Legal Decisions with Notes

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SALE OF LICENCE

1. CIT v. General Industrial Society Ltd. [2003] 262 ITR 1 (Cal)

Facts/Issues

Relevant assessment year 1986-87. The assessee was carrying on business in respect of some items other than white cement. It obtained a licence for setting up the business of manufacturing white cement. Instead of setting up the business the assessee transferred the licence to some other concern. However, the assessee had some interest by way of shares held in the said concern and some of the directors were common. On account of transfer of the said licence, the assessee received a sum of Rs.10 lakhs. In the return for the year 1986-87 this amount was shown but exemption was claimed by the assessee on the ground that this was not taxable either as income from business or as capital gains. It had treated the same as a capital receipt which was not chargeable to tax. The Assessing Officer treated the same as capital gains since it was not in dispute that the licence was treated as a capital asset. The Commissioner (Appeals) held that this amount could not be treated to be capital gains but it was definitely an income from business and was chargeable to tax. The Tribunal held that it was not business income since the assessee was not carrying on business in dealing with licences.

Decision

The licence was not an outcome of the business carried on by the assessee, who obtained the same for the purpose of setting up an altogether new business in respect of an item not covered by the business of the assessee. Therefore, the benefit arising out of the licence could not be set to be a benefit arising out of the business carried on by the assessee. It could not come within the scope of section 28(iv). Once a particular item was chargeable under one head and if it could not be computed and charged under that head it could not be charged under a different head or as income from other sources. The Court held that the licence was a capital asset and applied CIT v. B.C. Srinivasa Setty [1981] 128 ITR 294 (SC).

Notes

One possible issue is whether receipt on sale of licence would constitute income "in the course of business". See also section 28(iiia) inserted by the Finance Act, 1990 w.e.f. 1.4.1962.

DEDUCTION OF TAX AT SOURCE

2. Kranti Kumar Saxena, In re [2003] 262 ITR 33 (MP)

Facts/Issues

Land was compulsorily acquired and the assessee went in appeal for enhanced compensation which was granted. The same was deposited in the Execution Court and interest was awarded on such compensation. The issue was whether the Court should deduct tax at source.

Decision

Under section 194A tax is to be deducted in respect of interest on compensation on compulsory acquisition of land and also in respect of interest accrued on enhanced compensation under section 18 of the Land Acquisition Act. Section 204 gives the meaning of "person responsible for paying". In terms of sections 194A and 204 the real person responsible for paying income by way of interest is the Land Acquisition Officer/Collector who has the money in his possession. The Court is only a conduit for getting the money and it cannot be expected to deduct the tax at source.

EXPORTS

3. Baby Marine (Eastern) Exports v. Assistant CIT [2003] 262 ITR 88 (Ker)

Facts/Issues

The assessee was engaged in processing and export of marine products. He effected his exports through export

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houses and was paid a fixed percentage of FOB value described as incentive, service charges, premium etc. by the export house. By virtue of such exports the exporter was entitled to licence or additional licence on account of the export. This was being transferred to the export house under the contract and it would be received by the export house. The Assessing Officer deducted 90% of the export house premium while computing the deduction under section 80HHC(4A) read with the Explanation (baa) to section 80HHC as they were directly related to exports through a local receipt.

Decision

What was sold by the seller to the export house was not merely the marine products. The import permit earned by him as well was also sold. That was why a higher price was fixed for his wares. Hence, the amount described as a premium was in fact part of the price settled by him for sale of his merchandise and it was neither a brokerage, commission, interest, charges or collection of any amount of similar nature.

4. CIT v. Maganum Exports P Ltd. [2003] 262 ITR 10 (Cal)

Facts/Issues

The assessee furnished the audit report prescribed under section 80HHC(4) at the appellate stage. The deduction was denied on the ground that furnishing of audit report under sub-section (4) along with the return of income was mandatory which the assessee failed to do so.

Decision

Sub-section (4) of section 80HHC consists of two parts. The first part requires filing of the special audit report for claiming deduction without which the deduction is not admissible. This part is mandatory and a no deduction can be claimed without such certificate. The second part consists of the requirement that such audit report is to be filed along with the return. Filing of the report is a condition precedent for claiming deduction. But when this is to be filed is purely a matter of procedure. This has nothing to do with any condition. Therefore, sub-section (4) is mandatory in its first part, but directory in its second part. The deduction cannot be disallowed simply because the audit report was not furnished along with the return. The purpose of incorporation of sub-section (4) was to enable the Assessing Officer to ascertain the claim for deduction on the basis of authentication by the auditor that the goods or merchandise was really exported, which is otherwise admissible only on actual basis, a situation which is difficult for the Assessing Officer to determine. In such a case filing of the audit report at the Tribunal stage would not stand in the way of the deduction being allowed.

