Legal Decisions[1]

DIRECT TAXES

Income-tax Act

LD/60/101

SKF Boilers and Driers Pvt. Ltd, In Re, February 22, 2012 (AAR)

Section 9 read with Section 5 and 195 of the Income-tax Act, 1961 - Income - Deemed to accrue or arise in India

Where plant was exported by Indian manufacturer from India to Pakistan, commission paid to agent in Pakistan would be taxable in India when export order was executed in India

The applicant, Indian company received an order for supply of Rice Par Boiling and Dryer Plants from Pakistan. The order was received through two agents in Karachi. The plant was shipped. On completion of the export order, the assessee paid commission to the agents. The applicant's case was that the payment of commission on export order did not accrue or arise to the two non-residents in India and, hence, there is no liability to tax in India. The provision of tax withholding under section 195 of the Act would not apply.

The Authority for Advance Rulings held that section 5(2)(b) deals with the scope of total income whereby the income of a non-resident includes all income from whatever source derived, which accrues or arises or is deemed to accrue or arise in India during such previous year. Under section 9(1)(i), income accruing or arising directly or indirectly, through or from any business connection in India or source of income in India shall be deemed to accrue or arise in India. Sections 5 and 9 thus proceed on the assumption that income has a situs and the situs has to be determined according to the general principles of law. The words 'accrue' or 'arise' occurring in section 5 have more or less a synonymous sense and income is said to accrue or arise when the right to receive it comes into existence. No doubt the agents rendered services abroad and have solicited orders, but the right to receive the commission arises in India when the order is executed by the applicant in India. The fact that the agents have rendered services abroad in the form of soliciting the orders and the commission is to be remitted to them abroad are wholly irrelevant for the purpose of determining the situs of their income. The income arising on account of commission payable to the two agents is deemed to accrue and arise in India, and is taxable under the Act in view of the specific provision of section 5(2)(b), read with section 9(1)(i). The TDS provision of section 195 would apply.

LD/60/102

Organisation Development Pte Ltd.
Vs.
Deputy Director of Income-tax (International Taxation)
February 9, 2012 (ITAT-Chennai)
[Assessment Year 2007-08]

Section 9 of the Income-tax Act, 1961 read with Article 12 of the DTAA between India and Singapore - Income - Deemed to accrue or arise in India

Payment for process of development of strategic performance management tool balance score card system cannot be divided into two segments, one for royalty relatable to software and other for fees for technical services; software was only a part of tool of management consultancy and was never to be considered as independent divorced of total system and whole of amount received by assessee was nothing but fees for technical services and same was definitely taxable under DTAA between India and Singapore

The assessee, Singapore Company received payment on account of services rendered by it in developing Balance Score Card (BSC) system for its clients. For the development of such BSC system which is a strategic performance management tool, clients were required to download from the sites designated by the assessee a licensed software.

The assessee had sent its Principal Consultant with a team for helping its clients in implementing a licensed software, which was required to develop the Balance Score Card for such clients. The clients were required to make lump sum payments for downloading such software from the designated sites and such software was to be used in various phases of developing the Balance Score Card system.

The Chennai Bench of Tribunal held that a properly designed Balance Score Card can alert a manager on the areas where performance deviated from expected levels, and trigger improved performance. The measures will vary from organization to organization, as per its own goals and different strategies to reach such goals. It cannot be said this is a type of service which can be used by any organization by application of an off the shelf software. The software might be helpful in development of the phases of the Balance Score Card as well as functioning thereafter. But, considerable skill will be required in identifying the measures and fixing the targets for each such measure for a decisive meaningful Balance Score Card for different areas. So, the software is only a part of the total process of development of Balance Score Card.

[1] *Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.org.*

The software used by the assessee cannot be considered independent, but only as a part of the service rendered by the assessee. By means of the Balance Score Card system developed by the assessee, the clients were getting an advantage which went much beyond the period of agreement between the assessee and its clients. The Balance Score Card definitely enabled the clients to acquire the skills necessary for implementing their business strategies more effectively and this is definitely a long term objective. Assessee had definitely made available technical knowledge and skill which enabled its clients to acquire the knowledge for using Balance Score Card system for their business purposes for meeting their long term targets and the benefits ran well into the future. No doubt, all technical and consultancy services cannot fall within the scope of definition of "fees for technical services" as defined under the DTAA. To fit into the terminology "the technical knowledge, skill, etc." shall remain with the person receiving the services even after the particular contract comes into end. Balance Score Card did not become useless or was not meant for the use of the business needs of its clients after the tenure of the agreement it had with such clients. The Balance Score Card prepared for each client and system of filling data in such Balance Score Card on a continual basis, based on different types of measures adopted which again depended on the needs of each client and their functions can be considered as tools designed for exclusive use of such clients and the use of such a management tool would continue with such clients. Necessarily the technical knowledge and skill for use imbibed by the assessee remained with such clients. Thus, the fees received for designing of the management tool called Balance Score Card will definitely fall within the definition of "fees for technical services" as given under sub-clause (iv) of Article 12 of DTAA between India and Singapore. The software cannot be treated independently and a part of the amounts received by the assessee cannot be considered as royalty. The software was only a part of the tool of management consultancy and was never to be considered as independent divorced of the total system. Thus, the whole of the amount received by the assessee was nothing but fees for technical services and the amount was definitely taxable under the DTAA.

