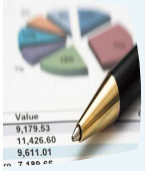


Issue – 01 | January 2009

SNK Newsletter

DIRECT TAXES

Judicial Pronouncements

Eih Associated Hotels Ltd. v. DCIT (2008) 16 DTR (Kol) (Trib) 181

Section 5 - Income – Accrual of notional gain on foreign currency swap

Even under the mercantile system of accounting, the Revenue can tax an income which is only a real income and not otherwise. Assessee has not actually realised any income because of the fluctuation of foreign exchange rates. While there was a book gain in two assessment years, assessee company incurred a book loss in a subsequent year. AO did not deduct the notional loss arising from currency swap while completing the assessment for that assessment year. This clearly proves that the gain shown in the books was a contingent income and not a real income. Hence, it is not taxable even though assessee is following mercantile system of accounting

Section 14A

It could not be assumed that assessee did not incurred any expenditure in earning dividend and therefore, disallowance under s. 14A restricted to 1 per cent of tax-free dividend received by the assessee.

Section 37(1)

Assessee company having not filed details of expenses on repairs, renewals, replacements and advertisement, strictly in the desired format, ad hoc disallowance of 2 per cent of the aggregate expenses is sustained.

Shri Samir A. Batra (Prop. of Samir Exports and Batra Overseas, Surat) v. The ITO (ITA No. 4130/Ahd/2007)

Export Commission – Sales recorded net-off commission and realisation also of net export proceeds

Firstly, each of the transactions between the Assessee as

the seller and the two buyers were mediated by agents, whole existence was established beyond doubt, by the confirmation letters. Secondly, there was rendering of services. The agents had clearly written that they have rendered services in procuring samples, deciding the orders and settling all matters between the buyers and seller including payments by the buyers to the seller. Considering the nature of such services rendered by the agents, even if they were appointed by the buyers, services were indirectly rendered to the assessee as the seller as well.

The existence of the agents and their functioning was for the benefit of the assessee as well. Therefore, the evidence produced by the Assessee cannot be wished away on the ground that the agents only provided services to the buyer and not to the assessee. In view of the above fact and circumstances, we are of the view that the commission payment is to be allowed to the assessee and accordingly, we allow the claim of the assessee, and the orders of the lower authorities are revered. This issue of the assessee's appeal is allowed.'

It was also held that the commission was not deducted from the export invoices in an ad hoc manner and it was clearly under an agreement between the buyer and the seller, as also between the buyer and the agent. Consequently, the assessee was under an obligation to deduct commission from the gross invoice values in the present case, there was a compulsion to deduct the commission from the export invoices which was clearly indicated in the confirmation letters of the agents, the ingredients which were necessary for such deduction of commission to be treated as diversion of income by overriding title was clearly present.'

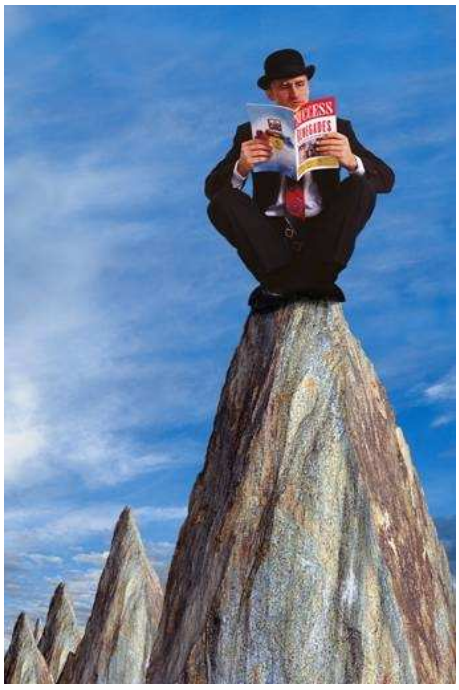
Further it was also observed that the gross export proceeds never reached in the hands of the assessee, no such income had therefore accrued to the assessee and this was because of an obligation or compulsion to deduct the commission from the export invoices which clearly showed this to be a case of diversion of income by overriding title. The amounts deducted from the export invoices were thus clearly allowable as deduction.'

Amline Textiles (P.) Ltd. v. ITO [IT Appeal No.5491 (Mum) of 2006]

Section 115JB of the Income-tax Act, 1961 – Minimum alternate tax - Assessment year 2003-04

While computing book profit for assessment year 2003-04 assessee claimed that aggregate amount of loss brought forward and unabsorbed depreciation relating to earlier years was to be considered for purpose of deduction from net profit as per profit and loss account. Revenue however, by relying on provisions of sections 71 to 73 held that loss brought forward or unabsorbed depreciation, was to be considered on year to year basis and not as an aggregate figure for all years in unison and accordingly, disallowed claim of assessee.

It was held that computation of 'book profit' is to be done strictly as per Explanation (1) to section 115JB and no assistance from any other section of Act can be taken for that purpose. Therefore, when clause (iii) of Explanation (1) of section 115JB clearly states that amount of loss brought forward or unabsorbed depreciation, which ever is less as per books of accounts is liable to be reduced, there was no authority for falling upon command of section 72 for holding that business loss unabsorbed depreciation was to be considered on year to year basis and not as an aggregate figure for all years in unison and therefore, reference to provisions of sections 71 to 73 for arriving at conclusion that section 115JB refers to year wise consideration of loss brought forward or unabsorbed depreciation was erroneous.



