Legal Decisions

*R. Devarajan**

"Derived from" - Its scope

1. Pandian Chemicals Ltd. v. CIT [2003] 262 ITR 278 (SC)

Facts/Issues

The point at issue in this case was the scope of the expression "derived from" occurring in section 80HH. The assessee had made a deposit with the electricity board for supply of electricity. The question was whether the interest on such a deposit could be considered as profits and gains "derived from" industrial undertaking for the purpose of deduction under section 80HH.

Decision

The provisions of section 80HH were intended to encourage industrial activity. Therefore, such provisions have to be liberally interpreted. Even then such a liberal interpretation is possible only if there is doubt with regard to express language used. When the words are clear and unequivocal there is no scope for importing a rule for the benefit of the assessee. The words "derived from" in section 80HH of the Income-tax Act, 1961, must be understood as something which has a direct or immediate nexus with the assessee's industrial undertaking. Although electricity may be required for the purposes of the industrial undertaking, the deposit required for its supply is a step removed from the business of the industrial undertaking. Accordingly, the interest derived by the industrial undertaking of the assessee on deposit made with the Electricity Board for the supply of electricity for running the industrial undertaking could not be said to flow directly from the industrial undertaking itself and was not profits or gains derived by the undertaking for the purpose of the special deduction under section 80HH.

Note

Section 80HH is not in the statute book. But the concept "derived from" is relevant. See the case below.

The author is an Additional Director of the Institute.

2. K. Ravindranathan Nair v. Dy. CIT (Assessment) [2003} 262 ITR 669 (Ker)

Facts/Issues:

What is the import of the term "derived from" occurring in section 80HHC?

Decision:

The provision of section 80HHC of the Income-tax Act, 1961, clearly provide that the deduction permissible under the said section is of the profits derived by the assessee from the export of such goods or merchandise. The meaning of the expression "derived from" has got only a limited import and, therefore, the expression "derived from" as used in section 80HHC must be understood as profit directly arising from the export of the goods and not incidental to the export.

Held, that, in the instant case, the interest from short-term deposits received by the appellant was not the direct result of any export of any goods or merchandise. The fixed deposit was made only for the purpose of opening letters of credit and for getting other benefits which were necessary requirements to enable the appellant to make the export. The interest income received on the short-term deposits though it could be attributed to the export business. Even assuming that the bank had insisted for making short-term deposits for opening letters of credit and for other facilities, it could not be said that the income was derived from the export business. The assessee was not entitled to special deduction under section 80HHC in respect of such interest.

Should only doctors run a nursing home?

3. Dr. K. P. Srivastava v. CIT [2003] 262 ITR 299 (All.)

The assessee was a reader in the Orthopedic Department of a college. He was carrying on his practice as orthopedic surgeon at Agra. He was assessed up to the assessment year 1982-83 on the salary as a reader as well as from his profession as surgeon. The Department carried out search operation at his residence on September 6, 1985. A nursing home was being run for the patients of the

assessee and the assessment of its income was made in the hands of the father of the assessee for the assessment years 1979-80 to 1981-82. The phisiotherapy centre was run by the wife of the assessee the income of which was assessed in the hands of his wife. The Income-tax Officer proceeded to estimate the professional income of the assessee consequent to the search made by him and held that the income earned from the nursing home which was shown in the hands of the father of the assessee and the income from physiotherapy centre shown in the hands of the wife and the income from x-ray machine shown as belonging to his son was includible in the hands of the assessee. He took a view that none of these persons had any professional or technical qualifications for running the various activities and they could not have any income of their own. The Commissioner (Appeals) was of the opinion that the assessee was a whole time employee of the Government and he had very little time to look after several activities like running of nursing home, physiotherapy centre and x-ray clinic. He also noted that that the assessee's father had engaged two whole time doctors who were paid regularly for this purpose. The assessee was paid operation charges only, the operations were done only by professional doctors that the investment in the nursing home was made by the father out of his personal resources which was received by him when he retired from Government service. The Commissioner relied upon the books of account, cash books and ledgers maintained by them. It was also noted that the hiring charges of the rooms and the bank accounts are also in the name of the father of the assessee. From the documents seized during the search it was found out that the wife of the assessee had some experience in physiotherapy work though she was not professionally qualified. A technical person and a doctor were engaged for this purpose. The wife had also made some investments in the physiotherapy centre by sale of jewellery. So far as the x-ray clinic, the finding was that the son had purchased these machines from his mother. While, the Commissioner (Appeals) deleted the additions the Tribunal restored it.