LD/60/103
Topman Exports
Vs.
CIT, Mumbai
February 8, 2012 (SC)
[Assessment Year 2002-2003]

Section 28(iiid) read with Section 28(iiib) and Section 80HHC of the Income-tax Act, 1961 – Profit on transfer of Duty Entitlement Pass Book Scheme

Not entire amount received by assessee on sale of Duty Entitlement Pass Book (DEPB), but sale value less face value of DEPB will represent profit on transfer of DEPB by assessee

It will be clear from section 28 that under clause (iiib) cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India is by itself income chargeable to income tax under the head "Profits and Gains of Business or Profession". DEPB is a kind of assistance given by the Government of India to an exporter to pay customs duty on its imports and it is receivable once exports are made and an application is made by the exporter for DEPB. Therefore, DEPB is "cash assistance" receivable by a person against exports under the scheme of the Government of India and falls under clause (iiib) of Section 28 and is chargeable to income tax under the head "Profits and Gains of Business or Profession" even before it is transferred by the assessee.

Under clause (iiid) of Section 28, any profit on transfer of DEPB is chargeable to income tax under the head "Profits and Gains of Business or Profession" as an item separate from cash assistance under clause (iiib). As DEPB has direct nexus with the cost of imports for manufacturing an export product, any amount realized by the assessees over and above the DEPB on transfer of the DEPB would represent profit on the transfer of DEPB.

Thus, while the face value of the DEPB will fall under clause (iiib) of section 28 of the Act, the difference between the sale value and the face value of the DEPB will fall under clause (iiid) of section 28. It is not right to take the view that the entire sale proceeds of the DEPB realized on transfer of the DEPB and not just the difference between the sale value and the face value of the DEPB represent profit on transfer of the DEPB.

The cost of acquiring DEPB, is not nil because the person acquires it by paying customs duty on the import content of the export product and the DEPB which accrues to a person against exports has a cost element in it. Accordingly, when DEPB is sold by a person, his profit on transfer of DEPB would be the sale value of the DEPB less the face value of DEPB which represents the cost of the DEPB. The second reason given by the High Court in the impugned judgment is that under the DEPB scheme, DEPB is given at a percentage of the FOB value of the exports so as to neutralize the incidence of customs duty on the import content of the export

products, but the exporter may not himself utilize the DEPB for paying customs duty but may transfer it to someone else and therefore the entire sum received on transfer of DEPB would be covered under clause (iiid) of Section 28.

DEPB represents part of the cost incurred by a person for manufacture of the export product and hence even where the DEPB is not utilized by the exporter but is transferred to another person, the DEPB continues to remain as a cost to the exporter. When, therefore, DEPB is transferred by a person, the entire sum received by him on such transfer does not become his profits. It is only the amount that he receives in excess of the DEPB which represents his profits on transfer of the DEPB.

As per section 28 under which "cash assistance" received or receivable by any person against exports such as the DEPB and "profit on transfer of the DEPB" are treated as two separate items of income under clauses (iiib) and (iiid) of section 28. If accrual of DEPB and profit on transfer of DEPB are treated as two separate items of income chargeable to tax under clauses (iiib) and (iiid) of Section 28 of the Act, then DEPB will be chargeable as income under clause (iiib) of section 28 in the year in which the person applies for DEPB credit against the exports and the profit on transfer of the DEPB by that person will be chargeable as income under clause (iiid) of section 28 in his hands in the year in which he makes the transfer. Accordingly, if in the same previous year the DEPB accrues to a person and he also earns profit on transfer of the DEPB, the DEPB will be business profits under clause (iiib) and the difference between the sale value and the DEPB (face value) would be the profits on the transfer of DEPB under clause (iiid) for the same assessment year. Where, however, the DEPB accrues to a person in one previous year and the transfer of DEPB takes place in a subsequent previous year, then the DEPB will be chargeable as income of the person for the first assessment year chargeable under clause (iiib) of Section 28 and the difference between the DEPB credit and the sale value of the DEPB credit would be income in his hands for the subsequent assessment year chargeable under clause (iiid) of Section 28. This interpretation, therefore, does not lead to double taxation of the same income, which the legislature must be presumed to have avoided.

