Legal Decisions[1]

Income Tax

LD/66/13

Commissioner of Income Tax vs. Oryx Finance and Investment P. Ltd. 01st July 2017

Bombay HC restricts levy of penalty u/s. 221 only on arrears of tax, excluding the interest under Sections 234A/B/C

The income tax return of assessee was processed u/s. 143(1) and a demand of ₹1.64 Cr. was raised along with a penalty of ₹1.19 Cr. u/s. 221(1) due to default in payment of demand. CIT(A) deleted penalty imposed holding that interest component was to be excluded while levying penalty u/s. 221(1). The ITAT upheld the order of CIT(A), aggrieved by which the Revenue filed an appeal before Bombay HC.

Revenue argued that payment of interest u/s. 234(A)/(B)/(C) is mandatory and the same would form part of the 'arrears of tax'. Further, since interest forms part of amount chargeable to tax u/s. 156 of the Act, the penalty under Section 221(1) is also imposable. The assessee argued that tax, interest and penalty are separate components and that the term "tax" would not include penalty or interest.

HC referred to Section 2(43) and noted that as per the given section "tax" means income-tax, super tax and/or the fringe benefit tax to be charged under provisions of the Act, and thus the interest component is not included in the definition of tax. Provisions of Section 221 should be strictly construed to the words used so that anything not included within the scope of the language should be excluded. HC stated that the aspect of default in payment of tax and the amount of interest payable should be treated as distinct and separate components. HC stated that Sec. 221 specifically stated that, when assessee is in default for payment of tax, he shall in addition to arrears and interest payable u/s. 220(2), also pay penalty which should not exceed tax in arrears. "Default in making a payment of tax and amount of interest payable" were to be considered separate for imposition of penalty which should be levied only on account of default in making a payment of tax and shall not exceed amount of tax in arrears. HC also clarified that penalty for non-payment of tax was in addition to the levy of interest u/s. 220(2) and by no interpretation did arrears of tax u/s. 221 include interest payable u/s. 220(2). HC observed that even notice of demand u/s. 156 defines tax, interest, penalty and fine separately.

Observing that Sec. 221(2) stated that if the amount of tax on which penalty was levied is reduced, the penalty shall be cancelled and amount of penalty paid shall be refunded. HC remarked that this clarifies the fact that payment of penalty was directly linked to default in payment of tax and not of interest.

Further, HC relied on SC ruling in *Harshad Shantilal Mehta* [*(1998) 231 ITR 871*] wherein it was observed that, definition of tax u/s. 2(43) does not include penalty or interest.

HC thus held that the phraseology "tax in arrears" as envisaged in Sec. 221 of the Act would not take within its realm the interest component. Ruling in favour of assessee, HC remarked that *"the Assessing Officer can impose penalty for default in making the payment of tax, but the same shall not exceed the amount of tax in arrears. Tax in arrears would not include the interest payable under Section 220(2) of the Act."*

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LD/66/14

Director of Income Tax vs. Nomura India Investment Fund, Mother Fund 15th June 2017

HC deletes penalty u/s. Sec. 271(1)(c) on wrong claim of carry forward of long term capital loss on sale of shares and not setting it off against exempt long term capital gains LTCG u/s. 10(38); Assessee observed to be under a bonafide interpretation of Section 10(38).

The assessee is an approved Sub- Account of the master Trust Bank of Japan (foreign institutional investor) registered with SEBI. While computing the total income, the assessee did not set off long term capital loss of ₹80.64 crore from long term capital gain of ₹697.70 crore, which was exempt u/s. 10(38) of the Income-tax Act. The Assessee by way of a note in his return reserved rights for carry forward of LTCL of ₹80 Cr. AO considered claim of the assessee as inadmissible and initiated penalty proceedings u/s. 271(1)(c) for ₹17.02 Cr. The CIT(A) rejected assessee's claim however ITAT allowed assessee's appeal.

Before HC, Revenue contended that assessee had furnished inaccurate particulars of income and provisions of Sec. 271(1)(c) were required to be invoked. Further, Revenue also pointed out that the provisions of

[1] *Contributed by CA. Sahil Garud, CA. Mandar Telang, Indirect Taxes Committee, Committee on International Taxation, Vaish Associates Advocates, Insolvency and Bankruptcy Laws Group, Disciplinary Directorate and ICAI's Editorial Board Secretariat.*
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Sec. 271(1)(c) would also be invoked where the amount is added or disallowed in computing total income or loss of an assessee in any order of assessment, even in case of loss not being shown. Assessee stated that it had given a note to reserve the rights to carry forward the loss of ₹80 Cr. and that the return was filed by him based on *bonafide* interpretation of Sec. 10(38) which categorically states that any income arising from the transfer of a long term capital asset, being an equity share in a Company or a Unit of an equity oriented fund. The said provisions contemplate income but do not take within its ambit the loss.

