Caselaw Analysis

CHYTHANYA K.K., B. Com, FCA, LLB

Advocate
#1109, 9th Main, Between Metro Pillars 303 and 304, Vijayanagar, Bangalore, Karnataka, India.
chyti@clclawyers.com, 09844114184

Doctrine of law of precedents : BPCL (2004) 8 SCC 579

1. Courts should not place reliance on decisions without discussing as to how the factual situation fits in with the fact situation of the decision on which reliance is placed
2. Court's observations are not to be read as Euclid's theorems
3. These observations must be read in the context in which they appear to have been stated
4. Judgments of Courts are not to be construed as statutes.
5. To interpret words, phrases and provisions of a statute, it may become necessary for Judges to embark into lengthy discussions but the discussion is meant to explain and not to define.
6. Judges interpret statutes, they do not interpret judgments.
7. They interpret words of statutes; their words are not to be interpreted as statutes

Ambiguity in exemption provision

Whether in favour of revenue or assessee?

Effect of decisions in Dilip Kumar and Ramnath

- Dilip Kumar (2018) 9 SCC 1 [CB]: In the context of an exemption notification, it was held that ambiguity in an exemption provision should be resolved in favour of department
- **Ramnath And Company Vs CIT** 2020-TIOL-100-SC-IT [DB]: Applied Dilip Kumar even in the context of income tax
- Dilip Kumar [supra] refers to Hari Chand Shri Gopal (2011) 1 SCC 236 [CB] which held that strict construction of exemption provision is subject to certain exceptions depending on the setting of the statute, object and purpose to be achieved.
- Dilip Kumar [supra] also refers State of West Bengal v. Kesoram Industries Ltd. [2004] 266 ITR 721 (SC); [2004] 10 SCC 201 [CB], : if the words are ambiguous and open to two interpretations, the benefit of interpretation is given to the subject. There is nothing unjust in the taxpayer escaping if the letter of the law fails to catch him on account of the Legislature's failure to express itself clearly
- Karnataka HC in Brigade Enterprises 429 ITR 511 Kar in para 12 notes that Dilipkumar followed Kesoram Industries

Effect of decisions in Dilip Kumar and Ramnath

- THE MAVILAYI SERVICE COOPERATIVE BANK LTD. & ORS.**TS-12-SC-2021 [three judges bench]: para 45 :** Section 80P of the IT Act, being a benevolent provision enacted by Parliament to encourage and promote the credit of the co-operative sector in general must be read liberally and reasonably, and if there is ambiguity, in favour of the assessee.
- **Moturi LakshmiTS-452-HC-2020(MAD) 428 ITR 462 para 8& 9** Madras HC chooses to follow a three judge bench of SC in Oxford University Press 247 ITR 658 SC over Dilip Kumar and Co

List of cases for discussion

1. National Co-operative Development Corp 427 ITR 288 SC
2. Pilcom 425 ITR 312 SC
3. Tiger Global AAR
4. Shree Choudhary Transport Company [2020] 426 ITR 289 (SC)
5. Exide Industries Ltd TS-212-SC-2020SC 425 ITR 1 SC
6. Maruti Suzuki India Ltd. [2020] 421 ITR 510 (SC)
7. Snowtex Investment Ltd (2019) 414 ITR 227 SC
8. Padmini Products 2020-TIOL-1797-HC-KAR-IT
9. KPTCL TS-570-HC-2020
10. Kemfin TS-284-HC-2020
11. Sessa Goa Ltd. 2020-TIOL-1185-HC-MUM-IT-Goa
12. Shree Rama Multi Tech TS-199-SC 2018, 403 ITR 426 SC
13. Shiv Raj Gupta TS-353-SC-2020/ [2020] 425 ITR 420 (SC)
14. Gondia Beedi Leaves Contractors Association (2020) 422 ITR 404 (Bom.Nag)

National Co-operative Development Corp 427 ITR 288 SC

Some important principles

National Co-operative Development Corp 427 ITR 288 SC - **Facts**

- Assessee was formed under NCDC Act, 1962

- Main object is to advance loans or grant subsidies to State Government for financing co-operative societies and provide loans and grants to National level co-operative societies and State level co-operative societies

- Main sources of funds are loans and grants from central government, repayment of loans granted, interest on loan and dividend and other realisations on investments

National Co-operative Development Corp 427 ITR 288 SC - **Facts**

- Assessee though a pass-through entity is a distinct juridical entity
- Funds received from central government were treated as capital receipts and not charged to tax
- Interest earned on loans granted was treated as business income
- Issue is whether interest earned but disbursed as grant is eligible for deduction in computing the taxable income

National Co-operative Development Corp 427 ITR 288 SC - **Facts**

- AO denied deduction on the basis that such payment is capital in nature [on the basis that grants received from Central Government were also capital in nature]
- CIT(A) upheld the claim of the assessee under section 37(1)
- ITAT restored the order of AO on the basis that grants, additional grants and other sums received by assessee from Central Government went into a single fund and were not treated as income and therefore, disbursement therefrom also cannot be treated as revenue expenses
- High Court firstly held that interest on loans granted is to be regarded as business income
- High Court held all inflows formed one fund and monies advanced cannot be distinctly identified as forming part of interest income

Finding by SC : Characterisation

- The only business of the assessee is to receive funds and then to advance them as loans or grants.

- The interest income arose on account of the fund so received and it may not have been utilised for a certain period of time, being put in fixed deposits so that the amount does not lie idle.

- That the income generated was again applied to the disbursement of grants and loans.

- The income generated from interest is necessarily interlinked to its business and would, thus, fall under the head of 'profits and gains of business or profession'.

Finding by SC : Characterisation

- To decide the question as to whether a particular source of income is business income, one would have to look to the notions of what is the business activity.

- The activity from which the income is derived must have a set purpose.

- The business activity of the assessee-Corporation is really that of an intermediary to lend money or give grants.

- Thus, the generation of interest income in support of this only business (not even primary) for a period of time when the funds are lying idle, and utilised for the same purpose would ultimately be taxable as business income.

Finding by SC : Characterisation

- The fact that the assessee- Corporation does not carry on business activity for profit motive is not material as profit making is not an essential ingredient on account of self imposed and innate restriction arising from the very statute which creates the assessee-Corporation and the very purpose for which the assessee- Corporation has been set up.

- Impact of this observation on section 2(15) – 1st Proviso

Finding by SC : Taxability of income by way of interest

- The parties are at idem on taxability of interest as a revenue receipt

- The argument of diversion of income by overriding title was not applied qua income although the same was applied qua grants made out of such interest

- Ratio of Shree Rama Multi Tech Ltd. [2018] 403 ITR 426 SC – A possible stand that could have been taken.

Finding by SC : Allowability of deduction in respect of grant out of interest

- It is not a case of diversion of income of overriding income as the assessee had free play on the spread of its spending [viz either as loan or as grant etc.]

- This principle would apply, if the Act or the Rules framed thereunder or other binding directions bind the institution to spend the interest income on disbursal of grants

- Every application of income towards business objective of the appellant-Corporation is a business expenditure and nothing else

- The source of funds from which the expenditure is made is not relevant. It is also not really relevant as to whether the expenditure is incurred out of the corpus funds or from the interest income earned by the assessee-Corporation

National Co-operative Development Corp 427 ITR 288 SC - **Findings**

- SC did not agree with the revenue's contention of merger of all receipts into one single fund. According to SC, if it were so, interest received could not have been taxed as income
- SC held that in order to apply the doctrine of DOIBOT, there should be Act, Rules or other binding directions to bind assessee to spend the amount.
- In the instant case, assessee had the discretion to decide the grantee and therefore, DOIBOT does not apply
- Section 36(1)(xii) was introduced by FA 2003 wef 1.4.2001.
- Prior to insertion of the aforesaid provision, any outgoing covered by such provision is covered by section 37(1)

National Co-operative Development Corp 427 ITR 288 SC – **Take away**

- Interest is not ‘income from other sources’ by default.
- Character of payment cannot be determined by source of such payment
- Doctrine of DOIBOT could be seen in respect of non discretionary outgoings due to Act, Rules or other binding directions
- No estoppel on the assessee against his past tax treatment

PILCOM 425 ITR 312 SC

ACCRUAL OF INCOME AND WITHHOLDING

PILCOM 425 ITR 312 SC - **FACTS**

- ICC at London controls and conducts the game of cricket in the different countries of the world.
- India, Pakistan and Sri Lanka were selected to jointly host1996 World Cup
- These three host countries were required to pay varying amounts to the Cricket Control Boards/Associations of different countries as well as to ICC in connection with conducting the preliminary phases of the tournament and also for the purpose of promotion of the game in their respective countries.
- A Committee was formed by the three host members under the name PILCOM
- Bank accounts were opened by PILCOM in London to be operated jointly by Indian and Pakistan Cricket Boards
- Receipt from sponsorship, T.V. rights etc. were deposited and from which the expenses were met.

