Legal Decisions and Analysis

[R. Devarajan, Additional Director, ICAI]

1. CIT v. General Electric Co. India Ltd. [2002] 255 ITR 22 (Cal)

Facts/Issues

Whether Modvat credit is includible while valuing the closing stock?

Decision

Having regard to the Modvat scheme of excise duty the Modvat credit is not includible in the value of closing stock.

Analysis

The Calcutta High Court followed *CIT v. Berger Paints (India) Ltd. (No.2) [2002] 254 503 (Cal)* which in its turn followed the Supreme Court's case of *Collector of Central Excise v. Dai Ichi Karkaria Ltd., AIR 1999 SC 3234*. In this connection section 145A of the Income-tax Act requires that notwithstanding anything to the contrary contained in section 145, the valuation of purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head "Profits and gains of business or profession" shall be -

(a) in accordance with the method of accounting regularly employed by the assessee; and

(b) further adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

The Guidance Note on Audit under section 44AB of the Income-tax Act has come to the conclusion that section 145A of the Income-tax is revenue neutral.

2. Bakshi Ram Dogra v. Commissioner of Income-tax and Others [2002] 255 ITR 38 (HP)

Facts/Issues

For the four assessment years 1979-80, 1980-81, 1981-82 and 1982-83 the petitioner was assessed in accordance with law but thereafter notices were issued to him under section 271C of the Act for not paying legal income-tax and he was asked whether he was ready and willing to get the cases compounded. Pursuant to the said notice, the petitioner appeared before the Income-tax Officer and showed his willingness to get the cases compounded. Accordingly, orders were passed compounding the cases pending against him. The petitioner was asked to pay Rs.2,03,158/- which he paid. Subsequently, the Income-tax Officer informed him that the compounding charges had not been correctly calculated in the letter dated March 18, 1999. As in the case of the petitioner, the "total concealed income" exceeded Rs.1 lakh, the compounding fee payable by him would be more than the said amount and as such he was liable to pay Rs.3,51,304. The case, therefore, could not have been compounded and accordingly proceedings launched against him would proceed. The said action of the Department was challenged by the petitioner.

Decision

When the concealed amount did not exceed Rs.1 lakh

in any assessment year, each assessment year must be taken as an independent and separate unit and could not have been consolidated and no action could have been taken on that basis. The "Guidelines for Compounding of Offences under the Direct Tax Laws" had laid down guidelines for calculation of compounding fees where the concealed income exceed Rs.1 lakh. The said communication did not expressly or specifically state that an assessment year will not be taken as an independent unit. But even otherwise, in the light of the law laid down by the Supreme Court in several cases, for the purpose of considering the provisions of the Act, each assessment year has to be considered as independent unit for the purpose of payment of tax. If so, the guidelines dated October 20, 1995, would not apply to the cases on hand, inasmuch as in none of the assessment years 1979-80, 1980-81, 1981-82 and 1982-83, did the concealed amount reach Rs.1 lakh. The communication and all conquential actions were liable to be quashed.

Analysis

(a). Clause 17(e) of Form No.3CD requires the reporting of (i) expenditure by way of penalty or fine for violation of any law for the time being in force (ii) any other penalty or fine and (iii) expenditure incurred for any purpose which is an offence or which is prohibited by law. It is for consideration whether compounding fees paid to the Department would be in the nature of penalty or otherwise.

(b) In this case the concealed amount did not exceed Rs.1,00,000 for each assessment year. The point at issue is whether each assessment year is to be taken into account as an independent unit or all the four years can be considered as one unit simultaneously and action can be initiated on that basis. In other words whether the principle of *res judicata* would apply to the present case.

The Hon'ble Supreme Court has elaborately dealt with this aspect in joint family of *Udayan Chinubhai v. CIT [1967] 63 ITR 416;*

"It is true that an assessment year under the Income-tax Act is a self-contained assessment period and a decision in the assessment year does not ordinarily operate as *res judicata* in respect of the matter decided in any subsequent years, for the Assessing Officer is not a court and he is not precluded from arriving at a conclusion inconsistent with his conclusion in another year. It is open to the Income-tax Officer, therefore, to depart from his decision in subsequent years, since the assessment is final and conclusive between the parties only in relation to the assessment for the particular year for which it is made. A decision reached in one year would be a cogent factor in the determination of a similar question in a following year, but ordinarily there is no bar against the investigation by the Income-tax Officer of the same facts on which a decision in respect of an earlier year was arrived at."

