - Similar ruling was pronounced by the Gujarat High Court on an identical issue in CIT (TDS) v. Swayam Shipping Services (P) Ltd. (2011) 339 ITR 647.
14. Where remuneration paid to doctors is variable based on number of patients and treatment given to them, would the liability to deduct tax at source arise under section 192 or under section 194J?

*CIT v. Manipal Health Systems (P) Ltd (2015) 375 ITR 509 (Kar)*

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

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

**High Court's Observations:** The High Court observed that to decide whether the relationship of employer-employee existed or not, the contract entered into between the parties has to be seen - whether the same is a "contract for service" or a "contract of service". In order to ascertain the nature of contract, multiple-factor tests have to be applied. The independence test, control test, intention test are some of the tests adopted to distinguish between ‘contract for service’ and ‘contract of service’.

The High Court examined the terms of the contract entered into between the assessee-company and the doctors. As per the said terms,

- The remuneration paid to the doctors depends on the treatment given to patients and on the number of patients - if the number of patients are more, remuneration would be on a higher side or if no patients, no remuneration;
- The timing of the doctors is fixed; and
- They cannot have private practice or attend any other hospital.

It was observed that mere provision of non-competition clause in the agreement shall not change the nature of contract from profession to that of employment. Imposing a condition of bar to private practice is to make use of the expertise, skill of a doctor exclusively for the assessee-company, i.e., to get the attention and focus of the professional skill and expertise only to the patients of the assessee-company and to discourage doctors from transferring patients to their own clinics or any other hospital. The High Court also noted the Tribunal’s finding that none of the doctors are entitled to gratuity, provident fund, leave travel allowance and other terminal benefits. It is also pertinent to note that the doctors have filed their returns of income for the relevant

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assessment years showing the income received from the assessee-company as professional income and the same is said to have been accepted by the Department.

In CIT (TDS) v. Apollo Hospitals International Ltd. (2013) 359 ITR 78, the Gujarat High Court took a view that consultant doctors were not getting salary but payment to them was in the nature of professional fees liable to tax deduction at source under section 194J.

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

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


**Facts of the case:** The assessee company was engaged in the business of share broking, depositories, mobilisation of deposits and marketing public issues. Being a member of the Bombay Stock Exchange (BSE), it made payment to the Stock Exchange by way of transaction charges in respect of fully automated online trading facility and other facilities. These services are available to all the members of the stock exchange in respect of every transaction that is entered into. Revenue contended that tax is deductible at source under section 194J considering such transaction charges as “fees for technical services”.

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

**Supreme Court’s Observations:** The Apex Court made the following observations:

- The services provided by the stock exchange are available to all members in respect of every transaction that is entered into. There is nothing special, exclusive or customized in the service that is rendered by the stock exchange.
- A member who wants to conduct his daily business in the stock exchange has no option but to avail such services. Each and every transaction by a member involves the use of such services provided by the stock exchange for which the member is required to pay transaction charge based on the transaction value besides charges for the membership of the stock exchange.
Technical services like managerial and consultancy service are in the nature of specialised services made available by the service provider to cater to the special needs of the customer-user as may be felt necessary. **It is the above feature that would distinguish or identify a service provider from a facility offered.**

However, there is no exclusivity in the services rendered by the stock exchange and each and every member has to avail such service in the normal course of trading in securities in the stock exchange.

**Supreme Court's Decision:** The Apex Court, accordingly, held that the service provided by the BSE for which transaction charges are paid failed to satisfy the test of specialized, exclusive and individual requirement of the user or the consumer who may approach the service provider for such assistance or service. Therefore, the transaction charges paid to BSE by its members are not for technical services but are in the nature of payments made for facilities provided by the stock exchange. Such payments would, therefore, not attract the provisions of tax deduction at source under section 194J.

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

**CIT v. V.S. Dempo & Co P Ltd (2016) 381 ITR 303 (Bom) (FB)**

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

**High Court's Observations:** The High Court took note of the Tribunal’s observation that section 40(a)(i) would apply only when there is an obligation to deduct tax at source. The Tribunal placed reliance upon the CBDT Circular No. 723 dated September 19, 1995 to support its conclusion that there was no obligation to deduct tax at source in respect of payment made towards demurrage charges to non-resident shipping company falling within the scope of section 172. The Revenue did not dispute that section 172 applied in the present case. Section 172 is a charging as well as machinery provision in respect of non-resident shipping companies. It provides for determination and collection of tax. Thus, no obligation to deduct at source under section 195 would arise in respect of payment of demurrage charges to such companies.

The High Court also noted that section 172 is a complete code that applies to non-resident Indians and section 195 is part of recovery provision under the Income-tax Act, 1961.
The provisions of section 172 would apply notwithstanding anything contained in the other provision of this Act, for the purpose of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident which carries passengers, etc. shipped at a port in India. Since section 172(1) begins with a non-obstante clause, it would prevail over other provisions of the Act including section 195. Thus, the provisions contained thereunder would take care of the manner of determination of income from shipping business of non-residents as well as the levy and recovery of tax thereon.

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

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


**Facts of the case:** The assessee, an event management company, engaged the services of an agent to bring artistes to India. The assessee-company (i) paid commission to overseas agent; (ii) reimbursed the expenses in connection with the visit of the artistes in India; and (iii) paid fees to the artistes in India. The assessee-company deducted tax at source on the fees paid to the international artistes in India but did not deduct tax at source on the commission paid to the agent and on the reimbursement of expenses incurred in India by the artistes.

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

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

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

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

18. Can items of finished products from ship breaking activity which are usable as such be treated as “Scrap” to attract provisions for tax collection at source under section 206C?

CIT v. Priya Blue Industries (P) Ltd (2016) 381 ITR 210 (Guj)

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

Appellate Authorities’ views: The Commissioner (Appeals) observed that the assessee was engaged in ship breaking activity and the products obtained from the activity were finished products which constituted sizable chunk of production done by the ship breakers. The Commissioner (Appeals) agreed with the assessee that such products though commercially known as ‘scrap’ were definitely not “waste and scrap”. He further agreed with the contention of the assessee that the items in question were usable as such and, therefore, do not fall within the definition of “scrap” as given in clause (b) of Explanation to section 206C(1).

The Tribunal firstly recorded a list of items sold by the assessee from the ship breaking activity. It found that the assessee collected and paid tax, for seven items, but did not collect tax at source on certain items viz. old and used plates; non-excisable (exempted) goods like wood etc. It observed that the ‘waste and scrap’ must be from manufacture or mechanical working of material which is definitely not usable as such because of
breakage, cutting up, wear and other reasons. Since the assessee is engaged in ship breaking activity, these items/products are finished products obtained from such activity which are usable as such and hence, are not ‘waste and scrap’ though commercially known as scrap. Accordingly, the Tribunal also decided the issue in favour of the assessee.

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

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


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

**Apex Court’s Observations:** The Apex Court observed that the facts of the present case are squarely covered by the three judges’ bench decision of this court in the case of Kalyankumar Ray v. CIT (1991) 191 ITR 634, wherein it was held that the Form I.T.N.S 150 is also a form for determination of tax payable and when it is signed or intitialled by the Assessing Officer, it is certainly an order in writing by the Assessing Officer determining the tax payable within the meaning of section 143(3). The said form also contains the calculation of interest payable on the tax assessed. This form must, therefore, be treated as part of the assessment order.

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

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