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Case Laws

Commissioner of Income Tax, Chennai -IV
v.
M/s. Gem Granites

ITA Nos. 2787 & 2788/M/2012 (Assessment Year : 2006-07)

Chironjilal Sharma HUF
v.
Union of India and Others

ITA No. 305/Mds/2013 (Assessment Year: 2009-10)

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"Anticipated losses" – Mother of all Controversies

by
Dindayal Dhandaria, CA

In this article, the author describes the practice of provisioning for anticipated losses as the 'Mother of all controversies'. An exception is made to the 'Matching Principle' which is one of the fundamental concepts of accrual basis of accounting. Notwithstanding that such accounting practice is followed customarily, is mandated by Accounting Standards and has judicial approval, the Revenue Authorities continue to hold the view that it deprives them of the taxes legitimately due. In the past, legislative amendments have been made to further the cause of the Revenue. Recently, the Taxation Authorities have, instead of making legislative amendments, resorted to novel method of issuing Tax Accounting Standards meant for computation of taxable income and not for maintenance of books of account. The author opines that such Standards cannot be issued under section 145(2) of the Act.

Introduction

1. "Matching Principle" is one of the fundamental concepts of accrual basis of accounting that offsets revenue against expenses on the basis of their cause-and-effect relationship. It states that, in measuring net income for an accounting period, the costs incurred in that period should be matched against the revenue generated in the same period. To this matching principle, an exception is made by providing for anticipated losses. This exception to the rule is justified on the grounds of prudence and is practised since long with the express approval of the judiciary. But Taxation Authorities feel that such accounting treatments make it possible for an assessee to avoid the payment of correct taxes. So, a controversy arises between the taxpayers and the tax authorities.

The earliest instance of controversy over recognition of anticipated losses is found in the matter of valuation of unsold stocks of a trader. Stocks are valued at cost or market rate, whichever is lower. In case of construction contracts spread over a number of years, foreseeable losses are considered while valuing the work-in-progress. In case of foreign exchange transactions where liabilities are settled in instalments spread over a number of years, the losses anticipated to arise due to fluctuation in the rate of foreign exchange are being accounted for in books. Liabilities for bonus, gratuity, leave encashment, etc., which are due for settlement under various statutory enactments are contingent upon certain conditions in future. But, provisions are considered necessary for such known liabilities. Provisions are also made for warranties and claims that may arise in future, due to contractual obligations. All these issues have resulted into controversies.

The list of controversial issues cited above is not exhaustive one. But the underlying reason behind all the controversies is provisioning for anticipated losses. This controversy persists since a very long time in spite of customary practice, judicial pronouncements and the accounting standards and so, there is no hesitation in describing it as the "Mother of all controversies".

Hereinafter, the historical perspective, role of provisioning for anticipated losses in giving rise to various controversies, accounting practices/standards, measures taken by the Revenue to resolve the various controversies are discussed in details.

Valuation of unsold stocks

2. As long back as 85 years and almost coinciding with the enactment of the Indian Income-tax Act, 1922, a Court was called upon to rule upon the question of valuation of closing stock of a trader at cost or market rate, whichever was lower.

It was observed by one of the learned Judges in *Whimster & Co.* v. *Commissioners of Inland Revenue* [1926] 12 Tax Cas. 813, 837 as follows:–

> "Under this law (Revenue law) the profits are the profits realised in the course of the year. What seems an exception is recognised where a trader purchased and still holds goods or stocks which have fallen in value. No loss has been realised. Loss may not occur. Nevertheless, at the close of the year he is permitted to treat these goods or stocks as of their market value".

Prior to this, it was pointed out in paragraph 8 of the Report of the Committee on Financial Risks attaching to the holding of Trading Stocks, 1919, as follows:

> "As the entry for stock which appears in a trading account is merely intended to cancel the charge for the goods purchased which have not been sold, it should necessarily represent the cost of the goods. If it is more or less than the cost, then the effect is to state the profit on the goods which actually have been sold at the incorrect figure. .... From this rigid doctrine one exception is very generally recognised on prudential grounds and is now fully sanctioned by custom, *viz.*, the adoption of market value at the date of making up accounts, if that value is less than cost. It is of course an anticipation of the loss that may be made on those goods in the following year, and may even have the effect, if prices rise again, of attributing to the following year's results a greater amount of profit than the difference between the actual sale price and the actual cost price of the goods in question."

The aforesaid report is extracted in paragraph 281 of the Report of the Committee on the Taxation of Trading Profits presented to the British

Parliament in April 1951 and quoted by the Supreme Court in the case of *Chainrup Sampatram* v. *CIT* [1953] 24 ITR 481. On October 9, 1953, in *Chainrup Sampatram* (*supra*), the Hon'ble Supreme Court explained the purpose of the valuation of unsold stock as follows:

> "The true purpose of crediting the value of unsold stock is to balance the cost of those goods entered on the other side of the account at the time of their purchase, so that the cancelling out of the entries relating to the same stock from both sides of the account would leave only the transactions on which there have been actual sales in the course of the year showing the profit or loss actually realised on the year's trading. As pointed out in paragraph 8 of the Report of the Committee on Financial Risks attaching to the holding of Trading Stocks, 1919, "As the entry for stock which appears in a trading account is merely intended to cancel the charge for the goods purchased which have not been sold, it should necessarily represent the cost of the goods. If it is more or less than the cost, then the effect is to state the profit on the goods which actually have been sold at the incorrect figure .... From this rigid doctrine one exception is very generally recognised on prudential grounds and is now fully sanctioned by custom, *viz.*, the adoption of market value at the date of making up accounts, if that value is less than cost. It is of course an anticipation of the loss that may be made on those goods in the following year, and may even have the effect, if prices rise again, of attributing to the following year's results a greater amount of profit than the difference between the actual sale price and the actual cost price of the goods in question" (extracted in paragraph 281 of the Report of the Committee on the Taxation of Trading Profits presented to British Parliament in April 1951). While anticipated loss is thus taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into the account, as no prudent trader would care to show increased profit before its actual realisation. This is the theory underlying the rule that the closing stock is to be valued at cost or market price, whichever is the lower, and it is now generally accepted as an established rule of commercial practice and accountancy. As profits for income-tax purposes are to be computed in conformity with the ordinary principles of commercial accounting, unless of course, such principles have been superseded or modified by legislative enactments unrealised profits in the shape of appreciated value of goods remaining unsold at the end of an accounting year and carried over to the following year's account in a business that is continuing are not brought into the charge as a matter of practice, though, as already stated, loss due to a fall in price

> below cost is allowed even if such loss has not been actually realised."

The Madras High Court also had an occasion as early as 1925 to rule upon this controversy in the case of *CIT* v. *Chengalvaraya Chetti* [1925] ILR 48 Mad. 836. In this case, an illustration of the rule in its practical working has been given.

The statement of the concept of 'accrual' as explained by the Supreme Court in *E.D. Sasoon & Co. Ltd.* v. *CIT* [1954] 26 ITR 27, has held good till date. Therefore, it follows that while computing business income chargeable to tax under section 28, the Mercantile System of Accounting has to be followed and provision for anticipated losses and foreseeable liabilities will have to be taken into account. Section 145 also acknowledges the need to follow accounting standards. These may be prescribed by the Central Government. The accounting standards prescribed by the ICAI are also required to be followed by the assessees. This has received recognition in several decisions of the High Courts and the Supreme Court. [Para 11]

Thus, the practice of provisioning for anticipated losses as a prudent measure was accepted, both by custom and the judicial pronouncements on the subject, even before the Accounting Standards entered the field of accountancy.

Accounting standards adopt time-honoured practice

3. It would be evident from the following noting that Accounting Standards have adopted the practice evolved over a time.

The Institute of Chartered Accountants of India, recognising the need for setting high quality of Accounting Standards in the country, established Accounting Standards Board in 1977. This Board issued Accounting Standard (AS) 1, Disclosure of Accounting Policies in 1979. The issues considered by the Board in the selection of the Accounting Policies can be found in paragraphs 16 and 17 thereof which are reproduced as under:

> "16. The primary consideration in the selection of accounting policies by an enterprise is that the financial statements prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the enterprise at the balance sheet date and of the profit or loss for the period ended on that date.
>
> 17. For this purpose, the major considerations governing the selection and application of accounting policies are:–
>
> a. *rudence* – In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.
>
> b. *Substance over form*

c. *Materiality*

The Accounting Standards Board of the ICAI in June 1981 issued - Accounting Standard (AS) 2, Valuation of Inventories which was revised in 1999. Para 20 of this Standard prescribes as follows:

> "The practice of writing down inventories below cost to net realisable value is consistent with the view that assets should not be carried in excess of the amounts expected to be realised from their sale or use."

Various Accounting Standards prescribed under IND AS & IFRS are no exception and contain provisions similar to Accounting Standards issued by the ICAI.

CBDT accepts provisioning for known liabilities and losses on grounds of prudence

4. In exercise of the powers conferred by sub-section (2) of section 145 of the Income-tax Act, 1961 (43 of 1961), the Central Government notified accounting standards *vide* Notification No. 9949 [F. No. 132/7/95-TPL] dated 25-1-1996 to be followed by all assessees following mercantile system of accounting, namely:

> "4. Accounting policies adopted by an assessee should be such so as to represent a true and fair view of the state of affairs of the business, profession or vocation in the financial statements prepared and presented on the basis of such accounting policies. For this purpose, the major considerations governing the selection and application of accounting policies are following, namely .
>
> (i) *Prudence* – Provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information;
>
> (ii) *Substance over form*
>
> (iii) *Materiality*

Thus, there is no difference between Accounting Standard (AS) 1 issued by ICAI and the Accounting Standard notified by CBDT on the issue that Provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information. But the Taxation Authorities are not willing to concede the ground and controversies persist as illustrated herein below.

5. Controversies

5.1 ***Controversy relating to provision for foreseeable losses in construction contracts*** – The accounting practice of valuing unsold stocks at cost or net realisable value (market value) which is lower is widely accepted now. But when the same theory of prudence was applied to other anticipated losses in case of investments forming part of closing stock-in-trade, work-in-progress under construction contracts, fluctuations in foreign exchange transactions and other matters, litigations surfaced and persist till date.

In 1983, the Accounting Standards Board of the ICAI issued Accounting Standard (AS) 7, Accounting for Construction Contracts. Para 19 of the Standard stipulates as follows:

> "19. A foreseeable loss on the entire contract should be provided for in the financial statements irrespective of the amount of work done and the method of accounting followed."

When the assessees started adopting the accounting practice envisaged in the above Accounting Standard (AS) 7, the tax authorities rejected the same. Following few cases are stated as examples.

In a case before The ITAT Mumbai Bench 'A' in *Mazagon Dock Ltd.* v. *Jt. CIT* [2009] 29 SOT 356 decided on February 18, 2009, the issue was whether as far as change in method of valuation of work-in-progress was concerned, in view of mandatory requirements of AS-7, it was a *bona fide* change, particularly in view of qualification made in this regard by statutory auditors as well as by the Comptroller & Auditor General of India. It was held as follows:

"The question that came up for consideration was as to whether the anticipated loss on the valuation of fixed price contract, in view of the mandatory requirements of the AS-7, was to be allowed in the year in which the contract had been entered into or it was to be spread over a period of contract, as was done by the assessee in earlier years. As far as the change in the method of valuation of work-in-progress was concerned, it could not be disputed that in view of mandatory requirements of the AS-7, it was a *bona fide* change in the method of valuation of work-in-progress, particularly in view of the qualification made in this regard by statutory auditors as well as by the Comptroller & Auditor General of India. Therefore, the observation of the Commissioner (Appeals) that the assessee had booked bogus loss was not correct. As far as the basis of estimation was concerned, the same was done on technical estimation basis and, therefore, merely because there were some variations in the figures furnished by the assessee at different stages, it could not be said that the estimated loss was not allowable. It was not disputed that the department in earlier years had allowed the loss on estimated basis having regard to the expenditure actually incurred in various years. Therefore, in principle, it was not disputed that the estimated loss under the present circumstances was an allowable deduction. However, merely because the change in method of accounting was *bona fide*, it could not lead to the inference that the income was also deducible properly under the Act. This aspect is very evident from the first proviso to section 145 as it stood prior to the

> amendment by the Finance Act, 1995 with effect from 1-4-1997. It could not be disputed that from the method adopted by the assessee, the assessee's income could not be deduced properly in the year in which the loss had been anticipated. As a matter of fact this aspect was not disputed by the Assessing Officer also. He had been swayed more by the revenue loss than by the correct principle to be applied. The matching principle of accounting was not of much significance in the present context because if the loss had been properly estimated in the year in which the contract had been entered into, then it had to be allowed in that very year and could not be spread over the period of contract. The matching principle is of relevance where income and expenditure, both are to be considered together. However, in the instant case, the effect of valuation of WIP would automatically affect the profits of subsequent years accordingly. Therefore, there was no reason for not accepting in principle the assessee's claim as being allowable."

On May 26, 2009, the ITAT Mumbai Bench 'J' in the case of *Jacobs Engineering India (P.) Ltd.* v. *Asstt. CIT* [2011] 14 taxmann.com 186, held as follows:

> "Having regard to the above legal and factual discussions, and following the decision of the ITAT in the case of *Mazagon Dock Ltd.* (*supra*) and *Metal Box Co. of India Ltd.* (*supra*) and decision of the Hon'ble Delhi High Court in the case of *Woodward Governor India (P.) Ltd.* (*supra*) the contention of the assessee regarding allowability of foreseeable loss is accepted in principle. However, the issue is restored to the file of Assessing Officer, for the purpose of quantification and calculation of the said loss in terms of Accounting Standard - 7, as the same has not been done."

It is clear from above that the underlying reasons of controversy are the provisioning for anticipated losses. As the taxation authorities are not yet comfortable with the requirement of provisioning for anticipated losses, the CBDT has issued exposure draft of "Tax Accounting Standards on Construction Contracts" laying down rules for computation of taxable income.

5.2 *Controversy regarding anticipated losses in transactions involving foreign exchange* - The issue before the Delhi High Court in the case of *CIT* v. *Woodward Governor India (P.) Ltd.* [2007] 162 Taxman 60, was whether in cases where foreign currency is held on revenue account, increase in liability on account of fluctuation in rate of foreign exchange prevailing on last day of financial year is not notional or contingent and, therefore, can be allowed as a deduction in terms of section 37(1)? The Court ruled in favour of the assessee.

Similarly, the issue before the Supreme Court in the case of *Oil & Natural Gas Corpn. Ltd.* v. *CIT* [2010] 189 Taxman 292, was whether when assessee maintained its accounts on mercantile system of accounting, there was no finding by the Assessing Officer on correctness or completeness of account and assessee had complied with Accounting Standards laid down by the Central Government, 'loss' suffered by the assessee on account of fluctuation in rate of foreign exchange as on date of balance sheet could be allowed as an expenditure under section 37(1), notwithstanding fact that liability had not been actually discharged in year in which fluctuation in rate of foreign exchange had occurred? The Court ruled in favour of the assessee.

In *CIT* v. *International Creative Foods (P.) Ltd.* [2011] 9 taxmann.com 191 (Ker.), the Assessing Officer disallowed the assessee's claim for deduction of exchange rate fluctuation on outstanding loan on ground that loan remained outstanding and exchange rate fluctuation was not actual liability but was only a provision which could not be allowed. On appeal, first appellate authority as well as the Tribunal allowed the assessee's claim by following Accounting Standard (AS) II issued by the Institute of Chartered Accountants of India. The issue before the Kerala High Court was whether since there was nothing to indicate in orders of any of the authorities below as to when the assessee availed loan and whether the assessee was claiming deduction for every year whenever exchange rate fluctuation was adverse to it, matter required reconsideration and if it was found that the assessee-company had followed uniform practice of debiting and crediting profit and loss account with variation in exchange rate fluctuation, then deduction should be allowed in the assessment year in question also if exchange rate fluctuation had caused increase in rupee liability of loan account. The Court ruled in favour of the assessee.

