Legal Decisions

Can the High Court formulate substantial question of law after conclusion of arguments?

M. Janardhana Rao v. Joint Commissioner of Income Tax [2005] 273 ITR 50 (Supreme Court)

Decision: It is essential for the High Court to formulate the question of law and thereafter proceed with the matter. The High Court must make an effort to distinguish between a question of law and a substantial question of law.

In a particular case before the High Court the questions were formulated for adjudicating the appeal after the arguments were concluded for the purpose of rendering the judgment. The question of law was not formulated at the time of the admission of appeal.

Section 260A of the Income-tax Act, 1961 contains the procedures that are required to be followed when an appeal is made to the High Court. The High Court is not empowered to decide any case without adhering to the procedures prescribed under section 260A. The High Court has to insist on the statement of the substantial question of law and formulate the same at the time of admission.

It was held that the right to appeal is not an inherent right but is a statutory right. Thus, it should be strictly regulated as per the procedures provided in the law in force at the relevant time. The High Court is required to formulate the "substantial question of law" at the time of admission of the appeal. Formulating the question of law after conclusion of arguments is against the Act. Further efforts have to be made by the High Court to distinguish between a question of law and a substantial question of law.

Note: The Apex Court laid down the following tests for determining whether a substantial question of law is involved in the appeal:

a) Whether the substantial rights of the parties are being affected directly or indirectly, or
b) The question is of general public importance, or
c) The Supreme Court has not settled the issue, or
d) The issue is not free from difficulty, or
e) It requires discussion for an alternative view.

2. Will the cash credits and unexplained investments found in the books of account of a firm in the name of the partners be assessable in the hands of the firm or partners or both?

(1) Jagmohan Ram Ram Chandra
(2) Girish Narain
v. CIT [2005] 274 ITR 405 (Allah.- HC)

Decision: Firm and an Individual, being two separate entities will be assessed separately in respect of cash credit and unexplained investments found in the books of the firm in the name of the partners only if they fail to provide proper explanation regarding the source of such amounts.

The Assessee was a partnership firm consisting of six partners. In a particular assessment year the books of account of the firm contained certain credits in the names of its two partners. The Assessing Officer sought explanation regarding the source of such credits. The explanation presented to the Assessing Officer was that the two partners had surrendered the said sum in their individual returns and have been assessed thereupon. The ITO rejected the explanation and assessed the same in the hands of the firm invoking the provisions of section 68 of the Income-tax Act, 1961.

The Tribunal upheld the additions made by the ITO. On a reference to the High Court it was held that the provisions of section 68 (regarding cash credits) will be attracted and the sum found credited in the books in the names of the partners will be taxable in the hands of the firm as the firm is unable to give proper explanation in respect of its source. It was further held that there was no double taxation as the provisions of section 69 of the Income Tax Act, 1961 got attracted when the partner has made investment, which is not recorded in the books maintained by him for the source of income and the explanation given by him is not satisfactory. Thus, the amount will be taxable in the hands of the partners as well. The question of double taxation does not arise as full effect of the deeming provisions and presumptions provided under section 68 and 69 of the Income-tax Act, 1961 has to be given.

Note: The firm and the partners being treated as two different entities under the Act, assessment of income in the hands of the different assessees under different provisions of the Act are permissible.

3. Can the delay in furnishing the report under section 44AB by a government undertaking be condoned by the reason of non-appointment of statutory auditor by CAG?

M.P. State Agro Industries Development Corporation Ltd. v. CIT and others [2005] 274 ITR 582 (Madhya Pradesh-HC)

Decision: Non-filing of report under section 44AB is one of the defects which needs rectification and the Assessing Officer may condone the delay in rectification of the defect even if the time fixed of 15 days or further time allowed under section 139 (9) has expired.

The Assessee was a State Government undertaking. The assessee filed its return of income for the year 1993-94 on an estimated basis as its statutory auditor was not appointed by the Comptroller and Auditor General of India. The assessee received a notice under section 139(9) whereby the Deputy Commissioner intimated the defect of non-filing of the report under section 44AB. As per the notice the assessee was required to rectify the defect before the specified date. In view of the proviso to section 139(9) the assessee requested for some more time for the submission of audit report as the delay was due to the want of appointment of the auditors by CAG. The Deputy Commissioner refused to allow further time and treated the return as invalid. The assessee made an application for revision, which was rejected.

