Select Cases in Direct and Indirect Taxes 2009

Board of Studies
The Institute of Chartered Accounts of India
(Set up by an Act of Parliament)
New Delhi

SELECT CASES IN DIRECT AND INDIRECT TAXES [2009]

An Essential Reading for the Final Course

BOARD OF STUDIES

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

(Set up by an act of parliament)

This Supplementary Study Paper has been prepared by the faculty of the Board of Studies of the Institute of Chartered Accountants of India with a view to assist the students in their education. While due care has been taken in preparing this Supplementary Study Paper, if any errors or omissions are noticed, the same may be brought to the attention of the Director of Studies. The Council of the Institute is not responsible in any way for the correctness or otherwise of the amendments published herein.

Website	:	www.icai.org
Department/Committee	:	Board of Studies
E-mail	:	bosnoida@icai.org
Price	:	Rs.40/-
ISBN No.	:	978-81-8441-297-0
Published by	:	The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi- 110 002, India Typeset and designed at Board of Studies.
Printed by	:	Repro India Limited., Plot No. 50/2, T.T.C. MIDC Industrial Area, Mahape, Navi Mumbai 400 710. January/2010/15000 [Revised]

PREFACE

Direct Taxes and Indirect Taxes are two of the core competency areas of the Chartered Accountancy course. They require continuous updation in both legislative and judicial developments. The Board of Studies has been bringing out a number of publications in the area of direct and indirect taxes to help the students to update their knowledge on a continuous basis.

As an important value addition, the Board of Studies has come out with the 2009 edition of "Select cases in Direct and Indirect Taxes (2009) – An essential reading for CA Final Course" which contains a summary of recent significant judicial decisions having a bearing on the examination requirements of the students. This, read in conjunction with the Study Material, will enable the students to appreciate the significant issues involved in interpreting and applying the provisions of direct and indirect tax laws to practical situations. It will also help them to develop knowledge and expertise in legal interpretation. Further, appropriate notes added to the cases will provide the right perspective and stimulate the thinking of the students. It may be noted that this publication is relevant for both the existing and new CA Final course.

I am happy to note that the Board of Studies has introduced this academic update, which would help the students in understanding the process of judicial decisions. I appreciate the earnest and sincere efforts taken by CA. Ruchika Bhatia and CA. Shefali Jain, Faculty in the Board of Studies in preparing this publication. I am sure that this publication will be of great use to the students preparing for the Final Examinations.

Date: January, 2010
Place: New Delhi.

CA. Jaydeep N. Shah
Chairman, Board of Studies

INDEX

(Students may note that the Chapter headings correspond with the similar headings in the Direct and Indirect Taxes study materials)

INDIRECT TAXES

Central Excise

Customs

Service tax

INCOME TAX

1

BASIC CONCEPTS

1. Whether the refund collected illegally by the assessee by producing bogus TDS certificates can be treated as income of the assessee?

CIT v. K. Thangamani (2009) 309 ITR 015 (Mad.)

Relevant Section: 2(24)

The expression income in section 2(24) of the Income-tax Act, 1961 is wide and the object of the Act being to tax income it has to be given an extended meaning. Any kind of income earned by the assessee attracts income-tax at the point of earning and tax law is not concerned with the ultimate event how the income is expended. The Act makes an obligation to pay tax on all income received. The Act considers income earned legally as well as tainted income alike.

The assessee was engaged in tax consultancy and audit work. During the search conducted at the residential premises and office of the assessee certain incriminating documents were seized. From the documents seized it was revealed that the assessee had been claiming and receiving income-tax refunds by filing bogus TDS certificates with returns of income prepared by him even in the names of non-existing persons. The Assessing Officer treats the deposits, being the TDS certificates encashed by the assessee during the previous year, as professional income during the previous year. The Commissioner (Appeals) reduced the income on account of the refunds received by him and held it taxable under residuary head instead of Profession. The Tribunal held that the amount of refunds received by the assessee by fraudulent means could not be assessed as income of the assessee.

The High Court held that when the Tribunal found that the assessee had indulged in fabricating TDS certificates and got refunds from the Department it should not have come to the conclusion that such income was not taxable.

2. Whether the amount received by the assessee from WAFM for holding a national convention for farmers was a capital receipt in the hands of the assessee or income under section 2(24)(iia)?

Bharat Krishak Samaj v Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del)

Relevant Section: 2(24)(iia)

The assessee had received an amount of Rs.2,00,000 from WAFM for the purposes of holding a national convention of farmers. According to the assessee, the amount was

received by way of advance for holding the convention but the convention could not be held in that year and was only held in the subsequent year. The assessee claimed that this amount constituted a capital receipt in its hands. The Assessing Officer rejected the claim. The Tribunal held that the amount was assessable under section 2(24)(iia).

The High Court held that there was nothing in the record of the case to suggest that the amount was actually received by the assessee as an advance as contended. The amount received was for holding a national convention. It is also not clear from the record whether the national convention of farmers was to be held for and on behalf of the donor or was to be utilised for holding a national convention of the assessee. Under the circumstances, in view of the failure of the assessee to explain the receipt of Rs.2,00,000 the provisions of section 2(24)(iia) of the Act would be attracted and the amount must be treated as income of the assessee and not as a capital receipt.

3. Can the expenditure incurred after the setting up of the business but before the commencement of the business, be allowed as a permissible deduction?

CIT v. Hughes Escorts Communications Ltd. (2009) 311 ITR 253 (Del)

Relevant Section: 2(34) & 3

A plain reading of section 2(34) of the Income-tax Act, 1961, shows that for a new business the previous year is the period beginning with the date of setting up of the business. There is a distinction between setting up and commencement of a business. There may be an interregnum, there may be an interval between a business which is set up and a business which is commenced and all expenses incurred during the interregnum after the setting up of the business and before the commencement of the business, all expenses would be permissible deductions.

The assessee carried on the business of satellite business communications for which very small aperture terminal VSAT equipment is used. The VSAT can be used only after establishing, maintaining and using the communication facilities on a licence from the Department of Telecommunications. The assessee made an application to the Department of Telecommunications for grant of such licence and entered into a licence agreement on August 1994, with the Department of Telecommunications. The assessee placed a purchase order dated July 1994, with H, USA for the purchase of the VSAT equipment. In its return, the assessee claimed an expenditure of Rs.28,96,269. The Assessing Officer rejected the claim on the ground that the assessee had begun receiving the satellite signals only in the month of February and further since the installation was complete only on March, it could be said that the business of the assessee had been set up only on March. The Tribunal, however, allowed the assessee's claim.

The High Court held that the business of the assessee involved different activities in which the first step was the purchase of the VSAT equipment. The purchase order was placed on July. The application to the Department of Telecommunications for licence and the receipt of the satellite signals were the consequential stages. The signals were to be received after the VSAT equipment was installed in the premises

of the customer. In the circumstances, the business of the assessee should be held to have been set up on July. This was the relevant date for determining the nature of the expenses incurred thereafter. The expenses incurred in the previous year, prior to the commencement of the business but after the setting up its business, which two dates need not be the same, would be deductible as revenue expenditure.

4. **Whether the Tribunal was justified in upholding the order of Commissioner of Income-tax (Appeals) deleting the addition of Rs.10 lakhs as deemed dividend under section 2(22)(e) of the Income-tax Act ?**

CIT v. Hotel Hilltop (2009) 313 ITR 116 (Raj.)

Relevant Section: 2(22)(e)

The assessee-firm constituted of two partners ran a hotel business. It entered into an agreement with a private limited company formed by the two partners with their close relations under which the management of the firm's hotel was to be handed over to the company. The assessee-firm received a sum of Rs.10 lakhs as advance against security. The Assessing Officer made an addition to the income of the assessee treating the amount as deemed dividend under section 2(22)(e) of the Act. The Commissioner (Appeals) deleted the addition on the ground that the firm was not a shareholder of the company. The Tribunal confirmed the deletion.

The High Court held that in order to attract the provisions of section 2(22)(e) of the Income-tax Act, 1961, the following four conditions are the sine qua non : (i) the assessee should be a shareholder of the company ; (ii) the company should be a closely held company in which the public are not substantially interested ; (iii) there must be payment by way of advance or loan to a shareholder or any payment by the company on behalf of or for the individual benefit of the shareholder ; and (iv) there must be sufficient accumulated profits in the hands of the company up to the date of such payment.

It was further held that the assessee was not shown to be the shareholder of the company and the two individuals who were partners of the firm were the majority shareholders of the company. Therefore, the security advanced by the company to the assessee could not be deemed to be dividend as the assessee was not a shareholder in the company. The amount was paid by the company to the assessee on behalf of the individuals. Therefore, the liability of tax as deemed dividend could be attracted in the hands of the individuals, being the shareholders in the company. The Tribunal was justified in upholding the order of the Commissioner (Appeals) deleting the addition of Rs.10 lakhs made as deemed dividend under section 2(22)(e) of the Act.

5. **Whether the Tribunal was justified in deleting the addition which has been received on account of gift when no relation has been established from whom gifts have been received?**

CIT v. Padam Singh Chouhan (2009) 315 ITR 433 (Raj.)

Relevant Section: 68

The Assessing Officer found that the assessee and his family had received huge gifts from a person residing abroad and concluded that the gifts were not genuine. The Commissioner (Appeals) held that the gifts were made out of love and affection towards the assessee and having gone through the bank accounts of the donors he found there was sufficient cash balance on the date of the gift to the assessee and deleted the addition. The Tribunal affirmed the finding of the Commissioner (Appeals).

The High Court held that there was no legal basis to assume that to recognise the gift to be genuine, there should be any blood relationship, or any close relationship between the donor and the donee. The assessee had produced the copies of gift deeds and the affidavits of the donors. In the absence of anything to show that the act of the assessee in claiming gift was an act by way of money laundering, simply because he happened to receive gifts, it could not be said that they had to be added in his income.

6. Whether Tribunal was right in law to hold that the addition to the capital of the partner is not cash credit in the books of account of the firm but is cash credit in the case of the partner?

CIT v. Kulwant Industries (2009) 311 ITR 377 (P&H)

Relevant Section: 68

The assessee, a firm which had four partners filed its return. One of the partners J who enjoyed a 15 per cent share in the firm was asked to explain the credits which appeared in his capital account amounting to Rs. 25,000 which he claimed as gift by a non-resident Indian. The Assessing Officer made an addition of Rs. 25,000 by treating it as unexplained income credited in the capital account of J. The Commissioner (Appeals) deleted the addition of Rs. 25,000. The Tribunal held that the basic ingredients of cash credit were source of money and income and genuineness of the transaction and if the source was clearly and categorically explained and the amount was paid through genuine process then it was not advisable to refer to circumstantial and preponderance of the evidence. Therefore, it held that there was no logic in treating the gifts as income of the firm.

The High Court held that it had been categorically found by the Tribunal that the gift was genuine for the reason that the donor was the real maternal uncle of the donee. The gift had been made from the NRE account maintained by the donor and remittance in such an account could only be made from foreign exchange. The account had been found to be genuine as per the findings recorded by the Assessing Officer and duly accepted by the Tribunal. The identity of the donor stood established and the gift had been made through cheque by banking channel. Once the broad features and basic ingredients constituting gift were satisfied then it could not be replaced by circumstantial evidence.

2

INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME

1. Whether the Tribunal was justified in directing the Assessing Officer to allow the claim of the assessee for exemption under section 10(10C) of the Income-tax Act, 1961 to the extent of Rs.5,00,000 by applying the prospective amendment retrospectively?

Income-tax Officer v. Dhan Sai Srivas (2009) 315 ITR 318 (Chhattisgarh)

Relevant Section: 10(10C)

The assessee's employer had determined the ex-gratia amount payable to the assessee on his voluntary retirement at Rs. 7,13,513, but out of this amount only one-fifth, i.e., Rs. 1,42,703 was actually paid to the assessee in the previous year relevant to the assessment year 2003-04. The assessee, however, claimed deduction for a total sum of Rs.5,00,000, the maximum limit under section 10(10C) of the Income-tax Act, 1961. The Assessing Officer allowed exemption only for Rs.1,42,703 and added back the balance. The assessee preferred an appeal, whereupon the Commissioner (Appeals) partly allowed the appeal. The appeal preferred by the Department was dismissed by the Tribunal.

The High Court held that under the scheme, the liability to pay was incurred and the amount became payable at the time when the employee was released, having opted for the voluntary retirement under the scheme. Salary or benefit in lieu of salary payable to an employee opting for voluntary retirement was chargeable to tax under section 15(a) as soon as it became due, though not paid. The amount so received was exempt from being charged to tax to the extent of Rs. 5,00,000 by reason of section 10(10C) of the Act. Even if the payment was stretched over a period of years, it would not become chargeable to tax in any subsequent assessment year.

Section 10(10C) of the Act was inserted in order to make voluntary retirement more attractive and beneficial to employees opting for voluntary retirement. Therefore, this has to be interpreted in a manner beneficial to the optee for voluntary retirement, if there is any ambiguity.

It could not have been the intention of the Legislature to restrict the benefit under section 10(10C) of the Act to employees, who retired before April 1, 2004, to the extent of the amount actually received by them at the time of voluntary retirement for that particular assessment year and to other employees of the same organization who opted for voluntary retirement after that to extend that benefit for the amount received by them as well as the amount receivable by them in the subsequent financial years. Therefore, the amendment to clause (10C) of section 10 of the Act by the Finance Act, 2003 with effect from April 1, 2004 adding the words "or receivable" after the words "received" is clarificatory.

2. Whether the assessee can exemption under section 10B in respect of interest earned from advance amount received from its sister concern for purchasing goods?

CIT v. Hycon India Ltd. (2009) 308 ITR 251 (Raj.)

Relevant Section: 10(B)

The assessee purchased goods from its sister concern and for such purchases it paid in advance to the seller and the advance amount yielded interest income to the assessee. The Assessing Officer allowed exemption to the interest income under section 10B holding that the interest income was attributable to the business of the undertaking. The Commissioner found that there was nothing on record to show that the sister concern had desired the deposit any specific amount of advance prior to its agreeing to supply raw material to its own sister concern nor was there anything to indicate that the Assessing Officer examined the case from this angle, before allowing the exemption under section 10B. Likewise, the Commissioner considered that even if there was a business practice where the suppliers of certain goods required an advance for future purchase, the transactions of the assessee with its own sister concern were to be considered on a different footing. On these findings, the Commissioner revised the order of the Assessing Officer under section 263 on the ground that it was prejudicial to the interests of the Revenue. The Tribunal did not agree with the view of the Commissioner and held that interest income received by the assessee from its sister concern was income from business.

The High court held that "Profits and gains of business or profession" and "Income from other sources" are different species of income. Section 2(24) of the Income-tax Act, 1961, does not categorise separately, profits and gains of business or profession. The expression "profits and gains" as used in section 2(24) is wider and is not confined to "Profits and gains of business or profession". Section 10B provides for exemption with respect to any "profits and gains" derived by the assessee, and is not confined to "profits and gains of business or profession".

Hence, the interest income received by the assessee from its sister concern did fall within the expression "profits and gains" and was eligible for exemption as business income under section 10B.

3

CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS

1. Whether the Tribunal was right in negating the assessee's claim for accumulation of unspent income?

Bharat Krishak Samaj v. Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del)

Relevant Section: 11

The assessee, a society registered under section 12A of the Income-tax Act, 1961, filled in Form No. 10 provided under the Income-tax Rules, 1962, and submitted it to the Assessing Officer along with its resolution, seeking permission to accumulate unspent funds under section 11(2) of the Act for the objects of the trust. The Assessing Officer was of the view that the objects for which accumulation was sought were not particularised inasmuch as they covered the entire range of objects of the trust. On this basis, the Assessing Officer denied the benefit of accumulation to the assessee. This was upheld by the Tribunal.

The High Court held that it is not necessary for a charitable trust to particularise each and every object for which accumulation is sought. It is enough if the assessee seeks accumulation for the objects of the trust. Hence, the assessee had sought to accumulate the sum for purposes of the trust and had specified such objects. It was therefore, entitled to accumulate the sum under section 11.

2. Whether repayment of borrowed funds utilised for construction of commercial complex augmenting income of trust and amounts to application of income for charitable purpose eligible for exemption under section 11?

Director of Income-tax (Exemption) v. Govindu Naicker Estate (2009) 315 ITR 237 (Mad.)

Relevant Section: 11

During the assessment under section 143(3) of the Act, the Assessing Officer noted that, the trust had made part repayment of a loan taken from the bank for constructing a multi-storied building. The Assessing Officer opined that the multi-storied commercial complex was not one of the objects of the trust and the expenditure incurred for the construction of the building could not be treated as charitable in nature, that the repayment of loan could not be regarded as application of income towards the charitable objects of the trust and rejected the claim of the assessee. The Commissioner (Appeals) allowed the appeal on the ground that the property of the trust was in a dilapidated condition and fresh construction had to be undertaken by obtaining a loan. The subsequent letting out of the property was connected with the carrying out of the objects of the trust and hence, the repayment of loan ought to

have been treated as eligible application. The finding of the Commissioner (Appeals) was confirmed by the Tribunal.

The High Court held that the Tribunal was right in holding that the repayment of loan taken from the bank for construction of commercial complex was application of income for charitable purposes and the assessee-trust was eligible for exemption under section 11 of the Act. Even though the expenditure incurred is capital in nature, if the expenditure is incurred for the purpose of promoting the object of the trust, it could be considered as application of the income for the purpose of the trust. If the application of the income resulted in the maintenance of the property held under trust for charitable purpose, is for the purpose of augmenting income in order to pursue the objects of the trust that would amount to application of income for the purpose of the trust.

3. **Whether the Tribunal has erred in law in holding that the assessee carried on activity for charitable purpose in terms of section 2(15) and directing the Commissioner of Income-tax to grant registration under section 12AA of the Act to the assessee-society?**

CIT v National Institute of Aeronautical Engineering Educational Socieity (2009) 315 ITR 428 (Uttarakand)

Relevant Section: 12AA

The assessee, a registered society, moved an application before the Commissioner for grant of registration under section 12AA(1)(b)(i) of the Act, in Form 10A. The Commissioner examined the papers including the income and expenditure of the assessee for the previous years and concluded that the assessee was not carrying on any charitable activity within the meaning of section 2(15) of the Act, as it was in a profit making business. Consequently, he rejected the application for registration under section 12AA of the Act. The assessee preferred an appeal before the Appellate Tribunal, which was allowed.

The High Court held that section 12AA of the Act provides the procedure for registration. Clause (a) of sub-section (1) of section 12AA empowers the Commissioner to call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of the activities of the trust or institution and he may also make such inquiries, as he may deem necessary in this behalf. The Commissioner is not supposed to allow registration with blind eyes. The Commissioner had considered the relevant papers before him, which included the income and expenditure accounts of the previous years after the assessee society got registered with the Assistant Registrar of Firms, Societies and Chits. The Commissioner observed that the society was charging substantial fees from the students and making huge profits. Merely imparting education for the primary purpose of earning profits could not be said to be a charitable activity. In the expression "charitable purpose", "charity" is the soul of the expression. Mere trade or commerce in the name of education cannot be said to be a charitable purpose and the Commissioner has to satisfy itself as provided under section 12AA of the Act before allowing the registration. The order of the Commissioner was justified.

4

INCOME FROM SALARIES

1. Whether the amount received by the employee on cessation of employment with his employer will be exempted from tax under section 17(3)(i) of the Income-tax Act?

CIT v. Shyam Sundar Chhaparia (2008) 305 ITR 181 (MP)

Relevant Section: 17(3)

The assessee after his retirement was granted an amount of Rs.27,50,000 as a special compensation in lieu of an agreement for refraining from taking up any employment activities or consultation which would be prejudicial to the business/interest of his employer. The assessee claimed that it was a non-taxable receipt being the compensation for not taking up any competitive employment under a restrictive covenant. The Assessing Officer did not accept the claim of the assessee on the grounds that (i) the decision of the Supreme Court relied on by the assessee was that of an agency whereas the case of the assessee was that of one who was in service, and (ii) section 17(3)(i) was squarely applicable to the case of the assessee. The Commissioner (Appeals) held that as there was restriction for the assessee not to work in business of any type and anywhere, the compensation was received in lieu of loss of future work and was a capital receipt. The Tribunal held in favour of the assessee.

The High Court held that the assessee retired from service on attaining the age of superannuation and hence there was severance of the master-servant relationship and there was no material to suggest that there existed a service contract providing therein a restrictive covenant preventing thereby the assessee from taking up any employment or activities on consultation which would be prejudicial to the business/interest of his employer. Therefore, it could not be termed as profit in lieu of salary because it was not compensation due to or received by the assessee from his employer or partner- employer at or in connection with the termination of his employment. Thus, the Commissioner (Appeals) and the Tribunal rightly held that the amount could not be added for the purpose of income-tax.

