Legal Decisions

DIRECT TAXES

1. Is the exemption available under section 10(15)(iv)(h) in respect of interest earned on notified public sector bonds dependent on whether bonds were subscribed for or purchased in the market?

Ashok Leyland Ltd. V. Assistant Commissioner of Income Tax [2005] 277 ITR 22 (Mad.)

Decision: An assessee is eligible to claim exemption in respect of interest earned on notified public sector bonds irrespective of the fact that such bonds have been subscribed for or purchased in the market.

The appellant company purchased certain notified public sector bonds and claimed interest earned from these securities as exempt under section 10(15)(iv)(h) of the Income-tax Act, 1961.The Tribunal held that if the bonds were purchased from the market the ratio laid down by the Supreme Court in *Vijaya Bank Ltd. V. Addl. CIT [1991] 187ITR 541 would apply.*

The High Court held that to claim exemption under section 10(15)(iv)(h) of the Income-tax Act, 1961 the following points were to be considered:

(a) whether the assessee is the holder of the bond or debenture;

(b) whether the holder of such bond or debenture has got his name registered with the company; and

(c) whether the Central Government has issued a notification in the Official Gazette in this behalf.

It was further held that there was no dispute that all the conditions mentioned in section 10(15)(iv)(h) were satisfied in this case. On a plain reading of the above-mentioned section the assessee was entitled to the benefit of full exemption irrespective of whether the securities were subscribed for or purchased from the market.

Note: In Vijaya Bank Ltd. V. Addl. CIT [1991] 187ITR 541the Supreme Court held that the price paid for purchase of securities was in the nature of a capital outlay and no part of the said price can be setoff as expenditure against the income accruing on those securities. The Madras High Court found that the said decision had no relevance to the facts of the present case and thus the distinction drawn by the Tribunal was wholly untenable and irrelevant.

2. Would the lease income of an assessee from an asset, transferred to him in course of dissolution of a firm in which he was a partner, be treated as a business income or income from house property if, such income was treated as business income in the hands of the firm before dissolution?

CIT v. Smt. Sureshini Mittal [2005] 277 ITR 88 (Allah.)

Decision: If after dissolution the lessee accepted the assessee as a successor to the agreement of the dissolved firm and the assessee became the exclusive owner of the property, the income derived by the assessee would be taxed as business income as the lease income derived from the property by the firm in which the assessee was one of the partners was treated as business income during the continuance of the partnership.

The assessee respondent derived his income from a picture hall. Prior to the assessee the cinema hall was owned by a firm in which the assessee was a partner. The firm did not carry on the business of film exhibition but hired it out. However, the lease rent received by the firm was assessed as business income. On dissolution of the firm the assessee became the sole proprietor of the cinema hall.

The assessee claimed that the lease rent received by him should be assessed as business income. However, the Income-tax Officer rejected the assessee's claim and assessed such income as "income from house property" on the basis of the fact that the assessee was not carrying the business of film exhibition. The ITO allowed the depreciation on the furniture and fittings, air conditioner, sanitary fittings etc. The Appellate Assistant Commissioner found that the machinery hired was inseparable from the lease of the cinema hall. Therefore letting out of Cinema hall together with the machinery was to be assessed as income from business. The Tribunal relied on the clause 5 of the deed of partnership of the dissolved firm which clearly mentioned that the business of the partnership would consist of film exhibition of motion pictures including leasing out of the picture hall. Due to this the rental income of the firm was assessed as business income by the department in earlier years. The Tribunal found that the lessee had accepted the

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assessee as a successor to the agreement with the dissolved firm and the lease rent continued to be paid for the building as well as machinery. Thus the Tribunal confirmed the order of the Assessing Officer.

On a reference, the Allahabad High Court held that there was no fault in the order of the Tribunal when the assessee became the absolute owner of the picture hall on account of dissolution of the partnership and thus income derived by the assessee was to be taxed as business income.

3. Whether the conditions specified under clause 15(2)(c) of the Double taxation avoidance agreement between India and Netherlands is satisfied when the applicant is taxed in India based on the provisions of section 44D and section 115A of the Act?

DHV Consultants BV, In re [2005] 277 ITR 97(AAR)

Decision: The condition specified in clause 15(2)(c) of the DTA between India and Netherlands is related to the taxability of the employees and not to the applicant and was not relevant when the applicant was taxed in India on the presumptive basis under the provisions of section 44D and 115A.

