Issue – 12 | December 2008

SNK Newsletter

DIRECT TAXES

Judicial Pronouncements

Shri Bharat C Gandhi, Prop. of Darshan Roadlines v. ACIT ITA NO. 4/Mum/2006

Section 2(22)(e)

Assessee takes loan from a company in which it held 50% equity shares. AO treats the same as deemed dividend u/s 2(22)(e). Assessee contends that, firstly the provision of section 2(22)(e) does not apply because the interest was paid on the loan, and secondly if it is deemed dividend the provisions of section 115-O will apply to the company and liable to be taxed at the rate of 10%. CIT(A) holds that the main object of the assessee-company was never pursued and the loan given by the said company was to the family members and therefore, this cannot be treated as money lending activity.

It was held that the lending of money appears to be a business pursued by the assessee even during earlier year. Assessee charged interest from its Director as well. Hence the lending money could be treated as the business transaction and not attracting section 2(22)(e). Assessee's Appeal allowed.

CIT vs. J. K. Charitable Trust (Supreme Court) Civil Appeal No. 2092 of 2006

Section 11 – Charitable Trust

Where the High Courts had held in a number of cases that a charitable trust receiving shares of a company by way of donation did not forfeit exemption u/s 11 and the department had not filed appeals against those judgments and the question arose whether it was permissible for the department to challenge the same in the assessee's case, it was held that:

While merely because in some cases revenue has not preferred an appeal that does not operate as a bar for the revenue to prefer an appeal in another case where there is just cause for doing so or it is in public interest to do so or for a pronouncement by the higher court when divergent views are expressed by the different High Courts, this is NOT SO in a case where the fact situation in all the assessment years is the same. Where the fact situation is the same, the revenue cannot prefer an appeal if they have not done so in the other cases.

CIT v Monnel Industries Ltd. [ITA No. 450/2008]

Deductibility of interest paid on borrowed capital by an existing company for setting up a new line of business

A loan taken or capital borrowed is, by itself, not a capital asset, nor does it give an advantage of an enduring nature; as long as interest is paid on capital borrowed or loan taken in respect of new line of business which is in the same business fold for the purposes of ascertaining income under section 28 of the IT Act, it can be claimed as a deduction deduction under section 36(1)(iii) of the Act.

CIT v. Chetak Enterprises (P) Ltd. (2008) 14 DTR (Raj) 233

Allowability of deduction u/s. 80-IA - Conversion of firm into company under Part IX of Companies Act, 1956

Work of construction of roads was granted to the partnership firm and later the firm got itself registered as a company w.e.f. 28th March, 2000. Relevant previous year being 2000-01, it was the company which carried on the specified business right from the commencement of the relevant financial year. Further, firm had clarified in its first communication to the Chief Engineer of the State Government that the firm would be converted into a limited company. Conversion of the firm into company had the effect of statutorily vesting of the assets and liabilities in the company and thus the assessee fulfils all the conditions laid down in s. 80-IA(4). Even otherwise, proviso to s. 80-IA(4)(i) clearly provides that in the case of transfer, the transferee will become entitled to deduction with effect from the date of transfer. Therefore, assessee was entitled to deduction under s. 80-IA.

DCIT v. Brigade Enterprises (P) Ltd. (2008) 14 DTR (Bang)(Trib) 371

Deduction u/s. 80-IB - Income from developing and building housing project

Different units of a group project. Where some of the residential units in a bigger housing project, treated independently, are eligible for relief under s. 80-IB(10), relief should be given pro rata and should not be denied by treating the bigger project as a single unit, more so, when assessee obtained all sanctions, permissions and certificates for such eligible units separately. Assessee undertook a development project in an area of 22 acres 19 guntas consisting of 5 residential blocks, row houses, oak tree place, a club, a community centre, a school and a park and claimed deduction under s. 80-IB(10) in respect of two residential units only which if taken separately, were eligible for the relief. AO treated the entire project as a single unit and denied relief under s. 80-IB in entirety.