HC held that, provisions of Sec. 271(1)(c) can be invoked only when the conditions laid down in Sec. 271(1)(c) were satisfied. HC observed that assessee had disclosed LTCL of ₹80 Cr. in the return and a note was also given by him reserving right to carry forward the loss. HC stated that note was given by assessee considering Sec. 10(38) of the Act. HC remarked that *"Assessee bonafidely believed that under Section 10(38), the loss is not required to be considered and only income is required to be considered relying on the phraseology of the said provision. In the present matter, we are not testing the interpretation on the provisions of Section 10(38). However, suffice it to state that the assessee bonafidely and in good faith acted upon the said interpretation"*. Further HC observed that there was no effect on tax liability due to not setting off loss of ₹80 Cr.

HC thus ruled in favour of assessee and directed to drop the penalty proceedings.

LD/66/15

The Commissioner of Income Tax

vs.

K.V. Mohammed Zakir

10th April 2017

Section 47(xiv) of the Income-tax Act – Transfer of business from proprietorship to a company

In order to avail exemption under Section 47(xiv), the consideration should only be by way of issue of shares; capital gain exemption denied by the High Court as only partial consideration received as issue of shares, and balance was reflected in the current account as loan.

K. V. Mohammed Zakir was carrying on a sole proprietary concern having the business of civil constructions on a contract basis; which was run up to September 30, 2000. Thereafter, the sole proprietorship was taken over by KAP (India) Projects and Constructions (P) Limited ('the Company'). The proprietorship had transferred the complete business consisting of all the assets amounting to ₹9,64,39,231.19 [including goodwill value of ₹2,45,00,000/-] and the liabilities amounting to ₹4,47,35,333.56 to the company. As against the net assets of ₹5,17,03,897.63 taken over, an amount of ₹1,52,94,900/- represented the value of 1,52,949 shares of face value of ₹100/- each and the balance amount was payable at the end of the year, which was shown as 'amount due to the assessee' under "unsecured loans" due to the assessee. The assessee contended that conditions prescribed u/s. 47(xiv) had been complied with, and the transfer of business shall not attract capital gains.

The CIT issued a notice to revise the assessment u/s. 263, and opined that all the conditions u/s. 47(xiv)(c) were not satisfied in the case of the transfer of proprietary concern to the Company. The CIT opined that capital gains exemption will not be available and transfer of goodwill would be taxable under the head 'Capital gain'.

On first appeal, ITAT considered the amount in the current account of the proprietorship concern, as a 'loan to the proprietor', which was stated as taken over by the Company and extended capital gains exemption benefit.

On appeal by the Revenue, the Kerala HC rejected the reasoning given by ITAT in its order that 'deficit' has to be treated as 'loan' given by the proprietorship concern, to the proprietor and that conditions u/s. 47(xiv)(c) were complied. The HC noted that *"under no circumstances can a person borrow from himself and transpose as 'creditor' and 'borrower' at the same time. To this extent, 'proprietor' and 'proprietorship concern' are not two different entities. Whatever is pumped in by the 'proprietor' to his proprietorship, is nothing other than investment and it forms part of the asset, which, when taken over by the Company, will have to be compensated"*. Further, the HC stated that *"Though the amount actually did not come to the hands of the assessee/proprietor, the moment it is shown as 'loan' repayable to the proprietor, there results an indirect admission that the said amount had already come to the credit of the proprietor/assessee; from whom the Company had taken over the 'loan'"*. In view of the HC that part of the consideration was paid by the Company to the proprietor pursuant to taking over the proprietorship concern with all the assets and liabilities; which included the cost of the 'goodwill' as well, to an extent of ₹2.45 crore and the total number of shares transferred was only worth of ₹1.52 crore which was a clear deficit, and was never paid or satisfied in the form of shares as envisaged

u/s. 47(xiv)(c). On review of Section 47 (xiv)(c), the HC noted that it is quite categoric, that the proprietor shall not receive any consideration or benefit directly or indirectly, in any form or manner, other than by way of allotment of shares in the Company. Thus HC highlighted that *"When the Statute says something to be done in a particular manner, it shall be done only in that manner and not in other manner"*.

HC also commented that the order of ITAT resulted in 'stretching the proceedings/provisions even beyond the logical limits'. Further, the HC reaffirmed that *"there cannot be any agreement contrary to the provisions of law... The role of two different persons/entities and their status unfortunately has been conferred upon the same person, i.e. the 'proprietor'; thus propounding a strange proposition that the 'proprietorship concern' had borrowed an amount from the 'proprietor', to be satisfied in the due course on demand; which liability in turn was stated as taken over by the Company"*.

Transfer Pricing

LD/66/16

Commissioner of Income Tax

vs.

Aurionpro Solutions Limited

09th June 2017

LIBOR + 2% approved as arm's length interest rate in respect of interest free advances given by assessee to its wholly owned subsidiaries in USA, Singapore and Bahrain, by Bombay High Court; LIBOR+3% adopted by TPO rejected.

The assessee is engaged in the business of software development and web designing services. Assessee had granted interest-free loans to its wholly owned subsidiaries in USA, Singapore and Bahrain as working capital advances. Assessee benchmarked the transactions at cost plus zero mark-up. However, the TPO held that in a comparable uncontrolled situation such advances would have been liable to interest and thereby levied interest at LIBOR plus 3%. ITAT upheld TP-adjustment on the basis of LIBOR plus 2%.