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Section 80HHC read with Section 28(iii) of the Income-tax Act, 1961 - Deductions - Profits from export business

It cannot be concluded that where an assessee does not have export turnover exceeding ₹10 crores and it does not fulfil conditions set out in third proviso to Section 80HHC (iii), assessee is not entitled to a deduction under Section 80HHC on amount received on transfer of DEPB

Sub-section (1) of Section 80HHC makes it clear that an assessee engaged in the business of export out of India of any goods or merchandise to which this Section applies shall be allowed, in computing his total income, a deduction to the extent of profits referred to in sub-section (1B), derived by him from the export of such goods or merchandise. Sub-section (1B) of Section 80HHC gives the percentages of deduction of the profits allowable for the different assessment years from the assessment years 2001-2002 to 2004-2005. Sub-section (3)(a) of Section 80HHC provides that where the export out of India is of goods or merchandise manufactured or processed by the assessee, the profits derived from such exports shall be the amount which bears to the profits of the business, the same proportion as the export turnover in respect of such goods bears to the total turnover of the business carried on by the assessee.

The formula in sub-section (3)(a) of Section 80HHC is as follows:

$$\text{Profits derived from exports} = \frac{\text{Profits of the business x Export Turnover}}{\text{Total Turnover}}$$

Explanation (baa) under Section 80HHC states that "profits of the business" in the aforesaid formula means the profits of the business as computed under the head "Profits and Gains of Business or Profession" as reduced by (1) ninety per cent of any sum referred to in clauses (iiia), (iiib), (iiic), (iiid) and (iiie) of Section 28 or of any receipts by way of brokerage, commission, interest, rent, charges or any other receipt of similar nature including any such receipts and (2) the profits of any branch, office, warehouse or any other establishment of the assessee situated outside India.

Thus, ninety per cent of the DEPB which is "cash assistance" against exports and is covered under clause (iiib) of section 28 will get excluded from the "profits of the business" of the assessee if such DEPB has accrued to

the assessee during the previous year. Similarly, if during the same previous year, the assessee has transferred the DEPB and the sale value of such DEPB is more than the face value of the DEPB, the difference between the sale value of the DEPB and the face value of the DEPB will represent the profit on transfer of DEPB covered under clause (iiid) of Section 28 and ninety per cent of such profit on transfer of DEPB certificate will get excluded from "profits of the business". But, where the DEPB accrues to the assessee in the first previous year and the assessee transfers the DEPB certificate in the second previous year, as appears to have happened in the present batch of cases, only ninety per cent of the profits on transfer of DEPB covered under clause (iiid) and not ninety per cent of the entire sale value including the face value of the DEPB will get excluded from the "profits of the business". Thus, where the ninety per cent of the face value of the DEPB does not get excluded from "profits of the business" under explanation (baa) and only ninety per cent of the difference between the face value of the DEPB and the sale value of the DEPB gets excluded from "profits of the business", the assessee gets a bigger figure of "profits of the business" and this is possible when the DEPB accrues to the assessee in one previous year and transfer of the DEPB takes place in the subsequent previous year. The result in such case is that a higher figure of "profits of the business'" becomes the multiplier in the aforesaid formula under sub- section (3)(a) of Section 80HHC for arriving at the figure of profits derived from exports.

To the figure of profits derived from exports worked out as per the aforesaid formula under sub-section (3)(a) of Section 80HHC, the additions as mentioned in first, second, third and fourth proviso under sub-section (3) are made to profits derived from exports. Under the first proviso, ninety per cent of the sum referred to in clauses (iiia), (iiib) and (iiic) of Section 28 are added in the same proportion as export turnover bears to the total turnover of the business carried on by the assessee. In this first proviso, there is no addition of any sum referred to in clause (iiid) or clause (iiie). Hence, profit on transfer of DEPB or DFRC are not to be added under the first proviso. Where therefore in the previous year no DEPB or DFRC accrues to the assessee, he would not be entitled to the benefit of the first proviso to sub-section (3) of Section 80HHC because he would not have any sum referred to in clause (iiib) of Section 28 of the Act. The second proviso to sub-section (3) of Section 80HHC states that in case of an assessee having export turnover not exceeding ₹10 crores during the previous year, after giving effect to the first proviso, the export profits are to be increased further by the amount which bears to ninety per cent of any sum referred to in clauses (iiid) and (iiie) of Section 28, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee. The third proviso to sub-section (3) states that in case of an assessee having export turnover exceeding ₹10 crores, similar addition of ninety per cent of the sums referred to in clause (iiid) of Section 28 only if the assessee has the necessary and sufficient evidence to prove that (a) he had an option to choose either the duty drawback or the Duty Entitlement Pass Book Scheme, being the Duty Remission Scheme; and (b) the rate of drawback credit attributable to the customs duty was higher than the rate of credit allowable under the Duty Entitlement Pass Book Scheme, being the Duty Remission Scheme. Therefore, if the assessee having export turnover of more than ₹10 crores does not satisfy these two conditions, he will not be entitled to the addition of profit on transfer of DEPB under the third proviso to sub-section (3) of Section 80HHC.

