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DIRECT TAXES

Judicial Pronouncements

Pride Foramer S.A. v. ACIT (2007) 112 TTJ (Del) 313

Agreement between India and France - Salary paid to employees working in India. AO making assessment of the assessee u/s.44BB and observing that in assessment u/s.44BB, salary paid to employees is deemed to have been allowed deduction and, therefore, assessee having failed to deduct tax at source on such salary, was in default under s.201 and liable to interest.

Held that sec.44BB has a limited fiction as regards presumptive rate of tax @10% and no deeming fiction can be introduced for interpretation of art. 14(2) of the DTAA which deals with taxability of salary of employees of non-resident. As the duration of stay of expatriate employees in India was less than 183 days, salary was paid by the French company and no deduction of such salary was claimed in the return filed by PE of French company in India, all the conditions of art. 14(2) of the DTAA sbetween India and France stood satisfied, hence the salaries of employees were not taxable in India and assessee French company could not be treated as assessee in default under s. 201 for non-deduction of tax at source on such salary notwithstanding assessment u/s. 44BB.

ACIT vs. SMT. LAKSHMIKUTTY NARAYANAN (2006) 112 TTJ (Coch) 396

Dividend-Deemed dividend under s. 2(22) (e) - Loan by company to shareholder - AO noting that company had advanced loans and advances to assessee-director to the tune of Rs. 53,93,192 and company had a surplus to the tune of Rs. 9,02,892 in the relevant year, added the amount of Rs. 9,02,892 as deemed dividend in the hands of assessee. Contention of assessee that construction of commercial - cum-residential complex was entrusted to the company as per the agreement between the assessee and the company and the debit balance of Rs. 53,93,192 was on account of normal business transaction and that there was no accumulated profit in the earlier year when the relevant construction was made. CIT(A) accepting contention of assessee and deleting addition on the ground that there was no cash flow or any payment to the assessee during the previous year and hence s. 2(22)(e) was not attracted-Justified. It was not disputed that there was no transaction of any nature whatsoever during the previous year relevant to the A.Y. 1996-97, and whatever book entries were passed, those were relating to the earlier years and that was also in respect of the agreement between the assessee and the company.

Shivani Builders v. ITO (2007) 108 ITD 520 (Ahd.)

Since Provision of section 44AD is only for a person who dose not or chooses not to, maintain regular book of account, assessee having maintained its book of account, and disclosing therein its real income higher than that assessable under section 44AD, it cannot ignore book of results and claim to be entitled for being assessed at a lower presumptive rate of income than that revealed by such book.

Once assessee's income, in terms of underlying documents stands worked out at higher sum than presumptive income, same has to be accepted as such, excepting for prima facie adjustments in respect of clear inadmissible.

Unilever PLC v. JCIT (2007) 18 SOT 136 (MUM.)

Section 90, r.w.s 263 of Income-tax Act, 1961

Assessee company incorporated in U.K., had made investment in Government securities in India

and earned interest income on same. In its return of income, assessee had offered to tax net interest income on said Government securities at rate of 15% in terms of articles 11(3) and 12(2) of Indo-UK tax treaty. Assessing officer accepted said return. Subsequently, commissioner, in exercise of his powers under section 263, revised assessment order holding that taxability of interest on gross basis, and applicability of Indo-UK tax treaty had apparently not been taken into consideration while framing assessment by Assessing Officer and, therefore, Assessing Officer was required to look into these aspects afresh.

Held that order of Assessing Officer cannot be held to be erroneous just because commissioner suspects that some aspects of case had 'apparently' not been taken into Assessing Officer and further since, in terms of provisions of articles 11(3) and 12(2), interest and dividend income were to be taxed @ 15% only, under these circumstances, it was difficult to comprehend as to on what basis AO allegedly failed to make necessary enquiries and, therefore, order of Assessing Officer could not be said to be erroneous.

RBF Rig Corpn. LIC (RBFRC) v. ACIT (2007) 109 ITD 0141 (DELHI) (SB)

Section 10(10CC) of the ITA, 1961 Perquisite, not provided by monetary payment. Payment of tax on behalf of employee at option of employer is a non-monetary perquisite fully covered by sub-clause (iv) of clause (2) of section 17 and, thus, exempt under section 10(10CC) and is not liable to be included in total income of employee. Taxes paid by employer can be added only once in salary of employee and thereafter, tax on such perquisite is not to be added again.