ITAT held that interest free advances to wholly owned subsidiary are undoubtedly within the ambit of international transaction, relying on ITAT decision in *Tata Autocomp Systems Ltd. [2015] 56 taxmann.com 206]*. ITAT also noted that interest on Bank FD for a term equivalent to the term of loan to AEs would be the safest comparable.

Before HC, Revenue raised the question whether ITAT was justified in directing the AO to determine the Arm's Length interest by considering the LIBOR (London Inter Bank Operative Rate) plus 2% on the monthly closing balance of the advances. Revenue submitted that since the advances had been given in India, the rate of interest as applicable in India ought to have been applied.

Referring to the decision in the case of *Tata Autocomp*, HC noted that ALP in the case of loans advanced to Associate Enterprises would be determined on the basis of rate of interest being charged in the country where the loan is received/consumed. Relying on decision in case of *Tech Mahindra Limited [[2011] 12 taxmann.com 132 (Mum).]*, HC observed that *"When there is a choice between the interest rate of a currency other than the currency in which transaction has taken place and the interest rate in respect of the currency in which transaction has taken place, in our considered view, the latter should be adopted.....The LIBOR rate naturally will be considered to determine the Arm's Length interest, the same would be reasonable and proper in applying the commercial principle."*

HC thus upheld ITAT's direction for adopting LIBOR plus 2% instead of LIBOR plus 3% adopted by TPO.

LD/66/17

BNT Global (P.) Ltd.

vs.

Income Tax Officer

Mumbai Tribunal

Foreign inward remittance on account of share capital and share premium would fall within parameters of international transaction within meaning of Section 92B, henceforth penalty under Section 271BA for non-filing of Form 3CEB upheld

Facts:

The assessee had received foreign inward remittance from its Director as well as beneficial shareholder who was an NRI, on account of share capital and share premium.

In the Assessement Proceedings, the Assessing Officer ('AO'), noted that since the assessee had entered into an international transaction receiving foreign inward remittance from its Director as well as beneficial shareholder who was an NRI, on account of share capital and share premium, it was required to file Audit Report in Form No. 3CEB in respect of the said international transaction. In view of assessee's failure to file the Audit Report in Form 3CEB, the AO passed a penalty order under Section 271BA.

The Commissioner of Income-tax (Appeals) ('CIT(A)') confirmed said penalty order.

The issue that required consideration was whether the AO was right in considering the foreign inward remittance of share capital and share premium as 'international transaction' under Section 92B of the Act. Consequently, whether penalty under Section 271BA of the Act be levied for non-filing of Form 3CEB.

Held:

The Hon'ble ITAT, drawing support from the findings rendered by the Coordinate Bench in the case of *IL&FS Maritime Infrastructure Co. Ltd.* (*37 taxmann.com 297*) observed that the share investment transactions shall fall within the purview of Section 92E of the Act and the assessee is required to file Audit Report in Form 3CEB for such transactions, by the prescribed date, before the authorities concerned and that failure to do so would attract levy of penalty under Section 271BA of the Act.

Further, the Hon'ble ITAT distinguished the decision of Hon'ble Bombay High Court in case of *Vodafone India Services (P.) Ltd. vs. Union of India* (*50 taxmann.com 300*) which did not deal with penalty under Section 271BA of the Act. The Hon'ble ITAT concluded that the assessee had no reason which prevented by reasonable and sufficient cause from getting the Audit Report in Form 3CEB prepared by an Accountant in the prescribed proforma and filing the same before the concerned authority within the time specified, as stipulated under Section 92E of the Act.

The Hon'ble ITAT further concluded that transactions of share investment, as entered into by the assessee in the case on hand, clearly fall within the ambit of the provisions of Section 92E of the Act since the international transaction of investment in share capital of the assessee by the NRI Director of the assessee company falls within the ambit of Section 92E of the Act.

Thus, the failure on the part of the assessee to furnish the Audit Report in Form 3CEB from an Accountant in the prescribed proforma within the prescribed period, without reasonable cause, is a clear violation of the provisions of Section 92E of the Act and therefore upheld the levy of penalty under Section 271BA of the Act.

Legal Update

International Taxation

LD/66/18

DIT

vs.

Vanenburg Facilities BV

Telangana High Court

Sale of shares of Indian company by Dutch company covered under Article 13(5) of the India - Netherlands DTAA and hence not taxable in India. Revenue's approach of treating sale of shares as sale of immovable property as per Article 13(4) of the DTAA is not tenable

Facts:

Vanenburg NL, is a company incorporated in Netherlands and has a wholly owned subsidiary, namely Vanenburg IT Park India Private Limited (VITIPL), in India. VITIPL is engaged in the business of developing, operating and maintaining infrastructure facilities in India. Vanenburg NL sold 100% shares of VITIPL to Ascendas, a Singapore based company.

