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FOREIGN CASES

Appointment of an existing partner as representative partner for another party may circumvent the ceiling on number of partners

The assessee, a firm of Chartered Accountants, filed a return offering income of Rs. 17.70 crores which was accepted by the AO u/s 143(3). The CIT then passed an order u/s 263 stating that the assessee had amended its partnership deed pursuant to which Mr. Mukund Dharmadhikari, who was already a partner of the firm, was added once again as a partner in a representative capacity, to represent Deloitte Haskins & Sells, Mumbai. As Mr. Dharmadhikari had the right to share profit, both in the representative capacity as well as in his individual capacity, the CIT held that the number of partners exceeded 20, the maximum allowed under the Partnership Act, 1932, and that the assessee had, therefore, to be treated as an Association of Persons. He held that the assessee was not entitled to claim a deduction u/s 40(b) for the salaries paid to its' partners.On appeal by the assessee to the Tribunal HELD:

> A study of the partnership deed shows that Deloitte Haskins & Sells, Mumbai, which is the participating firm, is not a stranger to the assessee. The assessee can take policy decisions, which have a policy bearing on such firm, once there is an approval of the majority of the members of the "National Firm". Mukund Dharmadhikari was representing Deloitte Haskins & Sells, Mumbai, and the endeavour of the assessee was to bring on board the participating firm, on which it had powers to make policy decision, so that they became entitled for a share of profit. In other words, the effort of the assessee was to bring indirectly into the partnership M/s Deloitte Haskins & Sells, Mumbai, which was already a participating firm. The assessee was a renowned partnership firm and was well aware that number of partners cannot exceed 20. It is a well settled principle of law that what is permissible is tax planning, but not evasion. When an attempt is made by a concern to evade tax using subtle camouflages, bounden duty of the authorities is to find out the real intention. It is the duty of the Court in every case, where ingenuity is expended to avoid taxing and welfare legislations, to get behind the smoke screen and discover the true state of affairs. The Court has to go into substance and not to be satisfied with the form. Though in Rashik Lal 229 ITR 458 (SC) & Bagyalakshmi 55 ITR 660 (SC) it was held that a partner may be a trustee or may enter into a sub-partnership with others, or can be a representative of a group of persons and that qua the partnership, he functions in his personal capacity, these decisions will not apply since the assessee was indirectly trying to bring in M/s Deloitte Haskins & Sells, Mumbai, another firm, which was already a participating firm, as its partner, circumventing the limit of

maximum 20 members. The AO did not apply his mind and go into these aspects and so the CIT was justified in directing him to look into the issue. **[Trib. Ind.] 1398**

CBDT directed to inquire into conduct of AO in framing assessment with ill-will/ ulterior motive

The assessee sold agricultural land for Rs. 1.20 crore and deposited the cash proceeds in his bank account. He filed a return in which the transaction was disclosed and claimed to be not chargeable to tax. However, as the sale deed showed the transaction at Rs. 22 lakh and because the purchasers claimed that the sale value was only Rs. 22 lakh, the AO treated the difference of Rs. 97.80 lakhs as income from undisclosed sources. The AO admitted that the evidence produced by the assessee to show that the land was in fact worth Rs. 1.20 crore and that he had in fact received the said sum from the purchasers prima facie supported the version of the assessee though he still made the addition. The CIT(A) upheld the stand of the AO though the Tribunal reversed it on the ground that the evidence on record showed that the assessee had offered the entire sale proceeds and that the purchasers had sought to undervalue the land. On appeal by the department to the High Court HELD dismissing the appeal:

The assessee is an honest citizen who deposited the entire amount in the bank and voluntarily filed return. He also made a complaint to the registering authority that the sale deed has been registered at a value much below the amount actually received. The other evidence produced by the assessee was more than sufficient to discharge the burden which the AO had unreasonably placed on the assessee. The ITO did not act in a bonafide manner. He discarded the overwhelming evidence led by the assessee without giving any reasons at all. The assessment was framed only on the ipse dixit of the AO which gives us reason to believe that he had exceeded his authority with some ill will or with ulterior motive. The CBDT should cause an enquiry into the conduct and motives of the ITO in framing the assessment and raising demand of income tax against the assessee. **[H.C. Alh.] 1449**

Companies with extreme turnover like Infosys are not comparable

The assessee, a wholly owned subsidiary of Bay Packets Inc., USA, was engaged in the business of development of software for the parent company in the field of telecommunications. To determine the arms' length price, the TPO & DRP took Infosys Technologies as a comparable. On appeal by the assessee, the Tribunal (included in file) held that the assessee was not comparable with Infosys as Infosys was a large and bigger company in the area of development of software and the profits earned by it cannot be benchmarked or equated with the assessee's results. One of the aspects pointed out by the Tribunal was that Infosys' turnover was Rs. 9,028 crores while that of

the assessee was only Rs. 16.09 crores. On appeal by the department to the High Court, HELD dismissing the appeal:

> The Tribunal's findings that Infosys should be excluded from the list of comparables for the reason that (i) Infosys was a giant company and it assumed all risks leading to higher profits, whereas the assessee was a captive unit of the parent company and assumed only a limited risk and (ii) that the financial data (turnover) was not comparable has not been controverted by the Revenue. The Tribunal has given valid and good reasons for excluding Infosys as a comparable. **[H.C. Del.] 1412**

Department's practice of not giving prompt & full credit for TDS condemned

The assessee filed a return of income in which he claimed a refund of Rs. 2.11 lakhs. An intimation u/s 143(1) was issued by the CPC Bangalore in which credit for certain TDS certificates was omitted to be given. The assessee filed a rectification application u/s 154 before the AO which was not acted upon. The assessee filed a writ petition to challenge the neglect of the AO to give proper TDS credit. Before the High Court the AO argued inter alia that as the details of the e-return had not been transferred to him by the CPC, he was not authorized to accede to any request of the assessee. It was also claimed that the assessee had not filed full details relating to the claim. HELD by the High Court allowing the Petition:

> Form 26AS, available on the department's website, clearly reflects the assessee's entitlement to credit for TDS. Instead of giving credit for the TDS, the department has adamantly continued to take the stand that there is a failure on the part of the assessee to furnish details. We are not impressed with such a stand. Computerization is with the object to facilitate easy access to the assessee and make the system more viable and transparent. In the event of any shortcoming of software programme or any genuine mistake, the Department is expected to respond to such inadvertence spontaneously by rectifying the mistake and give corresponding relief to the assessee. Instead of that, even when it is being brought to the notice of the Department by the assessee, by a rectification application and subsequent communication, not only it has chosen not to rectify the mistake, but, the lack of inter departmental coordination has driven the assessee to this Court for getting his legitimate due. This attitude for sure does not find favour with the Court, as more responsive and litigant centric system is expected; particularly in the era of computerization. Tax payers friendly regime is promised in this electronic age. For want of necessary coordination between the two departments, the assessee cannot be expected to be sent from pillar to the post. If the Centralized Processing Center meant for return processing, accounts, refund, storage of data etc. adds to the difficulties of the Tax payers, due to lack of distribution of work between back office and front office, and that

too, after having been pointed out the actual error, a serious re-look is expected. **[H.C. Guj.]** **1441**

Disallowance Cannot Exceed Total Expenditure

In AY 2008-09, the assessee earned tax-free dividend income. Its' total expenditure as per the P&L A/c was Rs. 49 lakhs. The AO applied Rule 8D and made a disallowance u/s 14A of Rs. 2.37 crores which was reduced by the CIT (A) to Rs. 1.78 crores. Before the Tribunal, the assessee claimed that even assuming that the entire expenditure had been incurred to earn the dividend, the disallowance u/s 14A & Rule 8D could not exceed the expenditure incurred. HELD accepting the plea:

U/s 14A read with Rule 8D, disallowance can be made for the expenditure incurred for earning of exempt income. From the assessee's P&L A/c, it is evident that the total expenditure incurred was Rs. 49 lakhs only which was claimed as a deduction. The disallowance u/s 14A & Rule 8D cannot exceed the expenditure actually claimed by the assessee. Accordingly, the action of the AO & CIT (A) in making disallowance in excess of total expenditure debited to P&L A/c is unjustified. **[Trib. Ind.]** **1407**

Disallowance if satisfaction not recorded with reference to A/cs. Under Rule 8D(2)(ii) loans for specific business purposes cannot be included. Under Rule 8D(2)(ii) & (iii) investments which have not yielded income cannot be included

In AY 2008-09, the assessee invested Rs.103 crores in shares on which it earned tax-free dividends of Rs. 1.3 lakhs. The assessee claimed that though its borrowings had increased by Rs. 122 crores, the said investments were funded out of own funds like capital and profits. It claimed that no expenditure had been incurred to earn the dividends and no disallowance u/s 14A could be made. The AO applied Rule 8D and computed the disallowance at Rs. 4 crore. On appeal by the assessee, the CIT(A) reduced the disallowance to Rs. 26 lakh. On cross appeals, HELD by the Tribunal:

(i) When the AO does not accept the assessee's claim regarding the non-applicability/ quantum of disallowance u/s 14A, he has to record satisfaction on that issue. This satisfaction cannot be a plain satisfaction or a simple note. It has is to be done with regard to the accounts of the assessee. On facts, as there is no satisfaction by the AO, no disallowance u/s 14A can be made (Balarampur Chini Mills 140 TTJ (Kol) 73 (included in file) followed);

(ii) Rule 8D(2)(ii) is a computation provision in respect of expenditure incurred by way of interest which is not directly attributable to any particular income or receipt. This clearly means that interest expenditure which is directly relatable to any particular income or receipt is not to be considered under rule 8D(2)(ii). The AO has to show that the interest is not directly attributable to any particular income or receipt. In the assessee's case, the interest has been paid on loans taken from banks for business purpose.

There is no allegation that the loan funds have been diverted for making investment in shares or for non-business purposes. The loans are for specific business purposes and no bank would permit the loan given for one purpose to be used for making any investment in shares. Also, the assessee has substantial capital & reserves. Accordingly, the interest on the loans cannot be included in Rule 8D(2)(ii);

(iii) Further, in Rule 8D(2)(ii), the words used in numerator B are "the average value of the investment, income from which does not form or shall not form part of the total income as appearing in the balance-sheet as on the first day and in the last day of the previous year". The AO was wrong in taking taken into consideration the investment of Rs.103 crores made during the year which has not earned any dividend or exempt income. It is only the average of the value of the investment from which the income has been earned which is not falling within the part of the total income that is to be considered. Thus, it is not the total investment at the beginning of the year and at the end of the year, which is to be considered but it is the average of the value of investments which has given rise to the income which does not form part of the total income which is to be considered. The term "average of the value of investment" is used to take care of cases where there is the issue of dividend striping;

(iv) Under Rule 8D(2)(iii), what is disallowable is an amount equal to ½ percentage of the average value of investment the income from which does not or shall not form part of the total income. Thus, under sub-clause (iii), what is disallowed is ½ percentage of the numerator B in rule 8D(2)(ii). This has to be calculated on the same lines as mentioned earlier in respect of Numerator B in rule 8D(2)(ii). Thus, not all investments become the subject-matter of consideration when computing disallowance u/s 14A read with rule 8D. The disallowance u/s 14A read with rule 8D is to be in relation to the income which does not form part of the total income and this can be done only by taking into consideration the investment which has given rise to this income which does not form part of the total income.

[Trib. Ind.] 1374

ICAI directed to initiate disciplinary proceedings against CA for suppressing information and obtaining order by fraud

The assessee bought and sold shares and claimed that he had earned capital gains which were exempt u/s 54F. When the AO alleged that the transactions were bogus and entered into for converting black money into white, the assessee surrendered the claim for exemption u/s 54F and offered the capital gains to tax. The AO levied penalty u/s 271(1)(c) on the ground that the surrender of income was not voluntary. This was upheld by the Tribunal. The assessee filed an appeal before the High Court which was dismissed. The assessee thereafter filed a Miscellaneous Application

before the Tribunal on the ground that as the AO had not specified whether the penalty was for concealment or for furnishing inaccurate particulars, penalty could not be levied. The Tribunal allowed the MA and deleted the penalty (order included in file). The Department then filed a MA stating that as the first order of the Tribunal had merged in the order of the High Court, the subsequent MA was not maintainable. The assessee accepted that he was advised by his CA not to disclose the fact of dismissal of the appeal by the High Court in the MA so filed. The CA argued that though the fact of dismissal of the appeal was not stated in the MA he had not concealed the fact because it was known to the Department. HELD by the Tribunal allowing the MA:

> In the last 40 years, a new creed of litigants has cropped up. Those who belong to this creed do not have any respect for truth. They shamelessly resort to falsehood and unethical means for achieving their goals. In order to meet the challenge posed by this new creed of litigants, the courts have, from time to time, evolved new rules and it is now well established that a litigant, who attempts to pollute the stream of justice or who touches the pure fountain of justice with tainted hands, is not entitled to any relief, interim or final. On facts, it was the duty of the assessee to disclose the decision of the High Court to the Tribunal while moving the MA and by not doing so, they did not come to the ITAT with clean hands. The assessee and his CA are guilty of fraud for deliberately suppressing the fact that the High Court had dismissed the assessee's appeal and that the MA was not maintainable. The MA order is thus a nullity and non est in the eyes of law. The CA's conduct amounts to professional misconduct and requires disciplinary action by the ICAI. **[Trib. Ind.]** **1457**

Onus is on AO to show expenditure is incurred to earn tax-free income

For AY 2006-07, the assessee earned dividend of Rs. 17 lakhs and LTCG of Rs. 12 crores. The assessee claimed that it had incurred no expense to earn the tax-free income and so no s. 14A disallowance was permissible. However, the AO disallowed Rs. 2 crores under Rule 8D towards interest and admin expenditure. The CIT (A) accepted that no interest was incurred and deleted that disallowance. He also reduced the admin expenditure disallowance. On appeal to the Tribunal, HELD:

(i) The contention of the Revenue that some expenditure, directly or indirectly, is always incurred for earning tax-free income cannot be accepted. The burden is on the AO to establish the nexus of the expenditure incurred with the earning of exempt income before making any disallowance u/s 14A (Hero Cycles 323 ITR 518 (P&H), Jindal Photo followed)

(ii) As regards interest, the AO has to show the nexus between the borrowed funds and the tax free investments. If that is not done, disallowance of interest is not permissible (K. Raheja Corporation (Bom) followed)

(iii) As regards admin expenses, s. 14A disallowance cannot be made on an ad-hoc basis. It is the department's responsibility to bring material on record to show that expenditure was incurred for earning the exempt income. If this is not done, disallowance is not permissible (Wimco Seedlings followed) **[Trib. Ind.] 1421**

Though Duty Drawback & DEPB were held not eligible for deduction in Liberty India 317 ITR 218 (SC), answer could be different if business model shows dependence on Duty Drawback & DEPB for survival

The assessee claimed that the "duty drawback" receipt of Rs. 1.53 crores was eligible for deduction u/s 80-IB on the ground that the said duty drawback refund was a refund of customs and central excise duty on inputs used in manufacturing of its products. The AO & CIT(A) rejected the claim by relying on Liberty India 317 ITR 218 (SC) where it was held that duty drawback was not "derived" from the industrial undertaking. On appeal by the assessee to the Tribunal HELD:

Though in Liberty India it was held that duty drawback and DEPB arises from an independent source and is not "derived" from the industrial undertaking, in Dharam Pal Premchand 317 ITR 353 (Del) (SLP dismissed) it was held that refund of excise duty had a direct nexus with the manufacturing activity & was eligible for s. 80-IB deduction. Accordingly, though duty drawback & DEPB was held in Liberty India to be an independent source of income and to not have a "first degree" nexus with the undertaking, this was in the context of a fact-situation where the duty drawback & DEPB did not arise from core activities of the undertaking and was an additional, ancillary or supplemental profit. There can be situations in which duty drawback itself could be more than the overall profits and in such situations, the duty drawback may not be seen on standalone basis or as an independent source of income because the overall profit is only a part of the duty drawback receipt, and the commercial motivation of running the industrial undertaking is earning only that part of duty drawback receipts. On the present facts, the duty drawback was more than the entire operational profit and so it cannot be an open and shut inference that the duty drawback receipts are an independent source of income and have no first degree nexus with the business activity of the industrial undertaking. There is still room for consideration of the plea that but for the duty drawback the assessee would not have carried out the business activity in the industrial undertaking, because, that would have meant carrying out business for incurring losses. If that be so, the duty drawback receipts can be said to derived from the undertaking and to be eligible for s. 80-IB deduction. The question whether the duty drawback is an incidental profit or a profit of the first degree depends on the business model followed by the assessee.

[Trib. Ind.] 1485

CASE LAW

Section 14A of Indian Income Tax Act

— See **Disallowance if satisfaction not recorded with reference to A/cs. Under Rule 8D(2)(ii) loans for specific business purposes cannot be included. Under Rule 8D(2)(ii) & (iii) investments which have not yielded income cannot be included** (vi)

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The Development of Islamic Finance

by
*Davy Yun and Finsen Chan**

Recognizing the opportunities provided by the tremendous growth in Islamic financial products, Hong Kong has recently introduced a bill to amend its tax laws to provide a tax-neutral environment to promote the sector. This article looks at the proposed changes and the possibilities it could bring in positioning Hong Kong as an Islamic finance hub.

1. Introduction

The promotion of Islamic finance was articulated as a key policy initiative by the Hong Kong Chief Executive in 2007. After rounds of consultation and refinement, a 200-plus page legislative Bill amending both the Inland Revenue Ordinance and the Stamp Duty Ordinance was introduced and is due to be passed in 2013. The measures in the Bill are designed to provide a level playing field for Islamic finance from a Hong Kong tax perspective. Given Hong Kong's emphasis on maintaining its simple tax system, the scale of the proposed changes is remarkable.

This article looks at the proposed changes and explores Hong Kong's potential to become an Islamic finance hub from a tax perspective. The value of Islamic finance assets worldwide, estimated at USD 1.34 trillion in 2012, is growing at a compounded annual rate of 15% to 20%. During the global financial crisis, Islamic finance assets demonstrated their superior stability compared to traditional financial products due to their linkage with tangible assets (as compared to derivatives created under the conventional finance system). Recognizing the potential of the system, a number of countries have already taken steps to facilitate and promote Islamic finance and have become Islamic financial hubs. One approach, which has been adopted by countries such as Japan, Malaysia, Singapore and the United Kingdom, is to amend the domestic tax rules to make them conducive to an Islamic finance market.

As a reputable international financial centre, Hong Kong is well positioned to become a regional Islamic financial hub. Prior to analyzing the proposed legislative changes in Hong Kong, one should first look at what Islamic finance actually is.

2. What is Islamic Finance?

Very broadly speaking, the two fundamental characteristics of Islamic finance in which it differs from traditional are as follows:

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- Muslims may not invest in certain prohibited businesses, e.g. those related to alcohol, pork-related products, conventional financial services which involve the charging of "interest", gambling, tobacco, etc.;[1] and
- the charging or paying of "interest" is prohibited.

Although sharia law prohibits the charging or paying of interest, it does not preclude other forms of return on an investment such as rent or profits that the parties agree on at the time the contract is entered into.

3. Sharia-Compliant Products

Most discussion of Islamic finance concerns the various investment and bond arrangements arising from the prohibition of charging or paying. However, the prohibition on certain types of investment is no less important as it determines the types of investments Muslims can undertake. Jurisdictions without a large Muslim population can design products that will attract investment from Muslim jurisdictions. Accordingly, various jurisdictions have facilitated the setting up of funds encompassing investments that meet the "type of investment" criteria, and Hong Kong is no exception.

The Dow Jones Islamic Market China and Hong Kong Titans Index was set up in 2007, following the Chief Executive's policy speech in the same year, to track the performance of the 30 largest Hong Kong sharia-compliant listed companies with primary operations in Hong Kong and Mainland China. The Hang Seng Islamic China Index Fund is one of the funds that invest in such index constituent stocks (i.e. Hong Kong-listed shares, including "H shares"[2]). In short, Hong Kong has had mechanisms to attract investment from the Islamic population since 2007. Due to the rapid and continuing economic growth of China, more funds are investing directly into sharia-compliant Chinese companies listed on the Shanghai or Shenzhen stock exchanges through the Qualified Foreign Institutional Investor (QFII) programme, even though an Islamic tracking index has not yet been set up for "A shares".[3] The QFII programme, launched in 2002 in China, permits licensed foreign investors to buy and sell yuan-denominated A shares on the Shanghai and Shenzhen stock exchanges. From both Chinese and Hong Kong tax perspectives, it is advantageous to use a Hong Kong company as the vehicle investing in A shares under the QFII programme. One of the key benefits is the potential savings in

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[1] In addition to the categories of prohibited businesses, other criteria would include certain financial ratios that are intended to remove companies with specific debt and interest income levels in their balance sheets in accordance with Islamic law.

[2] "H" shares are shares of companies established in Mainland China that are traded on the Hong Kong stock exchange.

[3] "A" shares are shares of companies established in Mainland China denominated in renminbi currency that are traded on the Shanghai and Shenzhen stock exchanges. In general, A shares cannot be bought and sold by non-Chinese individual or companies unless through the QFII programme.

Chinese enterprise income tax under the China-Hong Kong tax arrangement when the Hong Kong company disposes of the shares of the Chinese company, provided (i) the Hong Kong company does not own 25% or more of the Chinese company at any time within the 12-month period before the date of disposal; and (ii) the Chinese company is not a landrich company.[1] Under the QFII programme, no single foreign investor is permitted to hold more than 10% of a Chinese company, so under the double taxation arrangement, such disposal gains may only be taxed in Hong Kong and may not be taxed in China. In Hong Kong, gains derived from the disposal of A shares traded only on a Chinese stock exchange are offshore-sourced and therefore non-taxable, which effectively means that such gains are potentially free of both Chinese and Hong Kong income taxes. However, it is not entirely certain that in these circumstances the Chinese tax authorities would accept the Hong Kong investment vehicle, which may simply be holding the investments on behalf of other investors, as the beneficial owner of the Chinese company whose shares are disposed of under Chinese tax law.

4. Investment Arrangements

Since the charging or payment of "interest" is prohibited under sharia law, alternative arrangements (i.e. investment arrangements) have to be deployed. Hong Kong's proposed legislation deals with the following types of arrangements:[2]

- *Ijarah (leaseback arrangements);*
- *Musharakah and Mudarabah (profit-sharing arrangements);*
- *Murabahah (purchase and sale arrangements); and*
- *Wahalah (agency arrangements).*

Under these arrangements, "interest" is replaced by another form of reward, such as rent or profits. Below are some examples demonstrating how these investment arrangements may work in practice.

In an *Ijarah* arrangement (see Diagram 1), the borrower may wish to borrow using its own property as collateral. To achieve this in a sharia-compliant manner, the lender would purchase the property and then lease it back to the borrower. After a number of years, the borrower would repurchase the property from the lender. The "rental payments" would, in substance, represent the interest element.

Diagram 1: *Ijarah* (leaseback arrangement)

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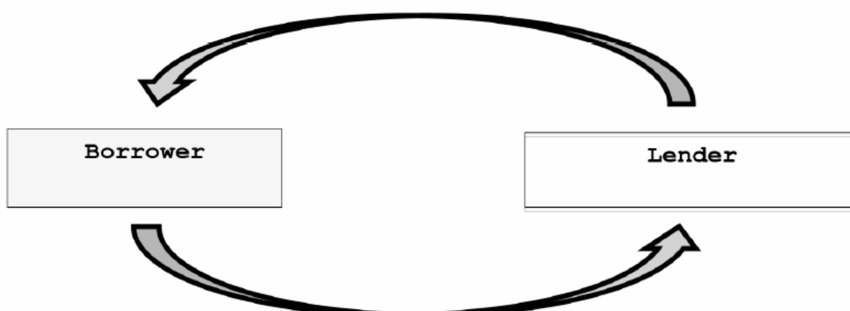
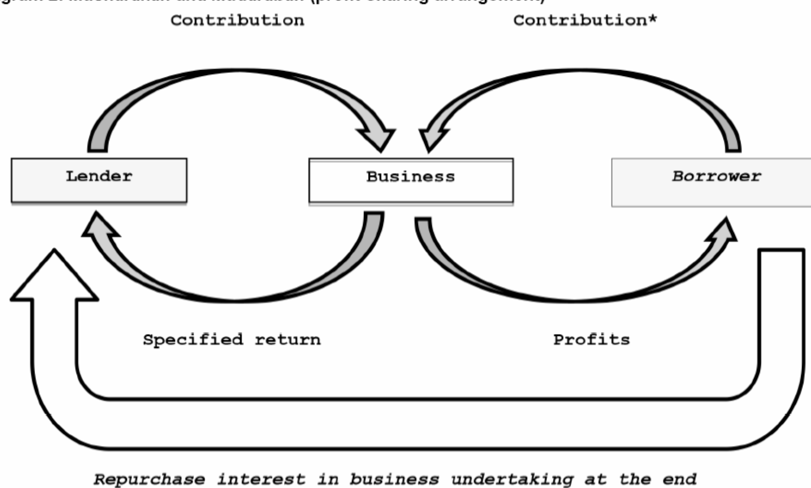
[1] More than 50% of the value of the Chinese company's assets comprise real estate located in China directly or indirectly.

[2] Other arrangements, such as Takaful (Insurance arrangements), which are commonly accepted in other countries are not covered by the proposed Hong Kong legislation.



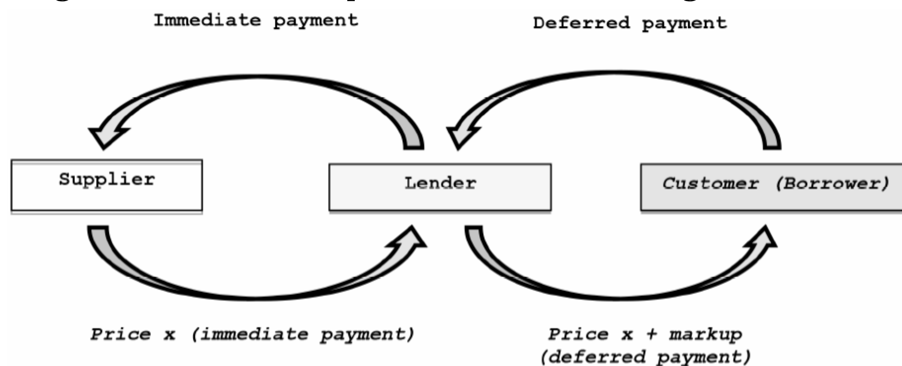
Under *Musharakah* and *Mudarabah* arrangements (see Diagram 2), the borrower wishes to borrow funds to embark on a new business. To comply with sharia law, the lender would enter into a business undertaking with the borrower under which the lender would contribute money and the borrower would make a cash or an in-kind contribution (*Musharakah*), or would contribute management or expertise and management skills (*Mudarabah*). The lender and the borrower would share the profits or losses arising from the undertaking. The return to the lender may be regarded as representing interest in certain cases.

Diagram 2: *Musharakah* and *Mudarabah* (profit-sharing arrangement)



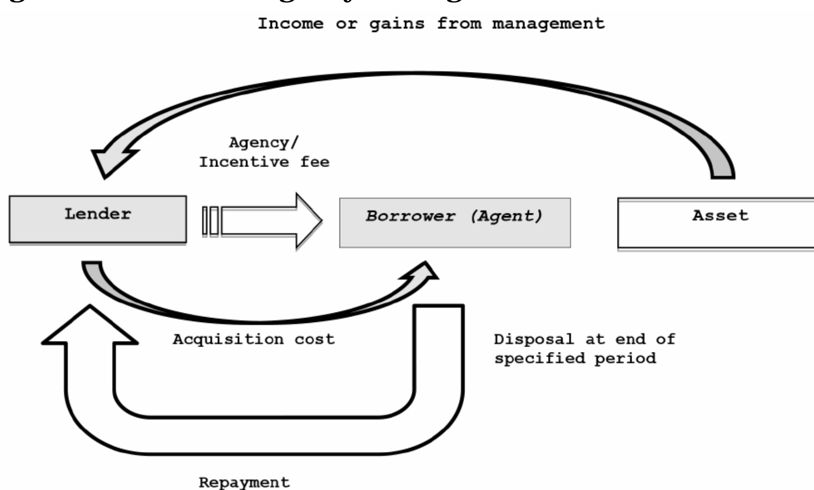
In a *Murabahah* arrangement (see Diagram 3), the borrower may wish to borrow to purchase trading stock. To comply with sharia law, the lender would first acquire the stock for an on-sale to the borrower at a markup. The borrower then would settle the purchase price on a deferred basis (e.g. after he had sold the stock). The markup may be regarded as representing the interest charge.

Diagram 3: *Murabahah* (purchase and sale arrangement)



In a *Wahalah* arrangement (see Diagram 4), the borrower seeks to borrow to purchase an asset to generate recurring income. To comply with sharia law, the lender would buy the asset and appoint the borrower as its agent in managing the asset. After a specified period, the lender would sell the asset to the borrower. During the interim period, the lender would receive income or gain from the management of the asset by the borrower acting as the lender's agent. The lender in turn would pay an agency/incentive fee to the borrower. The net return to the lender, being the difference between the income or gain and the agency/incentive fee expenses, may be regarded as representing the interest element.

Diagram 4: *Wahalah* (agency arrangement)



5. Bond Arrangements[1]

In addition to using their own equity, financial institutions can raise financing through the issuance of bonds. The ability of bondholders to redeem the bonds upon their expiry date means that there is no "interest" charge as such, although, in economic terms, the difference between the redemption price and the issuance price would closely resemble the "interest" element. Such a "bond arrangement" can involve unlisted or listed bonds on a local or foreign stock exchange.

While different jurisdictions accord different tax treatments to such bond arrangements and the investment arrangements discussed above, most take a "tax-neutral" approach, such that both the investment and bond arrangements receive the same tax treatment as in the case of conventional finance. For example, under an *Ijarah* arrangement (leaseback), the sale and repurchase transactions generally would be disregarded, with the rental income effectively being deemed to an interest expense and the purchase (or repurchase) amount a loan. An exemption would be granted from any transaction taxes, such as stamp duty, that otherwise would be charged on a sale and repurchase transaction. The same would apply to other investment arrangements, i.e. the transaction would be taxed as if it were a loan transaction involving an interest payment.

In addition to providing this tax-neutral treatment, some countries offer additional incentives to promote Islamic finance. For example, Malaysia grants a full tax exemption to Islamic banks on income derived from Islamic banking business conducted in international currencies from the year of assessment 2007 to 2016. Singapore reduces the income tax rate on Islamic finance activities to 12% (compared to the normal 17%) following the expiry of the 5% concessionary tax rate that applied from 1 April 2008 to 31 March 2013.

The proposed legislation in Hong Kong does not confer any additional tax incentives, but does grant tax-neutral treatment. Some of the conditions that must be satisfied to obtain tax-neutral treatment are unique:

(1) *Bond arrangements with investment arrangements*: Under the proposed legislation, if there was an investment arrangement, there would have to be a bond arrangement before tax relief could be granted. In other words, if a financial institution simply entered into an Ijarah with a borrower without issuing any bonds to finance the transaction, no tax relief would be available under the transaction. This is a different approach to approaches taken by other countries, such as Malaysia, Singapore, the United Kingdom, etc. This approach implies that the Hong Kong government's intention is probably not to implement Islamic finance on a "retail" scale, but rather on a

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[1] This refers to *sukuk*, the Arabic name for financial certificates, also the Islamic equivalent of bonds.

"wholesale" scale (see also point (2) below). This also may prevent some taxpayers from using Ijarah to avoid the payment of stamp duty and profits tax in avoidance schemes involving property transactions.

(2) *Requirement that investment and debt arrangements be classified as "loans" from an accounting perspective*: This condition in Hong Kong's proposed rules would require that both investment and debt arrangements be treated as a financial liability in accordance with Hong Kong Financial Reporting Standards or International Financial Reporting Standards. From an accounting perspective, both the investment and debt arrangements would be classified as loan and interest transactions. This could pose problems for some sharia-compliant investment arrangements, such as *Musharakah* and *Mudarabah*, in which profits and losses are shared. In practice, many *Musharakah* and *Mudarabah*[1] have been structured as products with a fixed percentage of distribution on profits bench-marked at an interest rate.

(3) "*Hong Kong connection*": Bonds issued under the debt arrangement must be connected with Hong Kong in some way, i.e. they must be listed on the Hong Kong stock exchange or be issued in good faith and in the course of carrying on business in Hong Kong, or marketed in Hong Kong, or lodged with and cleared by the Central Moneymarkets Unit operated by the Monetary Authority.

There are other conditions relating to investment and debt arrangements, such as the "maximum term length", "bondissuer as conduit," etc. that must be satisfied for tax-neutral treatment to apply. Nevertheless, the above distinctive conditions provide a basic landscape as to how Islamic finance in Hong Kong will operate going forward.

6. Conclusion

China currently does not have any plans to offer tax-neutral treatment for Islamic finance, although the Ningxia Hui Autonomous Region, the region with the highest Muslim population in China, has been considered a hub for Islamic finance since 2008. Given Hong Kong's peripheral position, the new legislation should open the door for Islamic banking, though perhaps, at this stage, not as widely as that door has been opened in other countries.

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[1] For this reason, it is not surprising that some Islamic scholars have commented that current *sukuk* may not be sharia-compliant, since under sharia principles there should be no fixed rate of profit or guaranteed refund of capital.

ESOP: Being used as a Double Edged Sword by the Department

by
Vidhan Surana, CA & Sunil Maloo, CA

Today, organizations realize that they have to go that extra mile to make their employees stay. Sharing their wealth and helping employees create wealth in the form of 'Employee Stock Option Plan (ESOP)' is one such initiative, which is gaining immense popularity in recent times.

An employee stock ownership plan (ESOP) is an employee-owner scheme that provides a company's workforce with an ownership interest in the company. This is the latest trend in the industry. This is a very important tool in almost all industries. Where, the greatest assets are the employees and their knowledge. The organization loses on this if the employee were to leave. So in order to retain the employees they are offered direct participation in the form of shares of the company.

1. Accounting Treatment of ESOP Costs:-

The ESOP scheme has to be constituted in accordance with the SEBI guidelines, provisions of Companies Act, 1956 and compliance of accounting treatments as laid down in guidance note issued by ICAI. In this regard, the ICAI has issued Guidance Note on Accounting for Employee Share-based Payments.

2. Allowability of ESOP Costs to Employers

Following are the justification for claiming a deduction of ESOP costs debited to the profit and Loss Account as an allowable deduction while computing "Profits and gains of business or profession":–

Justification of ESOP expenses could be summarized on the basis of following bullet points:–

a) Business Expediency of ESOP's in the present scenario

Employee Stock Option Plan (ESOP): Meaning

Section 2(15A) of the Indian Companies Act, 1956 defines "employee stock option" to mean '*the option given to the whole-time Directors, Officers or employees of a company, which gives such Directors, Officers or employees, the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a predetermined price*".

An ESOP is a right to buy shares at a pre-determined price. The option granted under the plan confers a right but not an obligation on the employee. Stock options are subject to vesting, requiring continued service over a specified period of time. Upon vesting of options, employees can exercise the options to get shares, by paying the pre-determined exercise price.

ESOPs are being increasingly used as a compensation tool to attract and retain talented employees. Companies believe that ESOPs enhance productivity, motivate employees and increase employees' interest in the company's overall performance. With the market bouncing back, job opportunities are being created at large. Hence, in the interest of company such type of incentive required and accordingly SEBI also approved such mechanism. Companies are looking at competent employees who can stay with them for a longer period. This means giving them something more than just cash reward; thus, organizations are coming up with an ESOP scheme for their employees. In this cut - throat competitive business environment, ESOPs are one of the important tools to attract and retain employees. The feeling of ownership encourages employees to have long term career aspirations in the organization.

Today, globalization and competition are pushing every organization to employ various techniques to retain and motivate employees, and the practice of giving ESOPs to employees certainly emerges as a winner.

Attracting and retaining competent personnel / employees is an uphill task faced by all organizations. Besides cash rewards, it is important for an organization to make its employees believe that their personal growth is linked with the growth of the organization. ESOP's are one of the important tools to achieve this objective. The feeling of ownership aligns employees' aspirations with the long-term objectives of the organization. **Therefore, in such situations, there is exerting obligation on part of the employers to retain its competent & qualified work force**.

Accordingly in present scenario more and more companies are considering equity-linked incentive plans as an avenue to incentivize their employees. The companies consider ESOPs for the following key reasons:

The market pays the upside to its employees.

There is no cash outflow for the company.

Helps in retaining and attracting talent.

Provides sense of ownership to employees.

Thus it is clear that the ESOPs costs are incurred by the employers for the purpose of business. It is settled principle of law that no businessman can be compelled to maximize his profit. While considering the claim of deduction of any expenditure, Income-tax authorities must put themselves in the shoes of the Assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own viewpoint, but that of a prudent businessman.

