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DIRECT TAXES LAW
(INCOME TAX)

*G C Bharuka**

I INTRODUCTION

INDIAN INCOME Tax Act is known for its complexities not only because of its cobweb statutory structure but also for its frequent amendments for various reasons. It is, thus, inevitable that the law on the subject remains in fluid state and necessitates an uninterrupted process of interpretation from various judicial fora. A review of the judgments arising out of income tax disputes this year concentrates largely around the principles governing statutory interpretation. Various rules of interpretation were pressed into service to clarify and declare the law of the land. For instance, *CIT-I, Ahmedabad* v. *Gold Coin Health Food Private Limited*[1] deals with the interpretation of the amendment made by the Finance Act, 2002 w.e.f 01.04.2003 in *Explanation* 4 to section 271(1)(c)(iii) being clarificatory or substantive in nature. Others pertain to interpretation of definition clause[2] (whether exhaustive or inclusive), contemporaneous interpretation, rules of executive construction, law of precedent, the functional test, etc. The importance of rule of *audi alteram partem* was re-emphasized in *Sahara India (Firm)* v. *CIT*[3] where, in the context of an order under section 142(2-A) of the Act, it was reiterated that unless a statutory provision either specifically or by necessary implication excludes the application of the principle of natural justice, the requirement of giving reasonable opportunity of being heard before an order is made is generally read into the provisions of a statute, particularly where the order has adverse civil consequences for the party likely to be affected. Other cases under review involve the power of appellate tribunal in respect of rectification of mistakes, the concept of 'resident but not ordinarily resident' (peculiar to the Indian income tax laws),

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1 (2008) 9 SCC 622.

2 Interpretation of definition of expression 'local authority' in *Explanation* to s. 10(20) of the Finance Act, 2002 in *Agricultural Produce Market Committee, Narela* v. *CIT*, (2008) 305 ITR 1 (SC).

3 (2008) 300 ITR 403 (SC).

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the test of a trader or commission agent, power to transfer cases under section 127 with respect to block assessments, business expenditure (interest on borrowings, interest paid by a firm to its partners, commitment charges and finance changes, interest on delayed payments), double taxation relief in context of the Double Taxation Avoidance Agreement between India and Malaysia, etc. Another important issue dealt with in one of the judgments under review relates to the nature of penalty in the context of taxing laws. The Supreme Court in *Union of India* v. *Dharmendra Textiles Processors*,[4] while dealing with an excise matter, has incidentally held that the provision for penalty under section 271(1)(c) is a civil liability.[5]

Overall, this year has witnessed a number of important judgments which clarifies the law to a great extent and naturally helps in its uniform application.

II ACCOUNTING

Method of accounting

Every assessee is entitled to arrange its affairs and follow the method of accounting, which the department has earlier accepted. It is only in those cases where the department records a finding that the method adopted by the assessee results in distortion of profits that the department can insist on substitution of the existing method.

In *CIT* v. *Bilahari Investment Pvt. Ltd.*,[6] the assessees, certain private companies, subscribed to chits as their business activities. They maintained their accounts on the mercantile basis and computed the profit/loss at the end of the chit period following the completed contract method. This was accepted by the department, but for the assessment years 1991-92 to 1997-98, the assessing officer came to the conclusion that the completed contract method for chit discount was not accurate in recognizing/identifying income and that the percentage of completion method was to be preferred. The high court held that the completed contract method of accounting adopted by the assessees for chit discount was valid and the department erred in spreading the discount over the remaining period of chit under the percentage of completion method on proportionate basis. On appeal by the revenue, the Supreme Court, while affirming the decision of the high court, held that keeping in view the various statements produced, the change from the completed contract method to percentage of completion method is not required.

4 (2008) 306 ITR 277 (SC).

5 Though while rendering this decision, the earlier decision of a three-judges bench of the Supreme Court in *Hindustan Steel Ltd.* v. *State of Orissa*, (1969) 2 SCC 627, was not referred to which held that penalty proceedings are penal in nature. See below under the heading 'Penalty'.

6 (2008) 299 ITR 1 (SC).

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The Supreme Court, however, did not consider the question on the basis whether the position would have been the same if the accounting standards enacted by the Institute of Chartered Accountants of India were adopted as required under section 211 (2) of the Companies Act, 1956 since the developments were of recent origin and they were not invoked by the department in this case.

Special audit of accounts

Sub-section (2-A) of section 142 of the Act empowers the assessing officer to get the accounts of the assessee audited by an accountant nominated by the Chief Commissioner or Commissioner of Income-tax by formation of an opinion based on certain criteria laid down in the said sub-section. The section *ipso facto* does not provide for hearing to be given to the assessee before any such order is passed. In *Sahara India (Firm)* v. *CIT*,[7] the question raised was that no decision for special audit can be taken before any opinion is formed in this regard. The Supreme Court, while relying upon a catena of judgments,[8] held that an order under section 142(2-A) entails civil consequences and therefore, the rule *audi alteram partem* is required to be observed. It has once again been reiterated that unless a statutory provision either specifically or by necessary implication excludes the application of the principle of natural justice, the requirement of giving reasonable opportunity of being heard before an order is made is generally read into the provisions of a statute, particularly where the order has adverse civil consequences for the party likely to be affected. The principle will hold good irrespective of whether the power conferred is on a statutory body or a tribunal or an order is to be passed by an administrative or quasi-judicial body.

Validity of accounting standard 22

Accounting Standard (AS) 22,[9] 'Accounting for Taxes on Income', issued by the Council of the Institute of Chartered Accountants of India,[10] comes into effect in respect of accounting period commencing on or after 1.4.2001. It is mandatory in nature for all the accounting periods commencing on or after 1.4.2001. The objective of AS 22 is:

> The objective of this Statement is to prescribe accounting treatment for taxes on income. Taxes on income is one of the significant items in the statement of profit and loss of an enterprise. In accordance

7 (2008) 300 ITR 403 (SC).

8 *A.K. Kraipak* v. *Union of India*, (1969) 2 SCC 262; *ITO* v. *Madnani Engineering Works Ltd.*, (1979) 2 SCC 455; *Swadeshi Cotton Mills Ltd.* v. *Union of India*, (1981) 1 SCC 664; *State of Orissa* v. *Dr. (Miss) Beena Pani*, (1967) 2 SCR 625; *Canara Bank* v. *V.K. Awasthi*, (2005) 6 SCC 321; *Mohinder Singh Gill* v. *Chief Election Commissioner*, (1978) 1 SCC 405.

9 Issued in 2001.

10 See *Compendium of Accounting Standards* 356 (as on 1.7.2003).

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> with the matching concept, taxes on income are accrued in the same period as the revenue and expenses to which they relate. Matching of such taxes against revenue for a period poses special problems arising from the fact that in a number of cases, taxable income may be significantly different from the accounting income. This divergence between taxable income and accounting income arises due to two main reasons. Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognized for the computation of taxable income.

The validity of Accounting Standard 22 laid down by the Institute of Chartered Accountants was questioned before the Supreme Court in *J.K. Industries Ltd.* v. *Union of India*.[11] The Supreme Court, in an elaborate judgment has gone behind the rationale of impugned Accounting Standard 22, found it to be consistent with the accounting policy of the accounts having to reflect a "true and fair view" of companies' affairs, so that the rule-making power requiring the adoption of this accounting standard along with other accounting standards cannot be questioned. The Supreme Court has also explained the rationale behind AS 22, as one to rule-out timing difference in the nature of future tax liability arising out of difference between book depreciation and tax depreciation. There are also other similar differences arising out of incentives. Timing differences can also give rise to recognition of a deferred asset, where an amount of expenditure debited in the books is spread over for income-tax purposes as under section 35D as a requirement of law or where a legitimate deduction is postponed as a requirement of statutory provisions like section 40(a) (i) or 40(a)(ia) and section 43B. It is a welcome decision, which explains that the accounting requirement in AS 22 is not inconsistent with law.

III APPELLATE TRIBUNAL

Rectification of mistake

Section 254(2) of the Act reads as follows:

> The Appellate Tribunal, may at any time within four years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it under the sub-section, and shall make such amendment if the mistake is brought to its notice by the assessee or the Assessing Officer.