2. Can reimbursement of expenditure on medical treatment taken by the assessee, who was a member of the Legislative Assembly, be taxed as perquisite under section 17(2)(iv)?

CIT v. Shiv Charan Mathur (2008) 306 ITR 126 (Raj)

Relevant Section: 15 & 17(2*)*

Notice under section 148 was issued to the assessee, at the relevant time a sitting MLA and former Chief Minister of the State, for the reason that he received a sum from the State

Government as reimbursement of medical expenses which amount was liable to be taxed under section 17 but had not been offered for taxation. The contention of the assessee was that the amount received by MPs and MLAs was not taxable under the head “Salary” but under the head “Income from other sources”.

The High Court held that MLAs and MPs are not employed by anybody rather they are elected by the public, their election constituencies and it is consequent upon such election that they acquire constitutional position and are in charge of constitutional functions and obligations. The remuneration received by them, after swearing in, cannot be said to be “salary” within the meaning of section 15 of the Income-tax Act, 1961. The fundamental requirement for attracting section 15 is that there should be a relationship of employer and employee whether in existence or in the past. This basic ingredient is missing in the cases of MLAs and MPs. When the provisions of section 15 were not attracted to the remuneration received by the assessee, section 17 could not be attracted as section 17 only extends the definition of “Salary” by providing certain items mentioned therein to be included in salary. Thus, the reimbursement of medical treatment taken by the assessee, who was a member of the Legislative Assembly for open heart surgery conducted abroad was not taxable as perquisite under section 17(2)(iv).

5

INCOME FROM HOUSE PROPERTY

1. Is the rental income from the sub-letting of a building taken on lease taxable under the head 'income from other sources' or 'income from house property' or 'income from business?

Harikrishna Family Trust v. CIT (2008) 306 ITR 303 (Guj.)

Relevant Section: 22

A lease deed was executed between the owners of a property partly constructed and the assessee-trust. The trust took on lease the said property at a monthly lease rent of Rs.4,000. The beneficiaries were dependent relatives of the co-owners of the property. The trust, after completing construction work of the balance portion of the building, rented out the whole premises and the rental income was shown as income from property and originally assessed as such. Subsequently, by virtue of action under section 263 of the Income-tax Act, 1961, the CIT set aside the order. After enquiry the Assessing Officer assessed the income as business income but the CIT(A) on appeal held that it was income from other sources. The Tribunal held that the amount was assessable as business income.

The High Court held that the assessee-trust was merely a lessee of the property and had sub-let the property after completing the partly constructed building which the assessee-trust had taken on lease. In the circumstances, in the absence of the assessee-trust being the owner of the property, there could be no question of taxing the rental income from the said property in the hands of the assessee-trust under the head "Income from house property". The assessee-trust at no point of time indulged in any systematic activity so as to treat the assessee as having indulged in business or a venture in the nature of business. On facts the income was liable to be taxed as "Income from other sources".

6

PROFITS AND GAINS OF BUSINESS OR PROFESSION

1. Can the assessee treat shares held in subsidiary company, which is ordered to be wound up, as trading loss?

CIT v. H. P. Mineral and Industrial Development Corporation Ltd. (2008) 305 ITR 111 (HP)

Relevant Section: 28

One of the assessee's subsidiary companies was ordered to be wound up and the assessee decided to write off the value of the shares held by it in the subsidiary company. The lower authorities decided in favour of the assessee holding that there was no question of selling off the shares as the subsidiary company had gone into liquidation.

The High Court held that once a company had been ordered to be wound up, there was no question of any party dealing in the shares of that company. The Tribunal had come to a finding that the shares were stock-in-trade and had therefore allowed the loss. The loss had to be treated as a trading loss. The mere fact that the shares were not sold was of no significance since in fact the shares could not have been sold and had become worthless.

2. Whether the amount transferred to the reserve fund account as per the provisions of section 67 of the Gujarat Co-operative Societies Act, 1962, was diversion of income at source by overriding title or could such transfer be treated as business expenditure deductible either under section 28 or section 37?

CIT v. Mehsana District Co-op. Milk Producers' Union Ltd. (2008) 307 ITR 83 (Guj.)

Relevant Section: 28

The assessee contended that under sub-section (2) of section 67 of the Gujarat Co-operative Societies Act, 1962, at least one-fourth of the net profits of the society were required to be carried to the reserve fund every year, and hence there was a diversion at source by virtue of the provisions of section 67 which operates as an overriding title. Hence, it was submitted that the amount transferred to the reserve fund could not be charged as income liable to tax under the Act. Alternatively, it was pleaded that the amount of profits transferred to the reserve fund would constitute a charge on the taxable income under the provisions of section 28 of the Income-tax Act, 1961, or an expenditure having the characteristics of business expenditure under section 37. The Assessing Officer rejected the contention and this was upheld by the Tribunal.

The High Court held that it was only in the event the society did not choose to use the reserve fund for the business of the society that the question about investing the reserve fund in the specified category of investments and thereafter utilizing the same for the objects specified by the State Government could arise. Hence, not only was there no diversion of income by overriding title but in fact there was no outgoing of funds from the domain of the assessee-society. In fact, the profits at the specified percentage were set apart so as to be available to the society for use in the business of the society at a later point of time. Once the society was in a position to use the funds lying in the reserve fund for the business of the society as and when the society so chose, there could be no question of keeping out such profits from the purview of taxation. The Tribunal was right in law in holding that the amount transferred to the reserve fund account as per the provisions of section 67 of the Gujarat Co-operative Societies Act, 1962, was not diversion of income at source by overriding title nor could such transfer be treated as business expenditure deductible either under section 28 or section 37.

3. Whether the amount received by the assessee under a lease agreement is income from other sources or business income?

East West Hotels Ltd. v. DCIT (2009) 309 ITR 149 (Kar.)

Relevant Section: 28

The assessee was engaged in the hotel business activities. The assessee by an agreement with IHC gave one of its hotels on lease for an initial period of 33 years with an option to renew for a further period of 33 years. The assessee claimed that the amount received from IHC had to be treated as its business income. The claim was rejected by the Assessing Officer on the ground that the assessee was not getting any business income as the hotel had been leased out by the assessee to IHC and any amount received by the assessee from such company had to be treated as income from other sources and not business income. The Commissioner (Appeals) as well as the Tribunal held that the income received by the assessee from such hotel building was income from other sources.

The High Court held that the clauses in the agreement were more in the nature of a lease deed and not a licence given for a particular period with no intention to resume its business of hotel in the premises. It could not be said that the assessee had been managing the hotel through IHC. Therefore, the amount received from IHC had to be treated as income from other sources and not as business income.

4. Whether the swapping premium is profit derived from the business of providing long-term finance in terms of section 36(1)(viii) of the Income-tax Act, 1961 ?

Rural Electrification Corporation Ltd., In re (2009) 308 ITR 321 (AAR)

Relevant Section: 36(1)(viii)

The main object of the applicant, a public sector undertaking, was to provide long-term finance, primarily to State Electricity Boards, for the purpose of transmission, distribution and

generation of electricity to enable industrial, agricultural and infrastructure development. The applicant was filing income-tax returns right from the beginning and the Department had all along, in the past, allowed deduction under section 36(1)(viii) of the Income-tax Act, 1961, in respect of the special reserve created and maintained for providing long-term finance for industrial or agricultural development or development of infrastructure. For the assessment year 2004-05, the applicant credited Rs.170.85 crores as "swapping premium" received and claimed deduction thereon under section 36(1)(viii). "Swapping premium" was a scheme under which long-term finance given at a higher percentage of interest was converted to a lower rate of interest. The applicant itself had declared the swapping premium receipt in its balance-sheet as "Other income" and not income from lending operations. The Assessing Officer held that the applicant forfeited the claim for allowance of deduction under section 36(1)(viii) in respect of the "swapping premium". The Commissioner (Appeals) agreed with the Assessing Officer. The applicant appealed to the Appellate Tribunal but withdrew the appeal. Meanwhile, the applicant obtained permission of the Committee on Disputes to pursue the matter before the Authority. The Authority ruled:

(i) That the applicant was an eligible entity, i.e., a financial corporation as laid down in section 36(1)(viii).

(ii) That the applicant was engaged in the business of providing long-term finance to its clients for rural electrification which paved the way for industrial, agricultural and infrastructural development. The availability of electricity contributed significantly to the overall development of the country including that of industry, agriculture and infrastructure. The provision of electricity was essential for modernization and growth of agriculture and also catered to the requirements of industry including small and medium industries, agro-industries, Khadi and village industries, etc. The applicant had been providing finance for industrial and agricultural development and, keeping in view these very goals, the Government of India had granted approval to the applicant for deduction under section 36(1)(viii). The applicant could be said to be engaged in providing long-term finance for industrial and agricultural development in India.

(iii) That the long-term loan financed by the applicant to its clients in the beginning had not been tampered with on rescheduling of the interest and no fresh loan agreements had also been drawn.

(iv) That clause (e) of the Explanation to section 36(1)(viii) defined long-term finance as "any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereon during a period of not less than five years". In this case, the loans had been advanced in the beginning for five years and those loan amounts had not undergone any change, so the period of five years had to be counted from the date of advancing the initial loans and not from the date of rescheduling the interest rates.

(v) That the "swapping premium" was nothing but discounted interest and had "originated"

in the long-term finance initially advanced. The premium was actually traced to the original source and was not a step removed from the business of providing long-term finance. No fresh agreement had been entered into for advancing long-term financing and the one-time measure for rescheduling the interest had been actuated by business expediency. The swapping premium was simply a compensation received for agreeing to a lesser amount as against a higher fixed rate of interest initially fixed. The business of providing long-term finance was the immediate and effective source of the swapping premium received.

(vi) That the swapping premium could not be termed as compensation for breach of contract because neither party had breached the contract. The disclosure of the swapping premium in the balance-sheet as "Other income" instead of business income was also immaterial since entries in the books of account are not determinative of the true character of a receipt.

(vii) That, therefore, the applicant was entitled to deduction under section 36(1)(viii) in respect of the swapping premium received.

5. Whether the payments made by the assessee to its employees under the nomenclature 'Good work reward' constitute bonus within the meaning of section 36(1)(ii) of the Income-tax Act, 1961 or were allowable as normal business expenditure under section 37 ?

Shriram Pistons and Rings Ltd. v. CIT (2008) 307 ITR 363 (Del.)

Relevant Section: 37

The "good work reward" that was given by the assessee to some employees on the recommendation of senior officers of the assessee did not fall in any of the categories of bonus specified under the industrial law. There was nothing to suggest that the good work reward given by the assessee to its employees had any relation to the profits that the assessee may or may not make. The reward had relation to the good work done by the employee during the course of his employment and at the end of the financial year on the recommendation of a senior officer of the assessee, the reward was given to the employee. Consequently, the "good work reward" could not fall within the ambit of section 36(1)(ii) of the Income-tax Act, 1961. The "good work" reward was allowable as business expenditure under section 37(1) of the Act.

6. Whether the Tribunal was justified in deleting the addition of an amount represented rate difference payment in the purchase of milk paid by the assessee even though the said payment was paid at the end of the previous year?

CIT v. Solapur Dist. Co-Op. Milk Producers and Process Union Ltd. (2009) 315 ITR 304 (Bom.)

Relevant Section: 37

The assessee-societies were federal milk societies and their members were primary milk co-operative societies. The business of the assessee was to purchase milk from its members and other producers of milk at the rate, i.e., similar to both the members and outside milk producers and sell the milk to various parties. The rate of purchase price was fixed by the board of the assessee-societies. The purchase price was linked to the fat content of milk and also varied according to seasons. For instance, the rate for purchase of milk in the lean season was different from the flush seasons. The assessee-societies fixed the rate of processing of milk at the beginning of the year on the basis of the price declared by the Government of Maharashtra and the price which other buyers paid to the vendors. These rates were revised from time to time. It was made always clear that the rates were provisional and the final milk rate difference was determined in the month of March every year and the difference was paid subsequently in the following year. The primary milk society also in turn made payment of the final rate difference to the individual milk producers around Diwali. The assessees claimed deduction of the final rate difference. The Assessing Officer refused to exclude the final rate difference paid from the total amount paid by the assessee. The Commissioner (Appeals) upheld the order. The Tribunal allowed the appeal and allowed deductions of the final rate.

The High Court held that the amount to be paid was not out of the profits ascertained at the annual general meeting. It was not paid to all shareholders. The amount which was the subject-matter was paid to members who supplied milk and in some case also to non-members. The payment was for the quantity of milk supplied and in terms of the quality supplied. The commercial expediency for payment of this price was the market conditions and the need to procure more milk from the members and non-members to the assessee. Therefore, the amount paid could not be said to be dividend to the members or shareholders or payment in the form of bonus as bonus also had to be paid from the accrued profits. It was deductible.

7. Whether the expenses incurred by the assessee for promotion films, slides, advertisement films is capital expenditure?

CIT v. Geoffrey Manners and Co. Ltd. (2009) 315 ITR 134 (Bom.)

Relevant Section: 37

The assessee incurred expenditure on film production by way of advertisement for the marketing of products manufactured by it. The Assessing Officer disallowed the expenses incurred by the assessee for promotion films, slides, advertisement films and treated it as capital expenditure. The Commissioner (Appeals) held that the films were in the form of advertisement whose life term could not be ascertained. Therefore, they could not be held as capital expenditure. The Tribunal upheld the order of the Commissioner (Appeals).

The High Court held that if the expenditure is in respect of an ongoing business of the assessee and there is no enduring benefit it can be treated as revenue expenditure. If the expenditure is in respect of business which is yet to commence then it cannot be treated as

revenue expenditure since the expenditure is on a product yet to be marketed. Hence, the expenditure incurred in respect of promoting ongoing products of the assessee was revenue expenditure.

8. **Whether the expenditure incurred by the assessee in the machinery repairs could be treated as revenue expenditure though this related to the cost of motors and other items resulting in an enduring benefit to the assessee and was in the nature of capital expenditure?**

CIT v. Hero Cycles P. Ltd (2009) 311 ITR 349 (P&H)

Relevant Section: 37

The assessee claimed expenditure of Rs. 73,180 on purchase of motors and certain other items of machinery. The Assessing Officer rejected the claim for treating the amount as revenue expenditure on the ground that the items purchased by the amount were not spare parts but independent items and the amount had, thus, to be treated as capital expenditure. On appeal, the plea of the assessee that most of the items purchased were electric motors for replacement of existing machinery, was upheld. The Tribunal affirmed the order and held that occasional replacements were necessary having regard to the machinery installed.

The High court held that the Tribunal was right in law in allowing expenditure of Rs.73,180 shown by the assessee in the machinery repairs account as revenue expenditure.

9. **Whether the fine paid for belated payment of excise duty is a allowable business expenditure?**

CIT v. Hoshiari Lal Kewal Krishan (2009) 311 ITR 336 (P&H)

Relevant Section: 37

The assessee claimed deduction of Rs. 31,433 paid as fine for belated payment of the excise duty instalment. This was disallowed by the Assessing Officer as well as the appellate authority but the Tribunal allowed it.

The Supreme Court in *Prakash Cotton Mills P. Ltd. v. CIT [1993] 201 ITR 684,* observed that whenever any statutory impost paid by an assessee by way of damages or penalty or interest is claimed as an allowable expenditure under section 37(1) of the Income-tax Act, the assessing authority is required to examine the scheme of the provisions of the relevant statute providing for payment of such impost notwithstanding the nomenclature of the impost as given by the statute, to find whether it is compensatory or penal in nature. The authority has to allow deduction under section 37(1) of the Income-tax Act, wherever such examination reveals the concerned impost to be purely compensatory in nature.

Hence, in the present case, the High Court held that it had been clearly found that though termed as fine, the payment was not in the nature of punishment but was by way of compensation. The payment was deductible.

10. Whether section 40(b) of the Income-tax Act, 1961, is applicable to the amount of salary and bonus paid by the assessee-firm to its partners for their individual service as against their Hindu undivided family character?

CIT v. Unimax Laboratories (2009) 311 ITR 191 (P&H)

Relevant Section: 40(b)

The Assessing Officer made an addition under section 40(b) of the Income-tax Act, 1961, on account of salary and bonus paid by the assessee-firm to its four working partners. Those partners were partners in their representative capacity as karta of their Hindu undivided families. Since these partners represented their respective Hindu undivided families, they were treated to be partners for the purpose of disallowance of benefits under section 40(b) of the Act by the Assessing Officer. However, on appeal the addition was deleted on the ground that the salary and bonus were paid to these persons as individuals and in these circumstances section 40(b) of the Act had no application.

The High Court held that the Tribunal was right in allowing the amount of salary and bonus paid by the firm to partners for services rendered by them on the ground of having technical qualification and expertise, though they represented their Hindu undivided families and section 40(b) of the Act was not attracted.

11. Whether the amount written back by the assessee to the credit of its profit and loss account during the accounting period under consideration constituted income of the assessee-company under section 41(1) of the Income-tax Act 1961?

Jay Engineering Works Ltd. v. CIT (2009) 311 ITR 299 (Del.)

Relevant Section: 41(1)

The assessee had written back in its accounts unclaimed balances totalling Rs.1,16,240. The Inspecting Assistant Commissioner added back this amount to the income of the assessee. This was upheld by the Commissioner (Appeals) as well the Tribunal.

The High Court held that the amounts were not statutory liabilities but contractual liabilities. These amounts were unilaterally written off by the assessee. Therefore, the unclaimed liability written off by the assessee was taxable as income.

12. Whether the amount transferred to profit and loss account in case of waiver of loan taken by assessee for business purposes assessable as business income under section 41(1) of the Income-tax Act, 1961?

Solid Containers Ltd. v. DCIT (2009) 308 ITR 417 (Bom.)

Relevant Section: 41(1)

The assessee had taken a loan for business purposes which was written back and directly credited to the reserves account, as a result of consent terms arrived at in a suit. The assessee claimed this amount as capital receipt, even though it had offered the interest on the said loan as its income by crediting the same to its profit and loss account. The Assessing

Officer added the amount to the total income of the assessee as its income and this was upheld by the Tribunal.

The High Court held that it was a loan taken for trading activity and ultimately, upon waiver the amount was retained in the business by the assessee. The amount had become the assessee's income and was assessable.

13. Is depreciation under section 32 allowable in respect of emergency spares of plant and machinery, which though acquired during the previous year, have not been put to use in that year?

CIT v. Insilco Ltd. (2009) 179 Taxman 55 (Del.)

Relevant Section: 32

On this issue, the Delhi High Court observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

Note *– One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is "kept ready for use". For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term "use" embraces both active use and passive use. However, such passive use should also be for business purposes.*

14. What is the tax treatment of pre-payment premium paid by the assessee-company to IDBI for restructuring its debt?

CIT v. Gujarat Guardian Ltd. (2009) 177 Taxman 434 (Del.)

Relevant Section: 43B

The assessee-company paid pre-payment premium to IDBI during the relevant previous year for restructuring its debts and reducing the rate of interest. It claimed the full payment as business expenditure in that year on the reasoning that it was an upfront payment representing the present value of the differential rate of interest that would have been due on the loan if the restructuring of loan had not taken place. The Assessing Officer and Commissioner (Appeals) were of the view that the premium has to be amortised over 10 years, and accordingly allowed only 1/10th of the premium as deduction for the relevant previous year. The Tribunal, however, concurred with the assessee's view and held that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable.

The issue under consideration is whether the deduction has to be allowed in one lump-sum as claimed by the assessee or should the same be deferred over a period of time as opined by the Assessing Officer and Commissioner (Appeals).

The Delhi High Court concurred with the Tribunal's view that the deduction has to be allowed to the assessee-company in one lump sum according to the provisions of section 43B(d). Section 43B(d) provides that any sum payable by the assessee as interest on any loan or borrowing from any public financial institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the period or periods in which the liability to pay such sum is incurred by the assessee according to the method of accounting regularly followed by the assessee. As there was no dispute that the pre-payment premium paid represented interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, as per the provisions of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the actual payment was made i.e. the previous year relevant to the assessment year under consideration.

Note *– Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Section 2(28A) defines interest to include, inter alia, any other charge in respect of the moneys borrowed or debt incurred. Section 43B provides for certain deductions to be allowed only on actual payment. From a combined reading of these three sections, it can be inferred that –*

(i) pre-payment premium represents interest as per section 2(28A);

(ii) such interest is deductible as business expenditure as per section 36(1)(iii);

(iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).

7

CAPITAL GAINS

1. Can the loss on account of forfeiture of share application money be treated as short-term capital loss?

DCIT v. BPL Sanyo Finance Ltd. (2009) 312 ITR 63 (Kar.)