Held that CIT(A) was justified in allowing relief under s. 80-IB(10) treating the said two units as independent units. Material on record showed that the various local authorities duly inspected the plot and sanctioned plan for each of the blocks separately. Group housing approval was approval of a master plan as a concept. Further, the use of the words "residential unit" in cl. (c) of s. 80-IB(10) means that deduction should be computed unit-wise. Therefore, if a particular unit satisfies the condition of s. 80-IB, the assessee is entitled for deduction and it should be denied in respect of those units only which do not satisfy the conditions. Again, the accounting principles would also mandate recognition of profits from each unit separately.

ACIT v. Time Packaging Ltd. IT Appeal No. 6250 (Mum.) of 2007]

Section 145, read with section 43B of the Income-tax Act, 1961 - Method of accounting - Valuation of stock

During relevant assessment year, while examining provisions of section 145A, Assessing Officer noticed that assessee did not give effect to excise duty for valuation of closing stock and accordingly, increased valuation of closing stock.

Held that after making addition to closing stock under section 145A, it will be possible to claim a separate deduction for excise duty actually paid after year end but before due date for filing return of income on production of evidence as provided under section 43B. In instant case, even though assessee contended that while valuing closing stock it had followed procedure laid down by Institute of Chartered Accountants of India and detailed working was also given in tax audit report as required in clause 12 (b) of form 3CD, still deduction under section 43B was subject to verification and, therefore, matter was to be sent back to Assessing Officer to verify facts of case and calculate amount of addition, if any, accordingly.

D. Subhashchandra & Co. v. ACIT (2008) 15DTR (Ahd)fTrib) 125

Accounts – Section 145 - Valuation of closing stock - Cost or net realizable value whichever is less

Assessee having produced no evidence to justify the net realizable value put by it on the closing stock of polished diamonds, AO was justified in valuing the closing stock at average cost by adopting per carat rate. Though net realizable value method is duly recognized by AS-2, the onus is on the assessee to prove that the net realizable value shown by assessee is the correct net realizable value and is less than the cost. Assessee has not even furnished the subsequent invoice to verify the value actually realized. Valuing the closing stock at cost or market value whichever is lower is a well established method of accounting based on prudency. Assessee having earned gross profit @ 13.81 per cent, obviously net value realized should be more than the cost at least by that percentage. Cut and polished diamonds are sorted in different lots, sizes and qualities and these details are bound to be maintained by the assessee according to cut, carat, clarity and colour (the 4Cs). Contention of assessee that closing stock was valued as per Item 14 of AS-2 would have been tenable if the assessee had assigned the cost to each piece of diamond. The auditor who carried out audit under s. 44AB has qualified the audit report in respect of valuation of closing stock. Accounting standards issued under s. 145(2) are mandatory to be followed in view of s. 145(3).

Haryana Acrylic vs. CIT (Delhi High Court) WP(C) 4074/2007

Section 147 – Reopening after expiry of four years

Where the assessment was reopened after the expiry of four years from the end of the assessment year, HELD:

(a) In view of the Proviso to s. 147, merely having a reason to believe that income had escaped assessment is not sufficient to reopen assessments but it must be specifically alleged by the AO in the recorded reasons that the escapement was on account of the failure of the assessee to make a full and true disclosure of material facts. In the absence of such allegation, the reopening is without jurisdiction;

(b) Rejecting the argument of the AO that the "actual reasons" were different from the communicated reasons, there is a strong logic and purpose behind the directions issued by the Supreme Court in GKN Driveshafts 259 ITR 19 that the AO is bound to furnish reasons and pass a speaking order to deal with the objections of the assessee and that is to prevent high-handedness on the part of AO and to temper any action contemplated under S. 147 of the said Act by reason and substance. This is not a mere 'charade' or a 'pretence' or 'formality'. The argument rendered the entire process into a sham and made a mockery of the law.

(c) The requirement of recording the reasons, communicating the same to the assessee, enabling the assessee to file objections and the requirement of passing a speaking order are all designed to ensure that the Assessing Officer does not reopen assessments which have been finalized on his mere whim or fancy and that he does so only on the basis of lawful reasons. These steps are also designed to ensure complete transparency and adherence to the principles of natural justice. A deviation from these directions would entail the nullifying of the proceedings.