11 (2008) 297 ITR 176.

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In *Shri Spinning Sree Ayyanar Weaving Mills Ltd.* v. *CIT*,[12] the Supreme Court was concerned with the interpretation of above quoted section 254(2) regarding the powers of the tribunal in the matter of rectification of mistakes apparent from the records. In this case, the assessee had on 2.8.2002, filed an application for rectification of a mistake which according to him was apparent from the records in an adverse order passed by the tribunal on 9.12.1996. It is apparent that application under section 254(2) was filed within four years from the date of the tribunal's order dated 9.12.1996. The tribunal, by its order dated 31.1.2003, allowed the said application rectifying its earlier order. But on appeal by the department, the high court reversed the order of the tribunal holding that the tribunal under section 254(2) had no jurisdiction to rectify even any mistake apparent from the record after the lapse of fours years from the date of such order.

The Supreme Court found that the application filed by the assessee was well within four years of the date of the order of the high court sought to be rectified. The Supreme Court held that the time beyond four years was taken by the tribunal in disposing of the application of assessee. As such according to the Supreme Court, the high court had erred in holding that the application could not have been entertained by the tribunal after four years. The Supreme Court has approved a similar decision taken by the Rajasthan High Court in *Harshvardhan Chemical and Minerals Limited* v. *Union of India*.[13]

It is submitted that it is well-founded that no act of courts, which includes tribunals and quasi-judicial bodies, can harm a litigant and it is the bounden duty of the courts to see that if a person is harmed by the mistake of the court, he should be restored to the position he would have occupied but for that mistake. This is aptly summed up in the maxim: *Actus curiae neminem gravabit*.[14]

IV ASSESSMENT – PRIMA FACIE ADJUSTMENTS

The first *proviso* to section 143(1)(a) of the Act, as it stood prior to its substitution in 1999, permitted the department to make *prima facie* adjustments, *viz*., adjustment in the income or loss declared in the return in cases of arithmetical errors or in cases where any loss carried forward or deduction or allowance which on the basis of information available in such return was *prima facie* admissible but which was not claimed in the return or in cases where any loss was carried forward or deduction or allowance claimed in the return which on the basis of information available in such return was *prima facie* inadmissible.

In *Kvaverner John Brown Engg. (I) P. Ltd.*,[15] the assessee claimed the gross income earned in foreign exchange as the qualifying income for the

12 (2008) 3001 ITR 434 (SC).
13 (2002) 256 ITR 767.
14 See *Amar Singh* v. *Rana Bal Bahadur Singh*, AIR (1966) SC 1631 at para 6.
15 (2008) 305 ITR 103 (SC).

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purpose of deduction under section 80-0 of the Act. But the income tax officer (ITO) purporting to exercise his discretion under section 143(1)(a), recomputed the deduction by restricting the claim of the assessee to the net income. The high court upheld the order of the ITO.[16]

Reversing the decision of the high court, the Supreme Court has held that since there were conflicting judgments on the interpretation of section 80-o of the Act, *prima facie* adjustments contemplated by section 143 (1)(a) could not be applied in relation to the allowance under section 80-o and as such, the assessee could not be required to pay additional tax under section 143(1A).

V ASSESSEE

Resident but not ordinarily resident

The concept of 'resident' and 'not ordinarily resident' in India is peculiar to the Indian income tax law. Section 5 of the Act provides for the assessment of income on a basis which differs according to the residential status being 'resident' or 'not ordinarily resident' or 'non resident' during the previous year for which the income falls to be assessed. It is, accordingly with reference to the previous year i.e., the accounting year that the various tests of residency have to be applied, residential status during the assessment year being immaterial.[17]

In *Pradip J. Mehta* v. *Commissioner of Income Tax*,[18] during the course of his employment, the assessee, who was a marine engineer for a company in Hong Kong, was posted to work on the high seas and was paid in foreign currency for many years. For the assessment year 1982-83, as he was not resident in India for 9 out of 10 years, the assessee claimed the status of "not ordinarily resident" as defined in section 6(6)(9a) of the Act, which provides that in the case of a person "not ordinarily resident" income which accrues or arises to him outside India shall not be included in his total income. The assessing officer refused to grant the assessee that status on the ground that the assessee was a non-resident in India for only three years during the last 10 years and during the past seven years, he had stayed in India for more than 730 days. The assessee's appeal was dismissed by the commissioner (appeals) and the appellate tribunal. On reference under section 256(1) of the Act, the high court answered the question against the assessee.

On appeal, reversing the decision of the high court, the Supreme Court held that the assessee was "not ordinarily resident" in India within the meaning of section 6(6)(a) as he was not resident for nine out of 10 years. A person would become an ordinary resident only if, (a) he had been residing

16 (2008) 305 ITR 101 (Karn).

17 *Wallace* v. *CIT*, 60 ITR 204 at 244 (PC); *CIT* v. *Savumiamurthy*, 40 ITR 185 at 189; *Narsimha* v. *CIT,* 18 ITR 181; *Teomal* v. *CIT*, 40 ITR 170; *Girdhar Lal* v. *CIT*, 53 ITR 23.

18 (2008) 300 ITR 231 (SC).

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in India in nine out of 10 preceding years; and, (b) he had been in India for at least 730 days in the previous seven years. In this regard the views taken by the High Courts of Patna,[19] Bombay[20] and Travancore and Cochin[21] were approved.

VI BUSINESS

Whether trader or commission agent

At times, it becomes necessary to decide whether the assessee is a trader or commission agent. A commission agent derives income only from commission on sales effected by him. There are instances, where a person describes himself as commission agent but is free to sell goods received on consignment basis at market rate, while he himself is committed to pay only the agreed consignment price, so that he undertakes some risk on his own. His income is not merely confined to what he receives as commission, but it also includes his trading profits.

In the case before the Supreme Court in *Anis Ahmand and Sons* v. *CIT (Appeals)*,[22] it was found as of fact that the assessee credited the sale price minus his commission and other expenses incurred in relation to the sale to the account of the parties, whose goods he had sold. This would *prima facie* make the assessee a commission agent. The question whether the assessee's income was confined to commission or he had trading profits as well, is a matter to be inferred from the accounts and the facts of the case. The assessee offered his commission income at Rs. 1.32 lakhs, but by rejecting the books of accounts and resorting to best judgment assessment, the assessing officer inferred that he is a trader and assessed him on Rs. 4.07 lakhs and also initiated penalty proceedings under various heads. The matter went up in appeal, which was allowed in part. The tribunal remanded the matter to the assessing officer for proper scrutiny of the accounts. The assessing officer issued summons to ten of the assessee's clients, five of whom appeared and confirmed the assessee's case, while five others from outside the state, did not respond. The assessing officer then limited his estimate of income in respect of the trading transactions of the five absentee witnesses of outside the State of U.P. and re-determined the income at Rs. 2.31 lakhs. The commissioner, in the second round of appeal, accepted the assessee's case, since the enquiry conducted by the assessing officer did not reveal any adverse material. The tribunal, on further appeal by the department, held that since in respect of absentee witnesses, the assessee had not produced further evidence and therefore, the order passed by the assessing officer could not have been interfered. The high court upheld the order of tribunal by dismissing the assessee's appeal *in limine*.

19 *C.N. Townsend* v. *CIT,* (1974) 97 ITR 185 (Pat).
20 *Manibhai S. Patel* v. *CIT,* (1953) 23 ITR 27 (Bom).
21 *P.B.I. Bava* v. *CIT,* (1955) 27 ITR 463 (Trav and Coch).

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On appeal by the assessee, the Supreme Court found that assessee had filed voluminous information as well as charts to support his claim, which was also supported by five of the ten witnesses summoned by the assessing officer. No adverse inference could have been drawn against the assessee in respect of those witnesses who did not respond to the summons. No further information was gathered by the assessing officer. Accordingly, the Supreme Court set aside the order of the tribunal and that of the high court.

