LEGAL DECISIONS

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DIRECT TAXES

1. Will an incorrect interpretation of accounts by the Assessing Officer be taken as a valid ground to re-open assessment after the expiry of four years from the end of the relevant Assessment year?

Amiya Sales and Industries and Another v. Assistant Commissioner of Income Tax and others (2005) 274 ITR 25 (Cal.-HC)

Decision: *Once the assessee discloses all the material facts at the time of assessment, the failure on the part of the Assessing officer to correctly interpret the accounts leading to excessive relief will not enable him to re-open the assessment.*

Due to incorrect interpretation of accounts by the Assessing Officer the assessee got a benefit of carry forward loss of approximately Rs. 34 Lakhs, which was adjusted in the subsequent years. The above-mentioned assessment was made under section 143(3). After the expiry of four years from the end of the relevant assessment year such assessment was sought to be re-opened under clause (c) of Explanation 2 to section 147 which states that where an assessment has been made but income chargeable to tax has been under assessed, such income shall be deemed to be income-escaping assessment.

Proviso to section 147 states that where the assessment is done under section 143(3) no action can be taken under section 147 after the expiry of four years from the end of relevant assessment year, unless income has escaped assessment by the reason of failure on the part of the assessee to disclose fully and truly the material facts necessary for his assessment for that assessment year. Explanation 2 to section 147 of the Act, which contains the words "for the purpose of this section", should be read in conjunction with section 147. This reveals that the conditions precedent for reopening assessment as laid down in section 147 have to be complied with. This means that even if the income of the assessee is under assessed it will not be considered as income escaping assessment unless one of the conditions under proviso to section 147 (for example, failure on the part of the assessee to disclose fully and truly all material facts necessary for Assessment) is satisfied.

It was held that there was no failure on the part of the assessee to disclose fully and truly the material facts. The failure on the part of the Assessing Officer to correctly interpret the accounts of the assessee leading to excessive relief cannot be a ground for re-opening the assessment. The Assessing Officer who sought to re-open such assessment was not permissible under section 147 of the Act to assume jurisdiction. The order under section 147 was quashed.

Note: *This case establishes the principle that once the assessee discloses all the material facts at the time of assessment, the responsibility to scrutinize the books of account and other material in a proper manner shifts to the Assessing Officer. If due to his failure to verify the accounts properly, even if excessive relief is given to the assessee the assessment cannot be re-opened.*

2. Whether the gratuity liability of the transferor of the business related to the period of service under transferor, discharged by the transferee be considered as a capital expenditure in the hands of the transferee?

Sree Akilandeswari Mills Private Limited v. Deputy Commissioner of Income-Tax [2005] 274 ITR 1 (Mad.-HC)

Decision: *Discharge of the gratuity liability, transferred to the purchaser of the business, as part of the consideration is a capital expenditure.*

The appellant hereinafter referred to, as an "assessee" entered into an agreement with its holding company. As per the agreement a textile unit of the holding company was transferred to the assessee. The services of the employees working in the textile unit were continued and the agreement also protected the conditions of service of workmen taken over by the assessee. The possession of the unit was given on November 22, 1982. During the Assessment year 1988-89 the assessee company claimed a deduction of the gratuity payment made to the workers who had retired during the previous year.

The Assessing Officer held that the liability towards the payment of gratuity to the employees, related to the period of service rendered by the employees to the transferor could not be claimed as business expenditure in the

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hands of the assessee company and that the assessee company is entitled to claim deduction of part of the sum. The Tribunal upheld the disallowances. The matter went in an appeal to the High Court.

The appeal was dismissed by the High Court. It was held that the transferor had transferred the then gratuity liability of the employees of the textile unit to the assessee. The sale consideration of such unit was calculated after taking into account such liability, as ascertained by the Actuarial valuation. Thus the said gratuity liability was a part of the sale consideration, which was discharged later by actual payment by the assessee to the employees in subsequent years. Hence, it was a capital expenditure.

