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DIRECT TAX LAW (INCOME TAX)

*R Venkataramani**

I INTRODUCTION

THE YEAR under review witnessed the rendering of very important opinions by the Supreme Court. One of the major concerns of the people and of governance has been, and continues to be the gathering of information suggesting confidentially held monies in secret bank accounts outside India. The Supreme Court dealt with the question of the obligation of the state to divulge information and the rights of the citizens to access such information in *Ram Jethmalani* v. *Union of India.*[1] The Supreme Court also delivered an important judgment on the scope and application of section 115 JB. In yet another significant case, the Supreme Court dealt with extra territorial applications of the Income Tax Act in *GVK Industries Ltd* v. *ITO.*[2] The judgment feliticiously covers the relevant provisions of the Constitution, and has culled out the intricate dimensions of extra territorial application of domestic legislations, keeping in mind contemporary developments owing to globalization. As usual, a number of cases under section 260A relating to appeals to the high court have been decided by high courts. The authority for advance ruling has also rendered a large number of opinions covering a wide range of issues, including cases relating to business expenditure, nature of income, interest and principle of mutuality as also cases relating capital and revenue expenditure.

II APPEAL TO THE HIGH COURT AND SECTION 260A

The manifold dimension of substantial questions of law keep coming up almost every year and the digest of cases seems to be bulging. This happens despite the broad but well defined contours of an appeal under section 260A. The parallel with section 100-A CPC is also available. In the following cases the Supreme Court had to remand matters to the high court for reconsideration on a proper appreciation of the nature and scope of the appellate jurisdiction under section 260A.

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* Senior Advocate, Supreme Court of India and Member - Law Commission of India. The author is grateful to Anandh Venkataramani and Shankey Agrawal, Advocates for the research assistance and also acknowledges the use of landmark case notes by Rajaratnam, former member, ITAT.

1 [2011] 339 ITR 107 (SC).

2 [2011] 332 ITR 130 (SC).

In *Motor & General Finance Ltd* v. *CIT* [3] the Supreme Court found that the question as to whether certain transactions constituted financial transactions which may attract the provisions of Interest Tax Act, 1974 had not been examined by the high court and, therefore, remanded the matter back to it.

Even though the decisions in *CIT* v. *Sitamur Truck Operators Union* (No. 2)[4] and *CIT* v. *Oswal Agro Mills Ltd.*[5] were decided in the year 2008 and reported in 2009, the judgments have gone unnoticed in the matter of delineating substantial question of law.

It is submitted that a second appellate court is called upon to perceive a substantial question of law whether framed or not by the parties. This has to be done on the totality of the decisions under appeal. It may not be appropriate for the court to traverse the decisions set as a second court of appeal on facts and then come to a conclusion as to the existence or otherwise of a substantial questions of law.

In *H and M Information Technology Ltd.* v. *Asst. CIT*[6] when the appeal was taken up for hearing, the appellant submitted that one other substantial question of law also arose for consideration, namely, that the "reopening of assessment by invoking sections 147 and 148 of the Income Tax Act was not maintainable". The Madras High Court held that when the issue went before the tribunal, that issue came to be dealt with in *extenso* by the tribunal. In such circumstances, the issue relating to the validity of reopening of the assessment was fully contested by the parties before the tribunal. Therefore, merely because the said issue was not specifically formulated as a question of law while entertaining this appeal, it could not be held that the question should not be allowed to be agitated without formulating a question of law. The appellant had been agitating the question, right from the issue of the notice under section 148 of the Act.

That apart, under section 260A of the Act, the proviso to sub-section (4) specifically provides that nothing in the sub-section should be deemed to take away or abridge the power of the court to hear the appeal on any other substantial question of law not formulated by it, if the case involved such a question. Therefore, there was power vested in the court to deal with the substantial question of law not formulated at the time when the appeal was entertained, provided that such a question was involved in the case.

In *CIT* v. *West Bengal Infrastructure Development Finance Corporation Ltd.*,[7] the Supreme Court reasoned that having regard to the amount of tax involved the high court ought to have decided the matter on merits. The court further observed that in all cases where there was delay on the part of the department, the high court should consider imposing costs but it should examine the cases on merits and should not dispose of them merely on the ground of delay, particularly when huge stakes were involved.

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3 [2011] 334 ITR 33 (SC).
4 [2009] 313 ITR 27 (SC).
5 [2009] 313 ITR 24 (SC).
6 [2011] 332 ITR 403 (Mad).
7 [2011] 334 ITR 269 (SC).

III BUSINESS INCOME AND INCOME FROM OTHER SOURCES; AND BUSINESS EXPENDITURE

The issue of identification of the nature of income is always beset with issues of fact and the appreciation of fine distinction between different sources of income. The decision of the Delhi High Court in *CIT* v. *D.S. Promoters & Developers,*[8] however, misses the fine distinctions. There the assessee had let out a building taken on lease and it was let out for a restaurant business. The assessee was in the business of promotion of real estate. The high court was persuaded by the tribunal's finding treating the income as one from business. Facts such as that the property was used for a restaurant business, or that the building was renovated at substantial cost seem to have been wrongly led to such a view. It is clear in such circumstances that where the income in question had no nexus with the business of the assessee, it should be treated as income from other sources.

In *CIT* v. *H.S. Ramachandra Rao*[9] the high court held that the compensation received by the assessee, on relinquishment of membership and the office of secretary of an educational society would be assessable under the head 'other sources.' The assessee claimed that the compensation was the capital received without being liable for capital gain tax. The high court drew the above inference on the premise that the compensation was not for his service as an employee but for surrender of office. The inference seems to be open to some doubts. The compensation was not for giving up a source of income, since the assessee's office was in an honorary capacity. Section 28(ii) applicable for cases of compensation covered by business may not be strictly relevant.

Whether a one time receipt can be called 'income'

An interesting case relating to the concept of 'income' was dealt with in *CIT* v. *David Lopes Menezes (Late)*.[10] Members of a family had a controlling interest in a company. The company requested them to pass a resolution in the general meeting to give up the right to marketing, selling and distribution of the product in favour of company. They exercised their votes in favour of surrender of the right to use the trade mark by the company. The amount received in consideration for exercising the votes was claimed to be a capital receipt. The assessing officer (AO) understood the payment as a receipt for transfer of the trade mark. It was canvassed that the windfall arising out of one time affirmative voting on a resolution not being repetitive and unlikely to happen again did not have the character of income. The high court accepted the claim. The court went by the concurrent findings of the authorities below that the market right and the right to use the trade mark in question had come to an end on a certain day and that the money that was received must be held to be not by way of diminution in the value of the equity shares of the company arising out of giving up of the marketing rights. Another important factor was that if the money was received on account of diminution in the value of the equity shares of the company, the money would have been distributed proportionately between the

8 [2011] 330 ITR 291 (Del).
9 [2011] 330 ITR 322 (Kar).
10 [2011] 336 ITR 337 (Bom).

share holders in proportion of the shares held by them. Similar money was not to be paid to the members at any time in the past and never intended to be paid in future. Thus, it was a receipt by way of a windfall and not income within the meaning of section 2(14). It is a moot point, however, as to whether the conduct of voting or any such action on the part of assessees by which they become beneficiaries as directors and share holders, should not lead to treating the receipt on their hands as income within its wider meaning.

Business expenditure

Ordinarily, expenditure on minor repairs of a machine would be deductible. Where, however, there is a complete breakdown of a machine following long use whether expenditure of overhauling and reconditioning would fall within the meaning of current repairs under section 37 of the Act, was held against the assessee in *Bharat Gears Ltd* v. *CIT*.[11] It appears that the view of the high court is not free from doubt. Replacement of parts which have become decrepit and old, are generally treated as repairs. Some element of misconception relating to reconditioning and replacement seem to have persuaded the high court to place wrong reliance on two decision of the Supreme Court.[12] It does not appear the decisions of the Supreme Court can justify the reading of section 31 as was done by the high court.

The question whether ransom paid for the release of a whole time director of a company, would qualify for deduction came up for consideration in *CIT* v. *K.M. Jain, Tobacco Products P. Ltd.*[13] There the tribunal found that the decision to pay the ransom was taken in the course of business, necessitated by commercial expediency. It is not the duty of the employer to protect the employee. Payment of ransom by itself was not for any legal purpose and the explanation to section 37 (1) would not have been attracted.

IV CHARITABLE INSTITUTIONS

Registration of charitable institutions under sections 12A and 12AA is often dealt with a certain amount of undisclosed reluctance and an undue strictness. The Rajasthan High Court, Allahabad High Court, Andhra Pradesh High Court and the Madhya Pradesh High Court have dealt with the proper approach in the matter of registration of charitable trusts. It is interesting to notice that in all such instances only agriculture produce marketing committees had applied for registration. In *CIT* v. *Krishi Utpadan Mandi Samiti*[14] the High Court of Allahabad explained the propriety of condonation of delay in applying for registration. Once registration was effected under section 12AA, the entitlement of exemption under section 11 was not to be determined by any enquiry into the question whether the charitable trust fulfilled the conditions under sections 11 and 12. The Gujarat High Court in

11 [2011] 337 ITR 368 (Del).