Relevant Section: 45

The assessee company is engaged in non-banking financial business and applied for allotment of one lakh equity shares of the IDBI in response to the public issue of shares and remitted the share application money. The IDBI allotted 89,200 shares to the assessee as against one lakh equity shares applied for. Thereafter, the IDBI called the assessee to pay the balance sum for issuance of shares in its favour. As the assessee-company failed to remit the balance outstanding allotment money, the IDBI cancelled the allotment and forfeited the share application money. The assessee claimed it as a short-term capital loss in its return of income. The Assessing Officer disallowed the claim. The Commissioner(Appeals) confirmed the order passed by the Assessing Officer. The Tribunal allowed the appeal filed by the assessee.

The High Court held that consequent to the assessee's default in not paying the balance of money on allotment, its right in the shares stood extinguished on forfeiture by the IDBI. The loss suffered by the assessee, i.e., the non-recovery of share application money was consequent to the forfeiture of its right in the shares and was to be understood to be within the scope and ambit of transfer. It would amount to short-term capital loss to the assessee.

2. Can the transfer of capital asset by a company to its wholly owned subsidiary company be regarded as transfer and, therefore, attract levy of capital gains tax?

CIT v. Coats of India Ltd. (2009) 315 ITR 215 (Cal.)

Relevant Section: 47

The entire packaging coating units of the assessee was transferred to CCIPL for a sum of Rs. 29,89,87,000 by way of adjustment and issue of equity shares of Rs.10 each in CCIPL credited as fully paid-up share capital. In the process of such transfer a surplus amount of Rs. 19,14,55,804 was credited to the accounts of the assessee over and above the book value of the assets actually transferred to CCIPL. The assessee claimed that this excess amount was not taxable on the ground that the assessee transferred the assets of the company to its wholly owned subsidiary company. It was further stated that the unit was transferred with all its assets and, therefore, the value of each of the items could not be determined separately as the sale was made on slump basis and, accordingly, the actual profit from each asset

could not be determined. The Tribunal held that the entire packaging coating business undertaking itself constituted a distinct "capital asset" under section 2(14) of the Income-tax Act, 1961, for which consideration was not determined with reference to individual assets but with reference to the capitalised value of the said business, that the proviso to section 47(v) and (iv) was applicable only if, in the hands of the transferee the capital asset on its transfer constituted stock-in-trade, that such packaging coating business on its transfer was not accounted for in the books of CCIPL as stock-in-trade and that, therefore, since the entire paid-up capital of CCIPL as on December 31, 1997, was held by the assessee the transfer of the undertaking was covered by the provisions of section 47(iv) and, therefore, no income under the head "Capital gains" was assessable in the assessment year 1998-99 .

The High Court held that the Tribunal was right and no capital gains arose.

3. Can the actual sale consideration recorded in the agreement to sell of the asset and received by the assessee be substituted by the value as adopted by the District Valuation Officer under section 55A of the Act for the purpose of computing the capital gains chargeable to tax ?

Dev Kumar Jain v. Income-tax Officer (2009) 309 ITR 240 (Del.)

Relevant Section: 55A

The assessee declared income by way of capital gains arising from the sale of property. The Assessing Officer was of the view that the sale price disclosed in the agreement to sell was low and made a reference to the District Valuation Officer under section 55A for determining the fair market value of the property on the date of sale. The District Valuation Officer determined the value of the plot on the date of the sale and this was communicated to the assessee. The Tribunal accepted the stand of the Revenue that the actual sale consideration recorded in the agreement to sell should be substituted by the value arrived at by the District Valuation Officer under section 55A.

The High Court held that section 55A of the Income-tax Act, 1961, applies only where the Assessing Officer is required to ascertain the fair market value of a capital asset. Section 45(1A) stipulates that capital gains shall be computed by deducting from the full value of consideration received or accruing as a result of the transfer of the capital asset, the amount of expenditure incurred wholly and exclusively in connection with such transfer as also the cost of acquisition of the asset and the cost of any improvement thereto. A combined reading of section 45(1A) and section 48 shows that when a sale of property takes place, the capital gains arising out of such a transfer has to be computed by looking at the full value of the consideration received or accruing as a result of such transfer. The expression “full value of sale consideration” is not the same as “fair market value” as appearing in section 55A. Thus, for the purpose of computing capital gains there is no necessity for computing the fair market value. Further, there was nothing on record to show that the assessee received consideration for the sale of the property in excess of that which was shown in the agreement to sell. Thus, the actual sale consideration recorded in the agreement to sell and received by the assessee

could not be substituted by the value as adopted by the District Valuation Officer under section 55A for the purpose of computing the capital gains chargeable to tax.

4. Can exemption under section 54(1) be claimed for the purchase of more than one residential premises?

CIT v. D. Ananda Basappa (2009) 309 ITR 329 (Kar.)

Relevant Section: 54

The assessee a Hindu undivided family sold a residential house. The assessee purchased two residential flats adjacent to each other from taking two separate registered sale deeds in respect of the two flats situate side by side purchased on the same day. The vendor had certified that it had effected necessary modifications to the two flats to make it one residential apartment. The assessee sought exemption under section 54. The assessing authority gave exemption for capital gains to the extent of purchase of one residential flat. It was found by the Inspector that the residential flats were in the occupation of two different tenants. The Assessing Officer held that section 54(1) of the Act does not permit exemption for the purchasers for more than one residential premises. The Commissioner (Appeals) confirmed the order of the assessing authority. The Tribunal set aside the order of the Commissioner (Appeals) and held that the flats purchased by the assessee had to be treated as one single residential unit and that the assessee was entitled to full exemption.

The High Court held that it was shown by the assessee that the apartments were situated side by side. The builder had also stated that he had effected modification of the flats to make them one unit by opening the door in between the two apartments. The fact that at the time when the Inspector inspected the premises, the flats were occupied by two different tenants was not a ground to hold that the apartment was not one residential unit. The fact that the assessee could have purchased both the flats in one single sale deed or could have narrated the purchase of two premises as one unit in the sale deed was not a ground to hold that the assessee had no intention to purchase two flats as one unit. The assessee was entitled to the exemption under section 54.

5. Whether the assessee, in the computation of long-term capital gains, is entitled to deduction under section 54F of the Income tax Act in respect of investment in modification/expansion of an existing residential house?

Mrs. Meera Jacob v. Income-tax Officer (2009) 313 ITR 411 (Ker.)

Relevant section: 54F

The Tribunal took the stand that exemption is available only when the investment is in the construction of a house and not for investment in modification or renovation. Admitted facts are that the assessee had a fairly big house to which the assessee made addition of 140 sq. meters of plinth area. However, it is the conceded position that the assessee has not constructed any separate apartment or house. Section 54F does not provide for exemption on investment in renovation or modification of an existing house. On the other hand, construction

of a house only qualifies for exemption on the investment. Even addition of a floor of a self-contained type to the existing house would have qualified for exemption. However, since the assessee has only made addition to the plinth area, which is in the form of modification of an existing house, she is not entitled to deduction claimed under section 54F of the Act.

8

INCOME FROM OTHER SOURCES

1. Whether the Tribunal was right in law in holding that the income from lease of hospital, after giving a finding that the hospital basically remains a business asset, should be assessed as 'Income from other sources' and not as 'Business Income'?

Orient Hospital Ltd. v. DCIT (2009) 315 ITR 422 (Mad.)

Relevant Section: 56(2)(iii)

The assessee-company constructed a hospital building and ran the hospital. As the assessee-company suffered loss in running the business, it leased the hospital building along with equipment and machinery to A on a monthly lease of Rs.3,00,000 per month and claimed this sum as business income against which earlier business losses were set off. The Assessing Officer treated the income from lease of the hospital as "Income from other sources" and disallowed set off of the earlier years' business losses. The Commissioner (Appeals) allowed the assessee's appeal, but the Appellate Tribunal, while holding that the lease income was to be treated as income from other sources, allowed the lease income to be set off against the previous years' losses.

The High Court held that income derived out of the lease of property and furniture as in this case could not be treated as income from profits and gains of business or profession. The finding given by the Tribunal that the income was income from other sources was correct.

9

DEDUCTIONS FROM GROSS TOTAL INCOME

1. Whether the assessee was entitled to deduction under section 80-IB of the Income-tax Act, 1961, on the ground that conversion of jumbo rolls into salable packets/rolls of standard size was not manufacture or production of article or thing?

Computer Graphics Ltd. v. ACIT (2009) 308 ITR 96 (Mad.)

Relevant Section: 80IB

The assessee, a company engaged in the business of conversion of jumbo rolls of Konica colour paper, Konica graphic art film and medical x-ray films into saleable packets, filed its return of income for the assessment years claiming deduction under section 80-IB of the Income-tax Act, 1961. The Assessing Officer disallowed the deduction on the ground that there was no manufacture of any article or thing. The Commissioner (Appeals) as well as the Tribunal confirmed the disallowance made by the Assessing Officer.

The High Court held that the activity of converting jumbo rolls into marketable small sizes could not be regarded as a manufacturing activity and the assessee was not entitled to the benefit of section 80-IB of the Act as had been already decided in the assessee's own case in the earlier year.

2. Whether the assessee is eligible for deduction under section 80P(2)(a)(i) in respect of the interest income earned on deposits made with H.P. State Co-operative Bank in the shape of F. D. R. as income derived from banking business?

CIT v. Kangra Co-operative Bank Ltd. (2009) 309 ITR 106 (HP)

Relevant Section: 80P

The assessee, a co-operative bank, created under the H. P. Co-operative Societies Act, 1968, invested its reserve fund in another co-operative society. The Assessing Officer held that the interest income earned by the assessee by investing statutory reserve fund did not qualify for exemption under section 80P(2)(a)(i) of the Income-tax Act, 1961, as it was not income received from banking activities. The Commissioner (Appeals) partly allowed the appeal and remanded the case to the Assessing Officer. The Tribunal allowed the appeal of the assessee.

According to section 57 of the H. P. Co-operative Societies Act, 1968, every co-operative society is required to keep a percentage of its profits in a reserve fund. These reserve funds

can only be invested or deposited in a certain manner. Sub-section (4) provides that the portion of the reserve fund not being used in the business of the society shall be invested in post office savings bank, or in any security specified under section 20 of the Indian Trusts Act, 1882, or any other bank approved by the Registrar.

The High Court held that interest on investments made out of the reserve fund was eligible for deduction under section 80P(2)(a)(i) of the Act. Further, there was sufficient material on record to show that the Registrar had been approving the balance-sheets of the assessee-bank which implied the approval of the Registrar. Since the assessee had made an investment in another co-operative society, it was entitled for deduction under section 80P(2)(d) of the Act.

3. Whether a co-operative society engaged in the business of manufacture and sale of sugar out of the sugarcane grown by its members, can be denied deduction under section 80P(2)(a)(iii) of the Income-tax Act, 1961 on the ground that processing involves use of power ?

Budhewal Co-op. Sugar Mills Limited v. CIT (2009) 315 ITR 351 (P&H)

Relevant Section: 80P(2)(a)(iii)

Section 80P has been enacted with a view to encourage and promote growth of the co-operative sector in the economic life of the country and in pursuance of the declared policy of the Government. It has to be liberally construed. "Marketing" is a comprehensive term. It does not mean merely buying and selling. It includes "processing" which may be necessary for making the agricultural produce marketable.

The correct way of reading the different heads of exemption enumerated in the section would be to treat each as a separate and distinct head of exemption. Whenever a question arises as to whether any particular category of an income of a co-operative society is exempt from tax, what has to be seen is, whether the case falls within any of the several heads of exemption. If it falls within any one head of exemption, it would be free from tax notwithstanding that the conditions of another head of exemption are not satisfied and such income is not free from tax under that head of exemption.

The case of the growers of agricultural produce is dealt with by section 80P(2)(a)(iii). Sub-clause (iii) has a wider scope. Under this sub-clause, the members have to be growers themselves, meaning thereby, that for the society with members being growers, the deduction is available even if the agricultural produce is marketed without further processing or even if it is processed with the use of power. Sub-clause (v) of section 80P(2)(a) is a restrictive clause and has to be understood as covering a case of members having agricultural produce not grown by them. Sub-clause (v) is applicable on fulfilment of the following conditions: "(a) some processing is to be carried out on the agricultural produce; and (b) the processing is without the aid of power." Clause (v) is different inasmuch as sub-clause (iii) applies where the members of the co-operative societies are the growers of the agricultural produce

whereas sub-clause (v) applies in a case where the agricultural produce is not grown by the members but may belong to them. Additionally, there cannot be sufficient market for purchase of sugarcane itself as grown by the members. The sugarcane necessarily is to be converted into sugar before it can be made marketable. Therefore, keeping in view the legislative intent for enacting section 80P(2)(a)(iii), the benefit thereunder could not be denied to a society which manufactures and sells sugar out of the sugarcane grown by its members.

10

INCOME-TAX AUTHORITIES

1. Whether the asseesee can request condonation of delay in filing of return, where the reason for delay was not attributable to the assessee?

Pala Marketing Co-operative Society Ltd. v. Union of India (2009) 311 ITR 177 (Kar.)

Relevant Section: 119

The assessee, a co-operative society engaged in marketing agricultural produce of its members, filed its return after completion of audit by the auditor appointed under section 63(4) of the Kerala Co-operative Societies Act, 1969, claiming refund of advance tax and the tax deducted at source remitted by others. The Assessing Officer rejected the return as time barred and declined the refund claimed. The application filed by the petitioner under section 119(2)(b) of the Income-tax Act, 1961, before the Central Board of Direct Taxes for condonation of delay in filing the refund application was rejected.

The High Court held that the assessee was bound to get its accounts audited under section 64 of the Kerala Co-operative Societies Act, 1969, and the delay in audit by the auditor appointed under the Act was not attributable to the assessee. Besides showing sufficient cause for delay in filing the return for refund, the assessee had also established genuine hardship inasmuch as it had suffered losses in the five succeeding years. If the delay was not condoned the petitioner society would be deprived of Rs.10 lakhs which it was otherwise not liable to pay by virtue of exemption claimed under section 80P of the Act.

2. Whether the transfer of assessee cases from Kolkata to Patna not for the purpose of co-ordinated and effective investigation but for centralization, valid?

Dillip Kumar Agarwal v. CIT (2009) 314 ITR 291 (Cal.)

Relevant Section: 127(2)(a)

In connection with search and seizure operations against the R group of companies, the Commissioner of Income-tax after hearing the assessees passed a reasoned order directing transfer of the cases of the assessees from the Income-tax Officers at Kolkata to Patna.

On writ petitions challenging the transfer of cases the High Court held that the notices proposing transfer did not indicate that the transfer was for the purpose of co-ordinated and effective investigation. The transfer as proposed was for the purpose of centralisation. The assessees had made categorical statements in their representations that they had no business connection with their father, had no business at any place in Bihar, they managed their businesses on their own and had no business link with R, their father, and had no

relation either in the business or otherwise in the R group of companies, but the authorities had not rebutted the categorical statements made in the written objections. Thus, as the order did not disclose any nexus of the assessees with R or the R group of companies, the order was without merit and could not be sustained.

3. **Whether revenue was entitled to demand unrestricted access to acquire electronic records present in laptops pertaining to third parties unconnected with person searched?**

S. R. Batliboi and Co. v. Department of Income-tax (Investigation) (2009) 315 ITR 137 (Del.)

Relevant Section: 132

The petitioner was a firm of auditors. During the course of search and seizure operations conducted against EMAAR, the laptop computers of two employees of the petitioner, who were conducting an audit of EMAAR, were seized by the Deputy Director. Subsequently, the Deputy Director issued summons under section 131 to the employees of the petitioner and their statements were recorded. On the request of the Deputy Director these employees provided him with the electronic data relating to three companies of the EMAAR group together with the print copies of the data. The Deputy Director insisted on securing total and unrestricted access to the laptops of all the other clients of the petitioner. This request was refused by the employees. The seized laptops were sent by the Deputy Director to the Central Forensic Science Laboratory who, however, could not ascertain the password and accordingly could not access the entire data on the laptops. The petitioner was thereupon asked to disclose the password, which it again declined and thereafter the laptops were sealed in the presence of the employees of the petitioner.

On a writ petition the High Court held that the powers of search and seizure are very wide and the Legislature has provided a safeguard that the Assessing Officer should have reason to believe that a person against whom proceedings under section 132 of the Income-tax Act, 1961, are to be initiated is in possession of assets which have not been or would not be disclosed. Secondly, the authorised officer is also required to apply his mind as to whether the assets found in the search have been disclosed or not, and if no undisclosed asset is found no action can be taken under section 132(1)(iii) or (3). An arbitrary seizure is not maintainable. The objection of the petitioner was vis-à-vis only the material relating to its other clients and not to material which had causal connection with EMAAR against whom the search and seizure operation was directed. The offer in this regard had been spurned by the Revenue. In view of the fact that the Deputy Director had rejected the offer made by the petitioner the summons had to be set aside and the Deputy Director had to forthwith return the laptops to the petitioner.

11

ASSESSMENT PROCEDURE

1. **Whether the Tribunal was right in holding that the assessment framed in the status of HUF by the Assessing Officer as null and void, though the assessee himself admitted during the assessment proceedings that the land sold by him on which consideration was received and was declared in the return of income as capital gains, belonged to HUF?**

   CIT v. Rohtas (2009) 311 ITR 460 (P&H)

   Relevant Section: 148

   The assessee sold agricultural land which was assessable to tax under the head Capital gains but the assessee did not file the return. Pursuant to the notice under section 148 of the Income-tax Act, 1961, the assessee filed his return in the status of individual. The Assessing Officer completed the assessment treating the status of the assessee as Hindu undivided family as against individual. This was confirmed by the Commissioner (Appeals). The Tribunal held that the assessment framed by the Assessing Officer was null and void because the notice issued to the assessee under section 148 was without intimating his status to be Hindu undivided family.

   The High Court held that the finding of the Tribunal was that the assessee did not make any statement about the status of Hindu undivided family in the letter in question on which the Assessing Officer had placed heavy reliance. Once a notice under section 148 and other notices under section 143(2) and 142(1) were issued treating the assessee as individual then the Assessing Officer could not have framed the assessment treating the income in the hands of the Hindu undivided family.

2. **Whether the Tribunal was right in law in upholding the order of the CIT(A) in deleting the trading addition made by the Assessing Officer, as the assessee failed to produce the quantitative details of raw materials and finished products?**

   CIT v. Om Overseas (2009) 315 ITR 185 (P&H)

   Relevant Section: 143

   The assessee-firm derived its income from manufacturing and export of duries, rugs, woollen carpets, made ups, etc., and filed a nil return of income. Subsequently it was assessed under section 143(3) of the Income-tax Act, 1961 and it declared gross profit on the total turnover of 25.38 per cent as against 29.5 per cent declared in the immediate preceding assessment

year. Being dissatisfied with the explanation given by the assessee, the Assessing Officer rejected the books of account of the assessee invoking section 145(3) and applied the gross profit rate of 27 per cent which resulted in certain additions. The Commissioner (Appeals) deleted the additions made by the Assessing Officer. The Tribunal upheld the order of the Commissioner (Appeals).

The High Court held that the factual finding given by the Commissioner (Appeals) that the additions were made by the Assessing Officer without pointing out any specific defect in the books of account was upheld by the Tribunal. As no perversity or illegality in the finding was pointed out by the Department, no substantial question of law arose for determination.

3. Whether a proceedings sent pursuant to filing of returns without demand of tax or interest is an intimation under section 143(1)(a) of the Act?

CIT v. Sitaram Textiles (2009) 313 ITR 330 (Ker.)

Relevant Section: 154

The assessee has filed loss returns for the two assessment years which were accepted by the Assessing Officer and intimations were sent under section 143(1)(a) of the Income-tax Act, 1961. After issuing notice under section 143(2) of the Act, regular assessment was completed under section 143(3) of the Act. Later, the Assessing Officer noticed that the intimations sent were incorrect. Accordingly notices were sent under section 154(1)(b) of the Act and assessments were rectified. In the appeals filed by the assessee, the Commissioner of Income-tax (Appeals) held that the proceedings sent under section 143(1)(a) for the respective assessment years do not constitute intimations under section 143(1)(a) of the Act. Consequently, he cancelled the rectification orders in which additional tax was demanded under section 143(1A) of the Act. In second appeal filed by the Department before the Tribunal, the Tribunal confirmed the orders of the Commissioner of Income-tax (Appeals).

The proviso to section 143(1) of the Income-tax Act, 1961, makes it clear that besides acknowledgment of receipt of return, issue of an intimation under section 143(1)(a) is contemplated under the Act. The above provision specifically authorises rectification of mistakes in such intimations issued. In fact, prior to the amendment with effect from June 1, 1999, section 154(1)(b) provided for amendment of any intimation sent by the officer under sub-section (1) of section 143 or to enhance or reduce the amount of refund granted by it under that sub-section. An intimation sent without demand of tax or interest also could be rectified under section 154(1)(b).