The question arose regarding the gains arising on transfer of shares of VITIPL to Ascendas is taxable as capital gains in India in view of the India –Netherland Tax Treaty under para (1),(4) or (5) of Article 13.

Held:

Andhra Pradesh and Telangana HC upheld ITAT order for AY 2005-06 in favour of Vanenburg NL, capital gains arising to Vanenburg NL (a Dutch company) on sale of shares of its Indian subsidiary (holding investment in IT park) to Singapore buyer, not taxable in India under India-Netherlands DTAA.

The HC directed Revenue to expeditiously issue refund to assessee of the TDS deducted and deposited by the purchaser. The HC noted that AO and CIT(A) erred in applying Article 13(1) of the DTAA by equating alienation of a company's shares to alienation of its immovable property and held that the ludicrous logic that shares partake the character of immovable property be applied here.

The HC cited legal distinction between 'share sale' and 'asset sale' as summed up by SC in *Vodafone case*. The HC also approved ITAT's findings that alienation of shares by assessee does not fall under Article 13(1) of the DTAA and by virtue of residuary clause in Article 13(5), gains will be exempt from taxation in India.

Article 13(4) of the DTAA deals with taxability of gains arising from alienation of company shares, the value of which is principally derived from immovable property other than that used in the business of such company. Article 13(5) of the DTAA is the residuary clause which provides that gains from the alienation of any property other than that referred to other paragraphs shall be taxable only in the State of which the alienator is a resident. Further, the HC accepted assessee's objection to Revenue's claim raised first time before the HC of seeking to tax the transaction under Article 13(4) of the treaty. HC noted that both AO and CIT(A) explicitly held that Article 13(4) did not apply to the transaction and later neither CIT nor AO/CIT(A) took remedial steps. The HC also rejected Revenue's argument that applicability of Article 13(4) to share sale is a pure question of law and observed that *"Whether immovable property from which the company's shares principally derived their value was property in which the business of the company was carried on or not is a question of fact"*.

With respect to interest paid by the purchaser to compensate for the delay in remitting the sale consideration, HC upholds ITAT order that such interest was not taxable u/s. 9(1)(v) of the Act as "*there is no evidence of a debt being incurred or monies being borrowed for any business purposes in present case.*" Sec. 9(1)(v) of the Act provides that income by way of interest payable by a person who is a non-resident would be deemed to be income accruing or arising in India, where such interest is payable in respect of any debt incurred, or monies borrowed and used, for the purposes of a business or profession carried on by such person in India.

Further, HC affirmed applicability of Article 11 of the DTAA (which provides taxability in Netherlands), and rejected Revenue's stand that Article 11 was not applicable as it excludes penal interest. Article 11(1) of the DTAA provides that interest arising in one of the States and paid to a resident of the other State would be taxed in that other State. Article 11(6) defines 'interest' to mean income from debt-claims of every kind, but penalty charges for late payment shall not be regarded as interest for the purpose of the said Article. Referring to the Share Purchase Agreement, HC observes that the purchaser "*voluntarily undertook to pay interest for such late payment of the sale consideration, the same does not partake the character of penalty charges.*"

Accordingly, the HC in the above discussed case held that the shares in a company owning immovable property cannot itself be considered as immovable property.

Service Tax

LD/66/19

N. K. Bhasin
vs.
Union of India
30th May 2017

Constitutional validity upheld by High Court, regarding levy of service tax on renting of immovable property in terms of Sections 75(A)(6)(h) and 77 of Finance Act, 2010 amending 65(105)(zzzz) of Finance Act, 1994 with retrospective effect from June 1, 2007.

The instant petition has been instituted before the HC challenging the constitutionality of Sections 75(A)(6)(h) and 77 of Finance Act, 2010 and Sections 65(90)(a) which defines the term 'renting of immovable property' and Section 65(105)(zzzz) which defines 'taxable service pertaining to renting of immovable property' r/w Section 66 of Finance Act, 1994 as amended by Finance Act, 2007 and Finance Act, 2010. Further, the petitioners also challenged the validity of Circular No. 98/1/2008-ST dated January 04, 2008 and Notification No. 24/2007 dated May 22, 2007.

HC observed that the Delhi HC in *Home Solution Retail India Ltd. vs. UOI* [*2009 (22) VST 50*] held that Section 65(105)(zzzz) does not in terms entail that renting out of immovable property for use in the course or furtherance of business of commerce would by itself constitute a taxable service and be exigible to service tax under the said Act. While interpreting circular, it was found obnoxious and beyond the said provision. The High Court therefore, struck down the same. Thereafter, Parliament has made further amendment by Finance Act, 2010 in Section 65(105)(zzzz) and the substantive provision under Clause (zzzz) is amended and given retrospective effect from 01.06.2007 while Clause (v) inserted in Explanation I to Section 65(105)(zzzz) has been given effect from the date of amendment. The amended provision and its retrospective amendment was challenged in P&H HC in case of *Shubh Timb Steels Ltd. vs. UOI* [*2010 (236) CTR 562 (P&H)*], wherein HC has upheld the retrospective amendment and negatived arguments that service tax on service of renting of property is exclusively covered by Entry 49 List II and therefore, rejecting argument of lack of legislative competence.