PILCOM 425 ITR 312 SC - **FACTS**

- The surplus in the Bank account was decided to be divided equally between Pakistan and India after paying a lump-sum amount to Sri Lanka Board as per mutual agreements amongst the three Boards

- BCCI appointed its own committee INDICOM for discharge of its responsibilities and functions.

- From the said Bank accounts in London, certain amounts were transferred to the three co-host countries for disbursement of fees payable to the umpires and referees and also defraying administrative expenses and prize money

PILCOM 425 ITR 312 SC – **Payments in Euro**

(i)	**Guarantee money paid to 17 countries which did not participate in the World Cup matches**	**17,00,000**	**Not taxable**
(ii)	Amounts transferred from London to Pakistan and Sri Lanka for disbursement of prize money in those countries	1,20,000	Not taxable
(iii)	Payment to ICC as per Resolution dated Feb. 2, 1993	3,75,000	Not taxable
(iv)	Payment for ICC Trophy for qualifying matches between ICC Associate members held outside India	2,00,000	Reimbursement and not taxable
(v)	Guarantee money paid to South Africa and United Arab Emirates both of which did not play any match in India	3,60,000	Not taxable
(vi)	Guarantee money paid to Australia, England, New Zealand, Sri Lanka and Kenya with whom double taxation avoidance agreements exist	8,85,000	Taxable 17/37
(vii)	Guarantee money paid to Pakistan, West India, Zimbabwe and Holland	7,10,000	Taxable 17/37

PILCOM 425 ITR 312 SC – **High Court's findings**

- Section 194E obliges TDS of monies covered by 115BBA irrespective of whether income is chargeable in India

- Rejected argument that source of income of the foreign association is the grant of the privilege for the bid money and have no relation to matches played in India

- DTAA is not applicable to the deductor wrt section 194E

PILCOM 425 ITR 312 SC

- Only PILCOM appealed
- Department did not challenge the finding wrt sl.(i) to (v) and hence the findings became final
- Proportionality [17/37] not being challenged by parties also became final

PILCOM 425 ITR 312 SC – **SC findings**

- Mere grant of privilege does not mean income did not accrue in India
- Place of entering into agreement is not relevant [Performing Rights 106 ITR 11 SC]
- Payments though described as guarantee money are intrinsically connected with matches played
- Source of income is playing of matches in India
- Section 115BBA(1)(b) uses ‘in relation to’ which connects match in India to payment guaranteed

PILCOM 425 ITR 312 SC **– SC findings**

- Obligation to deduct tax under section 194E is not affected by DTAA

PILCOM 425 ITR 312 SC – **Take away**

- Proportionality principle of 17/37 is recognised

- Playing of matches in India constitutes source of income in India. Conversely, playing matches outside, constitutes source of income outside India.

- This interpretation is crucial to section 9(1)(vi)/(vii) for exceptions contained in (b) and (c).

- Consider a case of onsite work executed to foreign customer and royalty/FTS payments made to overseas vendors

PILCOM 425 ITR 312 SC – **Take away**

- Finding on section 194E cannot be applied to section 195 as the latter refers to section 2(37A)(iii) which in turn refers to DTAAs

- Vodafone 341 ITR 1 SC wrt TDS obligations on NR

- Effect of Explanation 2 to section 195(1) by FA 2012 and absence of such Explanation in section 194E

- Status of PILCOM – resident or non resident

- At page 316 [where high court order is reproduced] it is held that that sec 163 applies to both actual income and deemed income. This seems contrary to section 160(1)(i).

Tiger Global International
116 Taxmann.com 878
AAR New Delhi

Indo Mauritius DTAA

Tiger Global AAR findings

- The shares of the Applicant companies are held by USA group.

- The value of shares held by Applicant companies in Singapore company was derived substantially from assets located in India

- Applicants are part of the USA group company and have been held through its affiliates through a web of entities based in Cayman Islands and Mauritius.

Tiger Global AAR findings

- The head and brain of the Applicant companies and their control and management was with USA company.

- Therefore, the USA company is the real owners of shares held by Applicant Companies in Singapore Company and the Applicant companies based in Mauritius are ‘see-through’ companies.

- The investment made by the Applicants in the Singapore Company, with Indian subsidiary, was with a prime objective to obtain Indo-Mauritius treaty benefit.

Tiger Global AAR findings on Indo Mauritius DTAA

- Objective of Article 13 of Indo-Mauritius DTAA was to allow exemption of capital gains on transfer of shares of Indian Company only and any such exemption on transfer of shares of the company not resident in India, was never intended by the legislature.

- In the instant case what the Applicant companies had transferred was shares of Singapore Company and not that of an Indian Company.

- Therefore, AAR ruled that exemption is not available to Applicant companies

Tiger Global AAR - comments

- Decision of AAR on tax avoidance is plainly contrary to Azadi Bachao 263 ITR 706 SC and Vodafone 341 ITR 1 SC
- Section 245R(2)(iii) – application relates to a transaction or issue which is designed prima facie for the avoidance of income tax
- Transaction [section 92F(v) – arrangement, understanding or action in concert] v. Arrangement [section 102(1)] - TOSAU
- Could the AAR decide the issue when GAAR provisions/MLI were not in place?
- Examine the case of TESLA, USA which has entered India through the Netherlands

Tiger Global AAR – comments on observations on DTAA

- Having rejected the application, AAR could have ended the matter

- AAR needlessly embarked on working under Article 13(3A) of Indo-Mauritius DTAA and held that the Indo-Mauritius treaty benefit is not available to Applicant companies

- It is a classic case of an absolute misconstruction of scheme of capital gains taxation enshrined in the Article 13

Tiger Global AAR – comments on observations on DTAA

- The position before the insertion of Article 13(3A) & (3B) through the protocol w.e.f. 01.04.2017

- Article 13(4) provided that the capital gains shall be chargeable to tax only the state of alienator [Circular No. 682 dated 30.03.1994]

- The position after the insertion of Article 13(3A), 13(3B) and amendment of Article 13(4)

Tiger Global AAR – comments on observations on DTAA

- Article 13(3A) : gains from the alienation of shares acquired on or after 01.04.2017 in a company which is resident of a contracting state may be taxed in that State
- Article 13(3B) : tax rate on aforesaid gains arising during 01.04.2017 to 01.04.2019 shall not exceed 50% of tax rate.
- Article 13(4) : gains from the alienation of any property other than the referred to in sub-articles 1, 2, 3 and 3A shall be taxable only in the Contracting State of which the alienator is a resident.

Shree Choudhary Transport Company [2020] 426 ITR 289 (SC)

Disallowance u/s 40(a)(ia)

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Facts

- Assessee, a partnership firm entered into contract with A Ltd for transporting cement. It was not owning any transport vehicles of its own. Hence it engaged the services of other transporters for the purpose. The cement marketing division of A Ltd, namely, G Ltd made payments to Assessee after deduction of TDS.

- It filed its return for AY 2005-06 showing Total Income of Rs. 2,89,633/- arising out of the business of 'transport contract’.

- AO observed that payments to truck owners were made directly by the Assessee and not the consignor company. As per the terms of contract assessee was responsible for transportation of goods.

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Facts

- The freight charges were paid to the truck operators/owners from the income earned. Remaining amount was shown as commission.

- Even though the payments were made on the same date, each payment > Rs.20,000/- was shown in the cash book in 2 parts and two separate vouchers were issued.

- AO disallowed Rs.57,11,625/- u/s 40(a)(ia) r/w 194C and Circular No. 715 dated 08.08.1995 (Each goods receipt note to be considered a separate contract). AO's view was consistently accepted by the CIT(A), ITAT and High Court.

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

Oral contracts :

- Applicable even in absence of oral or written Contract
- Payment to sub-contractor in pursuance to a contract for carrying whole or any part of work undertaken by the contractor is a criteria.
- Privity of contract between the truck owners and the consignor company is not necessary.
- All the essentials of making the contract exist once the truck is engaged for execution of work and freight charges are payable upon execution.

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

Oral contracts :

- Once a particular truck is engaged by assessee on hire charges for carrying out the part of work undertaken by it (i.e., transportation of the goods of the company), the operator/owner of that truck became the sub-contractor and all the requirements of section 194C came into operation.