Where proceedings issued under section 143(1)(a) are not superseded or merged in the assessment issued under section 143(3), it would be open to the officer to rectify the intimation issued under section 143(1)(a).

4. Whether the Tribunal is right in holding that the rectification order under section 154 was not proper especially when the audit had raised an objection that the interest income was to be brought to tax under the head 'Income from other sources'?

CIT v. A. G. Granites P. Ltd. (2009) 311 ITR 170 (Mad.)

Relevant Section: 154

The assessee-company, an exporter of granite blocks, filed its return of income admitting an income of Rs.9,68,900 after claiming deduction under section 10B of the Income-tax Act, 1961, to the extent of Rs.1,32,389. The return was processed under section 143(1) and refund of Rs.1,280 was allowed. On verification of the records, it was noticed that the assessee had offered interest income on fixed deposit made under the head "Other income", but it was required to be assessed under the head "Income from other sources". Upon a notice under section 154 of the Act to the assessee, the Assessing Officer after considering the reply rectified the assessment order. The appeal filed by the assessee was dismissed by the Commissioner (Appeals). The Tribunal, allowing the appeal filed by the assessee, held that debatable issues were not to be rectified under section 154 of the Act.

Section 154 of the Income-tax Act, 1961, provides for rectification of mistakes, which are apparent from the record. The phraseology "mistake apparent from the record" has been considered by several judicial opinions and all those judicial opinions uniformly held that an error, which is not self-evident, and has to be detected by a process of reasoning, cannot be said to be an error apparent on the face of the record. There is a clear distinction between an erroneous order and an error apparent on the face of the record, while the first can be corrected by the higher forum, the latter can only be corrected by exercise of the power of rectification.

The High Court held that the issue as to the head under which the "interest income" had to be assessed was a debatable issue. Thus, the interest income offered by the assessee under the head "Other income" could not be reassessed under the head "Income from other sources" by way of rectification and on the basis of the objection raised by the audit parties.

12

PENALTIES

1. **Whether the Tribunal was right in confirming the penalty under section 271(1)(c) in respect of the inflation of purchase which was actually detected only when the assessment was subjected to audit under section 142(2A) as not a valid and correct ground?**

   Kalpaka Bazar v. CIT (2009) 313 ITR 414 (Kar.)

   Relevant Section: 271(1)(c)

   For the assessment year 1984-85, the Income-tax Officer completed the assessment of the assessee by including addition towards purchase and gross profit. In fact, search was carried out in the premises of the assessee and books of account and other documents were seized. Statutory audit was done under section 142(2A) of the Income-tax Act. The auditor brought out bogus purchases accounted by the assessee which represents proforma invoices not representing any actual purchases. Penalty is levied based on inflation of purchase value and on account of gross profit addition. However, in successive appeals, penalty attributable to gross profit addition was deleted which is final. However, the Tribunal sustained penalty pertaining to inflation of purchases.

   The High Court held that the disputed amount represents proforma invoices which do not represent actual purchases and so much so, the disputed expenditure is bogus purchase accounted by the assessee. Accounting of bogus purchase expenditure is nothing but concealment and, therefore, penalty was rightly levied which got confirmed in appeal.

2. **Whether the penalty under section 271(1)(c) can be imposed, when positive income reduced to nil after allowing set off of carried forward losses?**

   CIT v. R. M. P. Plasto P. Ltd. (2009) 313 ITR 397

   Relevant Section: 271(1)(c)

   The Supreme Court held that where in the year under consideration there was positive income of the assessee and the loss was reduced to nil only after set off of carried forward losses of earlier years penalty for concealment of income can be imposed under section 271(1)(c) of the Income-tax Act, 1961. The same view has been taken by the Supreme Court in the case of *CIT v. Gold Coin Health Food P. Ltd. [2008] 304 ITR 308 (SC)*.

3. **Whether, the imposition of penalty under section 271(1)(c) was justified in view of Explanation 4(a) to section 271(1)(c) due to inaccurate particulars of income by wrongly claiming the deduction under section 80P(2)(a)(iii) of the Income-tax Act, as it was engaged in manufacturing and not in marketing business?**

CIT v. Budhewal Co-operative Sugar Mills Ltd. (2009) 312 ITR 92 (P & H)

Relevant Section: 271(1)(c)

The assessee, a co-operative society, earned income from the activity of manufacturing of sugar, molasses and other by products from sugarcane. In the return of income, he claimed deduction under section 80P(2)(a)(iii) of the Act. The Assessing Officer disallowed the deduction claimed by the assessee under section 80P(2)(a)(iii) of the Income-tax Act, 1961 and initiated penalty proceedings under section 271(1)(c) of the Act for furnishing inaccurate particulars of income. The Commissioner (Appeals) confirmed the disallowance and penalty imposed on the assessee. The Tribunal upheld the disallowance of deduction but cancelled the penalty levied on the assessee on the grounds that the assessee had disclosed all the particulars relating to the computation of its income, paid the tax in advance and on self-assessment and that the assessee's claim was bona fide.

The High Court held that the society had paid advance tax as well as self-assessment tax not taking into account the deduction claimed under section 80P(2)(a)(iii) of the Act. It was evident from the facts that the assessee's claim was bona fide and that all the particulars relating to the computation of income had been disclosed. Thus, the Tribunal rightly cancelled the penalty levied.

4. Whether the imposition of penalty under section 271(1)(c) for furnished inaccurate particulars of income to the extent of making a wrong claim of share trading loss against the normal income is justified?

CIT v. Auric Investment and Securities Ltd. (2009) 310 ITR 121 (Del.)

Relevant Section: 271(1)(c)

The assessee in its return of income has claimed an amount of Rs.22,15,837 in its profit and loss account on account of share trading loss and has treated the same as normal business expense. However, during the assessment proceedings, the Assessing Officer found that this loss is speculative in nature and cannot be adjusted against normal income of the assessee. Consequently, the loss of the assessee has been assessed at the amount of Rs.85,259 against returned loss of Rs.23,05,096. The Assessing Officer also held that the assessee had furnished inaccurate particulars of income to the extent of making a wrong claim of share trading loss against normal income. Hence, he was liable for imposition of penalty. Therefore, penalty of under section 271(1)(c) of the Income-tax Act, 1961 was levied, for furnishing inaccurate particulars of income.

The High Court held that it is clear from the record that all the requisite information as required by the Assessing Officer, was furnished by the assessee. There is nothing on record to show that in furnishing its return of income, the assessee has either concealed its income or has furnished any inaccurate particulars of income. The mere treatment of the business loss as speculation loss by the Assessing Officer does not automatically warrant inference of concealment of income. The assessee did not conceal any particulars of income, as he filed full details of the sale of shares. In any case, it cannot be said that the assessee has

concealed any particulars so far as its computation of income is concerned and as the such provisions of section 271(1)(c) of the Act are not attracted in this case.

5. Whether the Tribunal has erred in law in deleting the penalty under section 271(1)(c) of the Act when concealed income had been brought to tax under section 147/148 of the Act ?

CIT v. Pearey Lal and Sons (Ep) Ltd. (2009) 308 ITR 438 (P&H)

Relevant Section: 271(1)(c)

The Assessing Officer completed the reassessment in respect of the assessee under section 147 of the Act and imposed penalty to the extent of 200 per cent. of the tax sought to be evaded. The Commissioner (Appeals) reduced the penalty to 100 per cent. The Tribunal set aside the penalty imposed by the Assessing Officer on the ground that the mention in the assessment order that "penalty proceedings under sections 271(1)(c) and 273(2)(a) of the Act were being initiated separately" did not amount to recording of satisfaction during the course of assessment in terms of section 271(1)(c) of the Act.

The High Court held the only requirement under section 271(1)(c) of the Income-tax Act, 1961, is that during the course of assessment there must be existence of satisfaction for initiating penalty proceedings and this must be expressly reflected in the assessment order. There is no required format in which such satisfaction is to be recorded. An indication in the assessment order regarding the initiation of penalty proceedings separately is tantamount to an indication as to the satisfaction of the authorities that the assessee has concealed income or furnished inaccurate particulars.

In the present case, the existence of satisfaction during the course of assessment was clear. Absence of satisfaction could not be inferred from the fact that the only words used in the assessment order were that proceedings were being separately initiated. The view of the Tribunal that mere mention of initiation of penalty proceedings separately did not justify initiation of penalty proceedings was to be set aside and the matter was remanded to the Tribunal for a fresh decision on the issue of penalty in accordance with law.

13

DEDUCTION, COLLECTION AND RECOVERY OF TAX

1. **Whether the assessee was under statutory obligation under the Income-tax Act, 1961, and/or the Rules to collect evidence to show that its employee(s) had actually utilized the amount paid towards leave travel concession(s)/conveyance allowance?**

   CIT v. Larsen and Toubro Ltd. (2009) 313 ITR 1 (SC)

   Relevant Section: 192 & 10(5)

   The employer is not under any statutory obligation under the Income-tax Act, 1961, or the Rules, to collect evidence to show that the employee had actually utilized the amount paid towards leave travel concession or conveyance allowance under section 10(5). Nor is there any circular of the Central Board of Direct Taxes requiring the employer under section 192 to collect and examine the evidence supporting the declaration submitted by the employee.

2. **Whether the rental income received by co-owner the assessee is covered by section 194-I(b) of the Act for the purposes of deduction of tax at source on the premise that the rent is paid to a HUF not to an individual?**

   CIT v. Lally Motors (2009) 311 ITR 29 (P&H)

   Relevant Section: 194-I

   The assessee had taken on rent the premises at different places and in each there were two landlords. The rental income received by the co-owner had been duly disclosed in their individual returns for the several assessment years which had been accepted as such. The contention of the Revenue that the assessee was covered by section 194-I(b) of the Income-tax Act, 1961, for the purposes of deduction of tax at source on the premise that the rent was not paid to an individual or Hindu undivided family was rejected by the Commissioner (Appeals). The Tribunal upheld the order of the Commissioner (Appeals). The High Court held that the tenancy was common, i.e., of four persons. No material had been placed on record by the Revenue to show that the rent was paid to the conglomeration and thereafter distributed among the co-owners. Therefore, the Tribunal held that the case was covered under section 194-I(a) of the Act and not by the provisions of section 194-I(b). The assessee rightly deducted tax at source at 15 per cent under section 194-I(a).

3. **Whether the Tribunal was correct in holding that no interest need to be paid by the assessee for non-deduction of TDS (being consequential) after having held that the assessee was liable to deduct TDS on the interest component paid by having remanded to verify certain facts and recomputed the interest?**

   CIT v. Oriental Insurance Co. Ltd. (2009) 315 ITR 102 (Kar.)

Relevant Section: 201(1A)

The proviso to section 201(1) of the Income-tax Act, 1961, empowers the levy of penalty if the tax deducted at source is not affected for any valid reason. However, section 201(1A) is a distinct provision to levy interest for delayed remittance.

Pursuant to the award made under the Motor Vehicles Act, the assessee paid compensation to the victim of the accident which included interest liability. The assessee failed to deduct and remit the tax deducted at source to the Revenue. The Assessing Officer directed the assessee to deposit the tax amount with interest. The Commissioner (Appeals) confirmed the order. The Tribunal set aside the direction to pay interest on the ground that the liability was in the nature of penalty but permitted the assessee to split and spread over the interest liability for each of the assessment years.

The High Court held that the assessee was liable to pay interest at the rate of 12 per cent for belated payment of tax for any reasonable cause. The levy of interest under section 201(1A) of the Act cannot be construed as a penalty. The Tribunal had rightly directed that the interest paid above Rs.50,000 was to be split and spread over the period from the date interest was directed to be paid till payment.

4. Whether the Tribunal were justified in passing an order under section 201 and in levying interest invoking section 201(1A) of the Income-tax Act, without considering the cause and explanation shown by the appellant?

Karnataka Urban Infrastructure Development Finance Corporation v. CIT (2009) 308 ITR 297 (Kar.)

Relevant Section: 201 & 201(1A)

The appellant is a public sector company wholly owned by the State of Karnataka. The appellant-company has entrusted certain contracts to a foreign company, which is a non-resident company, to provide technical know-how and consultancy to the appellant in terms of the contract. Similarly, it also entered into another contract with a company situated in the U. K. As per the terms and conditions of the agreement, the appellant-company in addition to making the payment towards the consultancy fees, the appellant has to reimburse the expenditure that may be incurred by those two companies, when they are in Karnataka (for the accommodation and conveyance of the staff of these two companies, when they are in India). In terms of the agreement, the appellant-company has to take care of the tax liability of the non-resident companies. The Income-tax Officer has initiated the proceedings by invoking the provisions of sections 201 and 201(1A) of the Income-tax Act on the ground that the appellant-company as required under section 195 of the Act did not deduct the tax at source and remit the same in accordance with law, in so far as the reimbursement of expenditure portion only. The assessee has sent the reply by stating that it was under the bona fide impression that no tax was required to be deducted in regard to the reimbursement since it was only an amount spent by the appellant-company towards the conveyance and accommodation to the officers/employees of non-resident companies, when they were in India for the purpose of execution of the agreement. The explanation offered by the assessee was not accepted. Accordingly, an order was passed under section 201 and also under section 201(1A) of the

Income-tax Act.

The High Court held that the authorities had not properly considered the explanation offered by the assessee, and there was no intention on the part of the assessee to violate the provisions of section 195 of the Act. The levy of penalty under section 201 was to be set aside.

Further, it was held that the levy of penalty under section 201 of the Income-tax Act, 1961 and the levy of interest under section 201(1A) of the Act are entirely different. An Assessing Officer has discretion to drop the penalty proceedings. But if the tax is not deducted under section 195 of the Act, the assessee is bound to pay interest, as it is a mandatory provision. Even if the penalty proceedings are dropped under section 201, the assessee cannot escape his liability to pay interest under section 201(1A) of the Act. Both the sections are independent and they are not interlinked and they cannot be read conjunctively as levy of interest and levy of penalty are two different proceedings. Hence, the order levying interest under section 201(1A) of the Act was to be confirmed.

14

ADVANCE RULING

1. Whether the income derived by him on the purchase in India and export of gold jewellery and on the purchase of gold for manufacture of jewellery for export accrued or arose in India and was taxable in India.

Mustaq Ahmed, In re (2008) 307 ITR 401 (AAR)

Relevant Section: 9

The applicant, an individual, was a resident of Singapore. He carried on business in the manufacture and sale of gold jewellery in Chennai (India). He sold jewellery in the local market as well as by export mostly to Singapore. He purchased gold for the purpose of conversion into jewellery and export and also purchased gold jewellery for export. The applicant's banks in Chennai acted on his behalf and received the export sale proceeds in India and they were credited to his account through electronic service. The applicant sought the ruling of the Authority.

The Authority ruled that the income arising from the sale proceeds of exported goods had actually been received from the importer/buyer at Chennai in India and the applicant's banks at Chennai in India had been crediting the amounts received from the importers/buyers to the account of the applicant. A reasonable inference could be drawn that the right to receive the payments had arisen in India on account of export sales of gold jewellery to the importers abroad (Singapore). The fact that the importers/buyers abroad were companies controlled by the applicant made no difference in law. Since the income actually accrued or arose in India there was no scope to say that the accrual was nullified by clause (b) of Explanation 1 to section 9(1)(i) of the Income-tax Act, 1961. The income was taxable in India.

WEALTH TAX

1

LEVY OF WEALTH TAX

1. Whether the assessee is not entitled to claim exemption under section 5(1)(iv) of the Wealth Tax Act, in respect of hotel building?

CIT v. Hiro J. Nagpal (2009) 313 ITR 028 (Raj.)

Relevant Section: 5(1)(iv)

The assessee claimed exemption under section 5(1)(iv) of the Act in respect of a hotel building. The valuation officer valued the interest of the assessee in the hotel property. The Wealth-tax Officer issued a demand under section 16(3) of the Act. The Appellate Assistant Commissioner of Wealth-tax upheld the order of the Wealth-tax Officer. The Tribunal granted the benefit of exemption under section 5(1)(iv) of the Act.

The High Court held that Section 5(1)(iv) of the Wealth-tax Act, 1957 was amended on April 1, 1972, taking away the words "exclusively used for dwelling purposes". The word "house" has neither been defined under the Wealth-tax Act nor under the General Clauses Act. The word "building" has been used in section 5(1)(iii) and the word "property" has been used in section 5(1)(i) of the Act. In common parlance, "house" means a dwelling place where people live. However, a residential building or house can also be used for commercial purposes. Hence, a hotel could not be considered to be house so as to qualify for the exemption under section 5(1)(iv) of the Act.

2

ASSESSMENT PROCEDURE

1. Whether penalty can be levied under Wealth-tax Act, against legal representative after the death of the assessee?

ACIT v. Late Shrimant F. P. Gaekwad (2009) 313 ITR 192 (Guj.)

Relevant Section: 15B

The assessee furnished the returns of wealth declaring his net wealth for the various assessment years. At the time of assessment penalty proceedings were initiated under sections 18(1)(a), 18(1)(c) and 15B of the Wealth-tax Act, 1957. The assessee expired in 1988 before the penalty proceedings could be completed and the estate of the assessee devolved upon his mother who also passed away and thereafter it devolved upon the sister of the assessee. The Assessing Officer passed penalty orders under sections 18(1)(a) and 18(1)(c) and 15B of the Act. The legal heir of the assessee challenged the penalty and the Commissioner (Appeals) deleted the penalty for all the years. The Tribunal confirmed the order of the Commissioner (Appeals).

The High court held that no penalty order was passed during the life time of the deceased. To make the legal representative liable for penalty under section 19(1) it was not enough that the penalty proceedings should be initiated during the life time of the deceased. It was also necessary that such penalty proceedings must result in penalty orders during his life time. Therefore, neither section 19(1) nor section 19(3) cast any obligation on the executor, administrator or other legal representative to pay the amount of penalty as they were not liable to face any such penalty proceedings for which they had committed any default. The default, if any, was committed by the assessee and the assessee was not alive when the penalty proceedings culminated in penalty orders.

CENTRAL EXCISE

1

BASIC CONCEPTS

1. Does the addition of stabilizing agent, masking agent etc. amount to manufacture within the meaning of section 2(f) of the Central Excise Act, 1944?

CCEx. v. Karam Chand 2009 (236) E.L.T. 647 (H.P.)

The respondent was engaged in the manufacture of liquid mosquitoes' destroyer. It used to obtain concentrated allethrin and convert it into diluted allethrin by adding solvent deodorized kerosene oil, perfume (as a masking agent) and DHT (as a stablising agent). The question which came for the consideration before the High Court was whether the addition of stabilizing agent, masking agent etc. amounted to manufacture within the meaning of section 2(f) of the Central Excise Act, 1944.

The High Court held that mere processing of the goods was not manufacture and to fall within the definition of manufacture a new substance should be formed. In the present case, no new substance was formed and only a diluted form of original substance was packaged under a different brand name. Allethrin in its concentrated form was an insecticide. The final product manufactured by the respondent was a diluted form of insecticide-allethrin which would only kill small insects like mosquitoes. Hence, only the potency of the insecticide was being reduced. Therefore, it could not be termed as manufacture.

2. Whether the assessee is required to pay duty on the activity of assembling and installing furniture at its customers' premises out of the components of Office Furniture System/Work Stations (OFS/WS) purchased from the supplier?

CCEx., Delhi v. Blow Plast Ltd. 2009 (236) E.L.T. 631 (Del.)

The assessee manufactured OFS/WS from the various parts of furniture purchased from the supplier (K&C). The assessee contended that they were only marketing OFS/WS and the entire system already stood duty paid at the hands of the manufacturer i.e. K&C. Thus, the question under consideration was whether assembling and installing furniture at customer's premises out of components of Office Furniture System/Work Stations (OFS/WS) purchased from the supplier (K&C) amounted to manufacture.

The Tribunal arrived at the conclusion that since K&C had cleared the complete set of elements required for the work station in a knocked down condition for the purpose of facilitating transportation, it could not be said that K&C had manufactured the parts and not the complete system.

The High Court, upholding the Tribunal's decision, held that the same product as known to the trade could not be manufactured twice over. Consequently, nothing new had come into existence so as to bring the activities of the assessee within the parameters specified in section 2(f) of the Central Excise Act, 1944. What the assessee received was complete OFS/WS and what it left on its clients' sites was also complete OFS/WS. Nothing new had come into existence. Hence, no duty was payable by the assessee.

3. Whether the assessee can be considered as manufacturer if it gets its products manufactured through its sister concern which is also situated in same premises?