It is axiomatic that the taxation rules are always embodied in the relevant Act, either in a specific or a general manner. Under the head 'Profits and gains of business or profession', there is section 37(1), which grants deduction for expenses not specifically set out in other sections, if the conditions stipulated in the section, are fulfilled. To put it in simple words, this section is a specific provision for granting deduction in respect

of the unspecified or the general categories of expenses. Therefore, Discount on ESOP is a general expense not specified anywhere else in the head of 'Profits and gains of business or profession' and hence shall be covered by the general provision of section 37.

b) Allowability based on principle of avoidance of double taxation in hands of employer as well as in hands of employees of the same item

The Action of the department in denying the allowability of the claim of ESOP Cost shall result into double taxation of the same item as under:–

Taxable in hands of the Employer as not allowable deduction; and

Taxable in hands of employees as "Perquisite" u/s 17(2) of the Act.

Taxation of ESOPs in India has witnessed continuous change. Up to the financial year ending March 1999, there were no specific provisions for taxing the benefits arising from ESOPs. The ESOPs were generally taxed as a perquisite in the hands of the employees on the difference between the FMV of the stock on the date of vesting of the options and the exercise price. Subsequently, there was a concessional tax treatment for ESOPs, which were designed in accordance with prescribed ESOP Guidelines. The taxation triggered only at the time of sale of the shares for such qualified ESOPs. Unqualified ESOPs were taxable as a perquisite on the difference between the FMV on the date of vesting/exercise and the exercise price.

During the period April 2007 to March 2009, employer was required to pay Fringe Benefit Tax (FBT) on benefit derived by employee from ESOPs. The employer was allowed to recover such FBT from the employees.

Currently, ESOP benefits are taxable as perquisite and form part of employee's salary income. The employer is required to withhold tax at source in respect of such perquisite. Section 17(2)(vi) of the Act (**as inserted by Finance (No. 2) Act, 2009**) in this regard is reproduced as under for ready reference:-

17(2) "perquisite" includes–

(vi) the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee.

Explanation.—For the purposes of this sub-clause,—

(a) "specified security" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and, where employees' stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme;

The perquisite value is computed as the difference between the FMV of the share on the date of exercise and the exercise price. There are specific valuation rules prescribed for listed and unlisted companies. Unlisted companies need to determine the FMV by a Category I Merchant Banker registered with SEBI.

It is important to note that under the scheme of the Income Tax, allowability of expenditure is absolutely linked with the method of the accounting consistently followed by the Assessee irrespective of the actual cash flow payment of the said transaction except specifically provided in the Act. Disallowance of claim of ESOP cost by the AO would tantamount to the double taxation of the same income, which has no sanctity under the scheme of Income Tax Act.

It is a cardinal principle of law that No one should be twice harassed for the same cause. The Department & Assessing Officer should not act like Sherlock Holmes —"**Head I win and tail you lose**" it would be alien to the principles of justice.

According to unambiguous provisions of section 17(2) of the Act, said item is taxable in the hands of employees as Perquisite, therefore, now there is no reason to again make double taxation in hands of employer of same item.

The doctrine of '**approbate and reprobate**' as borrowed in our jurisprudence from the scotch law gives strength to this basic rule. There cannot be approval and rejection in the same stream. To attempt to take advantage of one part and to reject the rest is against the fine norms of jurisprudence.

Denial of the claim of ESOP expenses debited to profit and loss statement shall result into clear cut breach of this tenet of law. It is abundantly clear from law as on date that the amount of ESOP Expenses is taxable to employees as perquisite. Then it is incumbent on the department to consider the claim of the ESOP cost judicially.

3. Judicial Pronouncements in this respect:-

Allowability of the ESOP cost has been a matter of scrutiny by various tribunals and diverse views on both sides were expressed. In the case of Ranbaxy Laboratories Limited v. DCIT [ITA Nos. 1666 & 2050/Del/2006] on 24.07.2009, the ITAT has upheld the action of the AO with respect to the denial of allowability of the claim of ESOP Cost and held that since the receipt of share premium is not taxable, any short receipt of such premium on issuing options to employees will be notional loss and not actual loss for which any liability is incurred.

However, Hon'ble Delhi High Court has admitted the further appeal against the judgment of the Delhi Tribunal in ITA No. 767/2010, **which is pending before the Court**. The Delhi High Court has admitted following questions of the law:–

(i) Whether on the facts and in the circumstances of the case, the tribunal erred in law in holding that the difference between the

price at which stock options were offered to the employees of the appellant company under the ESOP Scheme and the prevailing market price of the stock on the date of grant of such options was not allowable expenditure under Section 37(1) of the Act?

(ii) Whether on the facts and in the circumstances of the case, the tribunal erred in law in not holding that the difference between the prevailing market price of the stock and the price at which stock options were offered to the employees under the ESOP Scheme, resulting in benefit to the employees and thus constituting remuneration of the employees was, allowable deduction under Section 37 of the Act?

And also the statue book has been amended vide the Finance Act, 2012 by inserting clause (viib) of section 56(2) w.e.f. 1.4.2013 providing that : 'where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares', then such excess share premium shall be charged to tax under the head 'Income from other sources'.

Further, recently the Special Bench of Bangalore ITAT in case of *Biocon Ltd. vs DCIT*, reported in [2013] 35 taxmann.com 335 (Bangalore - Trib.) (SB) has considered this issue after detailed, careful and deep analysis of the law available on this issue as well as of all the earlier judicial pronouncements available in the matter.

The Special bench of Bangalore ITAT has answers very important questions as under:–

Sr. No.	**Question**	**Answer given by the Special Bench**
1	Whether any deduction of such discount is allowable?	Yes
	A. Is discount under ESOP a short capital receipt?	Para 9.2.6 *"It is quite basic that the object of issuing shares can never be lost sight of. Having seen the rationale and modus operandi of the ESOP, it becomes out-and-out clear that when a company undertakes to issue shares to its employees at a discounted premium on a future date, the primary object of this exercise is not to raise share capital but to earn profit by securing the consistent and concentrated efforts of its dedicated employees during the vesting period. Such discount is construed, both by the employees and company, as nothing but a part of package of remuneration.*

		Thus, the contention of the ld. DR that by issuing shares to employees at a discounted premium, the company got a lower capital receipt, is bereft of an force. *By no stretch of imagination, we can describe such discount as either a short capital receipt or a capital expenditure. It is nothing but the employees cost incurred by the company."*
	B. Is discount a Contingent liability?	Para 9.3.6 If we consider it at micro level qua each individual employee, it may sound contingent, but if view it at macro level qua the group of employees as a whole, it loses the tag of 'contingent' because such lapsing options are up for grabs to the other eligible employees. In any case, if some of the options remain unvested or are not exercised, the discount hitherto claimed as deduction is required to be reversed and offered for taxation in such later year. We, therefore, hold that the discount in relation to options vesting during the year cannot be held as a contingent liability.
	C. Fringe benefit	Para 9.4.1 Thus it is discernible from the above provisions of the Act that the legislature itself contemplates the discount on premium under ESOP as a benefit provided by the employer to its employees during the course of service. If the legislature considers such discounted premium to the employees as a fringe benefit or 'any consideration for employment', it is not open to argue contrary. Once it is held as a consideration for employment, the natural corollary which follows is that such discount (i) is an expenditure; (ii) such expenditure is on account of an ascertained (not contingent) liability ; and (iii) it cannot be treated as a short capital receipt. In view of the foregoing discussion, we are of the considered opinion that discount on shares under the ESOP is an allowable deduction.
2	If yes, then when and how much?	Para 10.8 We, therefore, agree with the conclusion drawn by the tribunal in SSI Ltd.'s case allowing deduction of the discounted premium during the years of vesting on a straight line basis, which coincides with our above reasoning.

3	Subsequent adjustment to discount	Para 11.1.6 11.1.6 The amount of discount at the stage of granting of options w.r.t. the market price of shares at the time of grant of options is always a tentative employees cost because of the impossibility in correctly visualizing the likely market price of shares at the time of exercise of option by the employees, which, in turn, would reflect the correct employees cost. Since the definite liability is incurred during the vesting period, it has to be quantified on some logical basis. It is this market price at the time of the grant of options which is considered for working out the amount of discount during the vesting period. But, since actual amount of employees cost can be precisely determined only at the time of the exercise of option by the employees, the provisional amount of discount availed as deduction during the vesting period needs to be adjusted in the light of the actual discount on the basis of the market price of the shares at the time of exercise of options. It can be done by making suitable northwards or southwards adjustment at the time of exercise of option.

Other judicial pronouncements allowing deduction for ESOP Costs:-

1. *S.S.I Ltd vs. DCIT* 85 TTJ 1049
2. *CIT v. PVP Ventures Ltd.* 23 taxmann.com 286 (Madras) in context of Section 263
3. *Spray Engineering Devices Ltd. v. ACIT* 23 taxmann.com 267 (Chandigarh - Trib.)

Conclusion:–

Thus, under the above background of the legal and judicial position as on date, it can be precisely concluded that ESOP costs debited by the Employers in the statement of Profit and Loss is not at all notional loss or contingent liability, on the contrary same is a business expenditure incurred wholly and exclusively for the purpose of the business and same deserves allowability under the Income Tax Act while computing 'Profits and gains of business or profession'. As by granting these options, the employer gets a sort of assurance from its employee for rendering uninterrupted services during the vesting period and as a quid pro quo it undertakes to compensate the employees with a certain amount given in the shape of discounted premium on the issue of shares. However, still the verdict of higher forums such as High Courts and Supreme Court is lacking in this matter, having implications on all the employers Assessee's through out India.

The Duties and Accountability of Lawyers

by
Sohrab Erach Dastur, Senior Advocate

Eminent Jurist Soli Dastur draws upon his rich experience of the past five decades to lay down the duties and accountability of lawyers and how they should deal with several ethical issues and areas of conflict that arise in day - to - day practice. With his usual candour and clarity of expression, he examines the issues threadbare and provides invaluable and authoritative guidance on what they should do in difficult situations so as to keep their professional integrity intact at all times. Though written in the context of lawyers, the article provides guidance to professionals in all fields

A story going the rounds is that the Chairman of a company after referring to the next speaker as a lawyer added "*he is nevertheless a nice person*." But is the jibe deserved? Before passing judgement it would be appropriate to consider the duties a lawyer owes to his client, to his profession and to the Court, his accountability therefor and the conflicts which arise in discharging the separate and distinct duties. Recently, the emphasis has shifted to the lawyer's duty to Society. Though one cannot ignore this duty it is a duty subordinate to his primary duties of accountability to his client, profession and to the Court. The meticulous performance of these duties with care and precision is itself the performance of his duty to Society. Though not normally referred to, there is a fifth and equally – if not more - important duty – his duty to himself.

Very often the lay person raises a question as to how a lawyer could defend a particular person or a particular action of his client which in the lay mind was indefensible. The Bar Council of India has framed a code of conduct to be followed by all advocates. One of the duties of an advocate is to accept a brief in the Courts or Tribunals in or before which he normally practices. If, however, his brief requires him to argue contrary to his beliefs and there is a conflict of duty to his client and to himself then, his duty to himself may justify his returning the brief. It is not for him to choose which is a good case and which is not. The central function of a lawyer is to represent his client and to say in legal parlance what the client would have said if he was to argue his own case and had the required legal acumen. **James Boswell** in his **Life of Samuel Johnson** records having asked the great man "*What do you think of supporting a cause which is known to be bad?*" Dr. Johnson's reply was to the effect: "*Sir, you do not know it to be good or bad till the judge determines it. You are to state facts clearly, so that your thinking or what you call knowing a cause to be bad must be from reasoning, must be from supposing your arguments to be weak and inconclusive …*"

Lord Macmillan in "**Law and Other Things**" has said that the advocate by the rules of his profession has, theoretically at least no choice in the selection of the cases he takes up. He quotes Erskine as saying that if an advocate is permitted to say that he will not stand between the Crown and the subject arraigned in the Court on the basis of his opinion above the correctness of his client's stand "from that moment the liberties of England are at an end."

It is the duty of an advocate to uphold the interest of his client by all fair and honourable means without regard to any unpleasant consequences to himself or to any other. An issue which sometimes arises is whether in discharging this duty there would be a conflict with the advocate's duty to the Court. Whilst he must uphold in all ways the interest of his client at the same time he must not put forward as a fact when he knows (as distinct from what he suspects) to be untrue. For example, if the client has told him that he has done something the advocate cannot urge that he has not done it though he would be justified in taking the stand that it is for the other side to prove that his client had indeed done the act as alleged by the other side. Many people take the view that this is a facetious distinction which lawyers draw. However, the rule of law requires that it is for the plaintiff or the prosecutor to establish his case with acceptable evidence and if the lawyer does not take this stand he would be cutting at the root of the rule of law. It is also urged that a lawyer's duty to society requires that he should not defend someone who he believes to be guilty of what is alleged against him. Those who would so urge should ponder over whether if a man sentenced to death for murder falls sick whilst in jail should a doctor attend to him or decline to do so in the belief that Society would be well served by his early demise. A lawyer's duty is to his client and to the Court and if one may say so to the law. In my opinion these override any amorphous duty to Society which is spoken of so glibly. An advocate's loyalty is to the law and the law requires that no man should be punished without adequate evidence. The cynic may counter that it is fortunate that people are born whose moral standards are sufficiently flexible to enable them to practise the calling of law!

Section 126 of the Indian Evidence Act provides that except with the client's consent a lawyer cannot disclose any communication made to him by the client or to reveal the contents of any document to which he has become privy in the course of his professional employment or disclose the advice tendered by him to his client. Contrary to this specific provision of law the activist, who champions the lawyers so called duty to Society, would urge that the lawyer must not keep secret his knowledge about an illegality committed by his client. In my view there is no such duty and the importance of complete and free communication between a lawyer and his client is itself for the welfare of Society at large.

An interesting issue arises when a client wants to know the consequences of his acting in a manner which is contrary to the law. It would appear

that it is the lawyer's duty to explain what would be the decision in law if the misdeed is discovered but he should in no way be a party to facilitate on such misdeed. A fine issue arises – is it the duty of the lawyer to tell the client that what he proposes to do is contrary to the law and he ought not to embark on the act. It would appear (though there may certainly be two views on the issue) that it is not for the lawyer to be a moralist but leave it to the client to decide whether knowing the consequences ethical and otherwise, of what he proposes to do, he should still go through with his earlier scheme. Here also the protagonist of "*duty to Society*" may take a contrary view.

An arguing Counsel owes a duty to his client and to the Court for attending the hearing of an appeal from the beginning to the end. It is not enough that the lawyer attends Court only at the time his turn comes to argue the case for his client and thereafter on completing the argument leaves the Court with some excuse or the other proffered to the judge. The lawyer's defence is that he owes a duty to other clients for whom also he is to appear on the very day. I feel that unless the lawyer is present throughout the hearing of the appeal and has heard the arguments of opposing Counsel he would not be able to give off his best to the client or to render full assistance to the Court. He should choose which case he will attend to and return the other briefs in good time or have the other hearing adjourned. In a witness action the position may be different.

Sometimes a possible conflict arises when a judge seeks Counsel's opinion on a particular matter which is in issue between the contesting parties. If the lawyer was to express his opinion or what he believes to be the right position in law he may be acting adversely to his client's interest. He would therefore be justified in politely declining the judge's request to give his opinion. Some purist may contend that in taking this stand the lawyer is not discharging his duty to the Court. Though the lawyer's duty to the client is certainly not more important than his duty to the Court, nevertheless the "*inquisitive*" judge should have realized that the duty of the lawyer is to argue his case and not to express his opinion on the issue involved. Undoubtedly, tact of a high degree is required in meeting such a situation. People must realize that what a lawyer believes and what he argues are not the same.

A related issue is to what extent the duty of a lawyer to the Court compels him to cite all possible decisions which he is aware of even though some of them may be contrary to what he is briefed to argue. Whilst the lawyer must bring to the notice of the Judge any judgement which is binding on the judge like that of the Supreme Court of India or of the Federal Court or the Privy Council (when the opinion of the Privy Council is as of a point of time when the same was binding on the Indian Courts). He will also have to disclose to the Court any judgement of the High Court of the state where he is arguing the matter as the same may be binding or if the judge wants to take a contrary view he may have to

refer the matter to a larger Bench. It is not the duty of the lawyer to cite decisions rendered by other Courts which are not binding. It is for the opposing lawyer, if he so thinks fit, to bring such decisions to the notice of the Court. This shows that the lawyer can honour his duty both to the Court and to the client in respect of a particular matter without infringing either.

Sometimes a very piquant situation arises. A judge recuses himself from a case on the ground that one of the parties has "*approached*" him. Should the lawyer of the alleged defaulter also opt out of the case? In my opinion, he should first of all satisfy himself that indeed a representative on behalf of his client had approached the judge, with the client's authority to do so. Unfortunately, there are today people who without being instructed by the client to do so approach a judge in a pending matter of which they are aware and then approach the client with the offer of procuring a favourable judgement. Once he is satisfied that the judge was indeed approached under his client's instructions he should return the brief though it is possible that this may prejudice the client adversely if the brief is returned in the midst of a hearing. It would also show his client in poor light. This sort of situation really calls for a fine balance being drawn between the lawyer's duty to the client and to the Court.

When discharging his duties to his client the lawyer often is faced with matching the same to his duty to the profession and to his co - professional. Though it may be in the interest of his client for the lawyer to interrupt the other side's Counsel so as to distract him from his trend of thought or interfere with the flow of his arguments, it would be a breach of his duty to a coprofessional and he must not indulge in it. I must say that I have found that in the southern states of India the respect for the right of the opposing professional to have full uninterrupted opportunity to express his views is far more evident than in the northern and, may I add, western states?

It is undoubtedly the duty of the lawyer to the Court always to be courteous and deferential to the judge but that does not mean he has to be obsequious. If for any reason it appears that the judge is acting unreasonably and making comments which are wholly uncalled for either against the litigant or the lawyer or the legal profession it is his duty to stand up to the judge and, as politely as possible, to correct him. It is not the lawyer's duty to the Court to submit to insults to himself or his profession or to fawn for petty favours. I remember an occasion when a judge was unreasonably giving a junior lawyer a tough time. As the Court rose for lunch a senior lawyer, who was waiting for his case to be called out got up and suggested that perhaps the junior lawyer deserved a more patient hearing. The judge – full marks to him – saw reason and hisattitude changed post lunch. It is remarkable that the senior lawyer really did not know the junior at all but the incident shows the

importance of standing up to a judge even when it does not affect the lawyer personally.

It sometimes happens that a "*succeeding*" lawyer in the course of his argument takes a stand different from what his predecessor, who was then representing the client, had taken. If it is in the client's interest for him to take a contrary stand he should do so but without in any way decrying or condemning the stand previously taken by the predecessor lawyer. In this manner he fulfills his duty both to the client and to the profession.

Sometimes a lawyer may feel that it would be advisable for a client to consult another lawyer or even to brief another lawyer rather than himself. He should frankly advise the client to do what is in client's interest though it may conflict with his own pecuniary interest. A lawyer is sometimes asked to recommend the name of a junior to assist him. The lawyer should either leave it to the client to choose the junior lawyer or suggest 3 or 4 names preferably not only from his chamber and leave it to the client to decide who should be briefed. This would fulfill the duty of the lawyer to his co - professional by not depriving a junior outside his chamber from being briefed.

In the practice of the profession sometimes peculiar situations arise which have a bearing on conflict of duties. It may happen that after a case is heard and decided the advocate reliably learns that the judgement was improperly procured. This would mean that even though the client may not himself be guilty of any improper conduct there was a miscarriage of justice. Is it the duty of the advocate in these circumstances to bring these facts to the notice of the Court for considering whether to order a retrial? The purist would undoubtedly say that it is advocate's duty to do so but there may be practical difficulties.

An interesting instance of conflict of duties may arise when a lawyer accepts a directorship. It may happen in this way: the company of which he is a director may be confronted with a particular problem and looking to the facts of the case the company may have to adopt a particular stand in law and the director would have voted in favour of taking such a stand. In the light of this peculiar position his view of what is the correct position may get warped and he may not be able to render independent advice to another company facing a similar problem. For a similar reason a lawyer who is a director of a company must not appear in Court for the company as he may not be able to maintain the sense of independence and detachment required of him. In similar vein a firm of solicitors, a partner of which is a director on the Board of a company, is not allowed to represent the company in Court. This is sometimes overcome by the solicitors firm interposing a dummy lawyer. But that is really a case of failure of duty to one's conscience!

A common source of conflict is where each of two partners of a firm represents persons arraigned against each other. They build some sort of a Chinese wall to urge that they both function independently. However,

there is no gainsaying the fact that there is bound to be at some stage a conflict of duties and the firm may tilt in favour of the client who is more important to it; namely, from whom it hopes to earn a larger fee in the long run.

It goes without saying that an advocate cannot be a party to procuring evidence by inducement. By procuring evidence the advocate may further the cause of justice but may he be guilty of breach of his duty to the Court or the profession and perhaps even to society. For example, a suit is filed by A claiming damages from B who had assaulted him. X was the only witness to the incident. When the matter is to be heard in Court X suggests to A's lawyer that he may not come to give evidence and if he is summoned he may plead that he did not remember what exactly happened. He may slyly add that he could be induced to state the truth. If the lawyer spurns X's suggestion it may mean that his client who was entitled in law to succeed may not be able to prove his case. On a strict view of the matter it would appear that the advocate is in breach of his duty to the Court and the profession if he succumbs to the suggestion made by the witness. If he does not succumb to X's demand is he in breach of his duty to the client because the client may fail in a cause where he deserved to succeed? The puritan will undoubtedly opine that upholding the process of law and justice is more important than an individual client's obtaining of damages for the wrong done to him. On the other hand, one may think that it is reasonable to do a little wrong to achieve a higher good in the form of a person justly succeeding in the litigation launched by him. It appears that whichever way he acts the lawyer may later have pangs of conscience. A self saving action on the part of the lawyer may be to tell his client to contact X if he so deemed fit. Of course this would mean that the lawyer would have to live with the disconcerting fact that he, at least passively, was a party to "*procuring*" evidence.

An advocate undoubtedly owes a duty to his fellow professional: not to run him down or attempt to take over his brief. Does it mean that he should not appear in a matter in which his fellow professional is sued? The answer obviously is that his duty to his client, who claims relief against a professional brother, is higher than his duty to a fellow professional or to the profession. If a lawyer declines to appear against a brother lawyer it would mean that the affected party may not be able to find a lawyer to represent him.

Sometimes a client realizes that he is bound to fail in his plea before the Court but he would like to postpone the evil day. It would appear that the advocate's duty to the client permits him to obtain an adjournment on whatever grounds are available but without putting forward a false excuse. The fact that thereby there is a delay which is adverse to the interest of the other side does not mean that the advocate is in breach of his duty to the profession or to the Court.

The lawyer's duty to the client does not extend to carrying out all his instructions. For example it is not his duty to oppose the grant of an adjournment sought by the other side because his client says so or to urge an argument the client insists on even though the lawyer feels it would be counter productive or not ethical to do so, then, the advocate's duty to himself, to the Court and to the profession must prevail. However, he should communicate his decision to the client in good time and he should give the client the option to brief another Counsel. In similar light is the case where the opposing side's Counsel has slipped up. Should the advocate take advantage of that position? The classical view would be he should not. I do not know how far that is practical because surely it is not Counsel's duty to say that his co - professional has made a slip in not pressing a particular point or not pressing it forcefully enough and the judge should consider the same.

I have referred above to a lawyer's duty to Society. It would be apt to mention Society's duty to "*law*." Nowadays the media pronounces upon a case and lawyers comment on a case in progress. This may prejudice the interest of one of the litigants in the case. Society and all of us owe a duty to law and its fair administration and to desist from action which can conflict with a litigant's right to a fair and free trial. I am conscious that if it were not for the interest taken by the media several matters of grave concern which involve prominent politicians and other personalities may have gone unattended to. Even so one should try to reconcile duties of the media to law and to Society.

Finally does the advocate - writer of an article owe a duty to his reader not to bore him even though his personal vanity tempts him to continue? I should think so and so in deference thereto and to fulfill a higher duty I shall wind up this piece!

India

Proposal for setting up of Tax Administration Reform Commission (TARC) approved

The Ministry of Finance has issued a press release dated 13.08.2013 stating that the Union Cabinet has approved the proposal for setting up of the Tax Administration Reform Commission (TARC).

The Commission will consist of a Chairman, two full time members and four part-time members, of which at least two part-time members will be from the private sector. The Chairman will be an eminent person having wide experience of tax administration and policy making. Full-time members of the Commission will be one member each with a background in revenue service pertaining to Income Tax and Central Excise and Customs respectively. The term of the Commission will be 18 months.

The Commission will review the application of tax policies and tax laws in India in the context of global best practices and recommend measures to strengthen the capacity of the tax system in India that would reflect best global practices. The Commission will help in removing ambiguity in application of tax policy and tax laws, thereby establishing a stable tax regime and a non-adversarial tax administration. The Commission will facilitate an efficient tax administrative system that would enhance the tax base as well as tax payer base.

The context for the setting up of the 'Tax Administration Reform Commission' is the statement by the Finance Minister in his Budget Speech for 2013-14 where he had said "An emerging economy must have a tax system that reflects best global practices. I propose to set up a Tax Administration Reform Commission to review the application of tax policies and tax laws and submit periodic reports that can be implemented to strengthen the capacity of our tax system."

Indian Parliament passes Companies Bill 2012

The Companies Bill 2012 was ratified by the Upper House of the Parliament (Rajya Sabha) on 8 August 2013. The Bill was ratified by the Lower House of the Parliament (Lok Sabha) on 18 December 2012. Once approved by the President, the Bill will be formally promulgated as the Companies Act 2013, replacing the existing Companies Act 1956.

The salient features of the Bill are: business friendly corporate regulations, pro-business initiatives, e-governance initiatives, good corporate governance and corporate social responsibility, enhanced disclosure norms, enhanced accountability of management, stricter enforcement, audit accountability, protection for minority shareholders, investor protection and activism, better framework for insolvency regulation and institutional structure.

United States

US Treasury Department and IRS announce 2013-2014 Priority Guidance Plan

The US Treasury Department and the Internal Revenue Service (IRS) have announced their Priority Guidance Plan for 2013-2014. According to the accompanying joint Treasury/IRS statement, the 2013-2014 Plan contains 324 projects that are priorities for the allocation of their resources during the 12-month period from July 2013 to June 2014.

The Priority Guidance Plan sets out the administrative guidance and regulations that the US Treasury Department and the IRS will issue during this period. Copies of the plan are available on the website of the IRS at http://www.irs.gov/uac/Priority-Guidance-Plan.

The Priority Guidance Plan is divided into the major areas of US taxation, including consolidated returns, corporations and their shareholders, employee benefits, excise taxes, exempt organizations, financial institutions and products, general tax issues, gifts and estates and trusts, insurance companies and products, international issues, partnerships, subchapter S corporations, tax accounting, tax administration, and tax-exempt bonds.

In the international area, the Priority Guidance Plan specifies 46 separate projects within the categories of Subpart F income, inbound transactions, outbound transactions, foreign tax credits, transfer pricing, sourcing and expense allocation, treaties, and other general topics.

Significant international projects for the 2013-2014 period include the following:

- guidance on Subpart F income (including the treatment of transactions involving commodities and non-functional currency, foreign base company sales income and services

income, the treatment of loans to foreign partnerships and related issues, the treatment of upfront payments on swaps, and passive foreign investment companies);

- guidance on inbound transactions (including dividend equipment payments, central withholding agreements, reporting requirements for foreign-owned US corporations, i.e. filing IRS Form 5472, and reporting requirements for foreign corporations engaged in a US trade or business);
- guidance on outbound transactions (including transfers of intangible property to foreign corporations, the failure to file gain recognition agreements (GRAs) and other required filings, substantial business activities, and surrogate foreign corporations);
- guidance on FTC issues (including non-compulsory payments, covered asset acquisitions, overall foreign losses, separate application of the FTC limitation to income resourced under treaties, and FTC splitting events);
- guidance on transfer pricing (including cost sharing arrangements, global dealing operations, the Advance Pricing Agreement (APA) program, and the Advance Pricing and Mutual Agreement (APMA) program);
- guidance on sourcing and expense allocation (including the allocation and apportionment of interest expense, and the source of income);
- guidance on US tax treaties (including payments through hybrid entities, procedures for requesting Competent Authority assistance, and agreements under Mutual Agreement Procedures (MAP) and Reciprocal Exemption Agreements); and
- guidance on other general topics (including the “presence test” for bona fide residency in a US territory, certain foreign currency transactions, including hedging transactions, withholding on non-resident individuals and foreign corporation and FATCA provisions, foreign financial asset reporting, information reporting related to foreign trusts and foreign gifts, and entity classification).

In the general tax issues area, the Priority Guidance Plan includes guidance relating to the recent US Supreme Court decision in

United States v. Windsor (No. 12-307, 26 June 2013), which held that US federal benefits cannot be denied to same-sex couples who are married under the laws of US states (see United States-3, News 11 July 2013).

The Priority Guidance Plan also includes an Appendix with the regularly scheduled guidance that will be published by the Treasury Department and the IRS during the 2013-2014 plan year. In the joint Treasury/IRS statement, the US Treasury Department and the IRS state their intent to update and republish the Plan periodically during the 2013-2014 period to reflect comments received from taxpayers and tax practitioners relating to additional projects and to respond to developments that occur during the period.

China (People's Rep.)

Income tax incentives for software enterprises – clarified

On 25 July 2013, the State Administration of Taxation (SAT) issued an announcement (SAT Gong Gao [2013] No. 43) clarifying the application of tax incentives designed for software enterprises in the Notice Cai Shui [2012] No. 27 which grant tax exemption in the first 2 years and a 50% tax reduction in the subsequent 3 years and apply to qualified software enterprises established on or after 1 January 2011. The announcement applies retroactively as from 1 January 2011 and its content is summarized below.

The announcement states that the incentives for software enterprises apply only to enterprises which are recognized by the authorized government agency upon an official certificate and calculate its business results based on the accounting records for the purposes of enterprise income tax (in contrast to the enterprises taxed on the deemed profit basis).

The income of the enterprise is referred to as the total amount of items of income mentioned in article 6 of the Enterprise Income Tax, i.e. income from sale of goods, providing services, disposal of property, dividends, interest, royalties, rental income and donations.

The first profit-making year (in which the tax incentive period starts to count) is the year in which the taxable income of the enterprise is positive for the first time since the commencement of business activities. Once the tax holiday period commences, it cannot be interrupted or suspended by losses in a certain year or other reasons.

Unless otherwise provided, the Notice Guo Shui Fa [2008] No. 116 on software enterprises' research and development (R&D) deduction applies with regard to deduction of R&D expenses.

The software enterprises which are established before 31 December 2010 and not recognized by the authorized government agency may apply for the recognition by reference to article 1 of the Notice Cai Shui [2008] No. 1 and Notice of the information department Xin Bu Lian Chan [2000] No. 968) and enjoy the remaining period of the tax holiday that was previously granted.

United Kingdom

Claims for refunds of stamp duty land tax (SDLT) invited following Court of Appeal decision in The Pollen Estate Trustee Company Limited and Kings College London v. HM Revenue & Customs (HMRC)

On 19 August 2013, Her Majesty's Revenue & Customs (HMRC) published a press release inviting claims in respect of any overpaid stamp duty land tax (SDLT) from charities that had purchased a property jointly with a non-charity purchaser, which satisfied the relevant conditions, but did not claim the relief. Details of how to make such claims are set out on the HMRC website.

The publication of the press release follows the decision of the Court of Appeal on 26 June 2013 in the case of The Pollen Estate Trustee Company Limited and King's College London v. HM Revenue and Customs (HMRC). The substance of this decision is that, when a charity purchases property jointly with another person who is not a charity (the "non-charity purchaser"), relief from SDLT under paragraph 1 of schedule 8 to the Finance Act 2003 is available on the charity's share of the property. The relief is subject to a test based on the extent to which the charity's share is used for charitable purposes.

Russia

Corporate income tax treatment applicable to income obtained by a foreign parent company further to reduction of its shareholding in a subsidiary – Ministry of Finance clarifications

On 16 August 2013, the Ministry of Finance published Letter No. 03-03-07/30021 issued on 29 July 2013, clarifying the corporate

income tax treatment of the income obtained by a foreign parent company further to the reduction of its shareholding in the capital of a Russian company.

A joint-stock company, a Russian resident, granted a loan to its foreign parent company. The foreign parent company wanted to terminate the loan agreement by reducing the share capital of the Russian joint-stock company.

The Ministry of Finance pointed out that according to the Law on Joint-Stock Companies, a joint-stock company may reduce its share capital under certain conditions.

Furthermore, it referred to article 251, section 1(4) of the Tax Code which provides that when a shareholder ceases to participate in the share capital of a company or the company is dissolved, assets or property rights that are received by the shareholder in proportion to the value of its contribution to the share capital of the company are excluded from the taxable income of the shareholder. However, the Ministry of Finance pointed out that this provision does not apply when the shareholder derives income further to the reduction of the share capital of the company.

Thus, the Ministry of Finance referred to article 309, section 2 of the Tax Code which provides that a foreign company that does not operate in Russia through a permanent establishment may not derive taxable income in Russia from the sale of goods and assets in Russia (except in cases stipulated in article 309, section 1(5) and (6) of the Tax Code).

Nevertheless, article 309, section 1(5) of the Tax Code provides that taxable income sourced in Russia and obtained by a non-resident includes income derived by the foreign company from the sale of shares in a resident company if the company has immovable property located in Russia and represents more than 50% of the assets of the company.

Consequently, the Ministry of Finance clarified that income obtained by a foreign parent company further to the reduction of its holding in the share capital of a Russian company is subject to corporate income tax in Russia only if more than 50% of the assets of the company represents immovable property located in Russia.

China

Ministry of Finance publishes report on activities of tax and customs administration in 2012

The Ministry of Finance recently published on its website the "Report on the activities of the Czech tax and customs administration in 2012" (the Report).

The Report observes that the number of tax audits performed in 2012 was lower by 5,077 (or 10.5%) as compared to 2011. However, 45.4% of all tax audits carried out in 2012 resulted in an additional assessment of tax. The reduced number of tax audits is attributed to an enhancement of their efficiency. In particular, in 2012, the tax authorities concentrated on taxpayers and tax audits where additional tax assessments could be anticipated. As a result, the amount of the additionally assessed tax in 2012 was higher by CZK 1,745 million (or 26.1%) as opposed to 2011. The additional assessment of VAT has seen the highest increase from 2011 (by 76.1%). A specialized unit within the tax administration also continued to scrutinize the transfer pricing arrangements between related parties.

In 2012, the Czech tax administration received an increased number of requests for international cooperation in the collection of taxes (a 40% increase compared to 2011). In particular, the number of requests for information increased by 290%.

United States

IRS issues draft of FATCA reporting form

The US Internal Revenue Service (IRS) has released a draft of IRS Form 8966 (FATCA Report). The draft is dated 13 August 2013. A draft of IRS Instructions for Form 8966 has not yet been released.

The Foreign Account Tax Compliance Act (FATCA) requires withholding agents to withhold 30% of certain payments to a foreign financial institution (FFI) unless the FFI has entered into an agreement (FFI agreement) with the IRS to, among other things, report certain information with respect to US accounts. FATCA also imposes on withholding agents certain withholding, documentation, and reporting requirements with respect to certain payments made to certain non-financial foreign entities (NFFEs).

In the preamble to the final regulations for implementing FATCA (TD 9610), the IRS announced its intent to release a new Form

8966 that will be used by FFIs (including qualified intermediaries (QIs) that assume withholding responsibility, withholding foreign partnerships (WPs), and withholding foreign trusts (WTs)) and withholding agents (in limited circumstances) to comply with their FATCA reporting obligations with respect to financial accounts.

The final regulations provided that a PFFI would be required to file its first information reports on its US accounts with respect to the 2013 and 2014 calendar years no later than 31 March 2015. According to IRS Notice 2013-43, the US Treasury Department and the IRS intend to modify these rules to require FATCA reporting on 31 March 2015, only with respect to the 2014 calendar year (for US accounts identified by 31 December 2014).

The draft of Form 8966 requests information on filers, account holders or recipients, US owners that are specified US persons, financial accounts, and the applicable pooled reporting type.

IRS Chief Counsel issues memorandum on refund claim based on FTC

The Chief Counsel of the US Internal Revenue Service (IRS) has issued a memorandum that discusses the period of limitations for a refund claim based on a foreign tax credit (FTC) for carried back excess foreign taxes.

Under the facts in the memorandum, the taxpayer filed, on Date 1 of Year 17, an amended income tax return to deduct, rather than credit, foreign taxes paid or accrued in Year 8, generating an increased net operating loss (NOL) in Year 8. The taxpayer carried back the increased NOL to Year 3, which released creditable foreign taxes that had been paid or accrued in Year 3. The taxpayer then sought to carry back the increased excess foreign taxes from Year 3 to Year 1 to credit against its US tax liability for Year 1, with the result that a tax overpayment was created for Year 1. The refund claim with respect to the taxes paid in Year 1 was also filed on Date 1 of Year 17.