(d) The decision of the Supreme Court in Phool Chand Bajrang Lal 203 ITR 456 that the AO may start reassessment proceedings either because some fresh facts had come to light which were not previously disclosed or some information with regard to the facts previously disclosed comes into his possession which tends to expose the truthfulness of those facts and that in such situation, it is not a case of mere change of opinion or the drawing of a different inference from the same facts as were earlier available, but, one of acting on fresh information DOES NOT APPLY as it was in the context of the old s. 147 prior to the amendment w.e.f 01.04.1989.

(e) Explanation I to Section 147 does not mean that production of account books and other evidence from which material evidence could with due diligence have been discovered by the Assessing Officer will not "in any event" amount to disclosure within the meaning of the said proviso. The said explanation only stipulates that such evidence will not necessarily "amount to disclosure" within the meaning of the said proviso.

(f) As the facts showed that there were specific enquiries by the AO during the original assessment proceedings and due disclosure by the assessee, the reopening was not justified.

ITO vs. Varia Pratik (ITAT A'bad) ITA No. 1226/Ahd/2007

Validity of notice issued u/s 143(2) in view of provisions of section 292BB

Where the assessee claimed that the assessment order was invalid for want of service of notice u/s 143(2) though he had participated in the proceedings, HELD rejecting the contention that:

(i) Though s. 292BB comes into force on 1.4.2008 and not from any particular assessment year, it is declaratory, procedural and curative in nature and accordingly the validity of notices issued/served will have to be decided after 31.3.2008 in accordance with the provisions of section 292BB irrespective of the assessment year involved;

(ii) Even if the assessee has appeared in any proceeding or cooperated at any time in the past, i.e., prior to 1.4.2008, in any inquiry related to an assessment etc that per se is sufficient to preclude the assessee from raising the objection of non-service.

Contrary judgment was given in Cebon India vs. ACIT (ITAT Del) where it was held that non-service of the notice was a jurisdictional defect and not merely a procedural defect and that s. 292BB was procedural and prospective.

Judicial Pronouncements - International Taxation

CIT vs. Siemens AG (Bombay High Court) Income Tax Reference No.251 OF 1988

Explanation to section 9 read with relevant DTAA provisions

(i) Amounts received towards reimbursement of expenses can, under no circumstances, be regarded as a revenue Receipt and is not chargeable to income-tax;

(ii) If the Tribunal has answered an issue and that has not been challenged by the revenue, it will not be open to the revenue to raise the said issue again in respect of the same assessee;

(iii) The judgment of the Supreme Court in Ishikawajima-Harima Heavy Industries v. DIT 288 ITR 408 (SC) has been overcome by the Explanation to s. 9 inserted by the FA 2007 which provides that income from royalty paid by a resident would be deemed to accrue in India even if the recipient has no PE;

(iv) The meaning of the term "laws in force" in the DTAA means that by a unilateral amendment it is not possible for one nation to tax income which otherwise was not subject to tax. However, the expression would not only include a tax already covered by the Treaty but would also include any other tax as taxes of a substantially similar character subsequent to the date of the agreement. It is not possible to accept the proposition that the law would be the law as was applicable or as defined when the D.T.A.A. was entered into;

(v) The rule of referential incorporation cannot be applied in dealing with a DTAA between two Sovereign Nations. Though it is open to a Sovereign Legislature to amend its Laws, a DTAA entered into by the Government have to be reasonably construed;

(vi) Under the old India-Germany DTAA, royalty other than royalty for mine, quarries, etc., constitute "industrial or commercial profits" and are not taxable under Article III(1) in the absence of a permanent establishment of the enterprise in India.

Burmah Castrol Plc vs. DIT A.A.R. No. 772 of 2008

Non-resident - Long-term capital gains - proviso to section 112(1) read with first proviso to s. 48

(i) A non-resident earning long-term capital gains on transfer of listed securities is entitled to the benefit of the lower tax rate in the proviso to section 112(1) in addition to the benefit granted by the first proviso to s. 48.