12 *CIT* v. *Shri Mangayarkarari Mills P. Ltd.* [2009] 315 ITR 114 (SC) and *CIT* v. *Sarvana Spinning Mills P. Ltd.* [2007] 293 ITR 201 (SC).

13 [2012] 340 ITR 99 (MP).

14 [2011] 331 ITR 154 (All).

Ahmedabad Urban Dev. Authority v. *Dy. DIT* [15] rightly appreciated the scheme of sections 11 and 12AA and faulted the AO from entering into any such enquiry. The Delhi High Court in *DIT* v. *Shree Visheshwar Nath Memorial Public Ch. Trust*[16] granted exemptions to a charitable trust whose income was invested in debentures. The high court endorsed the reliance placed upon the definition of debenture provided in section 2(12) of the companies act, 1956. Debentures being treated as bonds, the assessee could not be said to have contravened the provisions of section 13 (1) (d) of the Income Tax Act, 1961.

Three decisions of the Punjab & Haryana High Court[17] dealt with questions of the amount of expenditure incurred by charities for acquiring capital assets and deduction of such expenditure from their income and the allowance of depreciation. It may be pointed out that the Direct Taxes Code Bill, 2010 allows costs of the assets used in business as a deduction in computation of income required to be applied or accumulated, so that the question of depreciation would not arise under the Code. But the present law does not allow the capital expenditure in computation of income for purposes of application or accumulation. The view expressed in debatable issues on guidance note on audit of public charitable institutions under the Income-Tax Act, 1961 had probably given rise to the doubt, which can now be taken as having been resolved by the decisions of the high court.[18]

The high courts have come to the rescue of the charitable institutions in the context of registration. In *CIT* v. *Lucknow Educational & Social Welfare Sy.,*[19] the High Court of Allahabad held that the body formally formed and providing for objects which were charitable and activities whose genuineness could not be doubted was entitled to registration under section 12AA. Moreover, when the objects qualified for registration, within the meaning of section 2(15) of Income Tax Act, registration could not be denied. [20] The grant of approval under section 10(23C) must also receive a similar approach. Mere acceptance of amounts received as admission fees, donations, corpus or otherwise and loans from parents, would be no basis to infer diversion of funds to the members of the society.[21]

V BONUS - ELIGIBILITY FOR DEDUCTION

The question whether bonus not being ex-gratia should be eligible for deduction under section 37 has been considered by the Madhya Pradesh High Court in *Bhagwandas Shobhalal Jain* v. *Dy. CIT.*[22] It may be noticed that by the Direct

15 [2011] 335 ITR 575 (Guj).

16 [2011] 333 ITR 248 (Del).

17 *CIT* v. *Market Committee, Pipli* [2011] 330 ITR 16 (P&H); *CIT* v. *Tiny Tots Educational Society* [2011] 330 ITR 21 (P&H) and *CIT* v. *Manav Mangal Society* [2010] 328 ITR 421 (P&H).

18 The Institute of Chartered Accounts of India, Guidance note on Audit of Public Charitable Institutions under the Income Tax Act, 1961, 121-122 (2008).

19 [2012] 340 ITR 86 (All).

20 *CIT* v. *A.Y. Broadcast Foundation* [2012] 340 ITR 166 (Ker).

21 See *Dy. DIT* v. *Shanti Devi Progressive Educational Sy.* [2012] 340 ITR 320 (Del).

22 [2011] 330 ITR 217 (MP).

Taxes Laws (Amendments), 1987, restrictions on bonus under section 36(1)(ii) were omitted with retrospective effect from 25.9.1975. Consequently, the said provision could not come in the way of deduction with respect to the scheme of Bonus Act, 1965. Disallowance of bonus after the amendment could only be in respect of amounts paid to a person who may otherwise be entitled to them as dividend or commission. The reasoning of High Court of Calcutta in *CIT* v. *Shaw Wallace & Co. Ltd.*[23] seems to be in accord with the scheme of the Bonus Act and intendment of the retrospective amendment. The view taken by the Madhya Pradesh High Court differing from that of Calcutta High Court seems to require a review.

VI CONSTITUTIONALITY AND OTHER CONSTITUTIONAL ISSUES

In *Coca Cola Inc.* v. *Addl. CIT*[24] the Supreme Court was called upon to consider the judgment of the Punjab and Haryana High Court,[25] which dealt with the constitutionality of the provisions of sections 92 to 92F relating to transfer pricing. The said provisions have been enacted with the object of ascertaining reasonable fair and equitable profits in India. The high court upheld the vires of these provisions. The Supreme Court, however, found that the foundational facts were absent and the issues could not have been raised in a writ petition. The matter was relegated for consideration on merits.

In yet another case the question before the court was whether the tax on salary payable to the members of the legislative assembly being borne by the state was discriminatory. The High Court of Punjab and Haryana in *Manmohan Singh* v. *State of Punjab*[26] sustained the state legislation granting such concession. The high court considered the matter one of legislative wisdom and found that there was a reasonable classification between members of the legislative assembly and other classes of tax payers.

Another important and significant rendering is the judgment of the Supreme Court in *Ram Jethmalani* v. *Union of India.*[27] The factual background of which is as below: writ petitions were filed under article 32 of the Constitution, arising out of media reports and publications that various individuals, mostly Indian citizens, and other entities with presence in India, had generated and secreted away large sums of monies, through their activities in India or relating to India, in banks in jurisdictions that have strong secrecy laws with respect to the contents of bank accounts and the identities of individuals holding such accounts. The volume of such monies indicated a significant lack of control over unlawful activities through which such monies were generated, that these funds were then laundered and brought back into India, to be used in both legal and illegal activities, that the use of various unlawful modes of transfer of funds across borders gave support to such unlawful networks of international finance, and that the prevailing situation also had very serious connotations for the security and integrity of India.

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23 [1991] 190 ITR 455 (Cal).
24 [2011] 336 ITR 1 (SC).
25 *Coca Cola Inc.* v. *Addl. CIT* [2009] 309 ITR 194 (P&H).
26 [2001] 336 ITR 312 (P&H).
27 [2011] 339 ITR 107 (SC).

The petitioners contended that the Government of India, and its agencies, had been lax in efforts to curtail the flow of such funds out of, and into, India, that the efforts to prosecute the individuals, and other entities, who had secreted such monies in foreign banks, had been weak or non-existent, that various agencies, even though in possession of specific knowledge about the monies in certain bank accounts and upon issuance of show cause notices to the individuals concerned, had not proceeded to initiate and carry out suitable investigations and prosecute the individuals, that the Union of India and its departments had been refusing to divulge the details and information that would reveal the actual status of the investigation, that it may be reasonable to suspect or even conclude that investigation was being deliberately hindered, and that inaction in the matters was deliberately engineered for nefarious reasons.

The Union of India, contended, *inter alia*, that it had secured the names of individuals with bank accounts in banks in Liechtenstein, and other details with respect to such bank accounts, pursuant to an 'Agreement of India with Germany for Avoidance of Double Taxation and Prevention of Fiscal Evasion' (DTAA), that the agreement proscribed the Union of India from disclosing such names, and other documents and information with respect to such bank accounts, even in proceedings before the Supreme Court and the disclosure of such names and other documents and information, secured from Germany, would jeopardize the relations of India with a foreign state. On this the court drew the following conclusions:

(i) that the Double Taxation Avoidance Agreement between India and Germany by itself, did not proscribe the disclosure of documents and details and did not even remotely touch upon information regarding Indian citizens' bank accounts in Liechtenstein.
(ii) The Union of India was not entitled to claim that it was unable to reveal the documents and names on the ground that it was proscribed by the Agreement. The Agreement contained no absolute bar of secrecy. On the contrary it specifically provides that the information may be disclosed in public court proceedings.
(iii) While India was not a party to the Vienna Convention, it contained many principles of customary international law, and the principle of interpretation, under article 31 of the Vienna Convention, provided a broad guideline as to what could be an appropriate manner of interpreting a treaty. The Government could not bind India in a manner that derogated from the constitutional provisions, values and imperatives.
(iv) A proceeding under clause (1) of article 32, and invocation of the powers granted by clause (2) of article 32, was a primordial constitutional feature of ensuring such accountability. The very promise, and existence, of a constitutional democracy rested substantially on such proceedings. The redundancy of the last sentence of article 26(1) of the Double Taxation Avoidance Agreement with Germany, transgressed the boundaries erected by our Constitution, which could not be permitted.
(v) Withholding of information from the petitioners, or seeking to cast the relevant events and facts in a light favourable to the state even though

> ultimately detrimental to the essential task of protecting the fundamental rights, would be destructive to the guarantee in clause (1) of article 32. The state had the duty, to reveal all the facts and information in its possession to the court, and to provide the same to the petitioners.