The issue was whether the taxpayer's claim for refund of the Year 1 overpayment was time-barred under the version of section 6511(d)(3)(A) of the US Internal Revenue Code (IRC) as in effect prior to amendment in 1997.

IRC section 6511(d)(3)(A) applies the special 10-year period of limitations, instead of the general 3 years, to a claim for credit or refund, if the claim is attributable to foreign taxes for which a FTC

is allowed against US income tax. Prior to the 1997 amendment, IRC section 6511(d)(3)(A) provided that the 10-year limitations period stared to run from the date for filing the return for the year "with respect to which the claim is made".

The term, "the year with respect to which the claim is made" was interpreted by the IRS, the US Tax Court, and the US Court of Appeals for the Sixth Circuit to mean the year in which the foreign taxes were paid or accrued, while the US Court of Claims interpreted the term as the year to which excess foreign taxes were carried.

The taxpayer took the position that its refund claim for Year 1 was timely on the ground that it was "attributable to" the foreign taxes paid in Year 8, which is within 10 years from Date 1 of Year 17.

The memorandum determines that the taxpayer's refund claim is "attributable to" Year 3, and not Year 8, because the refund claim is "traced directly to" the Year 3 foreign taxes.

The memorandum also determines that, even if the taxpayer's refund claim were attributable to Year 8, the special 10-year limitations period would not apply because the taxpayer elected to deduct, rather than credit, the Year 8 foreign taxes, and thus a FTC is no longer allowed for the Year 8 foreign taxes, as required by the language of IRC section 6511(d)(3)(A). This portion of the memorandum focuses on the distinction between "allowed" and "allowable" as these terms are used in the provisions of the IRC with respect to deductions and credits.

Switzerland

Changes to Tax Administrative Assistance Act proposed

On 14 August 2013, the Federal Council initiated consultation proceedings on the partial revision of the Tax Administrative Assistance Act. The revision provides for:

- deferred notification of persons who are the subject of an administrative assistance request in certain cases;
- clarification of the procedure for group requests; and
- adjustment of the treatment of requests based on stolen data.

Background

According to the Federal Council, the Tax Administrative Assistance Act has to be amended with regard to the prior

notification of persons who are the subject of a request in order to be in line with the international standard and thereby the recommendations of the Global Forum. The revision provides for affected taxpayers to be notified only after information has been disclosed to the requesting state's authorities in urgent cases, e.g. when prior notification would compromise the investigation.

Revision

In addition to the change of the notification, the revision clarifies the procedure for group requests. Group requests are permitted under the currently applicable Tax Administrative Assistance Act. In order to ensure more efficient treatment, the revision makes provision for a special procedure for notifying persons affected by a group request. Moreover, it makes clear that the content of group requests is based on the OECD standard. With this amendment, Switzerland will comply with the international standard for the exchange of information.

Finally, the revision also takes account of the problem of administrative assistance requests based on stolen data. So far, Switzerland has been unable to respond to numerous requests due to a restrictive practice in this area. In order to resolve the impasse, it is possible for future requests to be processed, provided that the requesting state acquired the data passively, e.g. via another state, and not actively. Requests that are contrary to the principle of good faith will not be considered.

The consultation procedure on the revision of the Tax Administrative Assistance Act will run until 18 September 2013. A shortened procedure is necessary because the communiqué of the G20 finance ministers following the meeting of 19 and 20 July 2013 urged all jurisdictions to address the Global Forum's recommendations without further delay. As final grading, after completion of phases 1 and 2 of the peer review will commence in October 2013, Switzerland has a significant interest in being able to announce the revision of the Tax Administrative Assistance Act internationally as soon as possible and then put it into force.

The memorandum concludes that the refund claim is untimely under both interpretations regarding "the year with respect to which the claim is made" because the taxpayer's claim was filed more than 10 years after the due date of the returns for both Year 1 (the carry-back year) and Year 3 (the year in which the foreign taxes to which the refund claim is attributable were paid or accrued).

The memorandum notes that the result would be the same under the post-amendment version of IRC section 6511(d)(3)(A), which provides that the special 10-year limitations period starts to run from the date for filing the return for the year in which such foreign taxes were actually paid or accrued (i.e. Year 3 under the facts of the memorandum).

The memorandum is designated No. 201330031. It is dated 8 April 2013, and indicates that it was released on 26 July 2013.

OECD

More than 50 developed and developing countries, including all G20 members, are signatories to the Convention

As reported by OECD, 27 August 2013 China will sign the Convention on Mutual Administrative Assistance in Tax Matters. Through the Convention, China will participate in global efforts to combat tax avoidance and evasion by co-operating with other states in the assessment and collection of taxes.

United States

The deadline for financial institutions to finalize registration is 25 April 2014

The Internal Revenue Service has activated its new web-based registration system for financial institutions that need to register with the US Government's tax collecting body, under the Foreign Account Tax Compliance Act (FATCA).

The registration system is designed enable 24/7 secure account management. Companies will be able to establish online accounts, customise home pages to manage accounts, designate points of contact to handle registrations; oversee members and/or branch information and receive automatic notices of status change.

According to the IRS, as registrations are finalised and approved in 2014, registering financial institutions will receive a notice of registration acceptance and will be issued with a global intermediary identification number.

The IRS said that it will electronically post the first IRS Foreign Financial Institution (FFI) List in June 2014, and will update the list monthly.

2013 TRI 1374 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
KOLKATA "A" BENCH, KOLKATA

K.K. Gupta, Accountant Member and George Mathan, Judicial Member

FACTS/HELD

Section 14A: Disallowance if satisfaction not recorded with reference to A/cs. Under Rule 8D(2)(ii) loans for specific business purposes cannot be included. Under Rule 8D(2)(ii) & (iii) investments which have not yielded income cannot be included

1. In AY 2008-09, the assessee invested Rs.103 crores in shares on which it earned tax-free dividends of Rs. 1.3 lakhs. The assessee claimed that though its borrowings had increased by Rs. 122 crores, the said investments were funded out of own funds like capital and profits. It claimed that no expenditure had been incurred to earn the dividends and no disallowance u/s 14A could be made. The AO applied Rule 8D and computed the disallowance at Rs. 4 crore. On appeal by the assessee, the CIT(A) reduced the disallowance to Rs. 26 lakh. On cross appeals, HELD by the Tribunal:

   (i) When the AO does not accept the assessee's claim regarding the non-applicability/ quantum of disallowance u/s 14A, he has to record satisfaction on that issue. This satisfaction cannot be a plain satisfaction or a simple note. It has is to be done with regard to the accounts of the assessee. On facts, as there is no satisfaction by the AO, no disallowance u/s 14A can be made (Balarampur Chini Mills 140 TTJ (Kol) 73 (*included in file*) followed);

   (ii) Rule 8D(2)(ii) is a computation provision in respect of expenditure incurred by way of interest which is not directly attributable to any particular income or receipt. This clearly means that interest expenditure which is directly relatable to any particular income or receipt is not to be considered under rule 8D(2)(ii). The AO has to show that the interest is not directly attributable to any

particular income or receipt. In the assessee's case, the interest has been paid on loans taken from banks for business purpose. There is no allegation that the loan funds have been diverted for making investment in shares or for non-business purposes. The loans are for specific business purposes and no bank would permit the loan given for one purpose to be used for making any investment in shares. Also, the assessee has substantial capital & reserves. Accordingly, the interest on the loans cannot be included in Rule 8D(2)(ii);

(iii) Further, in Rule 8D(2)(ii), the words used in numerator B are "*the average value of the investment, income from which does not form or shall not form part of the total income as appearing in the balance-sheet as on the first day and in the last day of the previous year*". The AO was wrong in taking taken into consideration the investment of Rs.103 crores made during the year which has not earned any dividend or exempt income. It is only the average of the value of the investment from which the income has been earned which is not falling within the part of the total income that is to be considered. Thus, it is not the total investment at the beginning of the year and at the end of the year, which is to be considered but it is the average of the value of investments which has given rise to the income which does not form part of the total income which is to be considered. The term "*average of the value of investment*" is used to take care of cases where there is the issue of dividend striping;

(iv) Under Rule 8D(2)(iii), what is disallowable is an amount equal to ½ percentage of the average value of investment the income from which does not or shall not form part of the total income. Thus, under sub-clause (iii), what is disallowed is ½ percentage of the numerator B in rule 8D(2)(ii). This has to be calculated on the same lines as mentioned earlier in respect of Numerator B in rule 8D(2)(ii). Thus, not all investments become the subject-matter of consideration when computing disallowance u/s 14A read with rule 8D. The disallowance u/s 14A read with rule 8D is to be in relation to the income which does not form part of the total income and this can be

done only by taking into consideration the investment which has given rise to this income which does not form part of the total income.

Appeal partly allowed.

I.T.A. No. 1331/Kol/2011 (Assessment Year : 2008-09) & I.T.A. No. 1423/Kol/2011 (Assessment Year : 2008-09).

Heard on: 22nd May, 2013.

Decided on: 19th June, 2013.

Present at hearing: Ravi Tulsiyan, FCA, for Appellant. L.K.S. Dehiya, CIT(DR), for Respondent in I.T.A. No. 1331/Kol/2011. L.K.S. Dehiya, CIT(DR), for Appellant. Ravi Tulsiyan, FCA, for Respondent in I.T.A. No. 1423/Kol/2011.

JUDGMENT

Per George Mathan Singh:– (Judicial Member)

The ITA No.1331/Kol/2011 is an appeal filed by the Assessee and the ITA No.1423/Kol/2011 is an appeal filed by the Revenue against the order of the CIT(A), Central-I, Kolkata in Appeal No.03/CC-XXVII/CIT(A),C-II/10-11 dated 2nd August, 2011 for the assessment year 2008-09.

2. Shri L.K.S.Dehiya, CIT,D.R appeared on behalf of the Revenue and Shri Ravi Tulsiyan. FCA appeared on behalf of the assessee.

3. In the assessee's appeal, the assessee has raised the following grounds:

> *"1. The orders passed by the lower authorities are unwarranted, arbitrary, without proper reasons, invalid and bad in law, in so far as they are against the interest of the appellant company.*
>
> *2. On the facts and in the circumstances of the case, the learned CIT(A) erred in holding that proportionate management and administrative expenses are required to be deducted while computing exempt income or dealing with investment matter and in that view, in sustaining the disallowance of Rs.26,09,386/- under Rule 8D(2)(iii) of the Income Tax Rules.*
>
> *3. On the facts and in the circumstances of the case, the learned CIT(A) erred in sustaining disallowance of Rs.26,09,386/- u/s 14A of the Incometax Act, 1961, by applying the provisions of Rule 8D(2)(iii) of the Income Tax Rules against meager Dividend income of Rs.1,32,638/- only.*
>
> *4. The appellant craves leave to amend, alter, modify, add to, abridge and/or rescind any or all the above grounds in future."*

3.1 In the Revenue's appeal, the Revenue has raised the following grounds:

"01. That in the facts and circumstances of the case and in law, the Learned CIT(A) has erred in law in deleting the disallowance of Rs.37727610/- in respect of interest made u/s.14A of the Act read with Rule 8D of IT rules by holding that the investment of shares was made out of own funds of the assessee without considering that the linkage between the funds borrowed and the investments, the income of which is exempt, was not established by the assessee.

02. That in the facts and circumstances of the case, the Ld. CIT(A) has erred in law in deleting the disallowance of Rs.3,77,27,610/- in respect of interest made u/s.14A r/w Rule 8D of the Act, in view of the decision of the Hon'ble Kolkata High Court in the case of Danukha & Sons –Vs- CIT (Central)-I, Kolkata reported in 201 Taxman 105 (Kol) (Mag), wherein it has been held that in the absence of any material disclosing the source of acquisition of shares which is within the special knowledge of the assessee, the assessing authority can make proportionate disallowance.

03. That the Department craves leave to add, modify or alter any of the above ground(s) of appeal and/or adduce additional evidence at the time of hearing of the case."

4. At the time of hearing, it was submitted by the ld. D.R. that the assessee is a company which is doing the business of rice processing, power generation and retail sale. It was a submission that during the year, the assessee had received dividend income of Rs.1,32,638/-, which was claimed as exempt. The assessee had not debited any expenses in respect of expenditure incurred for earning such exempt income. The AO has invoked the provisions of section 14A read with rule 8D of the Act and has made a disallowance of an amount of Rs.4,03,36,996/-. It was a submission that on appeal, the ld. CIT(A) had reduced the disallowance under section 14A to Rs.26,09,386/-. It was a submission that against the relief granted of Rs.4,03,36,996/-, the Revenue has filed the appeal in ITA No.1423/Kol/2011 and in respect of disallowance confirmed by the CIT(A) to the extent of Rs.26,09,386/-, the assessee has filed the appeal in ITA No.1331/Kol/2011. It was a submission that the ld. CIT(A) had considered the various case laws to come to the conclusion that no disallowance under section 14A would be made. It was a submission that the case laws relied on by the ld. CIT(A) related to the period prior to the assessment year 2008-09, being the assessment year from which the provisions of Rule 8D came into application. It was a submission that the assessee had invested Rs.103 crores in shares during the relevant assessment year. It was a further submission that there was no increase in the share capital during the relevant assessment year. It was a submission that however, the assessee's loan account had increased by Rs.122 crores. It was, thus, the

submission by the ld. D.R. that the investment in the shares was out of interestbearing funds. It was a submission that the ld. CIT(A) had in his order in para 4.1 held that the assessee was having a common pool in respect of its own fund as also its loan fund. It was a submission that as the assessee had used interest-bearing fund for purchasing shares and the assessee had paid interest on the same, the disallowance as made by the AO by invoking the provisions of section 14A read with Rule 8D was liable to be upheld. It was a further submission that though the AO has in his assessment order specifically held that there is no disallowance liable to be made under rule 8D(i), disallowance under rule 8D(ii) had been made on the basis of the computation provided thereunder, as also under Rule 8D(iii). It was a submission that in view of the decision of the Hon'ble Jurisdictional High Court in the case of *Danukha & Sons vs CIT (Central)-I, Kolkata* reported in 201 Taxman 105 (Kol), it was for the assessee to show the source of acquisition of the shares by production of the materials that those were acquired from funds available in the hands of the assessee at the relevant point of time without taking benefit of any loan. The assessee having not shown such availability of funds, the disallowance was liable to be upheld.

4.1 He also relied upon the decision of the Hon'ble Kerala High Court in the case of *Leena Ramchandran* reported in 339 ITR 296. It was a submission that the order of the ld. CIT(A) was liable to be reversed to the extent that he has reduced the disallowance.

5. In reply, the ld. A.R. submitted that as per the provisions of section 14A(2), the AO was to determine the amount of expenditure incurred in relation to such income which does not form part of the total income, in accordance with such method as may be prescribed. It was a further submission that there was also supposed to be satisfaction to the correctness of the claim of the assessee. It was a submission that at the outset, the AO has not shown that the claim of the assessee that there is no amount disallowable was wrong nor is there any satisfaction recorded to such effect. On this point, the ld. D.R. submitted that the Coordinate Bench of this Tribunal has, in the case of Champion Commercial reported in 26 Taxman.com 342, held that it is only where the assessee offers a disallowance under section 14A, the AO is required to record satisfaction. When no expenditure is offered by the assessee, the AO need not record such satisfaction.

5.1 It was submitted by the ld. A.R. that as per the provisions of section 14A(3), the provisions of sub-section (2) also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to the income which does not form part of the total income under the Act. In the return filed by the assessee, there is no provision for making a claim that there is no expenditure. The fact that the assessee did not make any disallowance under section 14A, in the

return filed itself was the claim that no expenditure has been incurred. The ld. A.R. further drew our attention to P&L a/c. of the assessee for the year ended on 31.03.2008 as also the balance-sheet, which were at pages 78 to 95 of the paper book. It was a submission that the shareholders' funds in the balance-sheet showed that the share capital had increased by Rs.4 crores during the relevant assessment year and the Reserves and Surplus had gone up by Rs.112 crores. The loan fund had increased by Rs.122 crores. It was a submission that the loan funds were used for the acquisition of assets as also towards working capital and in fact the fixed assets net block increased by Rs.116 crores, after considering a depreciation of 57 crores. It was, thus, a submission that the actual increase in the fixed assets when compared to the net block for the year ended on 31.03.2007 was 174 crores. It was a submission that the profits available to the assessee before taxation for the assessment year 2008-09 was Rs.130 crores and the profit, after taxation, was Rs.109 crores. The amount available for appropriation for the assessment year 2008-09 was Rs.128 crores. He further drew our attention to the investments during the year, which is shown at page 84, being the investment in Varrsana Ispat Limited at Rs.103 crores. It was a submission that the other investments, which were there as on the beginning of the assessment year was to an extent of Rs.58,27,282/-. It was a submission that it is out of the shares of this investment of Rs.58,27,282/-, the assessee had received the dividend income and not on the investment of Rs.103 crores. The ld. A.R. further drew our attention to page 362 of the paper book, which was the copy of the loan sanction document from the State Bank of Bikaner and Jaipur dated 22.12.2007 for letter of credit of Rs.175 crores. It was a submission that this was on the security of the stock available with the assessee. He further drew our attention to page 370 of the paper book, which was the letter from Allahabad Bank for reviewing and enhancing the limits for working capital from the existing Rs.250 crores to Rs.500 crores. It was a submission that this was also enhanced working capital limit, which was to be released only after the tie-up of the entire limit of Rs.1800 crores from the Consortium. This was also for the Letter of Credit purpose. He further drew our attention to pages 372, 374 and 381, which were all credit sanction advices given by the various banks, being United Bank of India, Indian Overseas Bank. It was a submission that all these were for L.C. only. It was a submission that all the loans were directly related to the business of the assessee. The ld. A.R. further drew our attention to the decision of the Coordinate Bench of this Tribunal in the case of *Balarampur Chini Mills Ltd.* 140 TTJ (Kol) 73, wherein the Tribunal has held that section 14A and Rule 8D can be invoked only when the AO is not satisfied with regard to the account of the assessee that the claim of expenditure made by the assessee is not correct and the claim made by the assessee that no expenditure has been made in relation to income, which does not form part of total

income under the Act. Where the assessee has explained that the share capital and reserves, that is its own funds, were utilized for the purpose of investment in shares for earning dividend income which has not been negated by lower authorities and there is no linkage or nexus between the funds borrowed by the assessee and the impugned investments, no interest expenditure can be disallowed by mechanically applying the provisions of rule 8D. It was a submission that the decision of the Hon'ble Jurisdictional High Court in the case of Danukha & Sons (supra) would not apply in so far as in that case the assessee was not able to show that the investment was made out of its own independent non-interest bearing funds. It was a submission that no disallowance under section 14A could be made.

6. We have considered the rival submissions. A perusal of the provisions of section 14A, more specifically sub-section (2), shows that if the AO is not satisfied with the correctness of the claim of the assessee, then the AO shall determine the amount of expenditure incurred in relation to such income, which does not form part of total income under the Act. For this the method is prescribed in rule 8D. The provision of section 14A, sub-section (3) specifies the provision of 14A(2) would also apply where the assessee makes a claim that there is no expenditure incurred. This is because if the assessee does not make a disallowance under section 14A in its computation of total income, when filing the return, then if subsection (3) was not available, the AO might not be able to make a disallowance under section 14A. Thus, where the assessee makes a claim that only a particular amount is to be disallowed under section 14A or where the assessee does not make a disallowance under section 14A, if the AO proposes to invoke the section 14A, he is to record a satisfaction on that issue. This satisfaction cannot be a plain satisfaction or a simple note. It is to be done with regard to accounts of the assessee. In the present case, there is no satisfaction by the AO and consequently, in view of the decision of the Coordinate bench of this Tribunal in the case of Balarampur Chini Mills Ltd. referred to supra, no disallowance under section 14A can be made.

7. Now coming to the merits of the issue. A perusal of the provision of section 14A(1) clearly shows the wordings, "in relation to the income which does not form part of the total income under this Act". In the present case, this income, which does not form part of the total income under the Act, is the dividend income of Rs.1,32,638/-. Therefore, if any disallowance is to be made in respect of expenditure incurred, it should be in relation to this dividend income of Rs.1,32,638/-. If an assessee has invested in shares, which could get dividend or there is investment which generates dividend income or exempt income as also investment which does not generate exempt income, it is only such investments in respect of which the dividend income or exempted income has been earned which can be considered when computing the disallowance under section 14A

read with rule 8D. A perusal of the provisions of rule 8D also talks of satisfaction in sub-rule (1). Rule 8D(2) has three sub-parts. The first sub-part i.e. (i) deals with the amount of expenditure directly relating to the income which does not form part of the total income. That issue is not in dispute here and therefore, we do not go into it in this case. In second sub-part i.e.(ii), it is a computation provided in respect of expenditure incurred by the assessee by way of interest during the previous year which is not directly attributable to any particular income or receipt. This clearly means that if there is any interest expenditure, which is directly relatable to any particular income or receipt, such interest expenditure is not to be considered under rule 8D(2)(ii). In the assessee's case here the interest has been paid by the assessee on the loans taken from the banks for its business purpose. There is no allegation from the banks nor the AO that the loan funds have been diverted for making the investment in shares or for non-business purposes. Further rule 8D(2)(ii) clearly is worded in the negative with the words "not directly attributable". Thus for bringing any interest expenditure, claimed by the assessee, under the ambit of rule 8D(2)(ii) it will have to be shown by the AO that the said interest is not directly attributable to any particular income or receipt. Why we say here that it is to be shown by the AO is on account of the words in Rule 8D(1) being "where the Assessing Officer, …… is not satisfied with.

> (a) ……..
>
> (b) ……..
>
> in relation to income……., he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).

In the assessee's case, admittedly, the assessee has substantial capital. The increase in the capital itself is to an extent of Rs.4 crores and in respect of reserves and surplus, the increase is Rs.112 crores. The loans taken during the year admittedly are for the letters of credit and the assessee is bound to provide the bank stock statement and other details to show the utilization of the loans. No bank would permit the loan given for one purpose to be used for making any investment in shares. The ld. CIT(A), it is noticed that after considering these facts that the assessee had not used any of its borrowings for purchasing the shares, has deleted the disallowance. On this ground itself, the deletion as made by the ld. CIT(A) is liable to be confirmed and we do so.

7.1 In any case, the working of the disallowance under sub-part (ii) of subclause (2) of rule 8D as made by the AO also suffers from a substantial error in so far as in the said rule in regard to the numerator B, the words used are the average value of the investment, income from which does not form or shall not form part of the total income as appearing in the balance-sheet as on the first day and in the last day of

the previous year. Here the AO has taken into consideration the investment of Rs.103 crores made this year, which has not earned any dividend or exempt income. It is only the average of the value of the investment from which the income has been earned which is not falling within the part of the total income that is to be considered. This is why the question of satisfaction is provided in section 14A and rule 8D(1), that relates to the accounts of the assessee. Thus, it is not the total investment at the beginning of the year and at the end of the year, which is to be considered but it is the average of the value of investments which has given rise to the income which does not form part of the total income which is to be considered. A question may arise as to why the term "average of the value of investment" is then used. The term average of the value of investment would be to take care of cases where there is the issue of dividend striping. In any case, as we have already held that the assessee has not incurred any expenditure by way of interest during the previous year, which is not directly attributable to any particular income, the findings of the ld. CIT(A) on the issue stand confirmed and consequently the appeal filed by the Revenue stands dismissed.

8. In respect of provisions of rule 8D(2)(iii), which is the subject-matter of the appeal in the assessee's hand, a perusal of the said provision shows that what is disallowable under rule 8D(2)(iii) is the amount equal to ½ percentage of the average value of investment the income from which does not or shall not form part of the total income. Thus, under sub-clause (iii), what is disallowed is ½ percentage of the numerator B in rule 8D(2)(ii). Again this is to be calculated in the same line as mentioned earlier in respect of Numerator B in rule 8D(2)(ii) of the Act.

8.1 Thus, not all investments become the subject-matter of consideration when computing disallowance under section 14A read with rule 8D. The disallowance under section 14A read with rule 8D is to be in relation to the income which does not form part of the total income and this can be done only by taking into consideration the investment which has given rise to this income which does not form part of the total income. Under the circumstances, the computation of the disallowance under section 14A read with rule 8D(2)(iii), which is issue in the assessee's appeal, is restored to the file of the AO for recomputation in line with the direction given above. No disallowance under section 14A read with rule 8D(2)(i) and (ii) can be made in this case.

9. In the result, the appeal filed by the Revenue stands dismissed and the appeal filed by the assessee stands partly allowed for statistical purposes.

This Order is pronounced in the Court on 19th June, 2013.

INCOME TAX APPELLATE TRIBUNAL
KOLKATA "B" BENCH, KOLKATA

Mahavir Singh, Judicial Member and C. D. Rao, Accountant Member

Appeal partly allowed.

I.T.A No. 504/Kol/2011 (Assessment Year : 2008-09).

Decided on: 29th July, 2011.

Present at hearing: S. K. Tulsiyan, for Appellant. Sumanta Sinha, for Respondent.

JUDGMENT

Per Mahavir Singh:– (Judicial Member)

This appeal by assessee is arising out of the order of CIT(A), Central-II, Kolkata in Appeal No.90/CC-XIX/CIT(A)C-II/10-11 vide dated 23.02.2011. The assessment was framed by DCIT, Central Circle-XIX, Kolkata u/s. 143(3) of the Income Tax Act, 1961 (hereinafter referred to as "the Act") for Assessment Year 2008-09 vide his order dated 10.11.2010.

2. The first issue in this appeal of assessee is against the order of CIT(A) confirming the action of AO disallowing expenditure attributable to exempted income, dividend, by invoking provisions of section 14A of the Act r.w.s. Rule 8D of Income-tax Rules, 1962 (hereinafter referred to as "the Rules"). For this, the assessee has raised following ground nos. 1, 2 and 7:

> *"1. That, on the facts and in the circumstances of the case, the Ld. CIT(A) erred in confirming the Ld. A.O.'s order disallowing a sum of Rs.3,90,63,218, as expenditure attributable to exempt dividend income of Rs.1,08,72,574 in terms of Sec.14A of the I.T. Act, 1961, read with Rule-8D of the I.T. Rules,1962.*
>
> *2. That on the facts and in the circumstances of the case, the Ld. CIT(A) erred in confirming Disallowance of Rs.3,90,63,218/- U/s.14A of the Income Tax Act, 1961, by applying Rule-8D of the Income Tax Rules, 1962, disregarding the computation of Disallowance made by the Assessee at Rs. 1,49,995/- duly supported by the Certificate obtained from its Statutory Auditors.*
>
> *7. That, on the facts and in the circumstances of the case, the Ld. CIT(A) erred in sustaining the addition of Rs.3,90,63,218 being the disallowance u/s.14A of the Act/Rule 8D of the Rules to the Net Profit of the assessee company for the purpose of computation*

of its Book Profit under the provisions of Sec. 115JB of the I.T. Act, 1961."

3. The brief facts leading to the above issue are that the assessee company is engaged in the business of manufacture and sale of sugar, industrial alcohol, bio-compost fertilizers and generation of power in the form of steam and electricity. Its head office is at Calcutta but its factories, power undertakings, distillery undertaking etc. are located at various places in U.P. The AO during the course of assessment proceedings noticed that the assessee has claimed exempt income of dividend at Rs.1,08,72,574/- and offered a sum of Rs.1,49,995/- as expenses attributable to such exempt income and disallowed from its claim under the provisions of section 14A of the Act and this was supported by certificate from its statutory auditors. The AO noted that the assessee company has not computed the disallowance in accordance with Rule 8D of the Rules and accordingly, by invoking Rule 8D(ii) of the Rules made disallowance by stating that in the immediate preceding year, the assessee's claim is also disallowed by invoking the provisions of section 14A of the Act r.w.s. Rule 8D of the Rules. It was also noted by AO that the assessment order for AY 2007-08 was upheld by CIT(A), Central-II, Kolkata vide his order dated 06.07.2010. The AO following the decision of CIT(A) for AY 2007-08 computed disallowance as per Rule 8D2(ii) and 8D2(iii) of the Rules and made disallowance at Rs.3,90,63,218/-. Aggrieved, assessee preferred appeal before CIT(A). The CIT(A) also confirmed the action of the AO vide para 4.1 and 4.2 of his appellate order as under:

> *"4.1. I have gone through the assessment order and submissions of appellant. The undersigned is not empowered to decide the validity of Rule D or admit such an appeal of appellant u/s. 246A of the I. T. Act. The constitutional validity of Rule 8D can be challenged vide petition under Article 226 of the Constitution before the empowered courts. Therefore the issue of unreason ability of Rule 8D in this ground of appeal of appellant is ignored.*
>
> *4.2. Appellant has itself admitted that some expenditure has been incurred to earn exempt dividend income and appellant estimated such expenditure at Rs.1,49,995/-. No method of estimation or determination of such expenditure of Rs.1,49,995/- has been given by the appellant except for stating that this expenditure has been certified by statutory auditor. Appellant has not maintained accounts in such a manner where all exempt incomes, the corresponding expenditures, the corresponding funds and the corresponding investments have been separately maintained and such separate Profit & Loss account and balance sheet have been certified by any auditor. Non maintenance of separate accounts in respect of exempted income*

and the fact that appellant has made its own estimation of expenditure to earn exempt income is sufficient reason for satisfaction of Assessing Officer having regards to the accounts of appellant to estimate expenditure u/s. 14A(2) of the I. T. Act read with Rule 8D of the I. T. Rules. Further a certified estimate of such expenditure by a statutory auditor cannot override the estimation of expenditure as prescribed in Income Tax Rules. In view of these facts and position of law, I hold that Assessing Officer has rightly disallowed the expenditure of Rs.3,90,63,218/- consisting of interest of Rs.3,38,47,524/- and indirect expenditure of Rs.52,15,694/- to earn exempt income u/s. 14A of the I. T. Act."

Aggrieved, assessee came in appeal before Tribunal.

4. We have heard rival contentions and gone through facts and circumstances of the case. The first argument made by the Ld. Counsel before us was that the assessee admittedly earned dividend income at Rs.1,08,72,574/- and claimed exempt u/s. 34/35 of the Act. Ld. Counsel for the assessee stated that it has incurred expenditure to the sum of Rs.1,49,995/- as expenditure was relating to earning of exempt dividend income and this was disallowed suo motu by the assessee in view of certificate of its statutory auditors. Ld. Counsel for the assessee stated that there is no other expenditure except disallowed by assessee which is relatable to exempted income and the lower authorities i.e. neither AO nor CIT(A) has proved any nexus or expenditure attributable to exempted income despite the fact that all books of account and other details explaining that none of the expenditure is relatable to exempted income is disallowable. The Ld. Counsel for the assessee, first of all, filed a statement showing sources of funds and its utilization during the FY 2007-08 relevant to this AY 2008-09. The relevant statement is being reproduced as it is:

"Balarampur Chini Misss Limited
Assessment Year 2008-09

Statement showing Sources of Fund and its utilization during the Financial Year 2007-08

Sources of Fund	Calculation Sheet Sl. No.	Amount (Rs. in Lacs)	Utilisation of Fund	Calculation sheet Sl. No	Amount (Rs in Lacs)
Average Owned Capital Employed	1	98542.26	Average Investments acquired out of Owned Funds	6	10431.39
			Average Net Fixed Assets acquired out of Owned Capital	7	88110.87

Average Rupee Term Loans/ECBs Employed for Projects	2	78503.34	Average Net Fixed Assets acquired out of Rupee Term Loans/ECBs	7	78503.34
Cash Credit Facilities/ Bank Borrowings for Working Capital (Including Excise Loans from Bank)	3	69124.26	Average Net Current Assets financed by Cash Credit Facilities/ Bank Borrowings For Working Capital (Including Excise Loans from Bank)	8	65417.70
			Average Working Capital utilised for Modernisation/ Expansion	7	3706.56
Book Entry for Deferred Tax Liability	4	12951.91	Average Net Fixed Assets amount blocked out of the same. (In form of Depreciation)	7	12630.71
			Average Amount of Misc. Exp. Not W/Off	9	321.20
Average Sources of Funds as Per Audited Balance Sheet as on 31 .03.2008	5	259121.75	Average Application of Funds as Per Audited Balance Sheet as on 31 .03.2008	10	259121.75

1) Average Net Fixed Assets - (Rs.88110.87 + Rs. 78503.34 + Rs. 3706.56 + Rs. 12630.71)Lacs = Rs. 182951.48

Further, Ld. Counsel also filed calculation sheet of opening application of funds and closing application of funds for the entire FY 2007-08 relevant to this Assessment Year. This calculation sheet is being reproduced as it is:

Balarampur Chini Mills Limited
Assessment Year 2008-09
Calculation Sheet

Sl. No.	Particulars	Calculation Particulars	Calculation Workings (Rs in Lacs)	Amount (Rs in Lacs)
1	Average Owned Capital Employed	(Op. Share Capital & Reserves and Surplus plus Cl. Share Capital & Reserves and Surplus)/2	(10271844+94366.07)/2	98542.26

2	Average Rupee Term Loans1ECBs Employed for Projects	(Op.Secured Loans + Cl, Secured Loans- Excise Loans and CC Facilities from Banks + Deposit against Conv. Warrants)/2	(142900.22+109934. 96- 11643-510- 37616.52- 1359.52- 45619.47+ 920)/2	78503.34
3	Cash Credit Facilities/ Bank Borrowings for Working Capital (Including Excise Loans from Bank)	(Op.CC Facilities+ Cl. CC Facilities + Op. Unsecured Loans from Banks + Cl. Unsecured Loans from Banks + Excise Loans from Banks)/2	(45619.47 + 38976.04 +7500 + 34000 + 11643 + 510)/2	69124.26
4	Book Entry for Deferred Tax Liability	(Op. Deferred Tax Liability + Cl. Deferred Tax Liability)/2	(12483.9+13419.91)/ 2	12951.91
5	Average Sources of Funds	(Op.Sources of Funds + Cl. Sources of Funds)/2	(293022.56+225220. 94)/2	259121.75
6	Average Investments acquired out of Owned Funds	(Op. Investments + Cl. Investments)/2	(20562.12+300.65)/2	10431.39
7	Average Net Fixed Assets	(Op. Net Fixed Assets + Cl. Net Fixed Assets)/2	(191908.44+173994. 51)/2	182951.4
8	Average Net Current Assets financed by Cash Credit Facilities / Bank Borrowings for Working Capital (including Excise Loans from Bank)	(Op.Net Current Assets + Cl. Net Current Assets)/2	(80302.35+50533.04) /2	65417.70
9	Average Amount of Misc. Exp. Not W/Off	(Op. Misc. Exp Not W/Off + Cl. Misc.Exp Not W/Off)12	(249.65+392.74)/2	321 .20
10	Average Application of Funds	(Op. Application of Funds + Cl. Application of Funds)/2	(293022.56+225220. 94)/2	259121.75

The Ld. Counsel for the assessee filed Balance Sheet for the year ending 31st March, 2008 and compared the same with the balance sheet for the year ending 31st March, 2007 and showed that the reserve and surplus as on 31st March, 2007 was at Rs.94366.07 (in lacs) and as against the same reserves and surplus (including share capital) becomes at

Rs.102718.44 (in lacs). The Ld. Counsel for the assessee also referred to loan funds and the position was stated as under:

LOAN FUNDS

		31.03.2008	31.03.2007
a)	Secured Loans	142900.22	109934.06
b)	Unsecured Loans	34000.00	7500.00
		176900.22	117434.96

Ld. Counsel for the assessee also stated that even there is reduction in deferred tax liability from 31st March, 2007 at Rs.13419.91 (in lacs) to Rs.12483.90 (in lacs) as on 31st March, 2008. Ld. Counsel also stated that no loan amount is put in investment as is clear from the above position as the investments in the net fixed asset has increased in assessment year 2008-09 from 2007-08 as under:

	31.3.2008	31.03.2007
NET FIXED ASSET	191908.44 (In lacs)	173994.51 (in lacs)
INVESTMENTS	20562.12 (In lacs)	300.65 (in lacs)
NET CURRENT ASSET	80302.35 (In lacs)	50533.44 (in lacs)
MISCELLANEOUS EXPENDITURE	249.65 (in lacs)	392.74 (in lacs)

In view of these facts, Ld. Counsel for the assessee stated that there is no expenditure attributable to exempted income qua administrative expenses, interest expenses or any other directly related expenditure. Ld. Counsel for the assessee accordingly stated that in the present case Rule 8D of the Rules invoked b y the lower authorities is without any basis. He stated that in view of the above facts the picture is very clear that there is no investment from interest free or interest bearing loans and there is no directly related expenses relating to exempted income i.e. dividend income. Hence, he urged the bench to delete the addition.

