Legal Decisions[1]

LD/62/17
CIT-II, Hyderabad
vs.
Syed Ali Adil
December 20, 2012 (AP)
[Assessment Year 2007-08]

Section 54 of the Income-tax Act, 1961—Capital gains—Profit on sale of residential property

Exemption under Section 54 is allowable also for "a residential house" consisting of several units

As held in *D. Ananda Basappa's case 309 ITR 329* by the Karnataka High Court, the expression "a residential house" in Section 54 (1) has to be understood in a sense that the building should be of residential nature and "a" should not be understood to indicate a singular number and where an assessee had purchased two residential flats, he is entitled to exemption under Section 54 in respect of capital gains on sale of its property on purchase of both the flats, more so, when the flats are situated side by side and the builder has effected modification of the flats to make it as one unit, despite the fact that the flats were purchased by separate sale deeds. This decision was followed by the Karnataka High Court in *CIT vs. Smt. K.G. Rukminiamma, (2011) 331 ITR 211 (KAR)* where a residential house was transferred and four flats in a single residential complex were purchased by the assessee, it was held that all four residential flats constituted "a residential house" for the purpose of Section 54 and that the four residential flats cannot be construed as four residential houses for the purpose of Section 54. Admittedly the two flats purchased by the assessee are adjacent to one another and have a common meeting point. In the impugned order, the Tribunal has also relied upon the decisions in *K. G. Vyas's case 26 ITJ 491 (BOM) P. C. Ramakrishna, HUF's case 107 ITJ 351 (Chennai)* and *Prakash Bhutani's case 110 ITJ 440 (Delhi)* wherein it was held that exemption under Section 54 only requires that the property should be of residential nature and the fact that the residential house consists of several independent units cannot be an impediment to grant relief under Section 54 even if such independent units were on different floors. The decision in *Suseela M. Jhaveri's case 107 ITD 327 (Mumbai)* holding that only one residential house should be given the relief under Section 54 does not appear to be correct and, hence, to be disapproved.

LD/62/18
Marubeni India Pvt. Ltd.
vs.
DIT
April 25, 2013 (DEL)
[Assessment Years 2002-03 & 2003-2004]

Section 92C of the Income-tax Act, 1961—Transfer Pricing— Computation of

Where interest arose out of investment of surplus funds which were not immediately required for the core business of the assessee, interest income cannot be considered to be its operating income; nature of such income is essentially a question of fact to be gathered from the nature of the assessee's business and its business profile

Whether a particular activity of the assessee (i.e. the interest generating activity through investment of surplus fund in this case) should be taken into consideration in the determination of the ALP is a question which needs to be decided considering the nature of the business of the assessee, which is referred to as "business model" in the transfer-pricing jargon.

The Tribunal has noted that the fact that the memorandum of association gave powers to the assessee to earn interest by making investments is relevant only for the purpose of determining the appropriate head of income under Section 14 under which the interest would fall to be assessed.

The High Court of Delhi held that it has been rightly observed by the Tribunal that such a consideration is not relevant for the purpose of determining the operating income of an assessee for the purposes of transfer pricing regulations. Moreover, the Tribunal has also found as a fact that the interest arose out of investment of surplus funds which were not immediately required for the core business of the assessee. The Tribunal's view that in such circumstances the interest income cannot be considered to be its operating income is essentially a question of fact to be gathered from the nature of the assessee's business and its business profile.

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

Section 92C of the Income-tax Act, 1961—Transfer Pricing— Computation of

Benefit of 5% range under the express provisions contained in Proviso to section 92C(2) cannot be given while computing the adjustment on account of transfer pricing

The arithmetic mean of the PLI of the five comparable cases was 9.33%. If the benefit of +5% is allowed on this figure then the arithmetic mean would be 14.8% and 3.8% respectively.

The contention of the assessee was that if the benefit of this way of reading the *proviso* is given, there would be no need to make any adjustment to the price shown by it. The contention of the revenue on the other hand was that the variation of 5% of the arithmetic mean is not a standard deduction. The Tribunal agreeing with the revenue held that the effect of the *proviso* was only that the transfer price shown by the assessee was not to be disturbed if it was within +5% the arithmetic mean of the comparable prices. Applying this interpretation to the *proviso*, it was found by the Tribunal as a fact that the assessee's case did not fall within the variation.

