16

DIRECT TAX LAW (INCOME TAX)

*R. Venkataramani**

I INTRODUCTION

THE YEAR under review has generated the need for a closer attention towards deviations from strict conformity to matters of procedure and matters of procedure which may very often have a bearing on the outcome of proceedings. For instance, the exercise of revisional jurisdiction under section 263 of Income Tax Act, 1961. (herein at the IT, Act 1961) shows that the strict requirements of the provision are not duly conformed to. The requirement that the revisional authority must record a finding that the order made by the assessing order is erroneous and such finding must be supported by reasons is found wanting, as emphasized by more than one high court.

Similarly, even though it is well settled that a re-assessment is impermissible on the mere ground that there is change of opinion of the assessing officer, high courts had to find fault with assessments which failed to meet with the discipline of section147. Change of opinion is too subjective a process and thus an unsafe ground for re-assessment. It is also noticed that high courts are correcting hasty recovery proceeding. For instance, when the authorities attached the bank account of an assesse and withdrew monies from the account on the same day without affording an opportunity to the assesse, the Bombay High Court rightly criticized such conduct.

In the context of the meaning of total turnover relevant for the purposes of calculating export profit, the judgment of the Supreme Court in the case of *Punjab Stainless Steel Industry* has not taken into consideration the views taken by the High Courts of Kerala and of Punjab & Haryana which seem to have a bearing on the issue.

Uncertainties in international taxation continue to visit the interpretative problems. The range of the issues which have arisen over a period by and large seem to relate to certain recurring issues such as the effect of mutual agreement

---

* Senior Advocate, Supreme Court of India and Member – Law Commission of India.
The author is grateful to Neelam Singh, Yashraj Bundela and Supriya Garg, Advocates for the research assistance and also acknowledge the use of landmark case notes by Rajaratnam, former Member, ITAT.

procedures between parties particularly relating to the question of existence of 'permanent establishment' of a non-resident and the nature of services being rendered by employees who are second to the Indian establishment or the service provider. The mere existence of a second agreement cannot *ipso facto* mean existence of a permanent establishment in India. The question would always be whether the agreement is a sham and whether the Double Taxation Avoidance Agreement is artfully exploited.

II GENERAL PRINCIPLES

Principle of mutuality

The principle of mutuality applies when there is complete identity between the contributors and participators.[1] But where there is any 'taint of commerciality' the principle becomes inapplicable. The issue that arose for consideration before the High Court of Madras was whether dividend received by a subscriber in a chit fund scheme, over and above what had been subscribed by him would be treated as his income? Relying on the decision of Supreme Court in *CIT* v. *Bankipur Club Ltd.*,[2] the high court in *V. Rajkumar* v. *CIT*[3] held that the dividend earned by the assesse would be treated as income liable to tax. The court noticed that chit fund scheme is a business started by a third party. Mere incidence of assesse coming together as participants does not put forth a principle of mutuality. Consequently a chit fund scheme could not be compared to a mutual benefit club where participants contribute funds for their own benefit and any surplus amount received by participants is not treated as income.

Conclusion has been drawn by the court essentially by comparison of the activities of a chit fund scheme with the mutual benefit club. The chit fund operator aids the outcome of the chit fund subscriber's contributions and the operations of the contributions. The chit fund subscribers are thus not engaged in any business, more particularly when the operation of the chit fund is confined to the members of the group amongst whom there is mutuality. The role of the chit fund company may not be said to detract the element of mutuality amongst the members of the fund. The question needs to be seen not from the point of view of the chit fund company on the one hand but the members of the chit fund on the other hand. While the dividend can be treated as a surplus over contribution by the members, it is possible to treat it as not 'tainted by commerciality'. This line of reasoning could have made a difference in the outcome of the judgment.

---

1 For more discussion see R. Venkataramani "Direct Tax Law (Income Tax)" XLVII *ASIL* 341-342 (2012).

2 [1997] 226 ITR 97 (SC).

3 [2014] 363 ITR 21 (Mad).

III INCOME FROM PROPERTY

Computation of income from sub-let property

According to section 27 (iii) (b), a person who acquires rights (excluding by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof by virtue of transfer falling under section 269 UA (f) of Income Tax Act, 2000 (hereinafter IT Act, 2000) would be deemed to be owner of such property. Transaction under section 269 UA (f)[4] includes lease agreements for a term not less than twelve years. Sections 22 and 23 provide for computation of income from house property in the hands of the owner.

The issue under consideration in *Rayala Corporation Pvt. Ltd.* v. *Asst. CIT Madras* [5] was whether income received by the assesse by way of sub-leasing an already leased property, collection of maintenance charges, AC hire charges *etc*. would be "income from business" or "income from house property"?

Assesse in the present case derived income from sublease of rental properties, maintenance charges, air conditioner service charges *etc*. The assesse took the building for a period of 33 years on lease with an option of renewal of lease for five consecutive terms for same period. The high court while classifying the income as "income from house property" rejected the contention that the assesse was not owner of the building and that sub-leasing of buildings and providing other related services was its business activity. Since the assesse has taken the building on lease for a period of 33 years he would deemed to be owner of the property according to section 27 (iii) (b) read with section 269 UA (f). Therefore, the rent received by the assesse from sub-leasing the building would be termed as income from house

---

4 S.269UA (f)- (i) in, relation to any immovable property referred to in sub- clause (i) of clause (d), means transfer of such property by way of sale or exchange or lease for a term of not less than twelve years, and includes allowing the possession of such property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 3 (4 of 1882). Explanation.- For the purposes of this sub- clause, a lease which provides for the extension of the term thereof by a further term or terms shall be deemed to be a lease for a term of not less than twelve years, if the aggregate of the terms for which such lease is to be granted and the further term or terms for which it can be so extended is not less than twelve years;

(ii) in relation to any immovable property of the nature referred to in sub- clause (ii) of clause (d), means the doing of anything (whether by way of admitting as a member of or by way of transfer of shares in a co- operative society or company or other association of persons or by way of any agreement or arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of such property.

5 [2014] 363 ITR 630 (Mad).

property. The high court relied on the decision in *CIT* v. *Ideal Garden Complex P Ltd.*[6] to arrive at the above stated conclusion.

The high court also relied on *CIT* v. *Chennai Properties & Investment Ltd.*,[7] to hold that other income from services like maintenance, AC hire charges *etc*. would be assessed as income from other sources and not "income from house property"

IV TAX DEDUCTED AT SOURCE

Whether landing and parking charges for flight would be covered under the definition of 'rent'?

The issue under consideration before the High Court of Madras in *CIT* v. *Singapore Airlines Ltd.*[8] was whether the charges paid by an international airline company towards landing and parking charges would come within the definition of "rent".

The Madras High Court observed that the word "rent" stands defined exhaustively under explanation (i) of section 194-I of the IT Act, 2000 and only when an agreement or arrangement has the characteristics of lease or sub-lease or tenancy for use of land, the charges would fall under the definition "rent". The charges on landing and take-off being in reference to the number of facilities provided by the Airport Authority of India and not for any specific land use or allotted area were held to be not rent.

The Madras High Court disagreed with the decision of Delhi High Court, in *CIT* v. *Japan Airlines Company Ltd.*[9] which followed its earlier decision in *United Airlines* v. *CIT*[10] wherein the parking and landing charges for aircraft were held to be 'rent'. The court therein observed that the word 'rent', as defined in explanation (i) of section 194-I of the IT Act, 2000 has a wider meaning than 'rent' in common parlance and includes any agreement or arrangement for use of land. The court reasoned that when the wheels of the aircraft touch the surface of the airfield, use of land of the airport immediately begins.

The *ejusdem generis* rule applied by the Madras High Court may be open to considerable challenge in view of the use of the expression "any other agreement or arrangement" which intends to convey a larger set of situations or relationships other than conventional lease or sub-lease *etc.* While the decision of the Madras

---

6 [2012] 340 ITR 609 (Mad).

7 [2008] 303 ITR 33 (Mad).

8 [2013] 358 ITR 237 (Mad).

9 [2010] 325 ITR 289 (Mad).

10 [2006] 287 ITR 282 (Del).

High Court seems persuasive, since appeal against the judgment of Delhi High Court in *Japan Airlines* case[11] is pending in the Supreme Court it would be important for the Supreme Court to settle the issue in light of wide amplitude of the phrase "any other agreement or arrangement".