From a perusal of all the three cases cited above and also from many other cases on this issue, the controversy related to provision for anticipated losses is clear.

To nullify the impact of the above judgments, the provisions of section 43A of the Income-tax Act, 1961 were amended.

5.3 *Controversy relating to provision for dimunition in value of investments* - Para 31 of the Accounting Standard (AS) 13, Accounting for Investments, stipulates as under:

> "31. Investments classified as current investments should be carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on overall (or global) basis."

The recognition of lower of cost and fair value amounts to provisioning for anticipated losses. This accounting treatment is frowned upon by the taxation authorities. So, *vide* the Finance (No. 2) Act, 2009 these sections were amended *inter alia* to provide that any provision for diminution in the value of assets shall not be allowed while computing book profit under section 115JA and 115JB. These amendments have been made with retrospective effect from the date and the period during which respective section was/is in force.

5.4 *Controversy relating to provision for warranty claims* – In *Rotork Controls India (P.) Ltd.* v. *CIT* [2009] 180 Taxman 422 (SC), the assessee-company was manufacturing and selling valve actuators in large numbers. At the time of sale it provided a standard warranty, whereby in the event of any actuator or part thereof becoming defective within 12 months from the date of commissioning or 18 months from the date of dispatch, whichever was earlier, it undertook to rectify or replace the defective part free of charge. For the relevant assessment years, the assessee made a provision for warranty on account of warranty claims likely to arise on the sales effected by it and to cover up that expenditure. Since the provision exceeded the actual expenditure, it reversed the excess amount and claimed deduction in respect of the net provision under section 37(1). The Assessing Officer declined deduction holding that the liability was merely a contingent liability.

The issue before the Supreme Court was whether for a provision to qualify for recognition, there must be a present obligation arising from the past events, settlement of which is expected to result in an outflow of resources and in respect of which a reliable estimate of amount of obligation is possible. The Court ruled in favour of the assessee holding that if historical trend indicates that in the past large number of sophisticated goods were being manufactured and defects existed in some of the items manufactured and sold, then provision made for warranty in respect of such sophisticated goods would be entitled to deduction from gross receipts under section 37(1), provided data is systematically maintained by the assessee.

In this case also, the underlying reason behind the controversy can be traced to provision for anticipated losses.

5.5 *Controversy relating to provision for gratuity* – Gratuity is payable under the Payment of Gratuity Act. When the assessees provided for this liability in their books of account, the taxation authorities objected to it being contingent in nature.

In the case of *Metal Box Co. of India Ltd.* v. *Their Workmen* [1969] 73 ITR 53 (SC), the Supreme Court had an occasion to resolve the controversy. The Supreme Court held as follows:

> "Contingent liabilities discounted and valued as necessary can be taken into account as trading expenses if they are sufficiently certain to be capable of valuation and if profits cannot be properly estimated without taking them into consideration. An estimated liability under a scheme of gratuity, if properly ascertainable and its present value discounted, is deductible from the gross receipts while preparing the profit and loss account. This is recognised in trade circles and there is nothing in the Bonus Act which prohibits such a practice. Such a provision provides for a known liability of which the amount can

> be determined with substantial accuracy. It cannot be termed as a "reserve". Therefore, the estimated liability for the year on account of a scheme of gratuity should be allowed to be deducted from the gross profits. The allowance is not restricted to the actual payment of gratuity during the year."

The taxation authorities were not willing to concede the ground easily. The Finance Act, 1975 inserted the provisions of section 40A(7) with retrospective effect from April 1, 1973. It provided that no deduction is to be allowed, in the computation of the profits and gains of business or profession, in respect of any provision made for payment of gratuity to the employees on retirement or on termination of employment. However, this provision was subject to some exceptions. It did not apply to any provision made for the purpose of payment of a sum by way of contribution towards an approved gratuity fund that has become payable during the year, or for the purpose of meeting actual liability that has arisen during the year.

Even a provision made for contribution to a recognised provident fund was subjected to stricter conditions. The Finance Act, 1983 inserted section 43B with effect from April 1, 1984 providing that such provision would be allowed in the year when actual payment is made.

On December 4, 1989, the High Court of Calcutta in the case of *CIT* v. *Metal Box India Ltd.* [1992] 63 Taxman 160 held that claim for liability towards gratuity calculated on basis of actuarial valuation is allowable.

In 1995, the ICAI issued Accounting Standard (AS) 15, Accounting for Retirement Benefits in the Financial Statements of Enterprises.

Thus, the underlying reasons for the persisting controversy are traceable to provisioning for anticipated losses.

5.6 ***Controversy relating to provision for leave encashment*** – In *Bharat Earth Movers* v. *CIT* [2000] 112 Taxman 61 (SC), the issue was, if a business liability has definitely arisen in an accounting year, whether deduction should be allowed, although liability may have to be quantified and discharged at a future date but what should be definite is incurring of liability? The Supreme Court held 'Yes'. Provision was made by the assessee-company for meeting liability towards leave encashment proportionate to entitlement earned by the employees of company subject to ceiling on accumulation, as applicable on the relevant date. Whether assessee would be entitled to deduction of such provision out of gross receipts for accounting year during which provision was made for liability inasmuch as liability was not a contingent liability? Again, the supreme Court held 'Yes'.

As the taxation authorities were not willing to concede, they amended section 43B of the Income-tax Act, 1961. The Finance Act, 2001 inserted clause (*f*) with effect from April 1, 2002 providing that any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee shall be allowed in that previous year in which such sum is actually paid.

This amendment has been struck down by the Calcutta High Court in the case of *Exide Industries Ltd.* v. *Union of India* [2007] 164 Taxman 9, being arbitrary, unconscionable and *de hors* the Apex Court's decision in the case of *Bharat Earth Movers* (*supra*).

Against the judgment in *Exide Industries Ltd.'s* case *(supra),* the I-T Department filed a special leave petition in the Supreme Court which stayed the judgment.

Beginning of new innings of controversies

6. From the above write-up, it is clear that the taxation authorities have always been reluctant to accept the provisioning for anticipated losses. It is immaterial for them whether the Accounting Standards permit such accounting treatment and/or whether such Standards are issued under the authority of the ICAI or the Ministry of Corporate Affairs or by international bodies. In the event of adverse judicial pronouncements, they have frequently resorted to legislative changes.

Recently (*i.e.,* on October 17, 2011), in exercise of powers conferred under section 145 of the Income-tax Act, the CBDT has issued two Tax Accounting Standards - one relating to construction contracts and another relating to the Governmental Grants. It proposes to issue more such Standards. These Standards are meant to apply for computation of income chargeable under certain heads and not for the purpose of maintenance of books of account. The Tax Accounting Standard on construction contracts does not stipulate that expected losses should be recognised as an expense immediately. In this way, this Standard makes a provision which is contrary to that of Accounting Standard (AS) 7 issued by the ICAI.

By notifying Tax Accounting Standards (TAS) for the purpose of computation of income and not for maintenance of books of account, the CBDT has made paradigm shift in the way the income of an assessee would be computed in future.

Tax accounting standards unlikely to achieve purpose for which they are being issued

7. Section 145 of the Income-tax Act, 1961 is a part of Chapter XIV - Procedure for assessment. It reads as under:

> "145. *Method of accounting.* —(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.
>
> (2) The Central Government may notify in the Official Gazette from time-to-time accounting standards to be followed by any class of assessees or in respect of any class of income.

> (3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or accounting standards as notified under sub-section (2), have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144."

From a reading of the above provisions, it may be noted that sub-section (2) of the above section authorises the Central Government to notify Accounting Standards to be followed by any class of assessees or in respect of any class of income. This sub-section does not expressly specify the purpose for which such accounting standards can be notified. So, the question, whether a Standard can be notified by virtue of these powers for maintenance of accounts or for computation of taxable income or for both would have to be decided, keeping in view the scheme of the Act. If the heading of the section is taken as the guiding factor, then a notification under this section would necessarily have to be one prescribing maintenance of accounts and not for computation of taxable income.

Apart from above, sub-section (3) lays down the consequences of not following the same. Sub-section (3) is attracted under any of the following three circumstances:

(a) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee; or

(b) Where the method of accounting provided in sub-section (1) has not been regularly followed by the assessee; or

(c) Where accounting standards as notified under sub-section (2), have not been regularly followed by the assessee.

Not conceding, but assuming that an assessee maintains his accounts in accordance with the mandatory Accounting Standards issued by the ICAI and other authorised bodies but does not compute his taxable income in accordance with the Tax Accounting Standards. The Assessing Officer is satisfied about the correctness or completeness of his accounts. In this example, let us assume that an assessee fulfils the first two conditions envisaged in sub-section (3) of section 145 but does not satisfy the third condition. The three conditions are not cumulative. So, can it be argued that the third condition will have an overriding effect over the other two conditions and for non-compliance with the same, the consequences stipulated in sub-section (3) would follow. It is doubtful that the provisions of sub-section (3) would be attracted in such a situation.

It would be too early to say that notifications issued under section 145 of the Income-tax Act would receive judicial approval or not. But the following observations are equally noteworthy:

- irstly, inasmuch as the earlier Accounting Standard notified under section 145(2) of the Act under Notification No. 9949 -

F.N. 132/7/95-TPL, dated 25-1-1996 recognises 'Prudence' as a measure consideration governing the selection and application of accounting policies and TAS does away with this aspect, the two Standards are contradictory to each other - although both the Standards are notified by the same authority, *i.e.*, the CBDT.

♦ Secondly, the following observations in the judgment of the Gauhati High Court in the case of *MKB (Asia) (P.) Ltd.* v. *CIT* [2008] 167 Taxman 256 , deserve attention. [The Standard was adopted by the assessee on the advice of the author before it became mandatory]. In this case the Court held:

"The accounting system as contemplated in AS-7 is an approved system of accounting by the Institute of Chartered Accountants of India. As such, the authenticity of the said accounting system was not under challenge. The assessee was maintaining its accounts following the said system and the accounts were duly audited by a qualified chartered accountant. Maintenance of the accounts as well as the valuation of work-in-progress would not prejudice either side. Admittedly, the particular works contract was not completed and it came under the category of work-in-progress. There was also no dispute that the ultimate liability of the assessee as regards tax will be dependant upon the total (fixed) amount received by the assessee against the particular works contract. [Para 12]

The income-tax authority has no option/jurisdiction to meddle in the matter either by directing the assessee to maintain its accounts in a particular manner or adopt a different method for valuing the work-in-progress. An assessee has the option/liberty to adopt any recognized method of accounting for its business and the income should be computed in accordance with such regularly maintained accounting system. [Para 13]

Thus, the Tribunal was not right in not accepting the valuation of closing work-in-progress in accordance with Accounting Standard-7."

♦ Thirdly, one must take note of the strictures passed by the Calcutta High Court in the case of *Exide Industries Ltd.* (*supra*), while striking down the provisions of section 43B(*f*) of the Income-tax Act as being arbitrary, unconscionable and *de hors* Apex Court's decision in the case of *Bharat Earth Movers* (*supra*), as follows:

"Such enactment is not consistent with the original provision being section 43B, which was originally inserted to plug in evasion of statutory liability. The Apex Court considered the situation in *Bharat Earth Movers* v. *CIT* [2000] 245 ITR 428/ 112 Taxman 61 when clause (*f*) was not there. The Apex Court, considering all aspects, rejected the contention of the revenue and granted appropriate deduction to the concerned assessee. The Legislature, to get rid of the decision of the Apex Court, brought about the amendment which would otherwise nullify the Judge-made law. The Apex Court's decisions are Judge-made law and are applicable to all under the Constitution. The Legislature was entitled to bring such amendment; it was within its power to bring such amendment. However, it must disclose reasons which would be consistent with the provisions of the Constitution and the laws of the land and not for the sole object of nullifying the Apex Court's decision." [Para 13]

Conclusion

8. As long as the taxation authorities hold the view that provision for anticipated losses and accounting deprives them of the taxes legitimately due, they would reject the accounting practices, notwithstanding the fact that such practices are *bona fide* , justified or are adopted by a taxpayer under a mandatory Accounting Standard issued by the designated Accounting Standards Boards or under the provisions of other enactments, *e.g.* , the Companies Act, 1956, etc. It has been demonstrated herein above that in the event of judicial approval of the accounting practice of providing for anticipated losses under various circumstances, the Legislature has invariably resorted to legislative amendments to achieve its aim. The latest measures to issue Tax Accounting Standards meant for computation of taxable income are prone to give rise to new controversies. In *MKB (Asia) (P.) Ltd.'s* case (*supra*), the Court had ruled that "The income-tax authority has no option/jurisdiction to meddle in the matter either by directing the assessee to maintain its accounts in a particular manner or to adopt a different method for valuing the work- in-progress". In *Exide Industries Ltd.'s* case (*supra*), the Court was concerned with a legislative enactment passed by the Parliament and had no hesitation in striking off the same being arbitrary, unconscionable and *de hors* a judge-made law. As the Tax Accounting Standards are notified under the provisions of section 145(2) of the Act, the same cannot be equated with a legislative enactment passed by the Parliament and it remains to be seen if they meet judicial approval.

Power of CBDT Under Section 119(2)(b)

by
Shobhit Koshta

Introduction

1. The Income-tax Act, 1961 (herein after referred to as the "Act") contains various provisions which are mandatory in nature and some of them attain mandatory nature after passing of certain time-limit or orders. However, on principles of natural justice, relief should be available to an assessee on grounds of reasonableness, genuine hardships and exigencies beyond the control of the assessee.

Therefore, the Central Board of Direct Taxes (CBDT), which is the highest administrative authority for direct taxes, is empowered by the Act u/s. 119(2)(b) to issue general or special order, authorising any income-tax authority, not being the first appellate authority, to admit an application or claim for any exemption, deduction, refund or any other relief under the Income-tax Act after the expiry of the period specified by or under the Act for making such application or claim and deal with the same on merits in accordance with law.[1]

This article deals with the nature of the power, scope of the power conferred on CBDT, relevant circulars, along with restriction and limitations as per Instructions.

2. Scope of the power of CBDT

2.1 Orders issued by the Board:–

Section 119 is broad enough to cover or authorise any relief "in any case or class of classes" by a general or special order.[2] In terms of section 119(2)(b), the Board has powers to make orders for avoiding genuine hardship and authorise certain income-tax authorities to admit an application or claim for any exemption, deduction, refund or any other relief after the expiry of the specified time-limit for making such application or claim.

2.2 ***Class or classes of persons***– The term "any case or class of cases" used in section 119(2)(*b*) of the Act does not imply that the order under section 119(2)(*b*) of the Act can be exercised only in a class of cases; the power can be exercised even in an individual case. The Karnataka High Court's judgment in *Union Home Products Limited* v. *Union of India*[3] has doubted whether the powers that are exercised by the Board u/s 119(2)(*a*) would apply to the individual cases the though there is no such doubt when it comes to exercising it u/s 119(2)(*b*). Section 119(2)(*b*) envisages orders by the Board in any case or class of cases for the purpose of avoiding genuine hardship, which means that the Board can exercise this power u/s 119(2)(*b*) in regard to any class of cases in general or any "individual case" in particular.[4]

2.3 ***Whether requirement of a separate application is there?***– A claim raised by an assessee in a return for carry forward of losses or for "any other relief" cannot be rejected merely on the ground that the same was made only in a return and not by a separate application.[5] Thus, the

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[1] Section 119(2)(b) of the Income-tax Act, 1961.