5. On the other hand, the Ld. DR stated that the Rule 8D of the Rules is now mandatory and Hon'ble Bombay High Court in the case of Godrej Boycee has upheld the validity of this Rule and it is applicable for and from AY 2008-09 as held by Hon'ble Bombay High Court. He state that the AO and CIT(A) has rightly computed the disallowance by invoking the provisions of section 14A of the Act and Rule 8D of the Rules. But the Ld. DR could not point out any defect in the statement showing sources of fund and its utilization filed by the assessee as also the calculation sheet of opening application of funds and closing application of funds.

6. We find that during the previous year ended on 31.03.2008 assessee earned Dividend Income of Rs. 1,08,72,574/- which was exempt U/s. l0(34)/(35) of the Income Tax Act, 1961and assessee in its Return of

income offered for Disallowance a sum of Rs. 1,49,995/- as reasonable expenditure relating to earning of its exempt Dividend Income. However, Assessing Officer disallowed a sum of Rs.3,90,63,218/- of Dividend Income earned by the assessee, in terms of Section 14A by applying Rule 8D of the Rules, while assessing the total income of the Assessee. The break-up of the said Disallowance as per Rule-8D made by the Assessing Officer is as under:

i)	Interest Expenditure disallowed as per Rule-8D	3,38,47,524.00
ii)	0.5% of Average value of Investments disallowed under Rule 8D	52,15,694.00
		3,90,63,218.00

We find that the computation so made by Assessee was certified by its Statutory Auditors and this fact has been recorded by AO as well as CIT(A). We find from the orders of the lower authorities that none of them had pointed out any defect in the correctness of the Assessee's claim of expenditure amounting to Rs. 1,49,995/- as certified by its Auditors. We find from the above statement showing sources of funds and its utilization during FY 2007-08 that assessee borrowed money primarily for its main business activities of manufacture and sale of Sugar, Industrial Alcohol, Fertilizer, Generation and Distribution of Power etc and no part of borrowed money had any direct link or nexus with the investments made by assessee company, which had yielded tax-free Dividend Income. The Assessee had substantial Capital of its own i.e., Share Capital plus Reserves amounting to Rs.94,366.07 Lakhs (as on 31.03.2007) and Rs.102,718.44 Lakhs (as on 31.03.2008) averaging at Rs.98,542.26 Lakhs which is more than 9 times of the Average value of Investments, amounting to Rs. 10431.39 Lakhs computed by the AO in the Assessment Order itself. We have taken note from the said Statement that the Assessee had utilized its entire borrowings in the form of Term Loans/ECBs for setting-up Greenfield Projects / Expansion of existing Projects, similarly, borrowings in the form of Cash Credit Facilities were utilized for its day to day requirements of Working Capital to run the business. As per fund flow statement it is clear that entire amount of Investments, yielding taxfree Dividend Income to the Assessee, were acquired from its Owned Funds represented by the Share Capital and Free Reserves and neither Long Term Borrowings in the form of Term Loans ECBs etc. nor Short Term Borrowings in the form of Cash Credit Facilities etc. were used for the purpose of acquisition of Investments at any time during the previous year as is evident from Statement prepared on the basis of Audited Balance Sheet as at 31.03.2008.

7. In view of the above facts, now we have to go to Rule 8D of the Rules, which is being reproduced as it is:

> 8D. (1) Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with–

(a) the correctness of the claim of expenditure made by the assessee; or

(b) the claim made by the assessee that no expenditure has been incurred,

in relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).

(2) The expenditure in relation to income which does not form part of the total income shall be the aggregate of following amounts, namely:–

(i) the amount of expenditure directly relating to income which does not form part of total income;

(ii) in a case where the assessee has incurred expenditure by way of interest during the previous year which is not directly attributable to any particular income or receipt, an amount computed in accordance with the following formula, namely:–

A x B

C

Where A = amount of expenditure by way of interest other than the amount of interest included in clause (i) incurred during the previous year;

B = the average of value of investment, income from which does not or shall not form part of the total income, as appearing lit the balance sheet of the assessee, on the first day and the last day of the previous year;

C = the average of total assets as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year;

(iii) an amount equal to one-half percent of the average of the value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee , on the first day and the last day of the previous year.

(3) For the purposes of this rule, the 'total assets' shall mean, total assets as appearing in the balance sheet excluding the increase on account of revaluation of assets but including the decrease on account of revaluation of assets."

From rule 8D of the Rules, it is clear that, the AO can invoke this rule in case he is not satisfied with regard to the account of assessee that the claim of expenditure made by assessee is not correct and the claim

made by assessee that no expenditure has been made in relation to income which do not form part of total income under the Act, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of Rule 8D(2) of the Rules. Even the provisions of section 14A(2) clearly states that the AO shall determine the amount of expenditure incurred in relation to such income which does not form part of total income under this Act in accordance with such method as prescribed (under rule 8D of the Rules), if the AO having regard to the account of the assessee is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of total income under the provisions of this Act. The provisions of section 14A was enacted by the Finance Act, 2001 by retrospective effect, w.e.f. 1.4.1962, which postulated that for the purpose of computing the total income no deduction shall be allowed in respect of expenditure incurred in relation to income which do not form part of total income under the Act by an assessee. The memorandum explaining the provision in the Finance Bill, 2001 provides reasons for insertion of section 14A in the Act and the same are reported in (2001) 248 ITR (St.)192 and at page 195 and 196, which are as under:

> *"Certain incomes are not includible while computing the total income as these are exempt under various provisions of the Act. There have been cases where deductions have been claimed in respect of such exempt income. This in effect means that the tax incentive given by way of exemptions to certain categories of income is being used to reduce also the tax payable on the non-exempt income by debiting the expenses incurred to earn the exempt income against taxable income. This is against the basic principles of taxation whereby only the net income, i.e., gross income minus the expenditure is taxed. On the same analogy, the exemption is also in respect of the net income. Expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income.*
>
> *It is proposed to insert a new section 14A so as to clarify the intention of the Legislature since the inception of the Income-tax Act, 1961, that no deduction shall be made in respect of any expenditure incurred by the assessee in relation to income which does not form part of the total income under the Income-tax Act.*
>
> *The proposed amendment will take effect retrospectively from April 1, 1962 and will accordingly, apply in relation to the assessment year 1962-63 and subsequent assessment years."*

From the above memorandum explaining the provisions of Finance Bill 2001 clearly suggests that the expenses incurred can be allowed only to the extent that they are relatable to earning of the taxable income and expenses relatable to exempted income are to be disallowed.

8. Here in the present case, there is no linkage or nexus between the funds borrowed by assessee and the impugned investments, hence, no interest expenditure can be disallowed by mechanically applying the Provisions of Rule 8D of the Rules. The assessee has explained that the share capital and reserves, that is its own funds, were utilised for the purpose of investment in shares for earning dividend income and this has not been negated by lower authorities i.e. neither CIT(A) nor AO. The assessee has explained each and every investment with sources of funds and its utilization as well as opening application of funds and closing application of funds as noted above. It is an admitted position in law that expenditure can be disallowed U/s.14A of the Act if and only if it is incurred in relation to income which does not form part of total income. From the facts of the present case, it is clear that there is no link with expenditure for earning of dividend income incurred by the assessee and once the facts are clear, no disallowance can be made by invoking rule 8D of the Rules. Neither the AO nor CIT(A) has recorded any finding that having regard to the account of the assessee, they are not satisfied with the correctness of the claim of expenditure made by assessee or the claim made by assessee that no expenditure has been incurred in relation to income which do not form part of the total income under the Act for the relevant assessment year. In the absence of any such finding, facts of the present case shows that the investment in shares was made out of own capital employed and not from borrowed funds, no disallowance on account of interest expenditure can be made by invoking rule 8D of the Rules. Accordingly, in the given facts and circumstances, we delete the addition and allow this issue of assessee's appeal.

9. The next issue in this appeal of the assessee is against the order of CIT(A) in confirming the action of AO in reducing the claim of deduction U/s.801A of the Act, by deducting proportionate head office expenses on turnover basis. For this, the assessee has raised following ground nos. 3 to 6:

> *3. That, on the facts and in the circumstances of the case, the Ld.CIT(A) erred in sustaining the Ld. A.O.'s order reducing the assessee's claim of deduction u/s.80-IA of the I.T. Act, 1961, from Rs.109,61,26,467 to Rs.107,14,75,223 after deducting proportionate Head Office expenses of Rs.2,46,51,244 on turnover basis.*
>
> *4. That, on the facts and in the circumstances of the case, the learned CIT(A) erred in sustaining the Ld. A.O.'s order reducing the assessee's claim of deduction u/s.80-IB of the I.T. Act, 1961, from Rs.5,13,91,657 to Rs.4,63,56,020 after deducting proportionate Head Office expenses of Rs.50,35,637 on turn-over basis.*
>
> *5. That, while sustaining the Ld. A.O.'s order reducing the assessee's claim of deduction u/s.80-1A/80-IB of the I.T. Act,*

1961 as in Ground Nos. 3 and 4 above, the Ld. CIT(A) arbitrarily rejected the assessee's submissions supported by several judicial decisions holding that indirect expenses or expenses which have a remote connection should be ignored and only expenditure directly relatable to or have direct nexus with the industrial unit should be deducted.

6. That, while dismissing the assessee's submission that the H.O. expenses should not be disallowed, the Ld. CIT(A) erred in observing that the assessee had not identified the direct H.0. expenses or that it itself worked out the pro-rata allocation of H.O. expenditure of Rs. 16.89 crores on the basis of turnover.

10. The AO disallowed deduction u/s. 80IA of the Act after deducting proportionate head office expenses on turnover basis. The CIT(A) also confirmed the action of AO exactly on same facts and same reasoning, as under:

"4. I have gone through the assessment order and submissions of appellant. I have decided same issue with almost identical facts in my appellate order for Assessment Year 2007-08 in appeal no 133/CC-XIX/CIT(A)-C-I1/KOL/09-10. The only addition in the argument of appellant in the current appeal is that that the Assessing Officer should have bifurcated the direct or indirect expenditures out of HO expenses which were allocated towards 80IA/ 80IB units and the Assessing Officer should have considered only the direct expenditure on 801A/ 801B units out of HO expenditures. However, I find that appellant itself has also not identified the H.O. expenditures which may be considered as direct expenditure towards 80IA/80IB units either on the basis of specific identification method or on the basis of any reasonable method of estimation. Appellant has taken the same argument as in Assessment Year 2007-08 that none of the H.O. expenditures are for any of the 80IA/ 80IB units and this presumption is not supported by any evidence or even probability. In fact appellant had itself worked out the pro rata allocation of entire HO expenditure of Rs. 16.89 crore on the basis of turnover of each eligible unit u/s 80IA or 80IB during the assessment proceedings. I therefore do not find any reason to disturb the allocation of HO expenses made towards eligible 80IA and 80IB units during the assessment proceedings for running such units by the Assessing Officer following my own appellate order for Assessment Year 2007-08 in appeal no l33/CC-XIX/CIT(A)-C-II/KOL./09-10. I confirm the action of Assessing Officer to allocate H.O. expenses of Rs. 2,46,51,244/- being the proportionate H.O. expenses towards eligible 80IA units and I also confirm the action of the Assessing Officer in reducing the appellant's claim of deduction u/s.80IB by its proportionate

H.O. expenses of Rs. 50,35,637/- and reducing the claim of deduction of appellant u/s 801B of the I. T. Act accordingly, I must add here that even after reducing the claim made u/s 80IA and 80IB by the appellant, Assessing Officer has determined the allowable claim u/s 80IA at Rs. 107. 14 crore and claim u/s 80IB at Rs. 4.64 crore. The Gross total Income of appellant has been determined a loss of Rs.(-)189,13,04,166 by the Assessing Officer and therefore such reduction in allowable claim of deduction u/s 80IA or u/s 80IB will not make any difference to the total income of appellant which is determined at NIL by the Assessing Officer.

11. At the outset, the Ld. Counsel for the assessee stated that similar issues was involved in the Assessee's own case for the Assessment year 2007-08 before ITAT, 'A' Bench, Kolkata, in ITA No.1650/KOL/2010 and Tribunal vide order dated 24.6.2011 has decided the issue in favour of the assessee exactly on similar facts. Ld. Sr. D.R however, conceded that the facts in the present year are exactly identical, hence Tribunal can decide the issue. We find that the Tribunal has decided the issue as under:

"11. We have heard the rival submissions and perused the material available on record. On a careful consideration of the same we are of the view that the claim of the assessee has to be allowed. In order to arrive at the said conclusion we would first refer to the undisputed facts on record.

11.1. The undisputed facts on record are that the assessee made a claim u/s 80IA/80IB of the Act duly supported by the auditors report and Form No.10CCB. It is also an undisputed fact that identical claims qua these undertakings in the very same manner and the very same set-up have been allowed u/s 143(3) proceedings.

11.2. It is also an undisputed fact that the assessee following the earlier years constant practice has reduced from the profits of these undertakings the expenditure directly related to these undertakings.

11.3. It is seen that in the course of assessment proceedings the AO specifically directed the assessee to submit calculation in a certain manner making the pro rata disallowance of the expenditure on the basis of its turn over. A perusal of the assessment order shows that the said calculations were given by the assessee under protest repeating that direct expenses of the undertakings had already been accounted for. The AO as per record choses not to negatively comment on it and merely insist for providing calculations in a certain manner. Compliance made under protest has been held against the assessee since relying on same the deductions claimed were reduced to

Rs.98,80,78,140/- u/s 80IA of the Act and 64,81,301/- u/s 80IB of the Act as against the claim of Rs.101,55,74,745 and Rs.2,74,96,600/- respectively. The assessee has all along been contesting that the direct expenses incurred in the specific undertakings had already been reduced by the assessee from the profits of the said undertakings which was duly supported by the auditors report and Form No.10CCB. It is also a matter of record that identical claims made by the assessee in an identical manner have been allowed to the assessee. For these very undertaking over the years at times as old as since 2000-01 assessment year. It is also an undisputed fact that the authorities have nowhere pointed out that any expenditure which had been incurred by the head office pertain directly to the undertakings for which deduction u/s 80IA/80IB of the Act had been claimed. It is seen that the tax authorities have proceeded on the footing that some expenses must have been incurred by the head office suspicion cannot supplant evidence. Since there is no short coming pointed out in the accounting of the assessee no effort has been made to show that any specific expenditure incurred under the Head office actually pertained to the undertakings for which deduction is being wrongly claimed. This action purely based on suspicion ignoring the facts on record is not in accordance with law. Accordingly in the peculiar facts on record we find that the orders of the AO and the CIT(A) deserve to be set aside.

11.4. In arriving at the conclusion arrived at we have also taken into consideration the various case laws relied upon by the parties before the Bench we are fortified by the principle laid down in the order of the Kolkata Bench of the Tribunal in the case of M/s. Tide Water Oil (I) Ltd which on facts fully supports the case at hand as the Co-ordinate Bench has on the facts available before it has held that deduction u/s 80IA allowed by the CIT(A) was to be restored by the Tribunal to the file of the AO in view of Rule 46A violations giving directions that direct expenses had to be reduced from the Silvasa Unit and since fresh evidence had been entertained by the CIT(A) without furnishing the same to the AO. The facts were required to be verified. Thus this direction of the Tribunal fully supports the case at hand as there can be no two opinions on the principle that direct expenses pertaining to the eligible units had necessarily to be reduced from the profits of the said units so as to arrive at the deduction claimed. In the second round it is seen that on record it was evident that head office had accounted for office expenditure of Silvasa unit as such reduction of the said direct expenses from the profit of Silvasa unit had to be done, this does not mandate that in a case where direct expenses have already been accounted for in the eligible units even then a proportion of head office

expenses on the basis of suspicions must be further reduced. The order of the Co-ordinate Bench has been completely mis-applied on facts. In order to reduce the profits of the eligible unit and burden the assessee it is first necessary to show that specific expenditure relatable to the units were incurred by the head office whether the connection is direct or remote can be looked into only after that here no efforts whatsoever have been made to show that any specific expenditure incurred by the head office in fact pertained to the eligible unit. When the ratio laid down by the Apex Court in the case of Liberty India Ltd. is considered then it is eminently clear that direct connection with the eligible profits is necessarily to be there for income as considered by the Apex Court. In the facts of the present case all the relevant details are available before the AO before whom it is repeatedly agitated that expenses directly connected to the units have already been accounted for. Necessary evidences, Auditors certificate, books of accounts separately maintained for the units and the head office are available the AO refuses to look into the same and insists on applying proportionate disallowance on a pro-rata basis and when the assessee again agitates providing the details by way of a chart made available to the CIT(A) from the same evidence. The AO again refuses to look into it and insists that it is nearly impossible. This obdurate attitude of repeatedly refusing to look into necessary facts is unfortunate. No doubt if the accounts of an assessee are unreliable or are not in the manner as per the requirements of the law then in such a situation at times it becomes incumbent to resort to pro-rata proportionate disallowance of expenses. As it may in certain situations be the best possible method. However in order to apply the same it is first and foremost necessary to hold that the accounts are not reliable/maintained as per law which is not the fact in the present proceedings. To apply such a method to the facts at hand would be a travesty of justice as the repeated stand of the assessee all along has been that the expenses directly connected with these units have already been accounted for in computing the income of the eligible unit. No fault or shortcoming has been pointed out by the department. The law requires that the profit of every unit had to be computed as if it were the only source of income of the assessee during the relevant previous years and such expenditure incurred by the head office to the extent it is relating to the business unit eligible for deduction us 80IA/80IB should be deducted while determining profit of the said unit as eligible deduction u/s 80IA/80IB. This principle has been followed by the Co-ordinate Bench in the first round as well as in the second round in the case of Tide water.

No material has been placed on record to show that the assessee in the year under consideration has not followed this principle.

11.5. Coming to the other judgements referred to before us, it is seen that the Hon'ble Apex Court in the case of Pandian Chemicals Limited vs CIT 267 ITR 278 has dwelt at length on the wording "derived from" and "attributable to" their Lordships in the case of Liberty India Ltd. 218 ITR 317 although in the context of Duty Draw back and DEPB incentives also had an occasion to hold that connotation of the words "derived from" is narrower in meaning as compared to that of the words "attributable to" by using the expression "derived from" Parliament intended to cover source not beyond the first degree. The principle laid down by the Apex Court in the said judgement fully supports the claim of the assessee. Considering the general Head office expenses which are not as per record directly incurred for the said specific units they cannot be said to be such expenses whose connection to the unit is of the first degree. As such these expenses on a proportionate basis cannot be used to reduce the profits of the said undertakings purely based on suspicion. It is the duty of the department to place material on record on the basis of which the claim of the assessee can be rejected. Accordingly it is seen that the judgements of the Apex Court in the case of Liberty India Ltd. and Pandian Chemicals Ltd. fully support the case of the assessee. The facts and circumstances pertaining to the order of the Tribunal in the case of M/s. Tide Water Oil (I) Ltd. as has been observed therein have been wrongly applied to the facts of the present case. The principle laid down in fact fully supports the case of the assessee. Accordingly in terms of the detailed reasons given herein above on facts and position of law the claim of the assessee in ground no.3 and 4 are allowed."

We find that the issue is squarely covered in favour of assessee and against revenue in assessee's own case for AY 2007-08, taking a consistent view and respectfully following the same, we allow this issue of the assessee's appeal.

12. The next issue in this appeal of the assessee is against the order of CIT(A) confirming levy of Interest U/s.234B & 234C of the Act.

13. The charging of interest u/s. 234B and C of the Act being consequential relief only, AO is directed to re-compute the Interest after giving effect to the Order of Tribunal. Hence, need no adjudication.

14. In the result, the appeal of assessee is partly allowed.

Order pronounced in open court on 29.7.2011.

2013 TRI 1398 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
CHENNAI "D" BENCH, CHENNAI

Abraham P. George, Accountant Member and V. Durga Rao, Judicial Member

FACTS/HELD

Section 40(b): Appointment of an existing partner as representative partner for another party may circumvent the ceiling on number of partners

1. The assessee, a firm of Chartered Accountants, filed a return offering income of Rs. 17.70 crores which was accepted by the AO u/s 143(3). The CIT then passed an order u/s 263 stating that the assessee had amended its partnership deed pursuant to which Mr. Mukund Dharmadhikari, who was already a partner of the firm, was added once again as a partner in a representative capacity, to represent Deloitte Haskins & Sells, Mumbai. As Mr. Dharmadhikari had the right to share profit, both in the representative capacity as well as in his individual capacity, the CIT held that the number of partners exceeded 20, the maximum allowed under the Partnership Act, 1932, and that the assessee had, therefore, to be treated as an Association of Persons. He held that the assessee was not entitled to claim a deduction u/s 40(b) for the salaries paid to its' partners.On appeal by the assessee to the Tribunal HELD:

   A study of the partnership deed shows that Deloitte Haskins & Sells, Mumbai, which is the participating firm, is not a stranger to the assessee. The assessee can take policy decisions, which have a policy bearing on such firm, once there is an approval of the majority of the members of the "National Firm". Mukund Dharmadhikari was representing Deloitte Haskins & Sells, Mumbai, and the endeavour of the assessee was to bring on board the participating firm, on which it had powers to make policy decision, so that they became entitled for a share of profit. In other words, the effort of the assessee was to bring indirectly into the partnership

M/s Deloitte Haskins & Sells, Mumbai, which was already a participating firm. The assessee was a renowned partnership firm and was well aware that number of partners cannot exceed 20. It is a well settled principle of law that what is permissible is tax planning, but not evasion. When an attempt is made by a concern to evade tax using subtle camouflages, bounden duty of the authorities is to find out the real intention. It is the duty of the Court in every case, where ingenuity is expended to avoid taxing and welfare legislations, to get behind the smoke screen and discover the true state of affairs. The Court has to go into substance and not to be satisfied with the form. Though in Rashik Lal 229 ITR 458 (SC) & Bagyalakshmi 55 ITR 660 (SC) it was held that a partner may be a trustee or may enter into a sub-partnership with others, or can be a representative of a group of persons and that qua the partnership, he functions in his personal capacity, these decisions will not apply since the assessee was indirectly trying to bring in M/s Deloitte Haskins & Sells, Mumbai, another firm, which was already a participating firm, as its partner, circumventing the limit of maximum 20 members. The AO did not apply his mind and go into these aspects and so the CIT was justified in directing him to look into the issue.

Appeal partly allowed.

I.T.A. No. 1164/Mds/2012 (Assessment Year : 2008-09).

Heard on: 18th June, 2013.

Decided on: 4th July, 2013.

Present at hearing: Girish Dave, CA, for Appellant. R.B. Naik, CIT-DR, for Respondent.

JUDGMENT

Per Abraham P. George:– (Accountant Member)

Through this appeal, assessee assails an order passed by Commissioner of Income Tax-IV, Chennai, on 26.3.2012, under Section 263 of Income-tax Act, 1961 (in short 'the Act').

2. Facts apropos are that assessee, a firm of Chartered Accountants, filed its return for impugned assessment year on 30th September, 2008, declaring a total income of Rs. 17,70,69,972/-. The assessment was completed on 31st December, 2010 under Section 143(3) of the Act,

accepting the income returned. Thereafter, on 29.2.2012, CIT issued a show cause notice under Section 263 of the Act, inter alia, stating that the number of partners in the firm had gone above 20, during the relevant previous year. As per ld. CIT, there were some amendments in the partnership deed on 1st May, 2007, whereby one Shri Mukund Dharmadhikari, already a partner of the firm, was added once again as partner in a representative capacity, representing M/s Deloitte Haskins & Sells, Mumbai. Ld. CIT noted that Shri Mukund Dharmadhikari had right to share of profit, both in the representative capacity as well as in his individual capacity. Thus, according to him, the number of partners exceeded 20, maximum allowed under Indian Partnership Act, 1932. Assessee therefore had to be treated as an Association of Persons. Assessment order under Section 143(3), passed on 31.12.2010, as per CIT, did not consider this aspect, but had accepted the claim of the assessee that it was a firm and on account of this, assessee was allowed deduction under Section 40(b) of the Act on salaries paid to its partners.

3. To the above notice, reply of the assessee was that the number of partners did not exceed 20, but remained at 20. According to assessee, amendment dated 1.5.2007 clearly mentioned that the number of partners was 20 only. Relying on the decision of Hon'ble Apex Court in the case of *CIT v. Bagyalakshmi & Co* (55 ITR 660), assessee argued that an individual could represent group of persons as well as himself thereby occupying a dual position. Qua the partnership, he functioned in his individual capacity only. Qua the third parties, he functioned in a representative capacity also. As per assessee, the right of Shri Mukund Dharmadhikari was only to share the profits of the assessee-firm and nothing more. Reliance was also placed on the decision of Hon'ble Apex Court in the case of *Rashik Lal and Co. v. CIT* (229 ITR 458). As per assessee, through this decision, it was clarified by the Hon'ble Apex Court that only individuals could become partners of the firm and even if a person joined the firm in his capacity as representative of a body or association, vis-à-vis the firm, his position was still that of an individual only. Agreement which an individual had with a third party to divide the profits received from the firm did not bind the firm nor did it alter the position of the firm under the Partnership Act or Income-tax Act. Assessee argued that a 'person' mentioned in Section 4 of Indian Partnership Act, 1932 could only be a natural person or a juristic or legal person. A firm or Association of Persons was not a legal person. Thus, according to assessee, though Shri Mukund Dharmadhikari was acting in a dual capacity, the total number of partners never exceeded 20 during the relevant previous year. In any case, as per assessee, the view taken by Assessing Officer was a possible one and therefore, CIT did not have a jurisdiction to interfere by exercising power under Section 263 of the Act. For this, reliance was placed by the assessee on the decision of Hon'ble Punjab & Haryana High Court in the case of *CIT v. Max (India) Ltd.* (268 ITR 128).

4. However, the CIT was not impressed by any of the above contentions taken by the assessee. According to him, the amendment deed dated 1.5.2007 clearly showed that M/s Deloitte Haskins & Sells, Mumbai, participating in the firm became a partner through its representative Shri Mukund Dharmadhikari. Sharing of the profits among the parties, mentioned in the deed included M/s Deloitte Haskins & Sells, Mumbai. A sum of Rs. 267 lakhs was to be paid to Shri Mukund Dharmadhikari in his representative position and after that he was entitled to a percentage share in the balance profits. Ld. CIT noted that the cases relied on by the assessee, namely, Bagyalakshmi & Co. (supra) and Rashik Lal & Co. (supra) were concerned with Hindu Undivided Family and rights of a karta, when a karta entered into a partnership. As per ld. CIT, these decisions only dealt with the position of a karta of a HUF and his right to share in the profits of a firm in which he was a partner. Whereas in assessee's case, the partnership deed clearly mentioned that Shri Mukund Dharmadhikari was a partner, who was to account to M/s Deloitte Haskins & Sells, Mumbai, in his representative capacity. In addition, he also got a share of 20.0530% in the profits in his individual capacity. He was thus of the opinion that the amendment to the partnership deed on 1st May, 2007 resulted in the membership exceeding 20, the maximum limit prescribed under law. Since Assessing Officer had not considered this aspect, but allowed the claim of the assessee with regard to the salaries paid to its members under Section 40(b) of the Act, he directed the Assessing Officer to modify his assessment order and enhance the assessment by disallowing the claim made by the assessee under Section 40(b) of the Act.

5. Now before us, learned A.R., strongly assailing the order of CIT, submitted that both partnership deed dated 1.4.2007 and amended deed dated 1.5.2007 were before the Assessing Officer while he was finalizing the original assessment. As per learned A.R., Assessing Officer had considered such partnership deeds before completing the assessment under Section 143(3) of the Act. Relying once again on the decision of Hon'ble Apex Court in the case of Rashik Lal & Co. (supra), learned A.R. submitted that even if Shri Mukund Dharmadhikari was considered as a representative of M/s Deloitte Haskins & Sells, Mumbai, he still remained an individual qua the assessee-firm. For the purpose of count, what mattered was number of individuals. Section 4 of Indian Partnership Act, 1932 was clear that there had to be a relation between partners agreeing to share the profits for a partnership to come into existence. According to him, when a person was treated as a partner in his representative capacity, it could not be stated that the firm was bound to the person whom he was representing. 'Person' mentioned in Section 4 of the Indian Partnership Act, 1932, could either be a natural person or juristic or legal person. Once again relying on the decision of Hon'ble Apex Court in the case of Bagyalakshmi & Co. (supra), learned A.R. submitted that a partner could be a trustee, could enter into partnership

with others, could be a representative of group of persons or could be a benamidar. Even if he occupied a dual position, qua the partnership, he functioned in his personal capacity only. Here, Shri Mukund Dharmadhikari was a partner both in his individual capacity as well as in a representative capacity, but, qua the assessee-firm, Shri Mukund Dharmadhikari was only one person. Rights and obligations of Shri Mukund Dharmadhikari vis-à-vis the firm were regulated by the partnership deed. The firm M/s Deloitte Haskins & Sells, Mumbai, which was being represented by Shri Mukund Dharmadhikari, could never raise any legal claim against assessee. They could not pursue any legal action against the assessee for violation of any clause of partnership deed. Assessee had nothing to do with the contract Shri Mukund Dharmadhikari had with M/s Deloitte Haskins & Sells, Mumbai. As far as assessee was concerned, Shri Mukund Dharmadhikari was only a single person. Thus, as per the original partnership deed as well as amended deed, only 20 partners were there in the firm. Hence, number of partners never exceeded 20. Assessing Officer had taken a lawful view. CIT could not substitute a lawful view with his own view. Relying on the decision of Hon'ble Apex Court in the case of *Malabar Industrial Co. Ltd. v. CIT* (243 ITR 83), learned A.R. submitted that twin conditions viz. existence of an error and such error being prejudicial to the interests of Revenue, which were necessary for invoking revisionary powers under Section 263 of the Act were absent here. In any case, as per the learned A.R., the CIT fell in error when he directed the Assessing Officer to modify the assessment considering assessee as an Association of Persons and deny its claim of remuneration paid to its partners. This had completely tied up the hands of the Assessing Officer and such directions, according to learned A.R., were beyond the scope of the revisionary powers under Section 263 of the Act.

6. Per contra, learned D.R., strongly supporting the order of CIT, submitted that the Assessing Officer had committed gross error in not verifying the supplementary deed. Assessing Officer, according to learned D.R., had never gone into the aspect of number of partners in the assessee-firm. Assessing Officer had without applying his mind, accepted the claim of the assessee that it was a partnership firm and also allowed its claim of remuneration under Section 40(b) of the Act. Thus, non-application of mind was an error and such error was definitely prejudicial to the interests of Revenue. Hence, according to him, CIT was justified in invoking his revisionary power under Section 263 of the Act.

7. We have perused the orders and heard the rival submissions. There is no dispute that partnership deed dated 1.4.2007 and amendment deed dated 1.5.2007 were before the Assessing Officer when he completed the assessment under Section 143(3) of the Act originally. The amendments made through the latter deed, which has given rise to this dispute, are reproduced hereunder:–

IN THE PRINCIPAL DEED THE FOLLOWING CLAUSES SHALL BE AMENDED AS STATED BELOW:

Partner is Representative Capacity	1	the following shall be added as a part of the recitation under the first paragraph "PARTIES" SHRI MUKUND DHARMADHIKARI, a Party of the Fourth Part, is a Partner in the said Firm on his own behalf. In addition with effect from the first day of May, 2007, he shall be also be a Partner in a representative capacity, representing Deloitte Haskins & Sells, Mumbai, a Participating Firm.
PARTNERS' REMUNERATION AND SHARE OF PROFITS	2	clause 9 of the Principal Deed shall be substituted by the following:
Remuneration	a.	Each Active Partner shall be paid out of Parnership moneys each month, remuneration as set out in Annexure 1, and such payment shall be deemed to be an expense of the Partnership.
	b.	With effect from the first day of May, 2007 the net Profits or Losses for the year of the said Firm shall be shared by the Parties hereto in the following manner: i. First, Rs. 267 lakhs (Rupees Two hundred and sixty seven lakhs) being a share of profits (net of tax) shall be paid to SHRI MUKUND DHARMADHIKARI, A PARTY of the Fourth part in his capacity as a Representative Partner of Deloitte Haskins & Sells, Mumbai, a Participating Firm. ii. Thereafter, the divisible profits or losses, as the case may be, of the said Firm shall be calculated and the shares therein of the parties of the First to the Twentieth Parts shall be divisible in the manner set out in Annexure II.

8. Mode of division of profits, mentioned in Annexure II of the amendment deed reads as under:–

ANNEXURE II

PARTNER'S REMUNERATION AND SHARE OF PROFITS AND LOSSES

DELOITTE BASKINS & SELLS, CHENNAI

No.	Name	Share of Profits and Losses (%)
1.	M.K. Ananthanarayanan	7.0923
2.	V. Balaji	2.6481
3.	Bhavani Balasubramanian	4.4459
4.	Mukund Dharmadhikari	20.0530
5.	Anil Gupta	9.2697
6.	M. Lakshminarayanan	8.0450
7.	B. Mala	6.1396
8.	C.R. Rajagopal	3.0698
9.	K. Rajasekhar	5.1923
10.	B. Ramaratnam	2.9354
11.	M. Ramchandran	4.2577
12.	P.R. Ramesh	0.0005
13.	K. Sai Ram	6.6461
14.	K.R. Sekar	3.4932
15.	V. Srikumar	6.6461
16.	S. Sundaresan	0.0046
17.	Geetha Suryanarayanan	3.3873
18.	Ganesh Swaminathan	2.7522
19.	S. Thirumalai	0.0046
20.	Ravi Veeraraghavan	3.9166
	TOTAL	**100.0000**

9. Shri Mukund Dharmadhikari had a share of 20.0530% in the total profits left, after paying Rs. 267 lakhs to him in his capacity as representative partner of M/s Deloitte Haskins & Sells, Mumbai. M/s Deloitte Haskins & Sells, Mumbai is mentioned as a "Participating firm" in the original partnership deed dated 1st day of April, 2007. "Participating Firm" has been defined in the said deed as under:-

> *""Participating Firms" shall mean the group of Firms comprising, in alphabetical order, A.F. Ferguson & Co., A.F.*

Ferguson Associates, C.C. Chokshi & Co., Ahmedabad, C.C. Chokshi & Co., Baroda, C.C. Chokshi & Co., (Mafatlal House) Mumbai, C.C. Chokshi & Co., (Worli) Mumbai, C.C. Chokshi & Co., New Delhi, Deloitte Haskins & Sells, Ahmedabad, Deloitte Haskins & Sells, Baroda, Deloitte Haskins & Sells, Chennai, Deloitte Haskins & Sells, Kolkata, Deloitte Haskins & Sells, (National Firm), Deloitte Haskins & Sells, Mumbai, Deloitte Haskins & Sells, New Delhi, Fraser & Ross, Fraser & Ross Associates, P.C. Hansotia & Co., S.B. Billimoria & Co., Touche Ross & Co., Chennai, Touche Ross & Co., Mumbai, and such other Firms as may be decided from time to time."

There is a specific provision again in the very same deed which harps on the policy making powers that have an effect on "Participating Firm". This provision reads as under:–

Certain decisions by the Participating Firms	n.	Notwithstanding anything contained in any of the clauses the following shall prevail upto 30th September 2007.

All policy decisions affecting the Participating Firms will need the approval of the majority of the members of the National Firm.

Provided however that in respect of the following matters, the decision shall require approval of 75% affirmative vote of the total votes cast, any fraction being rounded off to the next higher number:

(i) Change in the name of the Firm

(ii) Merger with any other Firm

(iii) Admission of a Partner

(iv) Exit of a Partner

"National Firm" mentioned in the above clause is defined in the very same deed as under:–

""National Firm" shall mean the Partnership Firm Deloitte Haskins & Sells which is the Indian member Firm of Deloitte Touche Tohmatsu."