DCIT v. Gordhandas Lachmandas (2008) 16 DTR (Mumbai)(Trib) 26

Search and seizure - Block assessment, section 158BB - Computation of undisclosed income

AO made addition of Rs. 2,15,000 towards unexplained cash payment made by assessee towards purchase of land during the block period. CIT(A) found on examination of seized materials that a sum of Rs. 1 lac was paid on 21st June, 1988, which fell beyond the block period-Addition rightly deleted to that extent

Payment made by the assessee, which has been shown in the books of account of another group concern could not be treated as undisclosed income of the assessee.

Out of the total jewellery found at the time of search, AO treated jewellery worth Rs. 2,30,238 as unexplained. Some portion of the jewellery belonged to two deceased lady members of the assessee's family. Credit of 500 gms. of jewellery each has to be allowed in respect of jewellery belonging to two deceased ladies as per CBDT guidelines. No addition was called for. Decision in the case of ITO v. Late Shri Jawahar Lal Jain (1994) 48 TTJ (Del) 653, DCIT v. Arjun Dass Kalwani (2006) 102 TTJ (Jd) 977 and ACIT v. Gopi Lai Mor & Ors. (2007) 107 TTJ (Jd) 510 were relied on.

500 each towards purchase of flat. Assessee admitted that the figure 500 represents Rs. 5 lacs. However, it was explained that the third payment was not made. CIT(A) found that there were narratives against first two entries but not against the third entry. Explanation of the assessee being acceptable on the facts of the case, and the third payment not having been proved, addition in respect of said payment was rightly deleted.

Judicial pronouncements

Cash found in the locker belonging to mother-in-law of the main partner of the assessee firm cannot be held to be belonging to the assessee firm and cannot be treated as undisclosed income of the assessee in the absence of any material to link up the contents of the locker with the assessee firm or with any other concern of the group.

ACIT v. ASHOK KUMAR PODDAR (2008) 16 DTR (Kol)(Trib) 55

Search and seizure - Block assessment, section 158BB - Computation of undisclosed income

From a seized trial balance, AO picked up a few credit and debit entries at random without any basis and added Rs. 3,25,37,586, being the excess of credit entries over the debit entries, as the undisclosed income of the assessee. The veracity and correctness of the entries in the trial balance could not he established by the AO through any material or evidence brought on record. The assessee's contention that it is only a test run trial balance containing imaginaiy figures could not be rebutted by the AO through any piece of evidence. No enquiry in this regard was made by the AO as appears from record to justify his action and belief. Mere tally of certain code numbers in the trial balance with those in the regular books cannot prove the AO's case. The pick and choose method adopted by the AO in selecting without any basis certain credit and debit entries in the trial balance, ignoring all other entries therein, itself proves that the entries in the said trial balance is liable to be ignored altogether in absence of any material or evidence in support thereof.

AO was not justified in making addition of profits shown in three loose papers merely on the presumption under s. 132(4A) without verifying the handwriting and without making any enquiry or bringing any material on record to substantiate that the assessee had actually earned the income recorded in the said loose sheets. There was no seizure of any material showing any matching investment in any movable or immovable property. Therefore, addition of amounts noted on loose sheets was not justified.

CIT v. F. Praveen (2008) 16DTR (Mad) 80

Search and seizure - Block assessment, section 158BB - Computation of undisclosed income

Cash of Rs. 10lakh seized from assessee. Assessee's explanation that one S had given her Rs. 15 lakh for safe custody which she in turn gave to one T not found acceptable by Tribunal. Contention that entire amount of Rs. 15 lakh should be added as assessee's income and not only Rs. 10 lakh rightly rejected by Tribunal. Only Rs. 10 lakh had been recovered from the assessee and there was no material or evidence to prove existence of Rs. 5 lakh except mere statement of assessee.

Ch. Suresh Reddy v. ACIT (2008) 16 DTR (Chennai)(Trib) 14

Search and seizure - Penalty under s. 158BFA(2) under Block assessment

AO was not justified, looking to the facts and circumstances of the case, imposing penalty on the basis of difference in undisclosed income as declares by assessee and as assessed by AO. Assessee has accepted the addition only with the sole intention to avoid litigation and only because of that the assessee has not gone in appeal against the quantum addition. Statement made by assessee at the assessment stage makes it amply clear that the assessee had accepted the addition only to avoid litigation and to buy peace with the Department which fact has been recorded by AO himself. Assessee had been very cooperative with the Department. As regards addition on account of cash, assessee had furnished evidence regarding its receipts on various occasions. Assessee has also produced evidence as regards jewellery which was also bona fide, more so when husband and wife lived together. Addition of other income below taxable limit itself was unwarranted.

CIT vs. Harkaran Das (Delhi High Court) (ITA No. 1005/2007)

Levy of Penalty u/s 158BFA is not automatic

Where the Tribunal found that there was a bona fide surrender of undisclosed income and the question arose whether penalty u/s 158BFA (2) could be levied on the difference between the returned income and the assessed income, HELD

(a) Where the assessment was on the basis of surrender, there was no "determination" of undisclosed income by the AO u/s 158 BC(c) which is the requirement for imposition of penalty;

(b) The general proposition laid down in Sir Shadilal Sugar and General Mills Ltd 168 ITR 705 (SC) that the surrender of undisclosed income made by an assessee to buy peace did not necessarily lead to the conclusion that the amount surrendered was indeed concealed income, cannot be said to have been overruled in K.P. Madhusudhanan 251 ITR 99 (SC);

(c) Levy of penalty u/s 158 BFA (2) is discretionary and not automatic notwithstanding the use of the word "shall".

CIT vs. S. K. Katyal (Delhi High Court) (ITA No. 1198/2008)

Extension of time limit for completion of block assessment order by making new panchnamas.