The aforesaid discussion would show that where an assessee has an export turnover exceeding Rs.10 crores and has made profits on transfer of DEPB under clause (d) of Section 28, he would not get the benefit of addition to export profits under third or fourth proviso to sub-section (3) of Section 80HHC, but he would get the benefit of exclusion of a smaller figure from "profits of the business" under explanation (baa) to Section 80HHC of the Act and there is nothing in explanation (baa) to Section 80HHC to show that this benefit of exclusion of a smaller figure from "profits of the business" will not be available to an assessee having an export turnover exceeding ₹10 crores. In other words, where the export turnover of an assessee exceeds ₹10 crores, he does not get the benefit of addition of ninety per cent of export incentive under clause (iiid) of Section 28 to his export profits, but he gets a higher figure of profits of the business, which ultimately results in computation of a bigger export profit. Therefore, it cannot be concluded that where an assessee does not have the export turnover exceeding ₹10 crores and it does not fulfil the conditions set out in the third proviso to Section 80HHC (iii), the assessee is not entitled to a deduction under Section 80HHC on the amount received on transfer of DEPB.

This apart, as per the words used in *Explanation* (baa) to Section 80HHC read with the words used in clauses (iiid) and (iiie) of Section 28, the assessee would be entitled to a deduction under Section 80HHC on export profits.

Note: Judgment of Bombay High Court set aside.

LD/60/104
Catholic Syrian Bank Ltd.
Vs.
CIT, Thrissur
February 17, 2012 (SC)
[Assessment Year 2002-2003]

Section 36(1)(vii) of the Income-tax Act, read with section 36(1)(viia) of the Income-tax Act, 1961 - Bad debts

The proviso to section 36(1)(vii) operates only with reference to rural loans of a bank; a bank is entitled separately to general deduction up to an amount in an account which has become bad debt and is written off in books of account as irrecoverable

The clear legislative intent of the relevant provisions and unambiguous language of the circulars with reference to the amendments to section 36 of the Act demonstrate that the deduction on account of provisions for bad and doubtful debts under section 36(1)(viia) is distinct and independent of the provisions of section 36(1)(vii) relating to allowance of the bad debts. The legislative intent was to encourage rural advances and the making of provisions for bad debts in relation to such rural branches. Another material aspect of the functioning of such banks is that their rural branches were practically treated as a distinct business, though ultimately these advances would form part of the books of accounts of the principal or head office branch. The deductions permissible under section 36(1)(vii) should not be negated by reading into this provision, limitations of section 36(1)(viia) on the reasoning that it will form a check against double deduction. Such approach would be erroneous and not applicable on the facts of the case in hand.

Interpretation and Construction of Relevant Sections

The language of section 36(1)(vii) of the Act is unambiguous and does not admit of two interpretations. It applies to all banks, commercial or rural, scheduled or unscheduled. It gives a benefit to the assessee to claim a deduction on any bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year. This benefit is subject only to section 36(2) of the Act. It is obligatory upon the assessee to prove to the assessing officer that the case satisfies the ingredients of section 36(1)(vii) on the one hand and that it satisfies the requirements stated in section 36(2) of the Act on the other. The proviso to section 36(1)(vii) does not, in absolute terms, control the application of this provision as it comes into operation only when the case of the assessee is one which falls squarely under section 36(1)(viia) of the Act. The explanation to section 36(1)(vii), introduced by the Finance Act, 2001, has to be examined in conjunction with the principal section. The explanation specifically excluded any provision for bad and doubtful debts made in the account of the assessee from the ambit

and scope of `any bad debt, or part thereof, written-off as irrecoverable in the accounts of the assessee'. Thus, the concept of making a provision for bad and doubtful debts will fall outside the scope of section 36(1) (vii) simplicitor. The proviso, will have to be read with the provisions of section 36(1)(viia) of the Act. Once the bad debt is actually written off as irrecoverable and the requirements of section 36(2) satisfied, then, it will not be permissible to deny such deduction on the apprehension of double deduction under the provisions of section 36(1)(viia) and proviso to section 36(1)(vii). This does not appear to be the intention of the framers of law. The scheduled and non-scheduled commercial banks would continue to get the full benefit of write off of the irrecoverable debts under section 36(1)(vii) in addition to the benefit of deduction of bad and doubtful debts under section 36(1)(viia). Mere provision for bad and doubtful debts may not be allowable, but in the case of a rural advance, the same, in terms of section 36(1)(viia)(a), may be allowable without insisting on an actual write-off.