Decision

It was not essential that the nursing homes should only run by doctors. Anybody could run a nursing home. In the present case doctors were employed to look after the patients and for doing the necessary surgery. The Tribunal was not justified in holding that the nursing home could be run only by qualified doctors. The matter was remanded.

MAT

4. Kinetic Motor Company Ltd. v. Dy. CIT

[2003] 262 ITR 330 (Bom)

Facts/Issues

The assessee was a public limited company engaged in the business of manufacture and sale of two-wheelers. The relevant assessment year was 1990-91. In the books of account maintained for the statutory previous year i.e. the financial year April 1, 1989 to March 31, 1990 the assessee debited an amount of Rs.6,32,65,430 on account of depreciation. This depreciation was calculated on the WDV method which is one of the permissible method under the Companies Act as well as under the Income-tax Act. The assessee used to provide depreciation on straight line method (SLM) in its corporate accounts for which the financial year followed was different namely April 1, 1989 to June 30, 1990. The above treatment resulted in a book loss of Rs.1,64,49,937. These accounts were certified to be true and fair by the auditor. The auditors also expressly remarked that had this change not been made by the company the charge of depreciation should have been lower by Rs.91,23,951 and consequently book profit would be higher by that amount.

The Assessing Officer did not dispute that the profit and loss account was prepared strictly in accordance with the requirements of Parts II and III of Schedule VI to the Companies Act, 1956. However, for the purpose of computing book profits under section 115J of the Income-tax Act, the Assessing Officer took the view that there was no justification for the assessee to change the basis of providing depreciation. According to the Assessing Officer, the change in the method from the straight line method to the written down value was done only to avoid tax on book profits. Accordingly, the Assessing Officer reworked the depreciation at Rs.1,60,17,835 by not only excluding the earlier years depreciation but also deducting from book depreciation, the said amount of Rs.91,23,951. Thus, the Assessing Officer arrived at a revised figure of book profit of Rs.2,22,10,525 as against loss of Rs.1,64,49,937. The Tribunal confirmed this.

Decision

Following *Apollo Tyres Ltd. v. CIT [2002] 255 ITR 273 (SC)* it was held that once the amount of depreciation actually debited to the profit and loss account was certified by the auditors, it was not permissible for the Assessing Officer to make book adjustments.

Notes

This decision was rendered in the context of section

115J. Griven the facts of the case what will be the position under section 115JB?

Natural justice

5. St. Paul's Anglo Indian Educational Society v. ITAT [2003] 262 ITR 377 (Pat)

The trust was running a school. An application under section 12A of the Act was filed by the petitioner on April 20, 2001 for registration of the trust. The said application had to be determined within 6 months from the end of the month in view of the provisions contained in sub-section (2) of section 12AA. The Commissioner did not take any action till October 15, 2001 and a notice dated October 16, 2001 was served upon the petitioner on October 17, 2001 asking it to produce the relevant documents as mentioned in the notice and also to furnish required information on October 23, 2001. The school was closed on account of pooja holidays from October 17, 2001 to October 28, 2001. On the date, fixed in the case i.e. October 23, 2001 a time petition was filed on its behalf for grant of one month adjournment. However, as there was time constraint in view of the statutory provisions, the date was fixed on October 29, 2001. On that day the school produced the documents which could be made available up to that date. On the day a complaint petition containing allegations against the petitioner was also handed over to the petitioner but without annexures and the matter was adjourned to October 30, 2001. The school filed a reply to the allegations made in the complaint petition and requested for affording opportunity to rebut the allegations made in the complaint petition but the same was not allowed. The other documents made available on that day were also produced and thereafter the impugned order was passed on October 31, 2001 rejecting the application under section 12AA of the Act. The order was upheld by the Tribunal.

Decision

The assessee was not given a reasonable opportunity of hearing. Hence, the orders were quashed.

Notes

The law on the issue of registration of charitable trust by the Commissioner is evolving. Following principles of natural justice is a sine qua non in the whole exercise.