The Delhi High Court held as follows:

This controversy has been put at rest by the amendment made to Section 92C by the insertion of sub-section (2A) by the Finance Act, 2012 with retrospective effect from 01-04-2002, i.e., from the assessment year 2002-03. No substantial question of law can be said to arise.

Thus, in the instant case, the Tribunal, was correct in law, in not allowing the benefit of 5% range available to the Appellant under the express provisions contained in *Proviso* to Section 92C(2) while computing the adjustment on account of transfer pricing.

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Section 92C of the Income-tax Act, 1961—Transfer Pricing— Computation of

Where considering the nature of the remuneration received by the assessee from its associated enterprise, the payment of compensation on closure of the Indian offices would not have any impact on the transfer pricing issue or in the fixing of the ALP; the payment of compensation to the Indian units on their closure would represent abnormal costs which have to be excluded in the determination of the ALP

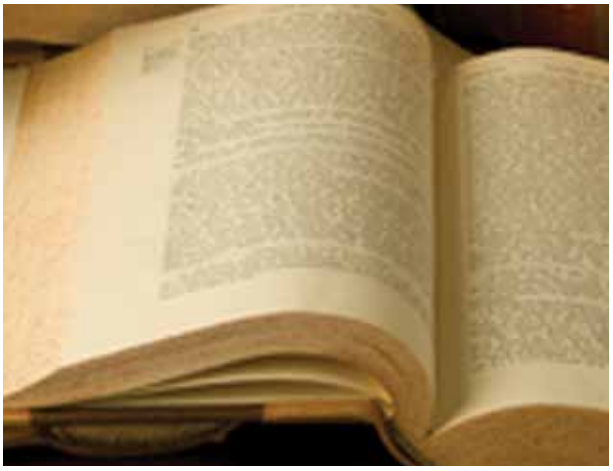
The Tribunal found that the expenses relating to the closure of the business were abnormal expenses and could not be considered relevant while arriving at the ALP in respect of the international transaction. It also referred to the finding of the Tribunal that none of the comparable companies had incurred such expenses. It was further submitted by the assessee that its Indian business was being run as a totally independent unit with authority to the management in India to

take decisions regarding closure of the offices in India. The payment of compensation for closure of the Indian units was an abnormal item of expense and therefore, ought to have been excluded from the operating costs while arriving at the ALP of the international transaction.

The case made out by the Income-tax Department was that since the assessee is a captive unit of its associated enterprise, it was actually the latter which undertook the entire risk, that the Japanese associated enterprise was paying the assessee at the rate of cost plus 10% that if the Indian units are closed then the operating costs would correspondingly be reduced and therefore, the compensation paid would form part of the operating costs and would thus be relevant for arriving at the ALP.

The Delhi High Court held as follows:

It may not be possible to lay down a formula that would be applicable universally to determine whether a particular expenditure or cost incurred by the assessee is a normal or abnormal item of expense, in cases relating to transfer pricing. If the assessee is compensated for its service on the basis of cost plus 10% then again the question may arise as to whether the compensation paid for closure of the Indian units can be considered to be normal or abnormal cost, because the compensation would directly depend or vary according to the quantum of the costs. In such case it would be relevant to consider whether the compensation paid for closure of the Indian units would amount to normal or abnormal expense. The assessee is being compensated by a fee or commission which has no connection with the costs incurred.



The Commissioner (Appeals) held that the decision was taken at the behest of the associated enterprises and therefore, for transfer-pricing purposes the assessee must be compensated by them and accordingly the costs of closure are not to be excluded for computing the operating expenses. The decision of the CIT (Appeals) was endorsed by the Tribunal which noted that since the Japanese associated enterprise was paying the assessee on the basis of cost plus 10%, the closure of the Indian units would automatically reduce the costs of the associated enterprise and therefore, would be a relevant issue for inclusion in the operating costs. In arriving at such a decision, it seemed that the revenue authorities and the Tribunal failed to keep in mind that even according to the assessing officer, the assessee was being compensated for its agency and market support service by way of handling commission and fixed service fee. It seemed rather remote that considering the nature of the remuneration received by the assessee from its associated enterprise, the payment of compensation on closure of the Indian offices would have any impact on the transfer pricing issue or in the fixing of the ALP. It therefore, appeared that having regard to the nature and manner in which the assessee is remunerated for its services, the payment of compensation to the Indian units on their closure would represent abnormal costs which have to be excluded in the determination of the ALP. Thus, the income tax authorities as well as the Tribunal had erred in holding to the contrary.