The applicant was a foreign company incorporated in Netherlands and engaged in business of providing consultancy services in the areas of highways, transportation, agriculture etc. The said company had set up several projects offices in India wherein the consultancy services were provided to certain projects in India. These project offices derived income in the nature of fees for technical services in India which was taxed in India on presumptive basis under section 44D read with section 115A of the Income-tax Act, 1961. The Company sent its employees to India to work on various projects being executed in India but during their stay in India salary was paid to them in Netherlands. Since the applicant in his capacity of an employer was under an obligation to deduct tax at source in India to the extent employees salary was taxable in India it was interested in knowing its liability towards payment of taxes on behalf of its employees. The salary paid to the employees either in India or outside India would be liable to tax in India for the services rendered in India. In case there is a double taxation avoidance agreement between India and the country in which that individual is a resident then the provisions of DTAA are made applicable to such an individual if they are more beneficial.

According to article 15 of the DTAA between India and Netherlands where the employee is a resident in Netherlands, remuneration paid to him for employment exercised in India would be exempt from tax in India if all the following conditions were satisfied:

(a) The total duration of his stay (in aggregate) in India does not exceed 183 days in a tax year.
(b) The remuneration for services rendered by the employee is paid by or on behalf of an employer who is not a resident of India.
(c) The remuneration is not borne by a permanent establishment or fix base, which the employer has in India.

Based on the above facts the applicant raised a question as to whether the conditions specified under clause 15(2)(c) of the Double taxation avoidance agreement between India and Netherlands is satisfied when the applicant is taxed in India based on the provisions of section 44D and section 115A of the Act.

The authority ruled that the remuneration of the employees is " borne by" a permanent establishment, if the same is deductible in computing the permanent establishment's taxable profits in the source country. Further, section 44D and section 115A cannot be read as treating gross receipts or fees for technical services without allowing deduction on account of expenses incurred for earning the same. In the scheme of section 44D and 115A salaries paid to the employees and all revenue expenses incurred for running the permanent establishments will have to be deemed to have been treated as deductible. However, the authority did not express any opinion regarding the duty of the company to deduct tax at source since the issue raised whether the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State was not relevant to this application.

Note: Sections 44AD, 44AE and 44AF dealing with presumptive taxation in respect of certain business specifically provide that any deduction allowable under the provisions of section 30 to 38 shall be deemed to have been already given full effect to and no further deduction under those sections shall be allowed. It is significant to note that the AAR has read this principle into the presumptive taxation under section 44D read with 115A.

4.(a) Is the reassessment on the basis of difference found in the figures of liabilities towards sundry creditors in the party ledger seized and the corresponding figures mentioned in the balance Sheet of the assessee firm valid?

(b) Can the above-mentioned difference be treated as unexplained investment as per section 69 without any material or information that the assessee had investment in some form or the other not mentioned in the books of accounts?

Aurobindo Sanitary Stores v. CIT [2005] 276 ITR 549 (Orissa)

Decision:(a) Substantial difference in the figure of liabilities towards sundry creditors in the party ledgers and the corresponding figures on the balance sheet of the assessee firm results in income escaping assessment because of failure of the assessee to disclose fully and truly all material facts necessary for assessment.

(b) Treating such difference as unexplained investment under section 69 without any material or information that the assessee had investments in some form or the other not reflected in the books of accounts is not legal and justified.

The appellant was a partnership firm carrying on the business of sanitary stores. The appellant filed a return for a particular assessment year, which was assessed under section 143(1)(a) of the Income-tax Act, 1961.On a later date search and seizure was conducted in the case of a partner of the assessee firm due to which survey was also conducted in the premises of the assessee firm. During this search certain party ledgers were seized. From the party ledgers so seized the Assessing Officer ascertained that there was substantial difference in the figures of the liabilities of sundry creditors as per books seized and the corresponding figures declared in the balance sheet filed along with the return. The figures mentioned in the balance sheet were on the higher side which gave the Assessing Officer reason to believe that the assessee firm had inflated the creditors by 2,81,072.02 and evaded the tax liability. The Assessing Officer ultimately made an addition of 2,70421 as inflated liabilities under section 69 read with section 68. The basis of such addition as given by the Assessing Officer was that the difference of Rs. 2,70,421 was invested by the assessee-firm.