Income-tax Enquiry

6. Amway India Enterprise v. Union of India [2003) 262 ITR 428 (Ker.)

The assessee was a private limited company with unlimited liability engaged in the business of direct selling of principally fast moving consumer goods. It had registered office at New Delhi. It started commercial operations in May, 1988. The first respondent was the Union of the India and the second respondent was the Dy. Director of Income-tax (Investigation) - II, Ernakulam South, Cochin.

By a letter dated June 6, 2001 the assessee was requested to furnish the true and complete details of all payments made by them to their distributors in Kerala during the period from April 1, 1996 to March 31, 2001 with the names and complete addresses of the respective payees and the amount paid in each financial year etc. and any other relevant details. This letter was issued in lieu of summoning the petitioner under section 131 of the Income-tax Act. The petitioner sought for a clarification as to the exact provision of section 131 under which such a letter was issued. He was informed that the letter was itself made the same clear. It was further informed that there was reason to suspect that the distributor of the petitioner company's products in Kerala were in receipt of remuneration from the petitioner company which had not been fully and properly offered for income-tax assessment in their respective hands and hence relevant details were called. A formal summons was also issued. The petitioner sought for time which was not granted. The petitioner contended that the summons suffered from the vice of vagueness as complete details of all payments were called for without any specific detail or transaction. Such information would be too voluminous. It was made clear by the Department that what was required was only the particulars of the commission/remuneration paid to the distributors based in Kerala and not the books of account.

Decision

The summons was issued under section 131 read with section 131(1A) by an officer specified under section 131A. Only the details relating to distributors within the State of Kerala to whom the total commission etc. paid during the accounting year amounted to rupees 50,000 and above were asked for. Further, the period for which the details were required was also specified. The powers had been exercised as per the provisions of the Income-tax Act. It was also made clear that there was likelihood of concealment of income. The letter of the Department was upheld.

Kar Vivad Samadhan Scheme

7. Hera Lal Hari Lal Bhagwati v. CBI [2003] 262 ITR 466 (SC)

The Gujarat Cancer Society (GCS) imported two machines and availed of the duty exemption on the basis of the exemption certificate issued in the name of the Gujarat Cancer and Research Institute (GCRI) on a bonafide belief that since all the activities of the GCRI were funded by the GCS and all the operations of the GCS were carried through the SCRI the same could be done. The customs raided the premises of GCRI and seized the machines and necessary papers on the ground that the exemption certificate was issued in the name of GCRI and not in the name of GCS and thus the GCS was not entitled to exemption and was therefore liable to pay customs duty. The Bombay Collector of Customs held that the GCS was liable to pay the customs duty thus denying the concessional benefit under the Customs Notifications. The Collector did not recommend any prosecution and only a token redemption fine of Re.1 was imposed. In these transactions Canbank Financial Services and ICICI acted as lessors. While the matter was under the appeal the GCS took advantage of the Kar Vivad Samadhan Scheme, 1998 and deposited the customs duty. The question arose whether the scheme granted immunity from prosecution from any offence under the Customs Act.

Decision

The import could not be termed as an illegal import under the Customs Act. It was clear that the customs authorities were satisfied that there was no intent to evade duty. The Kar Vivad Samadhan Scheme granted immunity from any offence under the Customs Act including the offence of evasion of duty. The FIR was not properly issued since there was no intention to evade customs duty. Therefore, the offence of cheating also could not be established.

Income from property or business?

8. CIT v. Bhoopalam Commercial Complex and Industries (P) Ltd. [2003] 262 ITR 517 (Karn)

Facts/Issues

The assessee was a private limited company. One of the directors of the company had taken some lands on a long term lease under a registered lease deed. He executed a registered deed of transfer in favour of the assessee company transferring his lease-hold right. Subsequently, the assessee company built a commercial complex on the said land and allotted the same to various parties and earned income therefrom. For the assessment year 1985-86 and 1986-87 the assessee filed returns showing losses and the Assessing Officer completed the assessment accordingly. The Commissioner felt that the order of the ITO was prejudicial to the interest of the revenue and revised the order holding that the income was to be assessed as income from house property. The Tribunal held that since the land over which the property had been built was a lease hold land the assessee could not be treated as the owner of the land which was a condition precedent for treating the income as income from house property under section 22 of the Act

Decision

Admittedly, the commercial complex has been constructed by the assessee and the rental income is being derived by the assessee alone in its own right. Therefore, for the purpose of section 22 of the Act, as explained and declared by the Supreme Court, the assessee has to be viewed as the owner. That being the legal position, irrespective of the fact that one of the objects of the assessee-company is to derive income by leasing sites and constructions thereon, the income has to be necessarily assessed under the head "Income from house property".