Note: *Payment of gratuity due to the employees constitutes part of the expenses towards remuneration of employees and hence constitutes revenue expenses in the hands of the employer. However, if the liability towards such gratuity is transferred to another person as a part of sale consideration, the payment of such liability by the purchaser will be capital expenditure.*

3. Whether the compensation received by the bottling company for destruction of Coca Cola bottles consequent upon bar by the Government be taxable as capital receipt or revenue receipt?

CIT v. Srikrishna Bottlers P. Ltd.[2005] 274 ITR 11 (A.P.-HC)

Decision*: Bottles constitute plant in the hands of bottling companies and are entitled to depreciation. The compensation received on their destruction will constitute revenue receipt.*

The Coca-Cola concentrate, which is used in the manufacture of the soft drinks, was imported by the assessee. For this purpose the assessee procured bottles, which bore the trademark embossed on them. In a particular year the Government prohibited the use of concentrates manufactured by the Coca Cola concentrates. Due to this all the embossed bottles lying in stock with the assessee became useless. In the meantime, the Coca Cola Corporation made an offer to these bottling companies. According to this offer compensation was to be given only in respect of those bottles lying with the bottlers, which were destroyed, under supervision of the Coca Cola Corporation after counting the bottles in the factory. Compensation was to be paid on pro-rata basis on the sales reported during the last full year of operation in India. The assessee claimed that such amount i.e Rs. 5,46,000 was a capital receipt and thus not taxable. The assessee also claimed depreciation under the then section 32 (1) (ii) of the Income tax Act, 1961.

The Assessing Officer rejected the claim of assessee regarding depreciation but the Tribunal allowed it. The Income tax Officer accepted the contention of the assessee that the compensation received was a capital receipt. However, the Commissioner (Appeals) was of the opinion that the compensation received was directly related to the bottles, which were destroyed by the Coca Cola Corporation and thus the deduction of depreciation under section 32 (1)(ii) should be set off against such compensation and the balance should be allowed as a deduction. The Tribunal held that the compensation received did not constitute a revenue receipt and thus not taxable.

On Appeal to High Court it was held that the bottles and shells constituted plant and thus depreciation was admissible under section 32 (1)(ii) of the Income Tax Act for the Assessment year 1979-80. It was further held that the assessee was doing business on behalf of the American Company in India and therefore the compensation received by it was chargeable to income tax and was to be treated as revenue receipt.

Note: *This case establishes a principle that where an assessee purchases bottles and embosses the trademark of the soft drink company on the bottles they constitute plant and they cannot be utilized for any other purpose. Depreciation is allowable on the same and any compensation received on their destruction is chargeable under section 28.*

4. Whether the notice for assessment served at the registered office and not at the principal place of business is a valid notice?

India Glycols Ltd. And another v. Commissioner of Income Tax and others [2005] 274 ITR 137 (Cal.-HC)

Decision: *The principal place of business to which notice is to be sent under section 124 may or may not be the registered place of business.*

As per section 124 of the Income Tax Act, 1961 an assessee cannot be compelled to file its return of income with the assessing Officer within whose jurisdiction the assessee does not have its principle place of business. The place from where all the business activities are controlled is treated as Principal place of business, which may or may not be the registered place of business.

The assessee had its principal place of business at Calcutta. The factory and the registered office of the assessee were at Moradabad. Since inception assessee filed its income tax return at Calcutta. The assessee received a notice at Moradabad office to file a return in Moradabad as it has registered office in Moradabad. The assessee filed a writ petition in Allahabad High Court against this notice. The Allahabad High Court passed an order by which the Commissioner of Lucknow was directed to decide the question of jurisdiction with regard to filing of returns. The Commissioner of Lucknow held

that the Assessing Officer at Moradabad had jurisdiction to assess the assessee. Even after such order the officials at Moradabad did not take any follow up action to get the return filed by the assessee. No action was taken up to two years until a writ petition was filed in the Calcutta High court.

The Calcutta High Court held that the assessee stated that the Income tax returns were filed in Calcutta, which is its principal place of business. The assessee had further stated that it had a registered office in Moradabad and also had branch offices at various places. The permanent Account number (PAN) was allotted to the assessee in Calcutta. The Court held that the findings of the Commissioner of Lucknow were not legally tenable, as it had not taken into account the facts stated by the assessee. The assessee had its place of business within the meaning of section 124 in Calcutta. The notice and order were not valid.