Radha Krishna Jalan v. CIT (2007) 165 TAXMAN 0538 (GAU)

Section 10(2A) of the ITA, 1961. Share of profits to partner of firm. A sub-partnership which is in receipt of share of profit of a partner in main partnership, has to be deemed to be a partner in main partnership for limited purpose of section 10(2A).

ITO v. Sunil Mittal (2007) 018 SOT 0362 (DELHI)

Section 28(iv) of the Income-tax Act, 1961 - Business income - Value of any benefit or perquisite, arising from business or exercise of profession - Where assessee had rendered help to a person on various occasions, who in return had gifted certain sum to assessee, such gifted amount would fall outside scope of income within meaning of section 28(iv), as such benefit was not received in course of business of assessee.

ACIT v. Claridges Investments & Finances (P.) Ltd. (2007) 018 SOT 0390 (MUM)

I. Section 14A, read with section 10(33), of the Income-tax Act, 1961 - Expenditure incurred in relation to income not includible in total income. Provisions of section 14A apply only when there is expenditure in relation to an exempt income and it does not create any legal fiction to deem any expenditure as expenditure incurred in relation to exempt income. Assessee-company which was dealing in securities in stock exchanges, required substantial funds to deal in same which was met from borrowed funds in addition to own funds. Thereafter, assessee had invested certain sum in mutual funds and shares and earned dividend income on same. Department held that as dividend income was earned by assessee which was exempt under section 10(33) expenditure relatable to such income was disallowable under section 14A. Held that since dividend income was merely an incidental income for which no borrowing was

made, impugned disallowance made by Assessing Officer was not justified and was liable to be deleted.

II. Section 28(i), read with section 36(2), of the Income-tax Act, 1961 - Business loss/deductions - Allowable as - Any bona fide loss arising in ordinary course of carrying on of business which is of a revenue nature is to be allowed as a business loss even if provisions relating to deduction of bad debt do not apply. Assessee-company purchased shares of a company 'C' on behalf of another company CCL and total amount receivable on this account was Rs. 2,47,69,500.69 - Assessee claimed that it did not receive said amount as two cheques issued by CCL of Rs. 1,25,00,000 each bounced. Assessee, therefore, claimed that amount of Rs. 2,47,69,500 be allowed as business loss/bad debt. Assessing Officer disallowed assessee's claim holding that since assessee had in its custody 6,40,000 shares of 'C' worth Rs. 74,56,000 and also had with it margin money of Rs. 15 lakhs, loss of Rs. 2,47,69,500 could not be claimed by assessee. Assessing Officer further held that assessee's claim for allowing this amount was not acceptable, as amount had not been written off also in books of account and requirements of provisions of section 36(2) were not met with. Held that since assessee had purchased shares on behalf of 'CCL' in ordinary course of its profit-making activity, it was entitled to deduction of money lost, however, since assessee had with it security deposit of Rs. 15 lakhs and also had 6,40,000 shares of company 'C' worth Rs. 74,56,000, disallowance to extent of Rs. 27,80,000 was justified and balance amount was allowable as a business loss.

III. Section 45 of the Income-tax Act, 1961 – Assessee-company disclosed investments in equity shares at Rs. 1,332.48 lakhs. It had converted said investments into stock-in-trade by passing a journal entry in account books and market value of said shares on date of conversion was Rs. 1,064.74 lakhs. Assessing Officer, in terms of provisions of section 45(2), treated difference between cost of investments and market value of shares as capital loss as against assessee's claim of business loss and, accordingly, did not allow benefit of set-off of loss against business income of assessee. Held that AO was justified in his action.

IV. Section 28(i) of the Income-tax Act, 1961 - Business loss/deductions - Assessee entered into various transactions in shares through three Kolkata based brokers. For relevant assessment year, assessee claimed deduction of Rs. 26.44 crores as business loss stating that Kolkata based brokers had defaulted in making payments. Assessing Officer, however, disallowed assessee's claim. Held that since assessee's transactions in shares through aforesaid brokers were supported by movement of shares as reflected in demat account; movement of money, as reflected in bank account; entries in books of account of assessee; prevalent market quotations of CSE; contract notes and delivery bills issued by Kolkata brokers and their statements in response to enquiries made by Assessing Officer, it could not be said that these transactions were shown only in order to generate loss or profit and were not genuine share transactions. Further, since loss, in question was no longer recoverable, denial of deduction of loss on ground that loss had not crystallized during relevant financial year was also untenable. Therefore, deduction of loss in question was to be allowed.