Scope of section 72A

9. Indian Metals and Ferro Alloys Ltd. v. Union of India [2003] 262 ITR 553 (Ori)

Facts/Issues

Amalgamation took place between K & Co. and I, the petitioner. The said amalgamation was approved by the Company Court by order dated December 11, 1981. The amalgamation was to be effective from January 1, 1979. In view of the approval of amalgamation by the Company Court on December 11, 1981 the petitioner, the amalgamated company on January 15, 1982 made a formal application under section 72A(1) of the Act. That application was not recommended by the specified authority. The Central Government considered the application and rejected it. On the direction of the High Court the Central Government re-examined the question and by order dated August 2, 1991 again declined to grant the declaration sought for by the petitioner. A writ was filed against the order.

Decision

The High Court dismissed the writ petition. It noted that the Central Government had taken note of the fact that even within the revival period there was closure of

the business of the amalgamating company and this was a material change that had to be taken note of. The business of the amalgamating company had been stopped. According to the Government the amalgamating company had not adhered to the scheme of amalgamation for a reasonably long time so as to be entitled to the benefit of section 72A of the Act. There were facts to support the reasoning of the Government. There was no revival of the business of the amalgamating company and there was no rehabilitation of the workmen employed by the amalgamating company most of whom had been retrenched or had been offered voluntary retirement upon payment of compensation. There was also no continuance of the production of the amalgamating company. In that situation public interest would surely suffer. The Court held that the guideline specifying that there should be a rehabilitation of the business of the amalgamating company by the amalgamated company without any modification and as per the existing product line and industrial license held by the amalgamating company was valid.

Firm - Genuine or Bogus

10.CIT v. Hazarimal Milapchand Surana [2003] 262 ITR 573 (Raj)

Facts/Issues:

The business of the assessee firm had commenced on November 9, 1969 and the partnership deed was executed on November 11, 1969. There were four partners. The shared profits in the ratio of 10, 30, 30 and 30% respectively. The relevant assessment year was 1977-78. The assessee filed a return declaring the income at Rs.1,23,370. By a deed of partnership dated June 23, 1976 one firm in the name and style of Manna Lal Nirmal Kumar Surana & Co., also came into existence. All the four partners in that firm were common as in the case of the assessee firm with the same profit and loss sharing ratio. The Income-tax Officer treated the later firm as just an extension of the assessee firm. The Tribunal noted that the second firm had its own Central Sales tax number, had a separate bank account and registration under the Indian Partnership Act as an independent entity and it was also granted registration under the Income-tax Act.

Decision

There was no material to suggest that the view taken by the Tribunal was perversed. When the books of account were separate, the partners had contributed capital and books of account were not rejected in the case of the latter firm it could not be treated as an extension of the assessee firm. The action of the Assessing Officer in treating both the firms as one and the same was not correct.

Notes

Can the Assessing Officer go into the question of genuineness of the firm in the present mode of assessment of firms?

Indo Mauritius Double Taxation Avoidance Convention

11.Union of India & Another v. Azadi Bachao Andolan & Another [2003] 263 ITR 706 (SC)

Facts/Issues

The Delhi High Court in *Shiva Kant Jha v. Union of India [2002] 256 ITR 536* held that Circular No.789 dated 13th April, 2000 was invalid because the Circular did not show that it had been issued under section 119 of the Income-tax Act and as such it would not be legally binding on the revenue. The CBDT could not issue any instruction which would be ultra vires the provisions of the Income-tax Act, 1961. The Income-tax Officer was entitled to lift the corporate veil in order to see whether a company was actually resident of Mauritius or not or whether the company was paying income-tax in Mauritius or not and this function of the Income-tax Officer was quasi judicial. Any attempt by the Central Board of Direct Taxes to interfere with the exercise of this quasi judicial power was contrary to the intendment of the Income-tax Act. "Treaty Shopping" by which the resident of a third country takes advantage of the provisions of the agreement was illegal and thus necessarily forbidden.