On appeal the Commissioner (Appeals) held that in view of the inflated liability, income chargeable to tax has escaped assessment and in such circumstances the Assessing Officer had reason to believe that income chargeable to tax had escaped assessment. However, it deleted the addition of Rs. 2,70,421 under section 69 as not maintainable. The Tribunal held that the addition of Rs. 2,70,421 in the income of the appellant was justified under section 69 read with section 68.

On further appeal by the assessee it was held that:

(a) the above-mentioned substantial difference in the figures of liabilities reflect a direct link and nexus for formation of belief by the Assessing Officer that income of the assessee had escaped assessment because of the failure of the assessee to disclose all material facts fully and truly necessary for assessment.

(b) The Assessing Officer had come to a conclusion that the assessee firm had made an investment of Rs. 2,70,421 only on an analysis of different figures of assets and liabilities taken from the balance sheet and the party ledger and not on the basis of material or information that the appellant had actually made investment in some form or the other which were not recorded in the books, the source and nature of which the assessee failed to explain. Therefore section 69 could not be applied to treat such sum as unexplained investments.

Note: For applying section 69 the Assessing Officer must come to the finding that the investments have been made which are not recorded in the books of account of the assessee and if thereafter the assessee had failed to provide an explanation of the nature and source of such investment such value of the investment could be added to the income of the assessee for that particular year.

5. Whether the sum paid for development purposes to a stock exchange for becoming a member of a stock exchange be treated as capital expenditure?

Rajendra Kumar Bachhawat v. CIT [2005] 276 ITR 567 (Cal.)

Decision: The sum paid for development purposes to a stock exchange for becoming a member of stock exchange gives an enduring advantage to the assessee and hence be treated as capital expenditure.

The assessee paid a sum of Rs. 25 lakhs for development purposes for the purpose of becoming a member of a Stock exchange. The assessee claimed that such sum was revenue expenditure and that it was entitled to be allowed a deduction in ten equal parts in the ten successive years.

On reference, the Calcutta High Court held that there was no doubt that an enduring benefit accrues to the assessee and thus the expenditure was in the nature of a capital expenditure. It was further held that there is no provision in the Act which entitled the assessee to carry forward the revenue expenditure after dividing it.

INDIRECT TAXES

1. Whether the refund of an encashed bank guarantee for all or part of the disputed excise duty, pursuant to an order of the Court, is governed by the provisions of section 11B?

Union of India v. Grasim Industries Ltd. 2005 (183) ELT 12 (Raj.)

Decision – As section 11B applies to refund of excise duty that has been paid to the Revenue, the refund of an encashed bank guarantee would not be governed by provisions of section 11B since the amount of the disputed tax or duty that is secured by a bank guarantee cannot be considered as having being paid to the Revenue.

A bank guarantee was furnished by the assessee under Court's order to secure the Revenue. The Court case was ultimately decided in favour of the assessee, however, the bank guarantee had been encashed by the Revenue by that time. Thus, the assessee was entitled to the amount of the bank guarantee being furnished by him. However, the Revenue contended that such amount was not refundable to the assessee having regard to the principle of unjust enrichment contained in the provisions of section 11B.

The High Court followed the Supreme Court's decision in case of *Oswal Agro Mills Ltd. v. Assistant Collector of C.Ex., Ludhiana 1994 (70) ELT 48 (SC)* wherein it was held that refund of an encashed bank guarantee for all or part of the disputed excise duty pursuant to an order of the Court is not governed by the provisions of section 11B. This decision of Supreme Court has been discussed below in detail:

The Supreme Court stated that section 11B applies when an assessee claims refund of excise duty. A claim for refund is a claim for repayment. It presupposes that the amount of the excise duty has been paid over to the excise authorities. It is then that the excise authorities would be required to repay or refund the excise duty.

The Apex Court explained that a bank guarantee is a security for the Revenue for recovering the dues in the event the Revenue succeeds in the dispute concerning the duty. However, if the bank refuses to honour its guarantee the revenue or the principal administrative officer of the Court (where the bank guarantee is in his favour) has to file a suit against the bank for the amount due upon the bank guarantee. Therefore, the High Court held that the amount of the disputed tax or duty that is secured by a bank guarantee could not be considered as being paid to the Revenue. Thus, provisions of section 11B would not be attracted as there was no refund.