ITO v. Monnet Industries Ltd. (Delhi) 18 SOT

Assessee-company had set up ferro-chrome and alloys manufacturing plant. In relevant year, it set up a sugar manufacturing unit and commenced it's

trial production. It incurred expenditure amounting to Rs. 5.6 crores on purchase of material consumed in trial production and claimed deduction of same. Assessing Officer held that sugar project was a new source of income and was not same business as that of manufacturing ferro-chrome or trading in it and, accordingly, disallowed assessee's claim Held that since assessee-company was having a common management which was looking after and was responsible for affairs of both units and further since source of fund was common for both ferro-alloys unit and sugar unit, it could be said that sugar manufacturing plant was a mere extension of existing business of ferro-alloy and its trading and sugar division was in same line of business of assessee. Since out of expenditure of Rs. 5.6 crores expenditure of financial charges amounting to Rs. 3,50,83,472 was incurred for purpose of setting up sugar division, same was allowable as deduction under section 36(1)(*iii*). And allowability of any other expenditure like administrative expenses, power and fuel expenses, etc., would depend upon question whether expenditure was capital or revenue in nature, and, therefore, matter was to be restored to Assessing Officer for passing a fresh order in that context.

Dy. CIT v. Samta Marine Kakinada (Mum.) 18 SOT

Assessment year 1999-2000 - Goodwill arising on transfer of business is assessable under head 'Income from capital gains' and method of accounting whether mercantile or cash system is not applicable while determining income under head 'Income from capital gains'.

Saurabh Srivastava v. DCIT (Delhi SB)

Section 28(i) read with sections 17(2), 17(3), 28(ii), 28(iv), 28(va), 45 and 56 of Income-tax Act, 1961 – Where compensation is received for composite partly for transfer of capital assets, incidental to carrying on business and partly for undertaking restrictive covenant of not competing with business of assessees, compensation relatable to such activity would be a capital receipt. Assessee, a Computer Engineer and associated with Software and Information Technology, was promoter and founder of as well as Managing Director of a company 'H' and held certain shares of said company. Company 'H' was agreed to be taken over by a U.K. company and as per shares purchase agreement dated 4-12-1997 entered into by U.K. company with shareholders of 'H' including assessee, 76 per cent of subscribed equity capital was agreed to be transferred in favour of U.K. company by shareholders in order to effect said taken over. In terms of said agreement, assessee sold his all shares of company 'H' to U.K. company. In addition to share transfer agreement, U.K. Company also entered into a non-compete agreement with assessee on same date, i.e., 4-12-1997, whereby assessee was restrained from carrying out any software development activity for any other person who directly competed with U.K. company and its associate and subsidiary companies for a period of 18 months. In meantime, assessee also entered into yet another new service agreement with company 'H' on 24-2-1998 whereby assessee was employed as Managing Director of said company. Therefore, shares purchase agreement was completed on 26-2-1998 and 76% of shares of company 'H' stood owned and vested in U.K company on that date. During previous year relevant to assessment year 1998-99, assessee received certain amount from U.K company as non-compete fees and claimed same to be exempt being in nature of a capital receipt. Assessing Officer rejected claim of assessee and held that amount in question was a revenue receipt liable to tax under section 28(ii). Held that:

1. Even though on date of payment of non-compete fees by U.K company to assessee an employer and employee relationship existed between company 'H' and assessee, since restrictive covenants stipulated in non-compete agreement were in nature of restrictive covenants for not doing something to compete with business of U.K. company and associate companies upto a period of 18 months from date of agreement dated 4-12-1997 to 31-5-1999 and further since non-compete agreement was an independent, distinct and separate agreement from service agreement and it was not dependent on assessee continuing in employment with company 'H' and further since restrictions accepted by assessee adversely affected his income earning potential by exploiting entrepreneur skill, knowledge etc., non-compete fees received by assessee was in nature of a capital receipt. Since entering into a non-compete agreement for restrictive covenant could not be considered and treated as part of rendering services to employer company 'H' would bring such compensation in nature and ambit of profits in lieu, non-compete fee was not taxable under head 'salary' under section 17(3)(*i*)/17(2)(*v*).