HELD in the context of s. 158BE (1) (b) which imposes a time limit for making a block assessment order with reference to the date of execution of the last of the authorizations for search u/s 132 which in turn is deemed to be the date of the conclusion of search as recorded in the last panchnama drawn that:

(i) a search is essentially an invasion of the privacy of the person whose property or person is subjected to search;

(ii) normally, a search must be continuous;

(iii) if it cannot be continuous for some plausible reason, the hiatus in the search must be explained;

(iv) if no cogent or plausible reason is shown for the hiatus in the search, the second or "resumed" search would be illegal;

(v) by merely mentioning in the panchnama that a search has been temporarily suspended does not, ipso facto, continue the search. It would have to be seen as a fact as to whether the search continued or had concluded;

(vi) merely because a panchnama is drawn up on a particular date, it does not mean that a search was conducted and/or concluded on that date;

(vii) the panchnama must be a record of a search or seizure for it to qualify as the panchnama mentioned in Explanation 2(a) to section 158BE of the said Act.

Anz Reality (P) Ltd. v. ITO (2008) 16DTR (Jp)(Thb) 534

TDS - Sections 2(22)(e), 194, 201 & 201 (1A)

Advances to non-shareholders - Payment or advances to non-shareholder does not require TDS u/s 194 and assessee cannot be held to be in default under s. 201 so as to attract interest under s. 201(1A).

CIT v. Assistant Manager (Accounts), FCI. (2009 - TMI – 31982) (HC-P&H)

Tax Deduction at Source

Assessee is a Government undertaking - AO created a demand, on the allegation that the assessee failed to make deductions at source in respect of payments made towards transportation and other charges. Tribunal rightly set aside the same on the ground that the payments made were not on behalf of the assessee but were part of cost of procurement of wheat and thus, provision for deduction at source was not applicable. No substantial question of law arises and accordingly revenue's appeal was dismissed.

Subodh Kumar Bhargava vs. CIT (Delhi High Court) (ITA No. 243/2008)

Limitation period for levy of penalty

Though s. 275(1) (c) provides that the limitation for levy of penalty shall be "after the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later", in a case where the initiation of action for imposition of penalty is not in the course of some proceedings (e.g. penalty u/s 271B for failure to get accounts audited u/s 44AB and non-filing of audit report), the first part of s. 275(1) (c) would have no application and it is only the period of limitation prescribed in the second part which would apply. Since only one period of limitation would be applicable, the expression "whichever period expires later" would have to be read as that very period of limitation.

Judicial pronouncements

Shivsagar Veg. Restaurant v. ACIT (2008) 220 CTR (Bom) 563

Order of Tribunal - Reasoned order and pronouncement of judgment

Tribunal being the final authority on facts, it is incumbent upon it to appreciate the evidence, consider the reasons of the authorities below and assign its own reasons as to why it disagrees with the reasons and findings of tie authority below. Mere statement that the findings of CIT(A) are just, fair and in accordance with law does not tantamount to giving reasons—Basic rule of natural justice requires recording of reasons in support of the order. That apart, the Tribunal passed the order more than four months after hearing the appeal. Therefore, impugned order is set aside and the appeal is restored to the Tribunal with direction to rehear the appeal and decide the same afresh by a reasoned order dealing with all the contentions on merits. President of the Tribunal is directed to frame and lay down guidelines in the matter of pronouncement of judgment.

Singapore Tourism Board, In re (2008) 175 TAXMAN 125 (AAR - NEW DELHI)

Section 115WA of the Income-tax Act, 1961 - Fringe benefit tax

It was held that a foreign entity not earning any income in India is liable to pay fringe benefit tax in respect of fringe benefits paid by it to its employees working in its liaison offices in India.

CIT v. J K Synthetics Limited (ITR 139/1988 and ITR No. 202/1989)

Capital or Revenue Expenditure

It was held that third instalment of know-how fee which related to grant of technical assistance and continuous know-how, in Italy, including training of personnel, in Italy is revenue in nature, any interest paid in relation to delayed payments will also, have to be treated, as one, which is, on revenue account.

Following broad principles were considered appropriate to be applied to the facts of the each case for determining the expenditure of capital or revenue in nature.

(i) the expenditure incurred towards initial outlay of business would be in the nature of capital expenditure, however, if the expenditure is incurred while the business is on going, it would have to be ascertained if the expenditure is made for acquiring or bringing into existence an asset or an advantage of an enduring benefit for the business, if that be so, it will be in the nature of capital expenditure. If the expenditure, on the other hand, is for running the business or working it, with a view to produce profits, it would be in the nature of revenue expenditure;

(ii) it is the aim and object of expenditure, which would, determine its character and not the source and manner of its payment;

(iii) the test of once and for all payment i.e., a lump sum payment made, in respect of, a transaction is an inconclusive test. The character of payment can be determined by looking at what is the true nature of the asset which is acquired and not by the fact whether it is a payment in lump sum or in an instalment. In applying the test of an advantage of an enduring nature, it would not be proper, to look at the advantage obtained, as lasting forever. The distinction which is required to be drawn is, whether the expense has been incurred to do away with, what is a recurring expense for running a business, as against, an expense undertaken for the benefit of the business as a whole;

(iv) an expense incurred for acquisition of a source of profit or income would in the absence of any contrary circumstance, be in the nature of capital expenditure. As against this, an expenditure which enables the profit making structure to work more efficiently leaving the source or the profit making structure untouched, would be in the nature of revenue expenditure. In other words, expenditure incurred to fine tune trading operations to enable the management to run the business effectively, efficiently and profitably leaving the fixed assets untouched would be an expenditure of a revenue nature even though the advantage obtained may last for an indefinite period. To that extent, the test of enduring benefit or advantage could be considered as having broken down;

(v) expenditure incurred for grant of License which accords `access' to technical knowledge, as against, `absolute' transfer of technical knowledge and information would ordinarily be treated as revenue expenditure. In order to sift, in a manner of speaking, the grain from the chaff, one would have to closely look at the attendant circumstances, such as:-

(a) the tenure of the Licence.