On a writ petition against the order it was held that the delay in the appointment of the auditor was not the fault of the assessee. The delay was on the part of the Comptroller and Auditor General of India. Once the auditors were appointed they took time to complete the audit and finalize the report under section 44AB. The application to extend the time limit was rejected by the Assessing Officer before the completion of audit. It was further held that the application for more time was covered under the proviso to section 139(9) and the Assessing Officer was bound to consider it in the light of facts and circumstances of the case. The order of the Commissioner was quashed.

Note: Under the proviso to section 139(9) if the defect in the return is rectified before the assessment is made, on existence of sufficient cause the Assessing Officer may condone the delay and treat the return as a valid return.

4. Will the loan given to the holding company of a holding company be considered as " deemed dividend" within the meaning of section 2(22)(e)?

Madura Coats P. Ltd., In re [2005] 274 ITR 609 (A.A.R)

Decision: The Authority for Advance Rulings decided that in the given case the interest bearing loan could not be deemed to be a dividend in the hands of the recipient company.

The applicant was an Indian company engaged in the manufacturing and trading of threads. It proposed to advance an interest-bearing loan to M/s CFL, a company incorporated in U.K, engaged in providing finance to the companies in the group. The applicant intended to give the loan to M/s CFL out of its accumulated profits. M/s CFL was the subsidiary of M/s CHL. Some subsidiaries of M/s CHL (other than CFL) and M/s JPC, a subsidiary of CFL held shares in the applicant company. Thus, the CIT held that M/s CFL has substantial interest in the applicant company and thus, the advance made was deemed dividend in the hands of M/s CFL.

Section 2(22)(e) requires the following conditions to be satisfied:

1. The payment should be made by the company in which public is not substantially interested;

2. The company should have accumulated profits;

3. The payment should be by the way of loan or advance:

a. To a shareholder who is the beneficial owner of shares holding not less than 10 per cent of the voting power; or

b. To any concern in which the shareholder is a member or a partner and in which he has a substantial interest.

c. By the company on behalf of or for the individual benefit of such a shareholder.

In this case the aforementioned requirements one and two were satisfied. However, the conditions of three were to

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be tested. In view of the aforesaid provisions and the facts stated the authority held that:

1. M/s CFL was not a registered shareholder of the applicant company.

2. M/s CFL is a concern and M/s JPC is a shareholder and JPC is not a member or a partner much less had it any substantial interest in M/s CFL as defined under section 2(32).

3. There was nothing on record to suggest that the loan had been advanced to M/s CFL on behalf of or for the benefit of M/s JPC.

The loan proposed to be given by the applicant to CFL would not be considered as "deemed dividend" under section 2(22)(e) to the extent of accumulated profits.

Note: The concept of beneficial shareholder was incorporated in section 2(22)(e) w.e.f. 1988-89. Prior to this assessment year the term 'shareholder' was constituted only as a registered shareholder.

5. Whether issue of bonus redeemable preference shares to a non-resident would amount to " deemed dividend" and require tax to be deducted at source?

Briggs of Burton (India) P. Ltd., In re [2005] 274 ITR 595 (A.A.R)

Decision: No deemed dividend at the time of issue of bonus redeemable preference shares as there was no release of assets of the company. As no income accrues at the time of allotment, no tax is required to be deducted at source.

The applicant was a private limited company with its head office in Bangalore. The applicant was registered under the Companies Act, 1956. It was a wholly owned subsidiary of a U.K. company. The applicant proposed to issue redeemable preference shares to its shareholders as bonus shares from the general reserves available with the company. These bonus shares were redeemable within 10 years from the date of allotment. Since the free reserves were converted into redeemable shares the applicant raised the issue whether allotment of such bonus shares to a non-resident would be covered by the provisions of section 2(22)(a) or (b) and whether the provisions relating to tax deduction at source get attracted.

On the basis of the facts the authority ruled that such distribution of bonus shares by the company out of its accumulated profits i.e general reserves does not entail release of assets of the company and thus the provisions of section 2(22)(a) do not get attracted on such allotment. However, there would be release of asset at the time of redemption of such allotted shares. It was also held that no income accrued to the non-resident at the time of allotment of the bonus shares, and therefore the applicant is not required to deduct tax at source.

Note: The inten tion of the Legislature in section 2(22)(a) and (b) is that the issue of bonus preference shares to equity shareholders should not be treated as deemed dividend at the time of issue but at redemption it can be said that there has been release of the assets of the company within the meaning of section 2(22)(a).

6. Whether a block assessment, on the basis of search conducted at the premises of third person, permissible?

CIT v. Deep Arts [2005] 274 ITR 571 (Kerala-HC)

Decision: Even if no search has been conducted at the premises of the assessee the Assessing Officer has jurisdiction to make assessment under section 158BC read with section 158BD on the basis of material obtained in a search conducted at the premises of a third person.