Note – This judgment illustrates that the excise duty shall be considered as paid only when the payment is in absolute terms. However, if the payment is contingent upon the action of third parties, it would not amount to payment of duty liability e.g. furnishing of a bank guarantee to secure the disputed duty would not amount to payment of duty as the encashment of guarantee depends upon the Bank's acceptance to honour the guarantee and also the outcome of the litigation.

2. Is kimam an excisable good?

Dharampal Satyapal v. CCEx., New Delhi 2005 (183) ELT 241 (SC)

Decision - Kimam is an excisable product as it comes in to existence by blending of sada kimam with saffron, spices, menthol etc. It is a distinct, identifiable product known to the market as 'kimam' and is classifiable as chewing tobacco or a preparation for chewing tobacco under sub-heading 2409.49/2404.40 of the Central Excise Tariff.

The assessee bought sada kimam as a raw material and blended it with saffron, perfumes, menthol etc. to form a compound. Such compound was then packed in "balties" in highly concentrated form and cleared to its three licensed units, where it was diluted and used in the manufacture of branded chewing tobacco named "Tulsi Zafrani Zarda". The assessee used to buy a similar compound (Lakhnawi Kimam) from the market from time to time and used it in the manufacture of their final product. The kimam was not edible, it was not capable of consumption as such, however, it was used as preparation in the manufacture of branded chewing tobacco.

The Supreme Court observed that the assessee occasionally purchased a similar compound viz., Lakhnawi Kimam from the market for manufacturing the final product. The Apex Court held that this fact indicated that blending of sada kimam with saffron, spices, menthol etc., brought into existence a distinct, identifiable product known to the market as 'kimam'. Such kimam was classifiable as chewing tobacco or a preparation for chewing tobacco under sub-heading 2409.49/2404.40 of the Central Excise Tariff.

On the issue of invoking extended period of limitation, the Supreme Court made the following observations:

(i) the assessee had been in the business of manufacturing Tulsi Zafrani Zarda for a couple of years without disclosing the existence of their units.

(ii) similar kimam was brought from various traders who operated from licensed units, however, the unit where the assessee manufactured kimam was not licensed, and

(iii) no central excise records were maintained.

The Apex Court thus, concluded that the assessee clandestinely manufactured kimam without payment of duty and held that the Department was right in invoking the extended period of limitation.

Note – This case is yet another example where the Supreme Court has held that a process may be termed as manufacture when a new and commercially different article having a distinctive name and character or use emerges as a result of such process.

3. Can a premises be registered in the name of two different persons?

Manibhadra Processors v. Addl. Commissioner of CCEx. 2005 (184) ELT 13 (Bom.)

Decision – No, as registration is always in respect of a particular premises and not with respect to particular person. A new person can obtain registration in respect of a already registered premises only when the person holding the earlier registration certificate surrenders the registration certificate in respect of that premises.

The assessee applied for registration of his factory in the prescribed manner under Rule 9 of the Central Excise Rules, 2002. However, the application was rejected by the Department on the ground that the earlier holder of the registration certificate had not paid their outstanding dues and failed to surrender their registration certificate with respect to the same factory premises. Thus, it was contended by the Department that no other unit in the same premises could be registered under the rules unless the original registration was deregistered or cancelled or surrendered by such registrant and all excise dues cleared.

A person, who produces, manufacturers, carries on trade, holds private store room or warehouse or otherwise uses excisable goods is required to obtain registration under Rule 9 of the Central Excise Rules, 2002. Rule 9(2) of the said Rules empowers the Board to issue notification and to prescribe conditions or limitations specifying person or class of persons who may not be required to obtain such registration. As per Rule 9(3), grant of registration is always subject to such conditions, safeguard and procedure as may be specified by the Board in the notification issued in this behalf.

The Apex Court pointed out that clause (2) of the said notification reads as under:

"Registration of different premises of the same registered person. If the person has more than one premises requiring registration separate registration certificate shall be obtained for each of such premises."

The High Court stated that it was clear that if one person had more than one premises, then he had to obtain separate registration certificate for each premises. It was thus clear that registration was always in respect of a particular premises and not with respect to particular person. The High Court opined that the intention was to prevent successive registration in respect of same premises. The High Court therefore, held that the person holding earlier registration certificate must surrender registration certificate in respect of that premises, then only, a new person could get registration in respect of that premises.