[2] SAMPATH IYEGNAR, LAW OF INCOME TAX 8769 (11th ed. 2012).

[3] [1995] 215 ITR 758 /84 Taxman 303.

[4] Tuticorin Vegetable Marketing Co. (P.) Ltd. v. ITO [2000] 243 ITR 202 (Mad.), [2002] 123 Taxman 116(Mad).

[5] Associate Electro Ceramics v. Chairman, CBDT , [1993] 201 ITR 501 (Kar.).

Board has the power to condone the delay in cases having claims of carry forward of losses in a return and there is no requirement of a separate application.[1]

2.4 *Condonation of the delay*– In the case of *Jaswant Singh Bambha v. CBDT* [2005] 272 ITR 1 (Punj. & Har.)/142 Taxman 528 (Punj. & Har.) (FB)[2]; the Punjab & Haryana High Court held that the Central Board of Direct Taxes has power to condone delay in filing application for refund. There is a similar power of condonation of the delay u/s 5 of the Limitation Act, 1963, where there is sufficient cause of delay. Section 237 of the Income-tax Act has not expressly excluded application of section 5 of the Limitation Act. So, there is nothing abnormal about the power of the Board to admit a delayed application for avoiding genuine hardship.[3] However, the same Court in *Niranjan Dass v. CBDT*, [2004] 266 ITR 489/ 135 Taxman 422 (Punj. & Har.)[4] took a contrary view which says that belated refund claim cannot be enterained and section 239 is not amenable to relaxation by the Board through instruction u/s 119 but this decision is not in consonance with the plain language of section 119 of the Act. Thus, the mandatory limitation provisions of section 239 are amenable to relaxation by the CBDT under section 119(2)(b), as section 239 has not expressly excluded the application of section 5 of the Limitation Act.[5]

Subsequently, the Court held that even for return u/s 148 claiming refund[6], revised return filed under section 139[7] beyond the time-limit, an application lies to the CBDT. Therefore, the power of the board for granting relief is available against the limitation prescribed in all other sections of the Act, until and unless it is expressly excluded by the provision of the Act.

A Cases to be dealt with as per its merits

3. Section 119(2)(*b*) of the Act empowers the board to grant relief to the assessee if it is satisfied that any claim or an application on merits, which was required to be made within the prescribed time, was not done so for good reasons and to relieve the assessee from hardship. When an application u/s 119 is considered by the Board, the Board is not required to write an order recording reasons but should pass a *speaking order*.[8] It is well-settled that in matters of condonation of the delay a highly pedantic approach should be eschewed and a justice oriented approach

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[1] CBDT Circular No. 8 of 2001 dated 16.05.2001.

[2] [2005] 272 ITR 1 (P&H).

[3] Supra Note, 4 at 8773.

[4] [2004] 266 ITR 489 (P&H).

[5] Dy. CIT v. Gopal Krishan Builders , [2004] 91 ITD 124 (Luck.). (SMC)

[6] Kakumanu Rao v. CCIT , [1998] 234 ITR 444 (AP).

[7] CIT v. Infosys Technology Ltd., [2008] 297 ITR 167 / 166 Taxman 204 (SC).

[8] Supra, Note 4 at 8767.

should be adopted. A party should not be made to suffer on account of technicalities.[1]

In the case of *John Shalex Paints Pvt. Ltd.* v. *CBDT* [1993] 201 ITR 523 (Kar.)[2] the Court held that where an oral hearing was given to the assessee and written arguments were also permitted to be filed, it was held that the Board had applied its mind to the merits of the case. It is, thus, submitted that it is mandatory on the part of the Board to consider the merits of the case before any application is rejected or accepted by it u/s 119(2)(b).

Board's Power : Quasi-Judicial in Nature

4. The Power exercisable by the Board under this sub-section is quasi-judicial in nature. Therefore, the Board is required to follow the principles of natural justice by affording an opportunity of hearing to the assessee[3] and pass a reasoned order.[4]

In the case of *H.S. Anantharamaiah v. CBDT*,[5] the Court, while explaining the nature of the power of, the Board, observed as under:

> *"The Board is required to exercise the discretion on taking into consideration all the relevant facts and circumstances and determine whether the delay in filing the return should or should not be condoned. The order must be informed by the reasons. It is not an arbitrary exercise of power. This power has all the traits of judicial power."*

Thus, the power exercisable by the Board under clause (*b*) of sub-section (2) of section 119 of the Act is quasi-judicial in nature.

4.1 ***Compliance with natural justice and recording of reason***– The Board before passing any order u/s 119(2)(*b*) of the Act has to conform to the principles of "natural justice" for which it has to afford an opportunity to the parties who are going to be affected by the decision of the authority. The Board is, therefore, required to afford an opportunity of hearing to the assessee, either oral or through written representation with reference to the points against the assessee for not granting relief sought for. His prayer should be considered and the same should be taken into account. When the Board rejected both the applications, without

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[1] Bombay Mercantile Co-operative Bank Ltd. v. CBDT , [2011] 332 ITR 87/[2010] 195 Taxman 106(Bom.).

[2] (1993) 201 ITR 523 (Kar.), See also Pallavan Transport Consultancy Service Ltd. v. Union of India , [1998] 233 ITR 745 [2000] 111 Taxman 685 (Mad.); Kusumben Parikh v. CBDT , [2000] 242 ITR 501(Guj.).

[3] Citizen Watch Co. Ltd. v. IAC , [1984] 148 ITR 774/[1983] 15 Taxman 438 (Kar.); Cf Modern Chemicalsv. Vineet Kulkarni , [1985[154 ITR 230 (A.P.)/[1984] 17 Taxman 66 (Bom.) Sivaraman v. ITO [1994] 209 ITR 36/[1995] 78 Taxman 110 (Ker.); Smt. Prameela v. CIT [1996] 220 ITR 271 /[1994] 75 Taxman 594(AP).

[4] Tiam House v. CBDT [2000] 242 ITR 539 /[1999] 104 Taxman 679 (Mad.); Dharmpal v. CBDT , [2001]250 ITR 629 (MP); Bhavani Mills v. Member (IT&J) , CBDT, [2000] 243 ITR 636 105 Taxman 335 (Mad.).

[5] [1993] 201 ITR 526/69 Taxman 291 (Kar.).

recording reasons the High Court ordered for the application to be remitted back to the Board which was then to be decided in accordance with the law.[1] In the case of *Desai Investments (P) Ltd.* v. *Central Board of Direct Taxes and Ors.*,[2] the Court refused to exercise its extraordinary jurisdiction in case petitioner was heard and after such opportunity, for reasons recorded and the said application was rejected. Thus, it is duty of the Board in case of an application filed under this section to comply with the requirements of natural justice along with recording the reasons for the same.

Grounds for condonation of the delay

5. While considering the question of delay, the Central Board of Direct Taxes will have to consider whether any genuine hardship would be caused to the petitioner if delay is not condoned. The phrase "Genuine hardship" should be construed liberally.[3] The Legislature has conferred the power to condone delay to enable the authorities to do substantive justice to the parties by disposing of the matters on merit. Any case of genuine hardship, therefore, has to be judged in the light of the facts and circumstances of the case, as refusing to condone the delay can result in a meritorious matter being thrown out at the very threshold and cause of justice being defeated. When substantial justice and technical considerations are pitted against each other, cause of substantial justice deserves to be preferred for the other side cannot claim to have vested right in injustice being done because of a non-deliberate delay.[4]

The word "genuine" means not fake or counterfeit real, not pretending (not bogus or merely a ruse).[5] The very object of conferring power on the Board is to consider the exceptional cases where a departure from the provisions of the Act with regard to the period with which the relief is to be sought, can be regarded as justified.[6] Also, for determining genuine hardship another well-known principle, that is, "a person cannot take advantage of his own wrong" may also have to be borne in mind.[7] Thus, when a person deliberately tries to take advantage of his wrong doing by claiming relief u/s 119(2)(b), then, being a quasi-judicial authority, the Board is entitled to refuse such an application.

6. Instances of Genuine Hardships

- In *Madhya Pradesh State Electricity Board* v. *Union of India*[8] the return of loss of Rs 1,500 crore could not filed because of

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1 Supra, Note 17.

2 MANU/MH/0479/2008.

3 Gujarat Electric v. CIT [2002] 255 ITR 396 / 120 Taxman 733 (Guj.)

4 Sitaldas K. Motwani v. DGIT (International Taxation) , [2010] 323 ITR 223/ 187 Taxman 44 (Bom).

5 B.M Malani v. CIT [2008] 174 Taxman 363 (SC).

6 Supra Note, 19.

7 Id.

8 [2011] 331 ITR 50 / 197 Taxman 238 / 9 taxmann.com 152 (MP).

bifurcation of Chhattisgarh and Madhya Pradesh. The Court held that in the peculiar facts of the case, the delay ought to have been dealt with by the Central Board of Direct Taxes in a proper perspective and remanded the matter to the board for re-consideration.

- Where delay in filing returns was only three days due to labour unrest, such case was a case of genuine hardship and delay in condonation for filing return was proper.[1]
- A delay of one day due to large queue while filing return is a case of genuine hardship, if the condonation of delay is not allowed.[2]
- When return could not be submitted in time due to ill-health of officer looking after the petitioner's case.[3]
- When some amount was paid erroneously and the assessee was entitled to refund, in such case rejection of application because it was beyond the limitation period was considered to constitute genuine hardship to the assessee.[4]
- The assessee was bound to get its accounts audited under section 64 of the Kerala Co-operative Societies Act, 1969. The delay in audit by the auditor appointed under the said Act was not attributable to the assessee. Therefore, the condonation of delay was proper.[5]

Other instances are when delay is due to auditor appointed under Multi-State Co-operative Societies Act, if delay was not condoned then such cases are cases of genuine hardships.

Remedy to an assessee against order of the Court

7. The only remedy an assessee has against the order of the Board u/s 119(2)(*b*) of the Act is to approach the respective High Court under article 226 of the Constitution of India, 1950. In a plethora of cases the approach of the Courts in cases where requirements under this section were not followed was to remand the matter to the board for re-consideration. In the case of *Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue*[6], the Court adopted a different approach instead of remanding the matter to the CBDT; the Court directed that the delay of one day in filing of the return was to be condoned.

Thus, we can conclude that the approach of the Court in such cases is that when a matter or not looked into merits, natural justice is not being

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[1] Id.

[2] Lodhi Property Co. Ltd. v. Under Secretary , (ITA-II), Department of Revenue, [2010] 323 ITR 441/191 taxman 74 (Delhi).

[3] Supra Note at 24.

[4] R. Seshammal v. ITO , [1999] 237 ITR 185 (Mad.).

[5] Pala Marketing Co-operative Society Ltd. v. Union of India , [2008] 167 Taxman 238 (Ker.).

[6] Supra Note at 30.

followed or reasonable grounds are not provided, then the matter is to be remanded to the Board for re-consideration to be decided in accordance with law but where as per the facts and circumstances of the case there is genuine hardship then the Court by considering the facts and circumstances can decide as to whether the delay is to be condoned or not? Thus, no need of remanding the matter to the board is there in such cases.

Restriction on Powers of the Board

8. The Madras High Court the case of *Precot Mills Ltd.* v. *Central Board of Direct Taxes*,[1] held that "Power under clause (b) was limited to extending the time within which the assessee might make claims for exemption, deduction or refund of other relief and permitting the assessee to make such claim even after the expiry of the period specified in the Act."

- ♦ By admitting a belated claim for refund, the Board neither interferes with the course of assessment of any particular assessee nor with the discretion of the CIT (A) which, according to the Supreme Court in *Union of India v. Azadi Bachao Andolan*[2], is the only restriction on the powers of the Board u/s 119 of the Act.
- ♦ As the provisions are to be assigned such meaning as would enable the assessee to secure the benefits intended to be given by the Legislature[3] only relief prescribed under the provisions can be given to the assessee and no other relief can be granted to the assessee by the Board, no matter the amount of hardship faced by the assessee.
- ♦ According to various instructions issued by the CBDT, the Board has no power for entertaining an application u/s 119(2)(*b*) of the Act, if–
  - – the applicant has made an investment in 8% Savings (Taxable) Bonds, 2003 issued by the Government of India opting for cumulative interest on maturity, but has accounted for interest earned on mercantile basis,
  - – the intermediary bank at the time of maturity has made deduction of tax at source (TDS) on the entire amount of interest paid without apportioning the accrued interest/TDS to various financial years involved.[4]

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1 Precot Mills Ltd. v.. CBDT [2004] 140 Taxman 662 (Mad.); See also H. P. Ranina, Wide are the Board's powers , http://www.thehindubusinessline.in/2005/07/09/stories/2005070901000900.html/ (last accessed on Dec 13, 2012).

2 Union of India v. Azadi Bachao Andolan [2003] 263 ITR 706 / 132 Taxman 373 (Mad.).

3 KANGA, PALKHIVALA & VYAS, THE LAW OF INCOME TAX 27 (9th ed. 2004).

4 CBDT Instruction No. 2/2012 dated 22-2-2012.

– the applications/claims under section 119(2)(*b*) for condonation of delay involving refund claims exceeding Rs. 50,00,000 can only be processed by the Central Board of Direct Taxes, both for acceptance and rejection[1] and no other claim below this amount can be entertained by the Board.

Conclusion

9. The guideline which the Parliament has given to the Central Board of Direct Taxes, when it delegated the power of waiver of interest under section 119(2)(b) of the Act is avoidance of "genuine hardship" in a case, so that any guideline which does not take into consideration genuine hardship in a particular case, cannot be said to meet the requirements of the delegated powers. The concept of "genuine hardship" does not get exhausted by merely listing some items in a circular.

At the time of considering the case under the provisions of section 119(2)(*b*), it should be ensured that the income declared and refund claimed are correct and genuine and also that the case is of genuine hardship on merits.[2] Any application or return not considered by the Board on merits or without looking at the genuine hardship caused to the assessee would result in defeating the intention of the Legislature, which is to provide relief to the assessee in genuine cases in order to avoid hardship to the assessee.

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[1] CBDT Instruction No. 13/2006 dated 22.12.2006.

[2] Ibid.

Australia – South Korea

Australia, S. Korea Conclude Trade Talks

Australia has concluded negotiations toward a Free Trade Agreement with South Korea, its fourth-largest trading partner.

The Australian Trade Minister Andrew Robb and his Korean counterpart, Yoon Sang-jick, completed the talks last week.

Under the deal, Korean tariffs will be eliminated on key Australian agricultural exports, resources, energy, and manufactured goods. New market opportunities will also be opened for Australian financial, accounting, legal, educational, and telecommunications services.

Bilateral trade reached AUD32bn (USD29.1bn) in 2012.

Independent modelling suggests that the treaty could be worth as much as AUD5bn over the period between 2015 and 2030. After this, it could boost the Australian economy by around AUD650m a year. Overall exports to South Korea could rise by 25 percent, resulting in the creation of more than 1,700 new Australian jobs. – *Courtesy tax-news.com*

Morocco

Morocco Hosts ITD Conference on Tax Decentralization

During his opening address at the Fifth International Tax Dialogue (ITD) Conference in Marrakech, Moroccan Finance Minister Mohamed Boussaid underlined the importance of fiscal decentralization.