The revelation of details of bank accounts of individuals, without establishment of *prima facie* grounds to accuse them of wrong doing, would be a violation of their rights to privacy. Public dissemination of banking details, or availability to unauthorized persons, has led to abuse in the past. The mere fact that a citizen has a bank account in a bank located in a particular jurisdiction cannot be a ground for revelation of details of his or her account that the state has acquired. The case carries further the debate on right to information and privacy. It remains to be seen as to what extent privacy rights may yield to public interest.

Extra territorial legislation

A Constitution bench of the Supreme Court in *GVK Industries Ltd* v. *ITO*[28] answered two questions which have a bearing on sections 9(1)(i) & 9(1) (vii) (b) of the Income Tax Act, 1961: (i) Is Parliament constitutionally restricted from enacting legislation with respect to extra-territorial aspects or causes that do not have, nor expected to have any, direct or indirect, tangible or intangible impacts(s) on, or effect(s) in, or consequences for :(a) the territory of India, or any part of India; or (b) the interests of, welfare of, well being of, or security of inhabitants of India, and Indians?; and (ii) Does parliament have the powers to legislature "for" any territory other than the territory of India or any part of it?

The appellant in the said case had challenged the vires of the section 9(1)(vii)(b) on the ground of legislative competence and violation of article 14 of the Constitution. The question was whether the appellant was liable to withhold a certain portion of monies being paid to a foreign company under either one of the above said sections. The high court while sustaining the validity of section 9(1) (vii) (b) also held in favour of the applicability to the case. Even though before the Supreme Court the appellant withdrew its challenge to the constitutional validity of section 9(1)(vii)(b), the court went into the question having regard to the constitutional importance of the issues. The reference to the Constitution bench having come *vis-a-vis* the *Electronics Corporation of India Ltd.* v. *CIT*[29] the court stated the dimensions in the following paras:[30]

> The issue under consideration in *ECIL* was whether section 9(1)(vii)(b) of the Income Tax Act, 1961 was unconstitutional on the ground that it constitutes a law with respect to objects or provocations outside the territory of India, thereby being ultra vires the powers granted by clause (1) of Article 245, interpreting clauses (1) and (2) of Article 245, Chief Justice Pathak (as he then was) drew a distinction between the phrases "make

28 [2011] 332 ITR 130 (SC).
29 [1990] 183 ITR 43 (SC).
30 *Id*. at 53.

> laws" and "extraterritorial operation" i.e., the acts and functions of making laws versus the acts and functions of effectuating a law already made.
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> In drawing the distinction as described above, the decision in *ECIL* considered two analytically separable, albeit related, issues. They relate to the potential conflict between the fact that, in the international context, the "principle of Sovereignty of States" (i.e., nation-states) would normally be "that the laws made by one State can have no operation in another State" (i.e., they may not be enforceable) and the prohibition in clause (2) of Article 245 that laws made by Parliament may not be invalidated on the ground that they may need to be or are being operated extra-territorially….
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> The learned Attorney General cited and relied on many decisions in support of his arguments. We find that none of the cases so cited have considered the issues of what the impact of constitutional text, wider constitutional topological and structural spaces, the representative capacity of a parliament and the like would be on the extent of powers of Parliament. Moreover, having gone through the cases, we do note that none stand for the proposition that the powers of a Parliament are unfettered and that our Parliament possesses a capacity to make laws that have no connection whatsoever with India.

Further the court presented the high moral ground of constitutional limitation and principles of public trust for the purposes of parliamentary cognizance of extra territorial aspects or causes. Ultimately the court answered the first question in the affirmative and the second in the negative. The judgment contains the following conclusions:[31]

> The answer to the above would be yes. However, Parliament may exercise its legislative powers with respect to extra–territorial aspects or cause - events, things, phenomena (howsoever common place they may be) resources, actions or transactions, and the like- that occur, arise or exist or may be expected to do so, naturally or on account of some human agency, in the social, political, economic, cultural, biological, environmental or physical spheres outside the territory of India, and seek to control, modulate, mitigate or transform the effects of such extra-territorial aspects or causes, only when such extra territorial aspects or causes have, or are expected to have, some impact on, or effect in, or consequences for : (a) the territory of India, or any part of India; or (b) the interests of, welfare of, well-being of, or security of inhabitants of India, and Indians.

VII AUTHORITY FOR ADVANCE RULINGS

The ruling of the authority for advance ruling (AAR) in *Transworld Garmet Co Ltd., In re,*[32] dealt with article 24 of the Double Taxation Avoidance Agreement

31 *Id.* at 54.

32 [2011] 333 ITR 1 (AAR).

between India and Canada. There the applicant questioned the benefit of indexation namely the indexed cost of acquisition of assets as dealt with in section 48 of Income Tax Act. The applicant raised the issue of the denial of indexation benefit as tantamount to discriminatory tax treatment within the meaning of double taxation agreement. The AAR, after referring to *Universities Superannuation Scheme Ltd. In re*[33] and *Application No. P-16 of 1998, In re*[34] came to the conclusion that no discrimination could be inferred from the differential rate of tax. The authority came to the conclusion that even though the view taken in *Application No. P-16 of 1998, In re*[35] had been set aside by the Supreme Court in *Societe Generale* v. *CIT,*[36] on the question of jurisdiction, it may be noticed that in *ABN Amro Bank NV* v. *Asst. DIT*,[37] and *Chohung Bank* v. *Dy. DIT,*[38] it has been held there was no discrimination in differential rates.

Three more rulings of the AAR pertaining to non-resident taxation deserve notice, section 44BB(1) of the Act deals with the presumptive taxation deeming income at 10 percent, of gross receipts and is applicable to the business of exploration of mineral oil. This section would be applicable, only if the income was not covered under the purview of explanation 2 to section 9(1)(vii) as technical fees. Further, the amendment to sections 44BB and 44DA made effective from April 1, 2011 clarified that both sections were mutually exclusive. The questions before the AAR in *Bergen Oilfield Services AS, Norway, In re*[39] were whether the revenue earned by the applicant from seismic data acquisition and processing contracts in India would be taxable under section 44BB at the effective rate of 4.223 per cent or 10 per cent of the receipts and whether the entire mobilization and demobilization of the revenues received were taxable or only the revenue attributable to the distance covered by the vessel in India. Once the assessee fell under section 44BB(1), the provision deeming profit at the rate of 10 per cent, of the amounts computed in sub-section (2) was mandatory, subject to the option to exercise of the right under section 44BB(3) by keeping accounts as required under section 44AA and by furnishing the audit certificate under section 44AB. Since the income did not fall under the head "technical fees," so as to attract section 44DA and the assessee had not fulfilled the conditions under section 44BB(3) by exercising the option thereunder, the assessment had to be under section 44BB(1) and not 44BB(3). In view of the above scheme of the provisions discussed by the authority in *Geofizyka Torun Sp., In re*[40] the AAR followed the said decision and essentially the view would be where the business was of specific nature envisaged by section 44BB, the said provisions would prevail over the provisions of section 44DA.

33 [2005] 275 ITR 434 (AAR).
34 [1999] 236 ITR 103 (AAR).
35 *Ibid*.
36 [2001] 251 ITR 657 (SC).
37 [2006] 280 ITR (AT) 117 (ITAT, Cal).
38 [2006] 286 ITR (AT) 231 (ITAT, Mum).
39 [2011] 337 ITR 167 (AAR).
40 [2010] 320 ITR 268 (AAR).

The ruling in *Geofizyka Torun Sp., In re*[41] was again followed in *Bourbon Offshore Asia Pvt. Ltd., In re.*[42] The applicant had entered into a time charter agreement with Transocean Offshore International Ventures Ltd. which provided services to ONGC and received consideration for the supply of plant use in offshore drilling activities integral to prospecting or extraction or production of oil and gas. The revenue argued that the services provided being in the nature technical service, would fall under section 44DA. The AAR declined such an argument, taking note of the amendment to section 44BB and 44DA effective from April 1 2011, which had classified the mutually exclusive character of the provisions.