V CHARITIES

Grant of loans impermissible

The issue under consideration before the high court in *CIT* v. *Fr. Mullers Charitable Institutions*,[12] was that where a charitable institution invests its funds and earns dividend whether it is only the income from such investments made in violation of section 11 (5) of the IT Act, 2000 that would be liable to tax or would such investment result in denial of exemption under section 11 to the total income of assesse.

It has been held in several cases[13] that violation of section 13 (1) (d) by a Charitable Trust does not tantamount denial of exemption under section 11 on the total income of the assesse. Only the income from investment made in violation of section 11 (5) of the Act would be liable to tax.

The decision of the Bombay High Court in *DIT (Exemptions)* v. *Sheth Mafatlal Gagalbhai Foundation Trust,*[14] was based on the reason that the phrase 'relevant income or part of the relevant income' in the proviso to section 13 (1)(d) is to be read in contradistinction to the phrase 'entire income' in sections 161 (1A). The Bombay High Court also observed that there is the distinction between 'eligibility for exemption' and 'withdrawal of exemption/forfeiture' on contravention of provisions of law and that contraventions of provisions would not make an assesse ineligible for exemption. This interpretation of the Bombay High Court was supported by circular,[15] which laid down that where a trust contravenes section 13 (1)(d), the maximum marginal rate of income tax will apply only to that part of the income which has forfeited exemption under the said provision and not the entire income.

The high court in the present case endorsed the view taken by the High Court of Bombay and Delhi held that from the bare reading of section 13 (1) (d) it is clear that maximum marginal rate of tax will apply only to dividend income and that violation of section 13 (1) (d) would not amount to denial of exemption under section 11 on the total income of the assesse.

---

11 *Japan Airlines Co. Ltd* v. *CIT*, C.A. No. 9875/2013

12 [2014] 363 ITR 230 (Karn).

13 *DIT (Exemptions)* v. *Sheth Mafatlal Gagalbhai Foundation Trust* [2001] 249 ITR 533 (Bom); *DIT (Exemptions)* v. *Agrim Charan Foundation*, [2002] 253 ITR 593 (Del).

14 [2001] 249 ITR 533 (Bom).

15 No. 387dated 06.07.84. [1985] 152 ITR (ST.) 1.

Religious charities to be understood in broader sense

The issue that arose for consideration in *CIT* v. *Dawoodi Bohra Jamat*[16] was whether a trust with collective charitable and religious purposes would be covered under section 13 (1) (b) and denied exemption under section 11 of the Act.

The expression 'charitable purpose' as defined under section 2(15) is expansive and inclusive and includes relief of the poor, education, medical relief, preservation of environment, preservation of monuments and advancement of any other object of general public utility. The phrase "any other object of general public utility" has been held to include all objects which promote the well-being of general public. The word 'general' pertains to a whole class[17]therefore; advancement of any benefit to the public or a section of public as distinguished from benefit to an individual or a group of individuals would be charitable purpose.[18]

Religious purpose though not defined has been held to include the advancement, support or propagation of a religion and tenets. A trust may either be a religious trust or charitable in secular sense or it can have a composite character with both charitable and religious purposes.

Section 11 of the IT Act, 2000 allows exemptions to religious and charitable institutions. Section 13 provides for exception to section 11 and when section 13 gets attracted, exemption under section 11 not available. According to section 13 (1) (b) if a charitable trust is established for benefit of any religious community or caste then exemption under section 11 would not be available to the assesse institution.

In order to determine the true character of the trust pre-dominant object test is applied. According to pre-dominant test if the primary or pre-dominant object of an institution is charitable, any other object which might not be charitable but which is ancillary or incidental to dominant of purpose the institution would be a valid charitable trust.[19] Therefore if a trust is composite one it would be necessary to examine if such religious-charitable activity carried on by the trust only benefits a particular religious community or class or serves across the community and for society at large.[20]

The assesse in the present case is a trust promoting charitable as well as religious activities. Most of the activities of the assesse trust, that is, provision of food to the public on religious days of Bohra Community, establishment of Madrasa and organization for dissemination of religious education, rendering assistance to

---

16 [2014]364 ITR 31(SC).

17 *CIT* v. *Gujarat Maritime Board*, [2007] 14 SCC 704.

18 *Ahmedabad Rana Caste* v. *CIT*, [1971] 82 ITR 704 (SC).

19 *Thiagaraja Charities* v. *Addl. CIT*, [1997] 4 SCC 724.

20 *Sole Trustee, Loka Shikshana Trust* v. *CIT*, [1975] 101 ITR 234 (SC).

needy and poor for religious activities reflected charitable purpose. Certain objects that is to give and take Qardan Hasana according to Farma of Qurani Majid and carrying out all religious activities for the prosperity Dawoodi Bohra Community were found to be completely religious in nature.

The court observed that the activities of the trust though both charitable and religious are not exclusively meant for a particular religious community and therefore the trust would not be characterized as charitable trust established for benefit of any particular religious community and would not fall under the provisions of section 13(1) (b) of the Act.

Right to approval under section 10 (23C) (vi)

Section 10(23C) defines certain categories of income which shall not be included in computing the total income of any person for a previous year. Approval under section 10 (23C) (vi) is granted to a trust existing solely for the purpose of imparting education.

The applicant in *C.P. Vidya Niketan Inter College* v. *UOI*[21] is a registered society with primary object of continuous development of education along with several social and charitable purposes. The issue that arose was whether a society with multiple objects besides imparting education would be entitled to exemption under section 10 (23C) (vi). The high court held that a society may have various objects but so long as the only activity carried out by the trust is conduct of educational institutions, it would be entitled for approval section 10 (23C) (vi). The court further observed that there are adequate safeguards, that if the activities other than educational activities are undertaken, the exemption may be withdrawn. Therefore, when in a particular year there are unexplained payments made by the assesse, an educational institution, it would be presumed that in that relevant year it existed not solely for education purpose but for the purpose of profit.[22]

VI EXEMPTIONS

Treatment of miscellaneous receipts in computation of exemption

Section 10(29) of the IT Act, 1961 allows exemptions to an authority constituted under any law for marketing of commodities, for any income derived from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities. Whether income earned is not derived from the above mentioned activities or has no direct nexus to these activities, the question of granting of exemption to those income does not arise.[23] Income earned from

21 [2013] 359 ITR 322 (All).

22 *Cambrian Hall Educational Trust* v. *CIT*, [2013] 359 ITR 401 (Utt).

23 *Orissa State Warehousing Corporation* v. *CIT*, [1999] 237 ITR 589 (SC).

activities incidental to storage, processing or facilitating the marketing of commodities would also qualify for exemption under section 10 (29).[24]

The phrase "marketing of commodities" is to be construed widely so as to include every activity of purchase, selling and distribution as also warehousing.[25]

The phrase "any income derived therefrom" in section 10 (29) is restrictive in application to income derived from letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities. The interest on fixed deposits not being such income would be ineligible for tax exemption.[26]

The issue that arose for consideration before the High Court of Madras in *Tamil Nadu Warehousing Corporation* v. *ITO (OSD),*[27]was whether warehousing charges, supervision charges, fumigation charges, interest on advance to staff, and other miscellaneous charges would be exempt from tax under section 10(29). The high court relying on Supreme Court judgments in *Orissa State Warehousing* case and *Uttar Pradesh State Warehousing* case, held that income from house property, income on bank deposits, income on loans and advances made to the members of the staff not being income from letting of godowns or warehouses for the purposes storage, processing or facilitating the marketing of commodities, would not be granted exemption. With respect to income from supervision charges, fumigation charges, service charges, weigh bridge receipt, income from sale of tender forms and interest collected on belated refund of advances it was held that these being income from incidental activities relating to warehousing of the produce for storage, processing or facilitating the marketing of commodities would be entitled for exemption.

VII BUSINESS EXPENDITURE

Current repairs

Section 37 of the IT Act, 1961 provides that expenditure in the nature described in sections 30-36 including capital expenditures would not be allowed under section 37, so as to compute a part of the business expenditure towards deduction. Further section 30 of the IT Act, 1961 provides deductions in respect of rent, rates, taxes and insurance for building for the purposes of the business, profession or vocation. Such deductions are allowed when:[28]

---

24 *Union of India* v. *U.P. State Warehousing Corporation*, [1991] 187 ITR 54 (SC).

25 *Addl. CIT* v. *Karnataka State Warehousing Corporation* ,[1980] 125 ITR 136 (Karn).

26 *Supra* note 23.

27 [2014] 363 ITR 1(Mad).