Lamina International v. CCEx., Bangalore 2009 (239) E.L.T. 232 (Kar.)

M/s Lamina International (LI), engaged in export of goods, got manufactured the products from M/s. Lamina Suspension Products Limited (LSPL) on job work basis. Revenue contended that since the documents furnished by the appellant clearly showed that the goods in question were manufactured by the assessee through LSPL; appellant could not be considered as a manufacturer. In this regard, the appellant replied that both the appellant and LSPL were housed in one premise and both the units were under the control and supervision of the appellant (assessee).

The High Court noted that the assessee was apparently a creation of LSPL and both the units were one and the same i.e. they were sister concerns. Considering the word 'manufacturer' (as defined under section 2(f) of the Act) which includes any person engaged in the production or manufacture on his own account, the Court observed that the manufacturer-LSPL was manufacturing the goods on behalf of the appellant and the appellant was having a full control and supervision over the activities of LSPL.

High Court also referred to the cases of *Commissioner of Sales Tax v. Sukh Deo AIR 1969 SC 499 and Modi Rubber Ltd. v. Union of India 1997 (19) RLT 479 (Del.)*,wherein it was held that manufacturer is a person by whom or at whose direction and control the articles or materials are made.

Considering the definition under section 2(f) and the case laws referred above, the High Court answered the question of law framed in the appeal in favour of the assessee. Hence, the appellant was held as the manufacturer of the goods.

4. Whether production of mustard oil and oil cake from mustard seeds amounts to manufacture?

Jai Bhagwan Oil and Flour Mills v. UOI 2009 (239) E.L.T. 401 (S.C.)

The Apex Court held that the true test to ascertain whether a process is a manufacturing process producing a new and distinct article is whether the article produced is regarded in the trade, by those who deal in it, as a marketable product distinct in identity from the commodity/raw material involved in the manufacture.

When mustard seeds were subjected to the process of extraction whereby mustard oil

and oil cake were produced, the process involved manufacture of mustard oil as also the manufacture of oil cake. It was certainly not a mere process of cleaning, repairing, reconditioning, recycling or assembling. Oil cake was a distinct and different entity from mustard seeds and it had a separate name, character and use different from mustard seed. Oil cake was not a waste to be thrown away, but was a valuable product with a distinct name, character, use and marketability. So, oil cake was a finished product and not a by-product and the said process amounted to manufacture.

2

CLASSIFICATION OF EXCISABLE GOODS

1. When entries in Harmonised System of Nomenclature (HSN) and the Excise Tariff are not aligned, can reliance be placed upon HSN for the purpose of classification of goods?

Camlin Ltd. v. CCEx., Mumbai 2008 (230) E.L.T. 193 (SC)

The Supreme Court ruled that when the entries in the Harmonised System of Nomenclature (HSN) and the Excise Tariff are not aligned, reliance cannot be placed upon HSN for the purpose of classification of goods under the said Tariff. It further added that in the instant case, the Tribunal erred in relying upon the HSN for the purpose of classification of the impugned product. The Tribunal failed to appreciate that since the entries under the HSN and the entries under the said Tariff were completely different, the Tribunal could not base its decision on the entries in the HSN.

2. Whether the rules of interpretation applicable to the cases of classification under the Excise Tariff are also applicable to interpretation of exemption notification?

CCEx., Jaipur v. Mewar Bartan Nirman Udyog 2008 (231) ELT 27 (SC)

The Apex Court clarified that it is well settled position in law that exemption notification has to be read strictly. A notification of exemption has to be interpreted in terms of its language. Where the language is plain and clear, effect must be given to it.

While interpreting the exemption notification, one cannot go by rules of interpretation applicable to cases of classification under the Excise Tariff. Tariff items in certain cases are required to be interpreted in cases of classification disputes in terms of HSN, which is the basis of the Tariff. The rules of interpretation applicable to the cases of classification under the Tariff cannot be applied to interpretation of exemption notification.

3. How to determine whether a product is covered by 'cosmetics' or 'medicaments?

CCEx., Nagpur v. Shree Baidyanath Ayurved Bhawan Ltd. 2009 (237) E.L.T. 225 (S.C.)

The question that arose for consideration before the Apex Court was in relation to classification of "Dant Manjan Lal" (DML) manufactured by M/s. Baidyanath Ayurved Bhawan Limited. While Baidyanath contended that the product DML was a medicament

under Chapter sub-heading 3003.31 of the Central Excise Tariff Act, 1985, the stand of the Department was that the said product was a cosmetic/toiletry preparation/tooth powder classifiable under Chapter heading 33.06.

The Apex Court observed that in order to determine whether a product is covered by 'cosmetics' or 'medicaments' or in other words whether a product falls under Chapter 30 or Chapter 33, common parlance test continues to be relevant. One should resort to the popular meaning and understanding attached to such products by those using the product and not to the scientific and technical meaning of the terms and expressions used. Hence, it is important to note how the consumer looks at a product and what is his perception in respect of such product.

The Supreme Court further ruled that merely because there is some change in the tariff entries, the product will not change its character. Something more is required for changing the classification especially when the product remains the same. Therefore, since there was no change in the nature, character and uses of DML, it had to be classified as a tooth powder as held earlier in case of the assessee itself in *Shree Baidyanath Ayurved Bhavan Ltd. v. Collector 1996 (83) E.L.T. 492 (S.C.).* The Apex Court clarified that although, this case related to old Tariff period i.e. prior to enactment of new Tariff Act but since the product in its composition, character and uses continued to be the same, even after insertion of new sub-heading 3301.30, change in classification was not justified as common parlance test continued to be relevant for classification.

4. Whether the carpet, in which jute is predominant by weight, but the surface is entirely of polypropylene, should be classified as jute carpet or polypropylene carpet?

CCEx., Bhubneshwar v. Champdany Industries Limited 2009 (241) E.L.T. 481 (S.C.)

The assessee was engaged in the manufacture of the carpets in which jute predominated by weight over every other single textile material. However, Revenue contended that the same should be classified as polypropylene carpet.

In this regard, the Apex Court considered the following points:-

(i) Relying on Note 1 to Chapter 57[1], Revenue argued that the surface of the carpet being entirely of polypropylene, the same should be classified as polypropylene carpet. The Supreme Court viewed that role of Chapter Note is limited to decide whether the goods in question are "carpets and other textile floor coverings" for the purposes of Chapter 57 or not. Once the goods are carpets and falling under Chapter 57, the role of Chapter Note 1 comes to an end.

Further referring to the relevant statutory provisions laid down in Section Notes 2(A) and 14(A) of Section XI[2], the Apex Court held since the impugned goods admittedly fell under Chapter 57 and consisted of more than two textile materials, it had to be classified on the basis of that textile material which predominated by

weight over any other single textile material. As, in the goods in question, jute admittedly predominated by weight over each other single textile material, the said carpet could only be classified as jute carpets and nothing else. The contrary interpretation given by the Revenue was incorrect.

(ii) Relying on the concept of essentiality test, Revenue argued that as the exposed surface of the carpet was polypropylene fiber and not jute, these goods could not be classified as jute carpets. The Court held the said argument of the Revenue to be erroneous because it was against the principle of predominance test.

(iii) Learned counsel for the Revenue further argued that the common parlance test should be applied for classifying the carpets and the carpets, to the common man, would not appear to be jute carpet but polypropylene carpet. The Supreme Court observed that it is already established principle that while interpreting statutes like the Excise Tax Acts or Sales Tax Acts, the common parlance test can be accepted only if any term or expression is not properly defined in the Act. Therefore, going by the aforesaid principle, the Court held that common parlance test did not have any application here.

(iv) Learned counsel for the Revenue argued that for the purpose of classification in this case, rule 3 of the 'Rules for the Interpretation of the First Schedule to the Central Excise Tariff Act, 1985' should be applied. Applying the said rule, Revenue wanted to classify the carpets under the residuary sub-heading 5702.90 of Heading 57.02 - "others". In this regard, the Apex Court observed that Revenue's stand in this case was contrary to the decision of Supreme Court in *HPL Chemicals Ltd. v. Commissioner of Central Excise, Chandigarh (2006) 5 SCC 208,* wherein it was held that rule 3(a) of the Interpretative Rules provides that if the goods are covered by a specific heading, the same cannot be classified under the residuary heading at all.

Apart from that, the Court noted that the point of rule 3, which had been argued by the learned counsel for the Revenue, was not part of its case in the show-cause notice. It is well settled that in Court, Revenue cannot argue a case not made out in its show-cause notice.

In the light of the above discussion, the Apex Court pronounced that the said carpets shall be classified as jute carpets and note as polypropylene carpet.

**Note :*

1. The Note 1 to Chapter 57 of the Excise Tariff is reproduced as below:-

"For the purposes of this Chapter, the term 'carpets and other textile floor coverings' means floor coverings in which textile materials serve as the exposed surface of the article when in use and includes article having the

characteristics of textile floor coverings but intended for use for other purposes."

2. *Section Notes 2(A) and 14(A) of Section XI of the Central Excise Tariff Act, 1985 is set out as follows:-*

"2(A) Goods classifiable in Chapters 50 to 55 or in heading 5809 or 5902 and of a mixture of two or more textile materials are to be classified as if consisting wholly of that one textile material which predominates by weight over any other single textile material."

"14(A) Products of Chapters 56 to 63 containing two or more textile materials are to be regarded as consisting wholly of that textile material which would be selected under Note 2 to this section for the classification of a product of Chapters 50 to 55 or of heading 5809 consisting of the same textile materials.

Note - The headings cited in some of the case laws mentioned above may not co-relate with the headings of the present Excise Tariff as these cases relate to an earlier point of time.

3

VALUATION OF EXCISABLE GOODS

1. Students may note that the Apex Court, in case of ***CCEx., Pondicherry v. Acer India Ltd. 2004 (172) E.L.T. 289 (S.C.)*** (reported in Select Cases-2005), had held that the valuation of goods would be subject to the charging provisions contained in section 3 of the Act and also sub-section (1) of section 4. The definition of 'transaction value' must be read in the text and context of section 3. Section 4 is a machinery provision and that the said machinery provision as well as the definition of "transaction value" contained therein can not override the charging provision of section 3.

   The Supreme Court, in case of ***CCEx., Indore v. Grasim Industries Ltd. 2009 (241) E.L.T. 321 (S.C.),*** has differed with its decision in case of *Acer's case* and held that the interpretation by the Supreme Court of sections 3 and 4 of the Central Excise Act, 1944 after the substitution of section 4, with effect from 01.07.2000, by the Finance Act, 2000 is not in conformity with the scheme of the Act prima facie, for the reasons that:-

   (i) section 3 is a charging section providing for levy of excise duty on excisable goods, whereas section 4 provides for the measure for valuation of excisable goods with reference to which the charge of excise duty is to be levied,

   (ii) both operate in their independent fields even though there may be a link between the two and

   (iii) in the case of *UOI v. Bombay Tyre International Ltd. 1983 (14) ELT 1896 (SC)*, the contention of the assessee that "the measure was to be found by reading section 3 with section 4, thus drawing the ingredients of section 3 into the exercise" was specifically rejected.

   Besides, the Supreme Court also had reservation with the observation in *Acer's case* that the definition of "transaction value" must be read in the text and context of section 3 of the Act. The Court held that this would amount to diluting the width of "transaction value" as defined in the substituted provision.

4

CENVAT CREDIT

1. In case of transfer of factory to another site, is the assessee entitled to transfer the CENVAT credit corresponding only to the quantum of inputs and capital goods transferred to the new site?

CCEx., Pondicherry v. CESTAT 2008 (230) ELT 209 (Mad.)

The assessee, a manufacturer of polypropylene bags and tubing, shifted its factory from one site to another. The assessee transferred the entire quantity of inputs and capital goods, available with it at the time of transfer, to the new site. On conducting physical verification, the Range Officer of the new premises reported that the capital goods, the inputs and unutilised CENVAT credit balance had been duly received and accounted for by the assessee in the respective registers of the new factory. The balance of unutilized CENVAT credit lying with the assessee exceeded the amount of CENVAT credit corresponding to the quantum of inputs and capital goods transferred to the new site. Revenue claimed that the assessee was entitled to transfer the CENVAT credit corresponding only to the quantum of inputs and capital goods transferred to the new site and not the entire balance of unutilized credit.

Madras High Court pronounced that rule 8 of the erstwhile CENVAT Credit Rules, 2002 [now rule 10 of the CENVAT Credit Rules, 2004*] does not provide that the assessee could transfer the CENVAT credit corresponding only to the quantum of inputs transferred to the new factory, but permits the assessee to transfer the entire balance of unutilised CENVAT credit along with inputs and capital goods in stock at the factory to the new site. Thus, requirement of erstwhile rule 8 of the CENVAT Credit Rules, 2002 [now rule 10 of the CENVAT Credit Rules, 2004*] had been complied with by the assessee. Hence, he could avail the entire CENVAT credit transferred by him.

Note:

**1. Relevant portion of rule 10 of the CENVAT Credit Rules, 2004 reads as follows:-*

If a manufacturer of the final products shifts his factory to another site, the manufacturer shall be allowed to transfer the CENVAT credit lying unutilised in his accounts to such transferred factory.

Such transfer of the CENVAT credit shall be allowed only if the stock of inputs as such or in process, or the capital goods is also transferred along with the factory or

business premises to the new site and the inputs, or capital goods, on which credit has been availed of, are duly accounted for to the satisfaction of the Deputy Commissioner/the Assistant Commissioner of Central Excise, as the case may be.

2. *Supreme Court, in an appeal filed by the Department, has maintained the decision taken by the High Court in above mentioned case [Commissioner v. CESTAT 2009 (237) E.L.T. A48 (S.C.)].*

2. Whether inputs can be confiscated under rule 15 of the CENVAT Credit Rules, 2004 on the ground of non-accountal of inputs in the records maintained in computer?

Green Alloys Pvt. Ltd. v. UOI 2009 (235) ELT 405 (P & H)

The High Court held that the procedure for seizure had to be reasonable and fair. There had to be some basis for continuing to detain the goods. In the instant case, it could not be held that there was a clear case for confiscation only on the ground that the seized goods had been found to be entered in the stock register, but not in the excel sheet in the computer.

There was nothing to show that in respect of such goods, there had been wrongful availment of CENVAT credit. Revenue sought to draw the presumption of wrongful availment of CENVAT credit on the ground that there was little value addition to the finished product over and above the value of the raw material. However, the High Court held it to be a debatable issue. Therefore, the Court held that there was not a strong prima facie case for confiscation of goods which would justify continued detention of goods.

3. Is Department justified in levying 10% on the sale price of the printed books in terms of rule 6(3)(b) of the CENVAT Credit Rules, 2004 even though the final product is exported?

Repro India Ltd. v. UOI 2009 (235) ELT 614 (Bom.)

The petitioner manufactured both dutiable (packaged software and stationery books) and exempted final product (printed books). The printed books were entirely exported by the petitioners. The petitioner had taken the credit on inputs used in the manufacture of dutiable as well as exempted final products by virtue of rule 6(6)(v) of the CENVAT Credit Rules, 2004. Department directed the assessee to pay the 10% of the sale price of the printed books even though they were exported. According to the Revenue, since the printed books were exempted goods/goods chargeable to nil rate of duty, they could not be allowed to be cleared by giving bond under rule 19 of the Central Excise Rules, 2002 and the petitioner has to follow the ARE-2 procedure for claiming refund of the duty on the exempted goods.

However, the High Court observed that if the exempted goods are exported outside India, the provisions of rule 6(6)(v) of the CENVAT Credit Rules, 2004 are applicable. Therefore, the bar provided under rule 6(1) and the liability created under rule 6(3)(b) are not attracted. The Department was not justified in levying 10% on the sale price of the printed books in terms of rule 6(3)(b). It was only in the event that the petitioner did not export the printed books and did not maintain the account as contemplated by rule 6(2), the petitioner would be required to pay 10% on the sale price of the printed books not so exported.

The High Court held that considering the language of rule 6(6)(v) of the said rules, the petitioner was entitled to avail CENVAT credit in respect of the inputs used in the manufacture of the final products being exported irrespective of the fact that the final product was otherwise exempt.

The Court clarified that the intent behind the Government enacting special scheme was to ensure that the duty was not levied even on inputs going into the export products. The intention was to ensure that only goods were exported and not the taxes. If the inputs of an export commodity were subject to excise duty, the Indian manufacturer would have become internationally uncompetitive. Therefore, rule 6(6) has been consciously and expressly enacted with the specific objective to ensure that duty is not levied on the inputs going to the export products.

Hence, levy of 10% on the value of the exported goods under rule 6(3)(b) on the footing that the printed books were exempt was completely incorrect.

Note:

(1) Rule 6(6)(v) of the CENVAT Credit Rules, 2004 reads as follows:-

The provisions of sub-rules (1), (2), (3) and (4) of rule 6 of the aforesaid rules shall not be applicable in case the excisable goods removed without payment of duty are cleared for export under bond in terms of the provisions of the Central Excise Rules, 2002.

(2) Notification No. 16/2009 - CE (NT) dated 07.07.2009 has amended rule 6(3)(i) so as to prescribe that a manufacturer of both dutiable and exempted goods, opting not to maintain separate accounts, shall pay an amount equal to 5% of the value of the exempted goods instead of 10%. The principle enunciated in above decision still holds good.

4. Whether CENVAT credit is admissible on plastic crates as inputs/capital goods?

Banco Products (India) Ltd. v. CCEx., Vadodara-I 2009 (235) ELT 636 (Tri-LB)

The appellant was using plastic crates as a material handling device within their factory premises. Such plastic crates were used for internal transportation of the raw material

from stores to processing machine, semi-finished goods from one machine to other machine and finished goods to their storage area. The appellant contended that the plastic crates were eligible capital goods for the purposes of CENVAT credit and alternatively as input.

The Tribunal first analyzed the definition of "accessories to the main machine" in order to decide whether plastic crates got covered in the definition of the capital goods as per rule 2(b) of the erstwhile CENVAT Credit Rules, 2002 [now rule 2(a)(A)(iii) of the CENVAT Credit Rules, 2004]. After meticulous consideration of various relevant judgments, the Tribunal observed that the only criteria for an object to be held as an accessory is that that a particular item should be capable of being used with a machine and should advance the effectiveness of working of that machine.

The plastic crates in question were used for transportation of the raw material to the processing machine and all the finished goods from the machine to storage area. If instead of using plastic crates manual transportation of the inputs or semi-finished goods had been opted for, practically, it would have hampered the continuous working of the machine on account of delays in the delivery of the raw material/semi-finished goods etc. Hence, viewed and judged in the light of the interpretation of the term "accessory" by various Courts, the Tribunal concluded that the plastic crates could be held as accessory. Hence, plastic crates would be eligible for CENVAT credit as capital goods.

While dealing with the expression "in the manufacture of the goods" in the definition of inputs under rule 2(g) of the erstwhile CENVAT Credit Rules, 2002 [now rule 2(k) of the CENVAT Credit Rules, 2004], the Apex Court, in the case of *Collr. of C.E. v. M/s. Rajasthan State Chemical Works 1991 (55) E.L.T. 444,* had observed that the said expression encompassed all processes which were directly related to the actual production. The process of handling/lifting/pumping/transfer/transportation of the raw material was also a process in relation to manufacture, if integrally connected with further operation leading to manufacture of the goods.

By applying the ratio as enacted by the Supreme Court to the issue in dispute, the Tribunal held that process started with the issuance of the inputs from the stores and their further transportation to the production platform was only a part of the process of manufacture integrally related to the final production. In absence of the delivery of the raw material to the manufacturing platform, the process could not start. Such delivery of the goods included transportation of the goods by plastic crates. Similarly, finished products were required to be stored in a bonded store room. The plastic crates were again used for such transportation. Hence, the Tribunal opined that the plastic crates would also be eligible for CENVAT credit as input.

In the light of aforesaid discussion, the large bench of the Tribunal held that CENVAT credit was admissble on the plastic crates used as material handling equipment in the factory premises as capital goods as also as input.

5. Whether Tribunal is empowered to reduce penalty imposable under rule 57-I(4) of the erstwhile Central Excise Rules, 1944 [now rule 15(2) of the CENVAT Credit Rules, 2004]?

CCus & Ex., Raigad v. Fibre Foils Ltd. 2009 (241) E.L.T. 201 (Bom.)

The Bombay High Court noted that from the plain or literal reading of the said sub-rule, it would be clear that the language used is "shall". Hence, the Court pronounced that undoubtedly, the language is mandatory and there is no discretion vested in the authorities in the matter of imposition of penalty. The penalty had to be imposed by the A.O. based on the material available and not on the defence which the assessee might have taken. Hence, the Court held that the penalty has to be equal to the amount of duty which is payable and not less than that.