As per the proviso to clause (vii), the deduction on account of the actual write off of bad debts would be limited to excess of the amount written off over the amount of the provision which had already been allowed under clause (viia). The proviso by and large protects the interests of the Revenue. In case of rural advances which are covered by clause (viia), there would be no such double deduction. The proviso, in its terms, limits its application to the case of a bank to which clause (viia) applies. Indisputably, clause (viia)(a) applies only to rural advances.

As far as foreign banks are concerned, under section 36(1)(viia)(b) and as far as public financial institutions or State financial corporations or State industrial investment corporations are concerned, under section 36(1)(viia)(c), they do not have rural branches. Thus, it can safely be inferred that the proviso is self indicative that its application is to bad debts arising out of rural advances.

The scope of the proviso to clause (vii) of section 36(1) has to be ascertained from a cumulative reading of the provisions of clauses (vii), (viia) of section 36(1) and clause (v) of section 36(2) and only shows that a double benefit in respect of the same debt is not given to a scheduled bank. A scheduled bank may have both

urban and rural branches. It may give advances from both branches with separate provision accounts for each.

In the normal course of its business, a bank is to maintain different accounts for the rural debts for non-rural/urban debts. It is obvious that the branches in the rural areas would primarily be dealing with rural debts while the urban branches would deal with commercial debts. Maintenance of such separate accounts would not only be a matter of mere convenience but would be the requirement of accounting standards.

Under law, it is obliged to maintain accounts which would correctly depict its statement of affairs. This obligation arises implicitly from the requirements of the Act and certainly under the mandate of accounting standards.

Banks could, for valid reasons, have rural accounts more distinct from the urban, commercial accounts:

(a) It is obligatory upon each bank to ensure that the accounts represent the correct statement of affairs of the bank.

(b) Maintaining the common account may result in over stating the profits or the profits will shoot up which would result in accruing of liabilities not due.

(c) Accounting Standard (AS) 29, issued in 2003, concerns treatment of `provisions, contingent liabilities and contingent assets'. Under the head `Use of Provisions', clauses 53 and 54 justify maintenance of distinct and different accounts.

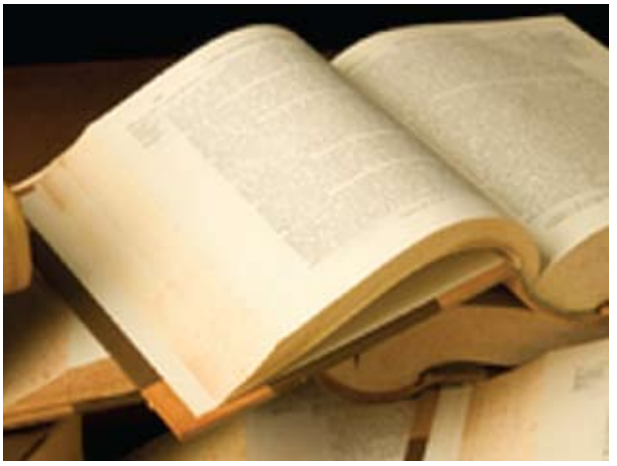
The Supreme Court in the case of *Vijaya Bank vs. Commissioner of Income Tax & Another* (2010) 5 SCC 416, held that under the accounting practice, the accounts of the rural branches have to tally with the accounts of the head office. If the repaid amount in subsequent years is not credited to the profit and loss account of the head office, which is what ultimately matters, then there would be a mismatch between the rural branch accounts and the head office accounts. Therefore, in order to prevent such mismatch and to be in conformity with the accounting practice, the banks should maintain separate accounts. Of course, all accounts would ultimately get merged into the account of the head office, which will ultimately reflect one account (balance sheet), though containing different items.

Another example that would support this view is that, a bank can write off a loan against the account of `A' alone where it has advanced the loan to party `A'. It cannot write off such loan against the account of `B'. Similarly, a loan advanced under the rural schemes cannot be written off against an urban or a commercial loan by the bank in the normal course of its business. In other words, if the case of the assessee does not fall under section 36(1)(viia), the proviso/limitation would not come into play.