Whether transfer of shares by a holding company to its subsidiary deserves to be treated as a gift attracting the exemption under section 47(iii) of the Act particularly when there was no consideration for such transfer, was answered in the affirmative by the AAR in *Deere & Co., In re.*[43] The AAR rightly found that in view of the lack of consideration for transfer of shares, the transfer pricing rule under sections 92 to 92F would have no application.[44] Consequently, there exists no need for tax deduction at source under these circumstances. Another important ruling of the AAR in *Verizon Data Services India Pvt. Ltd., In re*[45] also deserves notice. The issue which arose for consideration there was whether the salary reimbursement to what was technically called the employees on secondment basis, employed by an Indian subsidiary of a foreign company were taxable as income of the affiliate of parent company with whom the secondment agreement was entered into. The AAR held that the salary reimbursement to seconded employees was taxable as fee for included services under article 12 of the India-US Double Tax Avoidance Agreement and section 9(1)(vii) of the Income-Tax Act, 1961, where the services rendered by the employees were in the nature of technical services, so as to be liable for deduction under section 195.

In *Ishikawajima-Harima Heavy Industries Ltd* v. *DIT*[46] the Supreme Court laid down the principle that a non-resident could not be liable for income earned abroad. The AAR for Advance Ruling after referring the above decision in *L.S. Cable Ltd.*[47] observed that the offshore supply agreement regarding the transfer of ownership would not be taxable in India since the property in the goods changed hand outside India. In *Deepak Cable (India) Ltd v. Meera Srivastava, JDIT*[48] the applicant sought answer to the question as to whether the amount paid by the applicant to a foreign company as consideration of transfer of goods, where the property in the goods was transferred before they reached the customs frontiers of India, was taxable in its hands. The AAR ruled that the offshore supply of equipment was not liable to tax in India. Where the nature of services given by a foreign

41 *Ibid*.
42 [2011] 337 ITR 122 (AAR).
43 [2011] 337 ITR 277 (AAR).
44 See *V.N.U. International B.V., In re.* [2011] 334 ITR 56 (AAR).
45 [2011] 337 ITR 192 (AAR).
46 [2007] 288 ITR 408 (SC).
47 [2011] 337 ITR 35.
48 [2011] 337 ITR 127.

company could be classified under the head of royalty, it become taxable as specifically stipulated under article 12 of the Indo-Sri Lankan Agreement.[49]

VIII NON-RESIDENT TAXATION

A non resident UK Company transferred certain know-how to the assessee company. The assessee made payment of royalty for know-how which included sale of rights in the know-how. It is being consistently canvassed by the department that mere use of the know-how would justify a tax liability in India. The Supreme Court in *Alembic Chemical Works Co. Ltd.* v. *CIT*[50] had endorsed the view that the sale of technology by itself would enable avoidance of tax, as the payment of royalty would be eligible for relief under article XIII(3) of the Double Taxation Avoidance agreement between India and UK. The high court in *CIT* v. *D.C.M. Ltd*.[51] held that the tax was not required to be deducted on the remittance made for royalty. The reasoning of the court deserves to be set out:[52]

> The transfer of technology is, thus, quite often, as in the present case, brought about by executing agreements which give rights far greater than a mere right to use albeit on a non-exclusive basis. The argument made on behalf of the revenue that the transaction does not constitute a sale, misses the point that, for it to fall within the four corners of the provisions of Article XIII(3), the right conferred should be of usage; anything more than that, takes it out of ambit of definition of royalty as provided in the DTAA. We, therefore, agree with the conclusion arrived at by the Tribunal with regard to the terms of the agreement. Having come to this conclusion, it is quite obvious that the remittances made by the assessee to Tate would not fall in the definition of article XIII(3) of the DTAA. …
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> …A bare perusal of Article XIII(3) would show that the expression "payments of any kind" is circumscribed by the latter part of the definition which speaks of consideration received (including in the form of rentals) for "use" of or "right to use" intellectual properties. The Tribunal, in our view, rightly observed that the CIT(A) had erred in coming to the conclusion that the expression "payments of any kind" was broad enough to include even an outright sale. To drive home this point the Tribunal, once again, has correctly drawn a distinction between the definition of royalty as appearing in the DTAA and that which finds mention in Explanation 2 to section9(1)(vi) of the IT Act.

The issue, however, involved interpretation of the Double Tax Avoidance Agreement and sections 9(1)(6) relating to definition of royalty.

Section 44BB provides for presumptive taxation on receipts in the business of exploration and production of mineral oil in India. The provision was the subject

49 *Lanka Hydraulics Institute Ltd., In re* [2011] 337 ITR 47 (AAR).
50 [1989] 177 ITR 377 (SC).
51 [2011] 336 ITR 599 (Del).
52 *Id*. at 608 – 609.

matter of interpretation in *Sedco Forex International Inc.* v. *CIT*.[53] The kinds of receipts in this line of business vary, and thus the issue in such cases can be whether any or all such receipts could be treated as part of receipts covered by section 44BB. Mobilisation/demobilization charges in respect of voyages in Indian waters or outside for transportation of plant and machinery meant for the project in India seem to fall within the scope of section 44BB if *Sedco Forex International Inc*. v. *CIT*[54] states the correct view as decided in *CIT* v. *R and B Falcon Drilling Co.*[55] The same view was taken on identical facts in other cases.[56]

Similarly, the amount paid for seismic data acquisition and processing and similar services were all found to be covered by section 44BB in *Western Geco International Limited, In re.*[57] by the AAR.

An important ruling on the duration of a permanent establishment has been given by the AAR in *Tiong Woon Project and Contracting P. Ltd, In re.*[58] The AAR held that where a non resident had different projects, which are independent of each other, the presence of the non-resident in India should be considered project wise and could not be aggregated for purposes of measuring the duration of presence in India for computation of income of each such project. It is not merely the overlapping period between different contracts which deserve to be excluded. It is necessary in ascertaining the profits of a project, that the inference of permanent establishment be drawn with reference to that project.

Know-how is a capital asset, but whether payment for its use was royalty and was a revenue expenditure? It was so decided in *CIT* v. *G4S Securities System (India) P. Ltd.*[59] In coming to the conclusion, the high court pointed out that where the payment was directly relatable to services in the revenue field, it could be allowed as a deduction.[60] Where technical know-how continued to be intellectual property of the owner with the assessee merely operating on a license, payment could only be of a revenue nature.[61] Where there was no enduring advantage for the assessee's business, it could not be treated as capital expenditure.[62]

The question as to whether pendency of a return before the AO, would bar consideration of any issues in respect of such return by the AAR has been dealt with in *SEPCOIII Electric Power Construction Corporation, In re (No.1)*[63] and *SEPCOIII Electric Power Construction Corporation, In re (No.2)*[64] where the AAR held that such a petition was not maintainable. In yet another ruling the AAR opined

53 [2008] 299 ITR 238 (Utr).
54 [2008] 299 ITR 238 (Utr).
55 [2011] 338 ITR 152 (Utr).
56 *CIT* v. *Atwood Oceanic Pacific Ltd.* [2011] 338 ITR 156 (Utr) and *CIT* v. *S.O.I. (Burmuda) Ltd.* [2011] 338 ITR 147 (Utr).
57 [2011] 338 ITR 161 (AAR).
58 [2011] 338 ITR 386 (AAR).
59 [2011] 338 ITR 46 (Del).
60 *CIT* v. *Gujarat Carbon Ltd.* [2002] 254 ITR 294 (Guj).
61 *Goodyear India Ltd.* v. *ITD* [2000] 73 ITD 189 (Del).
62 *Travancore Sugars and Chemicals Ltd.* v. *CIT* [1966] 62 ITR 566 (SC).
63 [2012] 340 ITR 225 (AAR).
64 [2012] 340 ITR 231 (AAR).

that the pendency of any dispute in the case of resident tax payer as regards his duty to deduct tax at source would cover the question of liability of the non resident in respect of payment received by it and hence not entertainable by the AAR. It appears that these rulings are not consistent with other rulings of the AAR.[65]

IX REASSESSMENT

Compliance with the mandatory procedures, particularly in regard issuance of notices unfortunately entails lengthy litigations. In *Asst. CIT* v. *Hotel Blue Moon*[66] the Supreme Court dealt with the question of issuance of notice under section 143 (2) in block assessment as such assessment proceedings were no different from any other assessment proceedings. The Allahabad High Court in *Virendra Dev Dikshit* v. *Asst. CIT*[67] allowed the assessee's appeal and set aside the order of the tribunal, remanding the matter to the AO for issuance of fresh notice.

It has been repeatedly held that the following conditions are required to be satisfied for reassessment:-

(a) the income chargeable to tax should have escaped assessment;
(b) such escapement should have been by reason of failure on behalf of the petitioner to file the return under either section 139(1), 142(1) or 148, or;
(c) failure to disclose fully or truly material facts necessary for assessment.

Before reassessment become eligible, the Gujarat High Court in *Parle Sales & Service Pvt. Ltd.* v. *ITO*[68] rightly faulted the notice issued under section 148, since none of the conditions were satisfied.