(ii) Interest paid to the other shareholders pursuant to the order of SEBI to compensate for the delay is a part of the cost of acquisition of shares both in the plain sense and in the commercial sense because without such payment the acquisition would not have been possible.

Mustaq Ahmed vs. DIT (AAR) A.A.R. No. 743 of 2007

Accrual of income - Section 5(2) read with clause (b) of Explanation 1 to section 9(1)

Where the facts showed that the income arising from the sale proceeds of exported goods had actually been received in India because the applicant's banks at Chennai had been crediting the amounts received from the importer/buyer to the account of the applicant, HELD

(i) Where the income is actually received or has accrued in India, the resort to deeming provision is not warranted and s. 5(2) is sufficient to create a charge in respect of non-resident's income. Clause (b) to Explanation 1 makes no difference to this position.

(ii) As the right to receive the payment has arisen in India on account of export sales of gold jewellery to the importers abroad, the income actually accrues or arises in India and there is no scope for the argument that the accrual is nullified by clause (b) of Explanation 1 to section 9(1). Clause (b) does not have the effect of preventing the accrual of income altogether.

INDIRECT TAXES

Judicial Pronouncements

CCE v. Deloitte Tax Services India (P.) Ltd. (2008) 16 STT 449 (BANG. - CESTAT)

Section 65 of the Finance Act, 1994, read with rule 5 of the Cenvat Credit Rules, 2004 - Business auxiliary services

Period from May, 2005 to February, 2006 - Assessee provided various services to a foreign company like back office services and other assistance such as tax services, international assignment services, etc. In respect of those services, it had obtained registration under category of 'Business Auxiliary Services' (BAS) and 'Management consultancy services'. In course of providing those services, assessee received certain input services and paid service tax through Cenvat account. Subsequently, it applied for refund of Cenvat credit on ground that output services provided by it, namely, BAS had been exported. Revenue rejected refund claim main on the ground that services rendered by assessee did not amount to BAS and same were covered under category of 'Information technology service'; since information technology service itself was not taxable, assessee would not be entitled to any credit of service tax on input services.

Held that since services rendered by assessee were not in relation to designing, developing or main-tenance of computer parts or computerized data processing, but same related to tax returns and other business activities, those were to be taxed as BAS and thus, assessee was entitled to refund of credit.

Circulars / Notifications

Clarification regarding reversal of Cenvat Credit in case of trade discount –reg.

F.No.267/54/2008-CX-8 dtd 17th November 2008

1. Representations have been received from trade and industry seeking clarification on the issue whether proportionate credit should be reversed in cases where a manufacturer avails credit of the amount of duty paid by supplier as reflected in the excise invoice, but subsequently the supplier allows some trade discount or reduces the price, without reducing the duty paid by him.

2. The issue has been examined. Since, the discount in such cases are given in respect of the value of inputs and not in respect of the duty paid by the supplier, the effect of reduction of value of inputs may be that the duty required to be paid on the inputs was less than what has been actually paid by the inputs manufacturer. However, the fact remains that the inputs manufacturer had paid the higher duty. Rule 3 of Cenvat Credit Rules, 2004 allows credit of duty "paid" by the inputs manufacturer and not duty "payable" by the said manufacturer. There are many judgements of Hon'ble Tribunal in this regard which have confirmed this view.

3. In view of above, it is clarified that in such cases, the entire amount of duty paid by the manufacturer, as shown in the invoice would be available as credit irrespective of the fact that subsequent to clearance of the goods, the price is reduced by way of discount or otherwise. However, if the duty paid is also reduced, along with the reduction in price, the reduced excise duty would only be available as credit. It may however be confirmed that the supplier, who has paid duty, has not filed/ claimed the refund on account of reduction in price.