Further, the Orissa HC has also examined validity of Section 65(90a) and 65(105)(zzzz) as amended by Finance Act, 2007, 2008 and 2010 in the case of *Utkal Builders Limited vs. Union of India* [2011 (22) S.T.R. 257

(Ori.)], wherein the judgment of *Shubh Timb Steels Ltd.* was referred. Subsequently, a full Bench of Delhi HC in *Home Solutions Retails (India) Ltd vs. UOI* [2011 (STR) 129], overruled its earlier judgment in *Home Solution Retail India Ltd. (supra)* and held that amendments made with retrospective effect are nothing but clarificatory and by way of *ex abundant cautela*. It has also held that there is no lack of competence and earlier Bench did not properly appreciate Section 65(90a).

HC noted that various HCs have affirmed amendments which are under challenge in these writ petitions and against which appeals are pending before SC. HC therefore adopted the reasoning given in these judgments and refrained from making the judgment repeating the same. Thus, HC upheld the validity of the aforesaid provisions and dismissed the writ petitions.

LD/66/20

Superfil Products Pvt. Ltd.
vs.
Principal Commissioner of Central Excise
CESTAT-MAD
Chennai-I

Tribunal allowed service recipient's entitlement to CENVAT credit of entire 100% service tax, which was paid by such recipient directly to the service provider, instead of paying 75% of said liability to government under reverse charge mechanism in terms of obligation casted upon recipient under Notification No. 30/2012-ST dated 20.06.2012.

Facts:

As per Notification No. 30/2012-ST dated 30.06.2012, appellant, being service receiver of security agency services was required to discharge 75% service tax liability under reverse charge mechanism and remaining 25% was payable by service provider. However, service provider paid entire 100% liability in present case and reflected the same in their ST-3 return. Appellant's claim of CENVAT credit of entire 100% service tax paid to such service provider was denied by the department merely on the ground that appellant not discharging 75% service tax liability under RCM which would tantamount to non-payment of service tax and hence taking the credit of same amounts to taking of excess credit.

Appellant submitted that though service tax was not paid by them under RCM, they have paid 100% service tax to the service provider. Appellant relied upon ratio laid down in case of *Kerala State Electronic Corporation vs. CC Kochi 1996 (84) ELT 44 (Tribunal)* which *inter alia* held that MODVAT credit is to be allowed as per the amount of duty indicated in the duty paying documents and whether the duty short paid or paid in excess is not relevant.

Held:

Tribunal noted that payment of service tax liability is not disputed in present case and only quibble is that such payment is not made in terms of manner prescribed under Notification No. 30/2012-ST in the ratio of 75:25 by service recipient and provider respectively. Tribunal found that while laying down mechanism for distribution of tax liability between provider and recipient, said notification nowhere proclaims that 100% tax is discharged by service provider and suffered by service recipient, it would debar said recipient from availing CENVAT credit thereof. Accordingly, Tribunal held that as the said notification only lays down proportion of tax liability which the service recipient and service provider are "liable to pay", that cannot be considered as bar on CENVAT availment if the service tax liability on activity involved is paid to the government and has also been passed on to and borne by service recipient. Accordingly, Tribunal held there is no violation of Rule 3 of CENVAT Credit Rules, 2004 and thus, appellant was allowed CENVAT credit of entire 100% service tax liability paid by them to service provider.

Excise

LD/66/21

Commissioner of Central Excise
vs.
Tamil Nadu Petro Products Limited
13th June 2017

Mere failure to declare/disclose clearance of waste and scrap in Returns does not amount to 'suppression' absent "intention to evade payment of excise duty" so as to invoke extended period of limitation u/s 11A of Central Excise Act

Assessee is engaged in manufacture of linear alkyl benzene (LAB) and Epichloro hydrin, which are classified under sub-heading 3817.00 and 2910.00 of Central Excise Tariff Act respectively. Assessee was availing credit of specified duty paid on the inputs, viz., Lube oil, Hot oil, Activated Alumina, Sulphuric Acid and Pacal Catalyst, which were used in the manufacture of LAB. Upon the use of such inputs, they were cleared as waste and scrap however the assessee did not disclose the same in its returns filed in Form RT-12.

A surprise inspection was carried out which resulted in issuance of show cause notice imposing a

duty of ₹12.68 Lakhs related to aforementioned scrap while invoking extended limitation period. Penalty was also sought to be levied u/s. 11AC of Central Excise Act and Rule 9(2) and 173Q of Central Excise Rules 1944. The matter was ruled against the assessee at CESTAT level, aggrieved by which the assessee approached the HC.