It is unfortunate that in a case like the present one, the assessee had to go upto the Supreme Court, which should have been decided on the basis of the accounts which fully supported the assessee's returned income. The principle concerning adverse inference can be traced to *Illustration (g)* of section 114 of the Evidence Act, 1872 which says that "The Court may presume that evidence which could be and is not produced would, if produced, be unfavourable to the person who withholds it." As rightly held by the Supreme Court, this doctrine could not have been applied to the facts of the present case since the five persons to whom notices under section 131 were issued, were of outside the state and could not have been said to be within the control of the assessee to attract the doctrine of adverse inference.

VII BLOCK ASSESSMENT

Surcharge

Block assessments are made under chapter XIV-B of the Act, which lays down a special procedure for assessment of undisclosed income found during search of the "Block Period". Block period has been defined under clause(a) of section 158-B to, *inter alia*, mean the previous years relevant to ten assessment years preceding the previous year in which search was conducted under section 132. Section 113 provides that the total undisclosed income of the block period, determined under section 158BC, shall be chargeable to tax @ 60%. The Finance Acts of 2001 and 2002 had provided for levy of surcharge on the amounts of income tax determined under section 113. In the case of block assessments which comprises of more than two assessment years, it was not clear as to which rate of surcharge will be applicable to the block period. Therefore, by Finance Act, 2002, the following *proviso* was added to section 113 w.e.f. 1.6.2002:

> Provided that the tax chargeable under this section shall be increased by a surcharge, if any, levied by any Central Act and applicable in the assessment year relevant to the previous year in which the search is initiated under section 132 or the requisition is made under section 132A.

22 (2008) 297 ITR 441 (SC).

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In *CIT* v. *Suresh and Gupta*,[23] on 17.1.2001, a search was conducted in the premises of the assessee, an individual, as a result of which, unexplained expenses were unearthed. In the 'block assessment', the assessee's undisclosed income was determined at Rs. 1,62,427. The assessing officer computed tax thereon @ 60 per cent, on which a surcharge was levied @ 17 per cent. The commissioner (appeals), the appellate tribunal and the high court held the levy of surcharge to be bad. The department preferred an appeal to the Supreme Court contending that surcharge was leviable since the Finance Act, 2001, was applicable to 'block assessments' in question. The Supreme Court, reversing the decision of the high court, held that surcharge of 17 per cent, was rightly levied under the Finance Act, 2001, which applied also to tax on undisclosed income under the block assessment under section 158 BB.

According to the Supreme Court, the proviso was inserted in section 113 to indicate that the Finance Act of the year in which the search was initiated would apply. That proviso was only clarifactory in nature. There is no question of retrospective effect. The proviso has to be read as it stands. Prior to 1.6.2002, in several cases, tax was prescribed sometimes in the Income-tax Act and sometimes in the Finance Act and often in both. This made liability uncertain. Therefore, clarification was needed. The proviso is curative in nature. The proviso only clarifies that out of the four dates, Parliament has adopted the date, namely, the year in which the search under section 158BC is initiated, which would be relevant for applicability of a particular Finance Act.

Transfer of cases

In *K.P. Mohammed Salim* v. *CIT*,[24] the sole question was whether the power to transfer cases envisaged under section 127 of the Act could be exercised in respect of block assessments, the procedure for completion whereof is provided in chapter IV-B of the Act, which was brought on the statute book in the year 1996. "Block Period", as defined under section 158-B, includes an assessment for a period comprising of upto ten assessment years. In the present case, the assessee had challenged the order of transfer of his case from one assessing officer to another on the ground that section 127 of the Act can apply to the proceedings in relation to a particular assessment year and does not cover the proceedings like that of block assessment. Repelling the contention, the Supreme Court has held that section 127 is merely a machinery provision and it has to be construed to effectuate the charging section so as to allow the authorities concerned to do so in a manner wherefor the statute was enacted. The court was also of the view that it was a fit case where the doctrine of purposive construction[25]

23 (2008) 297 ITR 322 (SC).
24 (2008) 300 ITR 302 (SC).
25 By relying upon its earlier decision in *New India Assurance Co. Ltd.* v. *Nusii Neville Wadia*, (2007) 13 SCR 581.

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should be applied to read the word "any" as "all" for the purposes of section 127 of the Act. The court has approved the view taken by the Andhra Pradesh High Court in *Mukulta Lalita* v. *CIT*.[26]

VIII BUSINESS EXPENDITURE

Interest on borrowings

Sections 30 to 38 of the Act provide for deductions in computing the income chargeable under the head 'Profits or gains of business or profession'. Section 36(1)(iii) provides that the amount of the interest paid in respect of the capital borrowed for the purposes of business or profession shall be allowed as deduction.

In *Deputy Commissioner of Income Tax* v. *Core Health Care Ltd*.,[27] the question of law that fell for consideration before the Supreme Court was "whether interest paid in respect of borrowings on capital assets not put to use in the concerned financial year can be permitted as allowable deduction under section 36 (1) (iii) of the Act?"

The court has held that section 36(1)(iii) of the Act is a code by itself and has to be read on its own terms. The section does not make any distinction between the money borrowed to acquire the capital asset or revenue asset. All that the section requires is that the assessee must borrow capital and the purpose of borrowing must be for business which is carried on by the assessee in the year of accounting. The court answered the question by holding that the assessee was entitled to deduction as claimed for the assessment years 1992-93 to 1997-98 in relation to money borrowed for purchase of machinery even though the assessee had not used the machinery in the year of borrowing.

The law pronounced as above has been followed by the Supreme Court in its later decision in the case of *Assistant Commissioner of Income-tax* v. *Arvind Polycot Ltd.*[28]

Interest paid by a firm to its partners

In *Manjul Sales Corporation* v. *CIT*,[29] the question before the Supreme Court was whether operation of section 40(b)(iv) of the Act is subject to the provisions of section 36(1)(iii). The court answered the question in affirmative.

As noticed above, section 36(1)(iii) provides that the amount of interest paid in respect of capital borrowed for the purpose of the business or profession shall be allowed as deduction. But before the enactment of Finance Act, 1992, section 40(b)(iv) of the Act prohibited such deduction in case any interest was paid by a firm to any of its partners. By Finance Act,

26 (1997) 226 ITR 23 (AP).
27 (2008) 298 ITR 194 (SC).
28 (2008) 299 ITR 12 (SC).
29 (2008) 298 ITR 298 (SC).

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1992, section 40(b)(iv) was amended with effect from 1.4.1993. According to this amendment, the non-deductibility provisions contained is section 40 will not apply if the amount of interest paid by the firm to its partner does not exceed the amount calculated @ 18% simple interest per annum.

According to the Supreme Court, in order that interest paid on borrowings can be allowed as a deduction in computing business profits, every assessee, including a firm, has to establish, in the first instance that it was allowable under section 36(1)(iii) and in the case of a firm, further that the amount does not exceed the limit of interest fixed by section 40(b)(iv) of the Act.

Commitment charges and finance charges

In *Deputy CIT* v. *Gujarat Alkalies and Chemicals Ltd.*,[30] the assessee had established a phosphoric acid project as an extension to its existing business activities. For that purpose, it obtained foreign currency loan from the IDBI which in turn was refinanced by COFACE subject to the assessee paying "commitment charges" to COFACE. The department disallowed deduction of "commitment charges" on the ground that the payment was not in the nature of interest. The tribunal, however, allowed the deduction under section 37 of the Act. On appeal, the high court affirmed the order of the tribunal. On further appeal by the department, the Supreme Court, applying the law laid down in *Addl. CIT* v. *Akkamamba Textiles Ltd.*,[31] and *CIT* v. *Sivakami Mills Ltd.*,[32] affirmed the decision of the high court holding that the "commitment charges" were an admissible deduction under section 37 and there was no infirmity on the part of the appellate tribunal in allowing the same.

The assessee had also obtained, for the extension of its business activities, foreign currency loan from the IDBI which in turn was refinanced by COFACE subject to the assessee paying "finance charges". The department, relying upon explanation (8) to section 43(1) of the Act, disallowed the 'finance charges' on the ground that the interest had been paid in relation to the project of manufacturing phosphoric acid which had not commenced production during the assessment year concerned. The appellate tribunal and the high court allowed the deduction. On appeal the Supreme Court, while affirming the decision of the high court, held that the deduction had to be allowed under section 36(1)(iii). Further, the deduction could also be allowed under section 37. In this regard as well, the Supreme Court followed its earlier decisions in *Deputy CIT* v. *Core Health Care Ltd.*[33] and *Addl. CIT* v. *Akkamamba Textiles Ltd.*[34]

30 (2008) 299 ITR 85 (SC).
31 (1997) 227 ITR 464 (SC).
32 (1997) 227 ITR 465 (SC).
33 *Supra* note 27.
34 *Supra* note 31.