Emphasizing that tax revenues constitute the main pillar for financing development, and underscoring the importance of good governance in tax matters, Finance Minister Boussaid stressed that there must be a good distribution of fiscal powers between the central and local tax administrations. A tax “partnership” between central and local authorities, and distribution of fiscal powers, will guarantee “harmonious and balanced” development at regional and national level, he insisted.

Alluding to the various reforms of the Moroccan tax system that have been implemented, Finance Minister Boussaid made clear that Morocco had opted for decentralization as a means of ensuring democratic governance. Here, the Finance Minister explained that local authorities in Morocco currently receive 30 percent of income from value-added tax (VAT), 1 percent of revenue derived from individual income tax, and a further 1 percent of income yielded from corporation tax, to provide them with the necessary financial resources.

Furthermore, Boussaid pointed out that the country's general tax administration has undergone significant restructuring over the last few years, noting that during this process fiscal powers have been bestowed on the regions, and services decentralized. Consequently, the central administration is now only responsible for planning, cooperation, and monitoring, he stated.

Commenting, OECD Assistant Secretary General Rintaro Tamaki underlined the importance of decentralizing fiscal competencies, to improve territorial development. Almost one-third of public spending is carried out at local level, and expenditure is therefore decentralized while tax collection is not, resulting in weak budgetary performance, Tamaki warned.

The International Tax Dialogue was initiated in April 2002 by the International Monetary Fund, the OECD, and the World Bank. The joint initiative is intended to encourage and facilitate discussion of tax matters among national tax officials, regional tax organizations, and international organizations. – *Courtesy tax-news.com*

European Union

EU Advances Trade Relationships with Georgia & Moldova

Deals initialled last week by the European Union (EU) with Georgia and Moldova will establish Deep and Comprehensive Free Trade Areas (DCFTAs).

Negotiations toward the two Association Agreements began in 2010, and were completed earlier this year. The EU's aim in concluding treaties of this kind is to accelerate its political and economic relationships with partner countries. They foresee cooperation in over 25 different sectors, including the environment, agriculture, tourism, education, small- and medium-sized enterprises, and transport.

The DCFTAs set up under the Agreements will liberalize trade to the fullest extent possible, by reducing tariffs, facilitating improved customs procedures, and introducing rules of origin and trade defence instruments. Also included in the Agreements are stipulations on competition and transparency, the protection of intellectual property rights, and the adaptation of domestic public procurement laws within the EU.

Precautions have been made to ensure that only eligible goods can qualify for preferential treatment. Existing customs tariffs and regulatory barriers will be phased out, to increase the variety and quality of the products and services available. It is hoped that this will in turn encourage specialization, lower costs, and prompt further innovation.

It is estimated that Georgian exports to the EU will rise by 12 percent, and its EU imports by 7.5 percent. The country's gross domestic product (GDP) could increase by 4.3 percent in the long term, provided that the DCFTA is implemented and its effects sustained. Moldova's anticipated change in national income stands at 5.4 percent, while its EU-related exports and imports could go up by 16 percent and 8 percent, respectively.

The Agreements will be signed next year. All parties have confirmed their intentions to implement the provisions as soon as possible. – *Courtesy tax-news.com*

Austria

Austria's Future Coalition United on Taxation

Marking a significant step closer to a future coalition alliance in Austria, the Social Democrats (SPÖ) and the Austrian People's Party (ÖVP) have united on a raft of tax measures, aimed at consolidating the public finances and at ensuring a structural "zero deficit" in 2016.

The SPÖ and ÖVP have agreed crucially to limit tax breaks for executive remuneration in excess of EUR500,000 (USD686,102). This measure was championed by the SPÖ in their election campaign.

Furthermore, the prospective coalition partners reached a consensus on plans to raise the tax on tobacco and on alcohol. As a result, the cost of a packet of cigarettes is expected to rise by 15 cents a year over a period of three years, and a tax on sparkling wine will increase the cost of a bottle of Champagne by 75 cents. The country's motor vehicle tax is also forecast to rise.

Finally, both parties have agreed to compromise on key tax issues that have so far prevented the formation of an alliance. Chancellor Faymann's Social Democrats have renounced plans to introduce a wealth tax in Austria, while the ÖVP has relinquished its plans to undertake a complete reform of the country's pension system, including plans to increase the age of retirement. The introduction of a bonus-malus system for companies recruiting older workers is currently being considered, however. – *Courtesy tax-news.com*

Switzerland

Swiss SMEs Support Flat Tax

Switzerland's main trade association SGV usam, representing small- and medium-sized enterprises (SMEs) in the Confederation, has welcomed the "clear" decision by the Swiss Council of States to reject the people's initiative calling for an end to the controversial foreigners' flat tax regime, based on the cost of living rather than on the individual's wealth or income.

The Swiss Council of States blocked the proposal by 30 votes to nine, with three abstentions.

Insisting that the levy is a suitable and proven fiscal instrument, of considerable economic importance, SGV usam warned that abolishing the regime would lead to a revenue shortfall for the Confederation of an estimated CHF700m (USD785m) annually, and would serve to endanger 22,000 jobs. Such a measure would adversely affect Swiss SMEs in particular, especially those located in the mountain regions, the union argued.

Underlining its firm support for the flat tax regime, which currently benefits around 5,600 wealthy foreigners in the Confederation, the body emphasized that the levy yielded a total of around CHF695m last year. The lump sum system has a long tradition in Switzerland, enabling the cantons to compete with fierce international competition, the association ended.

Submitted by the Alternative Left party in October 2012, the initiative "end to tax privileges for millionaires" sought to ban the flat tax regime nationwide.

Although the regime has been abolished in five cantons in Switzerland, and tightened in four, the system still applies for direct federal tax throughout the country. However, to guarantee continued support for the levy, measures aimed at tightening the regime are to apply from 2016.

From then, the tax base for calculating direct federal and cantonal tax will be seven times the cost of living, compared with five times as is currently the case. Further, as regards direct federal tax, a minimal taxable income of CHF400,000 will apply. The Swiss cantons will be required to determine their own minimum taxable amount.

The initiative will now be submitted to the National Council, before subsequently being put to a referendum. – *Courtesy tax-news.com*

Bulgaria

Bulgaria Approves Renewable Energy Profit Tax Hike

Renewable energy producers in Bulgaria have reacted angrily to a new 20 percent tax on revenues, condemning the move as unconstitutional and warning that local and foreign investment will be discouraged.

The tax takes the form of an amendment to the Renewable Energy Sources Act, and affects wind and solar power producers. It was proposed by Volen Siderov, who heads the nationalist Ataka party, and 116 out of 182 Bulgarian MPs backed the measure.

Bulgaria's Ministry of Economy and Energy explained that producers of renewable energy had enjoyed a preferential tax regime due to the risks of investing in new technology, but that their share of the total output was now at 16 percent and so this was no longer necessary.

The Government believes that the tax will raise an extra LEV160m (USD112m).

Workers in the renewable energy industry held protests, at which banners written in English were displayed appealing for the European Union to prevent the tax. However, Finance Minister Petar Chobanov said that examples from other EU countries show that Bulgaria will not be penalized for restricting what he called "excessive profits" in the sector. – *Courtesy tax-news.com*

United States

IRS Advisers Recommend Delaying FATCA to 2015

The Information Reporting Program Advisory Committee (IRPAC) has urged the United States Internal Revenue Service (IRS) to delay the implementation date for the Foreign Account Tax Compliance Act (FATCA) by another six months, to January 1, 2015, to help withholding agents and their customers adjust to the new requirements.

FATCA, enacted by Congress in 2010, is intended to ensure that the IRS obtains information on accounts held abroad at foreign financial institutions (FFIs) by US persons. Failure by an FFI to disclose information on their US clients, including account ownership, balances and amounts moving in and out of the accounts, will result in a requirement on US financial institutions to withhold 30 percent tax on US-source income.

On July 12 this year, the US Department of the Treasury announced that FATCA implementation by FFIs would be postponed by six months to July 1, 2014, but it was only at the end of October that it provided a draft notice incorporating updates to certain due diligence, withholding and other reporting requirements, and including a draft FFI agreement.

While more detailed guidance and the FFI agreement are due to be finalized by December 31, 2013, IRPAC has now recommended that the IRS provides for an additional postponement until January 1, 2015, in order, it says, for withholding agents to complete the steps necessary to fulfill their FATCA obligations.

IRPAC confirms that withholding agents have already devoted substantial resources to the design of systems based on the draft final regulations and the associated draft forms. It is important to note, it adds, “that substantial work remains to be done and can only be undertaken after final and comprehensive guidance is issued.”

It notes that “the systems development process involves a series of steps. The remaining steps include refining the scope of the project, development and documentation of technical requirements, design and coding of program changes, testing to ensure compliance with technical requirements, finalization of programming changes, and scheduling the release of systems changes. Each of these steps requires a substantial commitment of time and resources and must be undertaken sequentially.”

So far, IRPAC notes, only preliminary work has been largely completed based on the guidance issued to date, and the completion of design, programming and testing can only be accomplished after the IRS has released comprehensive final guidance. – *Courtesy tax-news.com*

France

French Think Tank Assesses Exploitation of Local Tax Lever

Ahead of the upcoming municipal elections in France in 2014, French independent think tank Institut Montaigne has assessed how each of the ten major towns in France has applied the tax lever over the course of the current mandate (2008-2013), and made its prediction for the coming period.

Confirming the general trend, Institut Montaigne highlighted the fact that local taxes in France increased dramatically at the start of the mandate period, particularly in 2009 and 2010, while remaining stagnant or only posting a moderate rise over the last few years.

With the exception of Paris, local taxes predominantly comprise dwelling tax and land tax. The product of local tax equates to EUR778 (USD1,070) per inhabitant in Bordeaux, compared to EUR761 per inhabitant in Nice, EUR505 in Strasbourg, and EUR449 in Toulouse. In Paris, local taxes include dwelling tax, and land tax, as well as the levy imposed on the value added by a company (CVAE).

According to Institut Montaigne, Paris, Marseille, Nice, Rennes, and Lyon have all dramatically increased their local taxes. Indeed, local taxes have risen by almost 25 percent in all five major towns in the last six years. In Paris, the product of local taxes soared from EUR1.6bn in 2008 to EUR2.1bn in 2012, marking an overall rise of 27 percent.

In contrast, Toulouse elected to lower its local tax rates in 2010, before opting to subsequently freeze tariffs. Consequently, local taxes in Toulouse are currently 7 percent lower than in 2008. Local taxes have only risen moderately in Strasbourg between 2008 and 2013, up just 11.3 percent in total.

Criticized for being complex, obsolete, and unjust, local taxes do not always produce the desired revenue levels. Indeed, high tax rates can often be misleading. By way of example, despite imposing high rates of taxation, local taxes serve to yield very little in the French town of Lille, due to the small tax base. Similarly, despite a wide tax base and high rates, local tax revenues in Bordeaux have only risen by 15 percent over the period in question, due notably to the various tax exemptions accorded.

Concluding, the think tax stressed that there is little fiscal room for maneuver in the coming mandate, maintaining that the tax lever has been exhausted from both a technical and political point of view. All too aware that citizens in France have had their fill of tax rises, particularly in the last year, MPs have either pledged to freeze local taxes in the next term, or have provided their assurances that there will be greater justice in the tax system, following the Government's planned reform of taxation. – *Courtesy tax-news.com*

Guernsey

Guernsey Launches Aircraft Registry

The Guernsey Government has become the first of the two Channel Islands to launch an aircraft registry. Earlier it had been proposed that fellow Channel Island Jersey join forces with Guernsey to establish a combined registry. Negotiators however agreed that the project would not have been mutually beneficial, partially due to differences in the islands' tax regimes.

Announcing the registry's launch, Fiona Le Poidevin, the Chief Executive of Guernsey – the promotional agency for the island's financial services industry, said: "This is yet another landmark day for Guernsey's finance industry. In the last twelve months we have seen the development of the world's first image rights law and register, the introduction of Guernsey Foundations and now Guernsey has launched the first aircraft registry in the Channel Islands. This adds yet another service to the menu of options which we can offer our global client base."

"Guernsey has many fiduciary services providers with high net worth clients who own aircraft and now they can take advantage of the modern legislation offered by our aircraft registry. Indeed, it is expected to be particularly attractive to clients from emerging markets – such as the Middle East, Russia, and Asia – where personal luxury aircraft ownership is very popular, and it may encourage them to consider using Guernsey for their wider wealth management needs."

"Guernsey's broad-based finance industry means that we can also service many other aspects related to aircraft ownership, such as alternative financing arrangements and specialist aircraft insurance. This means that clients can come to Guernsey knowing that they have a jurisdiction which offers a "one-stop shop" to meet their aircraft needs," she added.

The registry is open to aircraft not currently used for commercial air transport, aimed mainly at owners, operators and asset managers of business aircraft, as well as aircraft lessors. Guernsey's nationality mark has been confirmed as "2" followed by four letters. – *Courtesy tax-news.com*

Germany

Berlin Waves through "City Tax"

Berlin's state parliament has waved through plans to introduce a so-called "city tax" on overnight stays in the German capital, from January 1, 2014.

Berlin intends to impose a 5 percent tax on the cost of overnight accommodation for all private stays, irrespective of whether or not the stay is in a hotel, youth hostel, or indeed on a campsite.

The charge will be imposed on a per night basis, up to a maximum period of 21 nights. Professionals staying overnight in the capital on a business trip will be exempt from the tax, however. The levy is expected to generate annual revenues of approximately EUR25m (USD34.4m).

Defending the measure earlier this year, Berlin's Finance Senator Ulrich Nußbaum underscored that the city of Berlin currently attracts millions of tourists every year from all over the world, emphasizing that tourism is growing rapidly. The overnight tax is designed to ensure that tourists visiting the city provide a small contribution to maintaining and improving Berlin's attractiveness, Nußbaum argued, making clear that the measure will benefit both those living in Berlin and visitors to the city.

Furthermore, Nußbaum pointed out that many other tourist destinations, both at home and abroad, levy similar fees, including notably Paris, Rome, and Barcelona. Experience in other cities shows that a moderate tax does not deter visitors, Nußbaum insisted. Finally, Nußbaum pledged to keep administration costs as low as possible, to avoid increasing the burden on businesses.

Firmly opposed to the plans, Hotel and Restaurant Association Dehoga Berlin has already announced its intention to submit a legal appeal challenging the city tax. Hotels and other accommodation providers in Berlin will be responsible for collecting the tax. More details will be provided shortly. – *Courtesy tax-news.com*

United Kingdom

UK Relief for Employee Ownership Structures Welcomed

The Chartered Institute of Taxation (CIOT) has welcomed the UK Government's decision to provide capital gains tax (CGT) relief to owners of limited liability companies who transfer a controlling interest in a trading company to an employee-owned structure.

The Government has also announced proposals to allow employee-owned companies the ability to pay up to GBP3,600 (USD5,900) per annum free of income tax to employees. The measures, announced on December 10, 2013, will, if approved, be included in the next Finance Bill.

John Barnett, Chairman of the CIOT Capital Gains Tax sub-committee, said: "We are pleased with the Government's commitment to supporting and encouraging employee ownership. The proposals also include a generous income tax exemption in respect of a bonus or similar payment to employees from the business and we welcome the commitment to keep the operation of the exemption as simple as possible. However, it should be noted that National Insurance Contributions (NICs) will be payable on the bonus payments: this is a change from the original proposal. Also, it is not clear to us why indirectly employee-owned businesses are to be favoured with this exemption and not, for example, directly owned employee businesses."

