Legal Decisions- Direct Taxes

R. Devarajan

1. Is it necessary for the Assessing Officer to issue show-cause notice or give an opportunity for the assessee to be heard before issuing directions for conduct of special audit under section 142(2A)?

Jhunjhunwala Vanaspati Ltd. v. Asstt. CIT (2004) 137 Taxman 214 (All.)

Relevant section:142(2A)

As regards this issue, the High Court observed that the Income Tax Act confers powers on revenue officials to direct special audit of accounts in complex cases. The Court held that it is not necessary for the Assessing Officer to give show-cause notice or give an opportunity for the assessee to be heard before issuing directions under section 142(2A) for conduct of special audit, since such direction is a purely administrative matter, the sole purpose of which is to ensure a correct assessment.

2. In a case where an order of assessment is set aside, can the offence of tax evasion under section 276C still be tried?

Gheru Lal Bal Chand v. Income-tax Officer (2004) 137 Taxman 397 (P & H)

Relevant sections: 276C & 277

The respondent filed a complaint under section 276C/277 alleging that the petitioners accused were guilty of maintaining duplicate set of books of account to evade income-tax. The petitioner filed an application before the trial court for dropping the proceedings on the ground that the order of assessment had been set aside in appeal and since the order of assessment was made on the basis of the complaint, the prosecution could not be continued. In brief, the contention raised on behalf of the petitioner was that since the order of assessment had been set aside, the offence of tax evasion under section 276C could not be tried.

The High Court dismissed the plea of the petitioners holding that their contention was not acceptable. The Court held that the offence of tax evasion is independent of assessment proceedings and there is no legal bar to the trial being conducted for such an offence, where the parties could lead all relevant evidence. Therefore, the offence of tax evasion can still be tried.

3. Is there any provision in the Income-Tax Act by which the Department can retain possession of seized jewellery during pendency of appeal, filed by revenue, against the assessee before High Court?

Naresh Kumar Kohli v. CIT (2004) 137 Taxman 438 (P&H)

During the course of search conducted at the residential and business premises of the assessee, the competent authority searched the lockers of the assessee and seized the jewellery contained in the said lockers. Thereafter, the Assessing Officer framed the block assessment and created an additional demand, which was paid by the assessee. The assessee filed applications before the Commissioner for release of the jewellery seized, but received no response.

On writ, the High Court held that since there were no existing liabilities against the assessee and jewellery was recovered and seized from the custody of the assessee, the department was liable to make over the jewellery to the assessee in terms of the provisions of section 132B. There is no provision in the Act under which the department can retain possession of seized jewellery during pendency of appeal filed by

The author is Additional Director, ICAI He can be reached at rdicai@sancharnet.in)

revenue. Therefore, the assessee was entitled to receive back the jewellery seized from him.

4. Can Development Officers approach Assessing Officer to issue certificates of no deduction of tax at source in respect of additional conveyance allowance?
Franco John & Others v. Union of India & Others [2004] 269 ITR 441 (ker.)

Relevant sections 10(14), 192, Relevant Rule - Rule 2BB

The Executive Officer of the Life Insurance Corporation issued periodical circulars providing guidelines for deduction of income-tax at source on additional conveyance allowance paid to development officers. In a writ petition, associations of development officers contended that the additional conveyance allowance paid to them qualified for exemption under section 10(14) of the Income-Tax Act, 1961, and therefore, the direction of the Executive Officer to deduct tax at source in accordance with the norms prescribed by the circulars was unauthorized and without jurisdiction:

The Court held that the circulars or guidelines issued by the Executive Officer of the LIC were not statutory and had no force of law. Thus, it was for the LIC to take the matter to the Central Board of Direct Taxes for appropriate circulars under section 199 of the Act. The actual expenditure incurred by the employee and reimbursed by the employer on being satisfied that the expenditure was incurred towards conveyance in the performance of duty of office shall not attract income-tax. Exemption was available to the additional conveyance allowance incurred by each development officer and reimbursed to him by the LIC. The normal procedure under the Act was for each and every development officer to approach the Assessing Officer with an application under section 197 and demonstrate that the additional conveyance allowance was exempt fully or partly and on being satisfied, the Assessing Officer had to necessarily issue the certificate. It was for the Income-tax Department to scrutinize the correctness of tax deducted at source made either while considering the LIC's tax deducted at source returns or while assessing the income of the development officers.

