Legal Decisions-Direct Taxes

1. Whether compulsory deduction made by sugar cooperative societies on account of non-refundable and refundable deposits and other funds are revenue receipts liable to be taxed under the Income-tax Act?

Siddheshwar Sahakari Sakhar Kaarkhana Ltd. v. Commissioner of Income-tax and Others [2004] 270 ITR 1 (SC)

The assessee was a co-operative society, which carried on the business of manufacturing sugar. Its members were predominantly sugarcane farmers. The share capital of the society was contributed not only by the members but also by the State Government. Its bye-laws provided for deduction of amounts towards refundable and "non-refundable" deposits from the cane price payable to the grower members. The bye-laws contained the rules regarding the treatment of such deposits by the society. The Appellate Tribunal held that the amounts collected by the assessee towards the non-refundable deposits and the refundable deposits (term deposits) could not be treated as the income of the assessee and the amounts deducted for being credited to the funds were not trading receipts of the assessee. The High Court held that the amounts collected towards the non-refundable and refundable deposits were trading receipts of the assessee but the amounts deducted towards the funds were diverted by overriding title and were not its income.

The Supreme Court held that the existence of features such as transferability of the deposit to another member and the provision for refund of the deposited amount to the member in case of cessation of membership or to his legal heirs in case of death indicated that the deposited amount could not be treated as money belonging to the assesee-society. The payment of interest at a specified rate from year to year was consistent only with the fact that the deposited amount still belonged to the members. And the fact that the deposited amounts were credited to the individual accounts of the members corroborated the circumstance that the deposits belonged to the members. The amounts deducted from the cane price towards the non-refundable deposits were not trading receipts of the assessee. It held that the amounts of refundable deposits could not in any sense be treated as income of the assessee society.

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2. Can a loss due to fluctuation on repayment of loan be treated as revenue or capital expenditure? Is the special deduction under section 80-O limited only in respect of amount actually received in convertible foreign exchange?

Atlas Cycle Industries Ltd. v. CIT [2004] 270 ITR 108 (P & H)

The Assessing Officer disallowed certain amounts during two assessment years. They represented loss arising on repayment of loan raised in foreign currency due to fluctuations of exchange rate. The Tribunal upheld the disallowance by treating it as a capital expenditure. The High Court agreed with the Tribunal.

The assessee was to receive a royalty of Rs.3,60,396 and Rs.8,60,302 for the assessment years 1976-77 and 1977-78, respectively, from a Tanzanian party. The said party withheld the amounts of Rs.60,000 and Rs.70,000 for the two years, respectively, on account of tax payable in that country. The assessee claimed that the entire amount of Rs.3,60,396 and Rs.8,60,302 was deductible under the provisions of section 80-O of the Act, whereas, the Assessing Officer held that deduction was to be confined only to the amounts which had actually been brought into India in convertible foreign exchange. He, therefore, disallowed the claim of the assessee to the extent of Rs.60,000 and Rs.77,000 for the two years, respectively. The Tribunal referred to the provisions of section 80-O of the Act to hold that the exemption therein was available only in respect of the amounts received in India in convertible foreign exchange. Accordingly, it upheld the action of the Assessing Officer in denying the claim of exemption under this provisions in respect of the sums of Rs.60,000 and Rs.70,000 which had, admittedly, not been brought into India. The High Court upheld the order of the Tribunal.

3. On import of telephone exchange equipment can the portion of payment relating to software be segregated and treated as payment relating to royalty?

Lucent Technologies Hindustan Ltd. v. ITO [2004] 270 ITR (AT) 62

The assessee, an Indian company, was engaged in the manufacture and sale of electronic switching systems required for the telecommunications industry and a substantial part of its sales were to the Department of Telecommunications. The Department of Telecommunications placed a single purchase order for a lump sum consideration of USD 1,29,804.56 for supply of digital local telephone exchange equipment on the assessee. The price for the equipment to be supplied was a lump sum price and the equipment to be supplied consisted of various modules as well as the software that ran the equipment. The price of the equipment to be supplied for one of its exchanges was Rs.6,84,94,690. The cost of the switching equipment was Rs.5,04,49,736. The cost of the software component embedded therein was Rs.50,78,876. On the basis of the order, the assessee imported the parts and components as well as the software from the non-resident company and thereafter integrated the software into hardware and sold the switch to the Department of Telecommunications. The Assessing Officer bifurcated the transaction of purchase of software and viewed the purchase of software as an independent transaction treating the payments as royalty and held that the assessee was an assessee-in-default for failure to deduct tax at source and consequently levied interest under sections 201 and 201(1A) of the Act. The Commissioner (Appeals) confirmed the order of the Income-tax Officer.

