JUDICIAL UPDATE [FOR MAY, 2019 EXAMINATION]

1. Can expenditure incurred in foreign exchange for provision of technical services outside India, which is deductible for computing export turnover, be excluded from total turnover also for the purpose of computing deduction under section 10AA?

CIT V. HCL TECHNOLOGIES LIMITED [2018] 404 ITR 719 (SC)

Facts of the case: The assessee-company was engaged in the business of development and export of computer software and rendering technical services. For the relevant assessment year, the assessee claimed deduction under section 10AA as per certificates filed in the prescribed form.

Issue: The issue under consideration is whether software development charges incurred in foreign exchange attributable to the delivery of technical services outside India, deductible from export turnover, be excluded from total turnover also for computing deduction under section 10AA.

Supreme Court's Observations: The term "total turnover" has not been defined in section 10AA under which the deduction is sought.

Export Turnover means the consideration in respect of export by the undertaking of articles or thing or computer software received in, or brought into India by the assessee in convertible foreign exchange, within a period of six months from the end of the previous year or within such further period as may be permitted by the RBI, but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India.

Section 10AA deduction depends on arriving at the profit from export business, thus, expenses excluded from "export turnover" must also be excluded from "total turnover", since one of the components of "total turnover" is export turnover. Expenses incurred in foreign exchange for providing the technical services outside are thus, to be excluded from total turnover also.

Supreme Court's Decision: If deductions in respect of freight, telecommunication charges and insurance attributable to delivery of articles, things etc. or expenditure incurred in foreign exchange in rendering of services outside India are allowed only against export turnover but not from the total turnover for computing deduction under section 10AA, then, it would give rise to inadvertent, unlawful, meaningless and illogical results causing grave injustice, which could have never have been the intent of the Legislature. Hence, such expenditure incurred in foreign exchange for providing technical services outside India are deductible from total turnover also.

Example: Suppose assessee exports goods outside India and provide technical services outside India. Let us say he is a 100% exporter. His billing of export are as under:

Particulars	Amount (₹)
F.O.B Value	80 Crores
Freight & Insurance	15 Crores

Expenses on providing technical services outside India	5 Crores
TOTAL	100 Crores

Now, let us say his P/G/B/P is 30 Crores.

Therefore,

Profits of Business	30 Crores
Export Turnover	80 Crores
Total Turnover	80 Crores

If he receives entire consideration of export by 30th September, 2019 then deduction under section 10AA shall be:

$$\text{Profit of the Business} \times \frac{\text{Export Turnover}}{\text{Total Turnover}}$$

= 30 Crores x 80 Crores/80 Crores = 30 Crores

2. Where the waiver is in respect of loan taken for purchase of plant and machinery and tooling equipment, would the same be subject to tax in the hands of the recipient by virtue of the provisions contained in either section 28(iv) or section 41(1)?

CIT V. MAHINDRA AND MAHINDRA LTD. [2018] 404 ITR 1 (SC)

This judgement is no more relevant. The amount of loan waived will go to reduce the actual cost of plant & machinery. This is as per Explanation 10 to section 43(1). If one takes the view that Explanation 10 to section 43(1) is not applicable since waiver is not covered there, then as per section 2(24)(xviii), assistance in the form of waiver by the Central Government or State Government or any authority or body or agency in cash or kind to the assessee would be included in the definition of "income".

3. Is interest income from share application money deposited in bank eligible for set-off against public issue expenses or should such interest be subject to tax under the head 'Income from Other Sources'?

CIT V. SREE RAMA MULTI TECH LTD. [2018] 403 ITR 426 (SC)

Facts of the Case: The assessee-company is engaged in the manufacture of multi-layer tubes and other speciality packaging and plastic products. It came out with an initial public issue of shares during the relevant assessment years and deposited the share application money received in banks. The interest of ₹ 1,71,30,202 earned on the deposits was set off of against the public issue expenses.