5. What are the principles governing the allocation as between capital and revenue, expenditure on issue of partly convertible debentures?
Network Limited v. DCIT [2004] 269 ITR (AT) 83 (Del.)

The assessee had incurred an expenditure of Rs.50,49,111 on the issue of partly convertible debentures, which it claimed as a deduction on revenue account. The Assessing Officer at the assessment stage noticed that the public issue was in respect of 6,72,000 partly convertible debentures against the issue price of Rs.125 per debenture out of which Rs.62,50 was to be paid at the time of application and the balance at the time of allotment. Part A of the issue pertained to the convertible portion of the debentures into two equity shares of Rs.10 each at a premium of Rs.12.50 each. In other words, out of a total sum of Rs.125 a sum of Rs 45 represented the convertible portion of the debentures into two equity shares and the balance sum of Rs 80, i.e., Part B, was the non-convertible portion of the debentures. The Assessing Officer allowed proportionate part of the expenditure, which represented Rs.80 out of Rs 125 being the amount towards the non-convertible portion of the debentures and the balance amount of Rs 18, 17,680 which related to the portion convertible into shares capital was disallowed. This was confirmed by the Commissioner (Appeals).

The Tribunal was divided on this issue. The majority held that it clearly emerged from the record that whatever be the nomenclature indicated in the various documents, the issue was of debentures and shares simultaneously and an applicant when making payment of application money and subsequently the allotment amount, was in no doubt that on payment of a stipulated amount he would be issued a debenture of a stipulated value and equity shares once again of a specified value. Nothing more was required to be done on the part of the applicant and the issue of debentures and shares was simultaneous and automatic. The total expenditure incurred on the issue was required to be bifurcated on a pro rate basis treating a part thereof to be capital in nature being related to the issue of share capital. Expenditure incurred in connection with the issue of shares with a view to increasing the share capital was directly related to the expansion of the capital base of the company and was, therefore, capital expen-

diture. The Commissioner (Appeals) was justified in confirming the action of the Assessing Officer, disallowing Rs 18,17,680 out of expenses of Rs 50,49,111 claimed by the assessee on issue of partly convertible debentures on pro rata basis. The dissenting member held that it was an undisputed fact that the assessee had gone for issue of debentures. The legal position as it stood was that any expenditure relating to issue of debentures is allowable. The nature of expenses, which from the very beginning related to issue of debentures remained the same even after subsequent conversion of debentures. The issue of debentures was one transaction and admittedly the expenses relatable to issue of debentures was allowable. The Assessing Officer had nowhere recorded a specific finding that any amount of the expenses claimed by the assessee was exclusively relatable to share capital as expenses relatable to issue of shares is a capital expenditure and in the absence of such finding the amount could not be apportioned.

6. When there was a premature termination of agency how to determine the portion attributable to capital receipt?

Parry and Co. Ltd. v. DCIT [2004] 269 ITR 177 (Mad.)

Relevant sections 28(ii)(c)

HMM was engaged in the manufacture of diverse items of food products and toiletries. The assessee was one of the selling agents for HMM for many years. HMM agreed to pay to the assessee a sum of Rs 40 lakhs in two-installments, one in consideration of the premature termination of the selling agency relating to the food products and toiletries and another in consideration of the restrictive convenants as contained in clause 2. The assessee had received Rs 25 lakhs during the year 1988-89 and Rs 15 lakhs during the year 1989-90. The Assessing Officer and the Commissioner treated the said amounts as revenue receipt. With reference to the assessment year 1988-89, the Tribunal allowed 20 per cent of the total compensation as restrictive convenant and obligations and deleted the addition to the extent of Rs 5 lakhs. With reference to the assess-

ment year 1989-90, the Tribunal held that out of the total compensation amount of Rs 40 lakhs received Rs 5 lakhs alone represented capital receipt and the balance of Rs 35 lakhs would be revenue in nature.