Note: *The words " the principal place of business" have many connotations. Even the word "address" given in clause 17 of Form no. 3CD has to be construed appropriately. This concept assumes importance in the context of jurisdiction of Assessing Officers to make assessment.*

5. Whether the part of the excess money (received by the bank from the Insurance Company on devaluation of rupee) paid to the assessee by the bank, be considered as business income or casual and non-recurring receipt?

CIT v. Swastika Metal Works [2005] 274 ITR 280 (Punj. & Har. -HC)

Decision: *The portion of currency fluctuation gain received by the assessee as a result of settlement between the parties is a casual receipt and not a trading receipt if the value of such lost goods is neither claimed by the assessee nor allowed in any assessment year.*

The Assessee, being a registered firm was engaged in the business of manufacturing and sale of brass, zinc and copper sheets. The assessee placed an order for the purchase of copper ingots with M/s Ore and Chemical Corporation, New York through an agent in Bombay. The payment was to be made in dollars. For the purpose of making payment in New York the assessee opened a letter of credit with a Mercantile Bank Ltd. in Delhi. The goods were dispatched and the payment was made by the Mercantile Bank against the delivery of documents of title along with the bill of exchange, which was drawn upon the assessee and endorsed in favour of the bank in the terms of the letter of credit. The bank presented the bill of exchange, which was payable after two months. In the meantime, hostilities broke between India and Pakistan. The cargo of the steamer travelling from New York to India via Karachi was confiscated by the Pakistan Government. After the due date, the Bank presented the bill of exchange through notary public and the assessee paid a minimal amount of Rs. 30,000. The cargo was also covered by an insurance policy. The Bank filed a claim for payment of insurance money. The claim of the bank was accepted by the Insurance Company and the amount specified in the Insurance policy was paid to the bank. Due to devaluation of the rupee the Bank received Rs. 8,60,217.88 as against the amount of Rs.4, 99,063.00 paid by the Bank to the supplier. When assessee came to know about this, he demanded the excess amount received by the Bank. After the bank refused the demand the assessee filed a suit against the bank in Delhi High Court. As per the order of the High Court the assessee received a sum of Rs. 1,35,000 from the Bank.

The amount received by the assessee from the bank was treated as business income under section 41(1) by the Assessing Officer. The decision was confirmed by the Appellate Assistant Commissioner but the Tribunal deleted it.

On a reference to the High Court it was held that the value of goods lost was not claimed by the assessee and the Assessing Officer also did not make any allowance in respect of lost goods in any assessment year. The amount, which represents the cost of goods, was paid by the bank, which was reimbursed by the Insurance Company. The benefit of devaluation of rupee belonged to the bank and not to the assessee as the relationship of the assessee with the bank was only that of creditor and debtor. The amount received by the assessee as result of settlement between the parties was nothing more than a casual receipt and not a trading receipt.

Note: *In CIT v. Tata Locomotive and Engineering Company Ltd. (1966) 60 ITR 405 (SC) the Apex Court laid down the principle that for bringing currency gains to tax, the intention with which the currency balance is held by the assessee is the guiding factor.*

Indirect Taxes

1. Can an appeal relating to demand of duty be sustained when department did not file appeal against an earlier order of the Tribunal which decided the same issue qua the parties for the same period?

Supdt. of Central Excise v D.C.I. Pharmaceuticals Pvt. Ltd. 2005 (181) E.L.T. 189 (S.C.)

Decision: *An appellant cannot agitate an issue collaterally when he has not preferred an appeal from the decision of the Tribunal in the related matter for the same period.*

In the instant case a demand was raised by the department denying the assessee the exemption under Notification

175/86-C.E. Assistant Collector allowed the benefit of exemption but the Commissioner (Appeals) denied the said exemption on an appeal by the department. However, Tribunal finally upheld the order of Assistant Collector, granting the exemption and quashing the demand. The Department did not challenge this order by way of appeal. Meanwhile, another proceeding for the same period on the basis of classification list filed by the assessee were initiated and benefit of said exemption was denied to the assessee. The matter was carried to the High Court which held that the assessee was eligible to excise exemption albeit for grounds which were independent of the decision of the Tribunal. The Department then approached the Supreme Court.