28 *Available at:* http://tkbsen.in/wp-content/uploads/2013/06/Income-Tax-Act-1961.pdf. (last visited on July 16th 2014).

a. The premises are occupied by the assessee as a tenant, the rent paid for such premises; and further if he has undertaken to bear the cost of repairs to the premises, the amount paid on account of such premises;

b. The premises are occupied otherwise than as a tenant, the amount paid by him on account of current repairs to the premises. ……..

This section grants an allowance in respect of the amount expended by the assessee on repairs to the premises. If the assessee is a tenant, the repairs done by him need not be 'current repairs' but may be of the nature of capital expenditure,[29] so long as he has undertaken to bear the cost of repairs. The issue arises when the assessee is otherwise and not a tenant, he is entitled to deduction under this section in respect of "Current repairs" to the premises.[30]

"Repairs" would refer to 'renewal' of existing or replacement of a part or a supporting part and not complete replacement or reconstruction. In the case of *Lurcott* v. *Wakely and Wheeler Lord Justice Buckley*[31] drew a distinction between "repair" and "renewal".

The Bombay High Court in *New Sherrock Spinning & Manufacturing Co. Ltd* v. *CIT*[32] has observed that "The simple test that must be constantly borne in mind is that as a result of the expenditure which is claimed as expenditure or repairs what is really being done is to preserve and maintain an already existing asset. The object of the expenditure is not to bring a new asset into existence, nor is its object the obtaining of a new or fresh advantage. This can be the only definition of 'repairs' because it is only by reason of this definition of repairs that the expenditure is a revenue expenditure, if the amount spent was for the purpose of bringing into existence a new asset or obtaining a new advantage, then obviously such an expenditure would not be an expenditure of a revenue nature but it would be a capital expenditure, and it is clear that the deduction which, the Legislature has permitted under section 10(2)(v) is a deduction where the expenditure is a revenue expenditure and not a capital expenditure."

---

29 *CIT* v. *Goyal* [1970] 78 ITR 414 (P&H) Explanation.-For the removal of doubts, it is hereby declared that the amount paid on account of the cost of repairs referred to in sub-clause (i), and the amount paid on account of current repairs referred to in sub-clause (ii), of clause (a), shall not include any expenditure in the nature of capital expenditure.

30 An explanation to s. 30 of the Income Tax Act, 1961 was inserted, by the Finance Act, 2003, *w.e.f.* 1st April 2004 which is as follows: If section 30 is read in its entirety with the explanation it is seen that two conditions have to be satisfied for the expenditure to be allowed as deduction:

a. Amount spent should be in the nature of the current repairs

b. Amount should not be in the nature of capital expenditure.

31 [1911] 1 KB 905 (CA).

32 [2013] 130 ITR 338 (Bom).

The Supreme Court in *CIT* v. *Saravan Spinning Mills (P) Ltd*[33] has laid down that in order to determine whether a particular expenditure amounts to current repairs the test is "whether the expenditure is incurred to preserve and maintain an already existing asset and not to bring a new asset into existence or to obtain a new advantage. For current repairs determination, whether expenditure is revenue or capital is not the proper test."

In consonance with the above decisions, the Delhi High Court in the case of *Surinder Madan* v. *Assistant Commissioner of Income Tax*[34] where the issue pertained to whether change of entire flooring of the ground floor, first floor and second floor including the basement would be termed as "current repairs. It was held that:[35]

> …[R]enewal and installation of entire flooring of 9000 sq. ft. in the entire building with new flooring is not covered under the expression 'current repairs'. It is a case of complete replacement and change.

A new asset of enduring benefit in form of completely new flooring of marble, different and distinct from the earlier flooring, has come into existence. However test of enduring benefits has its limitations but the said test is not redundant.

The judgment is not based on sound principles that have been upheld by the Supreme Court. If an expenditure has enduring benefits, that alone would resultantly be a ground to be not included in "current repairs" so as to be not allowed as a deduction.[36]The court has not seen that the line to be drawn between enduring assets and current repairs though thin is real and substantials.

Premium for guarantee liability, whether deductible

It is settled law that the expenditure which is deductible towards liability actually existing and keeping aside money which may become expenditure on the happening of an event is not expenditure.[37]The matter that arose in *Oswal Agro Mills Ltd.* v. *CIT*[38] was whether a bank guarantee given by the assesse would be an allowable deduction in computation of income?

---

33 293 [ITR] 201 (SC).

34 [2014] 364 ITR 461 (Delhi).

35 *Id*. at para 14.

36 *Empire Jute Mills Co. Ltd*. v. *CIT* [1980] 124 ITR 1 SC.

37 See *Indian Molasses Co. Pvt. Ltd* v. *CIT*, [1959] 37 ITR 66 (SC); *Standard Mills Co. Ltd*. v. *CIT* [1998] 229 ITR 366 (Bom) ; *CIT* v. *Indian Smelting and Refining Co. Ltd*., [1998] 230 ITR 194 (Bom).

38 [2014] 363 ITR 486.

The assessee engaged in manufacturing and trading of products like de-oiled meals, industrial hard oils, edible oils, marine products, emergency lighting units and soaps, *etc.* contracted with three importers for purchase of imported materials at landed cost *i.e.,* CIF price, custom duty, clearing charges, *etc*. and 3% of the total cost. The assessee also undertook the liability to bear post import custom duty, excise duty, penalty, sales tax, *etc*.

There was a dispute over levy of customs duty on such imports that was challenged by the importers before the Supreme Court which allowed the clearance of imported material on payment of 15% of the disputed additional custom duty and granted stay for balance 85% of the said duty, subject to furnishing of bank guarantees by the importers. The provision against such guarantee obligations was claimed in computation of assessable income. It was held that the liability of the assessee was only a contingent liability dependent on the final decision of the Supreme Court in the pending writ petition. Since the liability was not ascertained liability, the deduction was not allowed by the high court.

While there is a distinction between pure statutory liability and a mere contractual liability, there can be circumstances that a contractual liability is triggered by a statutory liability. Where a contractual liability or an obligation is discharged entirely by the conduct of parties or on their own volition, the link between statutory liability and contractual liability may not arise. Where however, a possible link can be suggested and a contractual stipulation gets attracted only by reason of an external factor such as a statutory liability, the question of deduction may have to be seen in a different light.

VIII CAPITAL GAINS

No transfer of goodwill on settlement of account of retiring partners

A partnership firm is not a distinct legal entity apart from the partners constituting it. Firm's property is property of all the partners having joint or common interest. Whatever is contributed by a partner (capital money or property) becomes trading property of the partnership with all the partners having interest proportionate to their share. Thus the property ceases to be property of any particular individual. During the subsistence of a partnership, a partner is entitled to receive his share of the profit. When a partner retires, there is no severance of status of the partnership. The retiring partner would take its capital investment plus profit (if he is accountable for any loss that would also be worked out) and retire from partnership and the others continue to carry on the business. When a retiring partner takes only money towards the value of his share and when there is no distribution of assets among the partners there is no transfer of capital asset.[39] Therefore, the assets and liabilities of the firm continue as such without any change including tangible and intangible. The issue that came up for consideration before the High Court of Kerala in *Oberon*

39 *CIT* v. *Dynamic Enterprises*, [2013] 359 ITR 83 (Karn).

Trading Corporation v. *Income Tax Officer*[40] was whether the money paid to a retiring partner could be paid as depreciation by the partnership firm on account of transfer of goodwill.

The assessee, a partnership firm was constituted by four partners and later three new partners were inducted. Subsequently, after continuing for some time, the old partners retired in four consecutive assessment years. The high court observed that the four partners who decided to go out did not transfer the entire business concern to the new partners, rather decided to stay for some time and retire as and when they wanted. Therefore it was held that what was paid to the retiring partner was its share of the capital and not as cost towards acquisition of any right from him.

Meaning of residential house for the benefit of section 54

Section 54 provides that if an assessee invests capital gains arising from transfer of a long term assets being buildings or lands or a residential house to purchase or construct a residential house, the amount of capital gains shall not be charged under section 45.

The issue that arose in *CIT* v. *Gita Duggal*[41] was whether capital gains on sale of property being a residential house would also be exempt from tax if the amount is invested in two or more flats.

