Recent Decisions:-

Direct Taxes

R. Devarajan

1. Whether expenditure incurred on replacement of old frames for efficient functioning of the machines without intermittent breakdowns would be deductible under section 31?

CIT v. Gitanjali Mills Ltd. (2004) 136 Taxman 21(Mad.)

The assessee incurred of Rs.63.80 lakhs during A.Y.1990-91 on replacement of ring frames that were decades old. The Tribunal observed that frames had no independent existence or utility unless worked with other machines; that the function of these frames was ancillary; that these frames supported other machines and were used for twisting, drafting and winding the yarn; that replacement of these frames was made for efficient functioning of the machines without intermittent breakdowns, since the frames were decades old. The issue was whether the expenditure incurred in replacement of frames is allowable as deduction as current repairs under Section 31. The High Court observed that the expenditure was in the nature of accumulated repairs and not current repairs and therefore, deduction was allowable under Section 37 and not Section 31.

2. **Whether the burden of assessee to prove genuineness of transactions must remain confined to transactions which have taken place between assessee and creditor and it is not his burden to prove that sub-creditor was creditworthy.**

Nemi Chand Kothari v. CIT (2004) 136 Taxman 213 (Gau.)

In the instant case, the assessee had established the identity of his creditors – namely "N" and "P". The assessee had also shown, in accordance with the burden, which rested on him under Section 106 of the Indian Evidence Act, that the said amounts had been received by him by way of cheques from the creditors. Once the assessee had established that he had received the said amounts from "N" and "P" by way of cheques, he had proved that his creditors had the creditworthiness to advance the loans. Thereafter, the burden had shifted to the Assessing Officer to prove the contrary. If the creditors have failed to prove the creditworthiness of the sub-creditors, then the Assessing Officer, could not, as a corollary, treat the amount as income from undisclosed sources in the hands of the assessee, when there was neither direct or circumstantial evidence on record that the said loan amounts actually belonged to, or were owned by, the assessee.

The Assessing Officer, in this case could not show that the amounts, which had come to the hands of the creditors from the hands of the Sub-creditors, had actually been received by the Sub-creditors from the assessee. Therefore, in the absence of any such evidence on record, the High Court held that the Assessing Officer was not correct in treating the said amounts as income derived by the assessee from undisclosed sources.

3. Whether expenditure incurred by the assessee-company at regular intervals in order to maintain and upkeep its hotel situated in hilly area due to severe climatic conditions in that region would be in the nature of revenue expenditure?

CIT v. Hotel Control (P) Ltd. (2004) 136 Taxman 312 (Uttaranchal)

The assessee-company ran a hotel at Mussoorie, a hill-station. The Commissioner (Appeals) found that the structure of the hotel was very old and that the climatic conditions of Mussoorie was very severe, since generally Mussoorie gets heavy rainfall. Therefore, the assessee was required to incur expenditure at regular intervals in order to maintain and upkeep the hotel. The expenditure was on account of – (a) Replacement of cement roof by a tiled roof; (b) Construction of water tank; (c) Replacement of cement concrete floor by Kota stones; (d) Fixing of tiles in the kitchen; (e) Repair of furniture

The High Court observed that since the assessee had shown that it was required to incur expenditure at regular intervals due to weather conditions prevailing in Mussoorie, the expenditure was in the nature of revenue expenditure.

The author is Additional Director, ICAI

4. Whether, in the course of reassessment proceedings under Section 147, the Assessing Officer was competent to make fishing enquiries on concluded matters?

CIT v. M.P. Iron Traders (2004) 136 Taxman 520 (P&H)

In the instant case, the Assessing Officer had completed the assessment under Section 143(1) without disputing any cash credit entries which were entered in the books of account of the assessee. Thereafter, proceedings under Section 147 were initiated only because of information received from another Assessing Officer regarding the purchases made by the assessee which had not been recorded in the books. In the course of reassessment proceedings the assessee was asked to explain as to why it had not entered all the purchases in its books. The Assessing Officer was satisfied that assessee had no explanation and, therefore, he made addition on this account. Further, the Officer also gave notice to the assessee to prove the genuineness of cash credit entries made in books of account, and on failure of the assessee to do so, he treated entire amount of cash credits as assessee's income from undisclosed sources.

The High Court held that since the issue regarding cash credit entries stood concluded when the original assessment was completed and no material was shown to have come to the notice of the Assessing Officer casting doubts as to the genuineness of cash credits, it could not be reopened in the course of reassessment proceedings initiated on the basis of the information received on another ground. Proceedings under Section 147 are open only *qua* items of under-assessment or escaped income. The finality of assessment proceedings on other issues remains undisturbed and the Assessing Officer is not competent to make fishing enquiries on concluded matters.

5. Whether interest paid on capital borrowed for business purposes can be disallowed on the ground that the assessee had willfully and deliberately chosen not to collect its outstanding dues from its sister concern and on the other hand, borrowed capital from the market and paid interest thereon?