Issue: The issue under consideration is whether the interest income from share application money is taxable under the head 'Income from Other Sources', or can the same be set-off against public issue expenses.

Supreme Court's Decision: The Supreme Court observed that the assessee-company was statutorily required to keep share application money in a separate account till the allotment of shares was completed. Part of the share application money would normally have to be returned to unsuccessful applicants, and therefore, the entire share application money would not ultimately be appropriated by the company. The interest earned was inextricably linked with the requirement of raising share capital.

Any surplus money deposited in the bank for the purpose of earning interest is liable to be taxed as "Income from Other Sources". Here, the share application money was deposited with the bank not to make additional income but to comply with the statute. The interest accrued on such deposit is merely incidental. Moreover, the issue of shares relates to capital structure of the company and hence, expenses incurred in connection with the issue of shares are to be capitalized. Accordingly, the accrued interest is not liable to be taxed as "Income from Other Sources"; the same is eligible to be set-off against public issue expenses.

4. Can Inland Container Depots (ICDs) be treated as infrastructure facility, for profits derived therefrom to be eligible for deduction under section 80-IA?

CIT V. CONTAINER CORPORATION OF INDIA LIMITED [2018] 404 ITR 397 (SC)

Facts of the case: M/s. Container Corporation of India Ltd. (CONCOR) is a Government company engaged in the business of handling and transportation of containerized cargo. Its operating activities are mainly carried out at its Inland Container Depots, Container Freight Stations and Port Side Container Terminals. CONCOR filed its income-tax returns for the relevant assessment years and claimed deduction under various heads including **deduction under section 80-IA for profits derived from inland container depots**. The claim for deduction on the profits earned from inland container depots was, however, rejected by the Assessing Officer.

Issue: The issue under consideration is whether profits derived from inland container depots can be treated as an infrastructure facility eligible for deduction under section 80-IA.

Supreme Court's Decision: Inland Container Depots function for the benefit of exporters and importers located in industrial centres which are situated at distance from sea ports. The purpose of establishing them was to promote the export and import in the country as these depots acts as a facilitator and reduce inconvenience to the exporter or importer.

Section 80-IA provides for a deduction of profits derived from operation of an infrastructure facility. The definition of "infrastructure facility" in Explanation to section 80-IA(4)(i) includes an inland port. The Supreme Court observed that, considering the nature of work such as custom clearance carried out at inland container depots, it can be considered as an inland port within the meaning of section 80-IA(4). Thus, deduction under section 80-IA can be claimed in respect of income earned therefrom.

5. Can payment of interest by Canara Bank to NOIDA be exempted from the requirement of tax deduction at source under section 194A on the ground that the same is a corporation established by or under the Uttar Pradesh Industrial Area Development Act, 1976?

CIT (TDS) and Anr V. CANARA BANK [2018] 406 ITR 161 (SC)

Facts of the case: Under section 194A(3)(iii)(f), a notification was issued by the Central Government exempting payments made to "any corporation established by a Central, State or Provincial Act" from the requirement of tax deduction at source.

Issue: The issue under consideration is whether NOIDA is a Corporation established by or under the Uttar Pradesh Industrial Area Development Act, 1976, consequent to which it is eligible for exemption from requirement of tax deduction at source in respect of payment of interest made to it.

Supreme Court's Decision: The Supreme Court held that NOIDA is a corporation established under state Act and therefore no TDS is required on payments made to it.

6. Are the provisions of tax deduction at source under section 194H attracted in respect of amount retained by accredited advertising agencies out of remittance of sale proceeds of "airtime" purchased from Doordarshan and sold to customers?

DIRECTOR, PRASAR BHARATI V. CIT [2018] 403 ITR 161 (SC)

This judgement is not relevant in view of the CBDT Circular No.5/2016 dated 29.2.2016, wherein it has clarified that TDS under section 194H is not attracted on retentions by an advertising agency (for booking or procuring of or canvassing for advertisements) from payments remitted to television channels/newspaper companies.