The high court referred to the decisions in *CIT* v. *Ananda Basappa*[42] and *CIT* v. *Smt. K.G. Rukminiamma.*[43] In *Ananda's* case it was observed that having regard to the provisions of section 13 of General Clauses Act, 1897 which states that "whenever a singular is used for a word, it is permissible to include the plural". The court held that the phrase 'residential house' should be understood to mean that the building should be residential in nature (as against a commercial building) and 'a' should not be understood to indicate a singular number. The judgment in *Ananda's* case was followed in *Rukminiamma's* case to hold that assessee was entitled to exemption under section 54 on purchase of two flats combined to make one residential unit.

Following the above mentioned judgments of the Karnataka High Court the High Court of Delhi held that the only requirement/condition imposed by section 54 is that the amount of capital gains be invested in a residential property and not a commercial one. Section 54 does not require a building to be constructed in a particular manner and exemption is allowed where house containing several independent units is purchased.

40 [2014] 360 ITR 19 (Ker).

41 [2013] 357 ITR 153 (Del).

42 [2009] 309 ITR 329 (Kar).

43 [2011] 331 ITR 211 (Kar).

The view that the assessee would be entitled to exemption if the independent units are in one residential building would be to give a narrow interpretation. The rationale should also be applicable to cases were residential units are scattered in more than one building. A further clarification on the issue from the Supreme Court would be necessary.

IX INCENTIVE DEDUCTION

Whether scrap sales would form part of total turnover while calculating export profit to claim deduction under section 80 HHC?

The issue that came up before the Supreme Court in *CIT* v. *Punjab Stainless Steel Industries*[44] was whether the income from scrap sales would be included in the total turnover of an assessee engaged in export of its goods to calculate profit from export for claiming deduction under section 80HHC of the IT Act, 1961. The formula to calculate export profit is as under:[45]

Export Profit = Business Profit * Export Turnover/Total turnover.

In the above formula, greater the denominator *i.e.,* total turnover, lower will be the export profit for which deduction is allowed under section 80HHC of the IT Act, 1961.

The Supreme Court relied on the definition of 'total sales' as mentioned in the guidelines issued by the Institute of Chartered Accountants of India (ICAI) which states that "total turnover, that is the aggregate amount for which sales are affected by the company, given the amount of sales in respect of each class of goods dealt with by the company and indicating the quantities of such sales for each class separately." It observed that total turnover means total sales *in relation to goods dealt with by the company* and scrap not being such a good, its sale would not form part of total turnover. The court distinguished the case of a manufacturer and exporter of stainless steel utensils from a buyer who purchases scrap from assessee and sells it to someone else. The sale of scrap by such a buyer would form part of his total turnover since he primarily deals in scrap. The court also remarked that when a provision is enacted to encourage export, maximum benefit under such provision should be given by revenue to the trader who is helping the nation by earning foreign exchange through his export business.

But a contrary view that exists is that a combined reading of clauses (b) and (ba) of explanation to section 80 HHC shows that anything which has a nexus with the sale proceed would be included in 'total turnover'. The High Court of Punjab and Haryana in *CIT* v. *Bicycle Wheels (India)*[46] held that sale of scrap; formed as

---

44 [2014] 364 ITR 144 (SC).

45 *Ibid.*

46 [2011] 335 ITR 384 (P&H).

a result of manufacturing of goods for export resulted in income to the assessee and would therefore form part of 'total turnover'. Similar view was taken by High Court of Kerela in *CIT* v. *Kar Mobiles Ltd.* [47]but adopted a different line of reasoning. The high court observed that exclusions mentioned in clause (baa) to the explanation to section 80HHC to calculate "profits of the business" are items of income referred to in section 28 (iii a), (iii b) and (iii c) of the Act and receipts by way of brokerage, commission, interest, rent charges or any other receipts of similar nature. Sale of scrap generated in the course of manufacture of goods for export not being income in the nature of brokerage, commission, interest, rent charges and systematically sold by the assessee would form part of the 'total turnover'.

The above mentioned judgments were not considered by the Supreme Court in the case of *Punjab Stainless Steel Industries* case and therefore a review of the same may be required in light of the reasoning of the High Courts of Punjab and Haryana and Kerala.

X SET OFF OF LOSSES

Two transactions of capital gains-whether *inter se* set off is permissible.

Section 71 of the IT Act, 1961 allows set off of loss from one head against income from another head. Section 71 (1) permits *inter se* set off of income falling under the same head "capital gains". Section 71 (3) provides that when "net income" under the head "capital gains" is a loss it has to be carried forward as per section 74.

The Karnataka High Court in *CIT* v. *McDowell and Co. Ltd,*[48] took a view contrary to the provisions of section 71 and disallowed setting off of loss from sale of a piece of land at Gujarat against profit from sale of polymer unit at Visakhapatnam s a going concern. The high court reasoned that the land was not property of the polymer unit since no industrial activity was carried on in the land. Secondly, the two properties were sold to two different persons. The view of the high court not being in consonance to the statute would require a review.

XI INTERNATIONAL TAXATION

What is technical fee

Uncertainties in International taxation continue to visit the interpretative problems. The range of the issues which have arisen over a period by and large seem to relate to certain recurring issues such as the effect of mutual agreement procedures between parties particularly relating to the question of existence of 'permanent establishment' of a non-resident and the nature of services being

---

47 [2011] 333 ITR 478 (Ker).

48 [2014]364 ITR 699 (Kar).

rendered by employees who are seconded to the Indian establishment or the service provider. The mere existence of a secondment agreement cannot *ipso facto* mean existence of a permanent establishment in India. The question would always be whether the agreement is sham and whether the Double Taxation Avoidance Agreement is artfully exploited. The task of determining the existence of a permanent establishment cannot rest merely on a solitary factor such as a secondment agreement. The nature of secondment agreement itself will have to be seen; is there a contrivance, to cloak a permanent establishment otherwise operating within India and whether the services provided therein including the nature of employment and that of the employees, are complete in themselves and integral to the establishment and not merely ancillary to the non-resident establishment.

Centrica India Offshore Private Limited (CIOP)[49] is a resident Indian company and a wholly owned subsidiary of Centrica Plc, incorporated in UK, BSTL (UK based co.) and DEML (Canadian Co.) are also subsidiaries of Centrica Plc. All these overseas entities are in the business of supplying gas and electricity and outsourced their back off support functions like debt collection/ consumers' billing/ monthly jobs *etc*. to CIOP, India. During its initial years of operations, CIOP sought some employees on secondment from these overseas entities for a fixed tenure as per secondment agreement.

The issue that came for consideration before the High Court of Delhi was whether the services provided by the overseas entities through 'seconded' employees, to their service provider *i.e.* CIOP, whose work was to ensure quality control and management of their vendors of outsourced activity, was technical in nature?

The seconded employees were permanent employees of the relevant overseas entity and there was no purported employment relationship with CIOP. All direct costs of such seconded employee's basic salary and other compensation *etc.* were ultimately paid by the overseas entity. CIOP paid an amount equivalent to the salaries of the seconded employees to their relevant overseas entity and claimed it to be reimbursement of their salaries and claimed tax exemption. CIOP was given right to only terminate the secondment agreement but could not terminate the services of the secondees. Thus the court held that there exists 'service permanent establishment' (Service PE) in India (CIOP) (which is a necessary condition as per DTAA for rendering technical services)

The high court observed that as per article 13 of India – UK Double Tax Avoidance Agreement 'a fee for technical services' is defined as "payments of any kind of any person in consideration for the rendering of any technical or consultancy services (including the provision of services of a technical or other personnel)". Since the definition expressly includes the provision for services of the personnel, the services provided by seconded employees would be termed as technical services. It further observed that 'technical' service is not restricted to

49 *Centrica India Offshore Pvt. Ltd.* v. *CIT*, [2014] 364 ITR 336 (Delhi).

technological services but rather extends to know-how, techniques and technical knowledge. Since the seconded employees use their knowledge and expertise to assist CIOP, the service would be termed as technical.

Article 12 of the Indian-Canadian treaty incorporates "fee for included service" which includes consultancy and technical services with an additional requirement of making available technical knowledge, skill, experience, know-how *etc*. Therefore, mere rendition of service would not be termed as an "included service" but would become "included service" when the skill behind that service is made available to CIOP. In the case of CIOP the secondees were not only providing services but rather tiding CIOP through the initial period and ensuring that going forward, the skill set of CIOP's other employees is built and these activities may be continued by them without assistance. The activity of secondees is thus transfer of their technical ability to ensure quality control. The court thus held that the payment made by CIOP to overseas entities was for the technical services provided by the seconded employees and was thus CIOP was required to deduct tax at source.

As we noticed above some of the outstanding uncertainties call for a resolution, both to protect the interest of revenue as well as to avoid undue overreach.