The Supreme Court held that since no appeal had been preferred from the decision of the Tribunal in the related matter for the same period, it was not open to the appellant to agitate the issue collaterally.

Note: *In this case the Supreme Court has not gone in to the actual facts of the issue involved but has decided in favour of the assessee on the principle that an appeal against the High Court cannot be sustained when the same issue decided by the Tribunal in another proceeding has not been appealed against.*

2. Whether the registered owner of a vehicle carrying contraband goods can be convicted when he has transferred the vehicle to a third party but the vehicle continued to be registered in his name?

Balwinder Singh v. Asstt. Commissioner, Customs & Central Excise 2005 (181) E.L.T. 203 (S.C.)

Decision: *The registered owner cannot be convicted, as there is no evidence to show that he has any control over the vehicle nor is he in possession of the contraband goods.*

Two trucks were intercepted by the Central Excise and Customs Department. The officers of the Customs Department conducted search of the vehicle in the presence of witnesses and it was found that one of the trucks had a secret compartment and 175 Kgs. of heroine and 39 Kgs. of Opium of foreign origin were concealed in that chamber. During the course of investigation, the statement of the appellant (the registered owner of the vehicle) was taken under Section 108 of the Customs Act and 15 witnesses had been examined. However, the appellant completely denied his culpability in the crime. The appellant contended that he had sold the truck much before the contraband goods were recovered therefrom but the vehicle continued to be registered in his name.
The Supreme Court observed that the appellant was convicted solely for the reason that he was the registered owner of the vehicle. There was no evidence to prove that he knowingly allowed any person to use the vehicle for any illegal purpose. There was also no evidence to prove the conspiracy set up by the prosecution. The Apex Court held that though the articles were recovered from the truck, there was no evidence to show that the appellant had any control over the vehicle nor was he in possession of those drugs. Therefore, the appeal was allowed and the appellant was acquitted of all charges framed against him.

Note: *Section 108 of the Customs Act. It can be inferred from this decision of the Apex Court that the owner of a vehicle carrying contraband goods cannot escape conviction on the plea that the vehicle is not registered in his name.*

3. Whether 'Licel' used for killing lice in human hair will be classified as a medicament or an insecticide?

Sujanil Chemo Industries v Commissioner of C.Ex., & Cus., Pune 2005 (181) E.L.T. 206 (S.C.)

Decision: *'Licel' is used for therapeutic and prophylactic purposes. It is thus a Medicament within the meaning of the term "Medicament" in Note 2 of Chapter 30.*

The appellants manufactured a product known as 'LICEL" used for killing lice in human hair. The appellants claimed that their product was classifiable under tariff sub-heading 3808.10 as an insecticide. However, according to the Department the product was classifiable under tariff subheading 3003.10 as a medicament.

The Appellants contended that as per the reports of chemical examiners and the Department of Dermatology & Venereology product was an insecticide. The appellants claim was augmented by various statements of dealers stating that in the market the product was considered to be an insecticide.

Chapter Note 1(c) of Chapter 38 indicates that Chapter 38 would not cover "Medicaments under Heading No. 3003 or 3004". Chapter Heading 2(i) of Chapter 30 defines "Medicament", *inter alia,* as a product comprising of two or more constituents which have been mixed or compounded together for therapeutic or prophylactic use.

The Supreme Court observed that even though, in normal parlance, a product might be considered to be an insecticide if that product had any therapeutic and prophylactic use but for purposes of classification that product could not fall under Chapter 38. In this case, the product was used only for killing lice in human hair. The Apex Court clarified that any medicine or substance which treats disease or is a palliative or curative is therapeutic. Therefore, since. Licel cured the infection or infestation of lice in human hair, it was therapeutic. Further, it was also prophylactic in as much as it pre-

vented disease which would follow from infestation of lice. Thus, The Apex Court held that 'Licel' was a product which was used for therapeutic and prophylactic purposes. It would thus be a Medicament within the meaning of the term "Medicament" in Note 2 of Chapter 30 and would be excluded from Chapter 38.