- Whether the appellant had specifically identified the trucks on its rolls or had been picking them up on freelance basis – the legal effect is same

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

AO can redraw profit and loss account?

- Assessee was only accounting commission of Rs.100 to Rs.250 per trip
- AO redrew the profit and loss account, took the gross hire charge as income and denied the deduction of hire charges paid applying 40a(ia)
- SC distinguishes Hardarshan Singh [2013] 350 ITR 427, where assessee was acting as a commission agent or a facilitator between consignor company and the transporter. He was not having any privity of contract with the transporter.
- Assessee in the present case has privity of contract with the lorry owner

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

Is there a GP addition in this case?

- **AO makes a lumpsum disallowance of Rs.20k to the declared income on the basis of lower NP being returned this year compared to earlier year**

- **Does this lumpsum disallowance on the basis of lower NP rate tantamount to taxing the assessee on GP basis?**

- **In the case of GP addition, no separate addition under section 40a(ia)/40A(3) can be made as held in**
  - **CIT vs. G. K. Contractor (19 DTR 305)(Raj);**
  - **CIT vs. Pravin & Co. 274 ITR 534 (Guj);**
  - **CIT vs. Banwari Lal Banshidhar 229 ITR 229 (All)**

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

Paid v. Payable:?

- The overall scheme of the provisions relating to collection and recovery of tax, it is evident that the object of legislature in introduction of the provisions like sub-clause (ia) of clause (a) of section 40 had been to ensure strict and punctual compliance of the requirement of deducting tax at source.

- The purpose and coverage of this provision as also protection therein have been tersely explained by this Court in the case of Calcutta Export Co. (supra). The purpose is to ensure tax compliance and not to punish the assessee.

- Whether disallowance under section 40(a)(ia) of the Act is confined to the amount "payable" and not to the amount "already paid" ?- Deducting tax at source is obligatory. Section 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid - Palam Gas (supra) & P.M.S. Diesels [2015] 374 ITR 562(Punj.).

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

Paid v. Payable:?

- The overall scheme of the provisions relating to collection and recovery of tax, it is evident that the object of legislature in introduction of the provisions like sub-clause (ia) of clause (a) of section 40 had been to ensure strict and punctual compliance of the requirement of deducting tax at source.

- The purpose and coverage of this provision as also protection therein stated in Calcutta Export Co.,404 ITR 654 SC was reiterated

- Section 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid - Palam Gas 394 ITR 300 SC reaffirmed.

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

Paid v. Payable:?

- The expression "payable" is descriptive of the payments which attract the liability for deducting tax at source. It is not used in the provision to specify any particular class of default on the basis as to whether payment has been made or not.

- The decision of Co-ordinate Bench is equally binding and could be doubted only if the view is shown to be not in conformity with any binding decision of the Larger Bench or any statutory provisions or any other reason of the like nature.

- Argument that in the Bill words ‘credited or paid’ were used while in the Act, the word ‘paid’ is used was not considered.

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

Paid v. Payable:?

- Section 40(a)(ia) is not a stand-alone provision. It provides additional consequences as indicated in section 201.

- The obligation of section 194C of the Act is the foundation of the consequence provided by section 40(a)(ia) of the Act, and thus, reference to the former is inevitable in interpretation of the latter.

- Ratio of J.K. Synthetics (1994 taxmann.com 370 (SC) on difference in connotation of the expressions "payable" and "paid & ICAI [1997] 93 Taxman 588 (SC) on general principles is not applicable.

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

40(a)(ia) inserted by the Finance (No. 2) Act, 2004 with effect from 1-4-2005, is applicable for the financial year 2005-06.

- In PIU Ghosh [2016] 386 ITR 322(Cal.], it was held that Finance (No.2) Act, 2004 got presidential assent on 10-9-2004. As the assessee could not have foreseen prior to 10.09.2004 that any amount paid to a contractor without deducting tax at source was likely to become not deductible under section 40, it was held section 40a(ia) could not have applied to payments made upto 10.09.2004.

- As the appeal was not filed by the department due to low tax effect, the said decision cannot be treated as final declaration of law.

- The law in force in the assessment year in question is to be applied unless stated otherwise by express intendment or by necessary implication. CIT v. Isthmian Steamship Line [1951] 20 ITR 572 (SC) and Karimtharuvi Tea Estate Ltd. v. State of Kerala [1966] 60 ITR 262 (SC)

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

As regards 40(a)(ia) inserted by the Finance (No. 2) Act, 2004 with effect from 1-4-2005, is applicable only from the financial year 2005-06.

- The legislature consciously made Sec. 40(a)(ia) of the Act effective from 1-4-2005. It is applicable from and for the assessment year 2005-2006
- The proviso effectively took care of the case bona fide assessees who would earnestly comply with the requirement of deducting the tax at source.
- The date of assent of the President is not the date of applicability of the provision.
- Thus, disallowance would apply to the payments already made prior to 10.09.2004.

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

As regards 40(a)(ia) inserted by the Finance (No. 2) Act, 2004 with effect from 1-4-2005, is applicable only from the financial year 2005-06.

- Sri Loknath Goenka, 417 ITR 521 Patna FB held that a new liability under the Act can only be fastened on an individual if the same was existing at the time of accrual and not at the time of assessment.

- SC upsets the above proposition

- Article 20 (1) of Constitution which contains prohibition against "ex-post facto penal law" (i.e.. law making an act of being offensive from retrospective effect) was applied in J.K. Spinning 32 ELT 234 SC which inter-alia held that there could be no retrospective imposition of penalty and confiscation of goods

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

Does it mean can TDS default be made on retro basis?

- **Courts have always upheld the principle of 'lex on cogid ad impossibilia' :** Krishnaswamy S. Pd. & Anr. Vs. Union of India [2006] 281 ITR 305 (SC)

- **No TDS on retro basis as held in KPTCL** 383 ITR 59 Kar and Creative Infocity Ltd. 397 ITR 165 Guj

- **The finding by the Supreme Court in paragraph 17.7 should be understood as confined only to the effect of section 40(ia) and not to TDS provisions per se. The SC notes that liability under section 194C already existed when section 40a(i) was brought in with effect from 01.04.2005**

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

As regards disallowance causing prejudice to assessee?

- Sections 40(a)(ia) and 40A(3) of the Act intends to enforce due compliance of the requirement of other provisions of the Act and to ensure proper collection of tax as also transparency in dealings of the parties. Disallowance comes into operation only in case of default.

- The disallowance does not cause prejudice/ legal grievance to the assessee.

- **Hence the disallowance of Rs. 57,11,625/- u/s 40(a)(ia) was upheld.**

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

As regards 30% disallowance by Finance (No.2) Act, 2014 not to apply retrospectively

- The disallowance under section 40(a)(ia) only to the extent of 30% brought by the Finance (No.2) Act, 2014 cannot be applied retrospectively.

- Calcutta Export Co. [2018] 404 ITR 654 (SC)] dealt with procedural hardship likely to be faced by the bona fide taxpayer who had deducted tax at source but could not make deposit within the prescribed time so as to claim deduction.

- The ratio cannot be applied to the amendment of the substantive provision by the Finance (No.2) Act, 2014

Shree Choudhary Transport Co. [2020] 426 ITR 289 (SC) - Findings

<u>As regards 30% disallowance by Finance (No.2) Act, 2014 not to apply retrospectively</u>

- The assessee is not a bona fide assessee who had made the deduction and deposited it subsequently. It could not have derived the benefits that were otherwise available by the curative amendments of 2008 and 2010.

- Hence amendment of Section 40(a)(ia) of the Act by the Finance (No.2) Act, 2014 cannot be applied retrospectively.

UOI v. Exide Industries Ltd
425 ITR 1 SC

Section 43B(f) is constitutionally valid

UOI v. Exide Industries Ltd 425 ITR 1 SC - Facts

- Section 43B(f) was inserted vide FA, 2001 w.e.f. 1.4.2002 to provide for disallowance of provision for encashment of leave salary unless actually paid

- It made the actual payment of liability to the employees as a condition precondition for extending the benefit of deduction irrespective of the system of accounting followed by the assessee employer.

- Intent is to overcome BEML's case in 245 ITR 428 SC

- Hon'ble Calcutta High had held that clause (f) of Section 43B of IT was arbitrary and violative of Article 14 of the Constitution of India on various counts.