According to it, law for most part of the period in issue was in a state of flux with regard to exigibility of waste/scrap. Given this state of law, assessee was well within its right to hold *bonafide* belief that waste and scrap were not excisable goods, and therefore, not amenable to duty. Moreover, assessee submitted that mere non-disclosure of clearance of such waste/scrap would not necessarily lead to a conclusion that there was suppression with an intention to evade payment of excise duty. In this regard, assessee relied on *Padmini Products vs. Collector of C.Ex [1989 (43) ELT 195 (SC)].*

Perusing Section 11A, HC observed that where excise duty was not levied/paid or had been short levied or short paid or erroneously refunded, the Revenue within 6 months from the relevant date, could serve a show cause notice to assessee to call upon him to pay the requisite amount. The defining principle for invoking the extended period of limitation was that there should be an "intention to evade payment of duty". HC observed that, in so far as the waste and scrap were concerned, clearly there was an uncertainty for a long period of time as to whether or not they were excisable goods and various orders of CESTAT showed that law on the subject was in fact, in a state of flux.

HC remarked that "mere failure to make declarations and disclosures in the returns, in the given facts and circumstances, would amount to an "intention to evade payment of excise duty". HC relied on decision of SC ruling in *Padmini Products vs. Collector of C. Ex., [1989 (43) ELT 195 (SC)]* wherein it was held that, *"....before the extended period could be invoked against the noticee "something positive other than a mere inaction or failure on the part of the manufacturer or the producer had to be shown"..."*

Further, HC observed that the payment of penalty u/s. 11AC would follow only if there was finding of fact regarding escapement of duty due to a conscious and deliberate wrong doing on the part of the assessee, which was not an inference in the instant case.

HC thus ruled in favour of assessee.

Legal Update

Securities and Exchange Board of India

SEBI
Mr. S. Rajagopal and Mr. V. K. Ramani, Independent Directors of Zylog Systems Limited
WTM/GM/EFD/26/JUNE/2017

The Securities and Exchange Board of India ("SEBI") in its order in respect of Mr. S. Rajagopal and Mr. V. K. Ramani, Independent Directors of Zylog Systems Limited, dated June 20, 2017, observed that the independent directors of a company will not be liable for the failure of such company to pay out the declared dividends if it is seen that they had fulfilled their duties as independent directors satisfactorily.

Facts and arguments:

Zylog Systems Limited ("Zylog") had declared dividend to its shareholders. This dividend was not disbursed by Zylog, and SEBI acting upon a multitude of complaints by the disgruntled investors sent a letter to Zylog seeking information regarding declaration and payment of dividend under the Companies Act, 1956 (the "Act") and reasons for default with respect to the same. Zylog replied to the above letter pleading liquidity crunch and furnished the list of directors of the company at the time of declaration. As a result, SEBI issued show-cause notices to all directors, including to Mr. S. Rajagopal and Mr. V. K. Ramani who served as the independent directors at the time when the dividend was declared. The show-cause notices were issued for violation of S. 205(1A) and S.207 of the Act, which obligates directors of a company to deposit the amount of dividend declared into a separate bank account within 5 (five) days of the declaration, and provides penalty for failure to distribute dividends within 30 (thirty) days respectively.

In response to the show-cause notice, both the independent directors pleaded that they were not involved in the day-to-day functioning of Zylog. They were made aware about the default in payment of dividend at various instances in November, 2012. Mr. Rajagopal was also the Chairperson of the Audit Committee, which raised concerns and reservations regarding the non-payment of dividends, and sought to bring the concern about the same to the notice of the board of directors and ensure that the management complies with what was a statutory obligation. In the board meeting held on November 14, 2012, the matter regarding the non-payment of the dividends had been brought up before the board and reservations had been raised about the same. The board took note of the reservation of the Audit Committee and Mr. Rajagopal regarding the default. Eventually, Mr. Rajagopal tendered his resignation as a director on November 20, 2012 and Mr. Ramani followed suit on January 2, 2013. In the light of the minutes of these meetings, and copy of minutes as an evidence of the same, the independent directors pleaded that they had acted promptly and diligently, and hence should not be held liable for the default.

Observations of SEBI and decision:

SEBI held that the duties of the independent director include guiding the management, working in the best interests of the company, protecting the minority shareholders and ensuring compliance of the company to statutory duties or obligations. In the present matter, SEBI noticed that the noticees had strongly expressed reservations against the non-payment of dividends and attempted to convince the management to ensure that the payment is made as it was a statutory obligation. Once the advice was not heeded to, they submitted their resignations. Since as independent directors they were not involved in the day-to-day functioning of the company and that they discharged their own duties satisfactorily, the liability could not be imputed upon them. Hence, no directions were passed against Mr. Rajagopal and Mr. Ramani and the show-cause notice was accordingly disposed of.