It is useful to notice that in the proviso to section 36(1) (vii), the explanation to that section, section 36(1)(viia) and 36(2)(v), the words used are `provision for bad and doubtful debts' while in the main part of section 36(1)(vii), the Legislature has intentionally not used such language. The proviso to section 36(1)(vii) and sections 36(1)(viia) and 36(2) (v) have to be read and construed together. They form a complete scheme for deductions and prescribe the extent to which such deductions are available to a scheduled bank in relation to rural loans etc., whereas section 36(1)(vii) deals with general deductions available to a bank and even non-banking businesses upon their showing that an account had become bad and written off as irrecoverable in the accounts of the assessee for the previous year, satisfying the requirements contemplated in that behalf under section 36(2). The provisions of section 36(1)(vii) operate in their own field and are not restricted by the limitations of section 36(1)(viia) of the Act.

Conclusion:

The provisions of sections 36(1) (vii) and 36(1)(viia) of the Act are distinct and independent items of deduction and operate in their respective fields. The bad debts written-off in debts, other than those for which the provision is made under clause (viia), will be covered under the main part of section 36(1)(vii), while the proviso will operate in cases under clause (viia) to limit deduction to the extent of difference between the debt or part thereof written off in the previous year and credit balance in the provision for bad and doubtful debts account made under clause (viia). The proviso to section 36(1)(vii) will relate to cases covered under section 36(1)(viia) and has to be read with section 36(2)(v) of the Act. Thus, the proviso would not permit benefit of double deduction, operating with reference to rural loans while under section 36(1)(vii), the assessee would be entitled to general deduction upon an account having become bad debt and being written-off as irrecoverable in the accounts of the assessee for the previous year. This, obviously, would be subject to satisfaction of the requirements contemplated under section 36(2).



Consequently, the question is answered in favour of the assessee.

Note: Judgment of the Full Bench of Kerala High Court set aside.

LD/60/105

CIT, Kolkata – III
Vs.
Dataware Private Limited
September 21, 2011 (CAL)
[Assessment Year 2001-02]

Section 68 of the Income-tax Act, 1961 – Cash Credits

So long it was not established that return submitted by creditor had been rejected by its Assessing Officer, Assessing officer of assessee was bound to accept same as genuine when identity of creditor and genuineness of transaction through account payee cheque has been established

The share application money was paid to the assessee-company by account payee cheque. The creditor appeared before the Assessing Officer, disclosed its PAN number and also other details of the accounts but in spite of that the Assessing Officer did not enquire further from the assessing officer of the creditor but in stead, himself proceeded to consider the profit and loss account of the creditor and opined that he had some doubt about the genuineness of such account.

The High Court of Calcutta held that the Assessing officer of the assessee could not take the burden of assessing the profit and loss account of the creditor when admittedly the creditor himself was an income tax assessee. After getting the PAN number and getting the information that the creditor was assessed under the Act, the Assessing officer should enquire from the Assessing Officer of the creditor as to the genuineness of the transaction and whether such transaction has been accepted by the Assessing officer of the creditor but instead of adopting such course, the Assessing officer himself could not enter into the return of the creditor and brand the same as unworthy of credence.

So long it was not established that the return submitted by the creditor had been rejected by its Assessing Officer, the Assessing officer of the assessee was bound to accept the same as genuine when the identity of the creditor and the genuineness of transaction through account payee cheque has been established. Therefore, no addition could be made under section 68.

LD/60/106

Red Hat India Private Limited, In Re
February 3, 2012 (AAR)

Section 245 of the Income-tax Act, 1961 - Refunds – Set off of tax

If the applicant before Authority for Advance Rulings had already filed a return of income involving the amount arising out of identical transaction on which a question for the Authority's ruling is raised by filing an application under section 245Q(1), the application before the Authority for Advance Rulings will be barred by the clause (i) of the proviso to section 245R(2) and the application will have to be rejected.

The Authority for Advance Rulings is a creature of the Income-tax Act. The provisions of the Act that create it and confer jurisdiction on it in certain matters, also restricts its jurisdiction or divests it of its jurisdiction in certain circumstances. One of the situations or circumstances, is when the question raised before it, has arisen before the Income-tax Authority. The question referred to in the proviso to section 245R(2), is the question before the Authority for Advance Rulings. When a return is filed, so many aspects arise out of that return. The question of computation of total income, computation of the exemptions and exclusions, acceptance or non-acceptance of an item of expenditure and ultimately the determination of chargeable income and the determination of the tax due, are all questions that arise. Therefore filing of a return ushers in all these questions. By filing a return, an assessee invites an adjudication on all the questions arising out of that return. Subsection (2) of section 245R only speaks of the question arising before the Authority. So if an answer to that question would be involved in the return filed or would arise out of the return filed, it would be a case where the bar is attracted. The arising of a question from out of a return filed, cannot depend on the volition, diligence, care or lack of care on the part of the Assessing Officer. A jurisdiction cannot depend on such vagaries.