Inference of permanent establishment

It is a well settled principle that a foreign company can be taxed in the country where it has a subsidiary, which is also a permanent establishment (PE), on the income attributable to the said PE, even if the subsidiary is being taxed in the said country. The principle being that subsidiary being an independent and a distinct entity is taxed for its income, whereas the foreign entity, *i.e.,* holding company is taxed for the income earned by the said independent entity attributable to the PE in the country where subsidiary is situated. The principle that creating or establishing a subsidiary company in the other treaty company, by a non-resident company would not *ipso facto* result in creating a permanent establishment of the foreign company in the said country is also generally accepted.

The issue that arose for consideration in *DIT* v. *e-Funds IT Solution*[50] was whether the activities of *e-Fund* India constitute permanent establishment of the foreign assessee companies, rendering their income attributable to *e-Fund* India, liable to tax in India. The assessee companies' e-Fund Inc. and e-Fund Corp are non-resident companies associated with e-Fund India, which is a company incorporated and resident or India.

The court discusses various types of permanent establishments possible in the facts of the case and the requirement necessary to conclude existence of a permanent establishment as per Double Tax Avoidance Agreement between USA and India.

a) Location or fixed place permanent establishment

50 [2014]364 ITR 256 (Del).

b) Service permanent establishment[51]

c) Two different types of agency PE: dependent and independent.

In the present case the Indian company performed back office support including data entry operations. The assesses did not have a fixed place of business in India nor were the premises of *e-Fund* India were at disposal of the assesses. The court observed that the close association between e-Fund India and assesses could not be a determinant factor to conclude fixed place PE.

Employees of *e-Fund* India were their own employees and not the employees of the assessee, therefore, there was no service PE. The transactions between assesses and the Indian company were at arm's length and were carried out in the ordinary course of business and hence no agency PE could be inferred.

The court held that the Mutual Agreement Procedure cannot be the primary basis to decide whether assesses has permanent establishment in India, and that a business connection did exist in India because the *e-Funds* India was providing information and details to the assessee's in USA for the purpose of entering into contracts with third parties and subsequently the said contracts were performed fully or partly by *e-Funds* India as an assignee or sub-contractee. But in order to tax profits of business outside India attributed to operations carried out in India, real and intimate connection must exist between operations carried out in India and business by nonresident outside India.[52] Since the attributions of profit to business connection had not been undertaken/applied, no income of the assesses was found to be taxable in India

XII NON RESIDENT TAXATION

Transfer pricing rules: powers of assessing officer, transfer pricing officer, dispute resolution panel and high

The issue of jurisdiction of authorities and writ jurisdiction of the high court came up for consideration before the High Court of Bombay in *Vodafone India*

---

51 See *DIT (International Taxation)* v. *Morgan Stanley & Co. Inc*., [2007] 292 ITR 416 (SC).

52 See also *Booz and Company (Australia) P. Ltd., In re,* [2014] 362 ITR 134 (AAR). The case discusses essentials features of "business connection" and summarizes the position as under:

(a) a real and intimate relation must exist between the trading activity carried on outside India by a non-resident and the activities within India ;

(b) such relation shall contribute, directly or indirectly, to the earning of income by thenon-resident in his business;

(c) a course of dealing or continuity of relationship and not a mere isolated or stray nexus between the business of the non-resident outside India and the activity in India, would furnish a strong indication of "business connection" in India.

Service Pvt. Ltd. v. *Union of India.*[53] It was observed by the high court that the transfer pricing officer is entitled to exercise powers under sub-section 2A and/or 2B of section 92CA to determine arm's length price[54] in relation to an international transaction only, independent of any reference made to it by the assessing officer (AO).[55] The Transfer Pricing Officer (TPO) is not permitted to go into the question whether there had been any international transaction during the period under consideration.

When a TPO determines the arm's length price of an international transaction, the AO cannot sit in judgment over the determination in any respect.[56] The AO has to prepare the draft order in conformity with computation done by the transfer pricing officer, which along with the order of the transfer pricing officer is challengeable on all grounds in their entirety before the dispute resolution panel (DRP).

The DRP is bound to consider the entire assessment and not the international transaction alone. It is entitled to go into all aspects of any issue before it (even the issue as to whether there was an international transaction or not), both as regards factual and legal aspects, so that a writ may not be maintainable against such order.[57] Further remedy of appeal to the tribunal is also available against the order of DRP and also against the order of Commissioner (appeals) in case the assessee opts to challenge report of TPO before Commissioner (appeals).

XIII TAX RECOVERY

Hasty recovery in respect of disputed demand

Law regarding proceedings for effecting recovery of tax has been settled by the High Court of Bombay in *UTI Mutual* v. *Income Tax Offices*[58] where the court has issued certain guidelines. As per these guidelines recovery of tax should not be made pending the expiry of time limit for filing appeal. This is to ensure justice and fairness to the assessee. Another important guideline issued in *UTI* case was that when a bank account has been attached, before withdrawing the amount, a reasonable prior notice should be given to the assessee to make a representation or seek recourse to a remedy in law.

---

53 [2013] 359 ITR 133 (Bom).

54 Arm's length price means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises in uncontrolled conditions.

55 Prior to insertion of sub section 2A with effect from June 1, 2011, the Transfer Pricing Officer could exercise such jurisdiction only upon the transaction being referred to him by the A.O. with prior approval from the Commissioner.

56 See *Veer Gems* v. *Asst. CIT*, [2013] 351 ITR 35 (Guj).

57 *Hindalco Industried Ltd.* v. *Addl. CIT*, [2013]359 ITR 46 (Bom).

58 [2012] 345 ITR 71 (Bom).

Even with the law ensuring fairness to the assessee, it is seen that at times the assessing officers act in gross violation of settled law and elementary principles of law thereby shocking the judicial conscience. One such case came before the High Court of Bombay where the court criticized the highhanded behavior of the authorities in attaching the bank account of the assessee and withdrawing the money from the account on the same day without affording any opportunity to the assessee to make a representation or seek remedy in law.

In *Director of Income Tax (Exemption)* v. *ITAT,*[59] the assessee was a statutory corporation and a demand of about Rs.200 crores was made from the assessee. The Commissioner ordered the assessee to pay the amount in ten equal installments and dismissed the appeal. On the same day as the assessee approached the tribunal against the order of the commissioner, the assessing officer attached the bank account and recovered the money from the bank. Even though the assessing officer had been informed by the assessee that no action of recovery be taken in the light of decision in *UTI* case[60] and that he would approach the tribunal in appeal against the order of the commissioner as and when the certified copy of the order would be furnished to him, the assessing officer proceeded with attachment of bank account and recovery of money in violation of law.

Similarly in *Dishnet Wireless Ltd.* v. *Assistant CIT*[61] and others where the assessee was directed by the assessing authority to pay Rs. 46 crores approximately, as against which appeal lay to the tribunal, the assessing officer proceeded to recover the said amount and issued notice to the assessee within two days from the date of the order of the assessing authority. Such notice was stayed by the high court in writ petition filed by the assessee holding that appellate remedy is available to the petitioner and till the limitation period to file appeal lapses, assessing authority should not take coercive steps for recovery against the petitioner.

Stay of disputed demand

It is a settled proposition that when enhancement of assessment by CIT (Appeal) is made on grounds which are *prima facie* unsound, the payment of arrears of tax should be stayed during the pendency of appeal.

The High Court of Delhi in *Saipen Triune Engineering Pvt. Ltd.*[62] found that the CIT(Appeal) added an amount of approximately 30.44 crore by applying section 40 A (2), when in fact the amount had not been claimed by the assessee by way of expenditure, rather it was an amount embedded in the price paid on slump sale.

---

59 [2014] 361 ITR 469 (Bom). See also *Sony India P. Ltd. etc.* v. *Addl. CIT,* [2014] 363 ITR 330 (Del) ; *A.T. Kearney P. Ltd.* v. *Income-Tax Officer*, [2014] 363 ITR 172 (Del)

60 See *supra* note 58.

61 [2014] 361 ITR 449 (Mad).

62 [2014]364 ITR 154 (Del).

The high court noticed that *prima facie* the amount of Rs. 30.44 crores could not be added to the income of the assessee and therefore, it stayed the order of the tribunal for making payment of arrears during pendency of appeal.