(c) In the "guidelines for compounding of offences under the direct tax laws" it has been stated that the compounding fee would be worked out at 100 per cent of the tax calculated at the maximum marginal rate of income sought to be concealed, where the amount is less than Rs.1,00,000 and at 200 per cent if the income sought to be concealed exceeds Rs.1,00,000.

3. CIT v. Madras Race Club [2002] 255 ITR 98 (Mad)

The Madras Race Club was a company registered under the Companies Act. It had a committee of management elected from among its members. The managing committee in turn elected stewards. The managing committee also included nominees of the State Government who by virtue of such nomination are also stewards. The income of the club was assessed to tax. The club conducted racing at Madras and Ootacamund. The racing was conducted under the rules of racing framed by the club. The rules, *inter alia*, required the jockeys, trainers and others to obtain licences for which they are required to pay a licence fee. The stewards under the rules were empowered to impose fines and levy penalties. The amounts realised by way of licence fees, the penalties imposed and fines levied are by rule 175 of the Rules in Part XXIII of the rules of racing, required to be credited to a fund called Madras Race Club Benevolent Fund. The assessee-club in its assessment for the assessment years 1978-79, 1980-81, 1981-82 and 1982-83, 1984-85 and 1985-86 took the stand that the amount of the licence fees, penalties and fines realised by the club

did not form part of its income and was therefore to be excluded from the computation of total income, as according to the assessee, those amounts by overriding title became part of the funds of the benevolent fund. That claim of the assessee having been rejected by the Assessing Officer and the appellate authority, the assessee went up in further appeal to the Tribunal, which accepted the assessee's stand.

Decision

The licence fees, penalties and fines at the time the payments were made by those, who are required to make those payments were, at the time of payment, not regarded by them as amounts, which were earmarked for charity and they did not regard those amounts as having been paid as contributions for a benevolent or charitable purpose. The levy as also the payment was by reason of the regulatory power vested in the assessee-club to regulate racing in accordance with the rules framed by it, non-compliance with which would result in the jockeys, trainers and other being excluded from participating in racing. The levy had direct nexus with their activity as participants in racing and the levies were designed to ensure compliance with the requirement of the rules. There was no earmarking of those amounts for the benevolent fund *ab initio*. The amounts collected by the club as licence fees, fines and penalties were therefore, amounts which form part of its income. The execution of a trust deed and the inclusion of a provision in the Rules of racing for crediting the sums to the benevolent fund was merely the application of a part of the income of the assessee for benevolent purpose.

Analysis

To determine when income is diverted at source and when income will be deemed to be received and then applied the Hon'ble Supreme Court in *CIT v. Sitaldas Tirathadas [1961] 41 ITR 367* laid down the following test :

"In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Whereby the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied."

4. Padmasundara Rao (Decd.) v. State of Tamil Nadu and Others [2002] 255 ITR 147 (SC)

Facts/Issues

Where the Legislature has passed an enactment in which something is missing can the Court supply the missing links and complete the legislation? To what extent courts can rely on precedents? In this regard the Supreme Court has laid down the following important rules of interpretation.

Decision

1. The Court cannot read anything into a statutory provision which is plain and unambiguous. A statute is the edict of the Legislature. The Language employed in a statute is the determinative factor of legislative intent. The first and primary rule of construction is that the intention of the legislation must be found in the words used by the Legislature itself.

   The Court only interprets the law and cannot legislate. If a provision of law is misused and subjected to the abuse of the process of law it is for the Legislature to amend, modify or repeal it, if deemed necessary. Legislative *casus omissus* cannot be supplied by judicial interpretative process.

2. A *casus omissus* cannot be supplied by the court except in the case of clear necessity and when reason for it is found in the four corners of the statute itself. A *casus omissus* should not be readily inferred and for the purpose all the parts of the statute or section must be construed together and every clause of a section should be construed with reference to the

context and other clauses thereof so that the construction to be put on a particular provision makes a consistent enactment of the whole statute. This would be more so if a literal construction of a particular clause leads to manifestly absurd or anomalous results which could not have been intended by the Legislature. An intention to produce an unreasonable result is not to be imputed to a statute if there is some other construction available. Where, to apply words literally would defeat the obvious intention of the legislation and produce a wholly unreasonable result the court must do some violence to the words so as to achieve that obvious intention and produce a rational construction.