The High Court held that the assessee's transaction with the non-resident company was for the purchase of an integrated equipment, which consisted of both hardware as well as software. One could not function without the help of the other. It was impracticable to have such value addition without the help of the other. What the assessee had purchased was a copy-righted article and not copyright of the rights. It was wrong on the part of the Revenue to have bifurcated the transaction as one of supply of hardware and the other of software and treating the software part of royalty. The assessee had not acquired any rights in the software. The assessee could not be seen to be duplicating the software in making use of the same. The software that was supplied by the non-resident company was customer-specific and was required only to be integrated into hardware that was supplied for the specific unit. It was a case of a business transaction of purchase of equipment along with the software to make the hardware functional. Hence, the payments for the transactions did not partake of the character of royalty and, therefore, the assessee was under no obligation to deduct tax at source under section 195 of the Income-tax Act, 1961, in respect of the sums paid for acquiring software during the financial years relevant to the assessment years 1999-2000 and 2000-01.

4. Is expenditure incurred on the foreign travel of the wives of the directors an allowable deduction?

CIT v. Ram Bahadur Thakur Ltd. (2004) 138 Taxman 30 (Ker.)

The assessee claimed allowance of foreign travel expenses of the directors and their wives. The Assessing Officer disallowed the claim on the ground that the expenditure was not incurred wholly and exclusively for the purpose of the business. The Commissioner (Appeals), however, allowed the claim of the assessee relying on some decisions of the Tribunal wherein in similar circumstances, travelling expenses incurred by the wife of the director were considered to be admissible expenses. The Tribunal upheld the order of Commissioner (Appeals).

The High Court observed that the Tribunal had not given reasons for the admissibility of the travelling expenses of the wives of the directors. Mere statement from the company that the travelling expenses incurred by the wives of the directors were considered to be admissible expenses does not mean that this is not personal expenditure. The assessee has to prove that it is not to be treated as a personal expenditure. The High Court reversed the order of the Tribunal holding that it is the assessee's obligation to prove the business expediency of overseas travel by the wives of the directors. If the assessee fails in this regard, then such expenditure would be disallowed.

5. In case of a cash credit transaction, is it the onus of the recipient to prove the genuineness of the cash credit to the complete satisfaction of the Assessing Officer?

Krishan Kumar Aggarwal v. Assessing Officer (2004) 138 Taxman 1 (Delhi)

The Assessing Officer required the assessee to furnish evidence to prove the genuineness of a loan found in his books of account. The assessee filed a copy of the bank account of the creditor from where cheque in favour of assessee had been drawn. On perusal of the bank account of the creditor, the Assessing Officer noted a cash deposit before issue of cheque. The creditor confirmed that the cash was realised from the sale of jewellery. However, since the bill did not mention the particulars of the purchaser, the Assessing Officer did not believe the statement made by the creditor. Therefore, the Assessing Officer, not being satisfied with the explanation of the creditor regarding source of cash deposited by him in his account, before issuing cheque in favour of the assessee, added the loan amount to income of the assessee as unexplained cash credit.

The Commissioner (Appeals) reappraised the entire documentary evidence and sustained addition. The Tribunal also agreed with the same. The High Court also upheld the finding of the Tribunal, observing that such finding was based on cogent material and therefore, cannot be said to be perverse.

6. Is the Assessing Officer empowered to issue notice under section 148 to an assessee, if he has sufficient reasons to believe that income of the assessee had escaped assessment?

Syal Leasing Ltd. v. Assistant Commissioner of Income-tax (2004) 138 Taxman 4 (P&H)

In this case, for a certain assessment year, the assessee was allowed depreciation on certain leased vehicles. Subsequently, the Assessing Officer found that the arrangement of lease was nothing but financing of vehicles, and therefore, the depreciation claimed by the assessee on the alleged leased vehicles was not allowable. The Assessing Officer, therefore, had reason to believe that income in the hands of the assessee had escaped assessment for the relevant assessment year. Consequently, the Assessing Officer issued a notice under section 148 to the assessee.

The High Court observed that the Assessing Officer had determined that the relevant agreements were with a view to finance the vehicles and not leasing agreements. This finding of the Assessing officer was also affirmed by the CIT (Appeals). The High Court, therefore, held that the Assessing Officer had sufficient reason (to believe that income of the assessee had escaped assessment) to issue notice under section 148 of the Act.

7. Is it the duty of the Commissioner to examine whether the Assessing Officer has examined the books of accounts properly before giving approval for special audit under section 142(2A)?

West Bengal State Co-operative Bank Ltd. v. Joint Commissioner of Income-tax (2004) 138 Taxman 238 (Cal.)