Where stakes are below the monetary limits fixed by the instructions of the central board of direct taxes, appeals are not entertained. However, the validity of such appeals, falling within the limit revised after the date of filing of the appeal had been a matter of some controversy. The Bombay High Court in *CIT* v. *Madhukar K. Inamdar (HUF)*[69] held that the revised limit should have application for all pending appeals. Such a view was not followed by the full bench of the Punjab and Haryana High Court in *CIT* v. *Varindera Construction Co.*[70] wherein it was stated that the instruction prevailing on the date of filing alone should be relevant for the reason that what was a valid appeal at the time of filing, could not become invalid merely because of the revised limit. The issue may have to be resolved in the Supreme Court, unless the revenue accepts the interpretation placed by the Bombay High Court in the light of the objective of reducing the number of appeals by introducing a monetary limit. Where an appeal falls within one of the exceptions under the instructions, it would anyway be entertained notwithstanding the amount at stake, so that revenue's interests are sufficiently

65 See *Mustaq Ahmed, In re* [2007] 293 ITR 530(AAR) and *Airports Authority of India, In re*. [2008] 299 ITR 102 (AAR).
66 [2010] 321 ITR 362 (SC).
67 [2011] 331 ITR 483 (All).
68 [2011] 337 ITR 203 (Guj).
69 [2009] 318 ITR 149 (Bom).
70 [2011] 331 ITR 449 (P&H).

safeguarded, while the object of reducing litigation would be better achieved, if the revised limit is accepted as applicable to all pending appeals.

On the question of reassessment proceedings, the high courts have strictly construed, the four year time limit. For instance, in *Northern Strips Ltd* v. *ITO*[71] the Delhi High Court found that the reassessment notice was issued beyond the four year time limit in respect of a relief which was certified by a chartered accountant and duly accepted in the regular assessment.

This view taken by the Madhya Pradesh High Court in *Hind Syntex Ltd*. v. *CIT*[72] and that of the Madras High Court in *CIT* v. *Baer Shoes (India) Pvt. Ltd.*[73] are correct. The view, that a subsequent decision on interpretation of law cannot justify a reassessment notice, has been endorsed by the Madras High Court in *Austin Engineering Co. Ltd* v. *Joint CIT.*[74] Eligibility of goodwill which is an intangible commercial asset, for purposes of depreciation under section 32(i)(ii), however, continues to be open to difference of opinions.

Eligibility would depend on whether it is commercial right of the same nature as know-how, patent, copyright, trademark, license, franchise or any other business or commercial right. The view that goodwill is entitled to depreciation is a plausible view, so that the commissioner is not justified in exercising his justification under section 263 on the basis of the other view as decided by the high court in *CIT* v. *Hindustan Coca Cola Beverages (P.) Ltd.*[75] However, in *CIT* v. *English Indian Clays Ltd.*[76] where the claim had been allowed without examination of the merits , the claim of depreciation on assets allegedly acquired in the preceding years had been found to be false, the action under section 263 on the part of the commissioner setting aside the assessment order was upheld.

Two judgments faulting notices under section 148 may be noticed. Notice had been issued on the ground that a charitable institution was *benami* of the assessee, whereas the assessee had only been receiving advisory fees from the institution and it was later found that the genuineness of the institution was also accepted by the authorities dealing with such institution, the notice itself would not be valid as was found in *Bindeswar Pathak (Dr.)* v. *CIT.*[77] In *B.J.S. Co. Middle East Ltd.* v. *Dy. DIT,*[78] where an assessment was sought to be reopened under section 148 on the basis of a subsequent decision of the high court on application of section 44BB in respect of services and facilities in connection with exploration of mineral oils, it was held that the notice was based upon a change of opinion and could not, therefore, be valid. It is unfortunate that such re-assessment proceedings are undertaken despite the law settled by the Supreme Court.[79]

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71 [2011] 331 ITR 224 (Del).
72 [2011] 331 ITR 36 (MP).
73 [2011] 331 ITR 435 (Mad).
74 [2009] 312 ITR 70 (Guj).
75 [2011] 331 ITR 192 (Del).
76 [2011] 331 ITR 219 (Ker).
77 [2011] 339 ITR 272 (Pat).
78 [2011] 339 ITR 169 (Utr).
79 See *CIT* v. *Foramer France* [2003] 264 ITR 566 (SC) and *CIT* v. *Kelvinator of India Ltd.* [2010] 320 ITR 561 (SC). See also *H.K. Buildcon Ltd.* v. *ITO* [2011] 339 ITR 535 (Guj).

Validity of reassessment

In *Little Angels Education Society* v. *ITO*[80] and *Priyadarshini Educational Academy* v. *DGIT*[81] the Andhra Pradesh High Court came to hold that investments made in chit funds could prompt an inference of contravention of section 11(5) of the act, justifying a re-assessment notice. The Supreme Court in *Shriram Chits and Investments (P) Ltd.* v. *Union of India*[82] had held that the amount of chits collected could not be treated as deposits. It is understood that the surplus in the hands of the members of the chit groups waiting for favorable bid would also not be treated as interest. It appears that the nature and scheme of the chit funds, and the investment therein, may warrant a relook with reference to the provisions of section 11 of the Income Tax Act.

X PRINCIPLE OF MUTUALITY – PARTICIPATION OF NON MEMBERS

In *CIT* v. *Secunderabad Club Picket*[83] the Andhra Pradesh High Court dealt with the principle of mutuality. The Supreme Court in *CIT* v. *Bankipur Club Ltd*[84] had settled the law in this regard and held that the principle of mutuality would apply on incidental income from non members provided the activity giving rise of such income was not coloured by the taint of commerciality. Miscellaneous income from non members would not rule out the application of principles of mutuality. The issue has also been considered in *CIT* v. *Cawnpore Club Ltd.*[85] Two recent judgments taking opposite views may be noticed. In the matter of interest from deposits in banks, the Delhi High Court in *CIT* v. *Delhi Gymkhana Club Ltd.*[86] has taken a view in favour of the assessee while the Madras High Court in *Madras Gymkhana Club* v. *Dy. CIT*[87] has taken a view adverse to the assessee. The Andhra High Court has fallen in line with the narrower view. There are several aspects of law particularly relating to the legal personality of incorporated bodies and their relationship to its members as well as provisions relating to dissolution of the corporate body, which suggests certain avoidable flaws in the reasoning of the judgment.

XI INTEREST

Disallowance of interest on borrowed capital on the ground that part of the borrowing was given to a subsidiary company, was found to be vulnerable because the AO had failed to establish that the loan was not for a *bona fide* business purpose. It could not have, therefore, been disallowed as decided in *CIT* v. *Dalmia Cement Bharat Ltd.*[88] It is true that merely because a payment was made to a

80 [2011] 336 ITR 413 (AP).
81 [2011] 333 ITR 347 (AP).
82 AIR 1993 SC 2063.
83 [2012] 340 ITR 121 (AP).
84 [1997] 226 ITR 97 (SC).
85 (2004) 140 Taxmann 378 (SC).
86 [2011] 339 ITR 525 (Del).
87 [2010] 328 ITR 348 (Mad).
88 [2011] 330 ITR 595 (Del).

subsidiary company, it cannot be treated as not having been used for business, unless it is shown that it was for a non-business consideration. But then, the claim that it is for business consideration should probably be established by the assessee on whom the burden falls. When the high court dismissed the departmental appeal on the ground that the ground for denial of debentures was not established by the revenue, it could probably be understood that the initial burden was discharged by the assessee in which case, the burden would stand shifted to the department.

Reinvestments of amounts received by HUF as a consideration of sale of residential properties and the availability of relief under section 54(f) is again a matter on which uniform lacks. For instance, the inclusion of the name of the mother of the *karta*, who is also a member of HUF has received a liberal interpretation in *CIT* v. *V. Natarajan.*[89] The name in which the investment was made should hardly be material as long as the investment is for the benefit of the assessee. HUF not being a legal entity, is the investment in the *karta's* name as one made by him in his individual capacity? The Delhi High Court in *Vipin Malik (HUF)* v. *CIT*[90] failed to notice the following judgments in *Mir Ghulam Ali Khan (Late)* v. *CIT*[91] and *ITO* v. *Saraswati Ramanathan.*[92]

The judgment of the Supreme Court in *Joint CIT* v. *Rolta India Ltd.*[93] resolved the issue by the company liable to book profits, should pay advance tax. The Supreme Court has approved the decision of Karnataka High Court in *Kwality Biscuits Ltd* v. *CIT*[94] and now no interest is chargeable for failure to pay advance tax when the tax is payable on book profits under section 115J. Noticing the difference in language in the provisions of sections 115JA and 115JB, the view taken by the Karnataka High Court, in *Jindal Thermal Power Coal Ltd.* v. *Dy. CIT*[95] that interest is chargeable for liability under the above said provision has been reversed.

