Legal Decisions

— *Ms. Priya Subramanian and* **Ms. Smita Pandey**

DIRECT TAXES

1. Can expenditure incurred by the assessee-company for renovation and repairs of the building of a club, in which its employees were members, be considered as a business expenditure?

Assam Brook Ltd. v. Commissioner of Income Tax (2004) 139 Taxman 229 (Cal.)

Relevant section: 37

The assessee-company was situated in a remote place and its employees were the members of a club. The assessee paid, *inter alia*, a sum of Rs.5 lakh to the club for renovation and repairs of the club building which had been damaged. The assessee claimed deduction of the same as business expenditure. The Assessing Officer as well as the Tribunal disallowed the assessee's claim on the ground that the assessee was not the owner of the club.

The High Court observed that since the company was situated in a remote place, the club was the only source of recreation for its employees, who were also members of the club. So, if the assessee-company paid some amount for the upliftment/running of the club in an effective way, then such payment was made in the interest of the assessee, so that its employees remained happy and, consequently, the work of the assessee was not hampered in any way due to dissatisfaction on the part of the employees. As the payment of Rs.5 lakh was made by the assessee to the club keeping its business interest in mind, the said payment must be held to be business expenditure, and accordingly, as per section 37 the assessee-company was entitled to get deduction. The High Court also observed that the fact that the assessee was not the owner of the club made its case stronger since there was no personal benefit for the assessee-company in making such payment.

2. Can remission of unsecured loan be treated as income of the assessee by invoking the provisions of section 41(1)?

CIT v. Chetan Chemicals (P.) Ltd. (2004) 139 Taxman 301 (Guj.)

Relevant section: 41(1)

The assessee was a private limited company. In the course of carrying on its business, the company had obtained unsecured loans from various creditors, and in the light of the financial difficulties faced by the company, the creditors approached the High Court by filing various petitions. During the course of those proceedings, a compromise was reached between the assessee-company and its creditors wherein, as per the terms of the compromise, certain creditors remitted unsecured loans amounting to Rs.1,77,052 and interest amounting to Rs.2,96,171. The assessee declared such remitted interest as income liable to tax under section 41(1), while filing its return of income. The ITO contended that the remittance of unsecured loan was also a benefit accruing to the company during the course of its business activity and brought the same to tax. The Commissioner (Appeals) confirmed the assessment order and the assessee approached the Tribunal. The Tribunal held that the remission of unsecured loans could not be subject to tax by invoking the provisions of section 28(iv), read with section 41(1).

The High Court observed that section 41(1) can be invoked only when an allowance or a deduction has been granted during the course of assessment for any year in respect of loss, expenditure or trading liability which is incurred by the assessee, and subsequently, during any previous year, the assessee obtains, whether in cash or in any other manner, any amount in respect of such trading liability by way of remission or cessation of such liability. In that case, either the amount obtained by the assessee or the value of the benefit accruing to the assessee can be deemed to be the profits and gains of a business or profession and can be brought to tax as income of the previous year in which such amount or benefit is obtained. **In this**

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case, since there had been no allowance or deduction in any of the preceding years in respect of the unsecured loan, the provisions of section 41(1) cannot be applied to such loan. *Therefore, the High Court held that the Tribunal was right in holding that the amount of Rs.1,77,052 arising as a result of remission of unsecured loans was not taxable in the hands of the assessee.*

3. Refundable and non-refundable, deposit cannot be considered as trading receipts and therefore, not durable.

Siddeshwar Sahakari Sakhar Karkhana Ltd. v. CIT (2004) 139 Taxman 434 (SC)

The assessee co-operative society was engaged in the business of manufacturing sugar. Its members were predominantly sugarcane farmers, who were obliged to sell their sugarcane to the assessee-society. The bye-laws framed under the Maharashtra Co-operative Societies Act, 1960 governing the affairs of the society provided for deduction of amounts towards refundable and non-refundable deposits from the cane price payable to the grower members. These amounts were to be utilized in the following manner–

(i) For repayment of loans of FIIs and capital contribution of Government;

(ii) Thereafter, the non-refundable deposits may be converted into shares in favour of the members;

(iii) The refundable deposits in the form of fixed deposits to be refunded to the members along with interest.

Further, pursuant to the orders passed or circulars issued by the State Government/Director of Sugars, amounts were also being deducted for being credited to various funds such as Chief Minister's Relief Fund, Y.B. Chavan Memorial Fund, Cane Development Fund etc. The issue under consideration is whether these refundable/non-refundable deposits and deductions towards various funds were revenue receipts taxable in the hands of the assessee.