Insolvency and Bankruptcy Code

Sree Metaliks Limited and Anr.
vs.
Union of India & Anr.
High Court of Calcutta
07th April, 2017

Section 7 read with Section 61 of the Insolvency and Bankruptcy Code, 2016 read with Rule 4 of the Insolvency and Bankruptcy (Application to Adjudication Authority) Rules, 2016 and Section 424 of the Companies Act, 2013 – Initiation of Corporate Insolvency Resolution Process by Financial Creditor

Facts:

An application under Section 7 of the Insolvency and Bankruptcy Code, 2016 was filed against the first petitioner (Corporate Debtor) before the NCLT Kolkata Bench. According to the first petitioner it had received a notice from a firm of practicing Company Secretaries with regard to the filing of the Company Petition however the notice does not contain any information as to the date of hearing of the company petition. The Corporate Debtor further contended that NCLT had proceeded to admit the company petition without affording any opportunity of hearing to it and therefore NCLT had acted in breach of the principles of natural justice in doing so. The order of NCLT was assailed by the Corporate Debtor before the NCLAT. The Corporate Debtor submitted that it had no objection to the admission of the Insolvency petition but objected to the appointment of the IRP. However, it did not press the point of breach of the principles of natural justice before NCLAT. The NCLAT disposed the appeal and only replaced the IRP appointed by the NCLT.

A writ petition was filed before the Calcutta High Court by the Corporate Debtor on the ground that Section 7 of the Insolvency and Bankruptcy Code, 2016 (Code of 2016) and the relevant Rules under the Insolvency and Bankruptcy (Application to the Adjudicating Authority) Rules, 2016 are vires as it does not afford any opportunity of hearing to a corporate debtor in a petition filed under Section 7 of the Code of 2016.

Decision:

In the scheme of the Code of 2016, an application under Section 7 of the Code of 2016 is to be first made before the NCLT. An appeal of the order of NCLT will lie before the NCLAT. NCLT and NCLAT are constituted under the provisions of the Companies Act, 2013 (Act, 2013). The procedure before the NCLT and the NCLAT is guided by Section 424 of the Companies Act, 2013.

Section 424 of the Companies Act, 2013 requires the NCLT and NCLAT to adhere to the principles of natural justice above anything else. It also allows the NCLT and NCLAT the power to regulate their own procedure. Fretters of the Code of Civil Procedure, 1908 does not bind it. However, it is required to apply its principles. Principles of natural justice require an authority to hear the other party. In an application under Section 7 of the Code of 2016, the financial creditor is the applicant while the corporate debtor is the respondent. A proceeding for declaration of insolvency of a company has drastic consequences for a company. Such proceeding may end up in its liquidation. A person cannot be condemned unheard. Where a statute is silent on the right of hearing and it does not in express terms, oust the principles of natural justice, the same can and should be read into in. When the NCLT receives an application under Section 7 of the Code of 2016, therefore, it must afford a reasonable opportunity of hearing to the corporate debtor as Section 424 of the Companies Act, 2013 mandates it to ascertain the existence of default as claimed by the financial creditor in the application. The NCLT is, therefore, obliged to afford a reasonable opportunity to the financial debtor to contest such claim of default by filing a written objection or any other written document as the NCLT may direct and provide a reasonable opportunity of hearing to the corporate debtor prior to admitting the petition filed under Section 7 of the Code of 2016. Section 7(4) of the Code of 2016 requires the NCLT to ascertain the default of the corporate debtor. Such ascertainment of default must necessarily involve the consideration of the documentary claim of the financial creditor. This statutory requirement of ascertainment of default brings within its wake the extension of a reasonable opportunity to the corporate debtor to substantiate by document or otherwise, that there does not exist a default as claimed against it. The proceedings before the NCLT are adversarial in nature. Both the sides are, therefore, entitled to a reasonable opportunity of hearing.

The requirement of NCLT and NCLAT to adhere to the principles of natural justice and the fact that, the principles of natural justice are not ousted by the Code of 2016 can be found from Section 7(4) of the Code of 2016 and Rule 4 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016. Rule 4 deals with an application made by a financial creditor under Section 7 of the Code of 2016. Sub-rule (3) of Rule 4 requires such financial creditor to despatch a copy of the application filed with the Adjudicating Authority, by registered post or speed post to the registered office of the corporate debtor. Rule 10 of the Rules of 2016 states that, till such time the Rules of procedure for conduct of proceedings under the Code of 2016 are notified, an application made under sub-section (1) of Section 7 of the Code of 2017 is required to be filed before the Adjudicating Authority in accordance with Rules 20, 21, 22, 23, 24 and 26 or Part-III of the National Company Law Tribunal Rules, 2016.

Adherence to the principles of natural justice by NCLT or NCLAT would not mean that in every situation, NCLT or NCLAT is required to afford a reasonable opportunity of hearing to the respondent before passing its order.

In a given case, a situation may arise which may require NCLT to pass an ex-parte ad interim order against a respondent. Therefore, in such situation NCLT may proceed to pass an ex-parte ad interim order, however, after recording the reasons for grant of such an order and why it has chosen not to adhere to the principles of natural justice at that stage. It must, thereafter proceed to afford the party respondent an opportunity of hearing before confirming such ex-parte ad interim order.

In the facts of the present case, the petitioner submits that, orders have been passed by the NCLT without adherence to the principles of natural justice. The petitioner was not heard by the NCLT before passing the order. It would be open to the parties to agitate their respective grievances with regard to any order of NCLT or NCLAT as the case may be in accordance with law. It is also open to the parties to point out that the NCLT and the NCLAT are bound to follow the principles of natural justice while disposing of proceedings before them.