Decision

The Supreme Court reversed the decision of the Delhi High Court and made wide-ranging observations on many matters including tax planning considerations. The following is a brief summary of the observations of the Supreme Court.

On the facts of the case, by Circular No.682 dated 30.3.94 issued by the CBDT in exercise of its powers under section 90 of the Act, the Government of India clarified that capital gains of any resident of Mauritius by alienation of shares of an Indian company shall be taxable only in Mauritius according to Mauritius Taxation Laws and will not be liable to tax in India. Later on, because of issue of show-cause notices to some FIIs

functioning in India, but incorporated in Mauritius, as to why they should not be taxed on profits and dividends in India, there was a panic and to clarify the position, CBDT issued Circular No.789, dated 13.4.2000 clarifying that FIIs, etc., which are resident in Mauritius would not be taxable in India on income from capital gains arising in India on sale of shares. The High Court quashed and set aside the Circular accepting the contention that the said circular is ultra vires the provisions of section 90 and 119 and is also otherwise bad and illegal.

Section 90 - Scope of Double Taxation Avoidance Agreements

The Supreme Court held that the judicial consensus in India has been that section 90 is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a double taxation avoidance agreement. Therefore, the provisions of such an agreement with respect to cases to which they apply, would operate even if inconsistent with the provisions of the Income-tax Act. Circular No.789 is a circular within the meaning of section 90; therefore, it must have the legal consequences contemplated by section 90(2). In other words, the circular shall prevail even if it is inconsistent with the provisions of the Income-tax Act, 1961 insofar as assessees covered by the provisions of DTAC are concerned. Section 90 enables the Central Government to enter into a DTAC with the foreign Government. When requisite notification is issued thereunder, the provisions of section 90(2) spring into operation and an assessee who is covered by the provisions of DTAC is entitled to seek benefits thereunder, even if the provisions of the DTAC are inconsistent with the provisions of the Act.

The principles adopted for interpretation of treaties are not the same as those in interpretation of statutory legislation. The interpretation of provisions of an international treaty, including one for double taxation relief, is that treaties are entered into in a political level and have several considerations as their bases. Many developed countries tolerate or encourage "treaty shopping", even if it is unintended, improper or unjustified, for other non-tax reasons, unless it leads to significant loss of tax revenue. The court cannot judge the legality of "treaty shopping" merely because one section of thought considers it improper. The court cannot characterise the act of incorporation under the Mauritian law as a sham or a device actuated by improper motives.

Section 119 - Power of CBDT to issue circulars

While commenting adversely upon the validity of the impugned circular, the High Court had said that "the circular itself does not show that the same has been issued under section 119; only in a case where the circular is issued under section 119, the same would be legally binding on the revenue." The Supreme Court observed that as long as the circular emanates from the CBDT and contains orders, instructions or directions pertaining to proper administration of the Act, it is relatable to the source of power under section 119 irrespective of its nomenclature. The Supreme Court held that the circular falls well within the parameters of the powers exercisable by the CBDT under section 119.

Tax planning

The Supreme Court referred to the judgement of the Madras High Court in M.V. Vallippan v. CIT (1988) 170 ITR 238 which concluded that the decision in Mc. Dowell's Co. Ltd. cannot be read as laying down that every attempt at tax planning is illegitimate and must be ignored, or that every transaction or arrangement which is perfectly permissible under law, which has the effect of reducing the tax burden of the assessee, must be looked upon with disfavour. The Supreme Court observed that not only is the principle in IRC v. Duke of Westminister (1936) AC 1 alive and kicking in England, but it also seems to have acquired judicial benediction of the Constitutional Bench in India notwithstanding the temporary turbulence created in the wake of *McDowell & Co. Ltd. v. CTO (1985) 154 ITR 148 (SC)*.

The Supreme Court held that if notwithstanding a series of legal steps taken by an assessee, the intended legal result has not been achieved, the Court might be justified in overlooking the intermediate steps, but it would not be permissible for the Court to treat the intervening legal steps as non-est based upon some hypothetical assessment of the 'real motive' of the assessee.