UOI v. Exide Industries Ltd 425 ITR 1 SC - Findings

- The two-fold approach (as envisaged under Article 14 of the Constitution) of testing the constitutional validity of a provision is well settled and the fundamental concern of the Court is to :
    - inspect the existence of enacting power ;
    - ascertain whether the enacted provision encroaches any right preserved in Part III of the Constitution

- The approach is followed in State of Madhya Pradesh v. Rakesh Kohli & Anr. [2012] 6 SCC 312, Bhanumati & Ors. v. State of Uttar Pradesh & Ors. [2010] 12 SCC 1, State of Andhra Pradesh & Ors. v. Mcdowell & Co. & Ors. [1996] 3 SCC 709and Kuldip Nayar & Ors. v. Union of India & Ors. [2006] 7 SCC 1

UOI v. Exide Industries Ltd 425 ITR 1 SC - Findings

- Prudent approach while examining the validity of statutes on taxability (Rakesh Kohli & Anr. [2012] 6 SCC 312):
  1. *“there is always presumption in favour of constitutionality of a law made by Parliament or a State Legislature,*
  2. *no enactment can be struck down by just saying that it is arbitrary or unreasonable or irrational but some constitutional infirmity has to be found,*
  3. *the court is not concerned with the wisdom or unwisdom, the justice or injustice of the law as Parliament and State Legislatures are supposed to be alive to the needs of the people whom they represent and they are the best judge of the community by whose suffrage they come into existence,*
  4. *hardship is not relevant in pronouncing on the constitutional validity of a fiscal statute or economic law, and*
  5. *in the field of taxation, the legislature enjoys greater latitude for classification "*

UOI v. Exide Industries Ltd 425 ITR 1 SC – Législative power

- The SC finds that the parliament has the power to enact Section 43B(f) under Article 245.

- Section 43B – legislature’s wisdom to impose condition on actual payment

- Section 145(1) – assessee can choose the method of accounting. However "subject to the provisions of sub-section (2)" Section 145(1), empowers the CG to prescribe ICDS. It signifies that the class of assessee is controlled by the regulation notified.

- Section 43B merely operates as an additional condition for the availment of deduction qua the specified head

UOI v. Exide Industries Ltd 425 ITR 1 SC – Nature of section 43B

- Since 1983, the scope of Section 43B was widened from time to time. It is a mixed bag having no uniformity in the nature of deductions. It is not restricted only to concerning statutory liabilities.

- 43B(f) does not control the timing of payment but controls the timing of claiming deduction.

UOI v. Exide Industries Ltd 425 ITR 1 SC – Mischief rule

- Section 43B(f) is pro-employee and subjugate double deduction to employers refusing to pay the employee. It was enacted to remedy a particular mischief and the concerns of public good, employees' welfare and prevention of fraud upon revenue is writ large in the said clause

- Effect of section 41 to obviate double deduction appears to have been missed

UOI v. Exide Industries Ltd 425 ITR 1 SC – Relevance of objects & reasons

- Objects and reasons are external aids to interpretation and can be used for limited purpose of ascertain condition prevailing during enactment, K. Shyam Sunder and Ors [2011] 8 SCC 737, State of West Bengal v. Union of India AIR 1963 SC 1241, Sanjeev Coke Manufacturing Company v. Bharat Coking Coal Limited and Anr. [1983] 1 SCC 147
- The presence or absence of objects and reasons has no impact upon the constitutional validity of a provision as long as the literal features of the provision enable the Court to comprehend its true meaning with sufficient clarity.
- Thus, the non-disclosure of objects and reasons per se would not impinge upon the constitutionality of a provision unless the provision is ambiguous and the possible interpretation violate Part III of the Constitution.

UOI v. Exide Industries Ltd 425 ITR 1 SC – Power of Parliament to overrule a court decision

- In Bharat Earth Movers [2000] 6 SCC 645, it was held that leave encashment liability is a contingent one. However, once the enactment itself stands corrected, the basic cause of adjudication stands altered and necessary effect follows the same. The Parliament exercises its legislative wisdom to shortlist the most desirable solution and enacts a law to that effect.
- The legislature is free to diagnose the law invalidated by the court and alter the invalid elements thereof. Legislature is not declaring the opinion of the Court to be invalid. Welfare Association. A.R.P. [2003] 9 SCC 358; Indian Aluminium Co. and Ors . [1996] 7 SCC 637
- Bharat Earth Movers (supra) was rendered in light of general dispensation of autonomy of the assessee to follow cash or mercantile system of accounting prevailing at the relevant time, in absence of an express statutory provision to do so differently.

UOI v. Exide Industries Ltd 425 ITR 1 SC - Findings

- Section 43B(f) applies prospectively. Once the FA, 2001 was passed by the Parliament inserting Section 43B(f) with prospective effect, the deduction against the liability of leave encashment stood regulated in the manner so prescribed. It does not reverse the nature of the liability nor has it taken away the deduction as such. It merely defers the benefit of deduction and links to the date of actual payment.
- The Court cannot venture into hypothetical spheres while adjudging constitutionality of a duly enacted provision and unfounded limitations cannot be read into the process of judicial review
- Section 43B(f) was held to be constitutionally valid and operative for all purposes.

UOI v. Exide Industries Ltd 425 ITR 1 SC – Argument not considered

- An argument was raised by the counsel that unlike other items in section 43B, in case of provision of leave encashment, the assessee does not have the choice of making the payment, even if wants to pay as the claims have not been made as yet.

- This argument was not considered.

Padmini Products TS-523-HC-2020(KAR)

Depreciation on the revalued asset transferred by the firm to the company on “conversion”.

Padmini Products TS-523-HC-2020(KAR) - Facts

- Assessee is a Private Limited Company engaged in the business of manufacturing, dealing and exporting of incense sticks and allied products.
- It was succeeded by a partnership firm viz., ‘Padmini Products’ with effect from 01.02.2005
- Prior to conversion the partnership firm revalued its intangible assets and arrived at a value of Rs.65,26,40,150/-.
- All assets and liabilities of the firm including the intangible assets were transferred to the company.
- In consideration of the same, only the shares of the company were allotted to its partners.

Padmini Products TS-523-HC-2020(KAR) – Facts (cont..)

- AO observed that the depreciation claimed by the assessee on the intangible assets is not in accordance with Section 32 of the IT Act. During the succession, the intangible assets were valued as per assessee's own valuation and not for actual consideration. The same was not acquired/purchased for actual consideration.
- Consequently, AO disallowed the depreciation on the Intangible assets by invoking 5th proviso to section 32(1)
- CIT(A) additionally applied Explanation 3 to section 43(1)
- Tribunal confirmed the disallowance

Padmini Products TS-523-HC-2020(KAR) – Findings

- The assessee's business largely depended on the intangible assets (i.e. tradename/ trademark). AO found that the firm was registered owner of the same.
- The valuation of shares was according to AS 10 and 26.
- The intangible assets have a real value of money. The same was not disputed by the lower authorities.
- The same was transferred by the firm to company for consideration. Hence the succeeding company is entitled for depreciation under Section 32(1) of the IT Act.
- Transfer of assets from a firm to a company is a recognised mode of transfer under Section 47 of the IT Act.

Takeaway – No bar on revaluation

- There is no bar on revaluation upon succession of firm by company

- Wherever such bar is intended specific provisions are made : Sections 2(19AA) and 50B

Take away – applicability of 5th proviso

- 5th Proviso to Section 32 cannot be invoked unless it is the case of aggregate deduction and scope for allocation between the predecessor and successor.

- In any case, it is applicable only in the year of the succession. It has no role for subsequent years.

Takeaway – Explanation 3

- In absence of finding in the order of AO, Explanation to Section 3 to Section 43(1) of the Act cannot be invoked.

- Reliance was placed on Sekar Offset Press[1995] 214 ITR 516 (Madras) and Ashvin Vasaspati Industries [2002] 255 ITR 26 (Gujarat).

KPTCL TS-570-HC-2020

Wheeling Charges that never “accrued”

KPTCL TS-570-HC-2020 (KAR) - Facts

- Assessee is Karnataka State Government undertaking and is engaged in the business of transmission of electricity.
- It filed its ROI for the AY 2001-02 declaring a loss of Rs.20,88,81,396/-. Subsequently, filed a revised 'NIL' return after setting off the b/f unabsorbed depreciation of Rs.2,16,63,815/-. The assessment was processed under Section 143(3) and the income was determined to be 'NIL'
- CIT exercising the powers under Section 263 held that assessment order was erroneous and prejudicial to the interest of revenue and consequently set aside the same.
- The AO made an addition of Rs.52.89 Crores on account of wheeling charges holding that the same was not offered by the assessee. He held that assessee having followed the accrual method of accounting cannot account the revenue of wheeling charges only when the same is collected.

KPTCL TS-570-HC-2020 (KAR) – Facts (Cont..)