LEASING - INCOME FROM BUSINESS OR OTHER SOURCES?

5. Madras Silk and Rayon Mills P Ltd. v. ITO/Asstt. CIT [2003] 262 ITR 122 (Mad)

Facts/ Issues

Relevant assessment year 1989-90, 1990-91 and 1991-92. The main object of the assessee company was to erect and work silk mills for large scale production of all kinds of silk, artificial silks, mixed, mercerised and similar fabrics. The memorandum auithorised the company to carry on any other business which might enhance the value or render profits by any of the company's properties or rights. The company went into losses with the result that most of the machinery had to be sold in December, 1971. From 1964 to 1971 there was no manufacturing activity. The company leased out part of its premises to various occupants to run their business or industry. The Assessing Officer held that such income was to be shown as income from other sources. The Tribunal also came to the same conclusion. The Tribunal found that there was nothing on record to suggest that the assessee could again take up industrial or manufacturing activities or that it had made any efforts to do so and held that the income could not be treated as business income.

Decision

The High Court agreed with the decision of the Tribunal.

EDUCATIONAL INSTITUTIONS AND HOSPITALS

6. Director of Income-tax (Exemptions) v. A.M.M. Hospitals and Medical Benefit Society [2003] 262 ITR 241 (Mad)

Facts/Issues

Relevant assessment year 1985-86 to 1987-88. The assessee ran a hospital. That hospital was not run for profit. The benefit under section 10(22) of the Act was nevertheless denied to the assessee by the Commissioner, who revised the order of the Assessing Officer who had granted such exemption by holding that a part of the income of the assessee was derived from sources other than the treatment of patients and, therefore, such income would disentitle the assessee to the benefit of section 10(22). The Tribunal, at the instance of the assessee, set aside the order of the Commissioner and directed that exemption be

granted to the income received from the hospital.

Decision

Following the ratio of its decision in CIT v. A.M.M. Arunachalam Educational Society [2000] 243 ITR 229 (Mad) exempting income in respect of an educational Institution under section 10(22), the High Court exempted the hospital from income-tax.

7. Director of Income-tax v. Sir Shriram Education Foundation [2003] 262 ITR 164 (Del)

Decision

Following the Supreme Court decision in Aditanar Educational Institution v. Additional CIT [1997] 224 ITR 310 it was held that the assessee was eligible for exemption under section 10(22) and that exemption could not be denied only on the ground that it was merely providing financial assistance to educational institutions and was not running these institutions by itself.

Notes

The Finance Act (No.2), 1998 omitted sections 10(22) and 10(22A) w.e.f. A.Y. 1999-2000 and brought significant amendments in section 10(23C) in respect of exemption of educational institutions and hospitals. How would the above cases be decided in the light of the amendments?

CHARITABLE TRUSTS

8. Dy. Commissioner of Income-tax v. Rajneesh Foundation [2003] 262 ITR (AT) 60 (Pune)

Facts/Issues

The assessee was a trust. From the assessment year 1970-71 and upto assessment year 1974-75 the trust was granted exemption under section 11. The trust changed its name in 1974 to "Rajneesh Foundation" and shifted its base from Bombay to Pune. The Department took a stand that the assessee was not eligible for exemption under section 11 on two grounds namely that Acharya Rajneesh's preachings were vague and his views were contradictory and were in fact harmful to the public interest. Secondly, since the Acharya was alive he could change his views and therefore there was an element of vagueness about his teachings. A three - Member Bench upheld the view of the Department. The assessee filed a writ petition before the Bombay High Court challenging the order of the Bench. Meanwhile, the assessee applied to the Commissioner for settlement of pending issues and putting an end to the litigation. The assessee offered to pay taxes up to the assessment year 1988-89 and to withdraw the writ petition before the High Court and also to suitably amend the trust deed. After getting the acceptance of the Commissioner the trust made the necessary amendments to the trust deed to make it in consonance with the Income-tax Act and the Bombay Public Trusts Act. The amendments were accepted. The Department allowed exemptions under section 11 for the assessment years 1989-90 and 1990-91. For the assessment year 1991-92 the Department rejected the claim for exemption. The Commissioner (Appeals) held that the Acharya was no more. Therefore, his message had become final and found more acceptance by the public. Further, the deed had also been amended to remove the Acharya from the control of the trust.