In *Coco Cola India P. Ltd.* v. *Asst. Registrar ITAT (Bom)*[63] also the high court found that the AO and the tribunal should have granted stay against recovery of approx. 64.34 crores (for the year 2007-2008) and Rs.73.55 crores (for the year 2008-2009). In this case the TPO observed that advertising, marketing and sales promotion expenses (AMP) of the assessee was 46.04 % of the sale and was much higher than other similar enterprises. Based on the said observation it was concluded that the assessee rendered intra group services like strengthening of the brand to its associated enterprise and that the non-routine AMP ought to be added to be assessee's income. The stay of recovery amount was denied by the AO. The high court relied on the full bench decision of the appellate tribunal in *L.G. Electronics Pvt. Ltd* v. *Assistant CIT*[64] wherein it was held that there is no impediment on the power of the assessee to spend as much as he likes on advertisement and mere fact that the assessee has spent disproportionately more on advertisement can, at best be the cause of doubt for the AO to trigger examination and satisfy himself that no benefit *etc.*, in the shape of brand building has been provided to the foreign associate enterprise. If it is found that the advertisement expenses are confined to advertising the products to be sold in India along with assessee's own name then AO will have to allow deduction for the AMP expenses. The high court held that the AO ought to have given consideration to the facts and give finding whether the assessee acted in concert with its foreign associate company and spent on its brand buildings while considering the stay application.

Similar issue of stay of recovery of disputed amount also came up before of the High Court Punjab and Haryana in *Motorola Solutions India Pvt. Ltd.* v. *CIT*.[65]

Assessee is a subsidiary of Motorola Solutions International Capital LLC, USA and Motorola Solutions Inc. USA. India and USA have signed a DTA treaty which provides for a mutual agreement procedure (MAP) whereby a person aggrieved by taxation can present his case to the competent authority of the country of its residence. A MOU has also been signed by the two States which requires assessing authority to suspend collection of tax potentially payable, collection and assessment of any interest or penalty levied on the assessee, during the pendency of MAP proceedings. The MOU also requires the assessee to furnish bank guarantee as security.

---

63 [2014]364 ITR 567 (Bom).

64 [2013] 22 ITR (tri) 1 Del (FB), The special bench enlisted certain relevant questions, whose answers would have considerable bearing on the question of determination of the cost/value of the international transaction of brand/logo promotion through AMP expenses incurred by the Indian asociated enterprise for its foreign entity.

65 [2014]364 ITR 663 (P & H).

During scrutiny a notice was served upon the assessee under section 143 (2) of the IT Act, 1961 by the assistant CIT. A demand notice of approximately 21.6 crores was served upon the assessee who invoked MAP proceedings and filed application for stay. Stay was granted subject to production of bank guarantee which was duly complied with by the assessee. Despite the stay order, pendency of MAP proceedings and existence of valid bank guarantee, revenue issued notice upon the petitioner to forthwith deposit Rs.26,26,87,000/- and sent another notice to the bank where the assessee maintained its account, to remit Rs.26,26,87,000/ -. The bank issued a DD in favour of the revenue.

The high court held that the notices were invalid and liable to be quashed in light of the above mentioned facts and directed the department to refund the amount to the assessee.

XIV ASSESSMENT

Filing of revised returns

The issue that arose for consideration in *CIT* v. *Sam Global Securities Ltd.*[66] was whether filing of revised returns is mandatory for claiming deductions or business loss when assessee failed to claim it in the return of income? The tribunal relying on decision of the Supreme Court in *CIT* v. *V. MR. P. Firm, Muar*[67] and circular[68] issued by the Central Board for Direct Taxes, that an officer must not take advantage of the ignorance of the assessee as to his rights, remanded the matter to the AO to be decided on merits. The high court upholding the order of the tribunal held that the powers of the tribunal hearing an appeal are very wide as against the power of an AO, who does not have the power to allow claims in absence of revised return. The tribunal has the discretion to allow a new claim (not filed through return or revised return) filed before it, since the purpose of the proceedings before the taxing authorities is to correctly ascertain the tax liability of the assessee. The decision in the case of *Goetze (India) Ltd.* v. *CIT* [69]was distinguished where the decision was limited to the power of assessing authority to entertain a claim for deduction otherwise than by a revised return and did not impinge on the powers of the tribunal.

Notice under section 142 (1) and 143 (2) is mandatory

Service of notice under section 142 (1) calling for return is mandatory for an assessment. Similarly where return is furnished by an assessee and any claimed loss, deduction, exemption, allowance or relief claimed in such return is found to

---

66 [2014] 360 ITR 682 (Delhi).

67 [1965] 56 ITR 67 SC.

68 *Circular No.* 114 XL-35, dated 11.04.55

69 [2006] 284 ITR 323 SC.

be inadmissible, the assessing officer is required to service a notice upon the assessee to produce evidence in support of such a claim. Failure to comply with the mandatory requirement of issuance of notice would render the assessment illegal and void *ab-initio*. The law in this regard has been settled by the Supreme Court in *Asst. CIT* v. *Hotel Blue Moon*.[70] It is also a settled principle of law that the onus of service of notice upon the assessee is on the revenue. Where the revenue fails to discharge the onus by any cogent material, the assessment would be illegal and liable to be cancelled as held by the high courts in *CIT* v. *Gita Rani Ghosh*[71] and *CIT* v. *Pratapbhai K. Soni*.[72] In the former case notices under sections 142 (1) and 143 (2) issued to the assessee carried incorrect Permanent Account Number (PAN) and address and also the receipt was with regard to assessment year 2001-2002 whereas the notice was with regard to assessment year 2002 – 2003 and in such circumstances the assessee did not feel the need to respond to the notices since these pertained to some other assessee. The high court concluded that the assessee shall be treated as having not been served with due notice in accordance with law. Similarly in the matter of *Pratapbhai* case where the revenue failed to demonstrate issuance of notice under section 143 (2) upon the assessee as per the provisions of the Act, the assessment orders were directed to be cancelled by the CIT (Appeals) and the said order of CIT (Appeals) was upheld by the tribunal as well as the high court.

Notice under section 143(2) whether issue in time is enough?

Proviso to section 132(2) (ii) provides that notice under sub clause (ii) should be served upon the assessee within six months from the end of the financial year in which the return is furnished.

The issue that came up for consideration before the High Court of Punjab and Haryana in *V.R.A. Cotton Mills* v. *Union of India*,[73] was whether the expression "served" is interchangeable with the word "issue" or is it to be used literally so as to mean actual physical receipt of the notice by assessee. High court relied on the decision of the Supreme Court in *Collector of Central Excise* v. *MM Rubber and Co.*,[74] wherein it was held that the decision of an authority become effective from the date it is signed by him: *i.e.,* when he ceases to have any authority to change it, which normally happens when it is notified in some form or when it can said to have left his hands. It was also held that date of communication of order to the affected party was not relevant for the purposes of determining whether the power has been exercised within prescribed time. On the same reasoning it was held in *V.R.A. Cotton Mills* that the expression "serve" means date of issue of notice.

---

70 [2010] 321 ITR 362 (SC).

71 [2014] 361 ITR 17 (Gau.)

72 [2014] 361 ITR 201 (Guj.)

73 [2013] 359 ITR 496 (P&H).

74 1992 Supp.1 SCC 471.

The high court relying on section 27 of General Clauses Act, 1897 and judgment of Supreme Court in *Banarasi Devi* v. *I.T.O*.[75] Held that the expressions "serve" and "issue" are interchangeable.

The decision in *Banarasi Devi's* case was rendered under section 34 (1) of Income Tax Act, 1922 wherein the provision only barred issue of notice beyond prescribed time limit whereas the provision under 1961 Act requires service within time. Hence the decision in *V.R.A. Cotton Mills'* case may need a review.

The issue of service of notice under section 143 (2) within time limit also came up for consideration in *Gujarat State Plastic Manufacturers Association* v. *Dy. D.I.T. (Exemptions)*.[76] The issue here was not whether the notice should have been issued or served within time limit, rather it was that when notice was required to be served upon the assesse on or before 30.09.12, is actually served on 01.10.12 *i.e.,* Monday, can it be said that notice has been served within time.

The court therefore acts on the assumption that mere issue of notice within time is not sufficient but it should be served within time limit on the assesse. The court applying the logic of section 10 General Clauses Act, 1897 finds that the law cannot compel the performance of impossibility. 30.09.12 being a holiday, service of notice was impossible therefore service of notice on next working day was sufficient compliance of the provisions of section 143(2) of IT Act.