- AO holds that the wheeling charges became due to the assessee once electricity supply is made available to other agencies. It cannot refuse to treat the same as income merely because the revenue was not realized in the relevant financial year. CIT(A) upheld the order of the AO.
- ITAT held that Assessee has neither incurred nor debited any expenditure for transmission of electricity to other states. Due to the dispute with regard to wheeling charges amongst all the constituent states, there was an uncertainty of receiving the transmission charges even though the assessee has raised demand.
- Merely because it was accounted, Tribunal held that hypothetical income would not accrue/arise to the assessee. Tribunal even applied the doctrine of consistency and held that the assessee has not deviated from its method of accounting.

KPTCL TS-570-HC-2020 (KAR) – Findings

- Assessee follows mercantile system of accounting.

- Reliance was placed on Notification dated 25.01.1996 r/w Section 145(2) of the IT Act.

- Accrual means that revenue and costs are accrued i.e., recognized as they are earned or incurred and recorded in the financial statements of the period to which they relate. [Clause 6(b) of the notification]

- ‘Accrual' refers to the assumption that revenue and costs are accrued that is recognized as they are earned or incurred and recorded in the Previous Year, to which they relate. [Notification dated 29.09.2016]

KPTCL TS-570-HC-2020 (KAR) – Findings (cont..)

- Assessee did not raise demand since there was uncertainty of recovery/collection. The same was approved by the board meeting,

- The arrangement of cost sharing of wheeling charges by the constituent States was scrapped prior to the date passing the assessment order.

- Bokaro Steels Ltd 263 ITR 315 (SC) - only real income can be brought to tax, not the hypothetical income

- It was held that the income was hypothetical and did not accrue to the assessee in view of Accounting Standard-9. Hence not taxable.

Kemfin Services Pvt Ltd
TS-284-HC-2020

Income from sale of shares held as capital asset after conversion from stock in trade is Capital Gains

Kemfin Services Pvt Ltd TS-284-HC-2020 - Facts

- The assessee was an NBFC engaged in the activity of trading investment in shares. On 01.04.2004, assessee stopped its trading activity and converted the shares held as stock in trade worth Rs.1,30,98,529/- to investments.
- AO held that mere interchange of heads in books of accounts does not alter the nature of transaction. The transactions of the assessee fall within the ambit of business income and not capital gain.
- Thus, the AO denied exemption under section 10(38). CIT(A) upheld the same while giving relief of Rs.16,215/- towards STT under Section 88E of the Act.
- Tribunal also upheld the view of AO & CIT(A) holding that surplus arising from converting the aforesaid shares held as stock in trade is a business asset and the income arising on account of stock in trade is a business income.

Kemfin Services Pvt Ltd TS-284-HC-2020 - Findings

- The assessee in the instant case had converted stock in trade into investments.

- Sir Kikabhai Premchand (1953) 24 ITR 506 (SC) – It is wholly unreal & artificial to separate the business from its owner and treating separate entities. Fictional sale and fictional profit is non-existent. A person cannot sell something to himself and making a profit out of the transaction.

- Income from sale of shares held as investment converted from stock in trade is to be treated as capital gain and not as business income is well settled principle.

- Taxing statute has to be strictly construed.

Kemfin Services Pvt Ltd TS-284-HC-2020 – Findings (cont..)

- Saraswati Sugar Mills v. Haryana State Board (1992) 1 SCC 418 - Subject cannot to be taxed without clear words in the Act and every Act of parliament must be read according to the natural construction of its words.

- GP Singh's "Principles of Statutory Interpretation" - if a person sought to be taxed comes within the letter of law, he must be taxed, however, great hardship may appear to the judicial mind to be.

- Section 28(via) came into force on 01.04.2019. Prior to insertion of the same, there was no law to tax the conversion - Memorandum of Finance Bill, 2018.

Kemfin Services Pvt Ltd TS-284-HC-2020 – Findings (cont..)

- The income arising from sale of shares held as capital asset after conversion from stock in trade is to be treated as capital gains. The Court relied on following decisions:

  - Pavitra Commerical Ltd., (2018) 402 ITR 66 (DEL)
  - Yatish Co. Pvt. Ltd., 2013-TIOL-117-HC-MUM- IT
  - Express Securities Pvt. Ltd 2013-TIOL-862-HC-DEL-IT,
  - Deeplok Financial Services Ltd., (2017) 393 ITR 395 (CAL)
  - Aditya Medi Sales Ltd. (2016) 242 TAXMAN 228 (GUJ)
  - Jannhavi Investment Pvt. Ltd. (2008) 304 ITR 276 (BOM)

Maruti Suzuki India Ltd. [2020] 421 ITR 510 (SC)

Maruti Suzuki India Ltd. [2020] 421 ITR 510 (SC)

- Assessee was following net basis of accounting

- At the end of FY 1998-1999, Rs. 69,93,00,428/- was left as unutilised MODVAT credit. In the return it was claimed that the Company was eligible for deduction under section 43B of the Income-tax Act as an allowable deduction.

- Similarly, the Company claimed deduction under section 43B of an amount of Rs. 3,08,88,171/-in respect of Sales Tax Recoverable Account.

- The Assessing Officer disallowed the claim of deduction of Rs. 69,93,00,428/- as well as Rs. 3,08,99,171/-.

SC held as follows : status of MODVAT credit

- Crucial words in section 43B(*a*) are "any sum payable by the assessee by way of tax, duty, cess or fee...".

- Unutilised credit under MODVAT scheme is not sum payable by the assessee by way of tax, duty, cess.

- The scheme under section 43B is to allow deduction when a sum is payable by assessee by way of tax, duty and cess and had been actually paid by him.

SC held as follows : status of MODVAT credit

- The unutilised credit in the MODVAT scheme cannot be treated as sum actually paid by the appellant.
- When the assessee pays the cost of raw materials where the duty is embedded, it does not *ipso facto* mean that assessee is the one who is liable to pay Excise Duty on such raw material/inputs.
- It is merely the incident of Excise Duty that has shifted from the manufacturer to the purchaser and not the liability to the same.
- Therefore unutilised credit under MODVAT scheme does not qualify for deductions under section 43B of the Income-tax Act

SC held as follows : Subsequent utilisation

- SC rejected the contention that since the unutilised credit was utilised for payment of Excise Duty on the manufactured vehicles by April of AY, the said amount ought to have been allowed as permissible deduction under section 43B in terms of the first Proviso.
- The crucial words in the proviso to Section 43B are "in respect of the previous year in which the liability to pay such sum was incurred". The proviso takes care of the situation when liability to pay a sum has incurred but could not be paid in the year in question and has been paid in the next financial year before the date of submission of the Return.
- In the present case, there was no liability to adjust the unutilised MODVAT credit in the year in question
- Had there been liability to pay Excise Duty by the appellant on manufacture of vehicles, the unutilised MODVAT credit could have been adjusted against the payment of such Excise Duty.

SC held as follows : Subsequent utilisation

- In the present case, the liability to pay Excise Duty of the assessee is incurred on the removal of finished goods in the subsequent year *i.e.* year beginning from 1-4-1999

- What we are concerned with is unutilised MODVAT Credit as on 31-3-1999 on which date the assessee was not liable to pay any more Excise Duty.

Take away

- Technically, the decision is correct as section 43B starts with the words "Notwithstanding anything contained in any other provision of this Act, a ***deduction otherwise allowable*** under this Act….

- However, the decision of SC in **CIT Vs Modipon Ltd 400 ITR 1 SC was not brought to the notice of the Court**

Modipon Ltd 400 ITR 1 SC para 9

- Deposit of Excise Duty in PLA is a statutory requirement designed to bring in orderly conduct in the matter of levy & collection of duty when both manufacture and clearances are a continuous process.

- Debits against the advance deposit in the PLA have to be made of amounts of excise duty payable on excisable goods cleared during the previous fortnight.

- Deposit once made is adjusted against the duty payable on removal and the balance is kept in the account for future clearances/removal.

- No withdrawal from the account is permissible except on an application to be filed before the Commissioner who is required to record reasons for permitting an assessee to withdraw any amount from the PLA.

Modipon Ltd 400 ITR 1 SC para 9

- The self removal scheme and payment of duty under the Act and the Rules clearly shows that upon deposit in the PLA the amount of such deposit stands credited to the Revenue with the assessee having no domain over the amount(s) deposited

- Having regard to the object behind the enactment of Section 43B and the preceding discussions, it would be consistent to hold that the legislative intent would be achieved by giving benefit of deduction to an assessee upon advance deposit of central excise duty notwithstanding the fact that adjustments from such deposit are made on subsequent clearances/removal effected from time to time.