6. Can the plastic dropper supplied along with pediatric drops be considered as an input used in or in relation to manufacture of final product (pediatric drops)?

CCEx., Mumbai v. Okasa Ltd. 2009 (241) E.L.T. 359 (Bom.)

The assessee were engaged in the manufacture of pharmaceutical product-pediatric drops. They contended that the plastic droppers supplied with the bottle containing drops were inputs used in or in relation to manufacture of final product namely Novamox pediatric drops. However, the Revenue argued that these droppers were separately kept in the cartons along with the sealed bottle of the pediatric drop. These droppers were neither used in the manufacture of pediatric drop nor used in relation to its manufacture.

The High Court agreed with the contention of the assessee that for purpose of dispensation or administration of the drugs in proper quantity as per the medical prescription, dropper had to be affixed on the bottle containing the drug. Further, as the droppers were necessary packaging material for marketing of the drug (as per the directions given by the Controller of Drugs for India), they would be covered by the words "packaging material". The Tribunal, while allowing the appeal in the instant case, had relied upon the decision taken in *Heal Well Pharmaceutical v. Collector 1994 (72) E.L.T. 446 (Tribunal)* wherein it was held that where dropper was provided in the carton along with bottle containing the drug, it amounted to manufacture and the manufacturer was entitled to credit of duty paid on such product being input of the firm product.

Considering the all the facts, circumstances and the legal position, the High Court, upholding the Tribunal's decision, held that the plastic dropper packed in the pediatric drops and marketed at the factory gate should be construed to be an input used in or in relation to the manufacture of the final product.

5

DEMAND, ADJUDICATION AND OFFENCES

1. Whether there is any discretion under section 11AC of the Central Excise Act, 1944 to impose penalty less than the amount equal to duty evaded?

UOI v. Dharamendra Textile Processors 2008 (231) E.L.T. 3 (S.C.)

The Apex Court pronounced that under section 11AC, there is no discretion vested with the authority to impose any penalty different than the one prescribed by the said provision. The Court observed that section 11AC of the Act was introduced in Union Budget of 1996-97. In para 136 of the Union Budget, reference had been made to the said provision stating that the levy of penalty was a mandatory penalty. In the Notes on Clauses also, the similar indication had been given.

The Court noted that if the contention of learned counsel for the assessee was accepted that the use of the expression "assessee shall be liable" proved the existence of discretion, it would lead to a very absurd result. In the same provision, there was an expression used i.e. "liability to pay duty". It could by no stretch of imagination be said that the adjudicating authority had even discretion to levy duty less than what was legally and statutorily leviable.

Note - Relevant portion of section 11AC of the Central Excise Act, 1944 reads as under:

"Where any duty of excise has not been levied or paid or has been short levied or short-paid or erroneously refunded by reason of fraud, collusion or any willful mis-statement or suppression of facts, or contravention of any of the provisions of this Act or of the Rules made thereunder with intent to evade payment of duty, the person who is liable to pay duty as determined under sub-section (2) of section 11A, shall also be liable to pay a penalty equal to the duty so determined.

Provided that where such duty as determined under sub-section (2) of section 11A, and the interest payable thereon under section 11AB, is paid within thirty days from the date of communication of the order of the Central Excise Officer determining such duty, the amount of penalty liable to be paid by such person under this section shall be twenty-five per cent."

2. **Whether Government dues have a priority of claim over the dues of secured creditors?**

Tata Metaliks Limited v. UOI 2009 (234) E.L.T. 596 (Bom.)

The Bombay High Court has reaffirmed that Government dues do not have priority of claim over that of secured creditors. However, if the Legislature makes those dues as having priority of claims, the State dues will rank higher in priority than dues of a secured creditor.

3. **Is the interest under section 11AB of the Central Excise Act, 1944 recoverable when differential duty is paid on account of price escalation?**

CCEx. & C v. Chloritech Industries 2009 (235) E.L.T. 17 (Guj.)

The High Court held that interest under section 11AB of the Central Excise Act, 1944 was not recoverable when differential duty was paid on account of price variation. In the instant case, at the time of undertaking the transaction, the additional price was not fixed. Hence, the liability of buyer to pay additional amount was not known to buyer himself. The Gujarat High Court observed that mere existence of an escalation clause in contract between parties could not bring the subsequent escalation within the definition of the term "transaction value" for the purposes of levying interest.

The High Court further provided that if neither side to transaction was aware as to the amount which was to be charged and which was to be paid under the escalation clause on the date when the transaction was entered into, no liability to pay interest could arise under the provisions of section 11AB. Section 11AB of the Act itself says that interest is to be paid on the amount short paid from the first date of the month succeeding the month in which the duty ought to have been paid under the Act.

4. **What are the conditions and the circumstances that would attract the imposition of penalty under section 11AC of the Central Excise Act, 1944?**

UOI v. Rajasthan Spinning & Weaving Mills 2009 (238) ELT 3 (SC)

The Apex Court, overruling the decision of the Tribunal, held that mandatory penalty under section 11AC of the Central Excise Act, 1944 is not applicable to every case of non-payment or short-payment of duty. In order to levy the penalty under section 11AC, conditions mentioned in the said section should exist. Supreme Court ruled that the Tribunal was not justified in striking down the levy of penalty against the assessee on the ground that the assessee had deposited the balance amount of excise duty (that was short paid at the first instance) before the show cause notice was issued. The Apex Court elaborated that the payment of the differential duty whether before/after the show cause notice is issued cannot alter the liability for penalty. The conditions for penalty to be imposed are clearly spelt out in section 11AC of the Act.

Supreme Court clarified that both section 11AC as well as proviso to sub-section (1) of section 11A use the same expressions : *"....by reasons of fraud, collusion or any wilful mis-statement or suppression of facts, or contravention of any of the provisions of this Act or of the rules made thereunder with intent to evade payment of duty,..."*. Hence, it drew the inference that the penalty provision of section 11AC would come into play only if the notice under section 11A(1) states that the escaped duty was the result of any conscious and deliberate wrong doing and in the order passed under section 11A(2), there is a legally tenable finding to that effect.

5. Whether the payment of differential duty by the assessee at the time of issuance of supplementary invoices to the customers demanding the balance of the revised prices is liable to interest under section 11AB and penalty thereof?

CCE v. SKF India Ltd. 2009 (239) E.L.T. 385 (S.C.)

The respondent-assessee, manufacturing ball-bearings and textile machine parts, paid the differential duty to the Department as the prices of the said goods were revised with retrospective effect. The Revenue took the view that the assessee was liable to pay interest on differential duty under section 11AB of the Central Excise Act and penalty thereof. The assessee replied that there was no question of charging interest and penalty as the payment of differential duty was made by it at the time of issuing supplementary invoices to the customers.

The Tribunal held that no interest was chargeable where there was no time-gap between the payment of the differential duty and issuance of supplementary invoices to the customers on the basis of upward revision of prices in respect of the goods sold earlier.

The Apex Court noted that section 11A relating to recovery of duties can be divided in two parts:-

(i) **Where the non-payment or short payment etc. of duty is not intentional and for a reason other than deceit**; the default is due to oversight or some mistake. Such cases are dealt with under sub-section (2B) of section 11A. It provides that the assessee in default may, before the notice issued under sub-section (1) is served on him, make payment of the unpaid duty and inform the Central Excise Officer in writing about the payment made by him. In that event, he would not be given the demand notice. However, from the combined reading of explanation 2 to section 11A(2B) and section 11AB, it can be concluded that the person who has paid the duty under sub-section (2B) of section 11A, shall, in addition to the duty, be liable to pay interest. No penalty is attracted.

(ii) **Where the non-payment or short payment etc. of duty is intentional, deliberate and/or by deceitful means**; "by reason of fraud, collusion or any wilful

mis-statement or suppression of facts, or contravention of any of the provisions of the Act or of Rules made thereunder with intent to evade payment of duty". Such cases are dealt with under sub-section (1A) of section 11A. Both interest and penalty are attracted.

The Apex Court, overruling the Tribunal's decision, held that the payment of differential duty by the assessee at the time of issuance of supplementary invoices to the customers demanding the balance of the revised prices clearly falls under the provision of sub-section (2B) of section 11A of the Act. Consequently, no penalty would be leviable on the assessee.

6

APPEALS

1. Discuss the interpretation of phrase "a mistake apparent from record".

Asst Commr, IT, Rajkot v. Saurashtra Kutch Stock Exchange Ltd. 2008 (230) ELT 385 (SC)

Supreme Court, while interpreting the phrase "any mistake apparent from record" under section 254(2) of the Income Tax Act, 1961, stated that a patent, manifest and self-evident error which does not require elaborate discussion of evidence or argument to establish it, can be said to be an error apparent on the face of the record and can be corrected while exercising certiorari jurisdiction. An error apparent on the face of the record means an error which strikes on mere looking and does not need long drawn-out process of reasoning on points where there may conceivably be two opinions. Such error should not require any extraneous matter to show its incorrectness.

The Apex Court further clarified that an error cannot be said to be apparent on the face of the record if one has to travel beyond the records to see whether the judgment is correct or not. An error which has to be established by a long drawn process of reasoning on points where there may conceivably be two opinions can hardly be said to be an error apparent on the face of the record.

The Court held that the error should be so manifest and clear that no Court would permit it to remain on record. If the view accepted by the Court in the original judgment is one of the possible views, the case cannot be said to be covered by an error apparent on the face of the record.

Note - The interpretation of phrase "mistake apparent from record" enunciated in above mentioned case may be applied to section 35C(2) of the Central Excise Act, 1944 and section 129B(2) of the Customs Act, 1962- sections corresponding to section 254(2) of the Income Tax Act, 1961.

2. Can there be a difference in the Final Order issued by Tribunal and the Handwritten Order in Order Sheet?

Dinkar Khindria v. UOI 2008 (231) ELT 47 (Del.)

The High Court held that a difference in the Final Order issued by the Tribunal and the Handwritten Order in Order Sheet i.e. a change of order by Members of the Tribunal

amounts to tampering with the judicial records. Once an order is passed and it is signed by the members, the same cannot be altered unless law provides for a review of the same and that too only after hearing the parties. The Tribunal should ensure that such unsavory incidents should not occur in the course of their conduct of judicial proceedings.

3. Whether the appeal filed by Commissioner himself and not by subordinate officer based on authorization under the erstwhile section 35B, is maintainable?

Commr. Of C.Ex. & Cus. v. Shree Ganesh Dyeing & Ptng. Works 2008 (232) ELT 775 (Guj.)

In the instant case, the assessee raised objection as to maintainability of the appeal on the ground that the appeal had been filed by Commissioner himself, instead of by the Central Excise Officer authorised by the Commissioner as required by the erstwhile section 35B(2) of the Central Excise Act, 1944.

The Court, while analyzing section 35B(2), held that section 35B(2) of the Act is made up of two parts or two stages:-

First stage is formation of an opinion by Commissioner that the order made by the appellate authority is not legal or proper.

Second stage is filing of an appeal against order of appellate authority by directing any Central Excise Officer authorised by the Commissioner in this behalf to file an appeal on behalf of the Commissioner.

Accordingly, the Commissioner is vested with a discretion, in the first instance to form an opinion as to whether appellate order is legal or proper and then exercise the discretion to decide whether an appeal should be preferred or not, having come to the conclusion that the order is not proper or legal.

The High Court further clarified that when a person is statutorily entitled to delegate powers to another person to file an appeal on behalf of the first named person, it goes without saying that the power which can be delegated is the power which the first named person would be entitled to exercise. Hence, until and unless the Commissioner himself is entitled to file an appeal, there is no question of the Commissioner authorising another officer to file appeal on his behalf. The language of the latter part of sub-section (2) of section 35B of the Act itself makes this more than abundantly clear when the provision uses the phrase 'to appeal on his behalf'.

Note - Section 35B(2) was amended vide the Finance Act, 2005 to provide that instead of Commissioner of Central Excise, a Committee of Commissioners of Central Excise shall review the orders of Commissioner of Central Excise (Appeals) and direct any Central Excise Officer authorized by him to appeal on its behalf to the Appellate

Tribunal. However, the principle enunciated in this judgment will hold good in respect of amended section 35B(2) as well.

4. Can the judgments of the courts be construed as statutes?

CCEx., Bangalore v. Srikumar Agencies 2008 (232) ELT 577 (SC)

The Apex Court held that judgments of Courts are not to be construed as statutes. Courts should not place reliance on decisions without discussing as to how the factual situation fits in with the fact situation of the decision on which reliance is placed. Observations of Courts are neither to be read as Euclid's theorems nor as provisions of the statute and that too taken out of their context. These observations must be read in the context in which they appear to have been stated. To interpret words, phrases and provisions of a statute, it may become necessary for judges to embark into lengthy discussions, but the discussion is meant to explain and not to define. Judges interpret words of statutes; their words are not to be interpreted as statutes. Circumstantial flexibility, one additional or different fact may make a world of difference between conclusions in two cases. Disposal of cases by blindly placing reliance on a decision is not proper.

5. Whether non-filing of appeal for some assessment years is a bar in filing appeal for other assessment years?

CIT v. J. K. Charitable Trust 2008 (232) ELT 769 (SC)

The Supreme Court pronounced that there may be certain cases where because of the small amount of revenue involved, no appeal is filed. Policy decisions may be taken not to prefer appeal where the revenue involved is below a certain amount. Similarly, where the effect of the decision is revenue neutral, there may not be any need for preferring the appeal. All these certainly provide the foundation for making a departure.

In the case of *C.K. Gangadharan's v. CIT 2008 (228) ELT 497 (SC),* it was held that 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. The Court further provided that if the assessee takes the stand that the Revenue acted mala fide in not preferring appeal in one case and filing the appeal in other case, it has to establish mala fides.

However, in the given case, the Apex Court noted that it was accepted by the learned counsel for the appellant (Revenue) that the fact situation in all the assessment years was same. Under the circumstances, the Court concluded that since the fact situation had not changed, Revenue could not prefer an appeal and thus, the court dismissed the appeal filed by the Department.

6. Can a writ petition be filed against the order of waiver of pre-deposit (under first proviso to section 35F of the Central Excise Act, 1944) or refusal thereof?

Cisco Systems India Pvt. Limited v. UOI 2009 (234) E.L.T. 618 (Del.)

The High Court held that power to waive pre-deposit to avoid hardship to party against whom demand is raised is discretionary. As long as discretion is not exercised in an arbitrary and unusual fashion, a writ court would not interfere with order of waiver of pre-deposit or refusal thereof. Mere fact that issues that arise for consideration of appellate authority were arguable is not in itself sufficient for a complete waiver of pre-deposit.

Writ court would be slow in interfering with discretionary order, especially so where appellant has not pleaded any financial hardship as such before appellate authority. The Delhi High Court ruled that recovery of taxes cannot be stayed under Article 226 of the Constitution except under exceptional circumstances.

Note : First proviso to section 35F of the Central Excise Act, 1944 reads as follows:-

Where in any particular case, the Commissioner (Appeals) or the Appellate Tribunal is of opinion that the deposit of duty demanded/penalty levied would cause undue hardship to such person, the Commissioner (Appeals) or, as the case may be, the Appellate Tribunal, may dispense with such deposit subject to such conditions as he or it may deem fit to impose so as to safeguard the interests of revenue.

7. Whether the Department is not required to state any reason while filing an application for condonation of delay in filing the appeal to CESTAT?

CCEx., Chennai v. CEGAT 2009 (236) E.L.T. 21 (Mad.)

The Department filed the appeal to the Tribunal 100 days after the expiry of the period prescribed for filing an appeal. However, the delay had not been supported by sufficient reasons.

Learned counsel for the petitioner submitted that in the case of the Department, the Court had always been lenient in condoning the delay. So, there could not be any exception to the procedure followed by this Court as well as the Supreme Court in respect of the fiscal matters.

The High Court observed that the power to condone the delay in filing the appeal had been vested with the Tribunal only on being satisfied with the reasonable cause shown for the delay. Since the Department had not substantiated any reason for causing the delay, it could not expect the Tribunal to condone the delay in a routine manner. Even before the High Court the petitioner had not stated the reason. If minimum pain or effort had been taken by the authorities, some reason would have been stated for the delay. However, in the absence of any sufficient cause, the Tribunal could not by itself invent reason and grant the relief as sought for by the petitioner.

7

REMISSION OF DUTY AND DESTRUCTION OF GOODS

1. Can goods lost by 'theft' or 'dacoity' be considered to be "goods lost or destroyed by natural causes or by unavoidable accident" under rule 49 of the erstwhile Central Excise Rules, 1944 (now rule 21 of the Central Excise Rules, 2002)?

Gupta Metal Sheets v. CCE 2008 (232) ELT 796 (Tri. - LB)

The Large Bench of the Tribunal ruled that as per rule 49 of the erstwhile Central Excise Rules, 1944 (now rule 21 of the Central Excise Rules, 2002); loss must be attributable to any natural cause or unavoidable accident. It clarified that the term 'loss' cannot be understood in the limited sense of 'loss to the manufacturer', but it has to be understood as being unavailable for consumption in the market. However, in case of theft or dacoity, the goods are not 'lost' or 'destroyed'; they rather enter the market for consumption, although illegally, after being removed from the approved premises or the place of storage.

'Natural cause' refers to some natural phenomenon i.e. vagary of nature or some act of nature like fire, flood or a similar natural calamity. The act of forcibly removing the goods by any means - non-violent or violent - amounting to theft or dacoity under the Indian Penal Code cannot be said to be a natural cause.

Considering the definitions of 'theft' and 'robbery' in the Indian Penal Code, the Tribunal inferred that 'theft' or 'dacoity' involves forcible removal of goods by non-violent or violent means, as the case may be, and this cannot be said to be a natural cause. The Tribunal opined that theft and dacoity are committed by a design and they cannot be said to be accident by any logic. By taking due care and caution, they can be avoided and, therefore, it cannot be said that theft or dacoity is 'unavoidable accident'.

In view of the above, the Tribunal held that 'theft' or 'dacoity' cannot be called unavoidable accident within the meaning of the rule 49 of the erstwhile Central Excise Rules, 1944 (now rule 21 of the Central Excise Rules, 2002) and the goods lost in theft or dacoity would not be eligible for remission. The issue was thus answered in the negative i.e. in favour of the Revenue and against the assessee.

Note : Rule 21 of the Central Excise Rules, 2002 containing the provisions regarding the remission of duty reads as follows:-

Where it is shown to the satisfaction of the Commissioner that ***goods have been lost or destroyed by natural causes or by unavoidable accident*** *or are claimed by the manufacturer as unfit for consumption or for marketing, at any time before removal, he may remit the duty payable on such goods, subject to such conditions as may be imposed by him by order in writing.*

2. Is remission of duty possible in case of loss occurring due to de-bagging, shifting of concentrates, seepage of rain water, storage and loading on trucks, accounting method adopted?

UOI v. Hindustan Zinc Limited 2009 (233) E.L.T. 61 (Raj.)

The assessee was engaged in the manufacture of lead and zinc concentrates. At the time of carrying out the physical stock taking, some difference was found between the physically verified stock and the stock as per the books. According to the assessee, this difference was due to de-bagging, shifting of concentrates, seepage of rain water, storage and loading on trucks, accounting method adopted. The assessee applied for the remission of the duty under rule 21 of the Central Excise Rules, 2002. Revenue contended that the shortage could have been avoided or minimized by the assessee, as these were neither due to natural causes, nor due to unavoidable accident. Thus, the prayer for remission was declined.

The Rajasthan High Court held that the expressions "natural causes" and "unavoidable accident" were required to be given, reasonable and liberal meaning, lest the provisions of rule 21, so far as they relate to admissibility of remission, on these two grounds, would be rendered altogether ineffective. The Court noted that if the contention of Revenue was accepted, no loss or destruction would fall in either of these clauses because in either case, grounds may be projected, on the anvil of requirement of appropriate storage, or safety measures, and so on and so forth. Even in cases of "unavoidable accident", it could always be contended that the accident could have been avoided by taking recourse of one or more measures. Thus, a bit liberal rather more practical approach was required to be taken in the matter.

The aspect of satisfaction under rule 21 was essentially a subjective satisfaction of authority concerned and in the instant case; the Tribunal independently recorded its satisfaction about the loss, or destruction having been sustained by the assessee under the circumstances as covered by rule 21. Therefore, merely on the basis of method of accounting of physical stock, the remission of duty could not be denied.