The assessee, a partnership firm was engaged in the manufacture and sale of note-books, greeting cards etc. The premises of one of the sister concerns of the assessee were searched under section 132 of the Act. During such search certain books of account and documents relating to the assessee were found and seized. On scrutiny of these books of account the Assessing Officer found that the sales had been understated. Cross-verification with the books of the agent also revealed that there was suppression of sales on by the assessee. The assessing officer completed the assessment and determined the undisclosed income of the assessee. The assessee contended that a block assessment could not be made on him in the absence of search conducted in his premises under section 132.

The Tribunal accepted the stand taken by the assessee. On a reference to the High Court it was held that section 158BD clearly specifies that the Assessing Officer is only required to satisfy himself that the undisclosed income belongs to any person other than the person on whom the search under section 132 was made or whose books of account or other documents or assets were requisitioned under section 132A. The books of account seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person. The order of the Tribunal was set aside.

Note: Section 158BD is reproduced below for reference:

"Where the Assessing Officer is satisfied that any undisclosed income belongs to any person, other than the person with respect to whom search was made under section 132 or whose books of account or other documents or any assets were requisitioned under section 132A, then, the books of account, other documents or assets seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person and that Assessing Officer shall proceed against such other person and the provisions of this Chapter shall apply accordingly."

7. Whether income of a co-operative society from a cold storage is exempt under the provisions of section 80P(2)(e)?

CIT v. District Co-operative Federation [2005] 144 Taxman 333 (Allahabad –HC)

Decision: The cold storage is used for storage of goods and can be said to be a 'warehouse' or 'godown' where goods are stored. Thus deduction under section 80P(2)(e) will be available.

The assessee, a co-operative society claimed a deduction in respect of income from cold storage under section 80P(2)(e) while filing its revised return of income. The Income Tax Officer disallowed such deduction. On an appeal the deduction was allowed by Commissioner (Appeals). However, the Tribunal disallowed the said deduction.

On reference to the High Court it was held that the terms "godown" and "warehouse" were interchangeable and have a common meaning that is they are used for storage of goods for a temporary period. The dictionary meaning of cold storage provides that vegetables, fruits and several other articles are stored in a cold storage. By applying liberal interpretation of the provisions of section 80P(2)(e) a cold storage can be treated as godown or warehouse where fixed temperature is maintained. Thus, deduction under section 80P(2)(e) will be allowed in respect of the income from cold storage.

Note: Reference has been taken from the following cases:

a) CIT v. Radha Nagar Cold Storage (P) Ltd. [1980] 126 ITR (Cal.-HC)

b) Delhi Cold Storage (P.) Ltd. v. CIT [1991] 191 ITR 656 (SC)

8. Will the interest paid on borrowed capital under deferred payment scheme for the acquisition of plant and machinery, in respect of the period till the asset was first put to use, be eligible for deduction under section 36(1)(iii) or section 37(1)?

JCT v. Deputy CIT [2005] 144 Taxman 435 (Cal. – HC)

Decision: Interest paid on borrowed capital under deferred payment scheme for the period relevant till the asset is first put to use will be included in the cost of the asset in view of Explanation 8 to section 43(1) and no deduction shall be allowed under section 36(1)(iii) or section 37(1).

The assessee purchased new plant and machinery for the expansion of its existing business. An agreement was entered into, by the assessee, wherein it was agreed that the payment (inclusive of interest) would be made under the deferred payment scheme. The assessee capitalised the same in its account but did not claim depreciation and development rebate. The assessee claimed the deduction under section 36(1)(iii) or section 37, which was declined by the Assessing Officer who considered the same to be a capital expenditure.

The Commissioner (Appeals) and the Tribunal affirmed the same. On reference to the High Court it was held that interest in respect of the period beginning from the date of capital borrowed till the date when the asset was first put to use was to be capitalised even if the payment was made under deferred payment scheme. The Court acknowledged that there was substance in the submission of the assessee that the amount so capitalised should be eligible for depreciation and development rebate but could not be claimed by the assessee. It was further held that the assessee could not claim the same as unless the deduction was eligible under law.

The Court clarified that the insertion of the proviso to section 36 by Finance Act, 2003 has clarified that the deduction under section 36(1)(iii) cannot be claimed in respect of interest paid for the period commencing before the asset was first put to use. The same comes under the purview of Explanation 8 of section 43(1).

Note: The proviso to section 36 inserted by the Finance Act, 2003 is in alignment with the Explanation 8 to section 43(1). ❐