The Court pointed out that this view had also been taken by the Supreme Court in the case of *ICPA Health Products (P) Ltd.* v. *Commissioner of* C. *Ex., Vadodara 2004 (167) E.L.T. 20* and Tribunal in *Collector of C.Ex., v. Pharmasia (P) Ltd. 1990 (47) E.L.T. 658* wherein in respect of an identical product it had been set out that such product would fall under Chapter 30 under Tariff Heading 30.03.

Note: *This decision is a pointer that while classifying any particular product, reliance on trade parlance can be sought only when one the Tariff does not provide a clear and direct answer to the question of classification. The judgment has clarified that killing of lice in human hair amounts to therapeutic or prophylactic use and that insecticides having any therapeutic and prophylactic use are not classifiable under Chapter 38 (Insecticides) of Central Excise Tariff.*

4. Can a refund not governed by the amended section 11B of the Central Excise Act be hit by bar of unjust enrichment?

Sahakari Khand Udyog Mandal Ltd. v. Commissioner of C. Ex. & Cus. 2005 (181) E.L.T. 328 (S.C.)

Decision*: Irrespective of applicability of Section 11B of the Central Excise Act, the doctrine of unjust enrichment can be invoked to deny the benefit to which a person is not otherwise entitled.*

The appellant was engaged in the manufacture of sugar. In 1978 a refund was claimed by the appellant on the basis of Notification No. *257/76,* dated September 30, 1976. The Notification *inter alia* provided for exemption from payment of excise duty leviable thereon in excess of average production of sugar of the corresponding period of preceding three years. The production of the appellant in the fourth year exceeded the average production of the sugar in the preceding three years by a certain amount, the duty paid on which was claimed as refund by the appellant. However, Department invoked the doctrine of unjust enrichment on such claim and transferred the said amount to Consumer Welfare Fund.

It was the contention of the appellant that the rebate was in the nature of an incentive to the factories to encourage them to produce more sugar and such rebate was not intended to benefit the consumers. It was, therefore, not open to the Authorities to take into account extraneous ground for refusing relief to them

It was also argued that provisions of Section 11B could not be invoked for denial of the benefit of notifications as section 11B was inserted in the Act by the Amendment Act of 1978 (Act 25 of 1978) w.e.f. 17.11.1980 (after the refund claim was made). The section was further amended by the Amendment Act of 1991 (Act 14 of 1991) w.e.f. 19.09.1991.

Supreme Court clarified that 'Unjust enrichment' means retention of a benefit by a person that is unjust or inequitable and it occurs when a person retains money or benefits which in justice, equity and good conscience, belong to someone else. The doctrine of 'unjust enrichment', therefore, is that no person can be allowed to enrich inequitably at the expense of another. A right of recovery under the doctrine of 'unjust enrichment' arises where retention of a benefit is considered contrary to justice or against equity. The juristic basis of the obligation is not founded upon any contract or tort but upon a third category of law, namely, quasi-contract or the doctrine of restitution.

Supreme Court opined that irrespective of applicability of Section 11B of the Act, the doctrine could be invoked to deny the benefit to which a person was not otherwise entitled. Section 11B of the Act or similar provision merely gave legislative recognition to the doctrine. That, however, did not mean that in absence of statutory provision, a person could claim or retain undue benefit. The Court stated that before claiming a relief of refund, it was necessary for the petitioner/appellant to show that he had paid the amount for which relief was sought, he had not passed on the burden on consumers and if such relief was not granted, he would suffer loss.

It was observed by the Apex Court that all the lower authorities had expressly recorded a finding that the appellant had recovered the amount from consumers and as such excise duty was passed on to consumers/customers. In view of the specific finding, the Court held that the appellant was not entitled to claim any amount. Allowing exemption or refund of amount would have resulted in 'unjust enrichment' by the appellant which could not be permitted.

Note: B*y this decision the judiciary has established that the principle of equity will always be recognised even though it may not be expressly spelt out in any part of the legislation.* ■