8

NOTIFICATIONS, DEPARTMENTAL CLARIFICATIONS AND TRADE NOTICES

1. Whether circulars can be given primacy over the decisions of the Court?

CCEx., Bolpur v. Ratan Melting and Wire Industries 2008 (231) ELT 22 (SC)

The assessee's contention was that once a circular had been issued, it was binding on the Revenue authorities and even if it ran counter to the decision of this Court, the Revenue authorities could not say that they were not bound by it. The circulars issued by the Board were not binding on the assessee but were binding on Revenue authorities. It had been submitted by the assessee that once the Board issued a circular, the Revenue authorities could not take advantage of a decision of the Supreme Court. The consequences of issuing a circular were that the authorities could not act contrary to the circular. Once the circular was brought to the notice of the Court, the challenge by the Revenue should be turned out and the Revenue could not lodge an appeal taking the ground which was contrary to the circular.

Revenue pleaded that the law declared by this Court was supreme law of the land under Article 141 of the Constitution of India. Supreme Court observed that in *Kalyani Packaging Industry v. Union of India and Anr. 2004 (6) SCC 719*, it was noted that law laid down by this Court was the law of the land. The law so laid down was binding on all courts/tribunals and bodies. It was clear that circulars of the Board could not prevail over the law laid down by this Court.

Supreme Court decided that circulars and instructions issued by the Board are no doubt binding in law on the authorities under the respective statutes, but when the Supreme Court or the High Court declares the law on the question arising for consideration, it would not be appropriate for the Court to direct that the circular should be given effect to and not the view expressed in a decision of this Court or the High Court. So far as the clarifications/circulars issued by the Central Government and of the State Government are concerned, they represent merely their understanding of the statutory provisions. They are not binding upon the court. It is for the Court to declare what the particular provision of statute says and it is not for the Executive. Looked at from another angle, a circular which is contrary to the statutory provisions has really no existence in law.

9

ADVANCE RULINGS

1. Can a writ petition be invoked against advance rulings?

UAE Exchange Centre Ltd. v. UOI 2009 (236) E.L.T. 223 (Del.)

The Delhi High Court held that the ruling by Advance Rulings Authority is binding on the applicant, the transaction on which ruling is sought and the Departmental officers concerned. It does not exclude the jurisdiction of the Courts either expressly or by implication. There is no provision which gives finality to the decision of the Authority. The Court viewed that the Courts would have jurisdiction to entertain actions under Article 226 of the Constitution (writ petition) impugning the ruling given by the Authority i.e. writ jurisdiction is invocable against advance rulings.

10

SETTLEMENT COMMISSION

1. Is Settlement Commission entitled to reject the 'rectification of mistake' application, filed on the basis of a Supreme Court judgment, holding the issue debatable?

CIT v. Settlement Commission 2009 (234) E.L.T. 584 (Ker.)

The Kerela High Court held that when an application for rectification is filed before Settlement Commission, within the permitted time limit, based on a subsequent decision of the Apex Court, directly on the point, normally, it has to be entertained. However, in this case, the Settlement Commission had rejected the application on the ground that the issue raised was a debatable issue.

The Court observed that when there is a decision of the Apex Court on a particular issue, no inferior court or Tribunal can say that the issue is a debatable issue for the reason that a bench of two judges of the Apex Court has doubted the correctness of the decision of the Constitution Bench. The inferior courts and Tribunals are bound to follow the decision of the Constitution Bench. So, the rejection of application was unjustified.

2. In a case where the Settlement Commission has sent the case back to the adjudicating authority under section 32L(1), can the order of adjudication passed by the Settlement Commission be considered to be final ?

Vishwa Traders Pvt. Ltd. v. UOI 2009 (241) E.L.T. 164 (Guj.)

The appellant filed an application with the Settlement Commission under section 32E of the Central Excise Act, 1944. However, as the applicant was not willing to accept the duty liability settled by the Commission, it sent the case back to the adjudicating authority in terms of section 32L(1) of the Act. It directed the adjudicating officer to dispose the case in accordance with the provisions of the Act as if no application had been made to Settlement Commission.

When case came up before Revenue for adjudication, it decided that since as per section 32M, any order made by the Settlement Commission was conclusive; the figure of duty liability fixed by the Settlement Commission had attained finality. Hence, the petitioner was required to make payment of the said amount along with penalty and interest.

The High Court held that under section 32L(1), once the Settlement Commission forms

an opinion that any person who made an application for settlement under section 32E of the Act has not cooperated in the proceedings before the Commission, the Settlement Commission may send the case back to the adjudicating authority to dispose of the case in accordance with provisions of the Act, as if, no application under section 32E had been made. If there is no application before Settlement Commission, there can be no question of any final order of adjudication. Consequently, the order passed by the Settlement Commission under section 32L(1) cannot be considered to be the final order of adjudication.

The High Court, while interpreting section 32L(3), held that for working out the time limit prescribed under section 11A for recovery of duties, the period commencing from the date of application to the Settlement Commission to the date of receipt of the order under section 32L by the adjudicating authority, shall be excluded. Therefore, the balance period available from the date of making of application before Settlement Commission shall be available to the adjudicating authority for making an order assessing duty liability of an assessee.

Hence, the High Court pronounced that Revenue shall continue the adjudication proceedings from the stage at which the proceedings before Settlement Commission commenced.

CUSTOMS

1

CLASSIFICATION OF GOODS

1. Where the importer clears the imported goods on the basis of classification which was upheld by Commissioner of Customs (A), is the seizure of such goods and collecting any amount in excess of what is assessed by the custom authorities justified?

Vodafone Essar South Ltd. v. UOI 2009 (237) E.L.T. 35 (Bom.)

The Commissioner of Customs (Appeals) in petitioner's own case, on 25-3-2008, had held that Optic Fibre Cables (OFC) imported by petitioners were classifiable under Heading 85.44 of the Central Excise Tariff, 1985. The Revenue filed an appeal before CESTAT against the said order claiming the classification of the goods under Heading 90.01. However, on 18-12-2008, the customs authorities (DRI officers) threatened the petitioner to arrest the directors of the petitioner-company and other staff unless differential duty between Headings 85.44 and 90.01 was paid.

The Bombay High Court held that the action of the Director of Revenue Intelligence (D.R.I. officers) in the Customs Department in seizing the goods and collecting money from the petitioners was wholly unjustified and uncalled for, because of following five reasons:-

(i) When the Commissioner of Customs (Appeals) in petitioner's own case on 25-3-2008 had held that OFC imported by petitioners were classifiable under Heading 85.44 of the Central Excise Tariff, the petitioners were not wrong in classifying the goods imported after 25-3-2008 under Heading 85.44 ibid.

(ii) Decision of Commissioner (Appeals) was neither stayed by CESTAT nor by any other competent authority. Hence, mere fact that appeal filed by Revenue against the decision of Commissioner (Appeals) was pending could not be a ground to hold the petitioner guilty of misclassification of goods.

(iii) D.R.I. officers were bound by the decision given by Commissioner of Customs (Appeals).

(iv) The Bills of Entry filed by the petitioners by classifying the goods under Heading 85.44 had been assessed under Heading 85.44 and the goods had been cleared only on payment of duty as assessed. Therefore, till the assessment was set aside, the customs authorities could not have seized the goods assessed and cleared under Heading 85.44, on the ground that the goods were liable to be assessed under Heading 90.01.

(v) In the absence of any reassessment order passed determining the duty liability, there would be no question of recovering differential duty.

2

IMPORTATION, EXPORTATION, AND TRANSPORTATION OF GOODS

1. Is the Port Trust liable to pay duty on goods pilfered while in their possession?

Board of Trustees of the Port of Bombay v. UOI 2009 (241) E.L.T. 513 (Bom.)

In the instant case, goods were pilfered before clearance while in possession of the Port Trust as custodian. The Department raised the demand of custom duty on the Port Trust because goods were pilfered whilst in their custody.

The High Court viewed that considering the language of section 45(3) of the Customs Act, the liability to pay duty is of the person, in whose custody the goods remain, as an approved person under section 45 of the Customs Act. Considering that the possession of the goods by the Port Trust is by virtue of powers conferred on the Port Trust under the Port Trust Act, the Court found it impossible to hold that the Port Trust is an approved person or can be notified as an approved person. It implies that section 45(3) of the Customs Act refers to the persons who have approved warehouses in terms of sections 9 and 10 of the Customs Act.

The High Court further opined that under section 45 of the Customs Act, the person referred to in sub-section (1) thereof can only be the person approved by the Commissioner of Customs. It excludes a body of persons, who by virtue of a law for the time being in force, is entrusted with the custody of goods by incorporation of law under another enactment,(for example, the Port Trust Act in the given case).

The Court interpreted that the intention of the law might have been to check the pilferage taken place from a private warehouse or a customs warehouse run by a private party. The negligence on such private parties should not cause loss to the exchequer.

Thus, the Court held that under section 45(1) of the Customs Act, the recovery of duty in respect of pilfered goods could only from the approved person and the Port Trust is not liable to pay duty on goods pilfered while in their possession.

3

PROVISIONS RELATING TO ILLEGAL IMPORT, CONFISCATION, PENALTY & ALLIED PROVISIONS

1. In case the Department fails to provide some contemporaneous evidence that the price declared in the invoice is not the correct price, how would the transaction value be determined? Would the goods be liable to confiscation in such a case?

Commissioner of Customs, Mumbai v. Mahalaxmi Gems 2008 (231) ELT 198 (SC)

The assessee imported three lots of rough diamonds supplied at different CIF prices per carat in the same shipment. Department opined that the goods were over-invoiced. As per the Appraisers' Valuation report as well as the Trade Panel report submitted through the Gems and Jewellery Export Promotion Council, the ascertained fair value of the goods was found to be lower than the invoiced value. Therefore, the Department proposed the confiscation of goods under section 111(m) of the Customs Act, 1962.

The assessee while explaining the reason for the same stated that the shipper had before hand informed that if after assortment, the assessee did not find the value of the goods to be satisfactory, it should reship the goods back.

The Tribunal held that the value of the goods that was declared was the transaction value. The genuineness of the invoice that the assessee produced has not been questioned. It has not been alleged that it was fabricated or fake or that any relationship existed between the importer and the exporter. It was also held that there was no contemporaneous evidence to prove that the goods imported were over invoiced.

Thus, Supreme Court, upholding the Tribunal's view, pronounced that the transaction value had to be accepted until and unless it was shown by some contemporaneous evidence that the price declared in the invoice was not the correct price. Hence, there was no over invoicing by the importer of the goods.

2. Whether the action of the custom authorities in selling the confiscated goods during the period of pendency of appeal is justified?

Shabir Ahmed Abdul Rehman v. UOI 2009 (235) ELT 402 (Bom.)

Revenue confiscated the gold carried by the petitioner from Muscat. The petitioner informed the custom authorities that he was filing an appeal against the order of confiscation. Revenue informed the petitioner that the confiscated goods had been handed over to the warehouse of the Custom House for disposal and consequently, auctioned the confiscated goods.

The High Court held that handing over the confiscated gold immediately after serving the order of confiscation itself was improper. In any event, after receiving letter from the petitioner, the custom authorities ought to have stopped the auction sale of the confiscated gold. The action of the custom authorities in selling the gold during the pendency of the appeal was not justified.

3. Can Custom Authorities take the petitioner into custody for custodial interrogation?

Arun Kumar Gupta v. DRI, Delhi 2009 (235) E.L.T. 457 (Del.)

The High Court held that there was no question of any custodial interrogation since in case of detention; the petitioner had to be sent to judicial remand. The Custom Authorities unlike the police authorities could not take the petitioner into custody for custodial interrogation.

4. Can a burden be cast on assessee to prove that the import is permissible even if imported goods are neither prohibited goods nor restricted goods?

Commissioner of Customs v. Filco Trade Centre (P) Ltd. 2009 (239) E.L.T. 19 (Guj.)

On a search conducted in the premises of the assessee, different varieties of ball bearings of foreign make were recovered. As per Revenue, the said goods were not imported under valid import documents. Hence, it seized the goods. Thereafter, confiscation of seized goods was ordered under section 111(d) of the Customs Act, 1962, redemption fine was fixed and penalties were levied.

The High Court observed that undoubtedly, goods, import of which is prohibited, either by the provisions of the Act or any other law in force, can be confiscated and consequential actions initiated under the provisions of the Act. However, in the present case, as noted by the Tribunal, there was no restriction on the goods in question and hence, it could not be stated that respondent assessee had committed any act of illegal import of prohibited goods.

Resultantly, the Court ruled that a negative burden could not be cast on respondent-assessee that although ball bearings were neither prohibited goods nor restricted goods, the respondent-assessee should show that import was permissible.

5. Is an exporter, who has been held guilty of exporting 'prohibited goods', entitled to an option to pay fine in lieu of confiscation under section 125?

CCus. (Preventive), West Bengal v. India Sales International 2009 (241) E.L.T. 182 (Cal.)

Learned Counsel for Revenue submitted that the Tribunal was not justified in granting an exporter, who had been held guilty of exporting 'prohibited goods', an option to pay fine in lieu of confiscation under section 125 of the Customs Act. He argued that word

which had been used by the legislators under section 125 as 'prohibited' had to be read as 'prohibited absolutely'.

The High Court opined that the Court cannot insert any word in the statute since it is within the domain of legislators. However, the Court has power to interpret the same without inserting anything. Whatever the legislators think fit and proper, can be legislated.

The High Court rejected the Revenue's contention that word 'prohibited' as used by legislators under section 125 of the Customs Act, 1962 could be read as 'prohibited absolutely'. It held that the Court cannot insert the word which has not been used in section 125 by legislators. Further, the option given under section 125 in respect of the prohibited goods and the right given to the authorities for redemption of the confiscated goods in question cannot be taken away by the Court by inserting a particular word therein.

Hence, the Court viewed that the Tribunal had the right to pass an order by giving an option to pay fine in lieu of confiscation of goods.

4

MISCELLANEOUS PROVISIONS

1. Can the Court grant anticipatory bail for an arrest under section 104 of the Customs Act, 1962?

Union of India v. Padam Narain Aggarwal 2008 (231) ELT 397 (SC)

The respondent - Padam Narain Aggarwal filed an anticipatory bail in the sessions court which dismissed it, but he later moved to the High Court which granted him anticipatory bail with a direction to the authorities that he should not be arrested without giving a ten days' prior notice to him. Revenue contended that the order passed by the High Court was illegal and erroneous.

Supreme Court observed that power to arrest a person by a Custom Officer under section 104 of the Customs Act, 1962 is statutory in character and cannot be interfered with. Supreme Court further noted that the law, on one hand, allows a Custom Officer to exercise power to arrest a person who has committed certain offences, and on the other hand, takes due care to ensure individual freedom by laying down norms and providing safeguards so that the power of arrest is not abused or misused by the authorities. 'Blanket' order of bail may amount to an invitation to commit an offence or a passport to carry on criminal activities.

Supreme Court pronounced that on the facts and in the circumstances of the present case, above directions could not be said to be legal or in consonance with law. Firstly, the order passed by the High Court was a blanket one and granted protection to respondents in respect of any non-bailable offence. Secondly, it illegally obstructed, interfered and curtailed the authority of Custom Officers from exercising statutory power of arresting a person said to have committed a non-bailable offence by imposing a condition of giving ten days prior notice, a condition not warranted by law. Hence, the order granting the anticipatory bail to the accused was set aside.

Note – Section 104 of the Customs Act, 1962 reads as under:-

If an officer of Customs empowered in this behalf by general or special order of the Commissioner of Customs has reason to believe that any person in India or within the Indian customs waters has committed an offence punishable under section 132 or section 133 or section 135 or section 135A or section 136, he may arrest such person and shall, as soon as may be, inform him of the grounds for such arrest [Sub-section 1]

Every person arrested under sub-section (1) shall, without unnecessary delay, be taken to a magistrate [Sub-section 2].

Where an officer of customs has arrested any person under sub-section (1), he shall, for the purpose of releasing such person on bail or otherwise, have the same powers and be subject to the same provisions as the officer-in-charge of a police-station has and is subject to under the Code of Criminal Procedure, 1898 (5 of 1898) [Sub-section 3].

Notwithstanding anything contained in the Code of Criminal Procedure, 1898 (5 of 1898), an offence under this Act shall not be cognizable [Sub-section 4].

SERVICE TAX

1. **In case of service provided in relation to "commercial or industrial construction service", whether the value of materials supplied free of cost by service recipient shall be included in the value of taxable service, while exemption under *Notification No. 1/2006-S.T.* is being availed?**

Era Infra Engineering Ltd. v. UOI 2008 (11) S.T.R. 3 (Del.)

The petitioner entered into a construction contract with NTPC. The petitioner contended that materials that were supplied free of cost by NTPC to him for the purposes of completing the contract could not be included in the "gross amount charged". Therefore, it could not be included in the value of taxable service.

The High Court held that prima facie it appears that any material that is supplied free of charge by NTPC or by any other party in respect of a contract of service cannot be included in the gross amount charged. It further referred to a decision of Madras High Court in *M/s. Larsen and Toubro Ltd. v. Union of India 2007 (7) STR 123* wherein the High Court had come to the view that value of goods supplied and provided free by the client of an assessee cannot be included for the purposes of calculating the value of taxable service.

In view of the above discussion, the High Court opined that for the purposes of determining the value of taxable service, the value of materials supplied free of cost by NTPC shall not be included and to this extent the **Explanation* to Serial No. 7 in the *Notification No. 1/2006 dated 01.03.2006*** will not be applied to the detriment of the petitioner.

Note: Notification No. 1/2006 ST dated 01.03.2006 provides that in case of commercial or industrial construction services [taxable under section 65(105)(zzq) of the Finance Act, 1994], service tax shall be levied only on 33% of the gross charges. This exemption shall not apply in such cases where the taxable services provided are only completion and finishing services in relation to building or civil structure. Further, this exemption shall also not apply in such cases where:

(i) the CENVAT credit of duty paid on inputs or capital goods or the CENVAT credit of service tax on input services, used for providing such taxable service has been taken under the provisions of the CENVAT Credit Rules, 2004; or

(ii) the service provider has availed the benefit under the Notification No. 12/2003-S.T., dated 20.06.2003.

Explanation - The "gross amount charged" shall include the value of goods and materials supplied or provided or used for providing the said taxable service by the service provider.

2

GAMUT AND COVERAGE OF TAXABLE SERVICES

1. Whether petitioner, engaged in construction of premises/flats for sale to prospective buyers, is liable to get registered under the category "commercial or industrial construction service"/"construction of complex service"?

Magus Constructions Private Limited v. UOI 2008 (11) S.T.R. 225 (Gau.)

The petitioner-company entered into agreements and constructed flats for the purpose of sale to those with whom such agreements are entered into. The High Court observed that petitioner-company was not shown to have undertaken any construction work for and on behalf of proposed customer/allottees and the title in the flat/apartments so constructed, passed to the customer only on execution of sale deeds and registration thereof. Until the time the sale deed was executed, the title and interest, including the ownership and possession in the construction, remained with the petitioner-company. The construction activities, which the petitioners had been undertaking, were in respect of the petitioners' own work and it was only the completed construction work, which was sold by the petitioner-company to the buyers, who might have made agreements for sale before the construction had actually started or during the progress of the construction activity or at the end or completion of the construction activity. Any advance, made by a prospective buyer, or deposit received by the petitioner-company, was against consideration of sale of the flat/building to such prospective buyer and not for the purpose of obtaining "service" from the petitioner-company. From the condition so incorporated in the relevant agreement for sale, it could not be inferred that the petitioner-company was making construction for and on behalf of the probable allottees or purchasers.

The High Court further clarified that the burden of registration and payment of "service tax" is on the person, who provides "taxable service" to any person. The Court drew the attention to *Circular No. 332/35/2006-TRU, dated 1-8-2006* [now *CBEC Circular No. 96/7/2007-S.T. dated 23-8-2007*] which clarifies that if no other person is engaged for construction work and the builder/promoter/developer undertakes construction work on his own without engaging the services of any other person, then in such cases in the absence of service provider and service recipient relationship, the question of providing taxable service to any person by any other person does not arise.

In the light of above discussion, it was held that the activities of the petitioner-company did not fall within the purview of "taxable service" so as to attract levy of "service tax". Hence, the petitioner was not liable to get registered under the service tax.

2. Whether foreign architect firms, not registered under section 23 of the Architects Act, 1972, are taxable under the category "architect's services"?

Unitech Limited v. Commissioner of Service Tax, Delhi 2008 (12) S.T.R. 752 (Tri. - Del.)

The Tribunal while analyzing the definition of 'architect' under section 65(6) held that there are two parts of the definition of architect.

First part covers any person whose name is entered in the register of architects maintained under section 23 of the Architects Act, 1972.

Second part i.e. the inclusive part, covers any commercial concern engaged in any manner, whether directly or indirectly in rendering the service in the field of architecture.