Decision

Mr. R. V. Easwar (Judicial) Member and Mr. B. L. Chhibber (Accountant) Member held that the registration was granted only after the Commissioner had satisfied himself as to the genuineness of the activities of the trust and the objects of the trust after conducting the necessary enquiry and after calling for the relevant documents and information. The Acharya had also been removed from the effective control of the trust in all its substantive matters. The teachings of the Acharya were also accepted by large sections of the community. An important amendment of the trust deed was the deletion of a clause which authorised the trust to print, publish, sell, distribute either free or for a price, books, magazines, lectures etc. which was considered by the earlier bench as an activity for profit. On these grounds the Members allowed the exemption. However, Mr. K.C. Singhal (Judicial) Member felt that there was no substantive change in the trust deed and that the primary object continued to be partly non-charitable and hence the assessee was not eligible for exemption.

9. CIT v. VGP Foundation [2003] 262 ITR 187 (Mad)

Facts/Issues

Relevant assessment year 1987-88. The assessee was a trust. It had advanced a sum of Rs.53,950 to its sister concern a private limited company of which the trustees of the assessee were also directors. The company was shown as a sundry debtor of the assessee in the books of account for that year. The company in its turn had shown the assessee as one of its sundry creditors. The assessee's claim was that the moneys so given were meant to be used to meet the cost of construction of a hospital and therefore should be regarded as having been applied for charitable purposes. The Assessing Officer rejected the claim.

Decision

It could not be said that the money had been applied by the assessee for charitable purpose in the relevant year. The fact that the money instead of lying with the assessee had laid with the sister company would not result in that amount being regarded as application of funds for a charitable purpose. By giving the money to a sister company which merely retained the money with it for the whole of the year it was not possible to give the assessee the benefit regarding the amount as having been applied for a charitable purpose. There had also been contravention of section 13(1)(d) read with section 11(5) of the Act in as much as the trustees were also directors of the company and that company had the benefit of the amount throughout the year. The assessee did not realise any interest on that amount nor did it have any security for the amount so made available to the sister company.

10.CIT v. Hyderabad Race Club Charitable Trust [2003] 262 ITR 194 (AP)

Facts/Issues

The Hyderabad Race Club decided to create a separate public charitable trust in the name and style "Hyderabad Race Club Charitable Trust". The stewards of the Hyderabad Race Club were the settlers of the trust. The main objects of the trust were advancement and propagation of education, medical aid and relief for poor. The stewards of the club as well as the trustees were identical. Races were conducted by the club and the income was added to the funds. The assessee trust claimed exemption under section 11. The Assessing Officer felt that the assessee was not eligible for exemption and alternatively he was of the view that even if the institution itself had been exempted, the income derived was from business and therefore, hit by section 13(1)(bb) of the Act. He was also of the view that the income could not be considered as one from property held under trust. The Commissioner (Appeals) felt that only the initial amount of Rs.1,116 provided by the club as the corpus of the fund could be exempted. He held that the income from races could not be treated as income from the property. He also held that it could not be said that the business was carried on in pursuance of the primary objects of the trust and as such the same was hit by section 13(1)(bb) of the Act. The Tribunal held that the licence obtained by the trust for conducting the races could be treated as property. It further held that even if it was not to be treated as property held under trust it could be treated as voluntary contribution given by the Hyderabad Race Club to the assessee and such voluntary contribution could not have the character of an income and it could only be a capital receipt in the hands of the assessee. It was not possible to hold that there had been business in the normal course. Even if it were to be a business it was not such a business as to be hit by section 13(1)(bb) of the Act since the assessee satisfied the conditions of section 2(15) read with section 11 of the Act and hence it allowed the appeal.

Decision

None of the objects of the trust can be said to be non-charitable in nature. Rather the objects of the trust are purely of charitable in nature. The main objects of the trust are advancement and propagation of education, medical aid and relief of the poor. In fact, promotion of sports and games is also one of the charitable objects. Merely because a discretion is vested in the trustees to utilise the income to any one or more of the objects will not make any difference.

Since there is no payment of club's funds to the trust, there is no scope for retrieval of the funds of the race club from the assessee-trust. Thus, it satisfies the test that the objects of the trust are not only charitable in nature, but also of general public utility and as such, attracts the provisions of section 11 of the Act and, therefore, the income derived by the trust is exempted under section 11 of the Act.