10. Thus two aspects are very clear. One is that M/s Deloitte Haskins & Sells, Mumbai,which is a participating firm,is not a stranger to the assessee. Assessee can take policy decisions, which have a policy bearing on such firm, once there is an approval of the majority of the members of the "National Firm". Shri Mukund Dharmadhikari was representing M/s Deloitte Haskins & Sells, Mumbai, which was a participating firm. What

can easily be construed from the above is that endeavour of the assessee through the amendment deed, was to bring on board the participating firm, on which it had powers to make policy decision, so that they became entitled for a share of profit. In other words, the effort of the assessee was to bring indirectly into thepartnership M/s Deloitte Haskins & Sells, Mumbai, which was already a participating firm. Assessee was a renowned partnership firm and was well aware that number of partners cannot exceed 20. It is a well settled principle of law that what is permissible is tax planning, but not evasion. When an attempt is made by a concern to evade tax using subtle camouflages, bounden duty of the authorities is to find out the real intention. It is the duty of the Court in every case, where ingenuity is expended to avoid taxing and welfare legislations, to get behind the smoke screen and discover the true state of affairs, as held by Hon'ble jurisdictional High Court in the case of Indo *Tech Electric Co. v. DCIT* in TC(A) No.2209 & 2210 of 2006 dated 16.12.2010 at para 15.1 of its order. The Court has to go into substance and not to be satisfied with the form. No doubt, as pointed out by the learned A.R., Hon'ble Apex Court in the case of Rashik Lal & Co. (supra) has clearly held that a partner may be a trustee or may enter into a sub-partnership with others, or can be a representative of a group of persons. Qua the partnership, he functions in his personal capacity. But, in our opinion, the above decision as well as decision in the case of Bagyalakshmi & Co. of Hon'ble Apex Court (supra) will not have any applicability here, since assessee was indirectly trying to bring in M/s Deloitte Haskins & Sells, Mumbai, another firm, which was already a participating firm, as its partner, circumventing the limit of maximum 20 members. It is also obvious that Assessing Officer despite having the amendmentdeed with him, had not gone into these aspects. Assessment order is a crisp one accepting the income returned by the assessee. Assessee has not been able to place any record to show that Assessing Officer had called for any details regarding the number of partners during the course of assessment. A crisp order by itself might not show that Assessing Officer had not applied his mind. But, when the circumstances show that despite availability of materials, aspects vital to the assessment were missed out, then the normal inference that can be drawn is that Assessing Officer had not looked into such aspects nor applied his mind. Assessee had claimed substantial amount as remuneration to its partners under Section 40(b) of the Act and this was allowed as such without considering the crucial aspect of the legality of its claim of status as a firm. In our opinion the circumstances would show that Assessing Officer had not applied his mind and such assessment order by virtue of this, became an erroneous one which was prejudicial to the interests of Revenue.

11. No doubt, the CIT went over board when he directed the Assessing Officer to modify the assessment order by treating the assessee as an AOP and disallow the claim of remuneration to its partners. The

CIT ought have simply set aside the order of A.O. for consideration of issue afresh, since it was erroneous insofar as it was prejudicial to the interests of Revenue and to this extent, order of ld. CIT required modification.

12. Thus, while confirming the order of CIT(Appeals) insofar as invocation of his powers under Section 263 of the Act is concerned, we find it necessary to modify his order. Assessing Officer shall be free to consider the claim of the assessee afresh and will not be constrained by the direction of the CIT that assessment has to be done disallowing the claim of remuneration to partners. Assessing Officer shall be free to proceed in accordance with law. Ordered accordingly.

13. In the result, appeal filed by the assessee is partly allowed.

Order was pronounced in the Court on Thursday, the 4th of July, 2013, at Chennai.

2013 TRI 1407 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
DELHI "C" BENCH, NEW DELHI

G. D. Agrawal, Vice President and A.D. Jain, Judicial Member

FACTS/HELD

Section 14A & Rule 8D: Disallowance Cannot Exceed Total Expenditure

1. In AY 2008-09, the assessee earned tax-free dividend income. Its' total expenditure as per the P&L A/c was Rs. 49 lakhs. The AO applied Rule 8D and made a disallowance u/s 14A of Rs. 2.37 crores which was reduced by the CIT (A) to Rs. 1.78 crores. Before the Tribunal, the assessee claimed that even assuming that the entire expenditure had been incurred to earn the dividend, the disallowance u/s 14A & Rule 8D could not exceed the expenditure incurred. HELD accepting the plea:

   U/s 14A read with Rule 8D, disallowance can be made for the expenditure incurred for earning of exempt income. From the assessee's P&L A/c, it is evident that the total expenditure incurred was Rs. 49 lakhs only which was claimed as a deduction. **The disallowance u/s 14A & Rule 8D cannot exceed the expenditure**

actually claimed by the assessee. Accordingly, the action of the AO & CIT (A) in making disallowance in excess of total expenditure debited to P&L A/c is unjustified.

Appeal partly allowed.

ITA No. 267/Del/2012 (Assessment Year : 200 2008-09).

Decided on: 23rd March, 2012.

Present at hearing: Pradeep Dinodia, R.K.Kapoor &Pallavi Dinodia, CAs, for Appellant. Alok Singh, Sr. DR, for Respondent.

JUDGMENT

Per G. D. Agrawal:– (Vice Member)

This appeal by the assessee is filed against the order of learned CIT(A)-VIII, New Delhi dated 4th November, 2011 for the AY 2008-09.

2. The grounds raised by the assessee read as under:–

> *"1. That the learned CIT(A) has erred in law and on facts in failing to restrict the disallowance u/s 14A read with rule 8D to Rs.1,78,83,842/- as against the disallowance of Rs.2,37,59,757/- made by the AO on proportionate basis, on wholly erroneous, illegal and untenable grounds.*
>
> *2. On the facts and in the circumstances of the case, the learned CIT(A) has failed to appreciate that for A.Y. 2008-09, the disallowance u/s 14A has to be worked out only in accordance with rule 8D of the I.T.Rules."*

3. At the time of hearing before us, it is stated by the learned counsel for the assessee that there are various factual errors in computing the disallowance as per Rule 8D. However, he is not arguing in detail with regard to those errors but, his argument is limited to the fact that the disallowance cannot exceed the expenditure claimed by the assessee. He stated that total expenditure claimed by the assessee in the profit & loss account is only Rs.49,04,028/- while the Assessing Officer disallowed Rs.2,37,59,757/-. That apart from dividend income, the assessee has other income to the extent of Rs.97,04,935/-. Therefore, part of the total expenditure incurred by the assessee is certainly attributable to earning of other income. However, even if it is presumed that the entire expenditure was incurred for earning of dividend income, then also, the disallowance cannot be made more than the expenditure actually claimed by the assessee. He stated that Section 14A provides that no deduction shall be allowed in respect of expenditure incurred by the assessee for earning of exempt income. Rule 8D is only a method for determining such expenditure. Therefore, in any case, what has not been claimed by the assessee cannot be disallowed. He stated that the entire expenditure claimed by the assessee was only Rs.49,04,028/- and, therefore, even if it

is presumed that the entire expenditure was for earning of dividend income, the disallowance cannot exceed Rs.49,04,028/-.

4. The learned DR, on the other hand, relied upon the orders of the authorities below.

5. We have carefully considered the arguments of both the sides and perused the material placed before us. Section 14A reads as under:–

> ***"Expenditur Expenditure incurred in relation to income not includible in total income income.***
>
> *14A. [(1) For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.]*
>
> *[(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.*
>
> *(3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act:]*
>
> *[Provided that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001.]"*

6. From the above, it is evident that as per sub-section (1) of Section 14A, no deduction is to be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of total income. Sub-section (2) of Section 14A provides the procedure for determination of such expenditure by the Assessing Officer. The Board has also prescribed Rule 8D for determining the expenditure incurred by the assessee for earning of exempt income. Thus, the disallowance can be made under sub-section (1) for the expenditure incurred for earning of exempt income. In the case under appeal before us, from the perusal of the assessee's profit & loss account, it is evident that the total expenditure incurred was Rs.49,04,028/- only. Thus, the assessee claimed the deduction for the expenditure of Rs.49,04,028/- which is debited to the profit & loss account. The disallowance cannot exceed the expenditure

actually claimed by the assessee. We, therefore, accept the assessee's contention that the disallowance made by the Assessing Officer and sustained by the learned CIT(A) in excess of total expenditure debited to profit & loss account was unjustified. Accordingly, we restrict the disallowance to the extent of expenditure actually claimed by the assessee i.e. Rs.49,04,028/-.

7. In the result, the appeal of the assessee is partly allowed.

Decision pronounced in the open Court on 23rd March, 2012.

INCOME TAX APPELLATE TRIBUNAL MUMBAI "E" BENCH, MUMBAI

B. Ramakotaiah, Accountant Member and Vivek Varma, Judicial Member

Appeal partly allowed.

ITA No.3464/Mum/2011 (Assessment Year-2007-08).

Heard on: 27th February, 2012.

Decided on: 2nd March, 2012.

Present at hearing: Saisudha Multani, for Appellant. Sandeep Goel, for Respondent.

JUDGMENT

Per B. Ramakotaiah:– (Accountant Member)

The issue in assessee's appeal is with reference to disallowance u/s. 14A.

2. The Assessing Officer noticed that assessee had made certain investments and accordingly invoking Rule 8D made disallowance u/s. 14A of the I.T. Act at Rs. 6,36,513/-. The Ld. CIT(A) confirmed the same by stating as under:

> *"I have considered the issue. Hon'ble Bombay High Court in the case of Godrej & Boyce Mfg. Co. Ltd. vs DCIT held that though the provisions of Rule 8D which have been notified w.e.f. 24.3.2008 shall apply w.e.f. assessment year 2008-09, even in respect of earlier years the AO would have to apportion the expenditure and disallow the expenditure incurred by the assessee in relation to income which does not form part of the total income. The relevant assessment year in the case in hand is 2007-08. Rule 8D is, therefore, not applicable here. The AO is, however, competent to determine and disallow such expenditure as may be reasonable having proximate nexus with the exempt income. In the absence of any other parameter or yardstick to arrive at such proximity or reasonableness, the AO rightly used a*

legally wedded method even though the method per se was not applicable to the current year. I, therefore, confirm the disallowance made of Rs. 6,36,513/-."

3. It was the submission of the Ld. Counsel that the company did not incur much expenditure while offering the income and filed Profit & Loss account to submit that except donation of Rs. 10,00,000/- and professional fees of Rs. 2,89,575/- the balance of expenditure is very small as under:

Expenditure	Current year Rupees
Bank charges	55,183/-
Filing fees	2,050/-
Audit fees	5,000/-
Tax Audit fees	5,000/-
Amortisation of preliminary expenses	5,900/-
Interest on delayed payment of service tax	2,287/-
Profession tax	500/-
Website charges	3,118/-
Printing & Stationery	780/-

4. The Ld. Counsel relied on the order of Co-ordinate Bench in the case of *Nivi Trading Ltd. vs DCIT* in ITA No. 5455/M/2010 dt. 12.10.2011 to submit that assessee does not have any other expenditure except to maintain day today activity and the expenditure has no nexus with the earning of tax free income, therefore, disallowance u/s. 14A is not warranted. The details of professional fees paid were also placed on record to submit that the expenditure was for business and not for earning exempt income.

5. Ld. Departmental Representative relied on the order of AO and Ld. CIT(A).

6. We have considered the issue. As seen from the details of the P&L account filed by assessee receipts were to the tune of Rs. 1.79 crores whereas the expenditure was only Rs. 13.69 lakhs, out of which Rs. 10 lakhs was donation. Out of the balance expenditure, the professional fees were to comply with certification charges and ROC matters and only an amount of Rs. 2.75 lakhs was paid for due diligence which has no relation to earning of exempt income. Only an amount of Rs. 55,183/-was paid as bank charges for clearance of various cheques in business activity. AO simply invoked Rule 8D disallowing the amount u/s. 14A without examining whether there is any nexus with the amount claimed as exempt income. Moreover, the disallowance made is more than the expenditure claimed in the P&L account. Therefore, we are unable to

uphold the orders of AO and Ld. CIT(A) on this issue. Considering that an amount of Rs. 77,63,301/- was earned by way of dividend, a token amount of Rs. 5,000/- was only considered as expenditure incurred towards earning exempt income, out of the total claim of expenditure in the P&L account. Accordingly, disallowance is restricted to an amount of Rs. 5,000/-. The AO is directed to allow the balance expenditure as claimed. The grounds raised by the assessee are accordingly, partly allowed.

7. In the result, appeal filed by the assessee is partly allowed.

Order pronounced on this 2nd day of March, 2012

2013 TRI 1412 (H.C. Del.)

HIGH COURT OF NEW DELHI

Sanjiv Khanna and Sanjeev Sachdeva, JJ.

CIT
v.
Agnity India Technologies Pvt. Ltd.

FACTS/HELD

Transfer Pricing: Companies with extreme turnover like Infosys are not comparable

1. The assessee, a wholly owned subsidiary of Bay Packets Inc., USA, was engaged in the business of development of software for the parent company in the field of telecommunications. To determine the arms' length price, the TPO & DRP took Infosys Technologies as a comparable. On appeal by the assessee, the Tribunal (included in file) held that the assessee was not comparable with Infosys as Infosys was a large and bigger company in the area of development of software and the profits earned by it cannot be benchmarked or equated with the assessee's results. One of the aspects pointed out by the Tribunal was that Infosys' turnover was Rs. 9,028 crores while that of the assessee was only Rs. 16.09 crores. On appeal by the department to the High Court, HELD dismissing the appeal:

    The Tribunal's findings that Infosys should be excluded from the list of comparables for the reason that (i)

Infosys was a giant company and it assumed all risks leading to higher profits, whereas the assessee was a captive unit of the parent company and assumed only a limited risk and (ii) that the financial data (turnover) was not comparable has not been controverted by the Revenue. The Tribunal has given valid and good reasons for excluding Infosys as a comparable.

Appeal dismissed.

ITA No. 1204/2011.

Decided on: 10th July, 2013.

Present at hearing: Suruchi Aggarwal, Sr. Standing Counsel, for Appellant. G.C. Srivastava and Preeti Bhardwaj, Advocates, for Respondent.

JUDGMENT

Sanjiv Khanna, J.–

This appeal by the Revenue, which pertains to the assessment year 2006-07, in the case of Agnity India Technologies Pvt. Ltd. raises a short issue. The respondent-assessee is a wholly owned subsidiary of Bay Packets Inc., USA and was/is engaged in the business of development of software for the parent company in the field of telecommunication. The respondent had filed return of income on 30th November, 2006 declaring total income of Rs.8,31,720/-. As respondent-assessee had undertaken international transactions with “Associated Enterprise” details of which were mentioned in the tax audit report, the matter was referred to Transfer Pricing Officer (TPO) to determine the fair market value of the international transactions. TPO opined that adjustment of Rs.3,73,74,985/- would be justified to bring it in line with arm’s length value. Addition of the aforesaid amount was suggested in the draft assessment order which was examined by the Dispute Resolution Panel before whom the respondent-assessee had filed objections. Dispute Resolution Panel vide order dated 17th June, 2010 directed the Assessing Officer to recomputed the arm’s length value by taking the ratio of operating profit to the total cost at 25.6%. This resulted in an addition of Rs.1,24,01,451/-.

3. Before the TPO, the respondent-assessee was asked to re-work the list of comparables and the same was reduced to 20. TPO also directed inclusion of Infosys Technologies Ltd. in the said list. The TPO in the final analysis has taken the comparables as under:-

“

“S.No.	Name	OP/TC (%)
1	Satyam Computer Service Ltd.	30.07

2	L&T Infotech Ltd.	11.11
3	Infosys Technologies Ltd.	40.08
Arithmetic mean		27.08

"

4. One of the companies which was included by the TPO was Satyam Computer Services Ltd. Dispute Resolution Panel excluded the said company from the comparables for obvious reasons.

5. The tribunal has observed that the assessee was not comparable with Infosys Technologies Ltd., as Infosys Technologies Ltd. was a large and bigger company in the area of development of software and, therefore, the profits earned cannot be a bench marked or equated with the respondent, to determine the results declared by the respondentassessee. In paragraph 3.3 the tribunal has referred to the difference between the respondent-assessee and Infosys Technologies Ltd. For the sake of convenience, we are reproducing the same:–

"

Basic Particular	**Infosys Technologies Ltd.**	**Agnity India**
Risk Profile	Operate as full-fledged risk taking entrepreneurs	Operate at minimal risks as the 100% services are provided to AEs
Nature of Services	Diversified-consulting, application design, development, re-engineering and maintenance system integration, package evaluation and implementation and business process management, etc. (refer page 117 of the paper book)	Contract Software Development Services.
Revenue	Rs.9, 028 Crores	Rs.16.09 Crores
Ownership of branded/proprietary products	Develops/owns proprietary products like Finacle, Infosys Actice Desk, Infosys iProwe, Infosys mConnect, Also, the company derives substantial portion of its proprietary products (including its flagship banking product suite 'Finacle')	
Onsite Vs. Offshore	-As much as half of the software development services rendered by Infosys are onsite (i.e., services performed at the customer's location overseas). And offshore (50.20%) (Refer	The appellant provides only offshore services (i.e., remotely from India)

	page 117 of the paper book) than half of its service, income from onsite services.	
Expenditure on Advertising/Sales promotion and brand building	Rs.61 Crores	Rs. Nil (as the 100% services are provide to AEs)
Expenditure on Research & Development	Rs. 102 crores	Rs. Nil
Other		100% offshore (from India)

"

6. Learned counsel for the Revenue has submitted that the tribunal after recording the aforesaid table has not affirmed or given any finding on the differences. This is partly correct as the tribunal has stated that Infosys Technologies Ltd. should be excluded from the list of comparables for the reason latter was a giant company in the area of development of software and it assumed all risks leading to higher profits, whereas the respondent-assessee was a captive unit of the parent company and assumed only a limited risk. It has also stated that Infosys Technologies Ltd. cannot be compared with the respondentassessee as seen from the financial data etc. to the two companies mentioned earlier in the order i.e. the chart. In the grounds of appeal the Revenue has not been able to controvert or deny the data and differences mentioned in the tabulated form. The chart has not been controverted.

7. Learned counsel for the appellant Revenue during the course of hearing, drew our attention to the order passed by the TPO and it is pointed out that based upon the figures and data made available, the TPO had treated a third company as comparable when the wage and sale ratio was between 30% to 60%. By applying this filter, several companies were excluded. This is correct as it is recorded in para 3.1.2 of the order passed by the TPO. TPO, as noted above, however had taken three companies, namely, Satyam Computer Service Ltd., L&T Infotech Ltd. and Infosys Technologies as comparable to work out the mean.

8. It is a common case that Satyam Computer Services Ltd. should not be taken into consideration. The tribunal for valid and good reasons has pointed out that Infosys Technologies Ltd. cannot be taken as a comparable in the present case. This leaves L&T Infotech Ltd. which gives us the figure of 11.11 %, which is less than the figure of 17% margin as declared by the respondent-assessee. This is the finding recorded by the tribunal. The tribunal in the impugned order has also observed that the assessee had furnished details of workables in respect of 23 companies and the mean of the comparables worked out to 10%, as

against the margin of 17% shown by the assessee. Details of these companies are mentioned in para 5 of the impugned order.

9. In view of the aforesaid position, we do not think that any substantial question of law arises for consideration. The appeal is dismissed.

INCOME TAX APPELLATE TRIBUNAL
DELHI "F" BENCH, DELHI

C.L. Sethi, Judicial Member and K.G. Bansal, Accountant Member

Appeal allowed.

ITA No. 3856(Del)/2010 (Assessment year: 2006-07).

Decided on: 4th November, 2010.

Present at hearing: Neha Arora & Rohit Tiwari.C.As, for Appellant. A.K. Pandey, CIT, DR & H.K. Lal, Sr. DR, for Respondent.

JUDGMENT

Per K.G. Bansal:– (Accountant Member)

This appeal emanates from the order of the ITO, Ward 12(1), New Delhi (hereinafter called the 'AO') on directions of the Dispute Resolution Panel, issued on 17.06.2010, and it pertains to assessment year 2006-07.

2. The facts of the case are that the assessee company is a wholly owned subsidiary of BayPackets Inc., USA, and it is engaged in the business of development of software required by the parent company in the field of tele-communication. The return declaring total income of Rs. 8,31,720/- was filed on 30.11.2006. In the course of assessment proceedings, it was found that the assessee had undertaken international transactions with the "Associated Enterprise" ("AE" for short), the details of which were mentioned in the tax-audit report. The determination of fair market value of the international transactions was referred to the Transfer Pricing Officer ("TPO" for short), who suggested that the value declared by the assessee required upward adjustment of Rs. 3,73,74,985/- to bring it in line with arm's length value. The addition suggested in the draft assessment order amounted to Rs. 3,73,74,985/-. The assessee filed objections before the Dispute Resolution Panel ("DRP" for short). The DRP, in its order dated 17.6.2010, directed the AO to re-compute arm's length price taking the ratio of operating profit to the total cost at 25.6%. This resulted in the addition of Rs. 1,24,01,451/-. The AO also made some disallowance u/s 14A. Thus, the total income of the assessee was assessed at Rs. 133,21,970/- against the returned income of Rs. 8,31,720/-.

3. Before us, the ld. counsel for the assessee submitted that the assessee, a captive service provider, had charged the parent company a profit margin of 17% of the cost. The assessee was a captive unit for development of software for its parent company. It was entitled to taxholiday u/s 10A of the Act. The assessee undertook controlled international transactions of the value of Rs.16.09 crore in this year. It applied the ratio of operating profit to total cost as profit-level indicator ('PLI' for short), which is about 17% in its case. For this purpose of justifying its PLI, the assessee furnished 23 comparable cases and their data for an earlier year whose mean was worked out at 10%. Thus, it was claimed that no adjustment was required to be made on the issue of transfer-price. The TPO excluded some cases on the grounds inter-alia that they were performing different functions or that the ratio of wages to sales was not comparable. He also considered the case of Infosys Technologies Ltd. as a comparable case. Thus, he considered 20 cases with mean of 27.08%. Therefore, upward adjustment of about Rs.3.73 crore was suggested. Before the DRP, the assessee took following objections to the ratio:-

> the ld. TPO failed to appreciate that the appellant is entitled to a tax holiday and hence has no untoward motive to shift profits out of India.
>
> the ld. TPO erred in applying an arbitrary financial criterion of wages/sales filter of 45-65 per cent to reject companies which were otherwise comparable to the appellant.
>
> the ld. TPO erred in rejecting companies which were otherwise comparable to the appellant on arbitrary/frivolous grounds of declining/fluctuating/static sales trend.
>
> the ld. TPO failed to appreciate the limited-risk nature of the assessee's business operations and accordingly did not grant the appellant the benefit of risk adjustment.
>
> the ld. TPO failed in appreciating the functional profile of the assessee and thereby erroneously including in the final comparable set one company, viz., Infosys Technologies Limited with differential functional and economic profile as compared to the captive software development services provided by the appellant;
>
> the ld. TPO erred in retaining one company 'Satyam Computers' in the final set of comparables in complete disregard of the fact that there is sufficient evidence available in public domain to demonstrate that the financial data of the company for FY 2005-06 is not reliable.

3.1 Based on the above arguments/contentions, the DRP agreed with the appellant with respect to the rejection of Satyam Computers from the comparable set thereby reducing the arm's length margin to 25.6% and

the resultant TP addition of Rs. 12,401,451 (refer page 15 of appeal set). However, the ld. DRP did not adjudicate on the other objections raised by the appellant.

3.2 It is further submitted that the main dispute in this case is regarding inclusion of the case of Infosys Technologies Ltd. This case has been included for the purpose of transfer pricing adjustments by the TPO. However, the case is not comparable at all as the assessee is a pigmy compared to giant Infosys Technologies Ltd. The latter's capital is Rs. 138 crores and reserves stand at Rs. 6,759/- crores. The expenditure on interest is Rs.1.00 crore and the current liabilities stand at Rs.642 crores against operating income of Rs. 928 crores. As against the aforesaid, the assessee's capital and reserves stand at about Rs. 8.44 crores. Its revenue amount to only about Rs. 16 crores. Therefore, the case is not comparable in terms of turnover or capital. It is also submitted that the risk assumed by Infosys Technologies Ltd. include inter-alia the market risk, which is borne by the parent of the assessee company and not by the assessee. This risk is significant and assumption of such risk leads to greater rewards. On this ground also, the two cases are not comparable. If this case is ignored, the results declared by the assessee are otherwise acceptable even as per the study made by the TPO, as confirmed by the DRP.

3.3 For the sake of ready reference, the case of the ld. counsel for excluding the case of Infosys Technologies Ltd. is shown in a tabular form as under:-

Basis/Particular	**Infosys Technoligies Ltd.**	**Agnity India**
Risk Profile	Operate as full-fledged risk taking entrepreneurs	Operate at minimal risks as the 100% services are provided to AEs
Nature of Services	Diversified-consulting, application design, development, re-engineering and maintenance, system integration, package evaluation and implementation and business process management, etc. (refer page 117 of the paper book)	Contract Software Development Services
Revenue	Rs. 9,028 Crores	Rs. 16.09 Crores
Ownership of branded/proprietary products	Develops/owns proprietary products like Finacle, Infosys ActiceDesk, Infosys iProwe, Infosys mConnect. Also, the company derives substantial portion of its revenue from sale of its proprietary products (including its flagship banking product suite 'Finacle')	

	As per the annual report of the company, it has intangibles assets worth approx. Rs. 69,500 crores for the period ended March 31, 2006.	
Onsite Vs. Offshore	-As much as half of the software development services rendered by Infosys are onsite (i.e., services performed at the customer's location overseas). RevenueSplit-Onsite (49.80%) and offshore (50.20%) (Refer page 117 of the paper book) -Typically, onsite services command higher billable rates and consequently it would not be appropriate to compare the appellant which earns its entire income from offshore services with Infosys which earns more than half of its service, income from onsite services.	The appellant provides only offshore services (i.e., remotely from India)
Expenditure on Advertising/Sales promotion and brand building	Rs. 61 Crores	Rs. Nil (as the 100% services are provided to AEs)
Expenditure on Research & Development	Rs. 102 crores	Rs. Nil
Other		100% offshore (from India).

4. In reply, the ld. DR drew our attention to paragraph no. 5.9 of the order of the TPO, in which it is mentioned that the comparable cases have been selected by the assessee and it has also asked for adjustment on account of working capital. The onus of furnishing the working of such adjustment is on the assessee. Coming to the merits, it is mentioned that adjustment can only be in respect of difference in credit terms and working capital policies. This involves consideration of time lag between sale of products and payments received, time lag between purchase of inputs and payments becoming due, and time lag between production and sale. Thereafter, the details of capital and reserves etc. of Infosys Technologies Ltd. have been mentioned and it is concluded that there is no case for capital adjustment. Such conclusions have also been arrived at in the case of Satyam Computers Services Ltd. and L&T Infotech Ltd. The case of the ld. DR on the basis of this discussion is that the comparables were selected by the assessee, the case of Infosys Technologies Ltd. is a comparable case and it does not require any

adjustment on account of the capital. Therefore, it was agitated that the adjustment made by the AO may be upheld.

5. We have considered the facts of the case and submissions made before us. We find that there is no dispute on the issue that cost plus method is the most appropriate method for valuing controlled-internationaltransactions in this case. The assessee had selected 23 comparables and adjustment was made towards working capital. On this basis the mean of the comparables was worked out 10% against the margin of 17% shown by the assessee. The details of this working are as under:–

Company Name-Prowess, Capitaline & Segmental	Database	Working capital adjusted OP/TC
E Star Infotech Ltd.	Prowess	15%
Goldstone Technologies Ltd.	Prowess	8%
Larsen & Tubro Infotech Ltd.	Prowess	9%
Melstar Inforfmation Technologies Ltd.	Prowess	4%
Netvista Information Technology Ltd.	Prowess	15%
Orient Information Technology Ltd.	Prowess	17%
Pentamedia Graphics Ltd.	Prowess	12%
Satyam Computer Servioces Ltd.	Prowess	29%
Shree Tulsi Online.Com Ltd.	Prowess	-10%
Sun Beam Infotech Ltd. (Hit Kit)	Prowess	7%
Transworld Infotech Ltd.	Prowess	30%
VJIL Consulting Ltd.	Prowess	2%
VMF Soft Tech Ltd.	Prowess	1%
Akshay Software Technologies Ltd.	Capitaline	10%
Kale Travel Technologies Ltd.	Capitaline	6%
Pentagon Global Solutions Ltd.	Capitaline	2%
Systemlogic Solutions Ltd.	Capitaline	24%
Powersoft Global Solutions Ltd.	Capitaline	24%
Advanced Micronic Devices Ltd.(Information Technology)	Seg-P	7%
Tata Infotech Ltd.	Seg-P	10%

5.1 In the proceedings before the TPO, the number of comparable cases was reduced to 20. He included the case of Infosys Technologies

Ltd. and excluded some case for the reasons mentioned earlier. No adjustment was made on account of working capital. The mean was worked at 27.08% against the margin of 17% declared by the assessee.

5.2 Various arguments, as stated earlier, were taken before the DRP which inter-alia included rejection of comparable cases; application of arbitrary filter of wage to sales ratio; ignoring that the assessee is a limited risk company; inclusion of Infosys Technologies Ltd.; and inclusion of Satyam Computers Services Ltd. in spite of the fact that its data is not reliable as publicly known. On the basis of these arguments, the DRP excluded the case of Satyam Computers Services Ltd., thereby reducing the arm's length margin to 25.6%. It is argued that the case of the assessee is not comparable with Infosys Technologies Ltd., the reason being that the latter is giant in the area of development of software and it assumes all risks, leading to higher profit. On the other hand, the assessee is a captive unit of its parent company in the USA and it assumes only limited currency risk. Having considered these points, we are of the view that the case of aforesaid Infosys and the assessee are not comparable at all as seen from the financial data etc. of the two companies mentioned earlier in this order. Therefore, we are of the view that this case is required to be excluded. Once that is done, it is the accepted position of both the parties that the results of the assessee are in line with the mean margin of comparable cases even if no adjustment is made on account of capital etc. Therefore, it is held that no adjustment was required to be made to the results declared by the assessee company.

6. In the result, the appeal is allowed.

The order was pronounced in the open court on 4th November, 2010.

2013 TRI 1421 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
DELHI "G" BENCH, NEW DELHI

G.E. Veerabhadrappa, President and A.D. Jain, Judicial Member

FACTS/HELD

Section 14A: Onus is on AO to show expenditure is incurred to earn tax-free income

1. For AY 2006-07, the assessee earned dividend of Rs. 17 lakhs and LTCG of Rs. 12 crores. The assessee claimed that it had incurred no expense to earn the tax-free income and so no s. 14A disallowance was permissible. However, the AO disallowed

Rs. 2 crores under Rule 8D towards interest and admin expenditure. The CIT (A) accepted that no interest was incurred and deleted that disallowance. He also reduced the admin expenditure disallowance. On appeal to the Tribunal, HELD:

(i) The contention of the Revenue that some expenditure, directly or indirectly, is always incurred for earning tax-free income cannot be accepted. **The burden is on the AO to establish the nexus of the expenditure incurred with the earning of exempt income** before making any disallowance u/s 14A (Hero Cycles 323 ITR 518 (P&H), Jindal Photo followed)

(ii) As regards interest, the **AO has to show the nexus** between the borrowed funds and the tax free investments. If that is not done, disallowance of interest is not permissible (K. Raheja Corporation (Bom) followed)

(iii) As regards admin expenses, s. 14A disallowance cannot be made on an **ad-hoc basis**. It is the **department's responsibility** to bring material on record to show that **expenditure was incurred** for earning the exempt income. If this is not done, disallowance is not permissible (Wimco Seedlings followed)

Order accordingly.

ITA No. 2431(Del)2010 (Assessment year: 2006-07) & C.O. No.349 (Del)2010 (In ITA 2431(Del)2010) (Assessment year: 2006-07).

Decided on: 4th May, 2012.

Present at hearing: S. Mohanty, DR, for Appellant. Ajay Vohra, Advocate, Rohit Jain, CA & Janpriya Rooprai, Advocate, for Respondent in ITA No. 2431(Del)2010. Ajay Vohra, Advocate, Rohit Jain, CA & Janpriya Rooprai, Advocate, for Appellant. S. Mohanty, DR, for Respondent in C.O. No.349 (Del)2010.

JUDGMENT

Per A.D. Jain:– (Judicial Member)

These are Department's appeal and the assessee's cross objections against the order dated 4.2.2010 passed by the CIT(A), XI, New Delhi. The following grounds have been taken by the Department:-

1. *"Ld. Commissioner of Income Tax (Appeals) erred, in law and on the facts and circumstances of the case, in restricting the*

disallowance of Rs. 2,08,83,181/- made by the AO u/s 14A of the I.T. Act to Rs. 16,54,531/-

2. *Ld. Commissioner of Income Tax (Appeals) erred, in law and on the facts and circumstances of the case, in deleting the disallowance of Rs. 5,000/- made by the AO on account of fines & penalties.*

3. *Ld. Commissioner of Income Tax (Appeals) erred, in law and on the facts and circumstances of the case, in directing the AO as under:–*

   i) *To verify the claim of the assessee and exclude interest income from UTI from income after due verification.*

   ii) *To allow the balance 50% of additional depreciation after verifying the contention of the assessee that 50% of additional depreciation was claimed and allowed in immediately preceding year i.e. A.Y. 2005-06.*

   iii) *Verify the claim of the assessee and allow credit of the TDS.*

Since the CIT(A), as per the provisions of section 251 (1)(a) of the I.T. Act, may confirm, reduce, enhance or annul the assessment and the above directions of the CIT(A) amount to setting aside the grounds of appeal."

2. The assessee has raised the following cross objections:–

1. *"That the CIT(A) erred on facts and in law in confirming the disallowance of expenditure amounting to Rs. 16,54,525/- under section 14A Income-tax Act, 1961 (the Act), alleged to have been incurred for earning tax free dividend income.*

   That the CIT(A) erred on facts and in law in not holding that disallowance under section 14A of the Act, could not have been worked out as per the method provided in Rule 8D of the Income-tax Rules, 1962 ('the Rules') since the same was prospective in operation and was not applicable to the year under consideration.

2. *That the CIT(A) erred on facts and in law in not directing the assessing officer to allow deduction under section 801A/80IB of the Act in respect of the three units of the appellant.*

2.1 *That the CIT(A) erred on facts and in law in not appreciating that deduction under section 80IA/80IB of the Act was not allowed in respect of the profits of the three units for the period 01.04.2005 to 30.06.2005 to the appellant as well as the resulting company."*

3. Apropos ground No.1 of the Department's Appeal & Cross Objection No.1 of the assessee, as per the assessment order, the AO noticed that the assessee had earned dividend income of Rs. 17,32,701/-

and long term capital gain of Rs. 12,15,93,111/-, against which, no expenses had been claimed to have been incurred. The AO asked the assessee to explain as to why disallowance u/s 14A of the I.T. Act be not made in respect of expenses attributable to income exempt u/s 10 of the Act. The assessee submitted that no expenses had been incurred to earn the exempt income. The AO, however, disagreed with the stand taken by the assessee. It was observed that the assessee had an opening balance of investment of Rs. 88,85,47,596/- and a closing balance of Rs. 1,00,47,31,991/-, from which, the assessee had earned the exempt income; that as available from the assessee's Profit and Loss Account, the assessee had incurred an interest cost of Rs. 3,22,99,963/- during the year; that the assessee company had been carrying on the business of manufacture of yarn, which had been transferred to Sutlej Textiles and Industries Ltd. ('STIL', for short), with effect from 1.7.2007, as per the scheme of arrangement sanctioned by the Hon'ble Rajasthan High Court; that the assessee company had retained the investment business; that as such, 50% of the expenses on account of interest were being treated as incurred for investment business, from which, the assessee had earned income in the form of dividend and capital gains; and that it was clear that the assessee had earned exempt income at the costs debited to the Profit and Loss Account. The AO further held that following the Special Bench decision of the Tribunal in "ITO, Mumbai v. Daga Capital Management Pvt. Ltd.", 2008 – TIOL – 509-Mumbai-(SB), Rule 8 D of the I.T. Rules read with Sections 14A(2) & (3) of the Act are applicable with retrospective effect. Holding so, the AO worked out the disallowance u/s 14 A of the Act as follows:-

A) Direct cost	
(50% of Interest)	1,61,49,981/-
B) Indirect cost	
Opening balance of Investment	88,85,47,596/-
Closing balance of Investment	100,47,31,991/-
	189,32,79,587/-
	94,66,39,793/-
	47,33,200/-
Total disallowance u/s 14A (A+B)	2,08,83,181/-

4. Before the ld. CIT(A), the assessee contended that as per the Scheme of demerger, the entire interest bearing liabilities, namely, secured and unsecured loans, belonging to the assessee company as on 30.6.05, the date preceding the date of demerger, were relatable to the demerged Textile Division and were transferred to the resulting company, i.e., STIL, as part of the demerger. The assessee supported such contention with documentary evidence, i.e., Schedule of assets and liabilities in respect of the residual undertaking forming part of the

Scheme of demerger, the Profit and Loss Account of the Company for the period from 1.7.2005 to 31.3.2006, wherein nil interest expenses had been debited and comparative Profit and Loss Account for the demerger period and for the complete year, showing that the entire interest expenditure related to the pre-demerger period from 1.4.2005 to 30.6.2005. The assessee thus contended that there was no interest expenditure actually related to the investment activity and so, no part of interest expenditure was disallowable u/s 14A of the Act. It was submitted that during the post demerger period, the assessee only had investment activity; that expenses of only Rs. 9,26,788/- had been claimed as deduction towards remuneration to Director, Audit Fee, etc., which also could not be said to be related to the earning of exempt income; that during the pre-demerger period, disallowance, if any called for, could be of only Rs. 7,27,743/-, since the rest of the expenditure related to Haridwar Holiday Home and Dehradun Holiday Home, which had also demerged with the Textile business; and that Rule 8D of the I.T. Rules was applicable only prospectively and not retrospectively.

5. The ld. CIT(A) asked for a remand report from the AO. In the remand report, the AO stated that interest expenditure also related to the investment activity and that the assessee was wrong in contending that no expenses related to the dividend income.