In such circumstances, the challenge to the vires to Section 7 of the Code of 2016 fails.

Disciplinary Case

CA. RVD In re:

Facts of the case:

A letter dated 24th October, 2008 was received from the Joint Commissioner (Audit), Central Excise & Customs, Surat containing certain allegations against CA. RVD (hereinafter referred to as the *"Respondent"*). On receiving the aforesaid letter, the Joint Commissioner (Audit) was requested to file a formal complaint in prescribed Form 'I'. But he did not file the same. In the absence of formal complaint and on overall examination of allegations, it was treated as *"Information"* within the meaning of Rule 7 of the Chartered Accountants (Procedure of Investigations of Professional and Other Misconduct and Conduct of Cases) Rules, 2007 (herein after referred to as the "Rules"). As per the information letter, the allegations in brief were as under:-

- During the course of scrutiny of documents submitted by M/s. SIL (hereinafter referred to as the "Company"), Central Customs & Excise Department observed that there were some discrepancies in the quantity of raw material consumption, production and sales in audited Annual Report for the financial years 2005-06, 2006-07 and Tax Audit Report for the financial year 2006-07. The Tax Audit Report of the Company was certified by the Respondent and it seems that the Company's Auditor have not verified the accounts.

The matter was enquired into by the Disciplinary Committee and the Committee, *inter alia*, gave its findings as under:

The Committee noted that there were several mistakes, omissions and commissioning in the Financial Statements of the Company for the financial years 2005-06 and 2006-07 which were audited by the Respondent. The Committee also noted the admission of the Respondent about the mistakes and omissions as also his submission that the mistakes/omissions did not result in any loss to the Central Excise Department.

Briefly, the omissions and commissions in the financial statements of the Company which were attested by the Respondent are as under:

(figures in M.T.)

Source Document	Figures As given in letter (as per old figures)			New Figures As per corrected statement		
	Raw Material consumption	Production	Sales	Raw Material consumption	Production	Sales
Annual Report 2005-06	3405.622	6870.380	5755.415	3815.198	6836.000	4565.858
Annual Report 2006-07	4359.479	5587.099	6520.461	4657.962	6778.051	4622.758
Tax Audit Report 2006-07	5093.540	5196.792	3799.446	6678.527	6778.047	4622.752

The Committee noted that in the financial statements of the Company for the years 2005-06 and 2006-07, the sales of finished goods were disclosed inclusive of Inter Branch transfer whereas as per the Accounting Standard – 9, Revenue Recognition, the Inter Divisional Transfer cannot be recognised as Sales/revenue as in case of inter-divisional transfers, risks and rewards remain within the enterprise and also there is no consideration from the point of view of the enterprise as a whole, the recognition criteria for revenue recognition are also not fulfilled in respect of inter-divisional transfers. However, in the present matter, the Company in its financial statements for the years 2005-06 and 2006-07 has shown the Sales/Revenue inclusive of Inter Unit/ Branch transfer in violation of the provisions of the Accounting Standard 9. Further, by adding the amount/quantity of Branch Transfer in the financial statements, the accounts were misstated and did not give a true & fair view of the affairs of the Company. In such circumstances, the Respondent ought to have disclosed the said fact in his Audit Report and/ or expressed qualified opinion. But the Respondent failed to do so.

The Committee further noted that the financial statements are very important documents for the stakeholders and the general public at large and they rely on the certification of Chartered Accountants for accuracy and the correctness of the same. The Committee also felt that the Respondent should have taken more care in ensuring that correct facts are stated in the financial statements so as to give true and fair view of the affairs/profit or loss of the Company.

The Committee though noted the admission of the Respondent of the mistakes in the financial statements, could not accept to his prayer that a lenient view may be taken of the mistakes. The Committee also noted that irrespective of the fact that there is no loss to the Government or anybody due to the above mistakes, the mistakes are very serious resulting in affecting the true and fair view of the financial statements. The Committee also felt that as a prudent professional, the Respondent ought to have exercised due care and caution and due diligence in certifying the financial statements with correct details. In view of the above, the Committee is of the opinion that the Respondent is guilty of professional misconduct falling within the meaning of Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949 {as amended by the Chartered Accountants (Amendment) Act, 2006}. The Disciplinary Committee, after giving an opportunity of hearing to the Respondent and after considering all the material on record, ordered that the name of Respondent be removed from the Register of Members for a period of one year.

The Respondent, aggrieved by the orders passed by the Disciplinary Committee preferred an appeal before the Appellate Authority bearing Ref.no. Appeal No. 17/ICAI/2011. The Appellate Authority found no merit in the appeal and accordingly, dismissed the same. The Respondent being aggrieved by the orders of Appellate Authority dismissing the appeal, approached Hon'ble High Court of Gujarat by filing a Special Civil Application No. 10813/2012 which was also dismissed as no case was made out to interfere in exercise of writ jurisdiction with the concurrent findings. The Respondent, aggrieved by the orders of Single Judge filed Letters Patent Appeal No. 28/2013 which was also dismissed. ■