"While these changes are designed to encourage employee ownership of companies, the continuing attack on employee benefit trusts generally, and the disguised employment proposals which will affect partnerships bringing employees in as partners, sends mixed messages to employers who want to grow their business through greater employee involvement," Barnett pointed out, concluding that: "While anything which improves employee-ownership is to be welcomed, the CIOT does have some concerns that these measures only address half the story as they would have benefited from a more wide-ranging and better thought-out approach to the whole area of employee engagement." – *Courtesy tax-news.com*

United States

CBPP: US 'Tax Extenders' Extension should be Funded

With pressure growing on the United States Congress to agree to the annual renewal of the group of federal tax provisions requiring frequent annual renewal (the "tax extenders"), the Center on Budget and Policy Priorities (CBPP) has advised that, given current fiscal deficits, policymakers should make a firm commitment to provide funding for any extension of these provisions.

There are said to be some 64 tax provisions expiring on December 31 this year, some of more significance than others. However, the CBPP confirms that "paying for those tax extenders that Congress continues would have a significant impact on long-term deficits."

For businesses, the tax extenders available until end-2013 include increased expensing under Section 179 (full deduction on cost of qualifying equipment), the 50 percent bonus depreciation; the work opportunity tax credit; and the credit for research and development expenses. For individuals, they include mortgage tax relief, the deduction for state and local sales taxes, education tax deductions, and tax-free distributions from individual retirement accounts for charitable purposes.

US public debt amounts to 75 percent of gross domestic product (GDP) in 2013 and, assuming the tax extenders are continued but not paid for, the CBPP projects that it will climb under current policies to 99 percent of GDP in 2040. If policymakers were to offset the roughly USD50bn annual cost of continuing the tax extenders, it forecasts that the debt-to-GDP ratio would rise about 8 percent less, reaching 91 percent in 2040 and eliminating about one-third of the projected rise in the debt ratio by 2040 under current policies.

In addition, the CBPP feels that having to pay for the extension of any tax extenders would also improve tax policy decision-making. "Imposing the same type of fiscal discipline on the extenders that we impose on other budgetary measures would apply needed scrutiny," it says. "In addition, the need to pay for continuing those extenders that withstand scrutiny should provide a vehicle to pare some highly inefficient tax subsidies."

It is advised that "Congress should adhere to this 'pay-for' norm on tax extenders, whether it extends them in a stand-alone bill or as part of broader tax reform."

"While the primary reason to require offsets for the tax extenders is fiscal responsibility, such a move also should improve tax policy by subjecting these provisions to needed (and, in some cases, long overdue) scrutiny," the CBPP concludes. "Policymakers may decide that some extenders are not worth maintaining. And a commitment to paying for the extenders would nudge policymakers to address some weaknesses in the tax code as they searched for other revenues to offset the extenders." – *Courtesy tax-news.com*

Australia

Repeal Carbon Tax, Australian Industry tells Senate

The Australian Senate has been urged to "spare business and households additional cost and uncertainty," and scrap the carbon tax.

The call was made by the Australian Industry Group (Ai Group), which warned of "great complications" should the Senate vote against the Government's proposals. It is thought that electricity pricing and contracting deals will bear the brunt of any extended delays.

Group Chief Executive Innes Willox recommended that both the Labor Opposition and Green parties no longer focus on less crucial elements of the Government's repeal package, such as the Clean Energy Finance Corporation and the Climate Change Authority. He stressed that resolving these issues was not urgent, because the two bodies do not impose any additional costs on energy. The Treasury should, therefore, "take the chance to repeal the core carbon pricing mechanism right away, giving energy users, generators and retailers the maximum chance to prepare."

Willox added that Australians need "a sound policy basis for future investment." To provide this, the country must "clear away the carbon tax and to focus on the major task of designing the Direct Action approach to meet the emission reduction targets to which Australia has committed."

Prime Minister Tony Abbott's Coalition does not have a majority in the Senate. However, the Senate's Environment and Communications Legislation Committee, which reviewed the repeal bills, is backing the Government on the issue. It found that the levy is "one of the highest and broadest carbon taxes in the world," and has "had a significant impact on costs for Australian businesses and families."

The Senate is expected to vote on the legislation within the next week and half, and the Government intends for the tax to be removed by July, 2014. – *Courtesy tax-news.com*

United States

US Aviation Industry attacks TSA Tax Hike

US aviation industry bodies have condemned the US Government's decision to raise the 9/11 Aviation Security Fee, from USD2.50 per passenger to USD5.60 from next year, in a Budget deal endorsed by the chairpersons of the US's bicameral legislature, Paul Ryan and Patty Murray, on December 10, 2013.

Airlines for America President and CEO Nicholas E. Calio said: "Raising taxes is lose-lose for airlines, passengers, jobs and our overall economy. It's inappropriate for Congress to use airline passengers as an ATM when it needs more money. Doubling the Transportation Security Administration passenger security tax would cost passengers more than USD730m annually, placing a huge additional tax on the travelling public, with no direct benefit to those who pay it."

In a similar vein, the Executive Director and Chief Operating Officer of the Global Business Travel Association, Michael McCormick, commented: "Putting aside the rhetoric, a tax by any other name is still a tax. Under the proposed budget, business travellers will share the burden of a billion dollars in new aviation security taxes. To aggravate the damage to business travel and US businesses' ability to conduct business effectively, the additional revenue will not be used to fund programs that benefit travellers. Enough is enough – business travellers are not bottomless piggy banks. Punishing a key driver of economic growth is the wrong approach."

The US Travel Association was more sympathetic, its President and CEO Roger Dow acknowledging that "user fees certainly have their place, the transportation sphere is full of them." He cautioned however that "a proper user fee must ultimately benefit the user." Adding: "It remains to be seen whether the air passenger experience will improve under the fee measures in the congressional budget blueprint. It is concerning that the move appears primarily aimed at getting a big chunk of Transportation Security Administration funding off the strapped federal ledger."

"Our hope is that the new funding structure will be used to perceptibly enhance the TSA's functions," he continued. Examples could include broadening the enrolment effort for the successful PreCheck program, additional testing and acceleration of the TSA's other risk-based screening programs, and boosting funding for redress programs, the Association suggested.

Pulling out the deal's positives, the Association stated: "We are encouraged that the budget agreement will continue TSA staffing of exit lines from secure airport areas, the proposed elimination of which was a very flawed idea. We are also heartened that leaders of both parties took a major step toward restoring stability to the overall budget process. With the recent shutdown having cost the country USD152m per day, or USD2.4bn overall, in travel-related spending alone, it is critical that we not put the recovering economy through that kind of a shock again," Dow concluded. – *Courtesy tax-news.com*

China

China to end anti-dumping duties on US car imports

China said on Friday it would stop levying anti-dumping and anti-subsidy duties on certain types of cars imported from the United States when the measures expire on December 15. On Dec. 14, 2011, China started levying punitive duties on sedans and sport-utility vehicles (SUV) with engines of 2.5 litres and above imported from the United States, in retaliation for US trade policies. China said at the time that US carmakers including General Motors Co and Chrysler Group had received government subsidies and dumped their vehicles into the Chinese market, which harmed China's auto industry. On Friday, the Ministry of Commerce said in a statement on its website that the duties would be terminated because it had not received any applications for a renewal in the anti-dumping investigations. – *Courtesy Daily Times*

2013 TRI 1983 (H.C. Mad.)

HIGH COURT OF MADRAS

Chitra Venkataraman and T.S. Sivagnanam, JJ.

Commissioner of Income Tax, Chennai -IV
v.
M/s. Gem Granites

FACTS/HELD

Section 271(1)(c) penalty cannot be levied if the assessee discharges the primary burden by a cogent explanation and the AO is unable to rebut it. MAK Data (SC) explained

1. Pursuant to a search conducted u/s 132 it was revealed that the assessee had "on-money" transactions in real estate dealings. The assessee accepted the "on-money" but claimed that it was taxable only on completion of the projects under the 'completed contract method'. The assessee's claim was rejected by all the authorities including the High Court. In the s. 271(1)(c) penalty proceedings, the assessee claimed that there was a mistake in the entries regarding the sale of flats to J.B. Exports in as much as the rate at which the property was shown as sold to the said party was much higher than the rate at which the property was sold to other parties. The AO and CIT(A) rejected the claim but the Tribunal accepted it on the basis that the huge difference in the rate of sale of the flat recorded in other cases and in the case of J.B. Exports supported the assessee's contention that there may be a mistake in recording the rate. It held that as the department had failed to prove concealment without any doubt, penalty could not be imposed. On appeal by the department to the High Court, HELD dismissing the appeal:

    Merely because the assessment proceedings have been confirmed does not automatically mean that penalty u/s 271(1)(c) is justified. Unless the case is strictly covered by s. 271(1)(c), penalty cannot be invoked. For sustaining penalty, the bona fide explanation of the assessee must be looked at so that the contumacious conduct of the assessee for the purpose of sustaining the penalty would be taken as condition that is the main requirement u/s 271(1)(c). In Mak Data P. Ltd vs. CIT the Supreme Court held that when a difference is noticed by the AO between the reported and assessed income, the Explanation to Section 271(1) raises a presumption of concealment and the burden is on the assessee to show otherwise, by cogent and reliable evidence. When the initial onus placed by the Explanation has been discharged by the assessee, the onus shifts on the Revenue to show that the amount in question constituted undisclosed income. On facts, the onus cast upon the assessee has been discharged by giving a cogent and reliable explanation. If the department did not agree with the explanation, the onus was on the department to prove that there was concealment of particulars of income or furnishing inaccurate particulars of income. Such onus has not been discharged by the department and so the Tribunal's finding cannot be interfered with (Dharmendra Textiles Processors 306 ITR 277 (SC) & Reliance Petroproducts 322 ITR 158 (SC) referred)

Appeal dismissed.

Tax Case (Appeal) No. 504 of 2009.

Decided on: 12th November, 2013.

Present at hearing: M. Swaminathan, for Appellant. M.P. Senthilkumar, for Respondent.

JUDGMENT

T.S. Sivagnanam, J.–

This Tax Case (Appeal) by the Revenue is directed against the order passed by the Income Tax Appellate Tribunal Chennai 'A' Bench, dated 11.11.2008 in I.T.A.No.715/Mds/2007, for the assessment year 1996-97.

2. The assessment in respect of the respondent/assessee for the assessment year 1996-97 was completed under Section 143(3) of the Income Tax Act (Act) on 30.03.1999, on a total income of Rs.26,12,140/-. The assessee owns quarries and is also a dealer in granite. There was a search conducted under Section 132 of the Act, and in which it was revealed that in a real estate dealings, there were "on-money" transactions and cash of Rs.27,00,000/- was seized. The assessee offered to admit the "on-money", but claimed that they will do so on completion of the projects under the 'completed contract method' and therefore, no income was offered by the assessee in the said year, namely, 1996-97.

The assessee took a stand that the cash found at the time of search represented "on-money" and the notings and workings made in the slips of paper, were not of relevance, since such notings related to one purchaser. The Assessing Officer found the explanation given by the assessee as not credible. Accordingly, the Assessing Officer based on the evidence included "on-money" component and completed the assessment. Penalty proceedings were also initiated under Section 271(1)(c) of the Act. As against the quantum assessment, the matter ultimately came before this Court in T.C.(A).Nos.1150 to 1152 of 2006, for the assessment years 1995-96 and 1996-97 respectively and this Court by order dated 03.08.2012, dismissed the appeals filed by the assessee holding that at no point of time, the assessee has taken steps to examine their Accountant nor produce any evidence to substantiate what could be the correct value per sq.ft, if the property was sold to J.P.,Exports. In respect of the penalty proceedings initiated under Section 271(1)(c) of the Act, the Assessing Officer passed a penalty order dated 26.04.2006. Aggrieved by the same, the assessee preferred an appeal to the Commissioner of Income of Tax (Appeals) contending that the Assessing Officer did not record his satisfaction about the concealment while initiating penalty proceedings and unless the said satisfaction is recorded, the penalty is not automatically leviable. In this regard, reliance was placed on decisions of various High Courts. The first Appellate Authority after analysing the contentions raised, held that the seized documents clearly evidenced the fact that the assessee was in the habit of receiving "on-money" in respect of sale of each and every flat at the rate of 50% of the sale consideration. Further, it held that this fact was borne out by various entries in the seized documents. Further, the first Appellate Authority observed that the entries relating to "on-money" received from J.B.Exports are clearly recorded in the seized documents and there is no escape from inevitable and infallible conclusion that the assessee had received "on-money" of Rs.86,50,250/. Taking note of the findings recorded by the Tribunal in its order in the quantum appeal, the first Appellate Authority held that there is no reason for deviating from the view and there is no infirmity in the imposition of the penalty under Section 271(1)(c) of the Act. Aggrieved by such order, the assessee preferred an appeal to the Tribunal.

3. Before the Tribunal, the assessee contended that there was a mistake in the entries regarding the sale of flats to J.B.Exports and the assesee also filed copies of the entry register in respect of two flats and also in respect of other similar flats, which were sold to other parties. Therefore, it was contended that even J.B.Exports produced the documents before the Assessing Officer, which were examined by the department wherein, it was stated that no "on-money" was paid to the assessee. Therefore, it was contended that the onus is on the department

to prove that the non-disclosure of the said income was deliberate and intentional on the part of the assessee.

4. The Revenue resisted the appeal by contending that in view of the decision of the Hon'ble Supreme Court in the case of *Union of India vs. Dharmendra Textile Processors* reported in [2008] 306 ITR 277 (SC), wherein it was held that the penalty provision is a civil liability and willful concealment was not essential. Thus, the Revenue sought to sustain the order passed by the first Appellate Authority. The Tribunal after considering the contention raised on both sides, allowed the appeal. As against which, the present Tax Case (Appeal) has been preferred by the Revenue and admitted on the following substantial question of law:–

> Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in cancelling the penalty of Rs.24,25,700/- levied under Section 271 (1)(c) of the Income Tax Act made on the basis of evidence relating to 'on money' receipts on sale of flats found during the search without properly applying the ratio of the Supreme Court in the case of *Union of India vs. Dharmendra Textile Processors* (306 ITR 277).

5. The short question which falls for consideration is whether the order of penalty under Section 271(1)(c) of the Act passed by the Assessing Officer and confirmed by the first Appellate Authority, is just and proper.

6. The case of the Revenue is that the quantum appeal had attained finality as the assessee's appeals in T.C.(A) Nos.1150 to 1152 of 2006, were dismissed by this Court, by order dated 03.08.2012, that itself would be sufficient to sustain the order of penalty under Section 271(1)(c) of the Act. The learned counsel for the Revenue relied upon the observations made by the first Appellate Authority in its order dated 31.01.2007 and submitted that the Tribunal erroneously reversed the said order.

7. Per contra, the learned counsel appearing for the assessee by relying upon the reasons assigned by the Tribunal sought to sustain the order of the Tribunal.

8. The Tribunal while allowing the assessee's appeal pointed out that onus to prove that there was a concealment of income with a view to avoid the tax, is on the department and penalty is not automatic and merely because the addition is confirmed does not *ipso facto* attract the penalty proceedings. While considering the facts of the case, the Tribunal observed that there is a huge difference in the rate of sale of the flat recorded in other cases and in the case of J.B.Exports and the document that has been relied on in its entirety cannot be considered a part of the document and in the seized material, 15 entries of sale of flats reveal the rate of flats between Rs.1300/- and Rs.3700/-. Moreover, the rate of flats

in 'G' block and very next flat of G8 and G9 has been recorded in the seized material at the rate of Rs.3600/- and Rs.3700/-, whereas the rate of flats G6 and G7 has been recorded at Rs.7500/-. Taking note of these factual details, the Tribunal pointed out that this prima facie supports the contention of the assessee that there may be a mistake in recording the rate and there may be a possibility that the rate of two flats are merged and recorded. Considering the facts and circumstances, the Tribunal observed that the possibility of wrong entry cannot be ruled out and the department having failed to prove concealment without any doubt, by relying upon the decision of the Hon'ble Supreme Court in the case of Dharmendra Textile Processors,(supra), allowed the assessee's appeal.