Note - The High Court has taken such a view so as to prevent anybody from walking away from the registered premises without satisfying duty liability.

4. Can a refund application, which has been filed before the prescribed authority, be returned by the said authority, without making an order?

United Phosphorus Ltd. v. Union of India 2005 (184) ELT 240 (Guj.)

Decision – No, as the returning of the claim application without making an order thereon by the prescribed authority amounts to refusal to perform the statutory duty, of considering the application and making an order thereof, imposed on it.

The petitioners submitted refund application under section 11B to the Assistant Commissioner of Central Excise claiming the refund of the excess duty. According to the petitioners, they had cleared the goods manufactured by them from their factories through their various depots by paying excise duty at higher value than the value at which the duty should have been paid by them. However, the refund claim application made by the petitioner was returned by the Assistant Commissioner.

Under Section 11B of the Act, any person claiming refund of any duty of excise may make an application for refund of such duty to the Assistant/Deputy Commissioner of Central Excise before the expiry of one year from the relevant date in the prescribed form. Such application should be accompanied by documentary or other evidence to establish that the amount of duty of excise in relation to such refund claim was collected from or paid by the applicant and that the incidence of such duty

had not been passed on by him to any other person. Under sub-section (2), the Assistant/ Deputy Commissioner is empowered to make an order of refund. Any person aggrieved by any order made under Section 11B would be entitled to prefer an appeal under Section 35 of the Act.

The High Court asserted that it was incumbent upon the authority to which an application for refund was made to make an order on such application. By returning the refund application which was already filed in the office of the Assistant Commissioner, the officer acted contrary to the provisions of the Act and the Rules. The High Court opined that once an application was filed before the concerned authority, it became a part of the record of the concerned authority and important original record like an application for refund could not have been parted with by the Assistant Commissioner by returning it to the claimant. It was held that the course adopted by the Assistant Commissioner in returning the claim application without making an order thereon amounted to refusal to perform the statutory duty imposed on him i.e., to consider the application and make an order thereof in accordance with law. Thus, the order returning the application of the petitioners for refund of claim was held to be illegal and void.

Note – This case establishes the principle that the adjudicating authority has to function within the framework provided by the statute and carry out tasks entrusted upon them in the manner prescribed vide such statute. Any novel procedure which is not contemplated by the Act should not be adopted by the adjudicating authority.

5. Should the penalty on delayed delivery of goods be deducted from the sale price for the purpose of assessable value?

HPL Socomac Pvt. Ltd. v CCEx., Delhi-III (Gurgaon) 2005 (182) ELT 191 (Tri. - Del.)

Decision – The excise law does not provide for deduction of penalty from the sale price for computing assessable value, thus penalty cannot be deducted from the sale price.

The goods in question were electricity meters which were delivered after the time stipulated in the contract of sale. Consequently, penalty was imposed on the manufacturers for delayed delivery. The Tribunal has held that such a penalty cannot be deducted from the sale price in order to arrive at the assessable value as penalty is separate from the price of the goods and there is no provision in the excise law which allows deduction of penalty from the sale price for computing assessable value.

FOR YOUR INFORMATION

INVITATION FOR CONTRIBUTING ARTICLES

To put the entire gamut of subjects related to 'Agriculture/Rural Development' in professional perspective, Editorial Board has decided to bring the February 2006 issue on the above theme. Experts in the field are invited to contribute articles for The Chartered Accountant journal.

The articles should not exceed 2500 words and every article should have an Executive Summary of about 100 words, author's e-mail ID, complete postal address and contact numbers along with a good quality passport size photograph (soft copy as well as hard copy). Authors may note that a declaration about the originality of the article is also required to be sent along with the article, without which the articles would not be considered by the Board. The articles may be sent by December 30, 2005.

The contributors are requested to go through the 'Guidelines for Authors of The Chartered Accountant Journal' hosted on the website of the Institute at the link http://www.icai.org/announ/guidelinesauthors.html for reference.

The articles can be sent to us by e-mail at eboard@icai.org/ eb@icai.org or by post (two manuscripts along with a soft copy of article and good quality passport size photograph) to -

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