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Section 92C of the Income-tax Act, 1961— Transfer Pricing— Computation of

Where the assessee has two segments, one pertaining to trading and the other pertaining to the services, bifurcation of the indirect expenses on the basis of revenues is not an appropriate "allocation key"

The assessee has two segments, one pertaining to trading and the other pertaining to the services. The dispute related only to the allocation of overhead/ indirect expenses between two segments of the assessee's business.

It is nobody's case that the expenses were not incurred. It is also not the case of the revenue before the Tribunal or before the High Court that the bifurcation of the indirect expenses on the basis of revenues is not an appropriate "allocation key". The decision of both the CIT (Appeals) and the Tribunal is based on the

undisputed figures submitted by the assessee. These figures have also been scrutinised by the transfer pricing officer. There was, therefore, no perversity in the decision of the Tribunal because it was based on the evidence embedded in the books of accounts themselves.

LD/62/19
Mindtree Ltd
vs.
Union of India
June 12, 2013 (KAR)

Section 115JB and 115-O of the Income Tax Act - Special provision for payment of tax by certain companies

The newly inserted proviso to Section 115JB(6) and 115-O(6) of the Income Tax Act in the second schedule to the Special Economic Zones Act 2005 is constitutionally valid

A new *proviso* is inserted to Section 115JB(6) and 115-O(6) of the Income Tax Act in the second schedule to the Special Economic Zones Act 2005 withdrawing exemption so far given to the SEZ units with effect from 01-04-2012.

The following points arise for consideration:

(i) Whether the impugned amendments brought by the Ministry of Finance to a special statute "SEZ Act" which comes under the exclusive domain of Ministry of Commerce is unconstitutional and without authority? (ii) Whether the impugned amendments are violative of Article 14 of the Constitution of India ? (iii) Whether the impugned amendments are opposed to the *Doctrine of Promissory Estoppel?* (iv) Whether the impugned amendments are opposed to principles of Legitimate Expectancy?

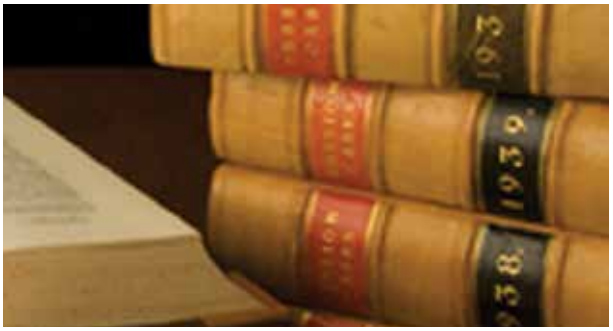
The Karnataka High Court held as follows:

(i) The Scope of Judicial Review

In view of the law declared by the Supreme Court the Finance Minister by introducing the Finance Act before the Parliament has the legislative competence to amend the Income Tax Act or any matter relating to the tax in any other statute. Therefore, the impugned amendment to the SEZ Act passed by the parliament on the Finance Bill introduced by the Finance Minister is well within the legislative competency since the same relates to a charge in the Income-tax Act. Therefore, I hold point no.1 in negative.

(ii) Issue of violative of Article 14 of the Constitution

By introducing sub-section 6 to Section 115-JB and sub-section 6 to Section 115-O of Income-tax Act a permanent exemption was given to SEZ establishments/units. It is a settled principle



that there can be no permanent tax exemption or incentive in fiscal legislation. Realising this lapse on the part of the Government the impugned *provisos* were introduced restricting the exemption only for a particular period. In the impugned amendment it is made clear that it is prospective in nature. Therefore, the impugned amendments can neither be said to be unreasonable or arbitrary.

At the time of passing SEZ Act, sub-section 6 of Section 115-JB and sub-section 6 to Section 115-O of the Income-tax Act was introduced totally exempting the SEZ establishment/units from payment of minimum alternate tax and tax on distribution of dividends. While all other companies are made liable to pay MAT and tax on dividend distribution, the SEZ establishments and units were exempted though they are making profits. This situation has lead to discrimination amongst SEZ establishment/units and other companies. Realising this discrimination among the companies the legislature in their wisdom brought the impugned amendments to remove the discrimination. Therefore, the impugned amendments are in accordance with Article 14 of the Constitution and not against it.