7. Whether delay in filing appeal under section 260A can be condoned where the stated reason for delay is the pendency of rectification application before the ITAT under section 254(2) for rectification of mistake apparent on record?

SPINACOM INDIA (P.) LTD. V. CIT [2018] 258 TAXMAN 128 (SC)

Facts of the Case: The appellants have approached the Supreme Court under a special leave petition. There has been a delay of 439 days in filing the appeal under section 260A for which reason the appellants requested for a condonation of delay. The appellants submitted that the delay was on account of pendency of rectification application before the Income-tax Appellate Tribunal (ITAT) under section 254(2).

Issue: The issue under consideration is whether delay in filing appeal under section 260A can be condoned where the stated reason for delay is in pursuance of pendency of an application before the ITAT under section 254(2) for rectification of mistake apparent on record.

Supreme Court's Observations: Under section 260A, an order of the ITAT can be challenged on substantial questions of law. The Court stated that the appellant had the option of filing an appeal under section 260A while also mentioning in the Memorandum of Appeal that its application under section 254(2) was pending before the ITAT. The time period for filing an appeal under section 260A does not get suspended on account of the pendency of an application before the ITAT under section 254(2) of the Act.

Supreme Court's Decision: Since no satisfactory reason has been provided by the Appellant for the extraordinary delay of 439 days in filing the appeal, the Supreme Court dismissed the application for condonation of delay.

8. Is the cancellation of registration of a trust under section 12AA, on the basis of search conducted in the premises of its Secretary General and the statement recorded by him under section 132(4), valid?

U.P. DISTILLERS ASSOCIATION (UPDA) V. CIT [2017] 399 ITR 143 (DEL)

Facts of the case: A search and seizure operation took place in the premises of the Secretary General of the assessee, that is, Uttar Pradesh Distillers Association. During the search, the Secretary General's statement was recorded under section 132(4) of the Act. In the meanwhile, the Commissioner of Income- tax (CIT) cancelled the assessee's registration under section 12AA(3) on the basis of the search operation and the statement made. The order was upheld by the Appellate Tribunal. The assessee contended that Secretary General's statement was made in the course of search in respect of his premises and not those of the assessee. Hence, the Secretary General's statement was not attributable to the assessee nor could the materials indicated by him be the basis for cancellation of registration of the trust under section 12AA

Issue: The issue under consideration is whether the cancellation of registration under section 12AA as a charitable trust on the basis of search conducted in the premises of the Secretary General of the assessee-trust and the statement recorded by him under section 132(4) is valid.

Delhi High Court's Observations: The Court dismissed the appeal to hold that although the premises, in which the search under section 132 took place, belonged to the Secretary General, he virtually ran the assessee-trust's activities from the same premises. The information which he provided in the course of the search pointed out to the activities of the assessee-trust and not to his own activities. Further, the Tribunal had expressly recorded that the search proceedings took place in the context of section 153A, in the very premises of the Secretary General, with respect to the assessee-trust.

Delhi High Court's Decision: The Delhi High Court, accordingly, held that cancellation of the trust's registration under section 12AA on the basis of search conducted in the premises of the Secretary General and the statement recorded under section 132(4) from him, is valid.

Note: The special leave petition filed against the aforementioned decision of the Delhi High Court was dismissed by the Supreme Court.

9. Is the notice for reassessment issued under section 148 on the basis of tax evasion report received from the Investigation Unit of the Income-tax department valid, if such notice has been issued erroneously in the name of the erstwhile company which has now been converted into an LLP?