The assessee was carrying on banking business. The books of account and documents of the assessee were regularly and systematically audited by the co-operative audit directorate, as well as by the auditor under section 44AB. The Assessing Officer decided to reopen the assessment for the relevant periods. While the petitioner was exchanging correspondence, meeting queries and supplying information, it was directed to get its accounts audited under section 142(2A). The Commissioner passed an order approving the proposal of the Assessing Officer for special audit. The assessee filed the writ application contending that the impugned order of the Commissioner was bad in law, since the Commissioner had no material to approve the proposal of the Assessing Officer for appointment of the special auditor.

The High Court observed the following –

(i) Unless the Assessing Officer examines the books of account, he cannot have any understanding as to the nature and complexity of the same, and consequently, it is not possible for him to come to the conclusion as to the necessity of special audit.

(2) The Assessing Officer, in this case, had neither formed any opinion nor given a direction for production of the accounts, wherever it is necessary.

(3) In the instant case, the Assessing Officer had to form an opinion as regards the complexity of accounts, for which purpose, he ought to have examined the goods of accounts.

(4) However, the Assessing Officer had never asked for the books of accounts to be produced.

(5) In his proposal to the Commissioner, the Assessing Officer had not stated the reasons for requiring a special audit to be conducted.

(6) The Commissioner had recorded his approval mechanically and his findings appeared to be independent of the decision of the Assessing Officer.

(7) Under section 142, the Commissioner should

exercise the jurisdiction of an approving authority and not as an appellate authority.

(8) Therefore, the Commissioner should have examined whether the proposal of the Assessing Officer for special audit deserved to be approved.

(9) In the instant case, he had not made any attempt in doing so and rather, he had come to his own finding different from that of the Assessing Officer. Accordingly, the approval was not in consonance with the requirement of law.

The High Court, therefore, set aside the order for special audit under section 142(2A).

8. Are social costs incurred by a company admissible as deduction?

CIT v. Madras Refineries Ltd. (2004) 138 Taxman 261

The assessee is a public limited company. As a good corporate citizen and as a measure of gaining goodwill of the people living in and around its industry, which is to some extent a polluting industry, it provided funds for establishing drinking water facilities to the residents in the vicinity of the refinery and also provided aid to the school run for the benefit of the children of those local residents. The Assessing Officer declined to allow that expenditure on the ground that it was not an item of expenditure incurred by the assessee for earning the income. The Tribunal, however, on examining the records, allowed the entire amount claimed as deduction.

The High Court observed that the concept of business is not static. It has evolved over a period of time to include within its fold the concrete expression of care and concern for the society at large and the people of the locality in which the business is located in particular. Further, to be known as a good corporate citizen brings goodwill of the local community, as also with the regulatory agencies and the society at large, thereby creating an atmosphere in which the business can succeed in a greater measure with the aid of such goodwill. In this case, the High Court upheld the order of the Tribunal allowing deduction for the amount spent on bringing drinking water to the locality and in aiding a local school.

Empanelment as a Peer Reviewer

As members are aware, Peer Review Mechanism put in place by the Institute, as per the Statement on Peer Review, has commenced with the implementation of stage I w.e.f. 1st April, 2003. The reviews are to be carried out by Reviewers empanelled with the Peer Review Board. The criteria for empanelment as a Reviewer is that a person should-

1. be a member;
2. possess at least fifteen years' experience of audit; and
3. be currently active in the practice of accounting and auditing

Applications were invited from members fulfilling the above criteria for empanelment with the Board. More than 1500 members have been empanelled as Reviewers. Applications received in the recent past are under process.

With the implementation of stage II w.e.f. 1st April, 2004, the number of Practice Units to be reviewed, selected on random sample selection, through a specially developed software, is substantial and from mofussil areas like Ambabari, Bareilly, Bhilwara, Bilaspur, Chittaurgarh, Gorakhpur, Lashkar, Muzaffarnagar, Panipat, Ameerpet, Anantapur, Belgaum, Eluru, Hubli, Nellore, Salem, Bid, Jalgaon, Miraj, Petlad, Solapur and Yavatmal. In addition, Practice Units under stage I have also been selected for Phase II of stage I.

To ensure that the reviews are carried out in time and as many PUs are reviewed as possible, including those located at places mentioned above, the Board wishes enlarge the resource pool of Reviewers. Members fulfilling the criteria mentioned above are invited to empanel themselves as Reviewers by applying in the prescribed format (available on Institute's Website www.icai.org under the link 'PEER REVIEW BOARD' or can be obtained from the Institute's Office at New Delhi) and send to Shri Vijay Kapur, Secretary, Peer Review Board, The Institute of Chartered Accountants of India, P.O. Box 7100, I.P. Marg, New Delhi 110 002.

We hope, in order to achieve the objective of Peer Review viz., enhancement in the quality of attestation services performed by the members of the Institute, cooperation would be forthcoming from the members by empanelling as a Reviewer.

Secretary,
Peer Review Board