(b) the right, if any, in the licensee to create further rights in favour of third parties,

(c) the prohibition, if any, in parting with a confidential information received under the License to third parties without the consent of the licensor,

(d) whether the Licence transfers the fruits of research of the licensor, once for all,

(e) whether on expiry of the Licence the licensee is required to return back the plans and designs obtained under the Licence to the licensor even though the licensee may continue to manufacture the product, in respect of, which access to knowledge was obtained during the subsistence of the Licence.

(f) whether any secret or process of manufacture was sold by the licensor to the licensee. Expenditure on obtaining access to such secret process would ordinarily be construed as capital in nature;

(vi) the fact that assessee could use the technical knowledge obtained during the tenure of the License for the purposes of its business after the Agreement has expired, and in that sense, resulting in an enduring advantage, has been categorically rejected by the courts. The Courts have held that this, by itself, cannot be decisive because knowledge by itself may last for a long period even though due to rapid change of technology and huge strides made in the field of science, the knowledge may with passage of time become obsolete;

(vii) while determining the nature of expenditure, given the diversity of human affairs and complicated nature of business; the test enunciated by courts have to be applied from a business point of view and on a fair appreciation of the whole fact situation before concluding whether the expenditure is in the nature of capital or revenue.

Judicial Pronouncements - International Taxation

Philips Software Centre (P) Ltd. v. ACIT (2008) 15 DTR (Bang)(Trib) 505

Transfer pricing - Conditions precedent for applicability of ss. 92C and 92CA

As per CBDT Circular No. 14 of 2001, which is binding on the Department, intention of transfer pricing provisions is to curtail avoidance of taxes by shifting profits outside India. Since the assessee was availing the benefit under s. 10A, it would be devoid of logic to argue that the assessee had manipulated prices and shifted profits to an overseas jurisdiction for the purpose of avoiding tax in India. Reference by Departmental Representative to the proviso to s. 92C(4) and OECD Guidelines is out of context and irrelevant. So is the argument on intention to avoid dividend distribution tax. Since the basic intention behind introducing the TP provisions is to prevent shifting of profits outside India, and the assessee is claiming benefit under s. 10A, the TP provisions ought not to be applied to the assessee.

Clifford Chance UK vs. DCIT (Bombay High Court) (ITA No.181 OF 2002)

Fees for technical/professional fees of a NR is not taxable in India if it is not rendered in India and utilized in India.

Where the assessee was a UK based firm of solicitors without an office or fixed base in India and it was appointed as English law legal advisers for projects in India and the question arose whether it was assessable to tax in respect of the entire fees or only that portion which was attributable to its operations in India, HELD, accepting the assessee's claim:

(1) Under Article 15 of the India-UK DTAA, fees from professional services may be taxed in India only if the services are performed in India and the assessee is present in India for more than 90 days in the relevant fiscal year;

(2) If the presence in India is for more than 90 days, the taxability of the income will have to be determined u/s 9(1) (i);

(3) The fiction of s. 9 is subject to the territorial nexus doctrine and income that arises out of a transaction requires to be apportioned to each of the territories. Whatever is payable by a resident to a non-resident by way of fees for services would not always come within the purview of section 9(1)(vii) of the Act. It must have sufficient territorial nexus with India so as to furnish a basis for imposition of tax.

(4) In accordance with the judgement of the SC in **Ishikawama Harima** 288 ITR 408 a non-resident is taxable on income for services only if the services are rendered within India and are part of a business or profession carried on by such person in India. Both the above conditions have to be satisfied simultaneously.

Accordingly, only the income charged on hourly basis in India and utilized in India is chargeable to tax.

Moser Baer India Ltd vs. ACIT (Delhi High Court)

Hearing procedure to be followed by the Transfer Pricing Officer

Where the assessees challenged by writ petitions the orders passed by the Transfer Pricing Officer ("TPO") determining the Arm's Length Price ("ALP") in relation to "International transactions" on the grounds that the said orders were passed without granting an oral hearing and without considering the documents and information filed by the assessees and without disclosing the information and documents obtained by the TPO which were used by him in the determination of the ALP, HELD, allowing the challenge:

(1) S. 92CA (3) imposes an obligation on the TPO to accord an oral hearing to the assessee. Even otherwise, an order entailing civil and penal consequences cannot be passed without a hearing.

(2) The fact that the assessee did not demand an oral hearing makes no difference. It is the constitutional obligation of the State to adopt a procedure which is both fair and just while dealing with its citizens. The fact that a citizen is unaware of his legal right cannot be used as a plank to seek legal sustenance for its actions which are otherwise invalid. It is duty of the State, in its role as a litigating party, to inform the citizen of his right i.e., to seek an oral hearing.

(3) The argument of the department that the failure to grant an oral hearing is a defect which could be cured by providing such an opportunity in the appellate forum is not acceptable.

(4) As a matter of procedure, the show-cause notice issued by the TPO just prior to the determination of ALP should refer to the documents or material available with the AO in relation to the international transaction in issue. The show cause notice should also give an option to the assessee:-

(a) To inspect the material available with the AO as give the leeway to file further material or evidence if he so desires, and

(b) to seek a personal hearing in the matter.

An order is passed in breach of the principles of natural justice is a nullity in the eye of law and consequently a writ petition is maintainable notwithstanding the availability of alternate remedy.