6. So far as regards the applicability of Rule 8D of the Income Tax Rules, the ld. CIT(A) confirmed the AO's view of the said Rule being retrospectively applicable. In doing so, the ld. CIT(A) also went by "Daga Capital Management"(supra).

7. So far as regards the merits of the disallowance, the ld. CIT(A) observed that the disallowance had been made on account of interest expenditure and other administrative and operative expenses. Concerning the interest expenditure, the ld. CIT(A) had asked the assessee to file the audited financial statements of STIL, i.e., the resulting company, as on 31.3.2006. There-from, the ld. CIT(A) observed that the entire loan, on which the interest expenditure had been incurred, actually stood transferred from the assessee company to STIL, pursuant to the scheme of demerger sanctioned by the Hon'ble Rajasthan High Court. The ld. CIT(A) observed that it stood established that the entire interest expenditure actually related to the earning of taxable income from the Textile Division and not to the earning of any exempt income. It was held that therefore, no part of the interest expenditure was disallowable u/s 14A of the Act read with Rule 8D of the Rules.

8. Regarding the disallowance of Rs. 47,33,200/- out of administrative and operative expenses, the ld. CIT(A) observed that the entire expenditure during the pre-demerger period, excepting Rs. 12,99,537/- related to the demerged Textile Division; that for the post-demerger period, the total expenditure was of Rs. 21,06,266/-, out of which, the assessee had itself disallowed Rs. 11,79,478/- and had claimed

only the balance of Rs. 9,26,788/-; and that thus, the total pre-demerger and post-demerger expenses, from which, disallowance could be made, aggregated to Rs. 22,26,325/-. The ld. CIT(A) observed that the disallowance of Rs. 47,33,000/-, as made by the AO u/s 14A of the Act read with Rule 8D of the Rules could not be sustained, since such disallowance had to be restricted to the actual expenditure incurred. The ld. CIT(A) further observed that, on the other hand, the contention of the assessee that no part of the expenditure of Rs. 22,26,000/- was disallowable, was also not acceptable; and that the assessee had actually earned exempt dividend income, due to which, the expenditure incurred in relation to such income needed to be disallowed in terms of section 14A of the Act. Observing that the expenditure of Rs. 5,71,794/- related to Haridwar Holiday Home and Dehradun Holiday Home, which also stood demerged as part of the Textile Division, the ld. CIT(A) reduced this amount from the amount of Rs. 22,26,000/- and held the entire balance expenditure of Rs. 16,54,531/- to be relating to the investment activity of the assessee company. It is this amount of Rs. 16,54,531/-, to which the disallowance of Rs. 2,08,83,181/-, as determined by the AO, was restricted by the ld. CIT(A).

9. The Department has raised ground No.1 of its appeal against this action of the ld. CIT(A), seeking confirmation of the entire disallowance of Rs. 2,08,83,181/-, as made by the AO. The assessee, on the other hand, has taken Cross Objection No.1, requesting for the deletion of the entire disallowance as against that restricted by the ld. CIT(A) to Rs. 16,54,531/-.

10. The learned counsel for the assessee has made oral arguments and a chart of issues had been filed as well. It has been contended that the provisions of section 14A of the Act are applicable only to expenditure incurred in relation to income not forming part of the total income. Reliance in this regard has been placed on "CIT v. Walfort Share and Stock Brokers", 326 ITR 1(SC) and "Godrej & Boyce Manufacturing Co. Ltd., Bombay v. DCIT", 328 ITR 81(Bom). It has been contended that in the present case, during the year, no expense, having either any direct or any indirect relation with the earning of exempt income, was incurred by the assessee; that no part of the interest expenditure actually related to the investment division, as also noted by the ld. CIT(A), since the entire loan on which the interest had been paid, had been transferred to STIL, the resulting company, pursuant to the scheme of demerger, with effect from 1.7.05. The learned counsel for the assessee has drawn attention to a copy of the scheme of demerger [pages 1 to 20 of the Assessee's Paper Book ('APB' for short)]. Reference has, then, been made to the Schedule of assets and liabilities in respect of the residual undertaking of the assessee company (APB 21 to 76). Further, the Profit and Loss Account of the residual company for the period from 1.7.05 to 31.3.06 (APB 78), the comparative Profit and Loss Account for the segregated period from 1.4.05 to 30.6.05, of the consolidated company and that for the year

ending 31.3.06 (APB 79 to 80) have also been referred to. It has been contended that if no nexus is shown between the borrowed funds and the tax free investment, no disallowance of interest on the borrowed funds can be made. For this proposition, reliance has been placed on the following case laws:–

1. "*CIT v. Hero Cycles*", 323 ITR 518(P&H);
2. "*CIT v. K. Raheja Corporation Pvt. Ltd.*", decision dated 8.8.11 in ITA No. 1260/2009, rendered by the Hon'ble Bombay High Court (Copy at pages 31 to 33 of the Case Laws Paper Book filed by the assessee, "CLPB" for short);
3. "*DCIT v. Jindal Photo Ltd.*", authored by one of us, the J.M., on 22.12.10, in ITA No. 4539(Del)2010 (copy at CLPB 39 to 45);
4. "*Maruti Udyog Ltd. v. DCIT*", 92 ITD 119(Del);
5. "*ACIT v. Eicher Ltd.*", 101 TTJ 369(Del); and
6. "*DCIT v. Maharashtra Seamless Ltd.*", 138 TTJ 244(Del).

11. Apropos the administrative expenditure, it has been contended on behalf of the assessee that firstly, no part of the administrative expenditure related to the investment division; that the AO did not bring anything on record to show that expenditure to have been incurred for earning exempt income; that the disallowance u/s 14A of the Act was made on an entirely adhoc basis, without discharging the onus of justifying the disallowance of such expenditure; and that this is impermissible in law, as laid down in–

1. "*Chemical and Metallurgical Design Co. Ltd.*", ITA No. 803/2008 …..?
2. "*PTC India Ltd. v. DCIT*", ITA Nos. 580 & 581(Del)09(Del) …?
3. "*Wimco Seedlings Ltd. v. DCIT*", 107 ITD 267(Del)(TM); and
4. "*CIT v. Ms. Sushma Kapur*", 319 ITR 299(Del).

12. It has been further contended that even otherwise, the provisions of sections 14A(2) and (3) of the Act and Rule 8D of the Rules are prospective and cannot be applied for any assessment year prior to assessment year 2008-09. For this, reliance has been placed on–

1. "*Godrej & Boyce Manufacturing Co. Ltd. v. DCIT*", 328 ITR 81(Bom);
2. "*Godrej Agrovet Ltd. v. ACIT*", 326 ITR 81(Bom); and
3. "*Continental Carriers (P)Ltd. v. ACIT*", 138 TTJ 249(Del).

13. Explaining the administrative expenditure actually incurred by the assessee, it has been contended that so far as regards the pre-demerger expenditure, the total expenditure was of Rs. 12,99,537/-. Reference in this regard had been made to APB 82 to 87. It has been submitted that this entire expenditure related to activities other than the

activities of the Textile Division; that an amount of Rs. 11,76,500/- out of the said expenditure of Rs. 12,99,537/- was debited as "miscellaneous expenditure"; that out of this expenditure, expenditure of Rs. 5,71,794/- related to Haridwar Holiday Home and Dehradun Holiday Home, which were also demerged under the scheme, (with regard to which, APB 199 has been referred to); and that therefore, only the balance expenditure of Rs. 7,27,743/- was incurred during the three months period from 1.4.05 to 30.6.05, under the head of "miscellaneous expenditure". Referring to the post-demerger expenditure from 1.7.05 to 31.3.06, the learned counsel for the assessee has argued that the total expenditure during this period amounted to Rs. 21,06,266/- (APB 81 referred to); that this expenditure primarily comprised of a restructuring/demerger expenditure of Rs. 14,74,347/- and balance other expenses, with regard to which, our attention has been drawn to APB 78 to 80; that in the revised return of income, out of the demerger expenses of Rs. 14,74,347/-, an amount of Rs. 2,94,869/- had been claimed u/s 35 DD of the Act, whereas the balance expenditure of Rs. 11,79,478/- was disallowed in the return (reference made to APB 283); that therefore, a total expenditure of only Rs. 16,54,531/- had been claimed and disallowance, if at all, could have been made only out of the said expenditure of Rs. 16,54,531/-; that so, the ld. CIT(A) went wrong in disallowing the entire expenditure, particularly when there is no evidence available to suggest that even any part of such expenditure was incurred to earn exempt income; and that further more, this expenditure includes expenditure towards remuneration of Director and Audit Fees, which expenditure had to be *incurred*, irrespective of exempt income being received or not and these expenses also could not be held to be related to the earning of exempt income.

14. The learned DR, on the other hand, has contended that the ld. CIT(A) has erred in restricting the disallowance of Rs. 2,08,83,181/- made by the AO u/s 14A of the Act to Rs. 16,54,531/-; that while doing so, the ld. CIT(A) has failed to take into consideration that the assessee had an opening balance of investment of Rs. 88,85,47,596/- and a closing balance of Rs. 1,00,47,31,991/-; that it was therefrom that the assessee had earned exempt income; that during the year, the assessee had incurred interest cost of Rs. 3,22,99,963/-, as available from the Profit and Loss Account; that the assessee had earned exempt income at the costs debited to the Profit and Loss Account; that undisputedly, a loan had been taken, on which, interest was being paid; that as such, the AO was right in holding 50% of the interest expenditure to be directly relatable to the earning of exempt income; that as such, the AO was correct in making the disallowance accordingly; that even though agreeing with the AO to the applicability of formula as per Rule 8D of the Rules, the ld. CIT(A) erred in restricting the disallowance made by the AO at Rs. 47,33,000/- being 0.5% of the average investment, to Rs. 22,26,000/-; that the ld. CIT(A) further erred in reducing a sum of Rs. 5,71,794/- and thereby restricting the disallowance to only Rs. 16,54,531/-; that even otherwise,

the matter needs to be remitted to the AO to examine the expenses regarding the exempt income in the light of "Godrej & Boyce"(supra), as per which, even if the assessee has utilized its own funds for making investments which have resulted in income which does not form part of the total income under the Act, the expenditure which is incurred in the earning of that income would have to be disallowed, which expenditure is what the AO has to determine.

15. We have heard the parties and have perused the material on record with regard to this issue. The assessee is a limited company and is in the business of making investments, besides other business. Earlier, it was carrying on the activity of manufacturing and dealing in Textiles. The Textile Division of the assessee, however, got demerged into the resulting company, STIL, with effect from 1.7.05. The AO made disallowance of interest expenditure of Rs. 1,61,49,987/- and of other administrative and operative expenses of Rs. 47,33,200/-, total amounting to Rs. 2,08,83,181/-. The ld. CIT(A), apropos the interest expenditure, held that the entire loan on which the interest expenditure had been paid actually stood transferred from the assessee company to STIL, the resulting company, pursuant to the scheme of demerger. This fact, as found by the ld. CIT(A), has remained established. Nothing to the contrary has been brought out . It remains undisputed that in the audited financial statement of STIL, as on 31.3.2006, this loan stood transferred pursuant to the scheme of demerger, from the assessee company to STIL. This was in accordance with the scheme of demerger as approved by the Hon'ble Rajasthan High Court. A copy of the said scheme of demerger is at APB 1 to 20. As per this scheme, the liabilities, duties and obligations of the assessee company relating to the demerged Textile Division were to be transferred to the resulting company, STIL. Then, as per the Schedule of assets and liabilities in respect of the residual undertaking forming part of the scheme of demerger, the relevant portion whereof is at APB 62 to 64, after the demerger, the books of the assessee do not show any outstanding loans, signifying that all the loans pertaining to the demerged Textile Division stood transferred. APB 64, states, inter alia,:–

Secured loans - Nil

Unsecured loans - Nil

APB 62 to 64 constitute the statement of assets and liabilities in respect of the residual undertaking of SIL (the assessee) as on the date immediately preceding the appointed date. Further, the details of Profit and Loss Account of SIL (the assessee), from July, 2005 to March, 2006 (APB 78) gives the details of the expenditure, as per which, the total expenditure was of Rs. 21,06,266/-. The comparative Profit and Loss Account for the segregated period, i.e., from 1.4.05 to 30.6.05, of the consolidated company, and for the year ending 31.3.06, are at APB 79 to 80. Therein, no interest expenditure stands shown as relating to the period from 1.7.05 to 31.3.06, i.e., the period during which the assessee

company was only an investment company. It was only to the three months period prior to the said period, i.e., from 1.4.05 to 30.6.05, that the total interest expenditure pertained. This clearly shows that the expenditure on interest concerned the demerged Textile Division of the assessee Company and not its investment activity. 16. As such, no nexus was brought by the AO between the borrowed funds and the tax free investment. That being so, disallowance of interest on borrowed funds was entirely uncalled for.

17. In "K. Raheja Corporation Pvt. Ltd." (supra), it was held by the Hon'ble Bombay High Court that in the absence of any material or basis to hold that the interest expenditure directly or indirectly was attributable for earning the dividend income, the decision of the Tribunal in deleting the disallowance of interest made u/s 14A of the Act could not be faulted. In the facts of the present case, as discussed, "K. Raheja Corporation Pvt. Ltd." (supra), is squarely applicable.

18. In "*CIT v. Hero Cycles*" (supra), it was held by the Hon'ble Punjab & Haryana High Court, inter alia, that the contention of the Revenue that directly or indirectly some expenditure was always incurred, which must be disallowed u/s 14A of the Act and the impact of the expenditure so incurred could not be allowed to be set off against the business income which may nullify the mandate of section 14A, could not be accepted; and that the disallowance u/s 14A required a finding of incurring of expenditure and where it was found that for earning exempted income, no expenditure had been incurred, disallowance u/s 14A could not stand. In the present case, as seen, the AO has not established any nexus whatsoever between the borrowed funds and the investment made. Therefore, "Hero Cycles" (supra), is applicable.

19. In "*ACIT v. Eicher Ltd.*" (supra), it has been held that the burden is on the AO to establish the nexus of the expenditure incurred with the earning of exempt income, before making any disallowance u/s 14A of the Act.

20. In "*Maruti Udyog*"(supra), it has been held that before making any disallowance u/s 14A of the Act, the onus to establish the nexus of the same with the exempt income, is on the Revenue.

21. In "*Jindal Photo*"(supra), following "Hero Cycles"(supra), "Eicher Ltd."(supra), "Maruti Udyog"(supra) and other decisions, we have held as follows:–

> *"18. Now, as per section 14A(2) of the Act, if the AO, having regard the accounts of the assessee, 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 assessee's total income under the Act, the AO shall determine the amount incurred in relation to such income, in accordance with such method as may be prescribed, i.e. under Rule 8D of the I.T.*

Rules. However, in the present case the assessment order does not evince any such satisfaction of the AO regarding the correctness of the claim of the assessee. As such, Rule 8D of the Rules was not appropriately applied by the AO as correctly held by the CIT (A). It has not been done by the AO that any expenditure had been incurred by the assessee for earning its dividend income. Merely, an ad hoc disallowance was made. The onus was on the AO to establish any such expenditure. This onus has not been discharged. In "CIT vs. Hero Cycles: (P & H) 323 ITR 518, under similar circumstances, it was held that the disallowance u/s 14A of the Act requires a clear finding of incurring of expenditure and that no disallowance can be made on the basis of presumptions. In "ACIT vs. Eicher Ltd.", 101 TTJ (Del.) 369, that it was held that the burden is on the AO to establish nexus of expenses incurred with the earning of exempt income, before making any disallowance u./s 14A of the Act. In "Maruti Udyog vs. DCIT, 92 ITD 119 (Del.), it has been held that before making any disallowance u/s 14A of the Act, the onus to establish the nexus of the same with the exempt income, is on the revenue. In "Wimco Seedlings Limited vs. DCIT", 107 ITD 267 (Del.) ™, it has been held that there can be no presumption that the assessee must have incurred expenditure to earn tax free income. Similar are the decisions in:

1. *"Punjab National Bank vs. DCIT", 103 TTJ 908 (Del.);*
2. *"Vidyut Investment Ltd." 10 SOT 284 (Del.); and*
3. *"D.J. Mehta vs. ITO", 290 ITR 238 (Mum.) (AT).*

19. In view of the above, finding no error with the order of the CIT(A) on the point at issue , the same is hereby confirmed. Ground No. 3 is thus rejected."

22. Moreover, as rightly contended, the finding of fact recorded by the ld. CIT(A), to the effect that no part of the interest expenditure actually related to the investment activity, has not been challenged by the Department.

23. Therefore, we hold that the ld. CIT(A) has correctly deleted the disallowance of the interest expenditure of Rs. 1,61,49,987/-.

24. Further, the AO made disallowance of Rs. 4,77,33,200/- out of administrative and operative expenses at 0.5% of the average investment of the assessee company, under the formula given in Rule 8D(2)(iii) of the Rules. The ld. CIT(A) observed that the entire expenditure incurred during the pre-demerger period related to the demerged Textile Division, but for Rs. 12,99,537/-. It was also noticed that the total expenditure for the post demerger period was of Rs. 21,06,266/-. Out of this amount, the assessee had itself disallowed Rs. 11,79,478/- and had claimed only the balance expenses of Rs. 9,26,788/-. The total expenses pre-demerger and

post-demerger thus amounted to Rs. 22,26,325/-. The ld. CIT(A) observead that it was out of this amount that the disallowance could be made. The CIT(A) agreed in principle with the argument of the assessee that just since the AO had worked out the disallowance of Rs. 47,33,000/- u/s 14A of the Act, being 0.5% of the average investment under Rule 8D of the Rules, and this amount exceeded the total expenditure incurred in connection with the earning of the exempt income, the expenditure as worked out as per the Rules, could not be disallowed. The ld. CIT(A) was of the view that the disallowance was to be restricted to the total expenditure of Rs. 22,26,325/- (rounded off to the figure of Rs. 22,26,000/-), lest the disallowance exceeded even the actual expenditure incurred. However, the assessee's stand that no part of the expenditure determined at Rs. 22,26,000/- was disallowable, was not accepted by the ld. CIT(A), observing that the assessee had actually earned exempt income by way of dividend and in terms of section 14A of the Act, the expenditure incurred in relation to that income was required to be disallowed. As such, out of the expenditure determined at Rs. 22,26,000/-, the ld. CIT(A) subtracted the amount of Rs. 5,71,794/- representing expenditure relating to Haridwar Holiday Home and Dehradun Holiday Home, which were found to be demerged under the Demerger Scheme, and arrived at the figure of Rs. 16,54,531/-. The ld. CIT(A) held this amount to relate to the investment activity of the assessee company and disallowed it as against the disallowance of Rs. 47,33,200/- made by the AO.

25. The assessee maintains that the ld. CIT(A) has erred in disallowing the sum of Rs. 16,54,531/- also, as according to the assessee, no part of the administrative expenditure related to the investment division of the assessee. This contention of the assessee, it is seen, carries force. To start with, it cannot be gainsaid that the disallowance u/s 14A of the Act cannot be made on an ad-hoc basis and it is the Department's responsibility to justify any such disallowance by bringing material on record to show that any expenditure was incurred for earning the exempt income. Reference in this regard has correctly been made to "*Wimco Seedlings Ltd. v. DCIT*"(supra), wherein it has been held that there can be no presumption that the assessee must have incurred expenditure to earn tax free income. "Wimco Seedlings Ltd." (supra) was followed by us in "Jindal Photo" (supra). 26. In "Ms. Sushma Kapur" (supra), it has been held by the Tribunal that to the extent it could be proved that the investment was made from borrowed funds, the expenses had been disallowed u/s 14A. This finding of fact recorded by the Tribunal was upheld by the Hon'ble jurisdictional High Court.

27. In the present case, the AO did not bring any evidence on record to establish that any expenditure had been incurred by the assessee company for earning the exempt income. In the absence of such evidence, it was wrong on the part of the AO to proceed to compute

disallowance of the expenses u/s 14A of the Act by merely applying Rule 8D(2)(iii) of the Rules.

28. Apropos the assessee's contention regarding the applicability of the provisions of Sections 14A(2) and (3) of the Act and Rule 8D of the Rules being prospective with effect from assessment year 2008-09, such contention is supported by "Godrej & Boyce"(supra) and "Godrej Agrovet Ltd."(supra). It is, however, well established, as held in "*Continental Carriers P.Ltd. v. ACIT*", 138 TTJ 249(Del), that even prior to assessment year 2008-09, when Rule 8D of the Rules was not applicable, the AO was duty bound to determine the expenditure incurred in relation to income not forming part of the total income, by adopting a reasonable basis. Therefore, nothing stopped the AO from determining the expenditure incurred in relation to the exempt income earned by the assessee. But for doing so, a "reasonable basis" had to be adopted. And the most reasonable basis, rather, the first reasonable basis for such determination can be none else than the nexus between the expenditure incurred and the exempt income earned. Now, evidently, the AO did not establish any such nexus between the expenditure incurred and the exempt income earned by the assessee Company.

29. Even the ld. CIT(A), though he restricted the disallowance from Rs. 47,33,200/- to Rs. 16,54,531/-, did not establish any such nexus and it was merely observed that this amount related to the investment activity of the assessee Company, without clarifying as to how it was found to be so.

30. We find that apropos the pre-demerger expenditure incurred during the period from 1.4.05 to 30.6.06, the total expenditure relating to the activities other than those of the Textile Division of the assessee Company, as available from the consolidated Profit and Loss Account for the year ended 31.3.06 of STIL (copy at APB 83 to 87), was Rs. 12,99,537/-, as follows:-

		Rs.
1.	Salary, wages, bonus etc.	61,353/-
2.	Employees' contribution to PF	2,792/-
3.	Rates and Taxes	3,440/-
4.	Insurance Premium(Net)	50,000/-
5.	Misc. expenses	11,76,500/-
	Total:	12,99,537/-

Out of the above expenditure of Rs. 12,99,537/-, it is seen, an amount of Rs. 11,76,500/- stands debited as misc.expenditure. The break up of these misc.expenses, as appended at APB 82, is as follows:–

Particulars	2005-06	3 Months	9 Months
*Detail of M/s. Expenses			
-Filing Fee	4000	0	4000
-General Expenses	12361	12361	0
-Postage & Telegram	118478	4929	113549
-Printing and Stationery	231675	469	231206
-Bank Commission	135	135	0
-Books and Periodicals	2497	2497	0
-Traveling Expenses	38696	38696	0
-Trunk & Telephone Exp.	1888	1888	0
-Haridwar Holiday Home	171231	171231	0
-Legal & Professional	80407	80407	0
-Electricity charges	2769	2769	0
-Water charges	425	425	0
-Advertisement	77570	77570	0
-Listing Fee	84250	58000	26250
-Maintenance Charges	3940	3940	0
-Directors Traveling	668018	178511	489507
-conveyance Charges	620	620	0
-Depository Fees	44080	44080	0
-Demat Expenses	46653	0	46653
-Dehradun Holiday Home Exp.	400563	400563	0
-Motor Car Exp.	80910	80910	0
-Press Conference Exp.	16500	16500	0
	2087666	1176501	911165

31. As noted above, an amount of Rs. 5,71,794/- was expenditure related to Haridwar Holiday Home (Rs. 1,71,231/-) and Dehradun Holiday Home (Rs. 4,00,563/-). These properties, pertinently, were shown in the Schedule forming part of the Balance Sheet as on 31.3.06 (copy at APB 199), as fixed assets of the company. Both these Holiday Homes, undeniably, were demerged under the Demerger Scheme and so, the ld. CIT(A) rightly did not disallow the expenditure on these Holiday Homes.

32. So, what remained as balance under the head of misc.expenditure incurred during the three months period from 1.4.2005 to 30.6.2005, was the amount of Rs. 7,27,743/-. Even this part of the expenditure has not been correlated by the Authorities below to the exempt income earned by the assessee Company.

33. So far as regards the post-demerger expenditure incurred by the assessee from 1.7.05 to 31.3.06, as available from the details of expenses in the Profit and Loss Account in March, 2006 and June, 2005, i.e., for the year ended 31.3.06 and for the period ended 30.6.05 (copy at APB 81), that is, the difference of expenses in the Profit and Loss Account for the period from 1.4.05 to 30.6.05 and 1.7.05 to 31.3.06, i.e., to say, the pre-demerger and the post-demerger periods, during the post-demerger period, the assessee had only investment activity and there was no activity of manufacture of Textiles, the Textile Division having been demerged. The total expenditure incurred during this period was of Rs. 21,06,266/-. This comprised of (as available from the copy of the details of the Profit and Loss Account of the assessee Company from July 2005 to March, 2006, at APB 78), of operative and other expenses of Rs. 14,78,766/- and Director's fees and commission of Rs. 6,27,500/-. The operative and other expenses of Rs. 14,78,766/- constituted, mainly, restructuring/demerger expenses of Rs. 14,74,347/- (APB 79). The balance operating and other expenses were of Rs. 4,419/-. A revised computation of income for the assessment year 2006-07 (copy at APB 283 to 286) was filed by the assessee before the AO along with letter dated 27.11.06 (copy at APB 287 to 292). In the revised return of income, out of the demerger expenses of Rs. 14,74,347/-, the assessee claimed an amount of Rs. 2,94,869/- as being allowable u/s 35 DD of the I.T. Act, being 1/5th of the said amount of Rs. 14,74,347/-. The balance expenditure of Rs. 11,79,478/- was disallowed. The revised computation (APB 283), in this regard, reads as follows:-

A. <u>Income from Business</u>

<u>Adjustments in accordance with sections 28 to 44</u>

………………………………….

7. Expenditure on account of demerger	Rs. 14,74,347/-
Less: Allowable u/s 35DD (1/5th of Rs. 14,74,347/-)	Rs. 2,94,869/-
	Rs. 11,79, 478/-

As such, it is evident that the assessee had claimed expenditure only of Rs. 16,54,531/-. The ld. CIT(A) has duly taken this into consideration. No doubt, the disallowance, if any, could have been made out of this amount only. However, in order to validate such a disallowance, as discussed hereinabove, what was required to be established was the nexus of the expenditure with the earning of the exempt income. The ld. CIT(A), in this regard, has merely observed that the entire balance expenditure of Rs. 16,54,531/- relates to the investment activity of the assessee Company. There is, however, nothing in the impugned order as to how this finding has been arrived at by the ld. CIT(A). It cannot be gain-said that the onus to prove the nexus between the expenditure incurred and the earning of income not forming part of the total income is squarely on the Department. In the absence of discharging this onus, no

disallowance in this regard can be made, much less sustained, as has been done by the ld. CIT(A). There is absolutely nothing on record to show that any part of the expenditure was incurred to earn the exempt income. And not only this, as rightly canvassed, this expenditure of Rs. 16,54,531/- even included expenditure towards remuneration to Director and Audit Fees. Now this kind of expenditure, irrespective of the fact whether or not income not forming part of the total income is earned, has to be incurred. Therefore also, these expenses cannot, in any manner, be said to be relatable to earning of exempt income by the assessee company.

34. Thus, looked at from any angle, the ld. CIT(A), in our considered opinion, was not at all justified in holding the entire balance expenditure of Rs. 16,54,531/- incurred by the assessee company as liable to disallowance u/s 14A of the Act. The grievance of the assessee in this regard is, therefore, found to be justified and is accepted as such. The grouse of the Department, on the other hand, is found to be baseless and ground No. 1 raised by the Department is, hence, rejected, whereas Cross Objection No. 1 taken by the assessee is accepted.

35. Turning to ground No.2 raised by the Department, it has been contended that the ld. CIT(A) has erred in deleting the disallowance of Rs. 5,000/- made by the AO on account of fines and penalties. The AO, it is seen, made disallowance of the expenditure of Rs. 5,000/- incurred by the assessee Company on account of fines towards traffic violation. Before the ld. CIT(A), the assessee contended that a similar amount had been allowed as a deduction in the case of the assessee for the assessment year 1990-91 by the Tribunal in ITA No. 2856(Del)93. The ld. CIT(A) deleted the disallowance following the said order of the Tribunal. Before us, the assessee has again pressed into service the Tribunal's order (supra) for the assessment year 1990-91 (copy at APB 225 to 228)in response to the ld. DR's argument that the payment for fines towards traffic violation and the AO had correctly made the disallowance.

36. The facts remaining the same for the year under consideration, as those for the assessment year 1990-91 and following the Tribunal order, the action of the ld. CIT(A) in deleting the disallowance is confirmed, rejecting Ground No.2 taken by the Department.

37. Turning to ground No.3, the Department contends that the ld. CIT(A) has erred in directing the AO to verify the claim of the assessee and exclude interest income from UTI from income after due verification and to allow the balance 50% of the additional depreciation after verifying the contention of the assessee that 50% additional depreciation was claimed and allowed in the immediately preceding year, i.e., in the assessment year 2005-06 and to verify the claim of the assessee and to allow credit of TDS.

38. In this regard, it is seen that the AO refused to allow additional depreciation @ 7.5% in respect of addition of plant and machinery during

the immediately preceding assessment year, i.e., assessment year 2005-06. Before the ld. CIT(A), the assessee contended that in the assessment year 2005-06, the assessee had claimed additional depreciation @ 7.5%, being 50% of additional depreciation of 15%, amounting to Rs. 5,32,65,467/-, in respect of new plant and machinery, installed at the new eligible industrial undertaking of the Company, i.e., Unit No.8, Kathua, u/s 32 (iia) of the Act, since the machinery had been put to use for a period of less than 180 days in that previous year; that the depreciation claimed in the return of income for the assessment year 2005-06 was allowed; that in the return of income for the year under consideration, the assessee had claimed the balance 50% of additional depreciation of 15% of the value of the plant and machinery installed in the immediately preceding assessment year; that this was done through Notes to Accounts appended to the return of income; that this claim was computed at Rs. 1,32,79,884/-, by apportioning 50% of the gross amount of additional depreciation of Rs. 5,32,65,467/- in the ratio of 91 days to the total period; and that however, the AO had not considered this claim made by the assessee.

39. The ld. CIT(A), in the impugned order, observed as follows:–

> *"8.2 Since the appellant is stated to be admittedly eligible for deduction of additional depreciation as 50% of the same has already been duly allowed by the AO in the immediately preceding assessment year 2005-06, there is nothing on record to indicate that the appellant should not be allowed deduction of the balance 50% of deduction in the current assessment year 2006-07. Accordingly, the ld. AO is directed to verify the contention of the appellant that 50% of additional depreciation was claimed and allowed in the immediately preceding assessment year 2005-06 and if this fact is found to be factually correct, the AO is directed to allow the balance 50% of additional depreciation during the year under consideration. This ground of appeal is accordingly treated as allowed for statistical purposes."*

40. There is nothing on record to show that the directions given by the ld. CIT(A) are not proper. The eligibility for deduction of additional depreciation stands admitted, since 50% thereof had already been allowed by the AO in the assessment year 2005-06, i.e., the immediately preceding assessment year. Therefore, obviously, the balance 50% of the deduction is to be allowed in the current year, i.e., assessment year 2006-07. The ld. CIT(A) has merely directed the verification of the contentions of the assessee and to allow the balance additional depreciation after such factual verification. Accordingly, finding no merit therein, ground No. 3 raised by the Department is rejected.

41. Now the only issue remaining is that comprising Cross Objection No. 2 raised by the assessee, which is to the effect that the ld. CIT(A) has erred in not directing the AO in allowing deduction to the assessee under

sections 80 IA/80 IB of the Act in respect of the three units of the assessee.

42. The AO refused to allow deduction under sections 80 IA/80 IB regarding the assessee's three units which stood demerged pursuant to the Demerger Scheme approved by the Hon'ble Rajasthan High Court. This demerger came about 1.7.05, as noted hereinabove. The disallowance was ordered by the AO as per the provisions of section 80 IA(12) read with section 80 IB of the Act.

43. Before the ld. CIT(A), the main contention on behalf of the assessee Company was that deduction u/s 80 IB of the Act had not been allowed for the pre-demerger period from 1.4.05 to 30.6.05, either to the assessee Company or to the resulting Company after the demerger.

44. The ld. CIT(A) held the action of the AO to be correct in view of the provisions of section 80 IA(12), as per which, where the eligible undertaking stands transferred in a Scheme of Amalgamation or Demerger, the deduction is allowable only to the resulting Company.

45. Before us, it has been contended on behalf of the assessee that undisputedly, the deduction under sections 80 IA/80 IB of the Act had been claimed with respect to the profit of certain eligible units of the assessee Company; that these units had been part of the assessee company during the pre-demerger period from 1.4.05 to 30.5.05; that these units had been transferred under the Demerger Scheme with effect from 1.7.05; that the deduction claimed was only with respect to the profits earned by these undertakings for the said pre-demerger period only and such deduction had not been claimed in the computation of income but by way of Notes appended to the return of income filed, the said Notes forming an integral part of the return of income; and that prior to the introduction of section 80 IA(12), CBDT Circular No. 15/5/63 – IT(A-I) dated 13.12.63 clarified that deductions under sections 80 IA and 80 IB of the Act were related to the eligible undertaking and accordingly, they got transferred with the undertaking, notwithstanding the ownership thereof. The learned counsel for the assessee has placed reliance on the following case laws in this regard:–

1. "*CIT v. P.K. Engg.& Forging Pvt. Ltd.*", 87 Taxmann 101(Cal);
2. "*A.G.S. Timber & Chemical Industries Pvt. Ltd. v. CIT*", 233 ITR 207(Mad);
3. "*ITO v. Hindustan Petroleum Corpn. Ltd.*", 25 TTJ (Bom)28;
4. "*Shah Granites Pvt. Ltd. v. ITO*", 28 TTJ 83(Bom);
5. "*ITO v. SLM Maneklal Industries Ltd.*", 17 ITD 515(Ahd.);
6. "*ACIT v. IIS Infotech Ltd.*", 82 TTJ 174(Del);
7. "*Tech Books Electronics Services (P)Ltd. v. ACIT*", 100 ITD 125(Del);

8. "*ACIT v. Prisma Electronics*" – ITA Nos. 3378(Del)2009 & 500(Del)2010(Del); and
9. "*ITO v. Advance Valves Global*" – ITA No. 2096(Del)2008(Del).

45. It has thus been contended that as such, the profits of the undertaking earned by the respective companies, i.e., the respective units, for the period the undertaking was owned by the respective companies, are eligible for deduction under sections 80 IA/80 IB of the Act; that the provisions of section 80 IA(12) merely facilitates the grant of deduction under sections 80 IA/80 IB of the Act to the resulting companies also, in the year of transfer/merger; that while bringing into the Statute Book, the said section 80 IA(12); that the Explanatory Note provides that these provisions have been introduced to make the Corporate Reorganizations tax neutral; that by virtue of the provisions of sections 80 IA/80 IB(12) of the Act, benefit of deduction under the profits earned by the demerger companies, for part of the period cannot, and so, ought not, be denied. It has further been contended that the provisions of the Act which are beneficial to the assessee must be liberally construed, as has been well settled in "*Bajaj Tempo v. CIT*", 194 ITR 188(SC), "*CIT v. Strawboard Manufacturing Co. Ltd.*", 177 ITR 431(SC) and "*P.R. Prabhakar v. CIT*", 284 ITR 548(SC). The learned counsel has then contended that as such, the provisions of sections 80 IA(12) and 80 IB(12) of the Act, being provisions beneficial to the assessee, require to be construed liberally; that deduction under the said sections is allowable to the demerged and resulting company in respect of the profits earned by both the companies for the respective period of ownership of the eligible undertaking in the year of demerger; that the AO has factually erred in observing that no audit report in form No. 10 CCB, as provided under sections 80 IA(12) and 80 IB(12) of the Act was filed; that actually, the audit reports for the respective units were duly filed in the assessment proceedings vide letter dated 7.11.08 by the assessee; that the details of deduction under sections 80 IA(12) and 80 IB(12) of the Act were also given in the tax audit reports, certifying such deduction; that the AO has also wrongly observed that since the deduction was not claimed in the computation of income, it could not be allowed, in view of "*Goetze India v. CIT*", 284 ITR 323(SC); that in fact, it remains undisputed that the deduction in question was claimed by way of a Note appended to the original return of income; that in "*CIT v. Sain Processing and Weaving Mill Pvt. Ltd.*", 325 ITR 565(Del), it has been held that the net profit cannot be determined, without taking into account the information disclosed in the Notes appended to the accounts, which Notes form part of the accounts of the assessee Company.

46. The ld. DR, on the other hand, has strongly supported the impugned order in this regard, submitting that it remains undisputed that under the provisions of section 80 IA(12) of the Act, in a case where the eligible undertaking stands transferred in a Scheme of Amalgamation

and Demerger, deduction is allowable only to the resulting company and so, the assessee/demerged company is not at all eligible for deduction under sections 80 IA/80 IB of the Act, as has rightly been held by both the Authorities below concurrently. It has further been contended that it would be wrong to canvass, as has been done in the case of the assessee, that the provisions of section 80 IA of the Act require to be read beneficially to the assessee; that the factual findings of the ld. CIT(A) in this regard are abundantly clear and nothing has been brought on record to dislodge them; that moreover, the AO has categorically observed in the assessment order that no report in form No. 10 CCB was filed by the assessee and it is only by way of an alibi that the assessee now contends to have done the needful in this regard before the AO during the assessment proceedings.