On appeals to the High Court, the Court held that the Tribunal took note of the fact that when the compensation was determined the parties concerned must have definitely considered the very old agency which the assessee had lost and came to the conclusion that a substantial portion of the compensation became payable on account of the loss to the assessee of a lucrative agency. The Tribunal rightly pointed out that for a proper understanding of the intentions of the parties concerned, it was necessary to read the agreement as a whole and that in understanding the nature of the payment clause 1 to the premature termination of the selling agency could not be ignored. The Tribunal rightly did not accept the plea that as the agencies continued only for a limited period on an ad hoc basis the assessee ceased to have any right to compensation on termination. It was rightly held by the Tribunal that the parties viewed it as a case of premature termination of selling agency for which the assessee was required to be compensated. The Tribunal fixed twenty per cent of the total compensation amount as attributable to the restrictive covenant and obligations, taking note of the fact that the restrictive covenants were in force for a short period of two years. The Tribunal was right in its finding that out of the sum of Rs 25 lakhs received by the assessee during the year 1988-89 and again Rs 15 lakhs during the year 1989-90 only a sum of Rs 5 lakhs was a capital receipt and not liable to tax as income under section 28(ii)(c) of the Income-tax Act, 1961.

7. Before the Authority for Advance Rulings

When the fees for a feasibility report was paid from an agency outside India through a grant and the resident undertaking in India did not receive any part of the grant would any taxable income arise?

Airports Authority of India, In re A.A.R [2004] ITR 355

The applicant, a resident public sector undertaking, entered into an agreement on March 22, 2001, with the Government of the USA through the US Trade and Development Agency (TDA) whereby the TDA was to provide $ 4,50,600 as a grant for funding a feasibility report on the proposed CNS/ATM project in India. The TDA would make disbursement of the funds of the grant directly to a contractor viz Innovative Solutions International (ISI), a US entity, selected for the feasibility study, and the applicant was not, at any point of time, to receive any money from the TDA or disburse the money to the contractor. Nor was the applicant directly or indirectly to receive any goods or services from the contractor. The final feasibility report was to be prepared and finalized in the USA. The applicant applied to the Authority for Advance Rulings for a ruling on the question whether the payment received by ISI, the non-resident US company, was liable to tax in India.

The Authority ruled

(i) that the role of the applicant was limited to approval of the invoice submitted by ISI and thereafter the funds were disbursed in the USA by the TDA to ISI. The work of preparation of the feasibility report would be done in the USA. Work to be done in India by ISI was limited to some meetings between the officials of the applicant and ISI. ISI did not have an office or establishment India. Therefore, the income of ISI could not be said to have been received or deemed to be received or to have accrued in India under section 5(2) of the Income-tax Act, 1961.

(ii) that the money was payable only by the TDA, which was an agency of the Government of the USA. ISI had no legal remedy to recover the money from the applicant, if payments were not made by the TDA. The applicant could not be termed as a conduit agency for passing the amount, because the money was not to be transferred to India: the amount of grant all along remained with the Government of the USA. Since the amount was not payable by the applicant, no income could be deemed to accrue or arise to ISI in India under section 9(1)(vi) or (vii).

(iii) that, since the source of the payment to ISI was the grant made by the Government of the USA, the royalties/fees for services of ISI had to be deemed to arise in the USA in view of paragraph 7(a) of article 12 of the Agreement for Avoidance of Double Taxation between India and the USA and were taxable only in the USA. ■