2. Since assessee continued to be Managing Director of company 'H' even after take over, payment of non-compete fees was not in any way directly or indirectly linked to termination of management and, therefore, non-compete fees was not covered under section 28(*ii*). Since non-compete fees did not arise to assessee from carrying on of business or profession, it would also be not be taxable under section 28(iv).

3. Since legislature, in their wisdom, has specifically made taxable receipt of a non-compete fees under an agreement under clause (va) of section 28 inserted by Finance Act, 2002 with effect from 1-4-2004, non-compete fees in question could not be brought to tax under amended section also.

4. Since assessee had not transferred any capital asset, non-compete fees was also not liable to capital gains under section 45.

5. Since non-compete fees received by assessee was for undertaking restrictive covenants of not undertaking or engaging himself in business of assessee or joining employment with any other concern, same was also not liable to tax under head 'income from other sources'.

In view of aforesaid, it could be concluded that non-compete fees for undertaking restrictive covenants was in nature of capital receipt and hence, not liable to tax under any head of income mentioned under section 14.

Circular

Circular No. 9/2007, Dated 20-12-2007

Explanatory circular on Fringe Benefit Tax arising on allotment or transfer of specified securities or sweat equity shares has been issued by the CBDT, which is available at following link:

http://law.incometaxindia.gov.in/TaxmannDit/DisplayPage/dpage1.aspx?md=1

The circular contains matters like applicability, method of computation of value of FB, Determination of the cost of acquisition for capital gains purposes, Determination of the period of holding, Recovery of FBT by the employer from its employee and various FAQs on the subject.

We cannot direct the winds, but we can adjust the sails.

INDIRECT TAXES

Judicial pronouncements

Security Print & Mint Corpn. of India Ltd. v. Gandhi Industrial Corpn (2007) 11 STT 296 (SC)

MODVAT CREDIT - Rule 57A of the Central Excise Rules, 1944

Appellant – security press floated tender for gumming and super-calendering work of stamp based papers. Said tender was awarded to respondent-claimant. While placing order with claimant, appellant added a term that Modvat credit, if any, availed by claimant would be passed on to it. Claimant accepted said order subject to withdrawal of term relating to passing of Modvat credit to appellant as Modvat credit is available to only manufacturer, i.e., claimant. Appellant did not respond to claimant's confirmation but forwarded inputs to claimant who, accordingly, delivered finished goods to appellant. However, later appellant finally informed claimant that Modvat Credit availed by it would be adjustable by way of deduction of amount payable to it. Claimant objected to same and matter was referred to arbitration. Arbitration took view that since Modvat Credit is only available to manufacturer, appellant could not get said benefit. Single Judge and division bench of high court upheld order of arbitrator and held that when terms and condition of tender had been reduced in supply goods as per order, then there was no going back from condition. Since claimant did not withdraw from contract and continued with it, on basis of clear terms of contract, claimant was bound by it and it had to restore Modvat Credit received by it to appellant.

CCE v. Dr.Lal Path Lab (P.) Ltd. (2007) 11 STT 307 (PUNJ. & HAR.)

Section 65 of the Finance Act, 1994 - Business auxiliary service - Assessee was engaged in collection of blood, urine and stool samples and sending same to its principal's lab for biological testing. Revenue demanded service tax from assessee on ground that its activities were covered under category of 'Business auxiliary service' as per section 65(19).

Held that since activity of assessee was confined to collection centre, its case appeared to be covered by exception postulated by section 65(106) which defines expression 'technical testing and analysis'. Merely because any incidental service was rendered by assessee like putting across or dropping of name of principal company, it would not become part of definition of 'Business auxiliary service' within meaning of section 65(19)(ii), therefore, no service tax could be demanded from assessee.

Circular

Amendment to Circular No. 96/7/2007-ST, dated 23-8-2007 - Clarification in respect of renting of immovable property service and works contract service

Circular No 98/1/2008-ST, Dated 4-1-2008

In the Circular No. 96/7/2007-ST dated the 23rd August, 2007,-

(i) after Reference Code 086.05 / 23.08.07, the following issue and clarification shall be inserted, namely:-

Issue	Clarification
Commercial or industrial construction service [section 65(105)(zzq)] or works contract service [section 65(105)(zzzza)] is used for construction of an immovable property. Renting of an immovable property is leviable to service tax [section 65(105)(zzzz)]. Whether or not, commercial or industrial construction service or works contract service used for construction of an immovable property, could be treated as input service for the output service namely renting of immovable property service under the CENVAT Credit Rules, 2004?	Right to use immovable property is leviable to service tax under renting of immovable property service. Commercial or industrial construction service or works contract service is an input service for the output namely immovable property. Immovable property is neither subjected to central excise duty nor to service tax. Input credit of service tax can be taken only if the output is a 'service' liable to service tax or a 'goods' liable to excise duty. Since immovable property is neither 'service' or 'goods' as referred to above, input credit cannot be taken.