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Interest on delayed payments

In *Kerala Road Line* v. *CIT*,[35] the assessee entered into an agreement to purchase 466 cents of land with building thereon. It was agreed that the sale deed would be executed in favour of the assessee or its nominees. Under the agreement, if the purchase price was not paid within the specified time, the assessee was liable to pay interest @ 18 per cent per annum. Thereafter, the buildings standing on the land were demolished and the scrap materials were sold at Rs.5,88,001. This income was treated as the business income of the assessee. The assessee had to pay interest of Rs. 4 lakhs for delayed payment of the purchase consideration. The assessee claimed this amount as revenue expenditure but the department disallowed the claim. The appellate tribunal, however, held that the payment of interest had to be allowed as a deduction under section 37 of the Act, especially when the sale proceeds of the scrap materials from the demolished structures had been treated as business income. The high court, on a reference, held that since the business of the assessee was of transport only, the expenditure would not be covered by section 37(1). On appeal, the Supreme Court reversed the decision of the high court.[36] It has been held that once the revenue accepted the sum of Rs.5,88,001 being the sale proceeds of scrap material as business income, the assessee would be entitled to claim the sum of Rs. 4 lakhs paid as interest on the delayed payment of the purchase consideration as revenue expenditure.

IX DOUBLE TAXATION RELIEF

Section 90(1) of the Act empowers the central government to enter into an agreement with government of any country outside India for granting relief from double taxation. Sub-section (2) of section 90 declares that where the central government has entered into an agreement with the government of any other country under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, provisions of the Act can apply to the extent they are more beneficial to the assessee.

Dividend income arising in Malaysia

In *Deputy Commissioner of Income Tax* v. *Torquoise Investment and Finance Ltd.*,[37] the assessee, along with the return, claimed refund of Rs.29,16,660 on the basis of deemed tax deducted at source on dividend received from a Malaysian company. The appellate tribunal held that on a plain reading of article XI of the Double Taxation Avoidance Agreement between India and Malaysia, the dividend income would be taxable only in the contracting state i.e., Malaysia where such income accrued. On appeal,

35 (2008) 399 ITR 343 (SC).
36 *CIT* v. *Kerala Road Lines*, (2002) 256 ITR 261.
37 (2008) 300 ITR 1 (SC).

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the high court upheld the view taken by the tribunal.[38]

On appeal preferred by the revenue, the Supreme Court following its earlier decision in *CIT* v. *Kulandagan Chettiar (PVAL)*[39] affirmed the decision of the high court by holding that the dividend income from the Malaysian company could not be taxed in the hand of the assessee under the Act. It also approved the view taken by the Madhya Pradesh High Court in *Deputy CIT* v. *Turquoise Investment and Finance Ltd.*[40] in this regard.

X EXEMPTION FROM INCOME TAX – LOCAL AUTHORITY

In *Agricultural Produce Market Committee, Narela* v. *CIT*,[41] the Supreme Court has held that the appellant, a marketing committee established under the Delhi Agricultural Produce Marketing (Regulation) Act, 1998 to provide facilities for marketing agricultural produce and for performing other functions and duties such as superintendence, direction and control of markets for regulating the marketing of agricultural produce was not a "local authority" under section 10(2) of the Act, as amended by the Finance Act, 2002 and was, therefore, not exempt from income-tax.

Since the words "other authority" were omitted from the scope of the expression "local authority" found in section 3(31) of the General Clauses Act, 1897, in the *Explanation* to section 10(20) of the Finance Act, 2002, it would not be correct to say that the entire definition of words "local authority" was bodily lifted from section 3(31) of the 1897 Act and incorporated by Parliament in the *Explanation* to section 10(20) of the Act. The *Explanation* to section 10(20) provides a definition to the expression "local authority"; and that is an exhaustive and not an inclusive definition. Therefore, the functional test and test of incorporation as laid down by the Supreme Court[42] is no more applicable to section 10(20) as amended by the Finance Act, 2002.

The Supreme Court refrained from going into the question whether agricultural marketing committees were legally entitled to control the local fund, *viz.*, market fund, under the Delhi Agricultural Produce Marketing (Regulation) Act, 1998 because, *inter alia*, their incomes would be exempt under section 10(26AAB) of the Act w.e.f. 1.4.2009.

XI FRINGE BENEFIT TAX

Non-resident employer's liability

The fringe benefit tax is a new concept. It is contained in chapter XII-H of the Act which was inserted by Finance Act, 2005. It came into force w.e.f.

38 See (2008) 299 ITR 143.
39 (2004) 267 ITR 654 (SC).
40 (2008) 299 ITR 143.
41 (2008) 305 ITR 1 (SC).
42 *Union of India* v. *R.C. Jain*, (1981) 2 SCC 308.

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1.4.2006. Section 115-W defines "employer" and "fringe benefit tax". Fringe benefit tax has been defined as a tax chargeable under section 115-WA.

In *R&B Falcon (A) Pvt. Ltd.* v. *CIT*,[43] interpretation and/or application of the provisions of section 115WB of the Act providing for imposition of tax on fringe benefits was in question. In this case, the assessee-company was incorporated under the laws of Commonwealth of Australia. It was engaged in the business of providing mobile off-shore drilling (MODR) along with crew on a day-rate charter hire basis to drill off-shore wells. Allegedly, due to the hard working environment and purported to be in line with global practices typical to such industry, the employees who may be residents of various countries including Australia, USA, UK, France, etc. work on MODR on a commuter basis. They come to India, stay on the rig for 28 days and go back to their own home being their place of residence for a further period of 21 days.

In the present case, on the facts found, the Supreme Court has held that the assessee, which was a non-resident, and had brought employees to the place of work in India and back to their homes abroad incurring transportation cost would be liable for fringe benefit tax. According to the court, such transportation cost would fall under "conveyance" and "tour" and "travel" in clauses (f) and (g) of section 115-WB(2). It has been held that since the non-resident had a permanent establishment in India and carried on business in India having employees, the liability for FBT cannot be avoided. While interpreting the provisions relating to FBT, the court has relied with approval on the interpretation given by the Central Board of Direct Taxes in its circular no. 8 of 2005 dated 29.8.2005 as being a contemporaneous exposition. For interpreting the statutory provision at hand, the court has observed that rules of executive construction in a situation of this nature may also be applied where a representation is made by the maker of the legislation at the time of introduction of the bill or construction thereupon is put by the executive upon its coming into force, the same carried great weight.[44]

XII INCENTIVE DEDUCTIONS

Export relief, where the income is partly from agriculture

In *CIT* v. *Williamson Financial Services*,[45] the assessee grew and manufactured tea and exported it. Under rule 8(1) of the Income-tax Rules, 1962, 40 per cent of the composite income from sale of tea grown and manufactured is deemed to be liable to tax under the Act. For the purpose of the special deduction under section 80HHC of the Act, the assessee claimed that the special deduction was to be granted against the entire tea income

43 (2008) 301 ITR 309 (SC).

44 The court has noticed that for a detailed analysis of the rule of executive estoppel, useful reference may be made to the article authored by Francis Benion entitled "*Executive Estoppel: Pepper* v. *Heart Revisited"* published in *Public Law*, Spring 2007 at 1, which throws new light on the subject.

45 (2008) 297 ITR 17 (SC).

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before applying rule 8(1). The assessing officer rejected the claim and held that the deduction could be allowed only after apportionment between agricultural income and income chargeable to tax under the Act. The commissioner (appeals) reversed the order of the assessing officer but, on further appeal, the appellate tribunal restored the order of the latter. But the high court did not agree with the Tribunal and restored the order passed by the commissioner (appeals).