Benefit arising from business

12. CIT v. Diners Business Services Pvt. Ltd. [2003] 263 ITR 1 (Bom.)

Facts/Issues

Relevant assessment year 1987-88. The assessee had let out a portion of its commercial premises in Bombay and Hyderabad to Diners Club India Ltd. (sister concern) for which the assessee received non interest bearing security deposit of Rs.48,51,000 for the Bombay property and

Rs.4,50,000 for the Hyderabad property. The assessee also received annual rent for both the properties from Diners Club India Ltd. The Assessing Officer held that the arrangement was a collusive arrangement between two sister concerns and that the assessee had received lesser rent vis-à-vis the market rent from Diners Club Ltd. Consequently the Assessing Officer held that 60% of the amount should be taxed as value of the benefit which accrued to the assessee. Accordingly, the Assessing Officer made an addition of Rs.20,19,921 to the income of the assessee on this ground under section 28(iv) of the Income-tax Act. During the year in question the assessee also received non-refundable entrance fees from its members amounting to Rs.4,08,950. This was also brought to tax as a business receipt. The Commissioner (Appeals) cancelled both the additions which was confirmed by the Tribunal.

Decision

The High Court noted that for the purpose of working out the benefit arising from business the Assessing Officer did not use interest free deposit as the point of reference. He had used the difference between the rent charged by the assessee on the premises let to Diners Club India Ltd. and what the Assessing Officer considered to be the market rent. He did not discount the amenities and facilities which existed in comparable premises. So far as entrance fees was concerned it was charged by the assessee for enrolment of its customers as members of the "executive centre". The entrance fee was a one time fee and only members were eligible to avail of the facilities available in the executive centre. It was also found by the Commissioner (Appeals) that the entrance fee was non-refundable. The High Court confirmed the order of the Tribunal.

Misapplication of trust funds

13. Action for welfare and awakening in Rural Environment (AWARE) V. DCIT [2003] 263 ITR 13 (AP)

Facts/Issues

AWARE was a society registered under the provisions of the Societies Registration Act, 1860. The society was also registered under section 12A of the Act and thus the exemption contemplated under section 11 of the Act was applicable.

The assessee had been receiving foreign contributions for various developmental projects in rural areas of the States of Andhra Pradesh and Orissa. Some of the projects like Rural Development Project (R.S.P.), Warangal, Women Development, bonded labour, rehabilitation of bonded labour, new perspective plan, Yanadi Development Project, etc., aimed at providing financial assistance to poor and needy people. The amounts were given in the form of interest-free loans to the beneficiaries and claimed as utilisation of the donations/grants in the return of income.

The society was assessed in the status of an association persons (trust) and filed its return for the assessment year 1993-94 on November 1, 1993, declaring "nil" income. The return was processed under section 143(1)(a) of the Act on August 31, 1994. Thereafter, the Assessing Officer issued a notice under section 148 of the Act on January 8, 1998, and the assessment was reopened. After a perusal of the evidence produced by the assessee and also hearing it, the assessment was completed on March 29, 2000, for a total income of Rs.10,44,82,246. After reopening, the major addition of Rs.9,99,62,664 was the total receipts of the trust, which was brought to tax on the ground that the provisions of section 13(1)(c)(ii) read with sections 13(2)(b) and 13(3)(d) of the Act were violated by the assessee.

The Assessing Officer noted that the Fixed deposits in the name of the assessee worth Rs.16 lakhs were pledged as security to the bank enabling R one of the members of the assessee to avail of a loan without adequate security and consideration thus mis-utilising the funds of the trust. Further, the assessee routed the entire transaction through an Association of Persons in which all the members were directors and employee of the assessee. Two identical properties were purchased one in the name of M, the Chairman of the trust in his personal capacity for Rs.20 lakhs and the other in the name of the assessee for Rs.20 lakhs. He therefore, assessed the trust in the status of Association of Persons. The Commissioner (Appeals) and the Tribunal confirmed.

Decision

The High Court found that this was a case where the funds of the trust were diverted and mis-utilised deliberately. The finding was that for the purchase of land the assessee routed the entire transaction through an association of persons in which all the members were directors and employee of the assessee and some amounts were paid directly to the land owner by the assessee, but an amount of Rs.49,24,343 was paid to an association of persons for the purchase of a property by M, the Chairman of the trust. These were questions of fact and the Income-tax authorities had taken a plausible view. No substantial question of law arose. ■