Coca Cola India Inc vs. ACIT (P & H High Court) (C.W.P. No.16681 of 2005)

Constitutional Validity of transfer pricing provisions

Where the AO issued reopening notices to the assessee, a foreign company, on the ground that income had escaped assessment because as per the transfer pricing provisions the profit charged by the assessee on services rendered to its associated enterprises was abnormally low and the same was challenged by the assessee on various issues, HELD, dismissing the Petition that:

(1) There is no lack of Legislative competence in enacting the transfer pricing provisions and making them applicable to foreign companies. The provisions seek to remedy the mischief of multinational companies of allocating profits in intra group transactions to outside jurisdiction resulting in tax evasion;

(2) The transfer pricing provisions are applicable to a well defined class which meets the test of intelligible differentia. It also meets the test of rational relationship to the object i.e. to determine the real income. There is no ambiguity or absurd consequence of application of Chapter X to persons who are subject to jurisdiction of taxing authorities in India;

(3) There is no requirement to establish transfer of profits outside India or evasion of tax before applying the transfer pricing provisions;

(4) The fact that under the FERA – RBI approval the assessee cannot charge more than particular price cannot control the arms' length price;

(5) There is no requirement to give a hearing at the stage of making reference under Section 92 CA of the Act because the decision to make a reference does not visit the assessee with any civil consequence;

(6) The fact that in the recorded reasons, the AO referred to the inapplicable provisions of s. 92 as it stood prior to amendment w.e.f. 1.4.2002 and the order of the TPO passed in respect of a subsequent assessment year is not a bar for reassessment.

ACIT v. M/s Rational Software Corporation (India) Pvt. Ltd. (Dated: November 14, 2008)

Income tax - royalty

Assessee purchases software from non-resident and makes payments. AO treats the same as royalty and disallows the expenditure u/s 40(a)(i) for non-deduction of TDS u/s 195. Held, it is a settled issue that the payment was made for purchase of the software and it does not represent royalty. Provisions of TDS is applicable.

ACIT v. M/s Enron Global Exploration & Production Ltd. [2008-TIOL-620 ITAT-DEL]

Permanent Establishment – Accrual of Income

With respect to 1 percent of the revenues charged by the taxpayer company as overhead charges, the Tribunal has held that this may have some element of profit but the same could not be brought to tax because income did not accrue or arise in India. This transaction was not charged on cost to cost basis and therefore profits arising from this transaction may attract tax liability in India.

Further the Tribunal observed that no employee of the taxpayer was present within India for a period more than 90 days during any 12 months period. However, it is pertinent to note that under the India-USA tax treaty, if services are performed for a related enterprise then even if such employee is present for a single day in India, it will result into PE in India.

The tribunal also held that there was no permanent establishment (PE) of the taxpayer in India and even if it could be held that the taxpayer was having a PE in India, there was no taxable profit in India because the taxpayer had incurred expenses of an equal amount to receipts for rendering the services.

Frontier Offshore Exploration (India) Ltd. v. DCIT [IT Appeal No. 2037 (Mad.) of 2006]

Section 40(a)(i) r.w.s. 195 of the Income-tax Act, 1961 - Interest, etc., payable outside India

In order to carry out drill work, assessee took two drilling units from non-resident companies. For said purpose, assessee was required to pay charter hire, base boat charges, rig management fees and service charges. During relevant assessment year, assessee deducted tax on bare boat charges only contending that under section 195(1), tax was required to be deducted only on that sum which could be ultimately assessed to tax under Act. Assessing Officer rejected assessee's contention holding that tax had to be deducted on gross sum of money paid to non-resident. Accordingly, Assessing Officer out of total payment made in foreign currency, after allowing payment proportionately to tax deducted by assessee, disallowed balance under section 40(a)(i).

Accordingly, it was held that whenever an assessee making payment to non-resident finds that only a particular portion is chargeable to tax, in view of provisions of section 195(2), assessee has to go before taxing authorities and get such appropriate proportion determined and accordingly deduct tax. Since, in instant case, assessee did not make such application under section 195(2), disallowance made by Assessing Officer by invoking provisions of section 40(a)(i) was to be affirmed.

Circular No. 11/2008, dated 19-12-2008

Definition of Charitable purpose under section 2(15) of the Income-tax Act, 1961

Exemption under section 11 in case of assessee claiming both to be charitable institutions as well as mutual organisations

Section 2(15) of the Income Tax Act, 1961 (Act) defines charitable purpose to include the following:-

(i) Relief of the poor

(ii) Education

(iii) Medical relief, and

(iv) the advancement of any other object of general public utility.

An entity with a charitable object of the above nature was eligible for exemption from tax under section 11 or alternatively under section 10(23C) of the Act. However, it was seen that a number of entities who were engaged in commercial activities were also claiming exemption on the ground that such activities were for the advancement of objects of general public utility in terms of the fourth limb of the definition of charitable purpose. Therefore, section 2(15) was amended vide Finance Act, 2008 by adding a proviso which states that the advancement of any other object of general public utility shall not be a charitable purpose if it involves the carrying on of

(a) any activity in the nature of trade, commerce or business; or

(b) any activity of rendering any service in relation to any trade, commerce or business;

for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention of the income from such activity.

2. The following implications arise from this amendment

2.1 The newly inserted proviso to section 2(15) will not apply in respect of the first three limbs of section 2(15), i.e., relief of the poor, education or medical relief. Consequently, where the purpose of a trust or institution is relief of the poor, education or medical relief, it will constitute charitable purpose even if it incidentally involves the carrying on of commercial activities.