3. Courts should not place reliance on decisions without discussing how the factual situation fits in with the fact situation of the decision on which reliance is placed. There is always peril in treating the words of a speech or judgement as though they were words in a legislative enactment. Judicial utterances are made in the setting of the facts of particular cases. Circumstantial flexibility, one additional or different fact may make a world of difference between conclusions in two cases.

5. Apollo Tyres Ltd. v. Commissioner of Income-Tax [2002] 255 ITR 273 (SC)

Facts/Issues

1. While computing the books profits of a company under section 115J of the Income-tax Act what are the powers of the Assessing Officer to make adjustments to the net profit as shown in the profit and loss account prepared in accordance with the Companies Act, 1956?

2. Is a "unit" of the UTI a share? Does trading in the units of UTI amount to speculation?

Decision

1. The Assessing Officer, while computing the book profits of a company under section 115J of the Income-tax Act, 1961, has only the power to examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. The Assessing Officer, thereafter, has the limited power of making increases and reductions as provided for in the Explanation to section 115J. The Assessing Officer does not have the jurisdiction to go behind the net profits shown in the profit and loss account except to the extent provided in the Explanation. The use of the words "in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act" in section 115J was made for the limited purpose of empowering the Assessing Officer to rely upon the authentic statement of accounts of the company. While so looking into the accounts of the company, the Assessing Officer has to accept the authenticity of the accounts with reference to the provisions of the Companies Act, which obligate the company to maintain its accounts in a manner provided by that Act and the same to be scrutinised and certified by statutory auditors and approved by the company in general meeting and thereafter to be filed before the Registrar of Companies who has a statutory obligation also to examine and be satisfied that the accounts of the company are maintained in accordance with the requirements of the Companies Act. Sub-section (1A) of section 115J does not empower the Assessing Officer to embark upon a fresh enquiry in regard to the entries made in the books of account of the company. Therefore, while determining the "book profits" under section 115J, the Assessing Officer could not recompute the profit and loss account by excluding provisions made for arrears of depreciation.

2. Even though section 32(3) of the Unit Trust of India Act, 1963, creates a fiction to make the UTI a deemed company and distribution of income received by the unitholder a deemed dividend for the purposes of the Income-tax Act, by virtue of those provisions it cannot be said that the section also makes the unit of the UTI a deemed share. The deeming provision in section 32(3) should be confined only to deeming the UTI a company and the income from units a dividend. In the absence of any specific deeming provision in regard to the units as shares it would be erroneous to extend the provisions of section 32(3) for the purpose of holding the unit a share.

Held accordingly, that buying and selling of units by the assessee-company could not be treated as a speculative business. The Explanation to section 73 of the Income-tax Act did not apply. Loss in buying and selling of units of the UTI was business loss not speculation loss.

Analysis

1. In *Sutlej Cotton Mills Ltd. v. ACIT 45 ITD 22 (Cal.)*. the Calcutta High Court held that where there is no allegation of fraud or mis-representation but only a difference of opinion whether a particular amount should be properly shown in the profit and loss or in the balance sheet, the provisions of section 115J do not empower the Assessing Officer to disturb the profits as shown by the assessee.

2. The Guidance Note on Audit under section 115JB of the Income-tax Act, 1961 has, *inter alia*, observed as follows :

   "13.3 Further, the accountant's own examination and/or the reports of other auditors may reveal various deficiencies and qualifications in the accounts being examined for computation of book profit. They may pertain to various matters e.g. disclosures under the Companies Act, true and fair view of the financial statements, matters relating to accounting policies or accounting standards etc. The accountant should examine them thoroughly. He should keep in mind that the purpose of the audit under this section is ascertainment of book profit and not the computation of income for regular assessment. As per the scheme of the Act the starting point for this section is the net profit as per profit and loss account. Therefore, the qualifications/ deficiencies pertaining to balance sheet may not have any relevance to the computation of book profit. Section 115JB is a self contained code in itself for computation of book profit and tax payable thereon. Further, the reporting requirement as per paragraph 7 of Annexure A of Form No.29B calls for a positive or negative assertion about the preparation of profit and loss account in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956 and does not require quantification thereof. The requirement of the section is the preparation of the profit and loss account in accordance with Parts II and III Schedule VI to the Companies Act. However, the proviso stipulates that the accounting policies, accounting standards and depreciation should be on the same basis as were adopted in the accounts laid in the annual general meeting. So long as both the accounts i.e. the accounts laid before the annual general meeting and the accounts from which book profit is calculated are based on similar accounting policies, accounting standards and depreciation method and rates, the qualifications or deficiencies referred to above will not be of relevance for this section. Such qualifications may affect the computation of income under regular assessment and therefore should be suitably considered for that purpose by the assessee and Assessing Officer. However, no adjustment is required to be made for them while making the report on computation of book profits. It would be advisable for the accountant to suitably disclose these qualifications in his report."