(iii) Issue of Doctrine of Promissory Estoppel and principles of Legitimate Expectancy

It is not in dispute that by inserting sub-section 6 to Section 115JB and Section 115O of the Income-tax Act the petitioners are exempted from paying minimum alternate tax and tax on distribution of dividends. By introducing the impugned *provisos* in the second schedule to SEZ Act the benefit extended is now withdrawn. In the circumstances, the petitioners are claiming relief on the basis of the Doctrine of Promissory Estoppel. It is settled position of law that this doctrine must yield when the equity so requires. Firstly, the exemption provided does not have a sunset clause and now under the impugned amendment this flaw in the law is removed. Secondly, the inequality between SEZ companies and other companies is removed. Thirdly, the exemptions provided to SEZ companies resulted in erosion of tax base.

Fourthly, the impugned amendment relates to fiscal policy of the state and any decision in the economic sphere is *ad hoc* and experimental in its nature and therefore the Government is well within it sovereign power to regulate the same. Lastly, the impugned amendments do not transgress any of the fundamental rights of the petitioners guaranteed under the Constitution. Therefore, it is to be held that the Doctrine of Promissory Estoppel cannot be made applicable to nullify the impugned amendments.

LD/62/20
CIT
vs.
Chhabil Dass Agarwal
August 8, 2013
[Assessment Year 1997-98]

Section 147 of the Income-tax Act, 1961 read with Article 226 of the Constitution of India—Income escaping assessment

The High Court should not interfere with the order passed by the assessing authority under Section 148 in exercise of its jurisdiction under Article 226 when an equally efficacious alternate remedy was available to the assessee under the Act

The assessee is a Sikkim-based non-Sikkimese who had filed his first return. Since no return was filed by the assessee for the Assessment Year 1996-1997 despite capitalising the profit, proceedings under Section 147 were initiated raising a tax demand. Further, penalty proceedings under Section 271(1)(c) were initiated.

The assessee approached the Writ Court under Article 226 of the Constitution of India re-assessment orders instead of exhausting the statutory remedy available under the Act, i.e., statutory appeal before the Statutory Appellate Authority (Commissioner of Income Tax (Appeals)). Suffice it is to notice here that the Writ Court has delved into the merits of the case and thought it fit to quash the order of the assessing authority.

The Supreme Court held as follows:

It is settled law that non-entertainment of petitions under writ jurisdiction by the High Court when an efficacious alternative remedy is available is a

rule of self-imposed limitation. It is essentially a rule of policy, convenience and discretion rather than a rule of law. Undoubtedly, it is within the discretion of the High Court to grant relief under Article 226 despite the existence of an alternative remedy. However, the High Court must not interfere if there is an adequate efficacious alternative remedy available to the petitioner and he has approached the High Court without availing the same unless he has made out an exceptional case warranting such interference or there exist sufficient grounds to invoke the extraordinary jurisdiction under Article 226.

Thus, while it can be said that this Court has recognised some exceptions to the rule of alternative remedy, i.e., where the statutory authority has not acted in accordance with the provisions of the enactment in question, or in defiance of the fundamental principles of judicial procedure, or has resorted to invoke the provisions which are repealed, or when an order has been passed in total violation of the principles of natural justice, the proposition laid down in *Thansingh Nathmal vs. Supdt. of Taxes, AIR 1964 SC 1419; Titagarh Paper Mills Co. Ltd. vs. State of Orissa*, AIR 1958 SC 86 and other similar judgments that the High Court will not entertain a petition under Article 226 of the Constitution if an effective alternative remedy is available to the aggrieved person or the statute under which the action complained of has been taken itself contains a mechanism for redressal of grievance still holds the field. Therefore, when a statutory forum is created by law for redressal of grievances, a writ petition should not be entertained ignoring the statutory dispensation.

The Act provides complete machinery for the assessment/ re-assessment of tax, imposition of penalty and for obtaining relief in respect of any improper orders passed by the Revenue Authorities, and the assessee could not be permitted to abandon that machinery and to invoke the jurisdiction of the High Court under Article 226 of the Constitution when he had adequate remedy open to him by an appeal to the Commissioner of Income Tax (Appeals). The remedy under the statute, however, must be effective and not a mere formality with no substantial relief.