47. On this issue, we find that indeed, as per Circular No. 15/5/63 – IT(A-I) dated 13.12.63 (supra) it has been clarified that deduction under sections 80 IA/80 IB of the Act relates to the eligible undertaking and, accordingly, it transfers with that undertaking, notwithstanding the ownership of such undertaking. The Circular relates that the Board agreed that the benefit of section 84 attached to the undertaking and not to the owner thereof and that the successor would be entitled to the benefit of the unexpired period of 5 years, provided the undertaking was taken over as a running concern. The case laws relied on by the assessee are to a similar effect.

48. In "Advance Valves" (supra), following, inter alia, "P.K. Engg. & Forging" (supra) and "A.G.S Timber" (supra), "Prisma Electronics" (supra) and the CBDT Circular (supra) it has been held that it is the successor on demerger, which would be entitled to the benefit for the unexpired period of 5 years, provided the undertaking was taken over as a running concern.

49. So far as regards the claim made by the assessee, it is on record that the assessee had duly filed the audit report in form No. 10 CCB vide letter dated 7.11.08 before the AO, in which audit report, deductions under sections 80 IA(12)/80 IB(12) of the Act were duly certified to have been claimed by the assessee. It is undisputed that the claim was made by way of a Note appended to the original return of income. It cannot be gain-said that the Note to the return of income formed an integral part of the return. That being the position, obviously, it cannot be held that the deduction was not claimed in the return of income. In this regard, in "Sain Processing" (supra), it has been held that net profit cannot be determined without taking into account the information disclosed in the Notes appended to the Accounts which formed part of the Accounts of the assessee Company.

50. In view of the above, we hold that the AO erred in denying the deduction under sections 80 IA(12)/80 IB(12) of the Act to the assessee and the ld. CIT(A) erred in confirming such disallowance. The grievance of the assessee in this regard is well justified, and Cross Objection No. 2 raised by the assessee is thus accepted.

51. In the result, whereas the appeal filed by the department is dismissed, the Cross Objection filed by the assessee is allowed.

Order pronounced in the open court on 04.05.2012.

2013 TRI 1441 (H.C. Guj.)

HIGH COURT OF GUJARAT AT AHMEDABAD

M.R. Shah and Sonia Gokani, JJ.

Vaghjibhai S Bishnoi
v.
Income Tax Officer & 1

FACTS/HELD

Department's practice of not giving prompt & full credit for TDS condemned

1. The assessee filed a return of income in which he claimed a refund of Rs. 2.11 lakhs. An intimation u/s 143(1) was issued by the CPC Bangalore in which credit for certain TDS certificates was omitted to be given. The assessee filed a rectification application u/s 154 before the AO which was not acted upon. The assessee filed a writ petition to challenge the neglect of the AO to give proper TDS credit. Before the High Court the AO argued inter alia that as the details of the e-return had not been transferred to him by the CPC, he was not authorized to accede to any request of the assessee. It was also claimed that the assessee had not filed full details relating to the claim. HELD by the High Court allowing the Petition:

   Form 26AS, available on the department's website, clearly reflects the assessee's entitlement to credit for TDS. Instead of giving credit for the TDS, the department has adamantly continued to take the stand that there is a failure on the part of the assessee to furnish details. We

are not impressed with such a stand. Computerization is with the object to facilitate easy access to the assessee and make the system more viable and transparent. In the event of any shortcoming of software programme or any genuine mistake, the Department is expected to respond to such inadvertence spontaneously by rectifying the mistake and give corresponding relief to the assessee. Instead of that, even when it is being brought to the notice of the Department by the assessee, by a rectification application and subsequent communication, not only it has chosen not to rectify the mistake, but, the lack of inter departmental coordination has driven the assessee to this Court for getting his legitimate due. This attitude for sure does not find favour with the Court, as more responsive and litigant centric system is expected; particularly in the era of computerization. Tax payers friendly regime is promised in this electronic age. For want of necessary coordination between the two departments, the assessee cannot be expected to be sent from pillar to the post. If the Centralized Processing Center meant for return processing, accounts, refund, storage of data etc. adds to the difficulties of the Tax payers, due to lack of distribution of work between back office and front office, and that too, after having been pointed out the actual error, a serious re-look is expected.

Order accordingly.

Special Civil Application No. 6726 of 2013.

Decided on: 9th July, 2013.

Present at hearing: SP Majmudar, Advocate, for Petitioner. Paurami B Sheth, Advocate, for Respondent.

JUDGMENT

Sonia Gokani, J.–

1. **Rule.** Learned advocate Ms. Paurami B. Sheth appears and waives service of rule on behalf of the respondent no.2.

2. This *writ* petition under *Article* 226 of the Constitution of India is preferred for seeking refund of Rs. 2,11,415/=, with the following factual background.

3. The petitioner is an assessee who filed his return of income as required under section 139 of the Income- tax Act, 1961 [**Act** hereinafter]

for the Assessment Year 2010-11. Such tax return was filed electronically declaring his total income at Rs. 8,61,077/= [*rupees eighteen lacs sixty one thousand seventy seven*]. As per the entire computation, the refund entitlement the petitioner claimed, was to the tune of Rs. 2,11,415/= on adjustment of Tax deducted at source {**TDS** for short}. It is averred that the respondent no.1 inadvertently missed out giving credit of the TDS of the amount of Rs. 3,78,608/= against the tax payable at Rs. 1,67,193 [*rupees one lac sixty seven thousand one hundred ninty three*].

3.1 An application for rectification under section 154 of the Act was preferred *vide* communications dated 8th July 2011 and 12th September 2011 addressed to the respondent no.2, the assessee pointed out this mistake and also requested giving of credit of TDS. However, since the request has not been accorded to and credit is not given as requested for, and, no reply to such communications has been received by the present petitioner, the present Special Civil Application is filed, *inter alia,* praying for a direction to the respondents-authorities to forthwith refund the amount of Rs. 2,11,415/= to the petitioner; being the refund due to the petitioner for A.Y 2010-11, alongwith interest at an appropriate rate.

4. In response to the issuance of the notice, the respondent no.2 filed affidavit-in-reply, *inter alia,* admitting filing of e-return by the petitioner for the A.Y 2010-11 on 20th September 2010 declaring his total income at Rs. 8,61,077/= and claiming refund of Rs. 2,11,415/=; after adjusting TDS of Rs. 3,78,608/= against tax payable of Rs. 1,67,193/=. It is also contended that the return of the petitioner assessee was processed under section 143 (1) of the Act on 17th March 2011 by the Centralized Processing Centre [**CPC** for short], Bangalore. However, such adjustment of TDS was not granted and the tax payable was determined at Rs. 1,93,429/=; which included both Tax and the interest, being a sum of Rs. 1,67,193/= and Rs. 26,235/= respectively. It is also contended that the petitioner failed to furnish all the relevant information as was required under Section 139 (1) of the Act in the e-return, and therefore, the adjustment of TDS was not allowed. A stand is further taken by the respondent no. 2 *inter alia* that he has not been transferred details of the e-return by the respondent no.1-CPC, Bangalore, and therefore, the respondent no. 2 is not authorized to accede to any request of the assessee. It is further admitted that the rectification application preferred by the petitioner was attended to by the CPC, Bangalore on 27th October 2011 by passing an order under section 154 of the Act, wherein the respondent no.2 observed as follow:–

> **During the processing of the return under section 143 (1), tax payments had not matched as proper details like BSR Code, Date of Deposit, Challan sequence number, Exact amount paid in case of multiple payments, Details of each payments to be furnished has not been furnished by the assessee, however, during rectification, the same has not been corrected by the assessee.**

5. Affidavit-in-rejoinder on behalf of the petitioner is preferred where he has denied all the contentions raised in the affidavit-in-reply. It is empathetically urged that all relevant details for claiming the TDS amount were submitted to the respondents authorities and all forms; including Form 16A were also annexed with the application and the respondents were aware that the TDS credit was required to be given and yet, for the reasons best known to them, the said mistake has not been corrected till the date. It is further urged that the jurisdictional Assessing Officer is the respondent no.2, however, on account of non-transfer of the details by the CPC, Bangalore [the respondent no.1] to the respondent no.2, the assessee has not been given his due by way of refund. It is further urged that the system is on-line and all details of TDS are available on the net. The TDS has been deducted at source by the public limited companies/government companies, and therefore also, such deductions shall have to be regarded. It is further contended that the complete details, which match with the payments; with BSR code; deposit challans, etc. have been furnished.

6. It needs to be noted that the respondent no. 1 has neither filed any affidavit-in-reply nor furnished any document to controvert the facts; although duly served. For the respondent no.2, Ms. Paurami Sheth appeared and advanced her submissions.

7. Learned advocate Mr. Majmudar appearing for the petitioner has fervently made his submissions along the line of the petition and insisted for grant of refund. He also further pointed out from the documents furnished by the respondent no.2 that his entitlement for refund is to the tune of Rs. 4,00,647=36p., however, what all he has asked for is Rs. 2.11 lacs [*rounded off*]. He argued that in wake of filing of the e-return, all details are already on the net, therefore, the respondents could have verified all the aspects and given refund to the petitioner. He argued that even due to inadvertence, this adjustment of TDS was not given, after the rectification application was made before the respondent no.1, he ought to have responded to the same. He further argued that lack of inter-departmental coordination has resulted into non-grant of refund to the petitioner in time. It is empathetically refuted that requisite documents were not furnished. He also contended that despite extensive computerization in the Income-tax Department, no fruitful benefits are available to the assessee.

8. Learned advocate Ms. Paurami Sheth appearing for the respondent no.2 has argued that the respondent no.2 is the jurisdictional authority which cannot act unless the CPC-Bangalore transfers the details. She further argued that in computation; if at all error is committed, unless the documents are transferred to the respondent no.2, he would not be in a position to act and grant refund, as requested for by the petitioner.

9. On thus hearing both the sides and on thorough examination of the material on record, at the outset, we would like to note that Section

139 of the Act provides for filing of return, process of which is to be done u/s. 143 (1) of the Act. It would be profitable to reproduce Section 143 (1) of the Act, which reads thus:–

> **143 (1)** Where a return has been made under section 139, or in response to a notice under sub-section (1) of section 142, such return shall be processed in the following manner, namely:–
>
> (a) the total income or loss shall be computed after making the following adjustments, namely:–
>
> (i) any arithmetical error in the return; or
>
> (ii) an incorrect claim, if such incorrect claim is apparent from any information in the return;
>
> (b) the tax and interest, if any, shall be computed on the basis of the total income computed under clause (a);
>
> (c) the sum payable by, or the amount of refund due to, the assessee shall be determined after adjustment of the tax and interest, if any, computed under clause (b) by any tax deducted at source, any tax collected at source, any advance tax paid, any relief allowable under an agreement under section 90 or section 90A, or any relief allowable under section 91, any rebate allowable under Part-A of Chapter VIII, any tax paid on selfassessment and any amount paid otherwise by way of tax or interest;
>
> (d) an intimation shall be prepared or generated and sent to the assessee specifying the sum determined to be payable by, or the amount of refund due to, the assessee under clause (c) ; and
>
> (e) the amount of refund due to the assessee in pursuance of the determination under clause (c) shall be granted to the assessee.

10. Section 139 of the Act requires every person, whose total income exceeds the maximum amount which is not chargeable to income-tax, to file the return on or before the due date. Such return is required to be processed in the manner prescribed under section 143 (1) of the Act. The total income or loss requires to be computed after making certain adjustments one of which is taking into account the arithmetical error in the return.

11. On having so done, an intimation is required to be prepared or generated and sent to the assessee specifying the sum determined to be either paid by him, or amount of refund due to the assessee. In absence of any arithmetical error or any mistake in the return, on following the computation; as provided under the law, it is expected that the respondent would need to grant refund under section 143 (1) of the Act; as claimed in the return of income.

12. The fact is not in dispute that in the case on hand, the return has been filed electronically for the A.Y 2010-11 wherein, the petitioner has

made a claim for deduction of TDS as per Form 26AS under section 203AA of the Act. This is also visible from the website of the Department. The total amount of TDS deducted is shown in the Form 26AS is Rs. 4,00647=36p.. This amount is more than what has been claimed in the return of income of the petitioner. The petitioner has also explained that he had earned total freight income of Rs. 1,23,88,721/=. The audit report declares his total freight income of Rs. 75,91,259/=; after deducting freight expenses of Rs. 47,97,462/=. Thus, the freight income shown by the petitioner in the Profit & Loss Account is net- freight income after deducting the freight expenses of Rs. 47,97,462/= from the gross income. According to the petitioner, this method of deducting the expenses from the total freight income is being followed by him consistently for all the years, and therefore, this issue is aptly and sufficiently answered and does not appear to have the bearing on the claim of the petitioner.

12.1 On examination of the material on record, it appears that Form 26AS, available on the net, clearly reflects different dates on which payment had been credit and the total tax deducted at source by various companies viz., Messrs. Indian Oil Corporation Limited; GAIL India Limited; Futura Travels Limited; Hindustan Petroleum Corporation Limited, etc. It is apparent from the communication in the form of an Order dated 17th March 2011 issued by the respondent no. 1 that he has not been given credit of TDS of Rs. 3,78,608/= , as is visible from the computation made under section 143 (1) of the Act. Thus, it can be seen that on one hand, in the details available with the Department from Form 26AS, the amount of TDS is to the tune of Rs. 4,00,647=36p. and in the return filed by the petitioner, the claim made by him is to the tune of Rs. 3,78,608/=. However, while passing the final order, there is a complete absence of taking into account the said amount of TDS in the computation as has been accepted by the Department as well. The petitioner is unable to explain as to why he has claimed less amount though the total amount of TDS shown in the department record is Rs. 4,00,647=36p. and the TDS income claimed is Rs. 3,78,608/=.

13. Be that as it may, the respondents have not succeeded in bringing anything on the record to indicate any default on the part of the petitioner to furnish any of the documents that have been directed. When the only claim which appears to have been missed out in computation is the TDS amount deducted by various government companies, while detailing with the petitioner and when such details are available on-line in Form 26AS, and when these details to the Court have been provided by the learned counsel appearing for the Department, there is no reason why there should be absence of such amount in the final computation of the e-return of the petitioner.

14. Again, when this came to the knowledge of the petitioner; on having received communication in the form of an order dated 17th March 2011, a rectification application appears to have been made which the

respondent no.1-CPC, Bangalore attended to and passed an order dated 27th October 2011. One glaring aspect that needs to be noted is that the respondent no.2 has reflected rejection of rectification application by way of reproducing a part of the order. However, the respondent no.1 has blissfully chosen not to respond to the notice of this Court, nor order on rectification application is brought on the record. We are not convinced from such reproduction as to in which manner assessee failed in furnishing necessary details which would have entitled the Department to discard the total amount of TDS, while computing the return of the petitioner, when all the details of TDS are available with the Department. What all it needs to do is to compute, as required under section 143 (1) of the Act. Instead of that, the respondents have adamantly continued to take a stand of this being a failure on the part of the petitioner to comply with the directions. We are not impressed with such a stand. On the contrary, we are of the firm opinion that computerization in every Department is objected with a view to facilitate easy access to the assessee and make the system more viable and transparent. In the event of any shortcoming of software programme or any genuine mistake, the Department is expected to respond to such inadvertence spontaneously by rectifying the mistake and give corresponding relief to the assessee. Instead of that, even when it is being brought to the notice of the Department by the assessee, by a rectification application and subsequent communication, not only it has chosen not to rectify the mistake, but, the lack of inter departmental coordination has driven the assessee to this Court for getting his legitimate due. This attitude for sure does not find favour with the Court, as more responsive and litigant centric system is expected; particularly in the era of computerization. Tax payers friendly regime is promised in this electronic age. For want of necessary coordination between the two departments, the assessee cannot be expected to be sent from pillar to the post.

14.1 Thus, from the discussion above, it can be very well said that the respondent no. 2 has failed to perform its duty as provided under section 154 of the Act. When a glaring mistake was pointed out to the authority, it ought to have amended the order of assessment by exercising powers under section 154 of the Act, which in the present case, the authority failed to exercise and consequently, the petitioner was compelled to approach this Court by way of the present petition.

15. We could not resist ourselves from taking note of details provided in the official website of Income-tax Department which reveals the extension of computerization in the department so far and their vision for the same in this field.

> With a view to improve the efficiency and effectiveness of Direct Taxes administration and to create a database on its various aspects, a Comprehensive Computerization programme was approved by the Government in October 1993. In accordance with

the programme, computerization was taken up on a three-tier system. In the apex level, a National Computer Centre [NCC] having large computers to maintain data base and to execute processing work of a global nature was envisaged. At the second level, 36 Regional Computer Centres [RCCs] were to be established across the country equipped with large computers to maintain regional databases and to cater to regional processing needs. All the RCCs were to be connected to the National Computerization Centre through high speed data communication lines. At the third level, computers were to be installed in the rooms of all the Assessing Officers and connected with the respective Regional Computer Center for data/information exchange, in a phased manner. Accordingly, in the first phase, Delhi, Mumbai and Chennai City regions were taken up and provided with state of art hardware and software connected with RCC, through inter-city and intra-city linkages. After stabilizing of the computer systems in the 3 RCCs, computerization of 33 other centres covering the rest of the country was taken up in the second phase.

The Director General of Income Tax [Systems], {DIT [S]}, New Delhi was made the main nodal authority for overall planning and implementation of the computerization programme; including procurement of hardware and software and development/installation of application software. In addition, at each RCC, the Chief Commissioner of Income Tax [CCIT] was required to monitor and co-ordinate with the DIT [S]. He would be assisted by CIT [Computer Operations] who would monitor the functioning of the RCC.

The main objectives of the computerization programme, as approved by the Committee on Non- Plan Expenditure [CNE], were (a) to improve the efficiency and effectiveness of tax administration; (b) to ensure timely availability and utilization of information; (c) to reduce compliance burden on honest tax payers; (d) to enhance equitable treatment of tax payers of income-tax and procedures; (e) to ensure better enforcement of tax laws; (f) to provide management with reliable and accurate information in time so as to assist them in tax planning and legislation and also in decision making; (g) to broaden th tax base; and (h) to keep the cost of administration at an acceptable level over a period of time.

15.1 Thus, computerization of the Income Tax Department when has undergone the exercise of "*a comprehensive business process re-engineering*", it is expected that Department's wish to herald "*Tax payers friendly regime*" becomes the reality. A "*paradigm shift is programmed*" as tax payers' population has been growing exponentially, ushering all the imperative changes and modernization of administration.

15.2 If the Centralized Processing Center meant for return processing, accounts, refund, storage of data etc. adds to the difficulties of the Tax payers, due to lack of distribution of work between back office and front office, and that too, after having been pointed out the actual error, a serious re-look is expected.

16. Resultantly, this petition succeeds. Respondents are directed to take into account the total sum of TDS as is reflected in Form 26AS and after computing such TDS amount, issue refund in the name of the petitioner. As mentioned hereinabove, the sum claimed by the petitioner towards TDS is Rs. 3,78,608/=, however, in Form 26AS, the amount of TDS is Rs. 4,00,064=36 paise. As the petitioner has chosen not to make any amendment in the petitioner, at present, while allowing his refund claim of Rs. 2,11,415/=; as requested for by the petitioner, he is also being permitted to make additional claim of refund, which shall be considered by the respondents in accordance with law and permit him more refund; if he is entitled to. The exercise of granting refund to the petitioner must be completed *within* four weeks from the date of receipt of this order. Rule made absolute accordingly. In the facts and circumstances of the case, we would have imposed the costs, however, as Shri Majmudar, learned advocate appearing on behalf of the petitioner has not insisted for costs, there shall be no order as to costs.

2013 TRI 1449 (H.C. Alh.)

<u>HIGH COURT OF ALLAHABAD</u>

Sunil Ambwani and Surya Prakash Kesarwani, JJ.

Commissioner of Income Tax
v.
Intezar Ali

FACTS/HELD

CBDT directed to inquire into conduct of AO in framing assessment with ill-will/ ulterior motive

1. The assessee sold agricultural land for Rs. 1.20 crore and deposited the cash proceeds in his bank account. He filed a return in which the transaction was disclosed and claimed to be not chargeable to tax. However, as the sale deed showed the transaction at Rs. 22 lakh and because the purchasers claimed that the sale value was only Rs. 22 lakh, the AO treated the

difference of Rs. 97.80 lakhs as income from undisclosed sources. The AO admitted that the evidence produced by the assessee to show that the land was in fact worth Rs. 1.20 crore and that he had in fact received the said sum from the purchasers prima facie supported the version of the assessee though he still made the addition. The CIT(A) upheld the stand of the AO though the Tribunal reversed it on the ground that the evidence on record showed that the assessee had offered the entire sale proceeds and that the purchasers had sought to undervalue the land. On appeal by the department to the High Court HELD dismissing the appeal:

> The assessee is an honest citizen who deposited the entire amount in the bank and voluntarily filed return. He also made a complaint to the registering authority that the sale deed has been registered at a value much below the amount actually received. The other evidence produced by the assessee was more than sufficient to discharge the burden which the AO had unreasonably placed on the assessee. The ITO did not act in a bonafide manner. He discarded the overwhelming evidence led by the assessee without giving any reasons at all. The assessment was framed only on the ipse dixit of the AO which gives us reason to believe that he had exceeded his authority with some ill will or with ulterior motive. The CBDT should cause an enquiry into the conduct and motives of the ITO in framing the assessment and raising demand of income tax against the assessee.

Order accordingly.

Income Tax Appeal No. 162 of 2013.

Decided on: 26th July, 2013.

Present at hearing: Dhananjay Awasthi, for Appellant.

JUDGMENT

Surya Prakash Kesarwani, J.–

1. We have heard Shri Dhananjay Awasthi, learned counsel for the income tax department. The affidavit of service of the assessee has been filed but no one appears for the respondent assessee.

2. This income tax appeal under Section 260A of the Income Tax Act, 1961 arises out of order dated 8.3.2013 passed by the Income Tax appellate Tribunal, Delhi Bench 'C' New Delhi in ITA No.1657/Del/2012

for the assessment year 2008-09. The department has preferred this appeal on the substantial questions of law framed in the memo of appeal as follows:–

> "(1) Whether on the facts and circumstances of the case the ITAT was justified in deleting the addition by holding that it is prevalent practice in the land transaction not to show full consideration and ignoring all the concrete findings of the lower authorities.
>
> (2) Whether on the facts and circumstances of the case the ITAT was justified in ignoring the provisions of Section 68 when such interpretation by the ITAT would result in serious curtailment of powers of Section 68.
>
> (3) Whether on the facts and circumstances of the case the ITAT was justified in deleting the addition of Rs.77,80,000/- without appreciating that the assessee himself declared the sale consideration of Rs.22,20,000/- as per the registered deed and there was no evidence on record that the purchase had given total consideration of Rs.1,20,00,000/-.
>
> (4) Whether on the facts and circumstances of the case, the ITAT was justified in not testing the case of the assessee on the anvil of the provisions of Section 68.
>
> (5) Whether on the facts and circumstances of the case, the ITAT was justified in deleting the addition of Rs.77,80,000/- without appreciating that the assessee had grossly failed to discharge its onus to prove the source of cash deposit in its banks account."

3. The assessee voluntarily filed return on 17.10.2008 disclosing total income of Rs.64,188/- and agricultural income of Rs.1,25,000/-. On receipt of certain information that the assessee had deposited an amount of Rs.1,08,32,752/- in bank account no.4621 with Syndicate Bank, Village Dehra, Tehsil Hapur, enquiries were made and statements of the assessee and purchasers were recorded. The assessee stated that he had sold agricultural land measuring 30 kachcha bigha situate in Village Gordhanpur, Tehsil Hapur, Distt. Ghaziabad for a sum of Rs.1,20,00,000/- on 12.11.2007 to Shri Yameen and Shri Raisuddin. Both the purchasers denied in their statements to have purchased the land for a consideration of Rs.1,20,00,000/- from the assessee. They stated that they had purchased the land only for Rs.22 lacs. The sale deed was executed on the sale value of Rs.22 lacs, whereas the assessee Shri Intjar Ali claimed that he had sold his land for Rs.1,20,00,000/-. Surplus amount of Rs.97,80,000/- over sale deed value was suspected to be income from undisclosed sources and case was selected for scrutiny on which notice under Section 143 (2) of the Act was issued on 18.9.2009.

4. On the queries served upon the assessee he filed copies of the khasra and khatauni (record of possession and title) in respect of agricultural land holding, the debit and credit entries in his bank account and justification in respect of agricultural income along with other documentary evidence.

5. The assessee produced the witness to the sale deed, who proved that the assessee had received Rs.1,08,32,752/- and which he deposited in his bank account. The Bank Manager of the Syndicate Bank, Village Dehra, Tehsil Hapur, which was the only bank in the village, and who had stayed late in the evening on the request of the assessee, deposed that the assessee had deposited the entire amount in his bank and which he had stated to be the sale consideration of the land sold by him. The assessee also produced the evidence of the land rates in the area and claimed exemption of the agricultural land, which is not capital asset within the definition of Section 2 (14) (iii) (a) (b) of the Act and is therefore not chargeable for capital gains tax. He also produced the evidence by way of report of Tehsildar, Hapur dated 28.9.2010 showing that the agricultural land in question lies more than 8 kms. from the local limit of Nagar Palika and also 9 kms. from the Local Town Area. The assessee also produced the evidence to show that in that area the land was valued at Rs.4 lac per bigha, which has increased manifold. The Income Tax Officer did not disbelieve the evidence that the amount was received by sale consideration. He, however, relying only on the report of the Stamp Valuing Authority took cognizance of the complaint and treated the amount to be undisclosed income. The findings recorded by the Assessing Officer are quoted as below:–

> "In view of the circumstantial evidence, based on the statements of three witnesses including that of the Branch Manager, Syndicate Bank Dehra who has been said to facilitate the deposit of Rs.90.00 lacs in the bank as late hour deposit on 12.11.2007 coupled with the affidavit of the assessee and report of the Tehsildar, Hapur dated 30.11.2010 prima facie support the version of the assessee. However stamp valuation authority, Ghaziabad has taken cognizance of the complaint of the assessee far evasion of stamp duty but sale consideration claimed in the impugned sale deed is not adjudicated in favour of the assessee till date. Further assessee could not furnish sources of funds ot purchasers to the extent of Rs.1,20,00,000/- instead of Rs.22,20,000/- neither their creditworthiness could be proved. The matter of unexplained investment by purchasers has been referred to the concerned assessing officers. In view of the facts that assessee is found to be owner of such money i.e. Rs.97,80,000/- but explanation about nature and source of acquisition of that money is not satisfactory. Since Rs.20,00,000/- out of Rs.97,80,000/- belongs to the financial year

2006-07 relevant to A.Y. 2007-08, Rs.77,80,000/- (97,80,000-20,00,000) is treated as income of the assessee. Accordingly addition of Rs.77,80,000/- is substantially made in the income of the assessee.

[Addition:Rs.77,80,000/-]"

6. In appeal written arguments were filed giving almost entire circumstances and the evidence by which the assessee had explained that the amount had been received by sale consideration and could not be treated as income from undisclosed sources. The CIT (A) also called for remand report and thereafter dismissed the appeal.

7. The assessee filed second appeal in which the appellate authority noted the submissions as follows:–

"In support of the grounds the ld. AR has reiterated the submissions made before the authorities below. He submitted that the sum of Rs.1,20,00,000/- is neither the income of the assesee from undisclosed source nor an unexplained money but represents sale consideration of the agricultural land sold by him which in turn, is exempt from income tax as well as capital gain tax. He submitted that assesseee is having no other source of income, hence, the only inference which can be drawn is that the money amounting to Rs.90,00,000/- deposited in the Syndicate Bank on 12.11.2007 is a part of the sale receipt of the land sold by the assessee on 12.11.2007. The ld. AR submitted that the AO himself admits that the evidence on record prima facie supports, the version of the assessee, however, because of evasion of stamp duty pending adjudication before the Assistant Commissioner of Stamps-II, Ghaziabad, he made the impugned addition. The sale consideration of Rs.1,20,00,000/- is supported by the comparable sale and another sale instances cited before the A.O. He submitted further that in their statements Shri Guljar and Shri Gaffar who had attested a sale deed as witness on 12.11.2007, had also stated that at the time of registry, the purchasers had in their presence made the payment of Rs.1,00,00,000/- to the assessee (Rs.7,00,000/- by DD and Rs.93,00,000/- in cash) and that the bank manager had collected the money from the assessee. They further stated that the market price of the land at that time was Rs.4,00,000/- per bigha which had increased manifold on the date of their statement. The bank manager, Syndicate Bank, Dehra where the sale proceeds 90,00,000/- was deposited, has also stated on oath that the assessee had told him that on 12.11.2007 sale deed in respect of his agricultural land would be executed and the sale consideration was intended to be deposited in his bank account on the same day and he (Bank Manager) should remain with him. The assessee had also filed a report of Tehsildar

Hapur dated 28.9.2010 showing that the agricultural land in question lies more than 8 km. from the local limit of Nagar Palika, Pilakhua and also 9 km. from the local limit of town area Dasna. He submitted that the agricultural land in the instant case is not a capital asset within definition of Section 2 (14) (iii) (a) (b) and is therefore, not chargeable to capital gain tax. He pointed out further that the assessee on his own had filed his return of income voluntarily well before the closing of financial year 2008-09 with true and full disclosure without waiting for any notice u/s 142 or 147/148 of the IT act from the department. He also informed that in the case of Mohd. Raisuddin, who is one of the two purchasers, the AO has accepted that the Raisuddin is owner of the money i.e. Rs.97,80,000/- and accordingly addition of Rs.77,80,000/- has been made on substantial basis in his hand as his income during the year. A copy of this assessment order has been made available on the record. he also referred page nos.1 to 88 of the paper book which are copies of: note dated 2.6.2008, Extract of Khatauni showing the land owned by the appellant, Extract of passbook showing deposit of Rs.14,50,000/- on 22.02.2007 (In dispute), Bank receipt showing late hour deposit, Pay-in-slip of Bank showing deposit for Rs.90.00 lakhs on 12/13.11.2007, Bank declaration by assessee dated 13.11.2007, complaint dated 14.09.2010- reminder to earlier complaint regarding evasion of stamp duty addressed to Assistant Commissioner of stamps, Bank statement showing of Rs.1,08,32,752/- in the account of Sh. Intizar Ali at the time of attachment on 06.12.2007, Undertaking, Note of A.O. Hapur showing non-compliance of notice u/s 131 by Raisuddin, Receipt for return filed voluntarily on 27.10.2008, Copy of return, Letter of ITO Hapur u/s 142 dated 21.12.2010, Letter dated 21.12.2010, Reply assessee for justification for non conversion of sale proceeds into unexplained one, Letter dated 24.12.2007 of ADM (LA) showing payment of compensation at 179.34 per sq. mt, Report of Tehsil showing agricultural income, Report of Tehsildar showing distance from Nagar Palika & T.A., Report of Tehsildar 30.11.2010/10.12.2010 showing market value of the land at Rs.1.20 crore, AC stamps recommendation for registration of case u/s 47A dated 28.09.2010 and transfer of the case to ADM (E), Statement of Intizar Ali, Assessee, Statement of Gaffar, Statement of Gulzar, Statement of Zahir Alam Zaidi, Bank Manager, Statement of Mohd. Yamin, Statement of Raisuddin, Letter dated 15.11.2007 addressed to District Magistrate, Ghaziabad, Letter dated 22.01.2008 addressed to District Magistrate, Ghaziabad and Assessment Order dt.30.12.2011 in the case of Sh. Raisuddin. The documents have been filed under the certificate that

documents made available at page nos.1 to 78 were made available before the Assessing Officer.

The ld. DR on the other hand tried to justify the orders of the authorities below on the issue. He submitted that onus lies heavily on the claimant to establish the claimed source of deposit to which the assessee has thoroughly failed to. The AO was thus justified in making the addition of Rs.77,80,000/- as unexplained."

8. The ITAT considered the submissions and found that the evidence led in the light of the explanation submitted by the assessee, source of deposit in question in the bank is sale of land by him. The reasons shown by the authorities below for deposit and the explanation of assessee are wholly arbitrary. The assessee had explained that the land was sold for Rs.1.20 crores out of which Rs.20 lacs was paid in advance and remaining sale consideration was paid to him at the time of registration of sale deed. Out of which Rs.93 lacs was paid in cash and Rs.7 lacs by demand draft. In this manner total amount of Rs.1,20,00,000/- was paid. The amount of Rs.22,40,000/- is shown in the sale deed out of which Rs.20 lacs was paid in advance pertaining to the financial year 2006-07. The appellate authority thereafter accepted the explanation of the assessee and recorded its findings as follows:–

"Besides Shri Gulzar and Shri Gaffar who were shown as witnesses in the sale deed had also stated that at the time of registry, the purchasers had in their presence made the payment of Rs.1,00,00,000/- to the assessee i.e. Rs.7,00,000/- by DD and Rs.93,00,000/- in cash and that the bank manager had collected the money from the assessee. The bank manager, of the concern branch of Syndicate Bank in his statement has also supported this fact that an amount of Rs.90,00,000/- was deposited by the assessee to his branch with this information that it was out of the sale receipt of the land sold by him. It is a prevalent practice in the land transaction that real sale consideration is not shown in the sale deed. There was also sufficient reason for the purchasers to conceal actual sale consideration in the sale deed to evade tax and stamp duty since it is paid by the purchasers only.

Ignoring the above documents, circumstantial evidence and the prevalent practice in the land transaction, we are of the view that the authorities below were not justified in doubting the explanation of the assessee for the source of deposit in question mainly on the basis that the registered sale deed signed by the assessee himself shows a sale value consideration of only Rs.22,20,000/- and that there is no full proof evidence on record that the purchasers had given total consideration of Rs.1,20,00,000/-. There was also nothing on record to suggest

> either that assessee was having any other source of income which has been given more weightage by the authority below than the explanation of the assessee that the source of the deposit in question was sale receipt of the land sold by him as the selling of land and deposit made out of the sale receipt made on the same day, when sale deed was registered has not been disputed. We thus find that preponderance of probability is more in favour of the explanation of the assessee. In its remand report which was furnished before the ld. CIT (A) on the submission of the assessee made before him, the AO has also failed to contradict the explanation furnished by the assessee with some positive evidence. On the basis of documents, explanation of the assessee and others and the prevalent practice in the land transaction it can be safely inferred that whatever the assessee had explained about the source of the deposit cannot be doubted especially in absence of contrary material on record.
>
> We thus while setting aside orders of the authorities below in this regard, direct the AO to delete the addition in question made at Rs.77,80,000/- on account of income from undisclosed sources. The grounds involving the assessee are thus allowed."

9. We have gone through the orders passed by the A.O., CIT (A) and ITAT and find that the questions of law as raised do not arise for consideration in as much as findings recorded by ITAT are findings of fact, which do not call for consideration or reconsideration of this Court.

10. We may observe here that the assessee as an honest citizen not only made a complaint to the registering authority that the sale deed has been registered at a value much below the amount, which he has actually received, he deposited the entire amount in the bank and voluntarily filed return. There was no material whatsoever or any circumstance, which could have suggested that this amount was received by him from any other source. The deposition of witness of the sale deed, the Bank Manager and the evidence filed with regard to valuation of the property was more than sufficient to discharge the burden, which the A.O. had unreasonably placed on the assessee. The A.O. in disbelieving the evidence has not given any reasons whatsoever to discard the statement of the witnesses, deposit of the entire sale consideration in bank and the deposition of the Bank Manager. The assessee had not only deposited the entire amount in the bank but also informed the registering authority of the deficiency of the stamp in the sale deed.

11. We further notice the observations made in the order of the Tribunal that in the case of Mohd. Raisuddin, one of the purchaser, the A.O. had accepted that he was the owner of the money i.e. Rs.97,80,000/- and accordingly addition of Rs.77,80,000/- was made in his hand on substantial basis as his income during the year for which a copy of the assessment order was filed on record.

12. The income tax appeal is dismissed.

13. Before parting with the case we may observe here that from the facts and circumstances on the record that in the present case the Income Tax Officer did not act in bonafide manner. The assessee led substantial evidence to establish that the amount treated to be undisclosed income by the A.O. was the sale consideration of sale of his agricultural land, which he had deposited in the bank and had voluntarily filed return disclosing his income. Overwhelming evidence led by him was discarded without giving any reasons at all. The assessment was framed only on the ipse dixit of the A.O., which gives us reason to believe that he had exceeded his authority with some ill will or with ulterior motive.

14. We, therefore, find it appropriate to direct the Registrar General of the Court to forward a copy of this judgment to the Chairman of the Central Board of Direct Taxes to cause an enquiry into the conduct and motives of Shri Yaduvansh Yadav, Income Tax Officer, Ward-1, Hapur in framing the assessment and raising demand of income tax against the petitioner.