2.2. Relief of the poor encompasses a wide range of objects for the welfare of the economically and socially disadvantaged or needy. It will, therefore, include within its ambit purposes such as relief to destitute, orphans or the handicapped, disadvantaged women or children, small and marginal farmers, indigent artisans or senior citizens in need of aid. Entities who have these objects will continue to be eligible for exemption even if they incidentally carry on a commercial activity, subject, however, to the conditions stipulated under section 11(4A) or the seventh proviso to section 10(23C) which are that

(i) the business should be incidental to the attainment of the objectives of the entity, and

(ii) separate books of account should be maintained in respect of such business.

Similarly, entities whose object is education or medical relief would also continue to be eligible for exemption as charitable institutions even if they incidentally carry on a commercial activity subject to the conditions mentioned above.

3. The newly inserted proviso to section 2(15) will apply only to entities whose purpose is advancement of any other object of general public utility i.e. the fourth limb of the definition of charitable purpose contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C) of the Act if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

3.1. There are industry and trade associations who claim exemption from tax u/s 11 on the ground that their objects are for charitable purpose as these are covered under any other object of general public utility.

Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants.

Therefore, where industry or trade associations claim both to be charitable institutions as well as mutual organizations and their activities are

restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) owing to the principle of mutuality. However, if such organizations have dealings with non-members, their claim to be charitable organizations would now be governed by the additional conditions stipulated in the proviso to section 2 (15).

3.2. In the final analysis, however, whether the assessee has for its object the advancement of any other object of general public utility is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, the object of general public utility will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible. Assessees, who claim that their object is charitable purpose within the meaning of Section 2(15), would be well advised to eschew any activity which is in the nature of trade, commerce or business or the rendering of any service in relation to any trade, commerce or business.

Notification No. 106 of 2008, 28th Nov., 2008

Notifications under s. 80-IA(4)(iii) of the IT Act, 1961

Notification is issued for making amendments in the Industrial Park Scheme, 2008.

Notification No. 1/2009, dated 5.1.2009

Government notifies conditions for pre-paid meal cards for the purpose of FBT

As per section 115WB(2)(B)(iii), inserted from the assessment year 2009-10, hospitality expenditure for the purpose of levy of FBT, does not include any expenditure on or payment through non-transferable pre-paid electronic meal card usable only at eating joints or outlets and which fulfils other prescribed conditions. CBDT has now notified Rule 40E prescribing such conditions. Following conditions have been prescribed:

(i) The card shall be granted by the employer to its employees under a scheme framed by the employer specifying therein the circumstances under which the meal card can be used by the employee.

(ii) The card shall be issued by the issuing bank.

(iii) An employee shall not be issued more than one card.

(iv) The card shall bear the name of the employer along with the name, photograph and signature of the employee to whom the card is issued.

(v) The card shall be used only by the employee to whom the card is issued.

(vi) The card shall be used by the employee only for the purpose of purchasing ready to eat food or non-alcoholic beverage from a member establishment.

(vii) The aggregate amount of ready to eat food or non-alcoholic beverage purchased during a day by an employee shall not exceed one hundred rupees.

(viii) The details of each transaction of purchases made by the employee against the card shall be maintained by the employer and the member establishment in such manner and for such period as is required under the Act for any other similar transaction.

Notification No. 2/2009, dated 5.1.2009

Additional statement to be furnished for approval u/s 35

The Government has amended Rules 5D and 5E pertaining to conditions for approval to a scientific research association u/s 35(1)(ii) or to a university, college or other institution u/s 35(1)(ii)/(iii), to provide that such association shall, by the due date of furnishing the return of income u/s 139(1), furnish a statement to CIT/DIT containing (i) a detailed note on the research work undertaken by it during the previous year; (ii) a summary of research articles published in national or international journals during the year; (iii) any patent or other similar rights applied for or registered during the year; (iv) programme of research projects to be undertaken during the forthcoming year and the financial allocation for such programme.

Notification No. 3/2009, dated 5.1.2009

Government notifies NHB Deposit Scheme u/s 80C

The Government has notified that subscription to National Housing Bank (Tax Saving) Term Deposit Scheme, 2008 shall qualify for deduction under section 80C.

INDIRECT TAXES

Judicial Pronouncements

Aditya Consultant v. CCE (Final Order No. 343 of 2007]

Section 78 of the Finance Act, 1994 – Penalty for suppressing value of taxable service – Period from 1-4-2004 to 30-9-2005

Assessee neither deposited service tax nor filed requisite return within prescribed period. On persuasion of department it deposited service tax along with due interest on delayed payment thereof and also filed its return before issuance of show cause notice. Adjudicating Authority, however, imposed penalty upon assessee under section 78 which was upheld by Commissioner (Appeals). Assessee challenged imposition of penalty. However, in case of CCE v. Machino Montell (I) Ltd. (2006) 202 ELT 398, it was held that payment of tax before issuance of show cause notice cannot prevent department from invoking penal provisions under law. It was held that in view of above decision, assessee had not made out any case in its favour and filed by it was to be dismissed and order of Commissioner (Appeals) was to be upheld.

Larsen & Toubro Ltd. v. Commissioner of Service Tax (2009 - TMI - 31987 – CESTAT)

Service Tax

Appellant (L & T) received technical assistance in consideration of royalty & technical know-how fees. Commissioner (A) was right in holding that L & T was not liable to pay tax towards Engineering Consultancy for technical know-how and technical assistance received from its foreign collaborators. Transfer of technical know-how for a consideration is sale of intellectual property. These cannot be held as provision of service by the collaborators of the L & T – revenue's appeal dismissed.