Where neither has the assessee-writ petitioner described the available alternate remedy under the Act as ineffectual and non-efficacious while invoking the writ jurisdiction of the High Court, nor has the High Court ascribed cogent and satisfactory reasons to have exercised its jurisdiction in the facts of the case in dispute, the Writ Court ought not to have entertained the Writ Petition filed by the assessee, wherein he has only questioned the correctness or otherwise of the notices issued under Section 148, the re-assessment orders passed and the consequential demand notices issued thereon.

LD/62/21
Mahesh Kumar Gupta
vs.
CIT
April 17, 2013 (ALL)
[Assessment Year 2000-2001]

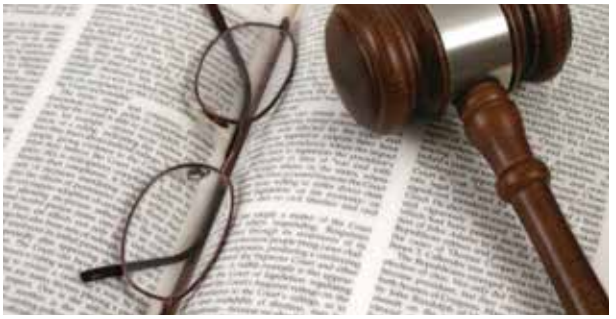
Section 149 read with Section 151 of the Income-tax Act, 1961— Income escaping assessment—Time limit for issue of notice

In absence of anything in reasons recorded to suggest that income chargeable to tax which has escaped assessment is ₹1 lakh or more, reassessment notice given after four years of close of assessment order is not valid

The petitioners were leaseholders of a Plot under the Government Grants Act, 1985. The leasehold rights subsequently got converted into freehold rights on August 1990. The petitioners decided to sell a parcel of the land and they applied for and were granted sanction by the Income Tax Department under section 230(A)(i). The parcel of the land was sold for a sum of ₹8,25,000 and each petitioner got ₹2,75,000 in his share. Accordingly the Petitioners filed their return for the assessment year 2000-01 which was accepted. However the Assessing Officer invoking extended period of limitation of six years issued notice under Section 148 on 23-3-2007 to the petitioners to reopen the assessment for the assessment year 2000-01. In response to the notice the petitioners had filed the return of income and objections challenging the very initiation of reassessment proceedings on various grounds which were rejected by the impugned order.

On the writ petition challenging the impugned order, the High Court held that:

The reason assigned for reopening was that the petitioner after converting the leasehold land into freehold sold the property within three years after converting the land into freehold resulting into short term capital gain. What income was said to have been escaped did not find mention therein. Even assuming for the sake of argument, the income was liable to be taxed as short term gain unless there was any material before the authority concerned that it exceeds the limit of ₹1 lakh, extended period of limitation of six years will not be available to the department. The normal period of limitation is four years for giving the notice under Section 148 and where the escaped income is



likely to amount to ₹1 lakh or more, the extended period of limitation of six years would be attracted. This objection of the petitioner had been rejected by the impugned order on the ground that since the permission had been granted by the Joint/ Additional Commissioner, statutory requirement stands fulfilled.

The Joint/Additional Commissioner was not aware about the fact that the income chargeable to tax which has escaped the assessment was ₹1 lakh or more for the relevant Assessment Year. In view of the *proviso* to Section 151(1), after the expiry of four years from the end of the relevant Assessment Year no notice under Section 148 shall be issued or unless the Chief Commissioner or Commissioner is satisfied on the reasons recorded by the Assessing Officer that it is a fit case for issue of such notice. On a true and proper construction of the *proviso* it is imperative that the Assessing Officer in his reason should state that the escaped income is likely to be ₹1 lakh or more so that the Chief Commissioner or the Commissioner may record his satisfaction. The sanctioning authority must be aware that it has exercised power of extended period of limitation under 149(1)(b). Exception has been carved out by clause (b) to section 149(1) in respect the income chargeable to tax which has escaped assessment, amounts to ₹1 lakh or more. To fall within exception clause the relevant facts should have been recorded by the Assessing Authority in its order while recording the reason so that a sanctioning authority may apply its mind to the proposition while granting the sanction.

For the reasons given above, on the basis of the reasons recorded by the Assessing Officer, the initiation of the reassessment proceedings relevant to the Assessment Year 2000-2001 by means of the notice dated 23-03-2007 after more than four years was clearly barred by time. ■