Notes

This decision requires wider debate. Compare this with Rajneesh Foundation case where even sale of the books containing the Acharya's teachings was considered by the Tribunal as profit oriented and hence non-charitable in nature. The trust had to amend its deed.

MISTAKE APPARENT FROM THE RECORD

11.Geo Miller & Co. Ltd. v. Dy. CIT [2003] 262 ITR 237 (Cal)

Facts/Issues

Based on a judgment of the Apex court in the case of CIT v. N.C. Budharaja and Co., delivered on September 7, 1993 reported in [1993] 204 ITR 412, the income-tax authorities contended that as per the interpretation of law made by the Apex court certain deductions were not admissible and therefore there was "a mistake apparent from the record" and therefore rectifiable under section 154 of the Income-tax Act.

Decision

A Division Bench of the Calcutta High Court in the case of Jiyajeerao Cotton Mills Ltd. v. ITO [1981] 130 ITR 710 observed as follows:

"The law as laid down or a provision in a statute is interpreted by the Supreme Court only when there is a debate or doubt on the interpretation of any provision of a statute requiring interpretation by the Supreme Court or when there is a conflict of judicial opinion on a provision of a statute between the different High Courts of India which is required to be resolved and settled by the Supreme Court. The law laid down by the Supreme Court, in our opinion, cannot be said to have retrospective operation in the sense that although a debate or doubt or a conflict of judicial opinion is resolved and settled by the Supreme Court, yet still that does not obliterate the existence of such debate or doubt or conflict that existed prior to the decision of the Supreme Court setting at rest such debate or doubt or conflict."

The High Court followed the above decision and declined to allow rectification.

NATURAL JUSTICE

12.J.T. (India) Exports v. Union of India [2003] 262 ITR 269 (FB) (Del)

There was divergence of views between two Division Benches on the question whether the third proviso to section 4M of the Imports and Exports (Control) Act, 1947 required grant of an opportunity i.e. in the nature of a personal hearing before exercising discretion to waive a part or the whole of the penalty. Reference was made to a larger Bench.

Decision

The concept of natural justice has undergone a great deal of change in recent years. Rules of natural justice are not rules embodied always expressly in a statute or in rules framed thereunder. They may be implied from the nature of the duty to be performed under a statute. What particular rule of natural justice should be implied and what its context should be in a given case must depend to a great extent to the facts and circumstances of that case, the framework of the statute under which the enquiry is held. The old distinction between a judicial act and an administrative act has withered away. Even an administrative order which involves civil consequences must be consistent with the rules of natural justice. The expression "civil consequences" encompasses infraction not merely of property or personal rights but of civil liberties, material deprivations, and non-pecuniary damages. In its wide umbrella comes everything that affects a citizen in his civil life.

Even if grant of an opportunity is not specifically provided for it has to be read into the unoccupied interstices and unless specifically excluded the principles of natural justice have to be applied. Even if a statute is silent and there are no positive words in the Act or Rules spelling out the need to hear the party whose rights and interests are likely to be affected, the requirement to follow fair procedure before taking a decision must be read into the statute, unless the statute provides otherwise.

INCOME

13.CIT v. G.S.R. Krishnamurthy [2003] 262 ITR 393 (Mad)

The assessee was a film actor as also a film distributor. During these years he had entered into an agreement with producers of films and had received remuneration for acting in those films which was duly accounted for by him as also by the producers. The assessee's children had received gifts from those producers on which gift tax was paid and his children also had filed the returns. The Assessing Officer took a view that as there was a pattern of the assessee's children receiving gifts from the producer from the year 1980-81 onwards in whose productions the assessee had agreed to act, the amounts gifted to the children must be regarded as the additional remuneration paid to the assessee. However, it was not stated by the Assessing Officer that there was any willful suppression of income on the part of the assessee.

Decision

The High Court noted that the Tribunal had found as a fact that the donors while complying with the provisions of section 285B of the Income-tax Act by filing Form No.52A, had admitted only the amount paid to the assessee as artist remuneration and included the same in the cost of production of the films and claimed deduction in arriving at the profit or the loss from the production of the film. In other words the donor did not claim as deduction the gifts made to the assessee's children as business expenditure but suffered gift tax on these gifts. The Department did not allow the gifted amount as cost of production in the hands of the producers. All these circumstances went to show that the gifts made by the producers to the assessee's children were not in consideration for the services rendered by the assessee as an artist. The High Court agreed with the Tribunal.