Caldern Pharmaceuticals Ltd. v. CIT (2004) 136 Taxman 531 (Cal.)

The assessee was a manufacturer of drugs, medicines, chemicals and other pharmaceutical products and was marketing the same throughout India. However, finding it difficult to look after both manufacturing and marketing, he entered into an agreement with its sister concern, appointing it as its marketing agent on the terms and conditions set out in the agreement. The sister concern would act as selling agent of the products to be supplied by the assessee. Since collection of outstanding dues from the market was slow, the assessee had to borrow a large amount from the market for the purpose of its business and on account of such borrowing it had to pay interest which it claimed as deductible under Section 36(1)(iii). The Assessing Officer disallowed the claim on the ground that the assessee had willfully and deliberately chosen not to collect its outstanding dues from the sister concern in order to accommodate that concern and had, on the other hand, borrowed capital from the market and paid interest thereon and the same amounted to diversion of funds by the assessee to its sister concern to the detriment of the revenue.

The High Court held that Section 36(1)(iii) does not contemplate a situation where an assessee is required to take positive steps for realizing its outstanding dues in order to be eligible for the claim for deduction of interest under the said provisions. Under this Section, an assessee would be entitled to deduction on interest paid on capital borrowings for the purpose of its business. Since no case had been made out before any of the forums that capital borrowing had not been utilized by the assessee for its business, the High Court held that benefit of Section 36(1)(iii) is allowable to him.

6. Whether, in order to claim deduction in respect of foreign travel expenses incurred in relation to the wife of the managing director of the assessee-company, it is necessary for the assessee to prove that the said expenses were incurred wholly and exclusively for the purposes of business of assessee?

CIT v. Autometer Ltd. (2004) 136 Taxman 562 (Del)

The issue under consideration is whether the foreign travel expenses incurred in relation to wife of the managing director of the assessee-company is admissible as business expenditure of the company.

The High Court observed that in order to be eligible for deduction under Section 37(1), the expenditure must have been laid out wholly and exclusively for the purpose of business. It is for the assessee to plead and prove before the authorities that the expenditure claimed as deduction was incurred wholly and exclusively for the purposes of the business of the assessee. In the instant case, that exercise

had not been undertaken. However, in view of meeting of Board of Directors wherein a resolution was passed that the managing director should be accompanied by his wife so that social functions could be attended during the tour and cordial relations could be developed, the Tribunal considered the case on a stronger footing for grant of the benefit. The High Court, taking into consideration the observation of the Tribunal and also the fact that the amount involved was small, allowed the same as deduction.

7. Where liability shown in the books of account of the assessee is found to be bogus and the assessee fails to give reasonable explanation in respect of the same, whether such amount can be added to income and brought to tax in the hands of the assessee?

V.I.S.P. (P.) Ltd. v. CIT (2004) 136 Taxman 482 (M.P.)

Relevant Section: 68

The assessee-company claimed that it had purchased water tanks from M/s. Surya Services, and made the entry in its books of account as a liability. The Assessing Officer found that the selling firm i.e. M/s. Surya Services was not assessed to tax and its books of account were reported to have been lost. These two factors aroused suspicion in the mind of the Assessing Officer. On inquiry, the Assessing Officer found that such purchases were not genuine and that the whole transaction of alleged purchase by the assessee was bogus and that the entry made in the trade account as a liability was only a paper entry. The Assessing Officer, therefore, took the entire liability shown as cash credit as income of the assessee and rejected the argument that Section 68 can be invoked only when the books of account of the assessee show cash entries and not otherwise.

The High Court held that if the liability shown in the accounts is found to be bogus and no plausible and reasonable explanation is offered by the assessee, the amount can be added towards the income of the assessee and brought to tax in the hands of the assessee.

8. Whether there is any reason to exclude the applicability of Section 139(5) to a return filed under Section 139(3)?

CIT v. Periyar District Co-op. Milk Producers Union Ltd. (2004) 137 Taxman 364 (Mad.)

The issue arose as a result of the appellant's submission that Section 80 does not contemplate that a revised return can be filed, and, therefore, the loss as indicated in the original return alone can be carried forward for set-off in the subsequent years.

The High Court held that a perusal of Section 139(3) makes it clear that a return of loss filed under Section 139(3) may be filed within the time allowed under Section 139(1). Once such a return is filed, all the provisions of the Act shall apply as if such return has been filed under Section 139(1). In other words, a return filed under Section 139(3) is deemed to be a return filed under Section 139(1). The provision contained in Section 139(3) makes it clear that all the provisions of the Act shall apply to such a return as if it were a return under Section 139(1). In view of such a specific provision, there is no further necessity in Section 80 to refer to such provision. Hence, there is no reason to exclude the applicability of Section 139(5) to a return filed under Section 139(3).

9. Whether notice under Section 148 can be issued during pendency of assessment proceedings?

Jhunjhunwala Vanaspati Ltd. v. Assistant Commissioner of Income-tax (2004) 137 Taxman 336 (All.)