On appeal, the Supreme Court held that relief under section 80 HHC in the case of tea companies with composite income from agriculture as well as manufacture, has to be reckoned only against taxable non-agricultural income from tea on its ascertainment under rule 8(1). The reasoning is that what is not chargeable to tax under section 10(1) of the Act read with entry 82 of list I of the Seventh Schedule to the Constitution of India cannot fall under any of the heads of income under section 14 of the Act. Therefore, the non-agricultural income has to be computed first before the deductions under chapter VI-A could be granted. Since section 80A requires deduction only from gross total income, it cannot include agricultural income. The Supreme Court reversed the view taken by the Gauhati High Court in *Bazaloni Group Ltd.* v. *CIT*[46] and *CIT* v. *Williamson Financial Services Ltd.*[47] This issue was also the subject matter of decision in *UOI* v. *Warren Tea Ltd.*[48] where a division bench of the Calcutta High Court, reversing the judgment of a single judge, held that relief under section 80 HHC can be allowed only after apportionment of income from tea under rule 8. This view has now been specifically approved by the Supreme Court. This decision of the Calcutta High Court was not brought to the notice of the Gauhati High Court. The Calcutta High Court had also referred and endorsed the view taken by the Central Board of Direct Taxes in circular no. 600 dated 23.5.1991.[49]

Sub-section (4B) which was inserted in section 80HHC by the Finance Act, 1999 with retrospective effect from 1.4.1992, provides that "any income not charged to tax under this Act shall be excluded". This provision was relied upon in *Warren Tea Ltd.* It was felt that, the earlier circular has been given statutory recognition by this retrospective amendment as also explained in the board circular[50] no. 779 dated 14.9.1999 which is to the following effect:

> Forty per cent of income derived from the sale of tea grown and manufactured by the sellers in India is chargeable to tax and the balance is regarded as agricultural income not chargeable to tax. In some cases where the assessee is exporting tea, the deductions under section 80 HHC are claimed with reference to the composite

46 (2005) 272 ITR 11.
47 (2007) 290 ITR 385 (Gau) and (2007) 295 ITR 371 (Gau)
48 (2004) 266 ITR 226 (Cal).
49 (1991) 189 ITR (St) 126.
50 (1999) 240 ITR (St) 3 at 28.

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> income, including the income not chargeable to income-tax. For removal of doubts, it has now been clarified that for the purposes of computing deduction under section 80 HHC, the amount of income not being charged to tax under the Act shall not be eligible for deduction under this section.
> This amendment will take effect retrospectively from the 1st day of April, 1992, and will, accordingly, apply in relation to the assessment year 1992-93 and subsequent years.

Proportionate profits for exports are eligible for relief even where there is loss in exports

Where an exporter has both export and local sales, relief is available under section 80HHC(3)(b) on proportionate profits attributable to exports in relation to total sales. Even if there had been identifiable loss from export, the proportionate profit with reference to exports cannot be denied. The reasoning behind it is that a person may export at a loss or at some sacrifice, even where he could have made larger profits in local sales. Central Board of Direct Taxes' circular no. 564 dated 5.7.1990[51] has also recognized this principle. The Supreme Court has also now endorsed such a view in *Mysodet Pvt. Ltd.* v. *CIT*[52] reversing the decision of the high court.[53] This decision was based upon the usual misunderstanding of the ruling of the Supreme Court in *IPCA Laboratory Ltd.* v. *Deputy CIT*,[54] which applied for formula requiring the net income from profits from export of trading goods, manufactured goods and incentive profits to be positive, so that where there was loss, deduction was not available in circumstances where this formula was applicable and not where proportionate profits of own manufactured goods had to be determined. The Supreme Court, in the case under review, pointed out that the formula, which denied the deduction to the assessee in *IPCA Laboratory*, would allow it in the case before it. It further pointed out that the circular in its *illustration* has brought out the position of law clearly in favour of deduction. This decision would go a long way in clearing the mist around the decision in *IPCA Laboratory*.

Ceiling on total amount of deductions falling in chapter VI-A

Chapter VI-A of the Act contemplates granting of deductions in computing total income of the assessee on fulfilment of various parameters. The permissible deductions are specified in section 80C to section 80U. Sub-section (2) of section 80A any how provides that the aggregate amount of deductions under chapter VI-A cannot, in any case, exceed the gross total income of the assessee. Further, sub-section (5) of section 80-B provides that "gross total income" means the total income computed in accordance with the provisions of the Act before making any deduction under chapter VI-

51 (1990) 184 ITR (St) 137.
52 (2008) 305 ITR 276.
53 *CIT* v. *Mysodet Pvt. Ltd.*, (2008) 305 ITR 240 (Karn).
54 (2004) 266 ITR 521.

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A. The method of computation of total income has been detailed in chapter IV of the Act.

In *Synco Industries Ltd.* v. *Assessing Officer (IT)*,[55] the assessee company was engaged in the business of oil and chemicals. It had two units at two different places, one for its oil division and the other for its chemical division. It had earned profit in AYs 1990-1991 and 1991-1992 in both the units. However, it had suffered losses in the oil division in earlier years. It claimed deductions under section 80-HH and section 80-I of the Act, pleading that each unit should be treated separately and that the loss suffered by the oil division in earlier years should not be adjusted against the profits of the chemical division for the purpose of calculating permissible deductions under sections 80-HH and 80-I. But, since the gross total income of the assessee before deductions under chapter-VI-A was "Nil", the assessing officer held that the assessee was not entitled to the benefit of deductions under chapter VI-A of the Act. After unsuccessfully approaching the CIT (Appeals), ITAT and the high court, the assessee company filed the appeals before the Supreme Court.

Before the Supreme Court, besides reiterating the contention raised by it before the department, the appellant company further contended that under section 80-I(6), the profits derived from one industrial undertaking could not be set-off against loss suffered from another and the profit was required to be computed as if profit-making industrial undertaking was the only source of income for the purpose of incentive deductions.

Dismissing the appeals, the Supreme Court has held that section 80-A(1) has introduced a new concept of "gross total income" as distinguished from the "total income" i.e., the net or taxable income. Section 80-B(5) defines the expression "gross total income". The effect of sections 71, 72 and 32(2) is that while computing the total income, the losses carried forward and depreciation have to be adjusted and thereafter the assessing officer has to work out the gross total income of the assessee. In view of section 80-A(2), if the gross total income is found to be a net loss on account of the adjustment of losses of the earlier years or "Nil", no deduction under chapter VI-A can be allowed.

Moreover, predominant majority of the High Courts like Madras,[56] Calcutta,[57] Bombay,[58] Delhi,[59] Allahabad[60] and Karnataka[61] have taken the

55 (2008) 299 ITR 444 (SC).

56 *CIT* v. *Madras Motors (P) Ltd.*, (1984) 150 ITR (Mad); *CIT* v. *Midda Ram*, (1984) 19 Taxman 23 (Mad); *CIT* v. *Rambal (P) Ltd.,* (1988) 169 ITR 50 (Mad); *CIT* v. *Sundraavel Match Industries (P) Ltd.*, (2000) 245 ITR 605 (Mad).

57 *CIT* v. *Bengal Assam Steamship Co. Ltd.*, (1985) 155 ITR 26 (Cal); *G-Altherton & Co.* v. *CIT*, (1987) 165 ITR 527 (Cal); *Orient Paper Mills Ltd.* v. *CIT*, (1986) 158 ITR 695 (Cal).

58 *CIT* v. *Mercantile Bank Ltd.*, (1988) 169 ITR 44 (Bom); *CIT* v. *Nima Specific Family Trust*, (2001) 248 ITR 29 (Bom).

59 *CIT* v. *Atam Ballabh Finance (P) Ltd.,* (2002) 258 ITR 485 (Del).

60 *CIT* v. *Lucky Laboratories Ltd.,* (2006) 284 ITR 435 (All).

61 *CIT* v. *R.P.G. Telecoms Ltd.*, (2007) 292 ITR 355 (Kant).

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view that deductions under chapter VI-A of the Act would be available only if computation of gross total income as per the provisions of the Act after setting off carried forward loss and unabsorbed depreciation of earlier years is not “Nil”. The Supreme Court has taken it to be well settled that where the predominant majority of the high courts have taken certain view on the interpretation of certain provisions, the Supreme Court would lean in favour of the predominant view. Therefore, it is held that the high court was justified in holding that gross total income must be determined by setting off against the income, the business losses of earlier years, before allowing deduction under chapter VI-A and if the resultant income is found to be “Nil”, then the assessee cannot claim any deduction under chapter VI-A of the Act.