9. Firstly, it is to be stated that the findings recorded by the Tribunal is a finding of fact. Therefore, unless it is shown that such finding is perverse, the same cannot be interfered, while considering an appeal which can be entertained only on a question of law. Further, it has to be pointed out that merely because the assessment proceedings namely, the quantum assessment having been confirmed by this Court in T.C.(A).Nos.1150 to 1152 of 2006, dated 03.08.2006, cannot automatically lead to the conclusion that the penalty proceedings are justified. Infact, the Tribunal rightly made an observations to the said effect that the quantum assessment cannot have a direct impact automatically leading to inference of concealment and consequent imposition of penalty.

10. The Hon'ble Supreme Court in the case of *Union of India vs. Rajasthan Spinning and Weaving Mills* reported in (2009) 13 SCC 448, considered the earlier decision of the Hon'ble Supreme Court in the case of *Union of India and Ors vs. Dharmendra Textiles Processors & Ors.*, reported in [2008] 306 ITR 277 (SC) and held that it goes without saying that for applicability of Section 271(1)(c) of the Act, condition stated therein must exist. The above said decision came up for consideration in the case of *Commissioner of Income Tax vs. Reliance Petroproducts Pvt., Ltd.*, reported in [2010] 322 ITR 158 (SC). On reading of Section 27(1)(c), the Hon'ble Supreme Court pointed out that in order to bring the case under Section 271(1)(c), there has to be concealment of the particulars of the income of the assessee. Secondly, the assessee must have furnished inaccurate particulars of his income. In order to expose the assessee to penalty, unless the case is strictly covered by the provision, the penalty provision could not be invoked. Thus, the Hon'ble Supreme Court pointed out that a mere making of a claim, which is not sustainable in law, by itself, would not amount to furnishing of inaccurate particulars regarding the income of the assessee. The reading of the decision of the Hon'ble Supreme Court referred to above, thus points out that for sustaining penalty, the bonafide explanation of the assessee must be looked at, so that the contumacious conduct of the assessee for the purpose of sustaining the

penalty would be taken as condition that is the main requirement under Section 271(1)(c) of the Act. Referring to the decision in the case of Dharmendra Textile Processors, (supra), the Hon'ble Supreme Court pointed out that in the background of Section 271(1)(c) of the Act, there is no necessity of mens rea being shown by the Revenue, however referring to the Explanation to Section 271(1)(c) penalty being a multiple liability, the bonafide of the conduct of the assessee necessarily assumes significant, even though willfulness of the assessee may not be a criteria, the conduct is to be considered. Thus, a mere fact that the addition in this case has been sustained by this Court by itself would not lead to the automatic application to Section 271(1), the Tribunal went into the explanation offered by the assessee as regards the charging of a higher amount in the case of J.B.Exports. Although, the Tribunal rejected the explanation for the purpose of assessment of goods, it considered it as a good ground for cancellation of penalty, when the explanation on the differential amount was given by the assessee that the entries were made in the account and the Accountant had not made the correct entry.

11. In a recent decision of the Hon'ble Supreme Court in Civil Appeal No.9772 of 2013, dated 30.10.2013 (*Mak Data P. Ltd., vs. Commissioner of Income Tax-II*), the Hon'ble Supreme Court while considering the Explanation to Section 271(1), held that the question would be whether the assessee had offered an explanation for concealment of particulars of income or furnishing inaccurate particulars of income and the Explanation to Section 271(1) raises a presumption of concealment, when a difference is noticed by the Assessing Officer between the reported and assessed income. The burden is then on the assessee to show otherwise, by cogent and reliable evidence and when the initial onus placed by the explanation, has been discharged by the assessee, the onus shifts on the Revenue to show that the amount in question constituted their income and not otherwise. Factually, we find that the onus cast upon the assessee has been discharged by giving a cogent and reliable explanation. Therefore, if the department did not agree with the explanation, then the onus was on the department to prove that there was concealment of particulars of income or furnishing inaccurate particulars of income. In the instant case, such onus which shifted on the department has not been discharged. In the circumstances, we do not find that there is any ground for this Court to substitute our interfere with the finding of the Tribunal on the aspect of the bonafides of the conduct of the assessee.

12. In the circumstances, following the decision of the Hon'ble Supreme Court, w uphold the order of the Tribunal and the Tax Case Appeal stands dismissed. No costs.

2013 TRI 1989 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "L" BENCH, MUMBAI

B.R. Mittal, Judicial Member and N.K. Billaiya, Accountant Member

FACTS/HELD

Section 115AD: High Court verdict in Bharat Ruia 337 ITR 452 (Bom) on taxation of derivatives as speculation income/ loss is not applicable to FIIs

1. The assessee, a Foreign Institutional Investor ("FII"), suffered a loss of Rs. 172.18 crore on account of derivative transactions which was claimed as a short-term capital loss. The AO held that the said loss constituted a business/ speculation loss and could not be set-off against the short-term capital gains. Though in the assessee's own case (Platinum Investment Management Ltd vs. DDIT (ITAT Mumbai)) it had been held that all income arising to a FII, including from dealings in derivatives, has to be assessed as capital gains, the department argued that this view was no longer good law in view of CIT vs. Bharat R. Ruia (HUF) 337 ITR 452 (Bom) where it was held that as transactions in derivatives are entered into and settled without taking any delivery of the shares, the same constitutes a speculative transaction. HELD by the Tribunal rejecting the department's case:

   The judgement of the Bombay High Court in Bharat Ruia is not applicable to assessees which are FIIs duly registered with SEBI. FIIs are allowed to only invest in the Capital Market and the income arising from transfer of security is to be considered as short term capital gain or long term capital gain as per s. 115AD of the Act. FIIs are not allowed to do business in the security market. Also, derivative is a security as per the clause (ia) to sub-section (h) of section 2 of The Securities Contracts (Regulation) Act, 1956 with effect from 22.2.2000. The co-ordinate Bench of the Tribunal has considered this aspect as well in the earlier order dated 5.12.2012 in which the earlier decision in LG Asian Plus Ltd v/s ADIT 46 SOT 159 was also considered.

Appeals allowed partly.

ITA Nos. 2787 & 2788/M/2012 (Assessment Year : 2006-07).

Heard on: 27th November, 2013.

Decided on: 4th December, 2013.

Present at hearing: F.V. Irani, for Appellant. Narendra Kumar, for Respondent.

JUDGMENT

Per B.R. Mittal:– (Judicial Member)

These appeals are filed by assessee against orders of ld. CIT(A), both dated 2.1.2012 relating to assessment year 2006-07.

2. The assessee is a sub-account of the Foreign Institutional Investor (in short 'FII') registered in Australia and operating in India, Registered with Securities and Exchange Board of India (SEBI). The activity of assessee involved in purchase and sale of securities in India and trading in derivatives. Both assessee(s) have filed return (s) of income as under:

a) the assessee, sub-account Platinum Asia Fund (ITA No.2787/Mum/2012) declaring total income of Rs.NIL and claimed a refund of Rs.1,45,96,129/-. The said assessee also claimed carried forward short term capital loss of Rs.78,91,43,597/-. However, AO completed the assessment vide order dated 24.12.2010 u/s 143(3) r.w. section 147 of the Income Tax Act, 1961 (the Act) at an income of Rs.93,26,84,307/- after holding that the net loss of Rs.1,72,18,27,904/- arising from index derivative transactions as business loss and assessable under the head income from business or profession as against the claim of assessee as capital loss. Ld. CIT(A) also confirmed the findings of the AO;

b) similarly, in respect of sub-account Platinum International Brands Fund, (ITA No.2788/Mum/2012) the return of income was filed on 25.7.2006 declaring total income at Rs.NIL and claimed refund of Rs.16,02,881/-. It also claimed short term capital loss of Rs.5,42,36,870/-. However, the AO completed the assessment vide order dated 24.12.2010 passed u/s 143(3) r.w.s.147 of the Act at an income of Rs.17,62,78,618/- by treating net loss of Rs.23,05,15,488/- arising from index derivative transaction as business loss assessable under the head business or profession as against capital loss claimed by assessee. The ld. CIT(A) also confirmed the action of AO.

Hence, both assessees who are sub-account of FII M/s Platinum Asset Management Ltd, are in appeals before the Tribunal taking the following Grounds:

3. <u>I.T.A.No.2787/M/2012</u>

> "1. On facts and in circumstances of the case and in law, the Commissioner of Income-tax (Appeals) -11, Mumbai, (hereinafter referred to as 'the CIT(A)') erred in confirming the re-opening of the case under section 147 of the Income Tax Act, 1961(the 'Act') by the Assessing Officer having failed to appreciate that there was no income which has escaped assessment.
>
> Your Appellant submits that the re-assessment proceedings being bad in law should be quashed.
>
> 2. On facts and in circumstances of the case and in law, the learned CIT (A), Mumbai, erred in upholding the action of the Assessing Officer (AO) in treating the net loss of Rs 1,721,827,904/- arising from index derivative transactions as business loss as against capital loss, and assessable under the head 'Income from Business or Profession', having failed to appreciate that the derivatives are securities and so in case of your Appellant being a Foreign Institutional Investor, the derivatives are capital asset and not business / trading asset.
>
> The CIT (A) ought to have held that the loss Rs. 1,721,827,904/- arising from index derivative transactions are short-term capital loss and so should be allowed set off against short-term capital gains arising on transfer of shares as per Section 70 of the Act and carry forward unabsorbed short-term capital loss on derivative transactions as per Section 74 of the Act.
>
> 3. Without prejudice to the above, on facts and in circumstances of the case and in law, the learned CIT(A) erred in holding that in absence of business connection in India or in absence of permanent establishment in India as per India Australia Double Taxation Avoidance Agreement, the business loss of Rs. 1,721,827,904 arising on transfer of derivatives cannot be determined and so the same is not allowable as set-off against the capital gains arising on sale of shares in India having failed to appreciate that the loss is arising through the transfer of capital asset situated in India and / or the loss is arising through or from source of income in India and so the loss arising on transfer of derivatives is determinable in India.
>
> The CIT(A) ought to have held the business loss of Rs 1,721,827,904 arising on sale of derivatives can be determined and should be set off against short-term capital gains of Rs. 921,955,751 and long-term capital gains of Rs 10,728,556 and

the balance loss of Rs.789,143,597 should be allowed to be carried forward to subsequent assessment years.

4. Without prejudice to the above, on the facts and in the circumstances of the case, the CIT(A) erred in not allowing set off of business loss of Rs. 1,721,827,904 arising on derivative transactions against capital gains arising on sale of shares under section 71 of the Act and carry forward of balance unabsorbed business loss as per section 72 of the Act in view of the provisions of section 90(2) of the Act

5. The CIT(A) ought to have held the business loss of Rs 1,721,827,904 arising on sale of derivatives should be set off against short-term capital gains of Rs. 921,955,751 and long-term capital gains of Rs 10,728,556 and the balance loss of Rs. 789,143,597 should be allowed to be carried forward to subsequent assessment years.

Your Appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at, the time of hearing of the appeal, so as to enable the Hon'ble Tribunal to decide this appeal according to law."

<u>I.T.A.No.2788/M/2012</u>

"1. On facts and in circumstances of the case and in law, the Commissioner of Income-tax (Appeals) -11, Mumbai, (hereinafter referred to as 'the CIT(A)') erred in confirming the re-opening of the case under section 147 of the Income Tax Act, 1961(the 'Act') by the Assessing Officer having failed to appreciate that there was no income which has escaped assessment.

Your Appellant submits that the re-assessment proceedings being bad in law should be quashed.

2. On facts and in circumstances of the case and in law, the learned CIT (A), Mumbai, erred in upholding the action of the Assessing Officer (AO) in treating the net loss of Rs 230,515,488/- arising from index derivative transactions as business loss as against capital loss, and assessable under the head 'Income from Business or Profession', having failed to appreciate that the derivatives are securities and so in case of your Appellant being a Foreign Institutional Investor, the derivatives are capital asset and not business / trading asset.

The CIT (A) ought to have held that the loss Rs.230,515,488/- arising from index derivative transactions are short-term capital loss and so should be allowed set off against short-term capital gains arising on transfer of shares as per Section 70 of

> the Act and carry forward unabsorbed short-term capital loss on derivative transactions as per Section 74 of the Act.
>
> 3. Without prejudice to the above, on facts and in circumstances of the case and in law, the learned CIT(A) erred in holding that in absence of business loss of Rs. 230,515,488/- arising on transfer of derivatives cannot be determined and so the same is not allowable as set-off against the capital gains arising on sale of shares in India having failed to appreciate that the loss is arising through the transfer of capital asset situated in India and / or the loss is arising through or from source of income in India and so the loss arising on transfer of derivatives is determinable in India.
>
> The CIT(A) ought to have held the business loss of Rs 230,515,488 arising on sale of derivatives can be determined and should be set off against short-term capital gains of Rs. 165,781,163 and long-term capital gains of Rs 10,497,455 and the balance loss of Rs.54,236,870/- should be allowed to be carried forward to subsequent assessment years.
>
> 4. Without prejudice to the above, on the facts and in the circumstances of the case, the CIT(A) erred in not allowing set off of business loss of Rs. 230,515,488/- arising on derivative transactions against capital gains arising on sale of shares under section 71 of the Act and carry forward of balance unabsorbed business loss as per section 72 of the Act in view of the provisions of section 90(2) of the Act The CIT(A) ought to have held the business loss of Rs 230,515,488 arising on sale of derivatives should be set off against short-term capital gains of Rs. 165,781,163 and long- term capital gains of Rs 10,497,455 and the balance loss of Rs. 54,236,870/- should be allowed to be carried forward to subsequent assessment years.
>
> Your Appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at, the time of hearing of the appeal, so as to enable the Hon'ble Tribunal to decide this appeal according to law."

3. At the time of hearing, the ld. AR of the assessee submitted that Ground No.1 of both the appeals is not pressed for. Hence, Ground No.1 of both appeals is rejected as not pressed.

4. The ld. AR of the assessee submitted that Ground No.2 in both the appeals is covered by the decision of Platinum Investment Management Ltd., A/c Platinum International Fund V/s DDIT(International Taxation) in ITA No.3598/Mum/2010 (AY-2007-08)order dated 5.12.2012 in favour of the assessee. He filed a copy of the said order to substantiate his submissions.

5. On the other hand, ld. DR relied on the order of ld. CIT(A). He further submitted that the Hon'ble Jurisdictional High Court in the case of *CIT vs. Bharat R. Ruia* (HUF) 337 ITR 452 (Bom) has held that the transaction in derivative are entered into without taking any delivery of stock and shares or commodity and periodically or ultimately settled. Hence, Transactions in respect of derivative is a speculative transaction. He submitted that prior to amendment made by Finance Act, 2005 in section 43(5) trading in derivative was a speculative transaction and after insertion of clause (d) to sub-section 43(5) by Finance Act, 2005 w.e.f. 1.4.2006, the transaction in respect of derivative at a recognized Stock Exchange is a business transaction and cannot be considered as an investment.