When an income is received or is expended as a permissible expenditure, both figure in the return and are dealt with while completing the assessment. If the return is accepted after scrutiny or without scrutiny, it would only mean that the claim of the applicant has been accepted by the Assessing Officer. The implication is that the question is answered in his favour. That would not mean that, that question or aspect has not arisen before the Assessing Officer, on the filing of the return.

The relevant date for considering the question is the date of filing of the application and that filing of a return prior to filing of the application for Advance Ruling would lead to a rejection of the application. Consistent with the purpose sought to be achieved, emphasized on behalf of the applicant, it is for an applicant, eligible in that behalf, to move this Authority at the earliest opportunity and not to wait until after it invokes the jurisdiction or is obliged to invoke the jurisdiction of the Assessing Officer, by filing a return of income. The obligation to file a return can well be fulfilled after moving this Authority and the Assessing Officer will have to await a Ruling by this Authority and take shelter under section 153 to complete the assessment. It could not be denied that the Ruling the Authority will give, will also impact the return already pending when the

application before this Authority was moved. It will then be impossible to say that the aspect does not arise out of the return filed.

When this Authority took the view in *Monte Harris and other* cases that the date of the filing of the application before the Authority should be the crucial date for determining the question of the applicability of clause (i) of the proviso to section 245R(2) and not the date when the application comes up for hearing either under section 245R(2) or under section 245R(4), the Authority was searching for a definite and consistant terminus a quo. This Authority felt that the period could not be left to the vagaries of the progress of the application before this Authority or the vicissitudes of procedure. The same principle should be applied to the other limb of the proviso. That can be achieved only by fixing the point at the filing of a return of income by the applicant and not the vagaries of the Income-tax authority issuing a notice or on the date of that notice. The Assessing Authority has a period of one year to issue a notice under any one of the provisions, and the starting point could not be made to depend on his issuing a notice or on his not issuing a notice at all. After all, while filing a return, a person is expected to be honest and is expected to set out all information truthfully even if he is of the view that an item of income derived is not chargeable to tax or is not chargeable to tax in this country. By filing a return, that person is inviting the Assessing Officer to decide the question for him and that makes the question pending before the income-tax authority. Then clearly, the bar under clause (i) of the proviso to section 245R(2) would be attracted.

OTHER LAWS

Arbitration and Conciliation Act

LD/60/107

Drive India Enterprise Solutions Ltd.

Vs.

Haier Telecom (India) Pvt. Ltd.

December 19, 2011 (BOM)

Section 9 of the Arbitration and Conciliation Act, 1996 – Interim measures by Court

Banker, who has issued Standby Letters of Credit (SBLC) or given bank guarantee, would only be required to reimburse amount upon a demand being made to issuing bank; banks are not required to go into each of breaches of contracting parties before honouring SBLCs as they are in nature of guarantees for the payment

The appellant-petitioner and Respondent No.1 entered into agreements for import and supply of certain mobile handsets. The petitioner was to issue certain Standby Letters of Credit (SBLC) at the request of Respondent No.1 but in favour of Respondent No. 2. The SBCLs were issued by Respondent No. 3. It was contended by the Petitioner that Respondent No. 1 did not supply the products in terms of the aforesaid agreements though the petitioner made full payment under the contract. The suit was filed for restraining Respondent No. 2 from encashing SBLCs.

The Bombay High Court held that the terms of the contract between the Petitioner and Respondent No.1 with regard to the delivery of the goods which aspect has been challenged by the Petitioner needed not be considered as the Court in a Suit for an injunction against the invocation of SBLCs was required to be guided only in terms of the SBLCs. The SBLCs were clear and unambiguous. The SLBCs had been extended from time to time. They had to be honoured as per the demand. They have to be paid as per the express terms contained therein without protest. Since they were independent of the terms and conditions of the agreement, those terms could not be considered.

The SBLC was expressly made subject to the uniform, customs and practice for Documentary Credits, (2007 Revision) International Chamber of Commerce (Publication 600) ("UCP"). Clause 14 (h) of the UCP states that if a credit contains a condition without stipulating the document to indicate compliance with the condition, banks will deem such condition as not stated and will disregard it.

The SBLC stipulates payment within 90 days from the date of shipment, but it did not stipulate any documents indicating the date of shipment. In this case no document was required to be presented for filing of SBLC e.g. any bill of lading. The banker is enjoined to disregard such condition.