The manner of reckoning relief under section 80 HHC and the range of interpretation placed appears to warrant a close examination of the issue by the central board of direct taxes. It is evident that the bare relief under section 80HHC is book profits. Even for the purpose of sections 150J – 150 JB, the book profits bare has been enacted. However, sub-sections (3) & (3a) of section 80HHC provides for the proportion to be applied. A persistent litigation even after the CBDT circular 21.02.1994, culminated in the decision of the Supreme Court in *Ajantha Pharma Ltd.* v. *CIT*[96] wherein the Supreme Court had reversed the decision of the Bombay High Court in *CIT* v. *Ajantha Pharma Ltd.*[97]

89 [2006] 287 ITR 271(Mad).
90 [2011] 330 ITR 309 (Del).
91 [1987] 165 ITR 228 (AP).
92 [2008] 300 ITR (AT) 410 (ATAT, Del).
93 [2011] 330 ITR 470 (SC).
94 [2000] 243 ITR 519 (Kar).
95 [2006] 286 ITR 182 (Kar).
96 [2010] 327 ITR 305 (SC).
97 [2009] 318 ITR 252 (Bom).

The high court had endorsed the contention of the department that the export profit for purposes of deduction from book profits should be the same as reckoned in computation for purpose of statutory income. Even though the Supreme Court did not state specifically and reiterate that the proper view would be to treat the book profit should be the base, the very reversal judgment of the Bombay High Court can only mean that the department's position to the contrary also stands rejected. In this context, the observation of the full bench of the Kerala High Court in *CIT* v. *Packworth Udyog Ltd.*[98] that the reasoning of the Supreme Court in the *CIT* v. *Ajantha Pharma Ltd*.[99] does not suggest the view other than what has canvassed by the revenue does not appear to be correct. It is submitted that the Supreme Court's analysis and line of reasoning coupled with similar views by other high courts, prior in point of time should have persuaded the Kerala High Court to carry the reasoning forward, applying the principle of purposive interpretation in full.

In *Punjab National Bank* v. *CIT*[100] the question of export credit subsidy and section 42(1B) fell for consideration before the court. Under an export subsidy scheme floated by the Reserve Bank of India, nationalised banks were required to advance loans to their customers at a lower rate of interest than the normal commercial rate of interest. As a result of this, the banks would suffer a short fall in interest earnings and the deficit would be made up by the Reserve Bank of India by way of subsidy. The question that fell for consideration was whether the amount received by the assessee from the Reserve Bank would fall within the meaning of the word "interest" as defined in the Interest Tax Act, 1974.

The Delhi High Court held that no loan or advance had been given by the assessee to the Reserve Bank of India. Any amount received by the assessee from the Reserve Bank of India was in the nature of export credit subsidy or compensation for loss of interest, by whatever name it may have been called. But that would not convert the amount received by the assessee from the Reserve Bank of India into an 'interest' as defined in section 2(7) of the Interest-Tax Act, 1974, since the amount received by the assessee was not relatable to a loan or advance given by the assessee to the Reserve Bank of India.

XII MINIMUM ALTERNATE TAX

In the case of *Joint CIT* v. *Rolta India Ltd*.,[101] the facts and issues were that the assessee furnished a return of income declaring total income nil. An order under section 143(3) was passed determining the total income at nil after set off of unabsorbed business loss and depreciation. The tax was levied on the book profit determined as per the provisions of section 115JA. The interest under section 234B was charged on the tax on the book profit as worked out in the order of assessment.

98 [2011] 331 ITR 416 (Ker).
99 [2009] 318 ITR 252 (Bom).
100 [2011] 332 ITR 337 (Del).
101 [2011] 330 ITR 470 (SC).

Aggrieved by the order, the assessee went in appeal before the CIT. The appeal was dismissed by the tribunal on the ground that the case fell under section 115JA and not under section 115J. But the Bombay High Court took a different view and held that the interest was not to be charged. Hence, the CIT filed an appeal before the Supreme Court.

The apex court held that the interest under sections 234B and 234C should be payable on failure to pay advance tax in respect of tax payable under sections 115JA/115JB. Section 115JB was a self-contained code and thus, all companies were liable for payment of advance tax under section 115JB and consequently provisions of sections 234B and 234C imposing interest on default in payment of advance tax were also applicable.

XIII INCOME DEEMED TO ACCRUE OR ARISE IN INDIA

In a significant ruling in *Asia Satellite Telecommunications Co. Ltd.* v. *DIT* [102] the Delhi High Court dealt with the complex and recurring issue of income deemed to accrue in India, in terms of section 9(1)(i) of the Income Tax Act, 1961.

The assessee, Asia Satellite Telecommunications Co. Ltd., was a company incorporated in Hong Kong which carried on business of private satellite communications and broadcasting facilities. The company had no office in India. The assessee had no customers, who were residents of India. During the previous year, relevant to the assessment year under appeal, the appellant was the lessee of a satellite called Asia Sat 1 which was launched in April 1990 and was the owner of a satellite called Asia Sat 2 which was launched in November 1995. These satellites neither used Indian orbital slots nor were they positioned over Indian airspace. The footprints of Asia Sat 1 and Asia Sat 2 extended over four continents - Asia, Australia, Eastern Europe and Northern Africa. The territory of India fell within the footprint of the South Beam of Asia Sat 1 and the C and B of Asia Sat 2.

The only activity that was performed by the appellant on earth was the telemetry, tracking and control of the satellite. This was carried out from a control center at Hong Kong. It was claimed by the appellant that no part of the income generated by it from the customers to whom the aforesaid services were provided was chargeable to tax in India and for this reason no return of income was filed in India.

The AO held that the assessee had a business connection under section 9(1)(i) of the Act, therefore, being an income deemed to have arisen in India, was taxable. Aggrieved by the order of the AO, the appellant preferred an appeal to the CIT (A).

The mere fact that the appellant had put in place a satellite in a manner that down linked signals which could be received in the Indian territory did not result in an inference that any part of the appellant's business operations were carried out in India.

The CIT (A) held that the customers were using a secret process put in place in the transponder on the satellite and the payments were made for this purpose and not for merely the use of a physical asset. The TV channels which made programmes predominantly meant for Indian persons were utilizing the processing facilities of

102 [2011] 332 ITR 340 (Del).

the appellant for the business carried on by them in India and hence the appellant was chargeable to tax in India.

On appeal therefrom, the tribunal concluded that the obligation of the appellant was to make available programmes of the TV channels in India through the transponder on its satellite. The appellant could acquire the right to receive its income from its customers only if the programmes were made available in India, and, therefore, the tribunal held that the appellant would have a business connection in India. The tribunal further held that no part of the appellant's income was chargeable to tax in India in terms of section 9(1)(i) as no operations to earn the income were carried on in India.

The high court after an exhaustive survey of the case law and the object and scope of the provisions observed:-

i. Carrying out operations in India, wholly or at least partly, was the *sine qua non* for the application of section 9(1)(i). Merely because the footprint area included India, and that ultimate consumers watched the programmes in India would not mean that the assessee was carrying out business in India.
ii. The role of the assessee was that of receiving the signals, amplifying them and after changing the frequency, relaying them back to earth, and for this service, the television channels made payment; it had not leased any property; there could be no transfer of the control and constructive possession of the transponder by the satellite operator to its customers; only access to bandwidth of transponder had been given; no use of the 'process' by television channels as per clause (iii) of explanation 2 to sub-clause (vi) of section 9(1); payment not royalty; no part of the activity of transmission took place in India.
iii. Money received from cable operators by the telecast operators (television channels) was treated as income by these telecast operators which had accrued in India and they had offered and paid tax, thus income generated in India had been duly subject to tax.
iv. Definition of royalty in the OECD model double taxation avoidance agreement was same as that in explanation 2 to section 9(1)(vi); the commentary issued by OECD on the same can be relied upon.

It is submitted that the reasoning of the high court is based on sound understanding of the fine and subtle dimensions of the space locale issue of operations of such nature and the actual accrual of income.

XIV SEARCH AND SEIZURE

A valid search is a precondition for effecting a block assessment. Question may arise as to the validity of a search and seizure. The Karnataka High Court in *C. Ramaiah Reddy* v. *Asst. CIT*[103] has taken the view that the tribunal will have

103 [2011] 339 ITR 210 (Kar).

jurisdiction to go into the question of validity of a search. A number of precedents were reviewed. There is a contrary judgment of the Delhi High Court in *M.B. Lal* v. *CIT*[104] which holds that it is the preserve of the high court to deal with the validity in question. It appears that this issue deserves to be reconciled.

XV SPECIAL DEDUCTIONS

In *CIT* v. *Swani Spice Mills P. Ltd.,*[105] the issue which arose was "where the business of the assessee is export of goods, and not investment of funds, can the interest earned out of investing surplus funds earned from the business of export be considered 'income derived by the assessee from the export of goods or merchandise for the purpose of deductions under section 80HHC?"