6. In rejoinder, the ld. AR submitted that the said case of Hon'ble Bombay High Court viz Bharat Ruia (supra) is not applicable to the facts and the issue involve as the assessees are FII duly registered with SEBI. He further submitted that the assessee is allowed to invest in Indian Capital Market and the income arising from transfer of security is to be considered as short term capital gain or long term capital gain as per section 115AD of the Act. He further submitted that assessee, FII is not allowed to do business in the security market. He further submitted that derivative is a security as per the clause (ia) to sub-section (h) of section 2 of The Securities Contracts (Regulation) Act, 1956 with effect from 22.2.2000. The said fact is not disputed by ld. DR that derivative " is a security" under The Securities Contracts (Regulation) Act, 1956. The ld. AR submitted that the Co-ordinate Bench of the Tribunal, has considered this aspect as well vide its earlier order dated 5.12.2012 (supra) in which the earlier decision of co-ordinate Bench in the case of *LG Asian Plus Ltd vs ADIT* (International Taxation) (2011) 46 SOT 159 was also considered.

7. We have carefully considered the submissions of the ld. Representatives of the parties and the orders of authorities below. We have also considered the earlier orders of the Tribunal, (supra) relied upon by ld. AR and also the decision of Hon'ble Jurisdictional High Court in the case of Bharat Ruia(supra). We agree with ld. AR that the decision relied upon by ld.DR is not relevant to the facts of the fact of the case before us. Further, the issue is squarely covered by the decision of the Tribunal, order dated 5.12.2012 which has been decided by considering the earlier order of coordinate Bench in the case of LG Asian Plus Ltd (supra). We consider it prudent to reproduce paragraph 8 of the said order of the Tribunal dated 5.12.2012 which read as under :

> "8. We have considered the rival submissions of the parties as well as relevant material on record. As regards the observation of the Assessing Officer that the derivative were sold on same day, we find that there is a factual error on this point because the derivative were settled/closed on various dates, either by subsequent purchases or on the expiry of period within the

month. This fact is clear from the details of page Nos.49 and 65-69 of paper book. On the issue of capital gain or business income, we note that an identical issue has been considered by the coordinate Bench of this Tribunal in the case of LG Asian Plus Ltd. (supra), one of us the Judicial Member is party to the decision. Though the Ruling of the Authority for Advance Ruling has a persuasive value, however, when a direct decision of the coordinate Bench of this Tribunal is on the identical issue then as per the rule of uniformity, the same is binding on us in the absence of any contrary decision of Tribunal or the High Court. The coordinate Bench of this Tribunal has considered and decided the issue after a detail and elaborate discussion of the relevant provisions and aspect relating to the transactions of derivatives by FII. The relevant concluding part of the order from para 8.12 to 11 is as under:–

> 8.11. From the Memorandum explaining the provisions of the Finance Bill, it is palpable that the foreign institutional investors shall be allowed to invest in the country's capital market. Income in respect of securities and income from transfer of securities has been made the subject matter of sec. 115AD. As per this provision, the income arising from the transfer of such securities is to be considered as short-term or long-term capital gain.
>
> 8.12. Thus, on a close scrutiny of the SEBI (FII) Regulations, 1995 together with section 115AD seen in the light of the Memorandum explaining this provisions of the Finance Bill, 1993, it is visible that a FII is allowed to invest only in the 'securities' and further the income from securities, either from their retention or from their transfer, is to be taxed as per this section alone. Coming to income arising from the transfer of securities, it has been provided in section 115AD that it shall be charged as short-term or long-term capital gain, which depends upon the period of holding of such securities. A FII is not allowed by the Central Government to do 'business' in the 'securities'. Once it is noticed that a FII can only 'invest' in 'securities' and tax on the income from the transfer of such securities is covered by a special provision contained in section 115AD, the natural corollary which follows is that tax should be charged on income arising from transfer of such securities as per the prescription of this section alone, which refers to income by way of short term or long term capital gains.
>
> 8.13. The ld. D.R. has relied on sub-section (2) of sec. 115AD for contending that the existence of 'Business income' from dealing in securities is also envisaged. We find that sub-sec.

(2) of sec. 115AD has two clauses. Clause (a) provides that where the gross total income of a FII consists only of income in respect of security referred to in clause (a) of sub-sec. (1) (i.e. income received in respect of securities, otherwise than from their transfer), then no deduction shall be allowed to it under sections 28 to 44C or section 57 or Chapter VI-A of the Act. It is but natural that when a lower rate of tax has been provided in respect of income earned by a FII from securities, then that rate of tax is final and the assessee cannot claim double benefit, firstly by being taxed at lower rate and secondly by claiming normal deductions etc. against this income. As sec. 115AD(2)(a) refers to income received in respect of securities and not from their transfer, the same would have no application to the instant case. According to clause (b) of sub-sec. (2) of sec. 115AD, where the gross total income includes any income referred to in clause (a) or clause (b) of sub-sec. (1) (i.e. income received in respect of securities by either retaining them or from their transfer), then the gross total income shall be reduced by the amount of such income and the deduction under Chapter VI-A shall be allowed as if the gross total income so reduced is the gross total income of the FII. A plain reading of sub-sec. (2) makes it manifest that the gross total income of a FII may include income other than that received in respect of securities or from the transfer of such securities. The emphasis of the ld. DR is on this part of the provision to bring home the point that a FII may also have 'Business income' arising from the transfer of securities. The argument is that a FII may have income from securities as falling under the head 'Capital gains', which is covered under section 115AD(1)(b) and also business income, as comes out from sec. 115AD(2)(b). This argument though looks attractive at first flush, but does not stand scrutiny in depth. The rationale behind section 115AD(2)(b) is that the income of a FII, other than that arising from the holding or transfer of securities, should find its place in the total income and the deductions under Chapter VI-A be allowed by considering gross total income net of income received in respect of securities or arising from the transfer of such securities. It is quite possible that a FII may deposit its surplus funds in banks resulting into interest income. Such interest income, which shall not fall under sub-sec. (1) of sec. 115AD, shall constitute part of the gross total income. It is a simple and plain interpretation of sub-sections (1) and (2) of sec. 115AD. We want to make it clear that the question before us is not to determine whether a FII can have any business income or not. We are confined to

determining whether the income from the transfer of securities would fall under sub-section (1) or (2). If it is presumed as a hypothetical case that a FII may also have any business activity, whether legal or illegal, then the income from such activity shall be considered as 'Business income' covered under subsection (2)(b). The only embargo against the above presumption is that the business should not be that of dealing in 'securities'. Once there is a special provision slicing away the income to a FII from the transfer of 'securities' from the other income, it has to find its home only under sub-section (1)(b), irrespective of the fact that the securities are viewed as 'Investment' or 'Stock in trade'. If the Revenue ventures to make a distinction between such securities as constituting capital asset or stock in trade, which is not contemplated by the Central Government as is evident from SEBI(FII) Regulations and the definition of FII in Explanation (a) to sec. 115AD, then this provision will become otiose. In our considered opinion if a FII receives any income in respect of securities or from the transfer of such securities, the same can be considered under sub-sec. (1) alone and sub-sec. (2)(b) cannot be invoked to construe it as 'Business income'.

8.14. The position has been clarified by way of a Press Note : F No. 5(13)SE/91-FIV dated 24.03.1994 issued by the Ministry of Finance, Department of Economic Affairs (Investment Division) , New Delhi, the relevant part of which is as under:

"The taxation of income of Foreign Institutional Investors from securities or capital gains arising from their transfer, for the present, shall be as under:–

(i) The income received in respect of securities (other than units of off-shore funds covered by section 115AB of the Income-tax Act) is to be taxed at the rate of 20%;

(ii) Income by way long-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 10%;

(iii) Income by way of short-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 30%;

(iv) The rates of income-tax as aforesaid will apply on the gross income specified above without allowing for any deduction under sections 28 to 44C, 57 and Chapter VI-A of the Incometax Act.

2. The expression "Foreign Institutional Investor" has been defined in section 115AD of the Income tax Act to mean such investors as the Central Government may, by notification in the Official Gazette, specify in this behalf. The FIIs as are registered with the Securities and Exchange Board of India will be automatically notified by the Central Government for the purpose of section 115AD." 8.15. From the above Press Note, it is abundantly clear that FIIs have been considered as "investors" (and not as traders). Secondly, income from transfer of securities has been viewed as chargeable to tax under the head 'capital gains' as long-term or short-term capital gain depending upon the period for which such securities are held.

8.16. In view of the above discussion, it is out-and-out that income arising to a FII from the transfer of 'securities' as specified in Explanation (b) to sec. 115AD can only be considered as short-term or long-term capital gain and not as 'business income'. As the 'derivatives' have been included in the definition of 'securities' for the purposes of this section, the income from derivatives shall also be considered as short-term or long-term capital gain depending upon the period of holding. If the viewpoint of the Department, to the effect that income from transfer of shares or debentures etc. should be considered as short-term or long-term capital gain (as has been accepted by the AO in the instant case) but that from derivatives should be considered as 'Business income' (speculation business), then it would mean considering shares and debenture etc. as distinct from derivatives. Moreover there is nothing on record to demonstrate that the assessee was visited with any consequences as per Regulation 7A for violation of Regulations 15 or 16. It shows that the regulations have been conscientiously followed by the assessee as per which it simply made only Investment in securities and there is nothing of the sort of trading. Although in common parlance, the shares or debentures etc. are distinct from derivatives, and their taxation may also differ in the case of non-FIIs, but such distinction is obliterated in the context of FIIs due to the inclusion of both shares and debentures etc. on one hand and derivatives on the other, in the definition of "securities" for the purpose of sec. 115AD and subsection (1) providing for the income from their transfer to be considered as long term or short term capital gain.

8.17. It is noticed that sec. 115AD falls in Chapter XII which deals with the determination of tax in certain special cases. This Chapter consists of sections 110 to 115BBC. Each section contains special provisions dealing with specific types of incomes for which a specified rate of tax is provided. If a particular item of income is covered in any of these sections, it shall be strictly governed by the prescription of that relevant section alone. We are reminded of the legal maxim 'Generalia specialibus non derogant', which means that special provisions override the general provisions. It is a well settled legal position that specific provisions override the general provisions. In other words, if there are two conflicting provisions in an enactment, the special provisions will prevail and the subject matter covered in such a special provision shall stand excluded from the scope of the general provision. The Hon'ble Supreme Court in the case of *Britannia Industries Ltd. vs. CIT* (2005) 278 ITR 546 (SC) has held that expenditure towards rent, repairs, maintenance of guest house used in connection with business is to be disallowed u/s. 37(4) because this is a special provision overriding the general provision."

9. Coming back to our context, it is seen that income arising from the transfer of securities of the FIIs has been included under sec. 115AD(1)(b) to be categorized as short-term or long-term capital gain depending upon the period of holding. In such a situation, it is impermissible to consider such income as falling under the head "Profits and gains of business or profession". Such income arising from the transfer of securities shall be charged to tax under the head "capital gains" alone. Once inclusion of such income from the transfer of securities is held to be falling only under the head "Capital gains", it cannot be considered as 'Business income', whether speculative or nonspeculative.

10. The heading of section 43 is : 'Definitions of certain terms relevant to income from profits and gains of business or profession'. The opening part of this section is : "In sections 28 to 41 and in this section, unless the context otherwise requires-". Thereafter, six subsections have been given, of which subsec. (5) defines "speculative transaction". It is, therefore, clear that sec. 43(5) defining 'speculative transaction' is relevant only in the context of income under the head 'Profits and gains of business or profession'. It rules out its application to income under any other head. If that be the position, the picture is clear that sec. 43(5) has no application to FIIs in respect of 'securities' as defined in Explanation to sec. 115AD, income from whose transfer is considered as short term or long term capital gains.

11. We, therefore, hold that the ld. CIT(A) was not justified in holding that income from Index based or non-Index based derivatives be treated as 'business income', whether speculative or nonspeculative. The impugned order is, therefore, set aside by

holding that income from derivative transaction resulting into loss of Rs.11.27 crores is to be considered as short-term capital loss on the sale of securities which is eligible for adjustment against short-term capital gains arising from the sale of shares."

In view of above order and respectfully following the decision of Co-ordinate Bench of the Tribunal (supra), we decide Ground No.2 of the appeal in favour of assessee. Accordingly, we hold that the income arising from transaction in derivative by assessee(s), being sub-account FII cannot be treated as business profit or loss.

8. Hence, Ground No.2 is decided in favour of assessee in both the appeals.

9. At the time of hearing, it was submitted that if ground No.2 is decided in favour of assessee, the ground Nos.3 to 5 in appeal No.2787/Mum/2012 and Ground Nos.3 and 4 in appeal No.2788/Mum/2012 become infructuous and no need to be adjudicated. Since, we have decided the nature of transaction as an investment and profit and loss has to be considered as capital profit or loss, Ground Nos 3 to 5 of Appeal No.2787/Mum/2012 and Ground Nos. 3 and 4 in Appeal No.2788/Mum/2012 have become infructuous.

10. In the result, both the appeals of assessee are allowed in part.

Order pronounced in the open court on 4th day of December 2013

2013 TRI 2000 (S.C. Ind.)

SUPREME COURT OF INDIA

R.M. Lodha, Madan B. Lokur and Kurian Joseph, JJ.

Chironjilal Sharma HUF
v.
Union of India and Others

FACTS/HELD

Section 132B(4)(b)/ 240/ 244A: Assessee is entitled to interest on cash appropriated during search even if refund is directed in appeal proceedings

1. Pursuant to a search conducted u/s 132, cash of Rs. 2.35 lakhs was recovered. The AO passed an order u/s 132(5) in which he calculated the tax liability and appropriated the seized cash. An assessment order was also passed to the same effect. The AO's

order was finally set-aside by the Tribunal and it became final. Consequently, the assessee was refunded the amount of Rs. 2.35 lakhs with interest from 4.3.1994 (date of last of the regular assessments by the AO) until the date of refund. The assessee claimed that he is entitled to interest u/s 132B(4)(b) of the Act for the period from the expiry of period of six months from the date of order u/s 132(5) to the date of regular assessment order. In other words, as the order u/s 132(5) was passed on 31.5.1990, six months expired on 30.11.1990 and the last of the regular assessments was done on 4.3.1994, the assessee claimed interest u/s 132B(4)(b) from 1.12.1990 to 4.3.1994. HELD by the Supreme Court:

> The department's argument that the refund of excess amount is governed by s. 240 and that s. 132B(4)(b) has no application is not acceptable. S. 132B(4)(b) deals with pre-assessment period and there is no conflict between this provision and s. 240 or for that matter s. 244(A). The former deals with pre-assessment period in the matters of search and seizure and the later deals with post assessment period as per the order in appeal. The department's view is not right on the plain reading of s. 132B(4)(b) and the assessee is entitled to simple interest at the rate of 15% per annum u/s 132B(4)(b) from 1.12.1990 to 4.3.1994. The interest shall be paid within two months from today.

Appeal allowed.

Civil Appeal No. 10601 of 2013 [Arising out of S.L.P. (C) No. 20381 of 2012].

Decided on: 26th November, 2013.

Present at hearing: Arijit Prasad, for Respondent.

JUDGMENT

Sanjiv Khanna, J.–

Leave granted.

2. The brief facts necessary for consideration of the issue raised in the appeal are these: In the search conducted in the house of the appellant on 31.1.1990, a cash amount of Rs. 2,35,000/- was recovered. On 31.5.1990, an order under Section 132(5) of the Income Tax Act, 1961 (for short "the Act") came to be passed. The Assessing Officer calculated the tax liability and the cash seized in the search from the appellant's house was appropriated. However, the order of the Assessing Officer was finally set-aside by the Income Tax Appellate Tribunal (for short "the Tribunal") on 20.2.2004. The revenue accepted the order of the Tribunal.