According to the Supreme Court, it is true that under section 80-I(6) for the purpose of calculating the deduction, the loss sustained in one of the units, cannot be taken into account because sub-section (6) contemplates that only the profits shall be taken into account as if it was the only source of income. However, section 80-A(2) and section 80-B(5) are declaratory in nature. They apply to all the sections falling in chapter VI-A. They impose a ceiling on the total amount of deduction and therefore the *non-obstante* clause in section 80-I(6) cannot restrict the operation of sections 80-A(2) and 80-B(5) which operate in different spheres.[62]

Duty drawback and cash compensation

Duty draw back and cash compensation export incentive may be either by way of import licence, cash compensation or duty-draw back. Cash compensatory support and duty draw back could be eligible profit for the purposes of section 80 HHC in view of board circular no. 564 dated 5.7.1990[63] and circular no. 571 dated 1.8.1990.[64]

In *B. Deshraj* v. *CIT*,[65] the assessee was engaged in the business of exporting fabrics to Bangladesh. Consequent upon exports made by him, inward remittance came into India during the accounting year ending 31.3.1990, the relevant assessment year being 1990-91, as an incentive for the said exports. The assessee received cash compensatory allowance and duty draw backs during the accounting year ending 31.3.1991, corresponding to the assessment year 1991-92. The claim of the assessee for the deduction under section 80HHC in respect of the said incentives made during the assessment year 1991-92 was rejected by the assessing officer on the ground that it did not constitute eligible income deductible from the gross total income under section 80HHC, since there was no export by the assessee during the relevant previous year ending on 31.3.1991. On appeal, though the claim was allowed by the tribunal but the high court reversed the same. The Supreme Court, on appeal, reversed the decision of the high court by holding

62 *IPCA Laboratory Ltd.* v. *CIT,* (2004), 12 SCC 742, followed.
63 (1990) 184 ITR (St) 137.
64 (1990) 185 ITR (St) 9.
65 (2008) 301 ITR 439 (SC).

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that in view of the amendment to section 28 by insertion of clause (iiib) in the Act and the circular issued by the Central Board of Direct Taxes, the department had to allow the deduction under section 80HHC in relation to the above export incentives during the assessment year 1991-92. The reasoning adopted by the Supreme Court is that the export incentives received by the assessee were profits of business for the purpose of calculating deduction under section 80HHC(3) of the Act.

XIII INTEREST

Power of reduction or waiver

Section 220(2A) of the Act confers jurisdiction upon the chief commissioner or commissioner to reduce or waive the amount of interest paid or payable by an assessee thereunder if he is, *inter alia*, satisfied that the payment of such amount has caused or would cause genuine hardship to the assessee. In *B.M. Malani* v. *CIT*,[66] the Supreme Court, for the purpose of interpretation of the word "genuine", relied on the meaning given in New Colins *Concise English Dictionary* according to which it means "not fake or counterfeit, real, not pretending (not bogus or merely a ruse)". It has been held that for interpretation of the provisions contained in section 220(2A) of the Act, the principle of purposive interpretation should be resorted to. The ingredients of genuine hardship must be determined keeping in view the dictionary meaning thereof and the legal conspectus attending thereto. For the said purpose, another well-known principle, namely, a person cannot take advantage of his own wrong may have to be borne in mind. For applying the said principle, the court has referred to a few precedents operating in the field.[67] The court has further clarified that a statutory authority must act within the four corners of the statute. The court has held that genuine hardship would, *inter alia*, mean a genuine difficulty that *per se* would not lead to the conclusion that a person having large assets could never be in difficulty as he can sell those assets and pay the amount of interest levied. The discretion conferred on the commissioner has to be exercised judiciously. This case lays down the well-established principles of administrative law pertaining to exercise of discretion vested in public and statutory authorities in a fair and judicious manner.

XIV KAR VIVAD SAMADHAN SCHEME, 1998

Parliament enacted the Finance (No. 2) Act, 1998, *inter alia,* framing a scheme known as Kar Vivad Samadhan Scheme, 1998 ("the scheme"). This

66 (2008) 306 ITR 196 (SC).

67 *Priyanka Overseas Pvt. Ltd.* v. *Union of India*, 1991 Supp(1) SCC 102, para 39; *Union of India* v. *Major General Madan Lal Yadav*, (1996) 4 SCC 127, paras 28-29; *Ashok Kapil* v. *Sanaulla*, (1996) 6 SCC 342, para 7; *Sushil Kumar* v. *Rakesh Kumar* (2003) 8 SCC 673, para 65; *Kusheshwar Prasad Singh* v. *State of Bihar*, (2007) 11 SCC 447, paras 13, 14, 16.

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scheme provided for settling tax arrears by paying 50% of the disputed amount thereof. The scheme was operative from 1.9.1998 to 31.1.1999. It provided that any tax arrears can be settled by declaring them and paying the prescribed amount of tax arrears. The scheme also offered impunities from penalty and prosecution.

The object of the scheme was to make an offer by the central government to settle tax arrears locked in litigation by giving multifold incentives. It had been found to be beneficial both for the revenue as also the tax payers. Despite this, the scheme has given rise to good number of litigations in the high courts and the Supreme Court, particularly pertaining to its applicability. In most of the cases, it has happened because of unwarranted or misplaced interpretations given by the designated authorities created under the scheme for entertainment of the declaration filed by the tax payers seeking settlement. Sometimes, the tax payers also have tried to take benefit of the scheme by overstretching its application.

Meaning of " pending appeals" for the purpose of the scheme

In *Swan Mills Ltd* v. *Union of India*,[68] the assessee was engaged in the business of manufacturing yarn and fabric. For the period between October 1994 to February 1997, it was served with show cause notices for recovery of differential excise duty of approximately Rs. 50 lakhs. On adjudication by the Assistant Commissioner of Central Excise, the demand was confirmed subject to re-computation by the range inspector. He also imposed penalty of Rs. 5,000/-. This order was passed on 12.11.1997. The range inspector re-worked the demand which came to Rs. 9,40,752/-. Therefore, fresh demand notices were issued on 18.5.1998.

Dissatisfied with the above demand notices, the assessee preferred appeal before the Commissioner of Central Excise (Appeals) on 2.9.1998. The appeal was dismissed by an order dated 25.2.1999 as barred by limitation. But before the appeal was so dismissed, the assessee filed a declaration under section 89 of the scheme before the designated authority on 31.12.1998. This declaration was rejected by the authority *vide* his order dated 25.2.1999 on the ground that the appeal filed by the assessee came to be rejected as barred by limitation.

Aggrieved by the order dated 25.2.1999 passed in the above referred appeal, the assessee preferred second appeal before the appellate tribunal, which by its order dated 29.11.1999 held that the appeal filed before the commissioner was well within time and remanded the matter for fresh disposal in accordance with law.

After passing of the order by the tribunal, the assessee approached the designated authority for reconsideration of its order dated 25.2.1999 to allow him the benefit of the scheme, but his request was rejected on the plea that the scheme itself was not in existence after 31.1.1999. Thereupon, the

68 (2008) 296 ITR 1 (SC).

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assessee approached the high court for remedying its grievance. The high court took the view that since the appeal was filed after the period of limitation and delay was not condoned, the assessee was not entitled to the benefit of the scheme. On further appeal, the Supreme Court, after examining the various provisions of the scheme and earlier judgments in *Mrs. (Dr.) Renuka Dalta* v. *CIT*[69], *Raja Kulkarni* v. *State of Bombay*[70] and *Tirupati Balaji Developers P. Ltd* v. *State of Bihar*[71] held that when a statutory provision contemplates "pendency of appeal", the appeal does not cease to be an appeal though irregular or incompetent. Accordingly, on the facts of the present case, the Supreme Court held that the appeal filed by the assessee should be treated as pending on the date when the declaration under section 89 of the scheme was filed and accordingly, the order of the designated authority was quashed.