During the course of the accounting year relevant to the assessment year, the total turnover of the assessee was 3.62 crores, out of which export sales constituted 3.45 crores. The assessee claimed deduction under section 80HHC. During the year, the assessee received an amount of Rs. 31.49 lakhs as discounting charges and interest on inter-corporate deposits. Assessee claimed that amounts so received aided in carrying on the business of export. The amount so received was used for paying off bank loans and borrowings taken from private parties, which were taken to conduct the business of export. AO held that the same did not amount to income from business of export, but income from other sources. Tribunal reversed the order of the AO holding that such income had direct nexus with the activity of export.

The Bombay High Court opined that the mere fact that an assessee carries on business would not result in an inference that the income which is earned by way of interest would fall for classification as business income. This is particularly so in a situation where the business of the assessee does not consist in the investment of funds. Such income would fall for classification as income from other sources. In section 80HHC(1), the legislature has made a specific provision for the deduction of profits of business derived from export activity. The expression 'derived from' has been construed to require a direct and proximate nexus with the business of export. Absent such a nexus, the income which results from the activity would have to be excluded from reckoning for the purposes of the formula prescribed by section 80HHC.

It is doubtful whether the expression 'derived from' can be read as above, as long as the amounts in question, are shown to have intermingled with those measures facilitating the conduct of export and are not merely investments of other nature.

In *CIT* v. *Bharti Information Technology Systems (P) Ltd.*[106] the Supreme Court was concerned with section 80HHE which is referred to in the explanation to section 115JA, clause (ix). Assessee filed its return of income for assessment year 2000-01. The assessee claimed a certain deduction under section 80HHE against net profit as per profit & loss account and book profit of a sum under section 115JA of the Income Tax Act, 1961.

104 [2005] 279 ITR 298 (Del).
105 [2011] 332 ITR 288 (Bom).
106 (2011) 245 CTR (SC) 1.

The AO rejected this claim holding that since in normal computation there is no profit after carry forward loss, deduction under section 80HHE to the extent claimed for computing book profit under section 115JA was not admissible. The court held that the judgment of the special bench of the tribunal in *Syncome Formulations*[107] squarely applicable to the case. The tribunal came to the conclusion that deduction claimed by the assessee under section 80HHE have to be worked out on the basis of adjusted book profit under section 115JA and not on the basis of the profits computed under regular provisions of law applicable to computation of profits and gains of business. It follows that computation of deduction under section 80 HHC and 80 HHE would be on similar lines. The dichotomy between regular income-tax profits and adjusted book profits under section 115JA was brought out in syncome formulations.

In *CIT* v. *Tidel Park Ltd.*,[108] one of the issues involved was whether on the facts and circumstances of the case, the tribunal was right in deleting the addition of a certain amount of excess depreciation claimed from the book profits under section 115JB of the Act even though it was claimed by virtue of the board resolution passed beyond the end of the accounting year.

The assessee-company changed the rates of depreciation charged in that accounting year and in the notes of annual report, it was mentioned that due to change in depreciation rate charged on the assets in the books, there was a reduction in the book profits to certain extent.

There was a change in the method of computing depreciation from straight line method to written down value method, thereby, the amount debited was reflected in the profit and loss account, which was audited, certified and filed with the registering authority. The board of directors also passed a resolution for changing the existing rates of depreciation for the purpose of books depreciation.

The Madras High Court held that that so long as the accounts of the company were audited by the statutory auditors in accordance with the provisions of the Companies Act, as per sub-section (ii) of section 115JB of the Income-Tax Act, in the same line of reasoning, it will have to be held that the passing of the resolution by the board of directors on July 4, 2003, was also in consonance with the provisions of the Companies Act empowering the board of directors for changing the rate of depreciation, which was beneficial to the company while working out its account which was also filed before the registrar of companies, in compliance with the provisions of the Companies Act. So long as the compliance in regard to the submission of the accounts had not suffered any statutory defect, the application by the tribunal of the ratio laid down by the Supreme Court in *Apollo Tyres Ltd.* v. *CIT*[109] was found to be justified.

In *New Noble Educational Society* v. *Chief CIT*[110] the high court dealt with a batch of writ petitions in which the rejection of the applications submitted by the petitioners for grant of approval under section 10(23C)(vi) of the Income Tax Act

107 (2007) 106 ITD 193 (Mum).
108 [2011] 334 ITR 126 (Mad).
109 [2002] 255 ITR 273 (SC).
110 [2011] 334 ITR 303 (AP).

was under challenge as being illegal and arbitrary. One of the issues involved was "whether the objects in the memorandum of association of a society/trust are conclusive proof of such a trust existing solely as an educational institution entitled for the benefits, and being eligible for approval, under section 10(23C)(vi) of the Act?"

The high court rightly held that in cases where approval, under section 10(23-C)(vi) of the Act, is initially sought, the objects in the memorandum of association of a society/trust are conclusive proof of such a trust existing solely as an educational institution entitled for the benefits, and as being eligible for approval, under section 10(23-C)(vi) of the Act. In addition, an application in the prescribed proforma should be submitted to the prescribed authority within the time stipulated and the specified documents should be enclosed thereto. The following reasoning of the high court deserves acceptance. If there are several objects of a society some of which relate to 'education,' and others which do not, and the trustees or the managers, in their discretion, are entitled to apply the income or property to any of those objects, the institution would not be eligible to be regarded as one existing solely for educational purposes, and no part of its income would be exempt from tax. In other words, where the main objects are distributive, each and every one of them must relate to 'education' in order that the institution may be held entitled for the benefits under section 10(23-C)(vi) of the Act. But if the primary or dominant purpose of an institution is 'educational,' another object which is merely ancillary or incidental to the primary or dominant purpose would not disentitle the institution from the benefit. The test which has, therefore, to be applied is whether the object, which is said to be non-educational, is the main or primary object of the institution or it is ancillary or incidental to the dominant or primary object which is 'educational.'[111] The test is the genuineness of the purpose tested by the obligation created to spend the money exclusively on 'education.' If that obligation is there, the income becomes entitled to exemption.[112]

XVI WRIT PROCEEDINGS

In *Little Angels Educational Society* v. *ITO*[113] on maintainability of writ petitions challenging reopening of assessments, the Andhra Pradesh High Court held that the question of maintainability of writ petition is intricately connected with the question of lack of jurisdiction under section 147 of the Act for reassessment, and the consequential impugned communication of reasons on the request of the petitioner. Therefore, both the issues need to be considered together. Of course if, on a *prima facie* consideration, the court came to the conclusion that the impugned action for reassessment of income was outside the scope of section 147 of the Act, any attempt of the respondent would suffer from inherent lack of jurisdiction or a jurisdictional error as the case may be. If, *prima facie*, it is demonstrable that initiation of reassessment proceedings satisfies the jurisdictional issues, a deeper

111 *Addl. CIT* v. *Surat Art Silk Cloth Manufacturers* [1980] 121 ITR 1 (SC).
112 *Sole Trustee, Loka Shikshana Trust* v. *CIT* [1975] 101 ITR 234 (SC).
113 [2011] 336 ITR 413 (AP).

probe is not called for. In such an event, the petitioner can avail the remedy of an appeal under section 246(1)(b) of the Act, and thereafter, remedy of an appeal under section 253(1) of the Act against which an appeal, on question of law, would lie to the high court under section 260-A of the Act. Against the notice of reassessment under section 148 of the Act, and the communication of reasons thereof, no appeal would lie. Therefore, to the limited extent of scrutinizing jurisdictional errors, a writ petition may lie.

Similarly, in *Rotary Club of Ahmedabad* v. *Asst. CIT*[114] the High Court of Gujarat held that the sufficiency of reasons for forming the belief, is not for the court to judge but it is open to an assessee to establish that there in fact existed no belief or that the belief was not at all a *bonafide* one or was based on vague, irrelevant and non-specific information. To that extent, the court may look into the conclusion arrived at by the AO and examine whether there was any material available on the record from which the requisite belief could be formed by the AO and further whether that material had any rational connection or a live link for the formation of the requisite belief. The AO has no power to review he has power to reassess. But the reassessment must be based on fulfillment of certain pre-conditions. The concept of 'change of opinion' must be treated as an in-built test to check abuse of power by the AO. The AO has power to reopen, provided there is 'tangible material' to come to the conclusion that there is escapement of income from assessment.