The High Court observed that in this case, the word "deposit" has been used and there were intrinsic indications in the by-laws that the expression had been used to mean just what it said. These were: (a) conversion of the deposit into additional shares; (b) transferability/heritability; (c) refundability; and (d) payment of interest on the deposit. Although the first three features were no doubt dependent upon the occurrence of certain contingencies or hedged in by certain limitations, the deposit amount was not denuded of its character of "deposit" for that reason alone.

On repayment of the loans of the description mentioned in the by-laws which were outstanding on the date the deposit was made, the Board of Directors of the Society were bound to covert the deposit amount into shares. There are several indicators that the assessee-society could exercise dominion over the deposits only within permissible limits. The existence of other features like –

(i) the obligation to convert the deposits into shares subsequent to repayment of certain types of loans,

(ii) the right of a member to seek transfer of the amount lying to his credit to another member and

(iii) the obligation to refund the deposit to the depositor on cessation of his membership or to his legal heirs

were important indicators against the treatment of the deposited amount as the money belonging to the society. The payment of interest from year to year at a specified rate was another important factor that supported the conclusion of the disputed sum being a deposit.

On a consideration of the by-laws as a whole, it was difficult to hold that the assessee can exercise complete dominion over the deposited amounts. Thus, the non-refundable deposits of members could not be treated as income of the assessee-society. Further, since the amount of refundable deposits were pure and simple fixed deposits repayable after the expiry of definite period of time with interest, they were clearly liable to be excluded from the assessee's taxable income.

Since the amount collected on account of the Chief Minister's Relief Fund, Y.B. Chavan Memorial Fund and Hutment Fund was not reaching the assessee as part of its income but the same was remitted to the Government/trustees, those receipts should not be treated as income of the assessee. However, since the beneficiaries of Cane Development Fund were no other than members of the assessee, the deductions made out of the cane

price towards the said Fund should be treated as income of the assessee. There was no scope for the application of the principle of diversion of income at source in the case of collections made towards Cane Development Fund. The amounts realised on this account undoubtedly reached the assessee as its income and were utilized by the assessee for the benefit of itself and its members.

Note *– The Apex Court has rightly held in this case that a conclusion should not be drawn to the effect that all realizations out of the price payable to the members get impressed with the character of revenue receipts, giving rise to taxable income in the hands of the assessee. It is not any and every receipt linked to the trading activity that acquires the quality of a revenue receipt.*

4. Would a liaison office performing an important part of the main work constitute a PE?

UAE Exchange Center in Re. (2004) 139 Taxman 82 (AAR-N. Delhi)

The applicant is a company incorporated in the UAE. The applicant company is engaged in offering remittance services for transferring amounts from UAE to India on commission basis. It received the entire commission in UAE. The company was granted licence by the RBI for setting up liaison offices in India for undertaking certain approved activities. The expenses of liaison offices set up in India was fully met out of funds received through normal banking channel from UAE. The applicant filed an application seeking advance ruling on the question as to whether any income has accrued in India.

The Authority for Advance Rulings (AAR) observed that the activities of the liaison office are –

1. Attending to complaint of clients in cases where remittances are sent directly to banks in India and
2. Downloading information from internet, printing cheques/drafts in the name of beneficiaries and sending them through couriers to various places in India in cases where the applicant has to remit amounts to beneficiaries in India.

The AAR held that as regards the first activity where the amount is directly transferred, the liaison office has no role to play except to attend to complaints of clients. This work is of auxiliary nature, and is exempted from constituting a Permanent Establishment (PE) as per DTAA between India and UAE. However, as regards the second activity, the liaison office performs an important part of the main work since the performance of the contract would not be complete without remittance of the amount to the beneficiaries. Therefore, undertaking this work would constitute PE of the applicant. In such a case, that portion of the profits which is attributable to the liaison office (PE) is deemed to accrue to the applicant in India, and hence, would be taxable in India.

5. Does interest on share application money accrue only after completion of the allotment process?

CIT v. Henkel Spic India Ltd. (2004) 139 Taxman 40 (Mad.)

The assessee deposited the share application money with its banker and earned interest thereon. The Assessing Officer sought to tax the interest earned on the deposit as income for the relevant assessment year, when the allotment process was not yet complete. The issue for consideration before the High Court was whether the interest earned by the assessee accrued during the relevant assessment year before the completion of the allotment process.

The High Court observed that until the allotment process was complete, the application money and the interest due thereon would remain with a trust in favour of the general body of the applicants. The prohibition incorporated in section 73(3A) of the Companies Act, 1956 was absolute and the amount so deposited cannot be transferred to any other account. The amount of interest earned on application money, to the extent to which it is not required for being paid to the applicants to whom moneys have become refundable by reason of delay in making refund, will belong to the company only when the trust terminates and it is only at that point of time that the amount can be said to have accrued to the company. The High Court, therefore, held that since the process of allotment was completed only in the next year, the interest can be said to have accrued in the next year only.