XV REASSESSMENT

Pre-conditions to be fulfilled to issue notice under section 147

Reassessment for any assessment year cannot be re-opened after expiry of four years from ending of relevant assessment year except when two important pre-conditions among others under section 147 are satisfied, namely; (a) that there has been underassessment to the belief of the AO and (b) such belief must be formed on the basis of omission or failure on the part of the assessee to make a return of his income or failure or omission to, *inter alia*, disclose fully and truly all material facts necessary for his assessment. Where these conditions are not satisfied the notice for reassessment would be invalid.[77]

The assessee is only under the obligation to disclose material facts *i.e.*, those primary facts which if taken into account would have an adverse effect on the

---

75 1964 (53) ITR 100 (SC).

76 [2013] 359 ITR 516 (Guj).

77 See in this regard, *Asst. CIT* v. *ICICI Securities Primary Dealership Ltd*. [2012] 348 ITR 299 (SC); *Dy. CIT* v. *Simplex Concrete Piles Ltd*., [2013] 358 ITR 129 (SC). For a detailed discussion see *Rabo India Finance Ltd.* v. *Dy. CIT*, [2012] 346 ITR 528 (Bom); *NDT Systems* v. *ITO,* [2014] 363 ITR 602 (Bom); *Moser Baer India Ltd.* v. *Dy. CIT*, [2013] 81 DTR 10 (Del); *Aventis Pharma Ltd.* v. *Asst. CIT*, [2010] 323 ITR 570 (Bom); *CIT* v. *Jagson International Ltd.*, [2010] 321 ITR 544 (Delhi) and *Asteroids Trading and Investments P. Ltd.* v. *Dy. CIT*, [2009] 308 ITR 190 (Bom).

assessee by higher assessment of income than actually made. He is not required to draw attention of the assessing officer to the inferences which may be drawn from such primary facts. The law on the issue has been summarized by the High Court of Andhra Pradesh in *GVK Gautami Power Ltd* v. *Asst. CIT (OSD)*[78]after considering all the relevant Supreme Court judgments.

The reopening of assessment has to be justified by the assessing officer by giving reasons stating what material facts the assessee failed to disclose. If the reasoning is based on material already on record during the original assessment, the notice for reassessment would be invalid. Reassessment of a completed assessment is thus impermissible on the mere ground that there is 'change of opinion' of the assessing officer.[79]

In the cases of *NTPC* v. *Dy. CIT*,[80] where no part of assessee's income had escaped assessment and there was no failure on part of the assessee in disclosing material facts, the reassessment under section 147, after expiry of 4 years from the relevant assessment year was held to be invalid. The court also noticed that the AO was seeking reassessment merely because there was a change in his opinion that the steam undertaking is not a separate undertaking even though in the assessment proceedings for the assessment year 1998-99, the AO had, after a detailed discussion, granted deduction under section 80-IA in respect of the separate profits of the gas and steam undertakings, though on the basis that they were integrated, he had adjusted the quantum of deduction. Change of opinion is too subjective a process or reason and thus an unsafe ground for reassessment.[81]

Similarly in *Kanak Fabrics* v. *ITO*,[82]*General Motors India P. Ltd.* v. *Deputy CIT (Guj)*,[83]*Gujarat Lease Financing Ltd.* v. *Dy CIT*,[84]*and Charotar Nagarik Sahakari Bank Ltd. (in liquidation)* v. *Dy. CIT*,[85] were all cases where the assessment was reopened after end of four year limitation period and no reasons were recorded by the AO indicating that income has escaped assessment due to failure on the part of the assessee to disclose fully and truly all material facts necessary of its assessment for the relevant year. In such circumstances the notice issued to the assessee for reassessment were quashed.

---

78 [2011] 336 ITR 451 (AP).

79 See *Atomstroy export* v. *Dy. DIT*, [2014] 363 ITR 612 (Bom).

80 [2013] 350 ITR 614 (Delhi) & [2014] 360 ITR 380 (Delhi).

81 *CIT* v. *Kelvinator of India Ltd.*, [2010] 320 ITR 561; and *CIT* v. *Usha International*, [2012] 348 ITR 485 (Delhi) (FB).

82 [2013] 359 ITR 447 (Guj).

83 [2014] 360 ITR 527 (Guj).

84 [2014] 360 ITR 496 (Guj).

85 [2014] 360 ITR 373 (Guj).

Where the notice of reassessment were issued by the AO based on incorrect/ misconceived facts, such notices are also liable to be quashed as held by high courts in *Nuwave E. Solutions Pvt. Ltd* v. *Asst. CIT*,[86] and *Reckitt Benckiser Healthcare India Ltd.* v. *Asst. CIT (OCD)*.[87] Whereas in the former case the order of reassessment was based on consideration of typographical notings in the notes of accounts of the assessee, in the latter case the it was based on the wrong observation made by the assessing officer that the assessee did not give any proof that while computing its return, it did not claim Rs. 86.17 lakhs related to SAP implementation charges as revenue expenses. In both the cases it was held that verification of facts in the returns filed and other evidence on record before the assessing officer during the original assessment proceedings would have brought the said factual errors in light.

However in *Tecumesh Products India Pvt. Ltd.* v. *Asst. CIT*[88] while quashing the notice of reassessment issued to the assessee since the pre-conditions specified in section 147 were not fulfilled, the high court granted liberty to the revenue to proceed in accordance with law, taking note of records, if there exists a strong ground for issuance of such notice. Whether the high court would be justified in making such an observation after quashing the notice for reassessment, needs consideration, as it may provide an occasion for vexatious process.

Reasons to be recorded

Section 148 requires the AO to record his reasons in the notice for reassessment. The assessee in *CIT-II* v. *Living Media India Ltd.*,[89] was served notice under sections 147/148 for reassessment pertaining to the issue of bad debt. After nine months additional reasons were adduced to the effect that there was failure to set of unabsorbed depreciation against long term capital gains and that the disallowance under section 14 A was not properly made.

The issue that came up for consideration was whether additional reasons could be recorded by the assessing officer after issuance of notice under section 148. The high court held the validity of proceedings initiated on issuance of notice would have to be judged from the stand point of reasons recorded in the notice. Notice under section 148 would stand or fall depending upon reasons recorded prior to the issuance of notice and additional reasons cannot be provided subsequently. The revenue however is empowered to issue another notice under section 148 for different reasons based on some other information that comes to his knowledge.

---

86 [2014] 360 ITR 351 (Delhi).

87 [2014] 360 ITR 427 (Guj).

88 [2014] 361 ITR 429 (AP).

89 [2013] 359 ITR 106 (Delhi).

The same issue also came up in *C.I.T.* v. *Cheil Communications India Pvt. Ltd.*[90] The high court while interpreting section 147 followed *C.I.T.* v. *Jet Airways (I) Ltd.*,[91] wherein it was held that section 147 empowers the assessing officer to assess or reassess the income which escaped assessment and which was the basis of the formation of belief and while doing so he can also assess or reassess any other income which comes to his notice during course of proceedings. However, if the assessing officer comes to the conclusion that the income regarding which he initially formed reasons to be believe, had escaped assessment, has in fact not escaped assessment, it is not open to him to independently assess some other income. For doing so fresh notice should be supplied under section 148.

The courts in all the above mentioned cases overlooked the amendment to explanation 3 to section 147, inserted by Finance (No.2) Act, 2009 with retrospective effect from 01.04.89 which gives jurisdiction assessing officer on such issues which "come to his notice subsequently in the course of proceedings notwithstanding the fact that it does not form part of the recorded reasons". The issue would thus need to be reviewed.

Penalty

Surrendered income

Surrendered income does not *ipso facto* relieve an assesse from penalty proceedings. Explanation to section 271 (1) raises the presumption of concealment when a difference is noticed by the assessing officer between the reported and assessed income. The burden is on the assessee to rebut the presumption by cogent and reliable evidence. The immunity from penalty is only available when the assessee made voluntary surrender. It was held by the Supreme Court in *MAK Data Pvt. Ltd* v. *CIT*[92] that when surrender of income is made in view of detection by the assessing officer and assessee is not able to explain concealment of particulars of income or furnishing inaccurate particulars of income, the disclosure would not be turned as voluntary.

In MAK's case even after certain documents like share application forms, bank statements *etc*. were impounded during survey proceedings conducted under section 133 A, the assessee failed to file returns declaring income inclusive of amount surrendered later under assessment proceedings goes to show that the assessee did not intend to make full and true disclosure of income and hence was held to be liable to penalty proceedings. The decision points to risk of tax evasion. Quasi-voluntary disclosures should be encouraged since it unburdens the responsibility of the tax administration.