SKY LIGHT HOSPITALITY LLP V. ASSISTANT CIT [2018] 405 ITR 296 (DEL)

Facts of the Case: Sky Light Hospitality (SH) LLP, a Limited Liability Partnership, had acquired the rights and liabilities of Sky Light Hospitality Private Limited (SHPL) upon conversion under the Limited Liability Partnership Act, 2008. Upon receipt of a tax evasion report, a reassessment notice had been issued under section 148. The petitioner-LLP has filed a writ petition to quash the notice and the reassessment proceedings.

Issue: The issue under consideration is whether a notice for reassessment issued under section 148 on the basis of tax evasion report received from the Investigation Unit of the Income-tax department can be treated as valid, if such notice has been issued erroneously in the name of the erstwhile company which has now been converted into an LLP.

Delhi High Court's Observations: The petitioner contended that the notice under section 148 was invalid because –

(i) the notice is not protected under section 292B as issuance of notice incorrectly in the name of SHPL had been done intentionally; and
(ii) the notice has been issued without a live nexus/reason to believe that the income had escaped assessment.

The High Court dismissed the contentions of the petitioner. Firstly, as long as there is "reason to believe" and not mere "reason to suspect", Courts should not interfere. In the notice for reassessment, reference was made to the tax evasion report received from the Investigation unit of the Income-tax department. The tax evasion report placed on record is detailed and elaborate. Peculiar and specific details relating to transactions between the assessee and a third party were mentioned in it. As per the tax evasion report, the assessee had not been able to satisfactorily explain source of ₹35 crores. Hence, there was evidence and material on record to justify issue of notice under section 148 of the Act.

Secondly, there is clear evidence that the notice was erroneously addressed to SHPL instead of SH LLP. The error or mistake was that the notice did not record the conversion of SHPL into SH LLP. However, it is clearly evident that the notice was meant for the assessee-LLP and no one else. Section 292B was enacted to ensure that technical pleas (such as mistake, defect or omission) or procedural irregularities do not invalidate assessment proceedings. Courts have not proceeded on technical trivialities. The error here was only a technical issue on the part of the respondent. No prejudice was caused. The Court acknowledges the lapses in the litigation but observes that mere human errors cannot be used to nullify proceedings.

Delhi High Court's Decision: The Delhi High Court held that the notice issued under section 148 on the basis of tax evasion report received from the Investigation unit of the Income-tax department is valid, since there was reason to believe on the basis of the said report that income had escaped assessment, even though the notice

was erroneously issued in the name of the erstwhile company which has now been converted into LLP. The petitioner-LLP is required to appear before the Assessing Officer to deal with the merits of the issues pertaining to the notice.

10. Does the Central Board of Direct Taxes (CBDT) have the power to amend legislative provisions through a Circular?

COMMISSIONER OF INCOME TAX V. SV GOPALA AND OTHERS [2017] (SUPREME COURT)

Facts: The CBDT had issued a Circular invoking the powers under Section 119 of the Income-tax Act, 1961. The Circular amended the provisions contained in Rule 68B of the Second Schedule to the Income-tax Act, 1961 relating to time limit for sale of attached immovable property.

Issue: Does the CBDT have the power to amend legislative provisions through a Circular?

Supreme Court's Decision: The Supreme Court observed that the CBDT does not have the power to amend legislative provisions in exercise of its powers under section 119 of the Income-tax Act, 1961 by issuing a Circular. The Supreme Court, accordingly, quashed the circular for being ultra vires.

11. Can dividend distribution tax under Section 115-O of Income tax Act, 1961 be levied in respect of the dividend declared out of agricultural income?

UNION OF INDIA V. TATA TEA (SUPREME COURT)

Facts of the case: The petitioner is a tea company engaged in cultivating and processing tea in its factory for marketing. The cultivation of tea is an agricultural process while the processing of tea in the factory is an industrial process. The petitioners contend that when the company distributes dividend, it is taxed under Section 115-O. The tax on dividend declared by it in this case is nothing but a tax on agricultural income. The legislative competence for taxing agricultural income lies with the State Government and not the Central Government.