XVII CAPITAL OR REVENUE RECEIPTS

In *Guffic Chem (P.) Ltd.* v. *CIT*[115] during the assessment year 1997-98 the assessee received a certain amount from Ranbaxy as a non-competition fee. The said amount was paid by Ranbaxy under an agreement. Assessee agreed to transfer its trademarks to Ranbaxy and in consideration of such transfer assessee agreed that it shall not carry on directly or indirectly the business hitherto carried on by it on the terms and conditions appearing in the agreement. Assessee was carrying on business of manufacturing, selling and distribution of pharmaceutical and medicinal preparations including products mentioned in the list in schedule-A to the agreement. The agreement contained several prohibitive prohibitive/ restrictive covenants. The agreement further showed that the payment made to the assessee was in consideration of the restrictive covenant undertaken by the assessee for a loss of source of income. The Supreme Court dealt with the issue – 'whether a payment under an agreement not to compete (negative covenant agreement)' is a capital receipt or a revenue receipt and held that compensation received for the loss of agency is a revenue receipt whereas the compensation attributable to a negative/restrictive covenant is a capital receipt.

The court perceived a dichotomy between receipt of compensation by an assessee for the loss of agency and receipt of compensation attributable to the negative/restrictive covenant. The compensation received for the loss of agency is a revenue receipt whereas the compensation attributable to a negative/restrictive

114 [2011] 336 ITR 585 (Guj).
115 [2011] 332 ITR 602 (SC).

covenant is a capital receipt. Compensation received under non-competition agreement became taxable as a capital receipt and not as a revenue receipt by specific legislative mandate vide section 28(va) and that too with effect from 1.4.2003. Reliance was placed upon *Gillanders Arbuthnot and Co. Ltd.* v. *CIT*.[116]

XVIII EXEMPTION/DEDUCTION

In *Swayam Consultancy (P) Ltd.* v. *ITO*[117] the high court dealt with the issue as to whether there could be deemed exports for the purposes of section 10 B of the Income Tax Act. The commission and the income tax appellate tribunal held against the assessee.

The appellant was engaged in the manufacturing and assembling of wire and cable drawing/manufacturing machines. The assessee filed income tax returns for the year 2007-08 declaring a certain loss. Though the surplus, as per the profit and loss account, was Rs. 1,29,79,828/-, the assessee claimed deduction of Rs. 1,28,97,161/- under section 10B of the Act. They contended that they were a 100% export oriented unit (EOU) as approved under the scheme of the Government of India, and were entitled for deduction under section 10B of the Act. The AO noticed that the goods were cleared from the factory on 04.11.2006 and, as per the invoice-cum-challan, the place of delivery was at Attola Village in Silvasa. During the scrutiny of the return, the assessee pleaded that the machinery was delivered to the agent of the foreign buyer, under section 143(3) of the Income Tax Act, on the express instructions of the foreign buyer, and therefore, it was deemed to be an export for the purpose of section 10B of the Act. The AO disallowed deduction holding that the assessee did not fulfill the conditions laid down for deduction under section 10B of the Act; as the goods were delivered in India.

The high court held that the document evidencing clearance and loading the goods for exportation was conclusive proof of export outside India. It was also the fact that, for the purpose of Central Excise Act and the Customs Act, certain transactions involving sale of goods in India were treated as 'deemed exports' under different schemes evolved by the central government to facilitate growth of income from export and import duties. But for the purpose of Income-Tax Act, the law neither contemplates nor recognizes such 'deemed exports'.

The term 'export' was not defined in the Income-Tax Act though the term 'export turnover' was explained/defined by four provisions, namely, the explanations to sections 10A, 10AA, 10B and 80HHC of the Act. Be it noted, section 10A of the Act enabled an undertaking in a free trade zone to claim deduction of profits and gains from the export of articles or things or computer software for a period of 10 consecutive years. Similarly, under section 10AA of the Act, a newly established unit in a special economic zone (SEZ) could claim deduction of 100% profits and gains derived from the export for a period of 10 years and, under section 10B of the Act, an assessee could claim deduction of profits and gains as are derived by 100% EOUs from the export of articles or things for a period of 10 years. Section 80HHC

116 [1964] 53 ITR 283 (SC).
117 [2011] 336 ITR 189 (AP).

of the Act was to the effect that an assessee, being an Indian company engaged in the business of 'export out of India', may be allowed deduction of the profits to the extent specified in section 80HHC(1B) of the Act.

Sections 10A, 10AA, 10B and 80HHC of the Act allowed an assessee to claim deduction of profits from export of articles. These provisions, in effect, dealt with different categories of eligible undertakings and establishments engaged in the export of articles and things in various locations. The explanation to these provisions defines/explains the 'export turnover'. The freight and telecommunication charges incurred in connection with the 'delivery of articles or things outside India' during the course of export could not be reckoned as 'export turnover'. This clearly indicates that when the profits from exports are allowed as deduction, the Parliament intended the actual export out of India of the articles or things. The intention was never to consider the delivery of goods to a foreign buyer in India as amounting to export.

This transaction of manufacturing machines in India by EOU and delivering them in India to another 100% EOU, which was alleged to be the agent of a foreign buyer, did not amount to 'export out of India' either under the Customs Act or under the Income-Tax Act. The AO, the appellate authority and the tribunal appreciated the principle of law and applied it correctly. The appeal was thus rejected.

XIX LIMITATION

In *Kanubhai M. Patel (HUF)* v. *Hiren Bhatt*[118] the question related to what constitutes issuance of notice under section 149.The expression to issue in the context of issuance of notices, writs and process, has been attributed the meaning, to send out; to place in the hands of the proper officer for service. The expression 'shall be issued' as used in section 149 would, therefore, have to be read in the aforesaid context. In the present case, the impugned notices had been signed on 31.03.2010, whereas they were sent to the speed post centre for booking only on 07.04.2010.

Considering the definition of the word 'issue', it was apparent that merely signing the notices on 31-3-2010, could not be equated with issuance of notice as contemplated under section 149 of the Act. The date of issue would be the date on which they were handed over for service to the proper officer, which in the facts of the case would be the date on which the said notices were actually handed over to the post office for the purpose of booking of effecting service on the petitioners. Till the point of time the envelopes are properly stamped with adequate value of postal stamps, it could not be said that the process of issue was complete.

In the circumstances, the impugned notices under section 148 in relation to assessment year 2003-04, having been issued on 7-4-2010 which was clearly beyond the period of six years from the end of the relevant assessment year, were clearly barred by limitation and as such, could not be sustained.

Again in *Cadila Healthcare Ltd.* v. *Dy. CIT*[119] the respondent AO issued notice dated 28.10.09 under section 148 of the Act seeking to reopen the assessment for

118 [2011] 334 ITR 25 (Guj).
119 [2011] 334 ITR 420 (Guj).

the year 2004-2005. The petitioner filed its reply to the said notice on 27.11.09 along with a copy of the acknowledgment of the return filed before the AO in response to the notice under section 148 and requested for a copy of the reasons recorded. The AO furnished the reasons for reopening the assessment vide letter dated 20.01.10. The petitioner filed its objections against the reasons for reopening on 8.02.10 which came to be disposed of vide order dated 05.03.10. Vide notice dated 05.03.10 under section 143(2) of the Act, the respondent called upon the petitioner to furnish certain information in connection with the return of income filed for assessment year 2004-2005. Being aggrieved the petitioner has approached the high court by way of a writ petition under article 226 of the Constitution of India.

The high court rightly faulted the conduct of the revenue and held that from the facts emerging on record, there was nothing to indicate that the petitioner has withheld any particulars. The successor AO had verified the record to come to the conclusion that there was escapement of income which could have been done at the initial stage itself. There was nothing on record to indicate any omission on the part of the assessee in fulfilling any obligation in law. Merely making a claim could not be stated to be non-disclosure of material facts so as to vest in the AO jurisdiction under section 147 of the Act. Besides, as already noted hereinabove, the respondent sought to reopen the assessment after a period of four years from the end of the relevant assessment year. In the reasons recorded, there was nothing to indicate that the assessee had failed to disclose fully and truly all material facts necessary for its assessment for the year under consideration. Hence, the ingredients of the proviso to section 147 of the Act were not satisfied. In the circumstances, there was no justification for assumption of jurisdiction by the respondent AO for reopening the proceedings under section 147 of the Act.

XX CONCLUSION

The cases surveyed show the recurrence of the default in drawing distinctions between questions of law and substantial questions of law and the lack of rigor in the perception of the scope of the high court's appellate power. A large number of cases relating to registration of charitable institutions have also been decided in the year under review. It is refreshing to note that the element of clarity required on the part of the registering authorities has emerged reasonably well. Similarly, on the question of reassessment, the mandatory requirements of law regarding notice and other conditions to be fulfilled have been well emphasized. A number of judgments relating to non resident taxation have also been rendered. The transfer of know-how, sale of rights in the know-how, provisions of services within or outside the country have received the attention of the courts and by and large the issues have been dealt with on sound principles of interpretation and intricacies of technology transfer.