Consequently, the appellant has been refunded the amount of Rs. 2,35,000/- along with interest from 4.3.1994 (date of last of the regular assessments by the Assessing Officer) until the date of refund.

3. The appellant (assessee) claims that he is entitled to interest under Section 132B(4)(b) of the Act which was holding the field at the relevant time for the period from expiry of period of six month's from the date of order under Section 132(5) to the date of regular assessment order. In other words, the order under Section 132(5) of the Act having been passed on 31.5.1990, six months expired on 30.11.1990 and the last of the regular assessments was done on 4.3.1994, the assessee claims interest under Section 132B(4)(b) of the Act from 1.12.1990 to 4.3.1994.

4. Section 132 of the Act deals with search and seizure. Sub-section (5) thereof, which is relevant for the purposes of the present appeal, reads as under:

> (5): Where any money, bullion, jewellery or other valuable article or thing (hereafter in this section and in sections 132A and 132B referred to as the assets) is seized under sub-section (1) or sub-section (1A), as a result of a search initiated or requisition made before the Ist day of July, 1995, the Income-tax Officer, after affording a reasonable opportunity to the person concerned of being heard and making such enquiry as may be prescribed, shall, within one hundred and twenty days of the seizure, make an order, with the previous approval of the Joint Commissioner)–
>
> (i) estimating the undisclosed income (including the income from the undisclosed property) in a summary manner to the best of his judgment on the basis of such materials as are available with him;
>
> (ii) calculating the amount of tax on the income so estimated in accordance with the provisions of the Income Income-Tax Act, 1922 (11 of 1922), or this Act;
>
> (iia) determining the amount of interest payable and the amount of penalty imposable in accordance with the provisions of the Indian Income-Tax Act, 1922 (11 of 1922), or this Act, as if the order had been the order of regular assessment;
>
> (iii) specifying the amount that will be required to satisfy any existing liability under this Act and any one or more of the Acts specified in clause (a) of sub-section (1) of section 230A in respect of which such person is in default or is deemed to be in default,
>
> and retain in his custody such assets/or part thereof as are in his opinion sufficient to satisfy the aggregate of the amounts referred to in clauses (ii), (iia) and (iii) and forthwith release the remaining portion, if any, of the assets to the person from whose custody they were seized:

> Provided that if, after taking into account the materials available with him, the Income Tax Officer is of the view that it is not possible to ascertain to which particular previous year or years such income or any part thereof relates, he may calculate the tax on such income or part, as the case may be, as if such income or part were the total amount chargeable to tax at the rates in force in the financial year in which the assets were seized and may also determine the interest or penalty, if any, payable or imposable accordingly:
>
> Provided further that where a person has paid or made satisfactory arrangements for payment of all the amounts referred to in clauses (ii), (iia) and (iii) or any part thereof, the Income-Tax Officer may, with the previous approval of the Chief Commissioner or Commissioner, release the assets or such part thereof as he may deem fit in the circumstances of the case."

5. Section 132B deals with the payment of interest on delayed assessment. Omitting the unnecessary part, the relevant provisions of Section 132B(4)(a) and(b) of the Act read as under:

> 132B: Application of retained assets..................
>
> (4)(a) The Central Government shall pay simple interest at the rate of fifteen per cent per annum on the amount by which the aggregate of money retained under Section 132 and of the proceeds, if any, of the assets sold towards the discharge of the existing liability referred to in clause 3 of subsection (5) of that section exceeds the aggregate of the amounts required to meet the liability referred to in clause (i) of sub–section (1) of this section.
>
> (b) Such interest shall run from the date immediately following the expiry of the period of six months from the date of the order under sub-section 5 of section 132 to the date of the regular assessment or reassessment referred to in clause (i) of sub-section (1) or, as the case may be, to the date of last of such assessments or reassessments.

6. A close look at the above provisions and, particularly, clause (b) of Section 132B(4) of the Act clearly shows that where the aggregate of the amounts retained under Section 132 of the Act exceeds the amounts required to meet the liability under Section 132B(1)(i), the department is liable to pay simple interest at the rate of fifteen percent on expiry of six months from the date of the order under Section 132(5) of the Act to the date of the regular assessment or re-assessment or the last of such assessments or reassessments, as the case may be. It is true that in the regular assessment done by the Assessing Officer, the tax liability for the relevant period was found to be higher and, accordingly, the seized cash under Section 132 of the Act was appropriated against the assessee's tax liability but the fact of the matter is that the order of the Assessing

Officer was over-turned by the Tribunal finally on 20.2.2004. As a matter of fact, the interest for the post assessment period i.e. from 4.3.1994 until refund on the excess amount has already been paid by the department to the assessee. The department denied the payment of interest to the assessee under Section 132B(4)(b), according to Mr. Arijit Prasad, learned counsel for the revenue on the ground that the refund of excess amount is governed by Section 240 of the Act and Section 132B(4)(b) of the Act has no application. But, in our view, Section 132B(4)(b) deals with pre-assessment period and there is no conflict between this provision and Section 240 or for that matter 244(A). The former deals with preassessment period in the matters of search and seizure and the later deals with post assessment period as per the order in appeal.

7. The view of the department is not right on the plain reading of Section 132B(4)(b) of the Act as indicated above.

8. We, accordingly, allow the appeal and setaside the impugned order and hold that the appellant is entitled to the simple interest at the rate of fifteen percent per annum under Section 132B(4)(b) of the Act from 1.12.1990 to 4.3.1994.

9. The revenue shall calculate the interest payable to the assessee as above and pay the same to the appellant (assessee) within two months from today.

No costs.

2013 TRI 2004 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
CHENNAI "C" BENCH, CHENNAI

Dr. O.K. Narayanan, Vice President and Challa Nagendra Prasad, Judicial Member

FACTS/HELD

Section 14A & Rule 8D: Onus is on AO to show how assessee's claim is incorrect. AO has to show direct nexus between expenditure & exempt income. Disallowance cannot be made on presumptions

1. In AY 2009-10 the AO made a disallowance of Rs 58 lakhs u/s 14A read with Rule 8D. The assessee claimed that the disallowance was not permissible on the grounds that (i) the AO had not recorded any satisfaction as to the correctness of the assessee's claim that it had not incurred expenditure of more

than 2% of the dividend income earned, (ii) it had not made any fresh investment during the year and the dividend was received from an unlisted company out of an investment made in an earlier year & (iii) the AO had not pointed out any direct nexus between the interest expenditure incurred and the exempt income earned during the year. The CIT(A) accepted the claim & restricted the disallowance to Rs 50,000 On appeal by the department to the Tribunal HELD dismissing the appeal:

> (i) A disallowance u/s 14A read with Rule 8D cannot be made without recording satisfaction as to how the assessee's calculation of s. 14A disallowance is incorrect. It is a prerequisite that before invoking Rule 8D, the AO must record his satisfaction on how the assessee's calculation is incorrect. The AO cannot apply Rule 8D without pointing out any inaccuracy in the method of apportionment or allocation of expenses. Further, the onus is on the AO to show that expenditure has been incurred by the assessee for earning tax-free income. Without discharging the onus, the AO is not entitled to make an ad hoc disallowance. A clear finding of incurring of expenditure is necessary. No disallowance can be made on the basis of presumptions, (ii) the mere fact that some interest expenses were incurred cannot be the reason for disallowance unless the nexus between the expense and the exempt income is established, (iii) the assessee did not make any fresh investment during the year which could generate exempt income in forthcoming years, (iii) the exempt income earned during the year comprised of dividend received from an investment made in an earlier year, (iv) the interest expenditure of the year is not directly related to the earning of exempt income & (v) the AO has not pointed out any direct nexus between the interest expenditure incurred and the exempt income earned during the year (Hero Cycles Ltd 323 ITR 518 P&H) & Godrej and Boyce 328 ITR 81 (Bom) followed)

Appeal dismissed.

ITA No. 305/Mds/2013 (Assessment Year: 2009-10).

Heard on: 7th November, 2013.

Decided on: 7th November, 2013.

Present at hearing: T.N. Betgeri, JCIT, for Appellant. Saroj Kumar Parida, Advocate, for Respondent.

JUDGMENT

Per Challa Nagendra Prasad:– (Judicial Member)

This appeal is filed by the Revenue against the order of the Commissioner of Income Tax (Appeals)-III, Chennai dated 20.11.2012 for the assessment year 2009-10. The only grievance of the Revenue in this appeal is that the Commissioner of Income Tax (Appeals) erred in restricting the disallowance under section 14A of the Act to Rs. 50,000/- as against disallowance of Rs. 58,64,016/- made by the Assessing Officer.

2. The Assessing Officer while completing the assessments disallowed Rs. 58,64,016/- invoking the provisions of section 14A read with Rule 8D. The assessee filed an appeal before the Commissioner of Income Tax (Appeals) contending that the Assessing Officer has not recorded any satisfaction as to the correctness of the assessee's claim that it had not incurred expenditure more than 2% of the dividend income earned. The appellant contended that it had not made any fresh investment during the year and the dividend was received from unlisted company out of the investment in shares of the company made in the year 2003-04. The interest expenditure incurred by the assessee during the assessment year does not relate to earning of exempt income. The Assessing Officer has not pointed out any direct nexus between the interest expenditure incurred and the exempt income earned during the year. Therefore, there is no justification in disallowing Rs. 58,64,016/- under section 14A read with Rule 8D. The Commissioner of Income Tax (Appeals) considering the submissions of the assessee restricted the disallowance to Rs. 50,000/- under section 14A of the Act against which the Revenue is in appeal before us.

3. The Departmental Representative supports the order of the Assessing Officer .

4. The counsel for the assessee supports the order of the Commissioner of Income Tax (Appeals) and also places reliance on the decision of the co-ordinate Bench of this Tribunal in the case of Shiva Distilleries in ITA No.2125/Mds/2012 dated 26.8.2013 in support of his contention that in the absence of any satisfaction recorded by the Assessing Officer in regard to the correctness of the claim of the assessee that it had not incurred any expenditure, no disallowance under section 14A of the Act can be made.

5. Heard both sides. Perused the orders of the lower authorities and the order of this Tribunal relied on by the counsel for the assessee. The Commissioner of Income Tax (Appeals) after considering the submissions of the assessee elaborately discussed the circumstances under which the provisions of section 14A read with Rule 8D especially the interest income cannot be subjected to disallowance observing as under:–

"4.2 I have carefully considered the facts of the case and the submissions of the Id. AR. I have also gone through the decisions relied on by the AO and the AR. The AO has applied rule 8D for the above disallowance because funds for the appellant came in a common kitty and the appellant could not clearly show the utilization of the funds. The appellant has strongly contested the disallowance made by the AO. From the details of investments filed, it is found that the value of total investments as on 31.3.2008 was Rs. 12,81,09,1102/- and as on 31.3.2009 it was Rs. 4,93,16,401/-, the decrease in the value of investments was due to loss in partnership firm. The details of exempt income filed by the appellant reveal that dividend income was received from the investments made in M/sVaigai Chemical Industries Ltd., this investment was made in the year 2003-04, there was no fresh investment in the relevant assessment year in this company from which dividend was. received. Appellant has given break-up of interest expenditure of Rs. 1,13,15,453/-, from the details reproduced in para 4.1.3 (supra), it is noted that no part of interest expenditure can be attributed to any borrowing which was utilised for making investments which could generate exempt income. From the above discussion, the following points emerge:

1. The appellant did .not make any fresh investment during the year which could generate exempt income in forthcoming years.

2. The exempt income of Rs.3,33,320/- earned by the appellant during the year comprised of dividend received from an unlisted company M/s. Vaigai Chemical Industries Ltd, investment in the shares 'of this company was made in the year 2003-04.

3. The appellant incurred interest expenditure of Rs. 1,13,15,453/- during the year under five major heads, none of which is directly related to earning of exempt income.

4. The AO has not pointed out any direct nexus between the interest expenditure incurred and the exempt income earned during the year.

4.3. It is pertinent to mention here the decision of the Mumbai Tribunal in the case of M/s. Krishna Land Developers Pvt. Ltd A.Y. 2008-09 wherein the Assessing Officer made a disallowance of Rs. 31 lakhs under section 14A of the Act by applying Rule 8D without recording any satisfaction as to how the assessee's calculation of section 14A disallowance was incorrect. The ITAT held that it is a prerequisite that before invoking Rule 8D, the must record his satisfaction on how the assessee's calculation is *incorrect. The AO cannot apply Rule 8D without pointing out any inaccuracy in the method' of apportionment or allocation of expenses. Further, the onus is on the AO to show that expenditure has been incurred by the assessee for earning tax-free income. Without discharging the onus, the AO is not entitled to make an ad hoc disallowance. ·A clear finding of incurring of expenditure is necessary. No disallowance can be made on the basis of presumptions.*

Further, the Punjab & Haryana High Court in the case of CIT vs Hero Cycles Ltd (2010) (323 ITR 518) has held that for the purpose of disallowance under section 14A of the Act, expenses must have been incurred for the purpose of earning exempt income. The mere fact that some interest expenses were incurred cannot be the reason for disallowance unless the nexus between the expense and the exempt income is established.

> *"It is held in the case of Godrej and Boyce Mfg Co. Ltd vs. DC IT (194 Taxman 203) High Court of Bombay) "Sub-section (2) of section 14A does not enable the AO to apply the method prescribed by rule 8D without determining in the first instance the correctness of the claim of the assessee, having regard to the accounts of the assessee. Sub-section (2) of section 14A mandates that it is only when, having regard to the accounts of the assessee, the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of expenditure incurred in relation to income which does not form part of the total income under the Act, that he can proceed to make a determination under the Rules. The satisfaction envisaged by sub-section (2) of section 14A is an objective satisfaction that has to be arrived at by the Assessing Officer having regard to the accounts of the assessee. The safeguard introduced by subsection (2) of section 14A for a fair and reasonable exercise of power by the Assessing Officer, conditioned as it is by the requirement of an objective satisfaction, must, therefore, be scrupulously observed. An objective satisfaction contemplates a notice to the assessee, an opportunity to the assessee to place on record all the relevant facts including his accounts and recording of reasons by the Assessing Officer in the event he comes to the conclusion that he is not satisfied with the claim of the assessee."*
>
> *From the above discussion, it transpires that the objective satisfaction of the AO as to the correctness of the assessee's claim was not recorded in the instant case. However, even if Rule 8D cannot be applied, the AO is obliged to ascertain the expenditure which had been incurred to earn the tax-free*

income. He must adopt a reasonable basis consistent with the relevant facts and circumstances of the case. The appellant's dividend income during the year is Rs. 3,33,320/- and appellant estimated an expenditure of 2% of dividend income as related to exempt income and disallowed an amount of Rs.6,666/- in the computation of total income. The expenditure estimated by the appellant appears to be highly inadequate. Appellant has to incur various direct and indirect expenses in as much as the efforts of the employees go in tracking the mutual fund and other investments, purchase and sale of mutual funds and other assets, deposit of the dividend warrants, portfolio management etc. Considering the facts and circumstances of the case and judicial precedents discussed in preceding paras, a sum of Rs. 50,000/- is considered as reasonable expenditure to earn the exempt income. Accordingly, the disallowance is restricted to Rs.50,000/-. This ground is partly ***allowed****."*

6. On a careful reading of the order of the Commissioner of Income Tax (Appeals), we do not find any valid reason to interfere with the findings of the Commissioner of Income Tax (Appeals). The grounds raised by the Revenue are rejected.

7. In the result, the appeal of the Revenue is dismissed.

Order pronounced in the open court at the time of hearing on Thursday, the 7th day of November, 2013 at Chennai.