It is settled position in law that SBLCs, as much as bank guarantees, are required to be honoured as per their terms and no Court may interfere with the due compliance thereof except in the case of established egregious fraud or irretrievable loss, harm and injustice.

In the instant case fraud was not even alleged by the Petitioner. The injustice was in the non delivery of the goods despite the claim of having made full payment. This contention itself was merely stated without being substantiated. In fact it was not even required to be stated or substantiated in this suit since neither the issuing bank nor the Court itself is required to go into those aspects. Assuming that there was no delivery or even short delivery or defective delivery, the law with regard to the SBLCs, as much as bank guarantees, was that those aspects are alien to the issues in a Suit in respect of invocation of such documents.

There was an arbitration contemplated by the parties. The arbitration agreement was invoked. In the arbitration the rights of the parties to the contract with regard to the delivery of the goods and the payment of the price would be decided and determined. The SBLC was quite different. The very fact that there was an arbitration provided in the contract between the parties

was the umbrella to guard against the injustice claimed. There was, therefore, no "irretrievable injustice"; it would be retrieved in arbitration. That was precisely why a separate guarantee for the demand by way of a SBLC or a bank guarantee was given. Hence, such SBLC was independent of the contract. Consequently even the term of the SBLC determining the mode of payment e.g. being 90 days from the date of the shipment was inconsequential when the description of the document is not supplied.

The banker would not know and would not be concerned with the date of shipment. The banker, who has issued the SBLC or given the bank guarantee, would only be required to reimburse the amount upon a demand being made to the issuing bank. It need hardly be mentioned that commercial trade, more specially international trade, would collapse if banks or even Courts are required to go into each of the breaches of the contracting parties before honouring the SBLCs which are in the nature of guarantees for the payment.

Therefore, the LC drawn in favour of Respondent No.2 would have to be honoured by Respondent No.3.

Competition Act

LD/60/108
Union of India
Vs.
Competition Commission of India
February 17, 2012 (DEL)

Section 19 read with Section 2(h) of the Competition Act, 2002 - Inquiry into certain agreements and dominant position of enterprise

Running railways, has a commercial angle and is capable of being carried out by entities other than the State, and it is, therefore, not an inalienable function of the State; therefore, Union of Government, (Railway Ministry) running railways covered by definition of 'enterprise'

Unless an activity can be classified as "relatable to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence & space", it cannot avoid being classified as an 'enterprise' under Section 2(h) of the Act. If it is an 'enterprise' under section 2(h), the Commission gets jurisdiction under Chapter IV of the Act.

Section 54 of the Act, which provides that the Central Government may, by notification, exempt from the application of the Act, or any provision thereof, and for such period as it may specify in such notification, inter alia, "any enterprise which performs a sovereign function on behalf of the Central Government or a State Government". Pertinently, no notification has been issued by the Central Government in relation to the services rendered by the Indian Railways. Even in relation to an enterprise which is engaged in activity, including an activity relatable to

the sovereign function of the Government, the Central Government may grant exemption only in respect of activity relatable to sovereign functions. Therefore, an enterprise may perform some sovereign functions, while other functions performed by it, and the activities undertaken by it, may not refer to sovereign functions. The exemption under Section 54 could be granted in relation to the activities relatable to sovereign functions of the Government, and not in relation to all the activities of such an enterprise. Pertinently, there is no notification issued under Section 54 either under Clause (c), or under the proviso. This clearly shows that the Central Government does not consider any of the activities of the petitioner as relatable to sovereign functions.

Even when the Government runs the Railways for providing quick and cheap transport for people and goods and for strategic reasons, it cannot be said that it is engaged in an activity of the State as a sovereign body.

Functions of the Government in a welfare state are manifold, all of which cannot be said to be the activities relating to exercise of sovereign power. The functions of the State not only relate to the functions of the country or the administration of justice (which are recognized as sovereign functions), but they extend to many other spheres as, for example, education, commerce, social, economic and political activities. These activities cannot be said to be related to sovereign power. The running of Railways was held to be a commercial activity.

Where the Union of Government had entered into a Concession Agreement under its PPP policy, by which informant had to perform activities related to running of railways, the informant was performing a commercial activity and rendering services for a charge, which, prior to the entering into the agreement with the Union of India, was being performed by the Union of India. The Union of India is also carrying out an activity, viz. running the railways, which also has a commercial angle and is capable of being carried out by entities other than the State, as is the case in various other developed countries. It is, therefore, not an inalienable function of the State. Therefore, the submission of the Union of India that it is not covered by the definition of 'enterprise', had no merit and is rejected. ■