Take away: GST Regime

- Electronic cash ledger and Electronic credit ledger

- **Refex Industries Ltd Vs Assistant Commissioner of CGST & CE** 2020-TIOL-382-HC-MAD-GST : No interest is leviable in respect of belated adjustment of ITC

Take away:

- Gross method v. net method
- Section 145A implications
- In Indo Nippon 261 ITR 275 SC, it was held that whichever method is followed, it is revenue neutral
- Guidance Note on Tax Audit, issued by ICAI, 2014 Edition [para 23.22] confirms that section 145A is revenue neutral both in case of trading concern as well as manufacturing concern

Shree Rama Multi Tech Ltd. [2018] 403 ITR 426 SC

Interest on share application money is deductible from public issue expenses

Shree Rama Multi Tech Ltd. [2018] 403 ITR 426 SC- Facts

- The Assessee is engaged in the manufacture of multi-layer tubes and other specialty packaging and plastic products. It filed the ROI for the Assessment Year 2000-2001 declaring a total income of Rs. 20,00,59,650/-. AO passed order assessing income of Rs. 27,61,14,254/-

- The Tribunal dated 16.12.2004 has directed for re-adjudication on certain matters including that of set-off as claimed under the head of interest on share application money. Consequently, AO re- determined the income at Rs. 17,30,88,691/- but was restricted to 20,00,59,650/- in view of proviso to Section 240(b). CIT(A) directed the AO to grant relief without applying the proviso to Section 240 of the IT Act.

Shree Rama Multi Tech Ltd. [2018] 403 ITR 426 SC- Facts

- Meanwhile, re-assessment proceedings were initiated u/s 147 and the AO determined the total income at Rs. 20,66,29,165/- rejecting the claim for the deduction of interest income of Rs. 1,71,30,212/- from public issue expenses in accordance with the directions of the ITAT

- CIT (Appeals) affirmed the finding of AO in not allowing set off of interest income from share application money.

- ITAT allowed the assessee's claim. The same was affirmed by HC.

Shree Rama Multi Tech Ltd. [2018] 403 ITR 426 SC- Findings

- The Assessee company made initial public issue of shares and received share application money.

- The said application money was deposited with the banks on which interest of Rs. 1,71,30,202/- was earned. The same was shown as “income from other sources” in the ROI and tax audit report

- However, an additional ground was raised before ITAT to allow the set off of such interest against the public issue expenses.

Shree Rama Multi Tech Ltd. [2018] 403 ITR 426 SC- Findings (cont..)

- The Assessee was statutorily required to keep share application money in the separate account till the allotment of shares was completed. Interest earned on such money was to be adjusted towards expenditure for raising share capital.

- Interest earned is inextricably linked with requirement of company to raise share capital and was adjustable towards the expenditures involved for the share issue.

- It is irrelevant that the application money was returned to unsuccessful applicants.

Shree Rama Multi Tech Ltd. [2018] 403 ITR 426 SC- Findings (cont..)

- Bokaro Steel Ltd. [1999]236 ITR 315 (SC) - Amounts directly connected and incidental to construction of plant were capital receipts and not income from any independent source.

- CIT v. Karnal Co-operative Sugar Mills Ltd. [2000] 243 ITR 2 (SC) – interest earned on deposit of money with the bank to open LOC for purchase of machine is directly linked with the purchase machine.

- The common rationale that is followed in all these judgment is that if there is any surplus money which is lying idle and it has been deposited in the bank for the purpose of earning interest then it is liable to be taxed as income from other sources but if the income accrued is merely incidental and not the prime purpose of doing the act in question which resulted into accrual of some additional income then the income is not liable to be assessed and is eligible to be claimed as deduction.

Shree Rama Multi Tech Ltd. [2018] 403 ITR 426 SC- Findings (cont..)

- The issue of share relates to capital structure of the company and hence expenses incurred in connection with the issue of shares are to be capitalized

- This is because the purpose of such deposit is not to make some additional income but to comply with the statutory requirement,

- Therefore, interest accrued on such deposit is merely incidental.

Shiv Raj Gupta
[2020] 425 ITR 420 (SC)

Non-compete fees is capital in nature for (AY 1995-96)

Shiv Raj Gupta TS-353-SC-2020/ [2020] 425 ITR 420 (SC) - Facts

- The appeal relates to AY 1995-96
- Assessee was the Chairman and Managing Director of CDBL which had a unit in Meerut manufacturing beer and IMFL.
- The Assessee, and his family members were the registered holders of 1,86,109 equity shares of INR 10 each constituting 57.29% of the paid-up equity share capital of CDBL listed in the Bombay and Delhi Stock Exchanges.
- Assessee entered MOU with SWC (Shaw Wallace Company Group). The controlling block of shares were sold for Rs.30/- per share. The entire sale consideration of Rs. 55,83,270/- was paid by SWC to assessee as a result of which assessee has irrevocably handed over physical possession, management and control of the said brewery and distillery of CDBL to a representative of the SWC group

Shiv Raj Gupta TS-353-SC-2020/ [2020] 425 ITR 420 (SC) - Facts

- On the same day, the Assessee entered into a Deed of Covenant with SWC wherein the SWC agreed to pay Rs.6.60 crores to the assessee towards “non-competition fee” for 10 years.

- AO treated Rs.6.60 crores as income of the Assessee invoking section 28(ii)(a). CIT (Appeals) dismissed the appeal against the order of AO.

- While the appeal stood allowed by a majority of 2 : 1 in the Appellate Tribunal.

- HC held that Deed of Covenant could not be read as a separate document and was not in its real avatar a non-compete fee at all. The sum of Rs.6.60 crores cannot be brought u/s. 28(ii)(a). However, the same can be taxable as capital gain as a sale consideration for transfer of shares.

Shiv Raj Gupta TS-353-SC-2020/ [2020] 425 ITR 420 (SC) - Findings

On Section 260A

- Section 260A is modelled on Section 100 of the CPC. HC's jurisdiction depends upon SQL involved in the appeal. First and foremost, it shall formulate that question and on the question so formulated, the HC may then pronounce judgment
- Section 260A(4) - If the HC wishes to hear the appeal on any other SQL not formulated by it, it may formulate and hear such questions if it is satisfied that the case involves such question after recoding the reasons.
- Section 260A(6), the HC may also determine any issue which, though raised, has not been determined by the Appellate Tribunal or has been wrongly determined by the Appellate Tribunal by reason of a decision on a substantial question of law raised.

Shiv Raj Gupta TS-353-SC-2020/ [2020] 425 ITR 420 (SC) - Findings

On Section 260A

- Proceeding to hear the appeal without formulating the substantial question of law involved in the appeal is illegal and is an abnegation or abdication of the duty cast on court Kshitish Chandra Purkait v. Santosh Kumar Purkait [1997] 5 SCC 438,

- Appeal shall lie to the High Court from an appellate decree only if the High Court is satisfied that the case involves a substantial question of law. Proviso to Section 100 of CPC empowers the court to hear on any substantial question of law not formulated after recording reasons Dnyanoba Bhaurao Shemade v. Maroti Bhaurao Marnor [1999] 2 SCC 471 and Biswanath Ghosh v. Gobinda Ghosh [2014] 11 SCC 605.

Shiv Raj Gupta TS-353-SC-2020/ [2020] 425 ITR 420 (SC) - Findings

On Section 260A

- SQL raised by the High Court did not contain any question as to whether the non-compete fee could be taxed under any provision other than Section 28(ii)(a) of the Income-tax Act, 1961.

- Hence the order of the HC was set aside.

Shiv Raj Gupta TS-353-SC-2020/ [2020] 425 ITR 420 (SC) - Findings

On Merits:

- SC rejected the HC's view on non-compete fee being ten times more and unrealistic.

- Commercial expediency has to be adjudged from the point of view of the assessee and the Department cannot enter question the reasonableness of amounts paid by the assessee. CIT v. Walchand & Co. [1967] 3 SCR 214, J.K. Woollen Mfgr. v. CIT [1969] 1 SCR 525, Panipat Woollen & General Mills Co. Ltd. [1976] 103 ITR 66 (SC), Shahzada Nand & Sons v. CIT [1977] 103 ITR 358 (SC), S.A. Builders Ltd. v. CIT [2007] 288 ITR 1 (SC) and Hero Cycles (P.) Ltd. [2016] 379 ITR 347 (SC).