6. Asst. Director of Inspection (Investigation) v. Kum A.B. Shanthi [2002] 255 ITR 258 (SC)

Facts/issues

Constitutional validity of section 269SS.

Decision

The object of introducing section 269SS is to ensure that a taxpayer is not allowed to give false explanation for his unaccounted money, or if he has given some false entries in his accounts, he shall not escape by giving false explanation for the same. During search and seizures, unaccounted money is unearthed and the tax payer would usually give the explanation that he had borrowed or received deposits from his relative or friends and it is easy for the so-called lender also to manipulate his records later to suit the plea of the taxpayer. The main object of section 269SS was to curb this menace. It is not discriminatory and is not violative of article 14 of the Constitution of India. Parliament has enacted the same with full competence. It cannot also be said that section 269SS deals with a subject outside the scope of the Income-tax Act or that it relates to a topic not within the competence of Parliament. The

provisions of section 271D or section 276DD are not unconstitutional on the ground that the provisions are draconian or expropriatory.

7. CIT v. Ramanathapuram Distt. Co-operative Central Bank Ltd. [(2000) 255 ITR 423 (SC)

Facts/Issues

The assessee is a co-operative society carrying on banking business. The assessee received interest on securities and subsidies from the Government. In addition, the assessee was also in receipt of dividend income. Three assessment years are involved in these cases. The common question that arises is whether (i) interest on securities; (ii) subsidies received from Government and (iii) dividend income received should be regarded as business income and whether the assessee is entitled to deduction under section 80P(2)(a)(i) of the Act.

Decision

The Supreme Court held that (i) interest on securities, (ii) subsidies from the Government, and (iii) dividend received by the assessee, a co-operative society carrying on banking business, were business income of the assessee, and the assessee was entitled to deduction under section 80P(2)(a)(i) of the Income-tax Act, 1961 in respect thereof.

The Supreme Court observed that a similar question came up for consideration before this court in case of another co-operative society in the case of *CIT v. Madurai District Central Co-op. Bank Ltd. (1984) 148 ITR 196*, wherein this court has held that the assessee would be entitled to exemption under section 80P(2)(a)(i) of the Act in respect of interest on securities as well as subsidies. In so far as the dividend is concerned, the Supreme Court held that the principle laid down in Madurai District Central Co-op. Bank's case (1984) 148 ITR 196 (Mad.) would apply to dividend income also.

8. CIT v. Jyoti Electric Motors Ltd. (Guj) - 2002 (255) ITR 345 (Guj

Facts/Issues

The Assessee, a motor manufacturing company, under an agreement dated 1.9.1972 with Jyoti Ltd., was granted a non-exclusive licence to manufacture electric motors which were manufactured by Jyoti Ltd., and for this purpose Jyoti Ltd. was to render technical and other experienced guidance to the assessee. Jyoti Ltd. reserved the right to grant similar licences to any other parties. Though the period of agreement was ten years and could be extended for a further period and the agreement was to continue in force until it was terminated, the agrement was liable to be terminated even earlier than the stipulated date, and upon termination the assessee was required to return to Jyoti Ltd., all the technical documentation within one month in the event of termination or lapse of the agreement. The assessee had to sell its products solely through the sole selling agent appointed by Jyoti Ltd. The assessee was to pay royalty at the rate of 7% on the net sale price of the products manufactured in terms of the agreement.