Datafield India Pvt Ltd Vs CCE, Coimbatore (Dated: September 5, 2008)

ST - Cenvat credit

Assessee is a manufacturer. It clears excisable goods on CIF price basis and transfers ownership of goods only at the buyer's premises. Avails credit for service tax paid on outward transportation - Revenue disallows - held, in view of the Board's clarification that if the excisable goods remain the property of the manufacturer and are transported on his own risk upto the premises of the buyer where the goods are delivered, the service tax incurred on freight for such transportation would be available to the manufacturer as input service credit - Assessee's appeal allowed.

Circulars / Notifications

Notification No.1/2009-ST dtd. January 5, 2009

In exercise of the powers conferred by sub-section (1) of section 93 of the Finance Act, 1994 (32 of 1994) (hereinafter referred to as the Finance Act), and in supercession of the notification of the Government of India in the Ministry of Finance (Department of Revenue), No.29/2008- Service Tax, dated the 29th June, 2008, published in the Gazette of India Extraordinary, vide G.S.R.482 (E), dated the 29th June, 2008, except as things done or omitted to be done before such supercession, the Central Government, on being satisfied that it is necessary in the public interest so to do, hereby exempts the taxable services specified in sub-clauses (j), (k), (zr), (zza), (zzb), (zzzf), (zzzq) and (zzzzj) of clause (105) of section 65 of the Finance Act, provided by any person to a goods transport agency for use by the said goods transport agency to provide any service, referred to in sub-clause (zzp) of clause (105) of section 65 of the Finance Act, to a customer in relation to transport of goods by road, from the whole of the service tax leviable thereon under section 66 of the Finance Act subject to the condition that the invoice issued by such service provider, providing services should mention the name and address of the goods transport agency and also the name and date of the consignment note, by whatever name called, issued in his behalf.

Judicial Pronouncements

Gujarat Gas Financial Services Ltd. v. ACIT (2008) 115 ITD 218 (AHD.KSB)

Section 2(5B) of the Interest-tax Act, 1974 - Financial company

Assessee-company was mainly engaged in leasing business. Apart from that, it was also deriving income from hire-purchase and interest received on investments, i.e., Government securities, inter-corporate deposits, etc. Assessee's case was that since its main business of leasing had no longer remained that of a credit institution, it was not liable to pay tax on its revenue income under provisions of Act. Assessing Officer rejected assessee's claim holding that its case fell within ambit of section 2(5B)(vi). It was held that since none of assessee's business had a share of more than 50 per cent on basis of income composition or assets composition, it could be said that none of assessee's business was its principal business. And, therefore, none of sub-clauses (i) to (v) of section 2(5B) would apply individually to assessee's case. Also held that since it was not revenue's case that assessee had received deposits as part of its business activity, it was not a company falling in sub-clause (va) of section 2 (5B). Further, since entire income of assessee excluding lease amounted to 53 per cent on income as a base or to 58 per cent if assets were taken as a base, said percentages could not be said to be exclusive and, thus, assessee's case might not fall within definition of credit institution as envisaged by either sub-clauses (i) to (va) or sub-clause (vi) of section 2(5B), however, since assessee had itself stated that lease transactions entered into by it were in nature of financial leases and not operating leases, assessee could be termed as a residuary financial company cumula-tively engaged in one or more businesses enumerated in section 2(5B).

Section 2(7) of the Interest-tax Act, 1974 - Chargeable interest

In case of a financial lease, recovery of finance charges would be interest on loans and ad-vances within meaning of section 2(7), though given a name of lease rent. And, therefore, income from leasing is not outside purview of chargeability of interest tax. Interest on inter-corporate deposits is not interest on loan or ad-vance and, thus, would not be includible in chargeable interest under Act. Interest on delayed payments from debtors would not be interest on loans or advances and, thus, would not be includible in chargeable interest under Act. Income from bill discounting is also covered under interest tax.

Section 36(l)(vii), read with section 36 (2), of the Income-tax Act, 1961 - Bad debts

Assessee, a financial company, was engaged in business of financing its customers by way of leasing, hire-purchase, bill discounting and inter-corporate deposits, etc. Assessee had offered income earned from said activities as income from business. Assessee also claimed deduction of certain amounts as bad debts under section 36(l)(vii) stating that said amounts were due from debtors on account of bill discounting, inter-corporate deposits and hire-purchase transac-tions. Assessing Officer disallowed assessee's claim on plea that aforesaid activities could not be considered as regular transactions in business of banking or money lending. Held that business of assessee of bill discounting could be equated with business of banking or money lending and, hence, principal amount due from debtors on account of bill discounting was allowable as bad debt. Since inter-corporate deposit debts could not be considered as loans or advances, those could not be allowed as bad debts arising in money lending business of assessee.

P.R.P. Granites vs. ACIT (Madras High Court)

Arbitrary assessment orders can be struck down

Where the AO issued a show-cause notice alleging that the Appellant was not an “new undertaking” eligible for deduction u/s 10B but in the assessment order denied deduction on the different ground that the activity of the assessee did not constitute “manufacturing” without considering any of the several judgements on the issue, HELD that arbitrariness was writ large on the face of the assessment order and that the same had to be quashed by the Court by exercise of its extraordinary powers under Article 226 of the Constitution even though the assessee had alternative remedies of appeal against the said order.

RBI

RBI/2008-09/343 A.P. (DIR Series) Circular No. 46, dtd. January 02, 2008

External Commercial Borrowings (ECB) Policy – Liberalisation

Link: http://www.rbi.org.in/scripts/NotificationUser.aspx?