OTHER LAWS

Judicial Pronouncements

Khoday Distilleries vs. CIT (Supreme Court) Civil Appeal No. 6654 of 2008

Gift tax Act – Allotment of right/ bonus shares

Where the department held that on the Company allotting rights and bonus shares to its shareholders in a disproportionate manner, it had made a "gift", HELD, rejecting the contention that:

(i) An allotment of shares is a "creation" of shares and not a "transfer" of shares. There is a vital difference between the two. An "allotment" is the creation of shares by appropriation out of the unappropriated share capital to a particular person. A share is a chose in action. A chose in action implies existence of some person entitled to the rights in action incontradistinction from rights in possession. There is a difference between issue of a share to a subscriber and the purchase of a share from an existing shareholder. The first case is that of creation whereas the second case is that of transfer of chose in action. An allotment is not a transfer and does not attract s. 4(1)(a) of the Gift-tax Act.

(ii) The issuance of bonus shares was nothing but mere capitalisation of the profits of the Company in respect of which certificates are issued to the shareholders entitling them to participate in the amount of the reserve but only as part of the capital. When a shareholder gets a bonus share the value of the original share held by him goes down. In effect, the shareholder gets two shares instead of the one share held by him and the market value as well as the intrinsic value of the two shares put together will be the same or nearly the same as the value of the original share before the bonus issue. The issuance of bonus shares does not amount to distribution of accumulated profit of a company. It would be a misnomer to call the recipients of bonus shares as donees of shares from the company.

Gujarat Gas Financial Services Ltd. vs. ACIT (2008) 14 DTR (Ahd)(SB) (Trib) 481

Chargeability of Interest-tax on Finance company - Interest-tax Act, 1974, ss. 2(5A), 2(5B), 2(7) & 4

As per its composition of income and clarification of RBI, principal business of assessee is leasing and none other. However, assessee's income and assets qua leasing business being less than 50 per cent, its principal business may not be leasing and certificate of RBI may not be of any help. What is to be judged is whether assessee is a financing company by applying the positive test, that is to say, whether assessee's principal business falls in any of the clauses of s. 2(5B). None of assessee's businesses is having a share of more than 50 per cent, looked at by either income composition or assets composition and therefore none of its business is a principal business and consequently none of the els. (i) to (v) would apply individually.

Judicial Pronouncements

In contrast to other clauses the requirement of cl. (vi) is that it is to be a company which carries on exclusively, or almost exclusively, two or more classes of businesses referred to in the preceding sub-clauses. Requirement of cl. (vi) is that assessee should be a company carrying on exclusively, or almost exclusively, two or more classes of businesses referred to in els. (i) to (va). Excluding leasing business, taking income as base it comes to 53 per cent (or considering equalisation reserve 46 per cent) and taking assets as base, it comes to 58 per cent which percentages cannot be said to be almost exclusively, not to speak of exclusively. Clause (vi) of s. 2(5B) may also, therefore, not apply. However, assessee itself having admitted in its letter that it was engaged only in financial lease and not operational lease, it was a financial company cumulatively engaged almost exclusively in one or more businesses enumerated in s. 2 (5B), hence exigible to interest-tax.

SEBI/RBI

Review of Prudential Norms – Provisioning for Standard Assets and Risk Weights for Exposures to Commercial Real Estate and NBFCs

RBI.No.2008-09/ 300 dtd. December 1, 2008

Please refer to circular UBD.(PCB). Cir. No.30/09.11.600/06-07 dated February 19, 2007 on provisioning requirement for standard Assets and UBD.PCB.Cir. No.55/ 09.11.600/ 05-06 dated June 1, 2006 on Annual Policy Statement for the year 2006-07- Risk weight on exposures to commercial real estate.

2. The aforesaid prudential requirements were prescribed in view of the continued high credit growth observed in specific sectors. On a review, it has now been decided, as a countercyclical measure, to effect the following changes in these norms, with immediate effect:

a) Provisioning Norms: The provisioning requirements in case of Tier II UCBs for all types of standard assets stand reduced to a uniform level of 0.40 per cent except in the case of direct advances to agricultural and SME sectors, which shall continue to attract a provisioning of 0.25 per cent, as hitherto. Tier I UCBs will continue to make a general provision of 0.25% on all their standard assets.