(ii) after Reference Code 097.01 / 23.08.07, the following Reference Codes and corresponding issues and clarifications shall be inserted, namely:-

Services provided in relation to execution of a works contract is leviable to service tax [section 65(105)(zzzza)]. VAT / sales tax is payable on the transfer of property in goods involved in the execution of a works contract. Service tax is leviable on the value equivalent to the gross amount charged for the works contract less value of the transfer of property in goods involved in the execution of the works contract which is leviable to VAT / sales tax [Rule 2A of the Service Tax (Determination of Value) Rules, 2006]. Whether or not, excise duty paid on goods, subjected to levy of VAT / sales tax under works contract service, can be taken as credit under the CENVAT Credit Rules, 2004?	Value for the purposes of levy of service tax under works contract service does not include the value pertaining to transfer of property in goods involved in the execution of a works contract leviable to VAT / sales tax. Works contract service provider is, therefore, not eligible to take credit of excise duty paid on such goods involved in the execution of works contract.
Services provided in relation to execution of works contract is leviable to service tax w.e.f. 01.06.07 [section 65(105)(zzzza)]. Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007 provides option to pay service tax @ 2% of the gross amount charged for the works contract. However, the service provider opting for composition scheme for payment of service tax should exercise the option prior to payment of service tax.	Prior to 01.06.07, service provider classified the taxable service under erection, commissioning or installation service [section 65(105)(zzd)], commercial or industrial construction service [section 65(105)(zzq)] or construction of complex service [section 65(105)(zzzh)], as the case may be, and paid service tax accordingly. The contract for the service was a single composite contract. Part of service tax liability corresponding to payment received was discharged and the balance amount of service tax is required to be paid on or after 01.06.07 depending upon receipt of payment.
The issue pertains to,- (i) contracts entered into prior to 01.06.07 for providing erection, commissioning or installation and commercial or residential construction service, and (ii) service tax has already been paid for part of the payment received under the respective taxable service. Whether in such cases, the service provider can revise the classification to works contract service from the respective classification and pay service tax for the amount received on or after 01.06.07 under the Composition Scheme?	Classification of a taxable service is determined based on the nature of service provided whereas liability to pay service tax is related to receipt of consideration. Vivisecting a single composite service and classifying the same under two different taxable services depending upon the time of receipt of the consideration is not legally sustainable. In view of the above, a service provider who paid service tax prior to 01.06.07 for the taxable service, namely, erection, commissioning or installation service, commercial or industrial construction service or construction of complex service, as the case may be, is not entitled to change the classification of the single composite service for the purpose of payment of service tax on or after 01.06.07 and hence, is not entitled to avail the Composition Scheme.

OTHER LAWS

PRESS RELEASE

PAYMENT OF BONUS (AMENDMENT) ACT, 2007 (No. 45 OF 2007)

An Act further to amend the Payment of Bonus Act, 1965 (w.e.f 01-04-2006)

Amendment of section 2

2. In section 2 of the Payment of Bonus Act, 1965 (21 of 1965) (hereinafter referred to as the principal Act), in clause (13), for the words three thousand and five hundred rupees, the words ten thousand rupees shall be substituted.

The poor man is not he who is without money, but he who is without a dream.

Amendment of section 12

3. In section 12 of the principal Act, for the words two thousand and five hundred rupees, at both the places where they occur, the words three thousand and five hundred rupees shall respectively be substituted.

Amendment of section 32

4. In section 32 of the principal Act, clause (vi) shall be omitted.

Due Dates of key compliances pertaining to the month of January-08:

5th Jan.	**Payment of Service Tax & Excise duty for December**
6th Jan.	**Payment of Excise duty paid electronically through internet banking**
7th Jan.	**TDS/TCS Payment for December**
10th Jan.	**Excise Return ER1 / ER2 /ER6**
15th Jan.	**PF Contribution for December, Excise payment by SSI**
21st Jan.	**ESIC Payment for December**

Success is how high you bounce when you hit bottom.