Circulars

RBI/2008-09/317 A.P. (DIR Series), Circular No. 39, dtd. December 08, 2008

Buyback / Prepayment of Foreign Currency Convertible Bonds (FCCBs)

Attention of Authorised Dealer Category - I (AD Category - I) banks is invited to Regulation No. 21 of Part III and Schedule I to the Notification No. FEMA 120 /RB-2004 dated July 7, 2004, as amended from time to time, relating to FCCBs. Attention of AD Category - I banks is also invited to A. P. (DIR Series) Circular No.5 dated August 1, 2005, A. P. (DIR Series) Circular No.60 dated May 21, 2007, A. P. (DIR Series) Circular No. 4 dated August 7, 2007, A. P. (DIR Series) Circular No. 43 dated May 29, 2008, A.P. (DIR Series) No. 16 dated September 22, 2008, A. P. (DIR Series) Circular No.20 dated October 10, 2008 and A. P. (DIR Series) No. 26 dated October 22, 2008 relating to instructions / guidelines in respect of External Commercial Borrowings, which are also applicable, mutatis mutandis, to FCCBs.

2. Under the extant ECB Guidelines, AD Category - I banks are permitted to allow prepayment of ECB up to USD 500 million without prior approval of the Reserve Bank, subject to compliance with the stipulated minimum average maturity period as applicable to the loan. Further, existing ECB can be refinanced by raising a fresh ECB, subject to the conditions that the fresh ECB is raised at a lower all-in-cost and the outstanding maturity of the original ECB is maintained. The existing provisions for prepayment and refinancing will continue, as hitherto.

3. As announced in para 4 (v) of the Press Release 2008:2009/697 dated November 15, 2008, Reserve Bank has been considering proposals, under the approval route, from Indian companies for buyback of their FCCBs, provided the buyback is financed out of their foreign currency resources held in India or abroad and / or out of fresh external commercial borrowing (ECB) raised in conformity with the current ECB norms.

4. As announced in para 12 of the Press Release 2008-2009/842 dated December 6, 2008, the existing policy on the premature buyback of FCCBs has been reviewed and it has been decided to liberalise the procedure and consider applications for buyback of FCCBs by Indian companies, both under the automatic and approval routes, as detailed hereunder:

A. Automatic Route:

The designated AD Category - I banks may allow Indian companies to prematurely buyback FCCBs, subject to compliance with the terms and conditions set out hereunder :

i) the buyback value of the FCCB shall be at a minimum discount of 15 per cent on the book value;

ii) the funds used for the buyback shall be out of existing foreign currency funds held either in India (including funds held in EEFC account) or abroad and / or out of fresh ECB raised in conformity with the current ECB norms; and

iii) where the fresh ECB is co-terminus with the outstanding maturity of the original FCCB and is for less than three years, the all-in-cost ceiling should not exceed 6 months Libor plus 200 bps, as applicable to short term borrowings. In other cases, the all-in-cost for the relevant maturity of the ECB, as laid down in A. P. (DIR Series) No.26 dated October 22, 2008 shall apply.

B. Approval Route:

The Reserve Bank will consider proposals from Indian companies for buyback of FCCBs under the approval route, subject to compliance with the following conditions:

the buyback value of the FCCB shall be at a minimum discount of 25 per cent on the book value;

the funds used for the buyback shall be out of internal accruals, to be evidenced by Statutory Auditor and designated AD Category – I bank's certificate; and

the total amount of buyback shall not exceed USD 50 million of the redemption value, per company.

Applications complying with the above conditions may be submitted, together with the supporting documents, through the designated AD Category - I bank, to the Chief General Manager-in-Charge, Reserve Bank of India, Foreign Exchange Department, ECB Division, Central Office, 11th Floor, Central Office Building, Shahid Bhagat Singh Road, Mumbai-400 001, for necessary approval.

5. General Conditions

In addition to the conditions set out above, the following additional conditions shall be applicable for the proposals both under the automatic and approval routes:

(i) The FCCB should have been issued in compliance with the extant guidelines.

(ii) The FCCB should have been registered with the Reserve Bank; the LRN number obtained and ECB 2 returns submitted up to date.

(iii) No proceedings for contravention of FEMA are pending against the company.

(iv) The right for buyback is vested with the issuer of FCCBs. However, the actual buyback is subject to the consent of the bond holders.

(v) The FCCBs bought back / repurchased from the holders must be cancelled and should not be re-issued or re-sold.

(vi) The buyback will not have any effect on the bond holders not opting for the buyback or on the non-participating bond holders of companies opting for the buyback.

(vii) The Indian company shall open an escrow account with the branch or subsidiary of an Indian bank overseas or an international bank for buying back the FCCBs to ensure that the funds are used only for the buyback.

6. The existing requirement of submission of ECB 2 return will continue as hitherto. Further, on completion of the buyback, a report giving details of buyback, such as, the outstanding amount of FCCBs, book value of FCCBs bought back, rate at which FCCBs bought back, amount involved, and source/s of funds may be submitted, through the designated AD Category - I bank, to the Chief General Manager-in-Charge, Reserve Bank of India, Foreign Exchange Department, ECB Division, Central Office, 11th Floor, Central Office Building, Shahid Bhagat Singh Road, Mumbai-400 001.

7. This facility will come into force with immediate effect and the entire procedure of buyback should be completed by March 31, 2009.

8. AD Category - I banks may bring the contents of this circular to the notice of their constituents and customers concerned.

9. The directions contained in this circular have been issued under sections 10(4) and 11 (1) of the Foreign Exchange Management Act, 1999 (42 of 1999) and is without prejudice to permissions / approvals, if any, required under any other law.

Due Dates of key compliances pertaining to the month of January 2009:

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***