Notes

This is a good case of intelligent tax planning.

CONCEPT OF REAL INCOME

14.CIT v. Balarampur Commercial Enterprises Ltd. [2003] 262 ITR 439 (Cal)

Facts/Issues

The assessee had advanced a loan to a HUF on February 25, 1983. The said loan was carrying interest @ 12% per annum. Interest was paid on the said loan for some time. But after May 30, 1986, no interest was paid. The debtor requested the assessee to waive the arrear interest after June 30, 1986. It had agreed to repay the principal amount. By a resolution dated August 1, 1987, this suggestion was ultimately accepted by the assessee in its commercial wisdom, having regard to the commercial viability of the situation. In the said resolution, the board of the assessee had decided to waive interest after June 30, 1986, provided the debtor repaid the amount of principal together with interest up to June 30, 1986, by instalments payable monthly commencing from January 1988. Subsequently, a suit was filed for the recovery of the principal amount also and the Tribunal noted that the debtor had denied the liability not only in respect of interest but also in respect of principal.

Decision

When the assessee treats a debt to have become bad and waives the accrual of the income by omitting to enter the income in the books of account, then the concept of real income comes into play. The accounting is finalised at the end of the previous year. Therefore, even if a decision is taken after the end of the previous year, but within a reasonable proximity pursuant to a consideration, which weighed with the assessee during the course of the previous year fructifying into a formal resolution after the close of the previous year, then the decision cannot be said to be inapplicable in respect of the relevant previous year for which the decision was taken.

In the present case, the assessee had omitted to enter the accrual of the income in the books of account and, therefore, the conduct had supported his case that the assessee had treated that there was no income in reality. In the present case, even though income had accrued, yet it cannot be said to have been accrued in reality even if the mercantile system is followed when in reality no interest had accrued and subsequent revival would not make the same liable to tax and for that particular year it may be liable to tax after it succeeds and the amount is received by the assessee. But it was to be seen whether having regard to the facts and circumstances of the case, the assessee was abusing or misusing the concept of real income or not. In the present case, there was no allegation that there were any mala fides on the part of the assessee for postponing or shifting the income to subsequent years for the purpose of taxation.

Notes

In CIT v. State Bank of India [2003] 262 ITR 662 the Bombay High Court held that the amount credited to interest suspense account was not taxable. The same Court in CIT v. Bank of America NT and SA [2003] 262 ITR 504 held that interest on sticky loans was not assessable. By these decisions the principle that even if an income has accrued under mercantile method of accounting it may not accrue for the purpose of Income-tax Act is emerging. This is to be found out by the action of the assessee. Is there then a difference between "accounting accrual" and "income-tax accrual" ? What are the precautions to be built in to see that the concept of real income is not misused.? What are the implications of such a principle on section 145 where under income from business is to be computed in accordance with the method of accounting regularly employed by the assessee.

INTERIM COMPENSATION

15.Amartaara Ltd. v. CIT [2003] 262 ITR 598 (Bom)

The assessee was a public limited company. It, along with two other companies as associate companies had taken out five policies of insurance under which loss or damage by fire to their buildings, plant and machinery, stock-in-trade etc. was covered. On August 15, 1976 there was a fire in the factory of the assessee and the building, machinery and stock-in-trade were distroyed. The insurance company paid Rs.8.5 lakhs on December 17, 1976 on account. The assessee company filed a suit against the insurance company stating that the insurance company was fully satisfied of the loss suffered by the assessee but since the ascertainment of the quantum of loss was likely to take time, the payment of Rs.8.5 lakhs was in part payment of the loss suffered by the assessee due to the said fire. Meanwhile, the Assessing Officer brought to tax Rs.8.5 lakhs in the assessment year in question i.e. 1978-79. This was upheld by the Tribunal.

Decision

The High Court noted that once the assessee had admitted in his plaint that Rs.8.5 lakhs was paid on account of minimum loss suffered by it, the burden on the Department to prove that the receipt constituted income stood discharged. Further, the assessee did not lead any evidence for allocating the receipt of the compensation as between plant and machinery and stock-in-trade. Therefore, the interim compensation was income in the hands of the company.

Notes

This case establishes a principle that interim insurance compensation could constitute income. Further, the implications of section 45(1A) introduced by the Finance Act, 1999 w.e.f. A.Y. 2000-2001 can also be considered. ■