It is of significance to note that the designated authority, *vide* its order dated 25.2.1999, had refused to entertain the declaration filed by the assessee on the plea that the scheme itself had ceased to exist after 31.1.1999 and held that even if the declaration filed by the assessee is treated to be maintainable, still because of lapse of the scheme itself, no relief can be granted. It is submitted that though this aspect has not been specifically considered by the Supreme Court while granting the relief to the assessee but it should be taken as implicit that once the declaration filed by the assessee under section 89 of the scheme is found to be in order, despite lapse of the scheme, the designated authority is bound to grant appropriate relief. It is so because nobody can take benefit of his own wrong. Further, it is well-settled that, "If the right created by the statute is of an enduring character and has vested in the person, that right cannot be taken away because the statute by which it was created has expired."[72]

Application of the scheme to state legislations

In of *Master Cable P. Ltd.* v. *State of Kerala & Anr.*[73] the question before the Supreme Court was whether in view of sub-section (3) of section 90 of the scheme, benefits thereunder can be extended to the disputed demands arising under the sales tax law of the states as well. Sub-section (3) of section 90 of the scheme reads as under:

> 90(3). Every order passed under sub-section (1), determining the sum payable under this Scheme, shall be conclusive as to the matters stated therein and no matter covered by such order shall be reopened in any other proceeding under the direct tax enactment or indirect tax enactment or under any other law for the time being in force.

69 (2003) 259 ITR 258.
70 AIR 1954 SC 73.
71 (2004) 5 SCC 1.
72 *State of Orissa* v. *Bhupendra Kumar*, AIR 1962 SC 945 at 954.
73 (2008) 296 ITR 8 (SC).

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The assessee, who wanted to avail the benefit of the scheme in relation to his disputed tax arrears and punitive action arising under the state sales tax law, raised the plea that even the disputed arrears of sales tax under the state legislation will also be covered by the scheme because of the use of the expression "under any other law for the time being in force" in section 90(3) quoted above.

The Supreme Court, while rejecting the plea of the assessee, rightly held that the amplitude of the provisions of the scheme having been extended only to the enactments made by Parliament having regard to the constitutional scheme contained in article 246 of the Constitution of India, the same cannot be extended to assessment of sales tax under state legislation. It has been further held that the legislative field to enact a law relating to sales tax is within the exclusive domain of the state legislature in terms of entry 54, List II of the Seventh Schedule of the Constitution and therefore, Parliament could not have made any law in respect thereof.

XV MINIMUM ALTERNATE TAX

The purpose of introducing section 115-J providing for a minimum alternate tax law was to enable the income-tax authorities to bring certain companies which were adjusting their accounts in such a manner as to attract no tax or very little tax within the net of income tax. Anyhow, where the assessee adopts the income tax rate of depreciation consistently, there is no justification of making adjustment to the book profits required to be computed under section 115-J by substituting company law rate. It has so been held by the Supreme Court in *Malayala Manorma Co. Ltd.* v. *CIT*[74] following its earlier decision in *Apollo Tyres Ltd.* v. *CIT*.[75] However, it is submitted that these decisions would not help the tax payers following income tax rate for computing book profits under sections 115-JA and 115-JB, since these provisions stand differently requiring the depreciation to be computed under section 210 of the Companies Act, 1956.

XVI PENALTY

The question which came up for consideration in *CIT-I, Ahmedabad* v. *Gold Coin Health Food Private Limited*[76] was whether the amendment made by the Finance Act, 2002 w.e.f 1.04.2003 in *Explanation* 4 to section 271(1)(c)(iii) was clarificatory or substantive in nature and thereby whether retrospective or prospective. It was held by the Supreme Court that the above *Explanation* is clarificatory and not substantive and therefore, would have retrospective application. The fact that the amendment was made operative

74 (2008) 300 ITR 251 (SC).
75 (2002) 255 ITR 273 (SC).
76 (2008) 9 SCC 622.

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from a later date did not decide its nature. The scheme of the statute prior and subsequent to the amendment had to be examined. The circumstances and the consequences of the amendment would have to be taken note of while deciding the nature of the amendment. The view expressed to the contrary in *Virtual Soft Systems* v. *CIT*[77] was rejected as incorrect by the court. Even during the period prior to the amendment, the position was that the penalty was leviable even in case where addition of concealed income reduced the returned loss or resulted in a profit which was less than the concealed income. The amendment simply made the position in law explicit which was previously implied.

Another important issue dealt with in one of the judgments under review relates to the nature of penalty in the context of taxing laws. The Supreme Court in *Union of India* v. *Dharmendra Textiles Processors*,[78] while dealing with an excise matter, has incidentally held that the provision for penalty under section 271(1)(c) is a civil liability. Wilful concealment or *mens rea* is, therefore, not an essential ingredient for imposing penalty under section 271(1)(c). Reference was made to a catena of decisions[79] wherein it was held that *mens rea* is not an essential element for imposing penalty for breach of civil obligations. The section indicates the elements of strict liability on the assessee for concealment or for giving inaccurate particulars while filing the return. The object of the enactment was to provide for a remedy for loss of revenue. However, it may be noted that the Supreme Court in *CIT* v. *Anwar Ali*[80] (a three-judges bench), while taking note of earlier Supreme Court[81] judgment and the English law,[82] had held that the true nature of a penalty is the imposition of an additional tax. It further held that one of the principal objects of section 28 (of the Income-tax Act, 1922) is to provide a deterrent against recurrence of default on the part of the assessee and hence, the proceedings are of a penal nature. Now, in view of the decision in *Dharmendra Textiles Processors*, to the effect that provision for penalty is a civil liability and is a remedy for loss of revenue, there seems to be a paradigm shift, and to some extent an apparent contradiction, in judicial approach pertaining to penalties and taxing laws. It is noteworthy

77 (2007) 9 SCC 665.

78 (2008) 306 ITR 277 (SC).

79 *Directorate of Enforcement* v. *M.C.T.M. Corporation P. Ltd.*, (1996) 2 SCC 471; *J.K. Industries Ltd.* v. *Chief Inspector of Factories and Boilers*, (1996) 6 SCC 665; *R.S. Joshi* v. *Ajit Mills Ltd.*, (1977) 4 SCC 98, *Gujarat Travancore Agency* v. *CIT*, (1989) 3 SCC 52.

80 (1970) 2 SCC 185.

81 *Hindustan Steel Ltd.* v. *State of Orissa*, (1969) 2 SCC 627, (three-judges bench holding that in sales tax laws, an order imposing penalty is the result of a quasi-criminal proceeding. Penalty will not ordinarily be imposed unless the party obliged either acted deliberately in defiance of law or was guilty of conduct contumacious or dishonest, or acted in conscious disregard of its obligation. Penalty will not also be imposed merely because it is lawful to do so).

82 *Fattorini (Thomas) (Lanchashire) Ltd.* v. *Inland Revenue Commissioner,* (1943) (11) ITR Supp 50.

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that both the decisions – *Dharmendra Textiles Processors* and *Anwar Ali* – were rendered by a bench of three judges. *Dharmendra Textile* has been rendered without taking note of *Anwar Ali*. It is, therefore, submitted that the law in this regard requires to be settled by a larger bench.

XVII PROVISION FOR BAD AND DOUBTFUL DEBTS

The controversy as to whether provision for bad and doubtful debts is a provision for an ascertained liability so that it should have ordinarily been deductible in computation of book profits, is now brought to an end by the apex court in *CIT* v. *HCL Comnet Systems and Services Ltd.*[83] The Supreme Court has pointed out that where the books of account are duly certified as having been maintained in accordance with the Companies Act, 1956 the assessing officer has jurisdiction only to make such adjustments as provided in the *Explanation* to section 115-JA. He cannot travel beyond the same as also pointed out by the Supreme Court in *Apollo Tyres Ltd.* v. *CIT*.[84] A provision for bad and doubtful debt is not a provision for liability. It is only meant to cover up probable diminution in the value of assets being debts receivable. Such a provision is not a provision for liability because even if the debt is not recovered, no liability can be fastened on the assessee. It is under these circumstances that the Supreme Court, affirming the decision of the Delhi High Court,[85] held that the assessing officer was not justified in adding back the provisions so made.