In respect of A.Y.1990-91, the Assessing Officer determined the assessable income of the assessee-company at Rs.62.47 lakhs as against loss of Rs.24.62 lakhs claimed by the assessee. The Commissioner (Appeals) set aside the order of the Assessing Officer and remanded the matter back to the Assessing Officer. However, the Assessing Officer subsequently issued a notice under Section 148 to the assessee, asking the assessee to submit the return. The High Court held that once Commissioner (Appeals) passed an order of remand, the assessment proceedings became pending before the Assessing Officer and notice under Section 148 cannot be issued during pendency of assessment proceedings. Hence, the notice under Section 148 issued to the assessee was invalid.

10. Whether the term "total turnover" used in Section 80HHC(3) should be understood and interpreted vis-à-vis definition of "export turnover" with reference to their definitions in Explanations (b) and (ba) to Section 80HHC?

CIT v. Bharat Earth Movers Ltd. (2004) 137 Taxman 421 (Kar.)

The issue involved in this case is whether sales tax collected by an assessee on its sales could be treated as part of "total turnover" for purposes of calculating deduction under Section 80HHC.

The High Court held that the term "total turnover" used in Section 80HHC(3) should be understood and interpreted, vis-a-vis, the definition of "export turnover" with reference to their definitions in Explanations (b) and (ba) to Section 80HHC. The interpretation should be contextual.

Sub-Section (3) of Section 80HHC refers to the "total turnover of the business" and "export turnover", to determine the profit on the export turnover with regard to which deduction is allowed under sub-Section (1) while computing the total income of the assessee. This means that the percentage which the export turnover bears to the total turnover is taken into consideration and applied on the profits of the business in order to find out the export profits for the purpose of deduction. Therefore, it is clear that both the "export turnover" and "total turnover" should have the same components. Consequently, it follows that if the export turnover does not have the elements of sales tax or excise duty, the total turnover should also not have the said inputs. In the circumstances, to include excise duty and sales tax for arriving at the total turnover, when sales tax and excise duty do not form part of the export turnover, would be illogical and arbitrary.

11. Does Section 40(a)(ii) make a distinction between income-tax paid by assessee on its own income and income-tax paid by assessee on income of its predecessor?

Himson Textile Engg. Industries Ltd. v. CIT (2004) 137 Taxman 432 (Guj.)

The assessee-company joined as a partner in a partnership firm, which was dissolved on 31-12-79. A deed of dissolution was executed between the partners of the said firm on 31-12-79, in which it was, *inter alia*, agreed that the assessee-company would take over all the assets and liabilities of the said firm as a going concern. The assessee-company claimed deduction in respect of income-tax liability of the said firm. The Assessing Officer, however, disallowed the assessee's claim. On appeal, the assessee-company contended that since it had undertaken to pay all the liabilities of the erstwhile firm, it had to make one such payment by way of income-tax of the erstwhile firm and, therefore, the payment of income-tax liability of the predecessor concern should be allowed as a deduction in computation of taxable income in the hands of the company.

The Tribunal observed that the assessee-company was one of the partners of the erstwhile firm and the assessee had agreed to take over the tax liabilities of the erstwhile firm at the time of dissolution. Hence, under the provisions of Section 189 also, the assessee was bound to pay the income-tax of the erstwhile firm.

The High Court agreed with the reasoning of the Tribunal and held that the categorical language of Section 40(a)(ii) leaves no room for doubt that the income-tax paid is not deductible and that the Section does not make any distinction between the income-tax paid by the assessee on its own income and the income-tax paid by the assessee on the income of its predecessor.

12. Whether, in view of the Agreement of Avoidance of Double Taxation entered into between Government of India and Government of Malaysia, tax liability arising in respect of a person residing in both the contracting States has to be determined with reference to his close personal and economic relations with one or other?

CIT v. P.V.A.L. Kulandagan Chettiar (2004) 137 Taxman 460 (SC)

The respondent-firm was resident of India and owning some immovable properties at Malaysia. During the course of the assessment year, the assessee earned income from rubber estates in Malaysia. The respondent also sold some property there and earned short-term capital gains.

The issues which arose for consideration were whether, since the respondent-firm had no permanent establishment in India, the business income in Malaysia could be included in his income in India and whether the capital gains in respect of sale of the property situated in Malaysia could be taxed in India.

The Supreme Court observed that the tax liability arising in respect of a person residing in both the contracting States had to be determined with reference to that State with which his personal and economic relations were closer and that the person should be deemed to be a resident of that contracting State in which he had an habitual abode.

The immovable property in question (i.e. Rubber Plantations) was situated in Malaysia and income was derived from that property. Further, there was no PE in India in regard to the business of rubber plantations. Therefore, the business income from rubber plantations could not be taxed in India because of closer economic relations between the assessee and Malaysia, being the place where the property is located and the PE has been set up.

Further, capital gains derived from immovable property situated at Malaysia was income, and, therefore, article 6 would be attracted. ■

With editorial inputs from Priya Subramanian, Education Officer, ICAI