- The decision in SA Builders [supra] was doubted in ACIT vs. Tulip Star Hotels Ltd (Supreme Court) [2012] 21 taxmann.com 97 (SC) and a reference was made to larger bench. However, in the meanwhile the decision of SA Builders received imprimatur by a bench of three judges in Shiv Raj Gupta v. CIT [2020] 425 ITR 420 (SC). This would render reference to large bench academic

Shiv Raj Gupta TS-353-SC-2020/ [2020] 425 ITR 420 (SC) - Findings

On Merits:

- As regards the HC's finding that the transaction is abusive tax avoidance, the SC found the findings of the majority judgment of ITAT acceptable:

1. FV of share Rs. 10 and MV Rs. 3; Rs. 30 was paid as control premium.
2. Each member of the family was paid for the shares held in the company. The lion's share being paid to the assessee's son and wife as they held the most number of shares within the said family.
3. The non-compete fee of INR 6.6 crores was paid only to the assessee. Assessee had acquired considerable knowledge, skill, expertise and specialisation in the liquor business.
4. Amount of INR 6.6 crores was arrived at as a result of negotiations between the SWC group and the assessee.

Shiv Raj Gupta TS-353-SC-2020/ [2020] 425 ITR 420 (SC) - Findings

On Merits:

5. The restrictive covenant for a period of 10 years resulted in the payment of INR 66 lakhs per year so that the assessee will not start or engage himself in relation to the manufacturing, dealing and supplying or marketing of IMFL and/or Beer. It was SWC's perception that the assessee could engage himself in a rival business.
6. Withholding Rs.3 crores out of INR 6.6 crores for a period of two years by way of a public deposit with the SWC group for the purpose of deduction of any loss on account of any breach of the MoU, was akin to a penalty clause. Hence there was no colourable device involved in having two separate agreements for two entirely separate and distinct purposes.

Shiv Raj Gupta TS-353-SC-2020/ [2020] 425 ITR 420 (SC) - Findings

On Merits:

- The revenue has no business to second guess commercial or business expediency of what parties at armslength decide for each other.

- Guffic Chem (P.) Ltd. v. CIT [2011] 332 ITR 602 (SC) negated the application of section 28(ii)(a) to such receipt. Compensation received for the loss of agency is a revenue receipt whereas the compensation attributable to a negative/restrictive covenant is a capital receipt. Gillanders case [(1964) 53 ITR 283 (SC)

Shiv Raj Gupta TS-353-SC-2020/ [2020] 425 ITR 420 (SC) - Findings

On Merits:

- Payment received as non-competition fee under a negative covenant was always treated as a capital receipt till Assessment Year 2003-04

- Section 28(va) was inserted by the FA, 2002 w.e.f 1-4-2003. That itself indicates that during the relevant assessment year compensation received by the assessee under non-competition agreement was a capital receipt. The amendment is not clarificatory.

- **Hence the non-compete fee was treated as capital in nature.**

Snowtex Investment Ltd [2019] 414 ITR 227 (SC)

Setting of losses of speculative business

Snowtex Investment Ltd [2019] 414 ITR 227 (SC) - Facts

- Assessee was registered as a NBFC under the RBI Act, 1934. Assessee filed its ROI for AY 2008-09.

- The assessing officer recorded that the principal business activity of the assessee is trading in shares and securities. The loss from share trading was held to be a speculation loss.

- In view of 43(5)(d) activities pertaining to futures and options could not be treated as speculative transactions. The loss from speculation cannot be set off against the profits from business.

Snowtex Investment Ltd [2019] 414 ITR 227 (SC) - Facts

- CIT(A) held that the assessee derived income from trading in derivatives and share business along with dividend and interest and was an NBFC. The provisions of Section 43(5) came into existence wef 01.04.2006 and hence the transactions in F&O must be treated as business income as distinct from trading in shares. CIT(A) rejected the contention of the assessee with respect to allowing speculation loss to be set off against profits of trading in futures and options.
- ITAT held that setting off the loss from share trading should be allowed against the profits from transactions in F&O. The character of the activities was similar and composite business.
- HC held that loss on trading in shares could not be set off against the profits arising from the business of futures and options.

Snowtex Investment Ltd [2019] 414 ITR 227 (SC) - Findings

- Section 43(5) was amended by the FA, 2005. The impact was that an eligible transaction on a recognised stock exchange in respect of trading in derivatives was deemed not to be a speculative transaction.
- Circular of the CBDT dated 27 February 2006 indicated that the amendment was made to bring greater transparency in the market for derivatives.
- Section 73(1)- A loss in speculation business can only be set off against the profits of another speculation business.
- Explanation to Section 73 deems certain businesses as speculation businesses. The same was amended by FA(No.2) Act, 2014 w.e.f 01.04.2015, and the business of trading in shares carried on by a company was taken out of purview of Explanation.

Snowtex Investment Ltd [2019] 414 ITR 227 (SC) - Findings

- While amending the provisions of Section 43(5), the Parliament indeed was cognizant of the provisions which were contained in Section 73(4). Memorandum proposed to reduce the period of carry forward of speculation losses from 8 AYs to 4 AYs.

- The Court may determine whether the amendment is clarificatory or was intended to operate with retrospective effect as an exercise of statutory interpretation. The test to be applied is essentially one of the intent of the legislature. Alom Extrusions Ltd., Vatika Township, Vijay Industries.

Snowtex Investment Ltd [2019] 414 ITR 227 (SC) - Findings

- Hence the amendments made by the Explanation to Section 73 vide FA(No.2) Act, 2014 are not clarificatory/ retrospective.

- Therefore, the loss from trading in shares (speculation business) cannot be set off against the profits of F&O since the latter is not a speculative business.

Snowtex Investment Ltd [2019] 414 ITR 227 (SC) - Findings

- Assessee argued that out of funds available of Rs.13.48 Cr, loans and advances given of Rs.11.32 Cr constituted 84% and hence its principal business could be considered as of granting loans and advances during the assessment year

- The SC notes that out of lending of Rs.11.32Cr, Rs.9.58 Cr is interest free

- The SC held that the specific admission of the assessee before the assessing officer assumes significance. The assessee made an admission on a statement of fact which must bind it.

SESA GOA LIMITED

2020-TIOL-1185-HC-MUM-IT-Goa

Sessa Goa Ltd. 2020-TIOL-1185-HC-MUM-IT-Goa

- The question before the HC is

'w*hether Education Cess and Higher and Secondary Education Cess, collectively referred to as "cess" is allowable as a deduction in the year of its payment ?'.*

- the question which arises for determination is whether the expression "*any rate or tax levied*" as it appears in Section 40(*a*)(*ii*) of the IT Act includes *"cess*".

Section 40a(ii)

- any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains

Explanation 1.-For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate or tax levied includes and shall be deemed always to have included any sum eligible for relief of tax under section 90 or, as the case may be, deduction from the Indian income-tax payable under section 91

Explanation 2.-For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate or tax levied includes any sum eligible for relief of tax under section 90A

High Court held

- There is no reference to any *"cess"*. Obviously therefore, there is no scope to accept the contention that *"cess"* being in the nature of a *"Tax"* is equally not deductable in computing the income chargeable under the head *"profits and gains of business or profession"*. Acceptance of such a contention will amount to reading something in the text of the provision which is not to be found in the text of the provision in Section 40(*a*)(*ii*) of the IT Act

- If the legislature intended to prohibit the deduction of amounts paid towards say, "e*ducation cess*" or any other "c*ess*", then, the legislature could have easily included reference to "c*ess*" in clause (*ii*) of Section 40(*a*) of the IT Act.

High Court held

- The legislative history bears out that the Income Tax Bill, 1961, as introduced in the Parliament, had Section 40(*a*)(*ii*) which read as follows :

"(*ii*) any sum paid on account of any cess, rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains"

- However, when the matter came up before the Select Committee of the Parliament, it was decided to omit the word "*cess*" from the aforesaid clause from the Income-tax Bill, 1961. The effect of the omission of the word "*cess*" is that only any rate or tax levied on the profits or gains of any business or profession are to be deducted in computing the income chargeable under the head "*profits and gains of business or profession"*. Since the deletion of expression *"cess"* from the Income-tax Bill, 1961, was deliberate, there is no question of reintroducing this expression in Section 40(*a*)(*ii*) of IT Act and that too, under the guise of interpretation of taxing statute

- Circular No. F. No. 91/58/66-ITJ(19), dated 18th May, 1967 *confirmed the above position*

High Court held

- Section 10(4) of 1922 Act banned allowance of any sum paid on account of '*any cess, rate or tax levied on the profits or gains of any business or profession*'.

- In the corresponding Section 40(*a*)(*ii*) of the IT Act, 1961 the expression "*cess*" is quite conspicuous by its absence.