INDIRECT TAXES

1. Is excise duty payable on the value of operational software loaded on the computer?

CCE, Pondicherry v. Acer India Ltd. 2004 (172) E.L.T. 289 (S.C.)

The Apex Court held that the value of the operational software loaded on the computer was not includible in the assessable value of the computers. The issue was discussed in detail as under:

Computer and operative softwares were different marketable commodities. They were available in the market separately and were classified differently. The rate of excise duty for computer was 16% whereas that of software was *nil.*

The computer and software were distinct and separate, both as a matter of commercial parlance and also under the statute. A computer might not be capable of functioning effectively without being loaded with software. However, it would not tantamount to bringing them within the purview of the part of the computer so as to include their value in the assessable value of the computers. Both computer and software must be classified under their respective headings viz., 84.71 and 85.24 and must be subjected to corresponding rates of duties separately.

Although the information contained in software was loaded in the hard disc, but the operational software did not lose its value and was still marketable as a separate commodity. It did not lose its character as a tangible goods being of the nature of CD-ROM. The fact that the manufacturers put different prices for the computers loaded with different types of operational software would not make any difference as regards nature and character of the 'computer'. Even if the manufacturers in terms of the provisions of a licence were obliged to preload software on the computer before clearing the same from the factory, the characteristic of the software could not be said to have transformed into hardware so that it could be chargeable to excise duty along with the computer.

As regards valuation it was pointed out by the Apex court that the valuation of goods would be subjected to the charging provisions contained in section 3 of the Act and also subsection (1) of section 4. The definition of 'transaction value' must be read in the text and context of section 3, the charging section i.e., the expressions 'by reason of sale' or 'in connection with the sale' contained in the definition of 'transaction value' could not be used to justify the chargeability of software to excise duty. Those expressions referred to such goods, which were excisable to excise duty and not the one, which were not excisable. The legal text contained in Chapter 84, as explained in Chapter Note 6, clearly stated that software, even if contained in hardware, did not lose its character as such. When an exemption had been granted from levy of any excise duty on software whether it was operating software or application software in terms of heading 85.24, no excise duty could be levied thereupon indirectly as it was impermissible to levy a tax indirectly.

The excise duty was chargeable on the excisable goods and not on the goods, which were not excisable. Thus, if non-excisable goods were transplanted into excisable goods, the assessee would not be liable to pay excise duty on the combined value of both. Excise duty, in other words, would be leviable only on the goods, which answered the definition of 'excisable goods' and satisfied the requirement of section 3. A machinery provision contained in section 4 and that too the explanation contained therein by way of definition of 'transaction value' could neither override the charging provision nor by reason thereof 'goods' which was not excisable would become excisable only because one was fitted into the other. While computing costs of manufacturing, expenses that would add to the value of the excisable goods had to be considered and not the value of non-excisable goods.

2. There is a mine from where the raw material is extracted, but no manufacturing process is carried on there. Whether such a mine will come in the scope of term 'factory' as defined in section 2(e) of Central Excise Act, 1944?

Whether credit can be taken on inputs, which are used outside the factory?

***CCE, Jaipur v. J.K. Udaipur Udyog Limited* 2004 (171) E.L.T 289 (S.C.)**

The assessee was engaged in the business of manufacturing cement. He used to excavate limestone for the purpose of manufacturing cement from a mine,

which was situated at a distance of few kilometres from the plant where the cement was manufactured. The contention of the assessee was that since the excavated limestone was brought from the mine to the factory by a ropeway, the mine was an extension of the factory area. However, on a perusal of the definition of factory as per section 2 (e) of Central Excise Act which read as:
"factory" means any premises, including the precincts thereof, wherein or in any part of which excisable goods other than salt are manufactured, or wherein or in any part of which any manufacturing process connected with the production of these goods is being carried on or is ordinarily carried on."
It was held by the Supreme Court that ***a mine connected to the factory by a ropeway could not qualify to be a factory as no manufacturing process was carried out there.***

The assessee used explosives for blasting the mines in order to excavate limestone. He wanted to avail Cenvat credit on such explosives to which the Excise Department objected. The Supreme Court observed that as per the definition of inputs in Rule 2(g)(erstwhile Rule 57AA) of the Cenvat Credit Rules, 2004, the credit could be taken only on the "inputs...used for manufacture of final products or for any other purpose, *within the factory* of production." Further, as per Rule 3(erstwhile Rule 57AC) of Cenvat Credit Rules, 2004 the credit could be taken on the inputs *"....received in the factory."* ***Therefore, if the inputs were not used within the factory of production, they could not be termed as eligible inputs under Rule 2(g)(erstwhile Rule 57AA) and also actual receipt and use of inputs within the factory was essential for availing credit on them***. Hence, it was held by the Apex Court that credit would not be available on the explosives as they were not used within the factory of production but were used in the mine which could not qualify to be a factory.