---

90 [2013] 354 ITR 549 (Delhi).

91 [2011] 331 ITR 236 (Bom).

92 [2013] 358 ITR 593 (SC).

Not exigible

Penalty proceedings cannot be initiated unless there are valid or good grounds to show that factual concealments have been made or inaccurate particulars on fact were provided in the computation.

In *CIT* v. *DCM Ltd.,*[93]the issue under consideration was whether an assessee could be penalized for claiming a loss, which was not allowable, during the course of assessment proceedings before the assessing officer. The assessee in this case granted a loan to its subsidiary DCM International Ltd. which was not paid back and was written off by assessee. During the assessment proceedings assessee claimed the loss as business expenditure or in the alternative to be considered as capital loss, which was denied by the assessing officer and penalty proceedings initiated against the assessee. It was held that the assessee is not prohibited from making a claim which he believes may be accepted or is plausible. Liberal view is required to be taken when such a claim is made during regular or scrutiny assessment, as the claim is bound to be carefully scrutinized both on facts and law. Threat of penalty cannot become a gag and or haunt an assessment for making a claim which may be legally erroneous or wrong, when made during the course of assessment proceedings.

In *CIT* v. *Sidh Nath Goel* [94] it was held that as per clause (2) of explanation 5 to section 271(1)(c) of the IT Act, 1961, when during the course of search the assessee makes a statement under section 132 (4) and admits his undisclosed income represented by assets found to be in possession of the assessee and further explains the manner in which the income was derived and pays tax together with interest, to the extent of the admission of income the assessee is not deemed to have concealed his income or the particulars thereof.

Similar issue came up for consideration in *CIT* v. *Manjunatha Cotton and Ginning Factory*,[95] wherein during survey under section 133A, transaction amounting to Rs. 7,98,000/- were disclosed which the assessee admitted as income and filed revised return and paid interest on the additional income. Subsequently penalty proceedings were initiated which were dismissed by the high court holding that there was no concealment of income. The *bona fides* of a claim or representation has to be seen not mere the wrongness of it as perceived by the revenue.

XVI INTEREST

Interest on refund

A "tax refund" is a refund of taxes when the tax liability is less than the tax paid. Section 237 of the IT Act 1962, provides that when the tax paid exceeds the

---

93 [2013] 359 ITR 101 (Delhi).

94 [2013] 359 ITR 481 (All).

95 [2013] 359 ITR 565 (Karn). The high court has analyzed various cases to arrive at law and framed 21 points in this regard.

amount with which the assessee is chargeable under this Act, he is entitled to refund when he satisfies the AO that such refund is due to him. Section 240 of the IT Act, 1961 further provides that as a result of any order passed in appeal, reference, revision, rectification or "other proceedings" refund of any amount becomes due to the assessee, the AO is bound to refund the amount to the assessee without him having to make a claim. Section 240 applies only where refund is due as a result of Appeal or 'any other proceedings' under the Act.[96]

Section 244 provides for payment of interest on the amount of taxes refunded pursuant to an order passed under the Act, including the order passed in an appeal. Hence an order passed under section 240, where refund was awarded to the assessee, interest in pursuance of section 244 will be also given on the amount so refunded. "Interest" on refund was governed by sections 214, 243 and 244 of the Act. By virtue of Direct tax amendment 1989, section 244A was inserted, wherein interests on refunds after 1989 were to be governed by this section.[97] The said section is introduced for payment of interest by the department for delay in grant of refunds.

A conjoint reading of section 240 with 244A would show that the revenue would be obligated to pay an interest on refund for the delay caused by the revenue to pay back the refund after an order is passed in pursuance of section 240 of the Act. The issue arises under what proceedings would section 244A be applicable? 244 A (1)(a) provides for three situations, when arisen under sections 115WJ, 206C, 199, interest shall be calculated at the rate of 1.5% per month.

244 A (1) (b) provides "in any other case". Since 244A has to be read in consonance with 240- the same would resultantly mean in a situation where refund becomes due to an assessee in pursuance of an order under the Act. "[O]ther proceedings under the Act", is of wide amplitude. The Supreme Court, keeping in view the above provisions, in the case of Union of India through *Director of Income Tax* v. *Tata Chemicals* [98] held that even deductor/ resident who has paid a certain sum in pursuance of section 195 (2), and later in an appeal against the order under section 195(2) the deductor was held entitled to refund with interest as contemplated under provisions of section 244A of the Act, the court held that when collection was illegal, there was corresponding obligation on the revenue to refund such amount with interest in as much as they had retained and enjoyed the money deposited.

Interest on interest

Section 244A only provides for payment of interest in cases where refund to the assessee is delayed. There is no provision for payment of interest on interest in case of delay of refund by the revenue. The issue that came for consideration

---

96 *Chandra Mohan* v. *UOI* 241 [ITR] 484.

97 *Circular No*. 549, dated 31.10.1989.

98 [2014] 363 ITR 658.

before the Supreme Court in *Sandvik Asia Ltd.* v. *CIT* [99] was whether the assessee is entitled to be compensated by the Income Tax department for the delay in paying interest on the refunded amount due to the assessee. The Supreme Court observed that there was an inordinate delay of 12-17 on the part of the revenue in refunding certain amount including the interest and therefore, in order to adequately and properly compensate the assessee, revenue was ordered to pay penal interest.

The said judgment was relied on by the High Court of Gujarat in *Gujarat Fluoro Chemicals* v. *CIT* [100] while granting compensation to the assessee at the rate of 9 per cent on the amount of statutory interest under section 244A. The Supreme Court in *CIT* v. *Gujarat Fluoro Chemicals*[101] while reviewing the judgment in *Sandvik*'s case clarified that section 244A only provides for interest on refunds under various contingencies and assessee is not eligible for interest on interest amount. It further clarified that the decision in *Sandvik's* case is not a law since the compensation in that case was paid based on the facts and circumstances therein.

XVII REVISIONAL JURISDICTION

The revisional jurisdiction under section 263 of the IT Act, 1961 though wide and broad can be exercised by the commissioner only if the order passed by the AO is 'erroneous in so far as it is prejudicial to the interests of the Revenue'. The view that the order of the assessing officer is erroneous and prejudicial to the interests of the revenue must be based on the material on record before the Commissioner. A distinction is to be made between orders passed 'without any enquiry' or 'inadequate enquiry'. If the order is passed based on inadequate enquiry, it would be difficult to hold the order of AO, who acted as an investigator, as erroneous, without any further verification/enquiry by the commissioner. Merely because he has a different opinion in the matter, would not give the commissioner jurisdiction under section 263. One has to see if there was application of mind by the assessing officer. There must be some prima facie material on record to show that tax which was lawfully exigible has not imposed or that by the application of the relevant statute on an incorrect or incomplete interpretation a lesser tax than that was just has been imposed. The commissioner must record a finding that the order made by the assessing officer is erroneous and also give reasons based on enquiry made by him.

Relying on above stated settled principles high courts have either upheld or dismissed the orders of the commissioner under section 263, based on the facts and circumstances of the case before it. In *Appollo Tyres* v. *Dy. Commissioner of Income Tax*,[102] in which case a detailed order was passed by the commissioner

---

99 [2006] 280 ITR 643 (SC).

100 [2008] 300 ITR 328 (Guj).

101 [2013] 358 ITR 291 (SC).

102 [2014] 360 ITR 36 (Ker).

discussing each of the nine points raised by the revisional authority and holding that there was no application of mind while considering the assessment under section 143 (3) of the Act, the exercise of revisional jurisdiction by the commissioner was upheld by the tribunal as well as the High Court of Kerala.

On the other hand the exercise of powers under section 263 by the Commissioner was held invalid in *CIT* v. *New Delhi Television Ltd*.[103] This was a case where the assessing officer after proper verification allowed claim under section 80HHF to the assessee in accordance with the provisions of the section. But the commissioner set aside the said order without forming an opinion on the question whether the acceptance of the claim by the assessing officer was erroneous or not and without recording any contrary findings. Since the order passed by the Commissioner was unclear and ambiguous and without setting out as to why the assessment was erroneous and prejudicial to the interests of the revenue, the same was set aside by the tribunal, which order was upheld by the High Court of Delhi.

We continue to see the swings in the conformity to the requirements of the appellate process. The need for emphasizing the discipline of the process deserves underscoring.

---

103 [2014] 360 ITR 44 (Delhi).