Decision

The High Court observed that the assessee did not acquire any enduring advantage. It had merely been granted a non exclusive licence for the use of an asset. The royalty was payable on the basis of the sales which the licensee would make and the payment was strictly linked with the quantum of sales and would vary with the quantum of sales. The amount of royalty paid by the assessee was revenue expenditure and allowable as a deduction in computing its profits.

9. CIT v. Oil and Natural Gas Commission (Raj.) - (2002) 255 ITR 413 (Raj.) -

Facts/Issues

The ONGC was the agent of a non-resident assessee engaged in the business of providing services or facilities in connection with prospecting for, or extraction or production of mineral oil as well as supplying plant and machinery on hire used, or to be used in the same. The assessee acting under section 44BB(2) returned its taxable income under the head "Profits and gains of business" on the basis of computation made in terms of section 44BB of the Act. According to the assessee, it was liable to pay tax on "10% of the aggregate of the amounts specified in sub-section (2) of section 44BB". Accordingly, it had included in the computation of its profits and gains of business or profession the sum received by it from its principal for the purpose of making payment of income-tax in connection with the activities carried on by it in India which were related to

prospecting for/exploration/production of mineral oil in India. This claim was originally accepted by the Assessing Officer. However, the CIT considered the inclusion of income-tax for aggregate of sums in the amounts referred to in sub-section (2) of section 44AB to erroneous and prejudicial to the interest of the revenue and directed the Assessing Officer to re-compute the income of the assessee by including the entire receipt of the income-tax payable by the company in India as part of the income from profits and gains of business failing under section 28(iv) of the Act, by excluding it from the computation of income under section 44AB(2). The please of the assessee found favour with the Tribunal, which set aside the order of the Commissioner under section 263 of the Act and held in favour of the assessee.

Decision

The Rajasthan High Court dismissed the appeals and applications and held that the tax liability of the non-resident assessee which had been undertaken by the ONGC and had been paid by the ONGC would be a perquisite arising from the business of oil exploration under the agreement entered into by the non-resident assessee with the ONGC and would be taxable as such. The computation of the same, would have to be made under sub-section (1) of section 44BB, and, therefore, only 10% of the same would be deemed to be the profits of such business chargeable to tax, and not the entire sum.

Analysis

Obviously the Department wanted to charge the tax paid on its behalf as a perquisite arising from business under section 28(iv). However, sub-section (1) of section 44BB provides that notwithstanding anything to the contrary contained in sections 28 to 41 and sections 43 and 43A, in the case of an assessee, being a non-resident engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils, a sum equal to ten per cent of the aggregate of the amounts specified in sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession". Accordingly income-tax paid on behalf of the non-resident can be held to come within the scope of sub-section (1) of section 44BB and outside the scope of section 28(iv).

10. Envory Mart v. Union of India and Others (2002) 255 ITR 425 (Delhi)

Facts/Issues

The petitioner, Envory Mart along with Indian Handicrafts Emporium and Minor Art Gallery filed to joint writ petition before the Delhi High Court. One of the prayers was to restrain the respondents from reopening the petitioner's assessments for the periods from 1986-87 to 1990-91. During the pendency of the writ petition, the respondents introduced the Kar Vivad Samadhan Scheme, 1998. This scheme was introduced by the Central Government with a view to collect revenue through direct and indirect taxes by avoiding litigation. The petitioner took the benefit of this scheme and made declaration under section 89 of the Finance (No.2) Act of 1998, in respect of Kar Vivad Samadhan Scheme, 1998. Against the last column which required mentioning pendency of any writ etc., the petitioner mentioned C.W. No.1991 of 1992 and date of filing as May, 25, 1992 in the Delhi High Court.

Decision

The High Court referred to a recent judgement of the Supreme Court in *Smt. Sushila Rani v CIT (2002) 253 ITR 275*, wherein it was observed that a certificate under section 90(1) of the Finance (No.2) Act, 1998 - Kar Vivad Samadhan Scheme, 1998 - making a determination as to the sum payable under the Kar Vivad Samadhan Scheme is conclusive as to the matters stated therein and cannot be reopened in any proceedings under any law for he time being in force except on the ground of false declaration by the declarant.

The High Court held, that in the instant case, the petitioner could not be held guilty of making any false declaration under the Kar Vivad Samadhan Scheme and therefore, the reassessment proceedings were not valid. ■

> Progress depends upon the belief that things can always be better
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> —*Frand Tyger*