3. What will be the proper classification for scented supari of betel nuts with menthol?

A.R.R. Enterprises v. Asstt. Commissioner of Central Excise, Thanjavur 2004 (172) E.L.T. 160 (Mad.)

The issue which came up before the High Court in the instant case was that whether the scented supari of betel nuts with menthol would be classifiable as "any other kind of" pan masala under sub-heading 2106.90 of Central Excise Tariff or as a preparation of vegetables etc. under Heading 20.01.

The contention of the assessee was that the betel nut was a nut and hence the proper classification would be under Heading 20.01, which read as under: Preparations of vegetables, fruits, nuts or other parts of plants, including jams, fruit jellies, marmalades, fruit or nut puree and fruit or nut pastes, fruit juices and vegetable juices, whether or not containing added sugar or other sweetening matter. However, the Department claimed that supari being betel nut came under Chapter 21 Note 3 and qualified to be the 'pan masala' under Entry 2106.90. The Entry 21.06 covered Pan masala containing lime, katha (catechu) or tobacco or any one or more of these ingredients. Heading 2106.90 covered 'other'. Note 3 defined Pan masala as any preparation containing betel nuts any one or more of other ingredients such as lime, katha (catechu), cardamom, copra, menthol and tobacco…

The High Court observed that betel nut was the common ingredient and when betel nut was mixed with any one or more of the aforementioned five ingredients, it became Pan masala, which was dealt in Entry 21.06. Therefore, it was held by the High Court that ***scented supari of betel nuts with menthol would be classifiable more particularly as 'any other kind of, pan masala under sub-heading 2106.90 and not as preparation of vegetable etc. under Heading 20.01***.

4. How will the goods covered under section 4A, but not sold in retail, be valued?

Commissioner of C. EX. & Cus., BBSR –II v. Mehar Shoes Industries 2004 (172) E.L.T. 409 (Tri. – Kolkata)

The assessee manufactured shoes on the basis of bulk orders received from various Government Departments. Neither did they make any retail sale to individual buyers, nor did they affixed any MRP on shoe packages sold by them. The assessee even did not file any declaration required under statues.

The issue, which arose before the Tribunal, was that whether the goods in question had to be classified as per the provisions of section 4 or as per the provisions of section 4A. The Tribunal followed the *Circular No. 625/16/2002 – C.X., dated 28.02.2002* that read:
"The issue, therefore, was how to value the tele-

phone sets which were sold by the manufacturer in bulk to the telephone deptt. The matter was referred to the Ministry of Law, who have opined that valuation of telephone instruments supplied in bulk to telephone deptt. will be done as per Sec. 4 of the C.E. Act, 1944 and the instruments sold in the market, with printed MRP, would be assessed under section 4A of the Act. The Ministry has accepted the opinion of the Law Ministry."

Thus it was clear from the above Circular that ***where MRP was not written on the pack, the goods were to be assessed under section 4 of C.E. Act, 1944***. In the instant case, the basic conditions of the goods to be valued as per provisions of section 4A were absent for the purpose of charging ad valorem duty. Therefore, it was held by the Tribunal that the goods had to be valued as per section 4 of the Central Excise Act.

5. Whether the principle of unjust enrichment applies to the claim for refund of customs duty paid on imported *capital goods*?

Design Classics Exports (P) Ltd. v. Commissioner of Customs, Chennai 2004 (172) E.L.T. 423 (Tri. – Chennai)

The Apex Court in the case of *Solar Pesticides* had held that doctrine of unjust enrichment would apply in respect of raw material imported and consumed in the manufacture of final products. However, in the instant case the goods in question were *capital goods* and not the raw material.

The Tribunal followed the judgements given by the Tribunal in the case of *Grasim Industries v. CCEx, Chennai III -2003 (157) E.L.T. 123* and *Golden Iron & Steel Forgings* wherein it was held that the ratio of the decision in *Solar Pesticides* was not applicable to a claim of refund of customs duty paid on imported goods. Therefore, it was held by the Tribunal that the **doctrine of unjust enrichment under section 27 of the Customs Act did not apply to the claim for refund of import duty paid on capital goods.** ■