   The revised norms would be effective prospectively but the provisions held at present should not be reversed. However, in future, if by applying the revised provisioning norms, any provisions are required over and above the level of provisions currently held for the standard category assets; these should be duly provided for.

b) Risk weights: The risk weights for advances to corporates secured by commercial real estate and to NBFCs stand revised as follows:

   (i) Loans and advances secured by commercial real estate: Such loans would attract a risk weight of 100 per cent as against the extant risk weight of 150 per cent.

   (ii) Loans and advances to NBFCs : As per extant guidelines, UCBs shall not finance NBFCs other than those engaged in hire-purchase / leasing. Such companies now stand reclassified as Asset Finance Companies, vide DNBS circular dated September 15, 2008. The risk weights on exposure to such companies will remain unchanged at 100 per cent.

OTHERS

External Commercial Borrowings Policy: Liberalisation

A.P. (DIR Series) Circular No. 26, dated October 22, 2008

This circular has liberalised ECB policy as under:

(a) ECB up to US $ 500 million per borrower per financial year is permitted for rupee/foreign currency expenditure for permis-sible end uses under the automatic route.

(b) Requirement of minimum average maturity period of 7 years for ECB in excess of US $ 100 million per financial year for Rupee expenditure for permissible end uses by borrowers in the infrastructure sector has been removed.

(c) Payment for obtaining licence/ permit for 3G Spectrum has been added as an eligible end use for ECB.

FLASH NEWS ON VODAFONE'S RECENT VERDICT (Source: TIOL)

Vodafone International vs. UOI (Bombay High Court) (Writ Petition No.2550 of 2007)

Bombay High Court dismisses billion dollar Vodafone capital gains case; also imposes costs on telecom major

Where the assessee, a Dutch company, purchased shares of a Cayman Company (which in turn held shares of an Indian company 'Hutch Essar') from another foreign company (HTIL) and the AO issued a notice asking the assessee why it should not be treated as an assessee in default for failure to deduct tax at source and the assessee filed a writ petition to challenge the same on the ground that a transaction between two foreign companies did not attract the provisions of the Act, HELD dismissing the writ petition that:

(a) Prima facie, the subject matter of the present transaction between the assessee and HTIL is nothing but transfer of interests, tangible and intangible in Indian companies and not an innocuous acquisition of shares of a shell Cayman Islands Company;

(b) As there was admittedly a transfer of controlling interest in the Indian company by the transferor in favour of the transferee, there was an "extinguishment of rights" and "relinquishment" by the transferor in the shares of the Indian company which constituted a "transfer";

(c) Apart from controlling interest the assessee had acquired other interests and intangibles rights in India such as an interest in a joint venture between HTIL and the Essar group and became a co-licensee with the Essar group to operate mobile telephony in India;

(d) In this case, the shares in the Cayman company were merely the mode or the vehicle to transfer the assets situated in India. The choice of the assessee in selecting a particular mode of transfer of such assets will not alter or determine the nature or character of the asset;

(e) As the assessee had willfully failed to produce the primary/ original agreement and other prior and subsequent agreements/ documents it was impossible to appreciate the true nature of the transaction and the constitutional validity of Income-tax provisions could not be gone into;

(f) It is settled law that a writ cannot be entertained against a mere show-cause notice unless the Court is satisfied that the show cause notice was totally *non est* in the eye of law for absolute want of jurisdiction of the authority to even investigate into facts. The assessee has not been able to demonstrate absolute want of jurisdiction in the AO.

Due Dates of key compliances pertaining to the month of December 2008:

5th Dec.	***Payment of Service Tax & Excise duty for December***
6th Dec.	***Payment of Excise duty paid electronically through internet banking***
7th Dec.	***TDS/TCS Payment for November***
10th Dec.	***Excise Return ER1 / ER2 /ER6***
15th Dec.	***Advance FBT for Quarter ending December***
15th Dec.	***Advance income tax for Companies (Quarter III)***
15th Dec.	***Advance Income Tax for Non Corporate Assesses (Quarter II)***
15th Dec.	***PF Contribution for November, Excise payment by SSI***
21st Dec.	***ESIC Payment for November***