XVIII RECOVERY OF TAX

Garnishee proceedings

In *Administrator, Unit Trust of India* v. *B.M. Malani*,[86] an important question relating to interpretation of sub-section (3) of section 226 of the Act came for consideration. This sub-section empowers the income tax officer to initiate garnishee proceedings against the debtor of the assessee who defaulted in payment of tax.

In this case, the respondent-assessee had invested an amount of Rs. 65 lakhs in Monthly Income Scheme (III) offered by the Unit Trust of India. Admittedly, the assessee was a defaulter in payment of income tax to the tune of about Rs. 48 lakhs. The income tax officer, having learnt about the assessee's investment with UTI issued notice dated 8.2.2002 to the branch manager, UTI under section 226(3) of the Income Tax Act, *inter alia*, requiring him to pay any money which may become due from UTI to the assessee to the extent of the amount of arrears.

83 (2008) 305 ITR 409 (SC).
84 (2002) 255 ITR 273 (SC).
85 *CIT* v. *HCL Comnet Systems and Services Ltd.*, (2007) 292 ITR 299 (Del).
86 (2008) 296 ITR 31 (SC).

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The manager UTI, on receiving the aforesaid notice under section 226(3) of the Act, paid a sum of Rs.43,69,083.30 to the department by calculating the current prevailing price of the units at the rate of Rs.6.93 per unit. It was so done without the consent of the assessee. Admittedly, the value of the unit had not become due to the assessee on the date on which notice under section 226(3) was served. Therefore, the assessee questioned the said action of the UTI by filing writ petition before the high court, which was partly allowed by holding that the assessee was entitled to the redemption value of the units at the rate of Rs. 10 per unit on completion of the locking period which was of five years.

On an appeal filed by the UTI, the Supreme Court has held that the UTI, which is also "State" within the meaning of article 12 of the Constitution of India, has acted illegally in prematurely disposing off the units in breach of the contract with the assessee, causing substantial loss to him. It has been noticed by the Supreme Court that the assessee's investment in the Monthly Income Plan (III) offered by the UTI constituted a contract between the two parties. The relevant provisions of the plan showed that the locking period was of five years. Though redemption of the unit was allowed from 1.9.2001 at NAV purchase price, but the option of redemption was to be exercised only by the unit holder. The UTI, despite the notice under section 226(3), could not have placed itself in the shoes of the unit holder. Keeping in view the above aspects, the Supreme Court has held that sub-section (3) of section 226 of the Act would have been applicable only when money fell due to the unit holder i.e., the assessee on completion of the locking period. It was further held that on the date when the notice under section 226(3) of the Act was issued to the UTI, no money was due from it to the assessee. According to the court, neither the UTI nor the income tax officer could have exercised the option on behalf of the assessee. The Supreme Court not only affirmed the judgment of the high court granting restitution but also held that the assessee was also entitled to the dividend declared during the period starting from the date of allotment.

The Supreme Court has rightly observed that UTI being a statutory authority should have acted strictly in terms of the conditions of the contract. It was to act reasonably, fairly, with prudence and sensitivity towards the interest of the investor. The law declared by the Supreme Court in this case will squarely apply to garnishee proceedings contemplated under order 21, rules 46-A to 46-I of the Code of Civil Procedure, 1908.

Sale by auction of property of defaulter

The law makes a clear distinction between a stranger who is a *bona fide* purchaser of the property at an auction sale and the decree-holder who purchases at the auction. Strangers to the decree are afforded protection by the court because they are not connected with the decree. Unless the protection is extended to them, the court sale would not fetch the market value or fair price of the property.

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In *Janatha Textiles* v. *Tax Recovery Officer*,[87] the appellants (a firm and its partners) had been assessed to tax for the assessment years 1985-86, 1986-87, 1987-88 and 1989-90. Recovery of all demands pertaining to the assessment years 1986-87 to 1989-90 had been stayed and only the demand for the assessment year 1985-86 was to be recovered. An amount of Rs. 5,68,913 was due for that year towards tax, penalty and interest. For recovery of this amount agricultural lands owned by the partners were brought to sale in public auction in proceedings under Schedule II to the Act and the sale to an independent purchaser, who offered the highest price, was configured. No procedural irregularity or illegality was alleged by the appellants. The appellants filed a writ petition challenging the sale and many hyper-technical grounds were raised. The department contended that the appellants had an effective alternative remedy under rules 60 and 61 of Schedule II to the Act. The high court dismissed the writ petition. On appeal, the Supreme Court, while affirming the decision of the high court, held that the appellants ought to have availed of the statutory remedy for ventilating their grievances under rules 60 and 61 of Schedule II. It was further held that the *bona fide* purchaser of the property of the appellants in the valid auction could not be disturbed as according to the well-established principle of law that a third party auction purchaser continues to be protected notwithstanding that the underlying decree might be set aside.

XIX SEARCH AND SEIZURE – BANK ACCOUNT

In *KCC Software Ltd.* v. *Director of Income- Tax (Investigation)*,[88] as part of a search under section 132 of the Act, the department seized certain jewellery, cash and fixed deposit receipts. Thereafter, the authorities not only issued restraint orders on the bankers of the assessee but also required the banks to issue demand drafts out of the balances in those accounts as well as for the values of fixed deposits favouring the Deputy Commissioner of Income Tax. The assessee filed a writ petition challenging the validity of the search but the high court dismissed it. On appeal the Supreme Court held that cash in bank was conceptually different from cash on hand and it was not permissible for the department to convert assets to cash and thereafter impound it.

The Supreme Court has further held that when moneys are deposited in a bank, the relationship between the banker and the customer is one of debtor and creditor and not trustee and beneficiary. The banker is entitled to use the monies without being called upon to account for such user, his only liability being to return the amount in accordance with the terms agreed between him and the customer. It makes no difference in the jural relationship whether the deposits were made by the customer himself, or by some other persons,

87 (2008) 301 ITR 337 (SC).
88 (2008) 298 ITR 1 (SC).

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provided the customer accepted them. There might be special arrangement under which a banker might be constituted a trustee, but apart from such an arrangement, his position *qua* banker is that of a debtor, and not trustee. In holding so, the Supreme Court has applied the law laid down in *Foley* v. *Hill*[89] and *Shanti Prasad Jain* v. *Director of Enforcement*[90] applied.

XX SUBSIDY

Capital or income

The character of the receipt of a subsidy in the hands of the assessee under a scheme has to be determined with respect to the purpose for which the subsidy is granted. In other words, one has to apply the purpose test. The point of time at which the subsidy is paid is not relevant. The source is immaterial. If the object of the subsidy is to enable the assessee to run the business more profitably then the receipt is on revenue account. On the other hand, if the object of the assistance under the subsidy scheme is to enable the assessee to set up a new unit or to expand an existing unit then the receipt of the subsidy would be on capital account.

This, as stated above, has been laid down by the Supreme Court in *Commissioner of Income-tax* v. *Ponni Sugars and Chemicals Ltd.*[91] In this case the assessee was a co-operative society running a sugar mill. During the relevant year in question, on account of various factors, it was not economically viable to run new sugar factories and, due to high financial costs, financial institutions did not come forward to advance loans to the entrepreneurs of new sugar factories. The tempo of establishing new sugar factories received a serious setback. A committee appointed by the government recommended that five possible incentives for making a sugar plant economically viable could be provided for, viz., capital subsidy, larger percentage of free sale of sugar, higher levy sugar price, allowing rebate on excise duty and remission of purchase tax. Following that report, schemes were formulated giving the following benefits: (i) incentive subsidy available only in new units and to substantially expanded units; (ii) minimum investment for new units and expansion of existing units; (iii) increase in free sugar sale quota. The benefit of the schemes had to be utilized only for repayment of loans. The department and the high court had held that the receipts from government under the incentive schemes were in the nature of revenue. On appeal, the Supreme Court, while reversing the decision of the high court, held that the main eligibility condition in the schemes was that the incentive had to be utilized for repayment of loans taken by the assessee to set up new units or for substantial expansion of an existing unit. The subsidy received by the assessee was not in the course of a trade but was of a capital nature.

89 (1848) 2 HLC 28.
90 (1963) 33 Comp Cas 231.
91 (2008) 306 ITR 392 (SC).