- In fact, legislative history bears out that this expression was in fact to be found in the Income-tax Bill, 1961 which was introduced in the Parliament. However, the Select Committee recommended the omission of expression "*cess*" and consequently, this expression finds no place in the final text of the provision in Section 40(*a*)(*ii*) of the IT Act, 1961.

High Court held

- Though the claim for deduction was not raised in the original return or by filing revised return, the Appellant - Assessee had indeed addressed a letter claiming such deduction before the assessment could be completed.

- Even if one proceeds on the basis that there was no obligation on the Assessing Officer to consider the claim for deduction in such letter, CIT(A) or ITAT, before whom such deduction was specifically claimed was duty bound to consider such claim.

- Contention based upon the decision in *Goetze* is not acceptable

Anomaly

- Cess is on IT+SC
- IT is on total income
- If cess is allowed as a deduction, it will vary the total income
- If total income varies, it will vary IT, SC and again Cess
- This causes iteration or circular function

Other decisions so holding:

- Chambal Fertilisers and Chemicals Ltd. TS-489-HC-2018(RAJ)
- Reckitt Benckiser (I) Pvt. Ltd. [2020] 117 taxmann.com 519 (Kolkata - Trib.)

Nature of ‘cess’

- Section 40a(ii) uses ‘any sum paid on account of any rate or tax levied’. Tax is defined in section 2(43) to mean income tax and includes FBT.

- Section 2(3) etc., of the FA 2020 provides that ***the amount of income tax shall be increased by a surcharge,*** for the purposes of the Union

- Section 2(12) of the FA 2020 provides that the amount of income tax as increased by applicable surcharge ***shall be further increased by an additional surcharge, for the purposes of the Union, to be called as the “Health and Education Cess on income-tax”***

Nature of ‘cess’

- Surcharge is nothing but an additional tax : CCT v. Bajaj Auto 97 VST 24 SC

- As a general concept, income-tax includes surcharge : Suresh N. Gupta (SC) [2008] 297 ITR 322 (SC)

- K. Srinivasan’s case 83 ITR 346 SC : legislative history of the Finance Acts, as also the practice, would appear to indicate that the term "income-tax" as employed in section 2 includes surcharge as also the special and the additional surcharge whenever provided which are also surcharges within the meaning of article 271 of the Constitution

- Race Course Licence Fee is a fee and not a tax: Test to determine character of a levy, delineating 'tax' from 'fee' is the primary object of the levy and the essential purpose intended to be achieved. Delhi Race Club Ltd Vs UoI 2012-TIOL-51-SC-MISC

Nature of ‘cess’

- Lubrizol 187 ITR 25 Bby (delivered in the context of surtax) " ... If the word ‘tax’ is to be given the meaning assigned to it by s. 2(43), the word ‘any’ used before it will be otiose and the further qualification as to the nature of levy will also become meaningless." ;

- Approved in Smith Kline & French 219 ITR 589 SC : Section 10(4) of the 1922 Act or section 40(*a*)(*ii*) of the present Act do not contain any words indicating that the profits and gains spoken of by them should be determined in accordance with the provisions of the Act. All they say is that it must be a rate or tax levied on the profits and gains of business or profession. ….. the surtax is essentially levied on the business profits of the company computed in accordance with the provisions of the Act. Merely because certain further deductions [adjustments] are provided by the Surtax Act from the said profits, it cannot be said that the surtax is not levied upon the profits determined or computed in accordance with the provisions of the Act.

Related cases

1) Sec 40a(ii) does not apply to interest on TDS default : Selvel Advertising 59 ITR Tri SN 46 Kolk

2) Contra : CIT v Chennai Properties and Investments Ltd. (1999) 239 ITR 435 (Mad)

3) All liabilities for interest incurred under various sections of income tax are not allowed as held in the following cases

- Bharat Commerce & Industries Ltd (1998) 230 ITR 733 SC
- Usha Sales Ltd v CIT (2001) 119 Taxman 472 Del

Foreign tax

- *S. InderSingh Gillv. CIT [1963]* 47 ITR 284 (Bom.) : tax paid by the assessee on his foreign income in the foreign territory cannot be deducted while computing the total income

- Himson Textile Engineering Industries (2004) 267 ITR 612 : even tax paid by assessee on the income of the predecessor is also ineligible

- Reliance Infrastructure 2016-TIOL-3078-HC-MUM –IT : The foreign tax paid to the extent not allowed under section 91 is not barred by section 40(a)(ii) on real income theory

- **Elitecore Technologies TS-129-ITAT-2017(Ahd)] :** the 'higher wisdom' of Supreme Court which, while approving the HC ruling in Lubrizol, ruled that " “s. 40(a)(ii) of the present Act do not contain any words indicating that the profits and gains spoken of by them should be determined in accordance with the provisions of the IT Act. All they say is that it must be a rate or tax levied on the profits and gains of business or profession...”;

Gondia Beedi Leaves Contractors Association

422 ITR 404 Bby-Nagpur

Facts

- question involved is whether the members of the petitioner-association, who are the contractors of Tendu leaves (a forest produce), are entitled to claim exemption under sub-section (1A) of Section 206C of the Income Tax Act, 1961 from the collection of tax at source from them by the seller, namely, the Forest Department of the State of Maharashtra?

- The members of the petitioner-association are registered Tendu contractors having separate registrations under the Maharashtra Forest Produce (Regulation of Trade) Act, 1969 as traders and not as manufacturers

- Department changed its earlier stance and advised forest department to collect tax under section 206C(1) holding that exemption under section is not available

206C(1) and (1A)

- 206C. (1) Every person, being a seller shall, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount from the said buyer in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, collect from the buyer of any goods of the nature specified in column (2) of the Table below, a sum equal to the percentage, specified in the corresponding entry in column (3) of the said Table, of such amount as income-tax

(ii)	Tendu leaves	Five per cent

- (1A) Notwithstanding anything contained in sub-section (1), no collection of tax shall be made in the case of a buyer, who is resident in India, if such buyer furnishes to the person responsible for collecting tax, a declaration in writing in duplicate in the prescribed form and verified in the prescribed manner to the effect that the goods referred to in column (2) of the aforesaid Table are to be utilised for the purposes of manufacturing, processing or producing articles or things or for the purposes of generation of power and not for trading purposes.

Process carried out by the buyer

- Pruning
- Plucking, bundling and tying
- Drying and sprinkling water
- Transportation to collection centre where drying and weathering takes place
- Sprinkling of insecticides
- Rinsing, shifting and arranging bundles
- Stacking and packing

It is only after completion of this entire process in the prescribed manner the leaves are ready for sale to the manufacturer of bidi

HC held as

- As non effecting TCS would entail penalty and prosecution and as wrong effecting of TCS would not create harm, it is necessary to hold that TCS is required
- Wrongly distinguishes *Chowgule & Co. Pvt. Ltd.* v. *Union of India* [1981] 1 SCC 653 which was held in the context of section 8 of CST Act but using the same language as section 206(1A) where the SC clearly held that transportation is a process
- Wrongly enhances processing as processing resulting in manufacture
- Misconstrues the placement of the word 'processing' in between 'manufacturing' and "or producing articles or things" under sub-section (1A) is also significantly indicate such intention of the Legislature.
- As members are registered as traders under section 4(1) of the Regulation of Trade Act and not as manufacturers under section 11 of the said Act

Manufacture

- **India Cine Agencies Vs CIT 308 ITR 98 SC**

- Arihant Tiles and Marbles P. Ltd. [2010] 320 ITR 79 (SC)

- **Oracle Software 320 ITR 546 SC**

Comments in tax audit report : Binding effect?

1) **Shree Rama Multi Tech TS-199-SC 2018, 403 ITR 426 SC para 8 : Assessee can take a stand contrary to tax auditor as per form 3CD**

2) **West Asia Exports & Imports TS-188-HC-2019(MAD**Madras 412 ITR 208 para 24 : refers to Metal Box 73 ITR 53 SC which held that mere auditor certificate is not sufficient [use this to argue that observation by auditor is not conclusive]

3) **A.P. Export 410 ITR 168 Cal para 21: mention in the tax audit report is not conclusive**

Section 40A(3)

- No disallowance if paid to agent who is required to pay in cash as per rule 6DD(k) in The Solution 382 ITR 337 Raj. It applied Attar Singh Gurmuk Singh 191 TR 667 SC even post omission of rule 6DD(j) see para 10 and para 11

- Expenditure upto the limit is allowable and only beyond the limit calls for disallowance : M G Pictures (Madras) Ltd 2015-TIOL-37-SC-IT

- Shankar S Koliwad [ITA 5040/2009] Karnataka High Court