The Tribunal noted that while there is a requirement of registration in the register of architects maintained under section 23 of the Architects Act, 1972 for individual persons covered by the first part of the definition, there is no such registration requirement for the second part of the definition, which covers the commercial concern engaged in any manner, whether directly or indirectly in rendering the services in the field of architecture. Hence, it held that the foreign architect firms in question were commercial concern engaged in rendering services in the field of architecture and therefore they were covered by the second part of the definition of architect. Consequently, such firms were covered by the definition of "architect", the service provided by them to the appellants was a taxable service under section 65(105)(p) of the Finance Act, 1994 as amended.

Note : The appellant challenged the order of the Tribunal before the Delhi High Court, wherein the High Court, in case of Unitech Limited v. Commissioner of Service Tax, Delhi 2009 (15) S.T.R. 385, held that appellant was not liable to pay service tax prior to 18.04.2006. However, the High Court did not go into the issue as to whether foreign architect firms are covered under service tax. Therefore, the principle enunciated in above mentioned judgment that the foreign firms are taxable under the category "architect's services" still holds good.

3. Whether the service tax is leviable on hire purchase finance?

CCEx. v. Bajaj Auto Finance Ltd. 2008 (10) S.T.R. 433 (S.C.)

The Apex Court, affirming the decision of the Tribunal, held that service tax is not leviable on hire purchase finance agreement. The Tribunal, in the light of the Apex Court's decision in *Sundaram Finance Ltd. v. State of Kerala & another (1966) 17 STC 489*, had accepted the contention of appellant that there is a fundamental difference between a hire purchase agreement and hire purchase finance agreement. In the case of the hire purchase agreement, the title to the goods remains with the hire purchase

company which bails the goods to the hirer in return for periodical payments and the title to the goods is transferred to the customer/hirer only if he exercises the option to purchase the same on full payment to the hire purchase company. While in the case of the hire purchase finance agreement, the title to the goods vests in the purchaser right from the beginning and the hire purchase finance company that has only a right to seize the goods for non-payment of the loan, is not the owner of the goods.

4. Can the assessee holding the Stevedoring license issued by the port, be made liable to pay service tax under the category "port service"?

CCEx., Mangalore v. Konkan Marine Agencies 2009 (13) S.T.R. 7 (Kar.)

The question raised before the High Court for consideration was whether the services rendered by assessee could be classified under the category "port service" or "cargo handling service". The assessee contended that it should be entitled to the refund of the service tax paid under the category "port service" because it had only handled export cargo and handling of export cargo had been exempted from the payment of service tax under the category of "cargo handling service" and that they had erroneously paid service tax on such export cargo handled by it. However, the Revenue contended that the assessee had been rendering the services exclusively within the port premises and the services rendered by the assessee were rightly classifiable under the category of "port service" and there was no exemption of payment of service tax under the said category in respect of export cargo.

After a bare reading of the definition of the "cargo handling service" under section 65(23) of the Finance Act, 1994 as amended, High Court elucidated that it was amply clear that ***handling of export cargo shall not attract service tax at all***[1]. Therefore, the service tax could not have been levied on the assessee who was handling loading of cargo meant for the export purpose. Further, the High Court rejected the Revenue's contention that since the Port has issued a Stevedoring license in favour of the assessee, he would be the ***person authorized***[2] within the definition of "port service" under section 65(82) of the Finance Act, 1994. The High Court held that undisputedly, assessee was engaged in the business of cargo handling, especially for loading of cargo for export and the definition of "cargo handling service" under section 65(23) clearly puts a bar with regard to the imposition of tax meant for export which also includes handling of the export cargo. Hence, assessee was not liable to pay service tax.

Notes :

1. *Section 65(23) of the Finance Act, 1994, interalia, provides that "cargo handling service"* ***does not include, handling of export cargo*** *or passenger baggage or mere transportation of goods.*

2. *Section 65(82) of the Finance Act, 1994 provides that "port service" means any service rendered by a port or other port or **any person authorised by such port or other port**, in any manner, in relation to a vessel or goods.*

5. Whether the chit fund activity falls within the expression "cash management" under "banking and other financial services"?

A.P. Federation OF Chit Funds v. UOI 2009 (13) S.T.R. 350 (A.P.)

The petitioner was doing the business of chit funds. The petitioner questioned the correctness of *C.B.E. & C. Master Circular No. 96/7/2007-S.T., dated 23-8-2007.* Considering the definition of "chit fund" and Supreme Court decision in case of *M/s. Shriram Chits & Investment (P) Ltd. v. Union of India - AIR 1993 SC 2063*, the High Court held that in the absence of a specific statutory definition of 'cash management' or even 'asset management', the question of its wider interpretation either by seeking to include or exclude any other transactions or business is not permissible. Therefore, it is amply clear that in the absence of any such inclusive definition available in the statute, it cannot be said that the petitioners would fall within the mischief of banking and other financial services. The entire action of the respondents of levying the service tax for the first time by way of a circular is merely an executive fiat, which is not permissible under the law. In the light of the foregoing reasons, High Court set aside the impugned *C.B.E. & C. Master Circular No. 96/7/2007-S.T., dated 23-8-2007.* As a result, the High Court held that the chit fund activity did not fall within the expression "cash management" under "banking and other financial services".

Note : Section 65(12), inter alia, provided that banking and other financial services means asset management including portfolio management, all forms of fund management, pension fund management, custodial, depository and trust services, **but does not include cash management. However, Finance Act, 2007 omitted the expression **"but does not include cash management"** thereby bringing the cash management within the service tax net. Hence, in the above mentioned case, the Revenue contended that chit transaction and business of the petitioners falls within the mischief of 'cash management', hence it attracted levy of service tax. Further, it called upon the petitioners to pay the service tax on the basis of C.B.E. & C. Master Circular No. 96/7/2007-S.T., dated 23-8-2007 which, inter alia, provides as follows:-*

***Issue**: Whether services provided in relation to chit fund is leviable to service tax under "banking and other financial services" or not?*

***Clarification**: Reserve Bank of India has clarified that the business of a chit fund is to mobilize cash from the subscribers and effectively cause movement of such cash to keep it working and, therefore, the activity of chit funds is in the nature of cash management.*

(a) In the case of Simple Chit Funds, no consideration is paid or received for the services provided and, therefore, the question of levy of service tax does not arise.

(b) *In the case of Business Chit Funds, cash management service is provided for a consideration and, therefore, leviable to service tax under "banking and other financial services".*

6. Elaborate the function of a Custom House Agent (CHA) with the help of a decided case law.

Lee & Muir Head Pvt. Ltd. v. CST 2009 (14) S.T.R. 348 (Tri. - Bang.)

The Tribunal elucidated that the function of a CHA mainly relates to the documentation part for the clearance of goods from the customs for import/export. The fees collected by the CHA for transportation of goods from foreign country to India before import of goods or transportation of goods from the warehouse or from the godown after clearance from the Customs House do not come under the category of CHA.

7. Whether the explanation inserted by Finance Act, 2008 to the definition of `business auxiliary service' is clarificatory or declaratory in nature so as to be construed having retrospective effect and retroactive operation?

Union of India & Ors v. M/s Martin Lottery Agencies 2009 (14) S.T.R. 593 (S.C.)

The Apex Court ruled that by reason of an explanation, a substantive law may also be introduced. If a substantive law is introduced, it will have no retrospective effect. Subject to the constitutionality of the Finance Act, 1994 in view of the explanation appended to this, the Supreme Court opined that the service tax, if any, would be payable only with a prospective effect and not with retrospective effect.

It further opined that in a case of this nature, the Court must be satisfied that the Parliament did not intend to introduce a substantive change in the law. For the aforementioned purpose, the expressions like 'for the removal of doubts' are not conclusive. The said expressions appear to have been used under assumption that organizing games of chance would be rendition of service. It held that the explanation is not clarificatory or declaratory in nature. Hence, it could not be construed having retrospective effect and retroactive operation.

8. Is it necessary that in order to levy the service tax under the category "clearing & forwarding agent's services", the agent must be rendering both clearing and forwarding services?

CCEx., Panchkula v. Kulcip Medicines (P) Ltd. 2009 (14) S.T.R. 608 (P & H)

The assessee-respondent entered into an agreement with M/s. Cipla for handling and distribution of their products and was entrusted with the job of receiving, storing and distributing Cipla products to their authorised stockists and distributing centres. For the services so rendered, the assessee-respondent was entitled to commission based on

agreed percentage of sales figures and also to reimbursement of recurring expenses. Revenue contended that the services provided by the assessee attracted service tax under the category "clearing & forwarding agent's services". On the other hand, the assessee pleaded that service tax could be levied under the said category only when clearing and forwarding agent would have carried out both clearing and forwarding operations.

The Tribunal held that as per the facts of the case, there was no clearing activity being undertaken by the dealer. Therefore, the services rendered by him would not satisfy the requirement of clearing and forwarding agent and consequently, no service tax liability would arise. The High Court, affirming the decision taken by the Tribunal, held that since no clearing activity was directly undertaken by the agent from the manufacturer's (Principal) premises, he was not liable to pay the service tax under the category "clearing and forwarding services". Service tax is leviable under the category "clearing and forwarding" only if an agent renders both clearing and forwarding services.

The High Court further elaborated the question - whether word 'and' used after the word 'clearing' but before the word 'forwarding' in section 65(105)(j) can be considered in a conjunctive (combined) sense or disjunctive (separating) sense. It elucidated that if one person who has rendered service only as 'forwarding agent' without rendering any service as 'clearing agent' would be deemed to have rendered both services, it would amount to replacing the conjunctive 'and' by a disjunctive which is not possible. Besides, the learned counsel for the Revenue failed to bring on record any material to show the word 'and' should be construed as disjunctive. Further, Revenue had also not shown any 'trade practice' which might lead to a necessary inference that service of one kind rendered was invariably considered to comprise both. Therefore the word 'and' should be understood in a conjunctive sense.

***Note** : Students may note that in the above case, the High Court has **overruled** the decision in case of Medpro Pharma Pvt. Ltd. v. Commissioner 2006 (3) S.T.R. 355 (Tribunal-LB) [reported in Select Cases-2006]. In Medpro Pharma, the large bench of the Tribunal had held that the "clearing and forwarding operations" cannot be dissected into "clearing" and "forwarding". Both fall in the common category and any service provided in that category will attract service tax. Even if one segment of activities is not performed, the appellants can be said to be engaged in the taxable service.*

9. Whether a sales agent or independent dealer can be regarded as a clearing and forwarding agent?

Valli Inc. v. CCEx., Triuchirappali 2009 (14) S.T.R. 528 (Tri. - Chennai)

The appellant, Valli, entered into an agreement with ITC. As per the agreement, the appellant has to maintain a showroom, display the products of ITC and remit the proceeds promptly to ITC. Revenue contended that that Valli had rendered clearing and forwarding agent's service to ITC.

The Tribunal held that the appellant did not satisfy the definition of a consignment agent as clarified in the *C.B.E. & C. Circular No. 59/8/2003-S.T., dated 20-6-2003*. The Board had clarified that a consignment agent receives and dispatches goods on behalf of the principal. However, in the instant case, Valli received the goods and sold them on its own as a dealer. The appellant was not an agent of ITC, but an independent dealer in ITC's branded goods. Merely receiving the goods in order to sell them from its own premises will not amount to clearing of the goods as a clearing and forwarding agent. In the instant case, the appellants received goods from ITC and disposed them on sale from its own outlet. The appellant was not engaged in clearing and forwarding of the branded goods of ITC.

The Tribunal affirmed the contention of Revenue that three agents are normally involved when clearing and forwarding agent's service is rendered, i.e., the principal, the ultimate recipient of goods in business and the clearing and forwarding agent that forwards the goods after taking delivery to dealers. In the given case, the dealer received the goods and sold them in retail to consumers. He had Sales Tax registration and issued bills for sales. No third agency was involved.

In the light of aforesaid discussion, it held that Valli could not be regarded as a a clearing and forwarding agent.

10. Whether the services provided by colour photo laboratories are liable to pay service tax under the category "photography services"?

Colorway Photo Lab v. UOI 2009 (15) S.T.R. 17 (M.P.)

In this case, the assessee's firm was engaged in the activity of developing of exposed negatives, film processing, and printing of photographs. According to the assessee, the services rendered by a colour photo laboratory did not fall within the mischief of "photography" and/or "photography studio or agency". Hence, they were not liable to pay the service tax.

The High Court pronounced that the colour photo laboratory is an extended design of a studio. In a photography studio, the photographer shoots the photos, develops the negatives in his dark room and, thereafter prints the desired size of the photographs. The work of the colour laboratory is to receive the exposed negatives/rolls, develop the same and print the photographs of the desired size as per the orders placed by the original consumer through the photographer who had taken the photographs either in the studio or anywhere else. When the word "photography" includes still photography, motion picture photography, lazer photography, arial photography, fluorescent photography etc., then any negative used for taking photograph would come under the inclusive definition of photography. The work of the photographer is not only to shoot the person or the scene but is also to develop the negatives and bring the prints. When a part of the work is done by the photographer and part of the work is assigned to others, such person i.e colour laboratory would in fact be a "photography studio or agency".

In the light of the above discussion, the High Court concluded that the colour laboratories would be a part of the "photography studio or agency" involved in providing the service to the consumer and were amenable to the service tax.

11. Whether packaging and bottling of liquor amounts to manufacture and whether it is liable to service tax under "packaging activity services"?

Maa Sharda Wine Traders v. UOI 2009 (15) S.T.R. 3 (M.P.)

The High Court pronounced that the decision rendered in *Vindhyachal Distilleries Pvt. Ltd. v. State of M.P. 2006 (3) S.T.R. 723 (M.P.)** did not state the law correctly in as much as it had expressed the opinion that packaging and bottling of liquor were not the part of manufacturing process and hence, liable to service tax. Further, the Court upheld the view taken in *Som Distilleries and Breweries Pvt. Ltd. v. State of M.P. and Another 1997 (1) JLJ 319* and, hence, ruled that packaging and bottling of liquor comes within the ambit and sweep of "manufacture" within the meaning of clause (f) of section 2 of the Central Excise Act, 1944 in view of the definition contained in section 65(76b) of the Finance Act, 1994 as amended especially keeping in view the exclusionary facet. Hence, packaging and bottling of liquor was not liable to service tax under "packaging activity services".

**Note : Students may kindly note that the case of Vindhyachal Distilleries Pvt. Ltd. v. State of M.P. 2006 (3) S.T.R. 723 (M.P.) was reported in Select Cases-2006.*

3

SERVICE TAX PROCEDURES

1. Whether the Tribunal could reduce the penalty imposable under section 76 of the Finance Act, 1994 as amended below the minimum limit prescribed under that section?

UOI v. Aakar Advertising 2008 (11) S.T.R. 5 (Raj.)

The Rajasthan High Court held that if the assessee proves that there is reasonable cause for failure to pay service tax, the penalty shall not be imposed. However, if reasonable cause is not shown, and penalty is required to be levied, then, the minimum penalty prescribed cannot be further reduced, under the garb of any existing discretion, assumed to be vesting, with the authority, including the Tribunal. Where the two limits have been prescribed, being the minimum and maximum limit, then obviously the free play is available between the two limits only, and the discretion can be exercised, within those limits. However, that does not mean, that the authorities have any power to impose penalty less than the minimum prescribed by the section. Accordingly, the question was answered in favour of the Revenue, and against the assessee.

Note: Amount of penalty under section 76 of the Finance Act, 1994 as amended is as follows:-

(a) Minimum Penalty

(i) a penalty which shall not be less than two hundred rupees for every day during which such failure continues

or

(ii) at the rate of two per cent of such tax, per month,

whichever is higher

starting with the first day after the due date till the date of actual payment of the outstanding amount of service tax :

(b) Maximum Penalty

The total amount of the penalty payable in terms of this section shall not exceed the service tax payable.

2. Can the CENVAT credit of the service tax paid on mobile phone services in respect of mobile phones used by employees and officers be availed?

CCEx. v. Excel Crop Care Ltd. 2008 (12) S.T.R. 436 (Guj.)

The respondent - assessee availed CENVAT credit of service tax paid on mobile phone services in respect of mobile phones used by employees and officers of respondent assessee. According to the appellant, the assessee was not entitled to the credit on the ground that mobile phones are not the phones installed in the factory premises and the definition of "input service" under rule 2(l) of the CENVAT Credit Rules, 2004 would not bring such service within the scope of input service so as to be eligible for credit under rule 3 of the said rules.

The High Court ruled that there was nothing on record to indicate that the activities carried out by such staff members were not relatable to the business of manufacturing carried on by the respondent assessee. It further provided that the mobile service provider, who was liable to pay service tax, and recovered the same by adding such service tax in his bill, was the person providing taxable service and was rendering 'output service' so as to constitute 'input service' in the hands of respondent assessee. Hence, the assessee was entitled to CENVAT credit of the service tax paid on mobile phone services in respect of mobile phones used by employees and officers.

3. Whether the assessee is entitled to the credit of the service tax paid on the freight up to the door steps of the customer i.e. the destination point?

Ambuja Cements Ltd. v. UOI 2009 (14) S.T.R. 3 (P & H)

The assessee was engaged in the business of manufacturing and selling of cement and had been duly paying the excise duty in respect of cement produced by it. The assessee claimed that it supplied cement to its customers "FOR destination" and bore the freight up to the door steps of the customer i.e. the destination point. The assessee had taken the CENVAT credit of the service tax paid on the aforementioned freight by it.

The Department contended that the payment of service tax on the freight incurred by the assessee was not input service as per rule 2(l) of the CENVAT Credit Rules, 2004 and hence the CENVAT credit was not admissible on it under the said rules.

The High Court observed that the 'input service' has been defined under rule 2(l) to mean any service used by the manufacturer whether directly or indirectly and also includes, *inter alia,* services used in relation to inward transportation of inputs or export goods and outward transportation up to the place of removal.

Further, the Board's *Circular No. 97/6/2007 (sic) 97/8/2007-ST, dated 23-8-2007* contemplates compliance of certain conditions where the sale has taken place at the destination point. These conditions are as follows:-

(i) the ownership of goods and the property in the goods remained with the seller of the goods till the delivery of the goods in acceptable condition to the purchaser at his door step;

(ii) the seller bore the risk of loss of or damage to the goods during transit to the destination; and

(iii) the freight charges were an integral part of the price of goods.

The circular provides that if aforesaid conditions are satisfied, the credit of the service tax paid on the transportation up to such place of sale would be admissible.

The first requirement was fulfilled because:-

(i) the supply of cement by appellant to its customer was 'FOR destination',

(ii) the freight up to the door step of the customer was borne by the appellant, and

(iii) the service tax on the freight charges was paid by the appellant.

Moreover, for transportation purposes insurance cover has also been taken by the appellant which further shows that the ownership of the goods and the property in the goods has not been transferred to the seller till the delivery of the goods in acceptable condition to the purchaser at his door step. Accordingly, the second condition also stood fulfilled.

Since, the delivery of the goods is "FOR destination' price, the third condition that the freight charges were integral part of the excisable goods also stood fulfilled.

In view of above discussion, the High Court opined that the questions of law deserved to be answered in favour of the assessee-appellant and against the Revenue. Hence, it held that the assessee was entitled to the credit of the service tax paid on the freight up to the door steps of the customer.

4. Whether the services availed by a manufacturer for outward transportation of final products from the place of removal up to the customer's premises should be treated as an 'input service'?

ABB Ltd. v. CCEx. 2009 (15) S.T.R. 23 (Tri. - LB)

In the instant case, Revenue contended that in the inclusive clause of the definition of "input service" under rule 2(l) of the CENVAT Credit Rules, 2004, it is specifically mentioned that only outward transportation up to the place of removal shall be included. Therefore, credit for outward transportation from the place of removal to the customer's place should not be allowed with reference to any other limb or category of the definition of input service which is general in nature. However, the large Bench of the Tribunal rejected the contention of the Revenue.

The Tribunal held that each of the limbs of the definition of "input services" is an independent benefit/concession. If an assessee can satisfy any one of the above, then credit on input service would be admissible even if the assessee does not satisfy the

other limbs. The expression “activities relating to business” admittedly covers transportation upto the customers place and, therefore, credit cannot be denied by relying on specific coverage of outward transportation upto the place of removal in the inclusive clause.

Revenue further alleged that since the cost of outward transportation did not form part of the transaction value of the manufactured goods, any service tax paid for the outward transportation of goods from place of removal could not be allowed as credit to the manufacturer. In this regard the Tribunal clarified that for admissibility of credit for outward transportation, there is no requirement that the cost of freight should enter into the transaction value of the manufactured goods. The two issues, namely, ‘valuation’ and ‘CENVAT credit’ are independent of each other and have no relevance to each other.

Hence, it inferred that the services availed by a manufacturer for outward transportation of final products from the place of removal should be treated as an input service and thereby enabling the manufacturer to take credit of the service tax paid on the value of such services.