Issue: Can dividend distribution tax be levied on the dividend income of a tea company under section 115-O?

Supreme Court's Decision: When dividend is declared to be distributed and paid to a company's shareholders it is not impressed with character of the source of its income. Dividend is derived from the investment made in the company's shares and the foundation rests on the contractual relations between the company and the shareholder. Dividend is not 'revenue derived from land' and hence cannot be termed as agricultural income in the hands of a shareholder. Hence, despite the petitioner's company being involved in agricultural activities, in the shareholder's hands, the income is only dividend and not agricultural income.

When dividend is declared to be distributed and paid to a company's shareholders, it is not impressed with character of the source of its income. Section 115-O is within the competence of the Union Parliament and therefore dividend distribution tax can be levied in respect of the entire dividend declared and distributed by a tea company.

12. Is an assessee receiving refund consequent to waiver of interest under sections 234A to 234C of the Income-tax Act, 1961 by the Settlement Commission, also entitled to interest on such refund under section 244A?

K. LAKSHMANSA AND CO. V. COMMISSIONER OF INCOME TAX [2017] (SUPREME COURT)

Facts of the case: The assessee had approached the Settlement Commission for waiver of interest under sections 234A to 234C of the Income-tax Act, 1961. The said interest has already been paid by the assessee. The Settlement Commission waived the interest but refused to grant interest on refund on the ground that section 244A does not provide for payment of interest in such cases. Further, the Settlement Commission's power to waive interest does not enable the Commission to provide for payment of interest under section 244A.

Issue: When refund is awarded by the Settlement Commission under section 244A, is there a right to receive interest on the same?

Supreme Court's observations: The Supreme Court observed that the right to claim refund is automatic once the statutory provisions have been complied with. The statutory obligation to refund, being non-discretionary, carries with it the right to interest. Section 244A is clear and plain – it grants a substantive right of interest.

Under section 244A, it is enough if the refund becomes due under the Income-tax Act, 1961 in which case the assessee shall, subject to the provisions of that section, be entitled to receive simple interest. It does not matter that the interest being waived is discretionary in nature; the moment that discretion is exercised and refund becomes due consequently, a right to claim interest springs into being in favour of the assessee.

Supreme Court's Decision: The Supreme Court held that the assessee has a right to interest on refund under section 244A.

13. Whether certain receipts by co-operative societies from its members (non-occupancy charges, transfer charges, common amenity fund charges) are exempt based on the doctrine of mutuality?

INCOME-TAX OFFICER V. VENKATESH PREMISES CO-OPERATIVE SOCIETY LTD. (SUPREME COURT)

Supreme Court's observations: The doctrine of mutuality is based on the common law principle that a person cannot make a profit from himself. The essence of the principle

of mutuality lies in the commonality of the contributors and the participants who are also the beneficiaries. The contributors to the common fund must be entitled to participate in the surplus and the participators in the surplus are contributors to the common fund. Any surplus in the common fund shall, therefore, not constitute income but will only be an increase in the common fund meant to meet sudden eventualities.

The Supreme Court made the following observations:

- If for convenience, part of the transfer charges were paid by the transferee, they would not partake of the nature of profit. The amount is appropriated only after the transferee was inducted as a member. In the event of non-admission, the amount was returned. The moment the transferee was inducted as a member the principles of mutuality would apply.

- Non-occupancy charges were levied by the society and were payable by a member who did not himself occupy the premises but let them out to a third person. The charges were utilised only for common benefit of facilities and amenities to the members.

- Contribution to the common amenity fund taken from a member disposing of property was utilized for meeting heavy repairs to ensure hazard-free maintenance of the properties of the society which ultimately benefitted the members.

Supreme Court's Decision: The doctrine of mutuality, is based on the common law principle that a person cannot make a profit from himself. Accordingly, the **transfer charges, non-occupancy charges common amenity fund charges and other charges are exempt** owing to application of the doctrine of mutuality.