2013 TRI 1457 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
AGRA BENCH, AGRA

Bhavnesh Saini, Judicial Member and A.L. Gehlot, Accountant Member

FACTS/HELD

ICAI directed to initiate disciplinary proceedings against CA for suppressing information and obtaining order by fraud

1. The assessee bought and sold shares and claimed that he had earned capital gains which were exempt u/s 54F. When the AO alleged that the transactions were bogus and entered into for converting black money into white, the assessee surrendered the claim for exemption u/s 54F and offered the capital gains to tax. The AO levied penalty u/s 271(1)(c) on the ground that the surrender of income was not voluntary. This was upheld by the Tribunal. The assessee filed an appeal before the High Court which was dismissed. The assessee thereafter filed a Miscellaneous Application before the Tribunal on the ground that as the AO had not specified whether the penalty was for concealment or for furnishing

inaccurate particulars, penalty could not be levied. The Tribunal allowed the MA and deleted the penalty (order included in file). The Department then filed a MA stating that as the first order of the Tribunal had merged in the order of the High Court, the subsequent MA was not maintainable. The assessee accepted that he was advised by his CA not to disclose the fact of dismissal of the appeal by the High Court in the MA so filed. The CA argued that though the fact of dismissal of the appeal was not stated in the MA he had not concealed the fact because it was known to the Department. HELD by the Tribunal allowing the MA:

> In the last 40 years, a new creed of litigants has cropped up. Those who belong to this creed do not have any respect for truth. They shamelessly resort to falsehood and unethical means for achieving their goals. In order to meet the challenge posed by this new creed of litigants, the courts have, from time to time, evolved new rules and it is now well established that a litigant, who attempts to pollute the stream of justice or who touches the pure fountain of justice with tainted hands, is not entitled to any relief, interim or final. On facts, it was the duty of the assessee to disclose the decision of the High Court to the Tribunal while moving the MA and by not doing so, they did not come to the ITAT with clean hands. The assessee and his CA are guilty of fraud for deliberately suppressing the fact that the High Court had dismissed the assessee's appeal and that the MA was not maintainable. The MA order is thus a nullity and non est in the eyes of law. The CA's conduct amounts to professional misconduct and requires disciplinary action by the ICAI.

Application allowed.

M.A. Mo. 04/Agra/2012 (Arising out of M.A. No. 02/Agra/2011 & ITA No. 468/Agra/2004) Assessment Year : 2001-02.

Heard on: 3rd July, 2013.

Decided on: 12th July, 2013.

Present at hearing: Waseem Arshad, Sr. D.R., for Applicant. Nitesh Agarwal, Advocate, for Respondent.

JUDGMENT

Per Bhavnesh Saini:– (Judicial Member)

This order shall dispose of miscellaneous application filed by the Revenue through Shri S.K. Verma, ITO 2(4), Agra u/s. 254(2) of IT Act against the ITAT order passed u/s. 254(1) of IT Act allowing the appeal of assessee by canceling penalty u/s. 271(1)(c) of the IT Act.

2. We have heard the ld. representatives of both the parties at length and perused the orders and the material on record.

3. Briefly, the facts of the case are that the assessee alleged to have purchased 4000 shares of M/s. Pernami Habitat Developers Ltd., Gurgaon at the rate of Rs.5.88 per share for a sum of Rs. 23,630/-. These shares were allegedly purchased on 09.06.1999 and 15.06.1999 through the share broker, M/s. Rakesh Nagar & Co., New Delhi. The shares were claimed to have been sold for a sum of Rs.5,03,772/- through the same broker, M/s. Rakesh Nagar & Co. The amount of Rs.5,03,772/- was deposited in the capital gain account for utilization in the construction of house and accordingly, the assessee claimed deduction u/s. 54F of the IT Act. The AO observed that the assessee had in fact taken benefit of bogus entries through these transactions with the sole motive of converting the black money into white money. The AO during the course of assessment proceedings discussed the matter with the assessee and his representatives in the presence of Addl. CIT, Range-2 Agra. The assessee was informed that the share broker, M/s. Rakesh Nagar & Co. in their statement had stated that no transaction of purchase and sale of 4000 shares of M/s. Pernami Habitat Developers Ltd, Gurgaon on behalf of the assessee were made through him. The assessee thereafter filed detailed reply and offered the amount of capital gain for taxation. The assessee filed revised computation of income on 28.03.2003 and revised return of income on 01.10.2003. In view of these facts, the AO observed that the surrender of income made by the assessee was not voluntary, but it was made after detection under compulsion. The AO accordingly initiated the penalty proceedings u/s. 271(1)(c) of the IT Act. The assessee at the penalty stage informed that he was not aware of the fraud in respect of purchase and sale of shares committed by the share broker. Therefore, the assessee has surrendered the amount in question for taxation. The AO was not satisfied with the reply of assessee and levied minimum penalty u/s. 271(1)(c) of the IT Act. The ld. CIT(A) confirmed the penalty and the matter reached before ITAT, Agra Bench in appeal filed by assessee in ITA No. 468/Agr./2004 for the assessment year 2001-02, which was dismissed by the Tribunal vide order dated 27.04.2007. The Tribunal while dismissing the appeal of the assessee held that the filing of revised return subsequently cannot be taken as voluntary disclosure on behalf of the assessee and Explanation-1 to section 271(1)(c) would apply against the assessee. The explanation of the assessee is false.

4. The assessee thereafter filed appeal before the Hon'ble Allahabad High Court against the order of the Tribunal dated 27.04.2007 dismissing the appeal of the assessee in Income-tax Appeal No. 477 of 2007 and the Hon'ble Allahabad High Court vide order dated 17.08.2010 held that the finding of Tribunal is finding of fact and no substantial question of law arises from the order of the Tribunal. The appeal of the assessee was accordingly dismissed.

5. The assessee, instead of filing an appeal/SLP before the Hon'ble Supreme Court against the decision of Hon'ble Allahabad High Court, filed a miscellaneous application No. 02/Agra/2011 on 24.01.2011 u/s. 254(2) before the earlier ITAT, Agra Bench against its order dated 27.04.2007 and it was stated that the AO has nowhere pointed out under which offence penalty has been imposed – whether the assessee had concealed the particulars of income or had furnished inaccurate particulars of income. The assessee also relied upon certain decisions in support of contention. However, the assessee has not disclosed the important fact in the above miscellaneous application that his appeal has already been dismissed by Hon'ble Allahabad High Court vide order dated 17.08.2010 confirming the order of the Tribunal dated 27.04.2007 against which miscellaneous application has been preferred. The earlier ITAT, Agra Bench after detailed discussion allowed the Miscellaneous Application No. 02/2011 filed by the assessee and cancelled the penalty imposed u/s. 271(1)(c) of the IT Act. The appeal of the assessee was allowed and in the result, the miscellaneous application filed by the assessee was allowed by rectifying the order dated 27.04.2007 in the manner as stated in the order dated 28.07.2011. The order dated 28.07.2011 u/s. 254(2) merged with order dt. 27.04.2007 passed u/s. 254(1) of IT Act and appeal of assessee in ITA No. 468/2004 was thus allowed, which is contrary to judgment of Hon'ble Allahabad High Court dated 17.08.2010.

6. The Revenue has now filed M.A. No. 04/Agra/2012, in question, stating the same facts and prayed that after dismissal of appeal of the assessee by Hon'ble Allahabad High Court, the Tribunal cannot adjudicate the matter, which is already decided by the Superior Judicial Authority in the case of assessee. It appears that the assessee has not intentionally disclosed the fact of dismissal of appeal by the High Court before the ITAT, Agra Bench. Therefore, the miscellaneous application of the revenue may be allowed in the light of decision of Hon'ble Allahabad High Court dated 17.08.2010.

7. The notice of the present miscellaneous application was issued to the assessee who has appeared in person through his counsel and filed a written reply dated 12.07.2012 in which it was explained that the assessee under the legal advice made available to him by his counsel Shri K.G. Agarwal, C.A. did not disclose the dismissal of appeal by the Hon'ble Allahabad High Court in the miscellaneous application so filed. This fact

was also confirmed by the assessee present in the court that as per advice of Shri K.G. Agarwal, C.A., he did not disclose the fact of dismissal of appeal by the Hon'ble High Court to the Tribunal when assessee's MA No. 02/2011 was filed. In view of the above reply of the assessee, the explanation of Shri K.G. Agarwal, C.A. who has represented the assessee in MA No. 02/2011 was called for. Shri K.G. Agarwal, C.A. filed his reply dated 03.12.2012 stating therein that the assessee made submissions in the miscellaneous application which were relevant only for the purpose of rectification of apparent mistakes in the said order and in no manner he intended to lower down the majesty of law or to conceal the facts knowingly. Otherwise also, no one can conceal a fact which is in the knowledge of the opposite party. He has also stated that nothing more was required to be disclosed in the miscellaneous application. Thus, the assessee or Shri K.G. Agarwal, C.A. did not dispute the fact that the order of the Hon'ble High Court dated 17.08.2010 dismissing the appeal of the assessee against the order of the Tribunal dated 27.04.2007 was not deliberately disclosed to the Tribunal while filing M.A. No. 02/2011.

8. The ld. DR contended that when Hon'ble Allahabad High Court dismissed the appeal of the assessee on 17.08.2010 confirming the levy of penalty by the Tribunal in their order dated 27.04.2007, it is a relevant and important fact and has bearing on miscellaneous application, therefore, the same judgment of High Court should have been disclosed by the assessee and their counsel while filing the miscellaneous application before the Tribunal. He has submitted that it is a solemn duty of the assessee to disclose all material facts before the Tribunal while filing the miscellaneous application. The order of the High Court is material fact which was deliberately concealed to get a favourable order from the Tribunal in miscellaneous application. He has submitted that the persons who have not come to the court with clean hands should not be heard on such matter and no relief should have been granted. It was also submitted that the decision of Hon'ble High Court dated 17.08.2010 was sent to the CIT-I, Agra vide letter dated 03.09.2010 by the AO, hence, High Court order was received in the office of ITO 2(4), Agra between 26.08.2010 & 03.09.2010. The ld. DR also referred to the reply of AO dated 26.07.2012 and submitted that prosecution is pending against the assessee on the same matter in issue, which was launched on 29.03.06. The ld. DR submitted that decision of Hon'ble Allahabad High Court is a finding of fact confirming the order of the Tribunal dated 27.04.2007 which was subsequently wholly reviewed by the earlier Members of Tribunal in miscellaneous application vide order dated 28.07.2011. The assessee should not have moved miscellaneous application No. 02/2011 before the Tribunal after dismissal of their appeal by the Hon'ble Allahabad High Court. Even in case the assessee filed MA against the order of the Tribunal dt. 27.04.2007, he should have disclosed the important fact of dismissal of appeal by the Allahabad High Court. If the assessee was at all aggrieved against the decision of Hon'ble

Allahabad High Court, he should have moved SLP before the Hon'ble Supreme Court of India. The assessee and their counsel have deliberately, intentionally and consciously in disregard to the order of the Tribunal and the High Court concealed and suppressed the material fact of dismissal of their appeal by the High Court have played fraud with the Tribunal. The ld. DR submitted that the order obtained by fraud by the assessee or their counsel dated 28.07.2011 is nullity and non-est in the eyes of law and such order cannot be allowed to stand. The ld. DR relied upon certain decisions of the Hon'ble Supreme Court, copies of which are placed on record. The ld. DR, however, strongly relied upon the findings and observations of Hon'ble Supreme Court relevant to the present issue under consideration in the case of *Ramjas Foundation and Another vs. Union of India and Others* delivered on 09.11.2010 in Civil Appeal No. 6662/2004 and the same reads as under:

> *"14. The principle that a person who does not come to the Court with clean hands is not entitled to be heard on the merits of his grievance and, in any case, such person is not entitled to any relief is applicable not only to the petitions filed under Articles 32, 226 and 136 of the Constitution but also to the cases instituted in others courts and judicial forms. The object underlying the principle is that every Court is not only entitled but is duty bound to protect itself from unscrupulous litigants who do not have any respect for truth and who try to pollute the stream of justice by resorting to falsehood or by making misstatement or by suppressing facts which have bearing on adjudication of the issue(s) arising in the case."*

Hon'ble Apex Court further observed –

> *"In the last 40 years, a new creed of litigants has cropped up. Those who belong to this creed do not have any respect for truth. They shamelessly resort to falsehood and unethical means for achieving their goals. In order to meet the challenge posed by this new creed of litigants, the courts have, from time to time, evolved new rules and it is now well established that a litigant, who attempts to pollute the stream of justice or who touches the pure fountain of justice with tainted hands, is not entitled to any relief, interim or final & quot."*

9. On the other hand, the ld. counsel for the assessee justified the action of the assessee in moving miscellaneous application before the Tribunal and submitted that there were no need to disclose order of Hon'ble Allahabad High Court dated 17.08.2010 while filing the miscellaneous application because the order of the High Court is not material fact to be disclosed in the miscellaneous application. He has submitted that when no appeal was admitted by the High Court would mean that no appeal has been filed. He has submitted that ITAT has no power to review its orders and earlier order of Tribunal dated 28.07.2011

allowing the appeal of the assessee is not review of the earlier order dated 27.04.2007 because it is a rectification made in the order of the Tribunal. He has submitted that res judicata applies to Income-tax proceedings. He has submitted that present M.A. filed by the Revenue is barred by limitation, which is filed on 03.02.2012, i.e., after four years from the date of original order dated 27.04.2007. He has submitted that the order u/s. 254(2) dated 28.07.2011 passed by the Tribunal in M.A. No. 02/2011 will merge with the original order dated 27.04.2007, therefore, the same would continue to be an order u/s. 254(1) of the IT Act. He has relied upon the decision of Hon'ble Madras High Court in the case of *Dr. S. Panneerselvam vs. ACIT*, 319 ITR 135, in which it was held that –"*any order passed under section 254(2) of the Income-tax Act, 1961, either allowing amendment or refusing to amend gets merged with the original order passed. The order as amended or remaining unamended is the effective order for all practical purposes. The same continues to be an order under section 254(1). That is the final order in appeal. Successive applications for rectification of the original order cannot be maintained as it will defeat the object of section 254(2) of the Act.*" He has further submitted that the order of Hon'ble Allahabad High Court dated 17.08.2010 was available with the Revenue Department, i.e., the AO and CIT, Agra on 03.09.2010 prior to M.A. moved by the assessee on 24.01.2011. Therefore, it was also duty of the AO and the CIT, Agra to disclose fact of dismissal of appeal of the assessee by the High Court to the Tribunal while miscellaneous application was argued by the DR. The ld. counsel for the assessee, therefore, submitted that miscellaneous application of the Revenue may be dismissed. He has also filed copies of some other decisions on record. During the course of arguments, the ld. counsel for the assessee was asked to explain that if the assessee would have disclosed in Misc. application the decision of Hon'ble Allahabad High Court dated 17.08.2010, whether ITAT Agra Bench would still have allowed the miscellaneous application of the assessee, the ld. counsel for the assessee could not explain. He was also asked to explain when the appeal of the assessee has been dismissed by the Hon'ble High Court, instead of approaching Hon'ble Supreme Court, whether it was fair on the part of assessee to move miscellaneous application by concealing the material fact from the Tribunal, i.e., the decision of High Court. The ld. counsel for the assessee also did not have any answer to this query.

10. The ld. DR further contended that the original order of the Tribunal dated 27.04.2007 was in favour of the Revenue, therefore, there was no reason for department to move any miscellaneous application against the said order. He has submitted that the order dated 28.07.2011 passed in miscellaneous application filed by the assessee is the order passed u/s. 254(2) of the IT Act and the same would get merged with the original order passed by the Tribunal. Therefore, the order of Tribunal dated 28.07.2011 would deemed to be an order u/s. 254(1) of the Act, hence, the present miscellaneous application filed by the Revenue on

03.02.2012 is filed within four years from the date of this order and as such the same is filed within the period of limitation. The ld. DR submitted that since fraud is played with the tribunal at the stage of miscellaneous application, therefore, the original order of Tribunal dated 27.04.2007 may be restored.

11. We have considered the rival submissions and the material available on record. The passing of different orders by the Tribunal and the Hon'ble Allahabad High Court are not in dispute. ITAT, Agra Bench while considering the penalty appeal of the assessee in ITA No. 468/2004, dismissed the appeal of the assessee vide order dated 27.04.2007 holding that the revised return filed by the assessee on 01.10.2003 cannot be taken as voluntary disclosure on behalf of the assessee. Thus, the finding of fact was made against the assessee that the assessee concealed the particulars of income u/s. 271(1)(c) of the IT Act read with Explanation 1 attached to the same section/provision. The assessee preferred appeal before the Hon'ble High Court against the said decision of Tribunal dated 27.04.2007 and the appeal of the assessee in ITA No. 477/2007 has been dismissed by High Court vide order dated 17.08.2010. The assessee did not prefer any appeal before the Hon'ble Supreme Court against the aforesaid decision of Hon'ble Allahabad High Court. Hon'ble Supreme Court in the case of A.V. Papayya Sastry & Ors vs. Government Of A.P. & Ors., (2007) 4 SCC 221 held as under in various paras of the judgment:–

> *"Even if the counsel for the appellants is right in submitting that after dismissal of SLPs the respondent herein could not have approached the High Court for recalling its earlier order and the High court could not have entertained such applications, nor the recalling could have been done, in the facts and circumstances of the case and in the light of the finding by the High Court that fraud was committed by the landowners in collusion with the officers of the Port Trust Authorities and the Government, no fault can be found against the approach adopted by the High Court and the decision taken. The High Court rightly recalled the order, and remanded the case to the authorities to decide the same afresh in accordance with law.*
>
> *Fraud may be defined as an act of deliberate deception with the design of securing some unfair or undeserved benefit by taking undue advantage of another. In fraud one gains at the loss ofanother. Even the most solemn proceedings stand vitiated if they are actuated by fraud. Fraud is thus an extrinsic collateral act which vitiates all judicial acts, whether in rem or in personam.*
>
> *A judgment, decree or order obtained by playing fraud on the court, tribunal or authority is a nullity and non est in the eye of the law. Such a judgment decree or order – by the first court or by the final court – has to be treated as nullity by every court,*

superior or inferior. It can be challenged in any court, at any time, in appeal, revision, writ or even in collateral proceedings.

The matter can be looked at from a different angle as well. Suppose, a case is decided by a competent court of law after hearing the parties and an order is passed in favour of the plaintiff applicant which is upheld by all the courts including the final court. Let us also think of a case where the Supreme Court does not dismiss special leave petition but after granting leave decides the appeal finally by recording reasons. Such order can truly be said to be a judgment to which Article 141 of the Constitution applies. Likewise, the doctrine of merger also gets attracted. All orders passed by the courts/authorities below, therefore, merge in the judgment of the Supreme Court and after such judgment, it is not open to any party to the judgment to approach any court or authority to review, recall or reconsider the order.

The above principle, however, is subject to exception of fraud. Once it is established that the order was obtained by a successful party by practicing or playing fraud, it is vitiated. Such order cannot be held legal, valid or in consonance with law. It is non-existent and non est and cannot be allowed to stand. This is the fundamental principle of law. The principle of "finality of litigation" cannot be stretched to the extent of an absurdity that it can be utilized as an engine of oppression by dishonest and fraudulent litigants."

11.1 In the case of A.V. Papayya Sastry & Ors. (supra) Hon'ble Supreme Court observed that even if counsel for appellant is right in submitting that after dismissal of SLPs, the respondent therein could not have approached the High Court for recalling its earlier order and the High Court could not have entertained such application nor the recalling could have been done in the facts and circumstances of the case, but when fraud is committed by the land owners in collusion of the officers of Port Trust Authorities and the Government, no fault could be found against the approach of High Court and its decision taken. In the present case after dismissal of appeal of the assessee by Hon'ble Allahabad High Court, the assessee if at all was aggrieved, should have moved SLP before the Hon'ble Supreme Court and should not have approached the ITAT, Agra Bench for recalling/review of the earlier order of the Tribunal dated 27.04.2007. It is the duty of the assessee to disclose the decision of Hon'ble Allahabad High Court to the Tribunal while moving miscellaneous application. The assessee and their counsel, therefore, did not come to ITAT, Agra Bench in miscellaneous application with clean hands. In this view of the matter and the decision of Hon'ble Supreme Court above, the concealment / suppression of decision of Hon'ble Allahabad High Court in miscellaneous application filed by the assessee

is, therefore, relevant and material fact and could not have been ignored as is argued by the ld. counsel for the assessee.

11.2 Finding of fact of ITAT, Agra Bench in its original order dated 27.04.2007 was that revised return was not voluntary because it was filed when the assessee was cornered by the AO. Hon'ble Allahabad High Court confirmed the order of the Tribunal and finding of fact was confirmed. The decision of ITAT, Agra Bench as was confirmed by the Hon'ble Allahabad High Court was also in consonance with various judgments on the same identical matter in issue and as such could not have been found fault with the same in subsequent miscellaneous application filed by the assessee concealing the decision of High Court. Some of the decisions confirming the above view of the Tribunal and the Hon'ble High Court are reproduced as under:

11.3 Hon'ble Bombay High Court in the case of *Jyoti Laxman Konkar vs. CIT*, 292 ITR 163 held–

> *"The assessee had filed a return for the assessment year 1999-2000 declaring an income of Rs.7,40,510. Not satisfied therewith, the Assessing Officer carried out a survey under section 133A of the Income-tax Act, 1961, and during the survey found that there was a discrepancy in stock to the tune of Rs.18,28,706 which was brought to the notice of the assessee, and the assessee filed a revised return disclosing additional income of Rs.18,28,706. The Assessing Officer imposed penalty under section 271(1)(c) and this was upheld by the Tribunal. On appeal to the High Court:*
>
> Held, *dismissing the appeal, that the question whether there is concealment of income or not has to be decided with reference to the facts of a given case and the fact finding authorities under the Act having come to the conclusion that in the facts of the case, the assessee had concealed the income initially with a view to avoid the payment of tax, the imposition of penalty was valid."*

11.4 Hon'ble jurisdictional Allahabad High Court in the case of *CIT vs. Rakesh Suri* 331 ITR 458 held–

> *"The assessee filed his return for the assessment year 2004-05 disclosing total of Rs. 1,17,600. The case was selected for scrutiny. It was found that the assessee had shown long-term capital gains on sale of shares. He had constructed a house between financial years 2001-02 and 2004-05 investing Rs.56,74,567. The income-tax authorities repeatedly required the assessee to furnish the contract note of purchase and sale of shares sold with a copy of bill of broker, justify holding of shares, which were sold, year-wise investment in the house property, valuation report of the approved valuer, confirmation of salary*

received from the company and other documents. The assessee did not furnish full details. His statement that the shares had been sold through the Delhi Stock Exchange was found to be false. The assessee was directed to furnish reply in terms of the order dated November 9, 2006. He was further directed to furnish the name of the stock exchange through which shares were purchased and sold, rate of shares in the stock exchange on date of purchase and sale on or before December 6, 2006. On December 6, 2006, the assessee surrendered the entry appearing in his bank account on sale of shares amounting to Rs. 61,35,844 on agreed basis. The Assessing Officer treated the sum of Rs. 61,35,844 as income from undisclosed sources under section 69A of the Incometax Act, 1961, and also levied penalty. The Commissioner (Appeals) cancelled the penalty and this was confirmed by the Tribunal. On appeal to the High Court:

Held, allowing the appeal, that the assessee had concealed the material facts and given incorrect statement of facts in the application and also not provided information required by the Assessing Officer, after receipt of notice. Accordingly the action of the assessee was neither bona fide nor voluntary. The manner in which the assessee had tried to prolong the case before the Assessing Officer by not providing information immediately and by narrating incorrect facts in the letter dated December 6, 2006 showed that the assessee had concealed the income and disclosure was not voluntary but under compulsion being cornered by the Assessing Officer. Penalty had to be imposed."

11.5 Hon'ble Gujrat High Court in the case of *LMP Precision Engg.. Co. Ltd. vs. DCIT*, 330 ITR 93 held–

"The Deputy Director of Income-tax (Investigation), Bombay undertook survey action some time in September, 1988 and on verification of certain purchases made by the assessee it was found that the purchases did not appear to be genuine. Before the proceedings could be finally concluded the assessee filed a declaration under section 273A of the Act disclosing additional income of Rs. 54,71,463 as being relatable to assessment year 1985-86. On the same day, declaration was also made of a sum of Rs.18 lakhs each for assessment years 1986-87, 1987-88 and 1988-89. This application under section 273A of the Act was followed by revised returns filed on February 14, 1989 for all the three assessment years declaring identical additional income in the revised returns. Before assessments could be finalised, after regularising the same by issuance of notice under section 148 of the Act, the assessee came forward with another application declaring additional income of Rs. 78,56,613. The first declaration was in relation to purchases from ISC while the

second disclosure was in relation to purchase made from SC, NB and NPST. The assessments were not challenged by the assessee. The Assessing Officer initiated penalty proceedings under section 271(l)(c). The explanation of the assessee for all the three years was that revised returns were voluntary, additional income in each of the revised returns was declared to purchase peace and no concealment was involved. It was submitted that the returns were revised even before issuance of notice under section 148 of the Act. The Assessing Officer did not accept the explanation of the assessee and levied penalties. Successive appeals filed by the assessee before the Commissioner (Appeals) and the Tribunal were dismissed by the two appellate authorities confirming the penalties levied by the Assessing Officer. However, the Tribunal came to the conclusion that the assessee had co-operated in finalisation of the assessment and accepted the assessment of additional income and so, the Tribunal reduced the penalty levied from the maximum to the minimum. On a reference:

Held, that it was only after the statement of the chairman and managing director was recorded by the Deputy Director of Incometax (Investigation Mumbai, that the first disclosure dated October 20,1988, Rs. 54,71,463 was made accompanied by another disclosure of Rs. 54 lakhs in a round figure being divided into three segments of Rs. 18 lakhs each for assessment yean 1986-87, 1987-88 and 1988-89. The revised return declaring a sum of Rs.78,56,613 came about as a consequence of follow-up proceedings undertaken by the Deputy Director of Income-tax in relation to the other three suppliers, viz., SC, NB and NPST. Therefore, the assessee could not be stated to have voluntarily come forward to disclose income which had unintentionally been omitted from the original return of income. The imposition of penalty was valid."

11.6 In view of the above decisions, there appears no scope to review the earlier order of the Tribunal dated 27.04.2007, which was also confirmed by the Hon'ble Allahabad High Court. Thus, the whole approach of the assessee was to get favourable order from the Tribunal by concealing and suppressing the material fact from the Tribunal. We may also note here that the assessee and his counsel has a motive to get the favourable order from the Tribunal because on the same matter in issue before confirmation of penalty by the Tribunal on dated 27.04.2007, the Revenue department as per reply of AO/D R have alreadylaunched a criminal prosecution against the assessee on 29.03.2006 and the same is pending against the assessee. We may also note here that there are case laws to the effect that when the Tribunal allowed the appeal of the assessee, noprosecution on the same matter in issue may continue. Thus, the assessee and their counsel were aware of the fact that the criminal

prosecution against the assessee would continue after dismissal of their appeal by the Tribunal and confirmed by the High Court, therefore, they with their predetermined mind and ulterior motive moved miscellaneous application on 24.01.2011 against the original order of Tribunal dated 27.04.2007 with delay of more than three and half years. The assessee and their counsel with ulterior motive to get a favourable order from the Tribunal did not disclose dismissal of their appeal by the High Court in their miscellaneous application. Whatever arguments were made originally have been taken care of by the Tribunal and altogether new plea was taken in miscellaneous application, which has been accepted by the Tribunal and the entire order has been reviewed. The assessee did not explain why new plea taken in MA was not earlier raised before Hon'ble High Court in appeal. The Tribunal in original order held that assessee concealed the particulars of income and explanation-I to section 271(1)(c) applies, then where was need to reconsider the question of whether assessee concealed the particulars of income or furnished inaccurate particulars of income as submitted by assessee in his Misc. application.

12. Fraud would mean wrongful or criminal deception intended to result in financial or personal gains. Fraud was committed by the assessee and material facts were deliberately suppressed by him with his counsel Shri K.G. Agarwal, C.A. The assessee and his Chartered Accountant were aware of the fact that High Court has dismissed the appeal of the assessee and the order of the Tribunal is confirmed and reached finality. Therefore, deliberately attention of the Tribunal was not invited to the order of the High court clearly revealed that there was total fraud on the part of the assessee and his Chartered Accountant and to some extent even the AO and CIT, Agra would be responsible for the fraud played with the Tribunal in the facts and circumstances of the case. If the assessee and his C.A. would have disclosed the decision of High Court dismissing the appeal of the assessee, perhaps the Tribunal would not have recalled the entire order and would not have allowed the appeal of the assessee contrary to the earlier order passed on 27.04.2007 and confirmed by the High Court. By dismissing the appeal of the assessee, Hon'ble Allahabad High Court confirmed the correctness of the order of the Tribunal, but the assessee and their counsel deliberately impressed upon the Tribunal in their miscellaneous application that their order is not correct by concealing the decision of Hon'ble Allahabad High Court. Such is a glaring example of fraud committed by the assessee and their counsel with the Tribunal and administration of justice. The order obtained by playing fraud on the Tribunal is thus nullity and non est in the eyes of law. It can be challenged by the Revenue legally in the present miscellaneous application. If the present miscellaneous application by the Revenue would not have been moved and correct facts would not have been brought to the knowledge of the Tribunal, the assessee would have financially and personally gained the benefit on dismissal of his criminal

prosecution and payment of penalty amount in the matter. It is, therefore, established on record that the assessee and their counsel have obtained the favourable order from the Tribunal by practicing / playing fraud, therefore, the entire order of the Tribunal dated 28.07.2011 is vitiated and such an order cannot be held to be legal, valid or in consonance with law. It is non-existent and non est and cannot be allowed to stand. Even the propriety demands that when the order of the Tribunal dated 27.04.2007 has been confirmed by the Allahabad High Court, the entire order dated 27.04.2007 should not have been recalled vide order dated 28.07.2011 and the appeal of the assessee should not have been allowed taking a totally contrary view on the matter in issue. There is thus mistake apparent from record of Tribunal, same can be rectified by recalling order dated 28.07.2011.

12.1 The ld. counsel for the assessee contended that the miscellaneous application filed by the Revenue on 03.02.2012 is barred by limitation because it is filed after four years from passing of the original order dated 27.04.2007. The contention of the ld. counsel has no merit and is accordingly rejected. The original order dated 27.04.2007 of the Tribunal was in favour of the Revenue, therefore, there could not have been any mistake in the order of the Tribunal from the point of view of the Revenue Authorities. The ld. counsel for the assessee , however, rightly contended that the order dated 28.07.2011 passed u/s. 254(2) would merge with the original order dated 27.04.2007 u/s. 254(1) of the IT Act, therefore, when the appeal of the assessee has been allowed vide order dated 28.07.2011, this order would be treated as order passed u/s. 254(1) of the IT Act. The Revenue has filed the present miscellaneous application within four years from the date of the order dated 28.07.2011 because the Revenue gets aggrieved after passing the aforesaid order. According to the decision in the case of Dr. S. Panneerselvam (supra) when the order u/s. 254(2) is passed, allowing appeal of assessee, the same would get merged with the original order passed, therefore, the same would amount to an order u/s. 254(1) of the IT Act. The Revenue,therefore, rightly filed present miscellaneous application u/s. 254(2) of the IT Act against the order now passed u/s. 254(1) of the IT Act allowing appeal of assessee. The miscellaneous application of the Revenue is, therefore, filed within the period of limitation. The ld. counsel for the assessee also contended that the order of the High Court was also within the knowledge of AO/CIT, Agra prior to filing of miscellaneous application by the assessee. Therefore, they should have disclosed the material fact before the Tribunal. It appears from the facts and circumstances that the order of High Court was available with the AO and ld. CIT, Agra prior to filing of miscellaneous application by the assessee on 24.01.2011. Therefore, it is also equally their duty to bring correct and material facts to the knowledge of the Tribunal in order to arrive at just decision in the matter. The action of the AO and the ld. CIT, Agra in not bringing relevant and material facts to the knowledge of the

Tribunal would amount to misleading the Bench and the matter therefore, requires action by CBDT. There is no dispute that the Tribunal has no power to review its earlier order, but the earlier Bench of Tribunal vide order dated 28.07.2011 has already reviewed the entire original order passed on 27.04.2007. Therefore, the Revenue was justified in taking steps in the matter. Principle of res judicata do not apply to the Income-tax proceedings and is also not relevant to the matter in controversy now. The ld. counsel for the assessee cited certain decisions with regard to formulation of substantial question of law etc. On going through the same decisions, copy of which are placed on record, we do not find them to be applicable to the facts and circumstances of the case because the core issue before the Tribunal is when the assessee played fraud with the Tribunal, what legal action requires to be taken in the matter. The decision of Hon'ble Supreme Court in the case of A.V. Papayya Sastry (supra) squarely applies to the facts and circumstance of the case in favour of the Revenue and against the assessee.

12.2 Considering the facts and circumstances of the case and discussion above in the light of the decision of Hon'ble Allahabad High Court dated 17.08.2010, and Hon'ble Supreme Court above, we recall the earlier order of the Tribunal dated 28.07.2011 which was obtained by fraud and restore the original order of the Tribunal dated 27.04.2007.

13. We may also note here that the conduct of the assessee and his counsel Shri K.G. Agarwal, C.A. in concealing the relevant and material fact from the Tribunal would amount to professional misconduct on the part of the Chartered Accountant. The Chartered Accountant has not only the duty to defend the case of litigant to the best of his ability, but equally has duty to maintain dignity and decorum of the courts. He has to assist the Bench as per law in arriving at the just decision in the matter. Shri K.G. Agarwal, C.A. consciously and deliberately in the garb of legal advice has concealed and suppressed the relevant and material facts from the Tribunal while filing miscellaneous application and arguing the same before the Tribunal. Therefore, his conduct is not above the board and requires action by the President, Institute of Chartered Accountant of India. We, therefore, recommend a disciplinary action against Shri K.G. Agarwal, Chartered Accountant. Copy of this order be forwarded to the President, Institute of Chartered Accountant of India, ICAI Bhawan, Indraprashtha Marg, New Delhi-110 002 for necessary action in this regard. Copy of this order be also forwarded to the Chairman CBDT, New Delhi to take necessary action in the matter. We also direct the ld. CIT-I, Agra to place copy of this order before the Criminal Court where the criminal prosecution of the assessee is pending on the matter in issue for appraisal of the concerned court and ensure implementation of this order.

14. We may also add here that both the ld. DR and the ld. counsel for the assessee now appeared before the Tribunal have assisted the Bench properly in arriving at the just decision in the matter. While defending

the case of assessee, the ld. counsel for the assessee has advanced arguments in support of the assessee, but at the same time, the ld. DR, while repudiating the contentions of opposite party, has made successful efforts to invite our attention to several judicial pronouncements and relevant facts for arriving at just decision in the matter in issue under consideration. Such an assistance by the ld. DR is worthy of appreciation. We appreciate their valuable suggestions and assistance in the matter, so that fraud with judicial authorities should not be repeated.

15. With the above observations, the miscellaneous application filed by the Revenue is allowed.

Order pronounced in the open court.

INCOME TAX APPELLATE TRIBUNAL
AGRA BENCH, AGRA

P.K. Bansal, Accountant Member and H.S. Sidhu, Judicial Member

Appeal allowed.

M.A. No. 02/Agra/2011 (in ITA No. 468/Agra/2004) Assessment Year : 2001-02.

Decided on: 28th July, 2011.

Present at hearing: K.G. Agarwal, C.A., for Appellant. Vinod Kumar, Jr. D.R., for Respondent.

JUDGMENT

Per P.K. Bansal:– (Accountant Member)

This miscellaneous application has been filed by the assessee u/s. 254(2) of the Incometax Act in ITA No. 468/Agra/2004 which was decided by the Tribunal vide order dated 27.04.2007.

2. The learned AR contended that the assessee has come in appeal against the order of CIT(A) sustaining the penalty imposed u/s. 271(1)(c) of the Act. The Assessing Officer imposed the penalty u/s. 271(1)(c) holding that the assessee has committed the default without reasonable cause in concealing the income and furnishing inaccurate particulars of his income. The CIT(A) confirmed the order of the Assessing Officer. The assessee went in appeal before the Tribunal. Before the Tribunal, the assessee has taken the plea that the penalty imposed is not legal, as the specific default/offence was not pointed out. The Assessing Officer took the view that the assessee has concealed the income and furnished inaccurate particulars of income. The Assessee contended before the Tribunal that specific charge for concealment of income or furnishing of inaccurate particulars of income must be spelt out by the Assessing Officer. The Tribunal did not consider this plea taken by the assessee.

Even the assessee has also submitted the decision of Agra Bench in the case of *Mahesh Chand Gupta vs. ITO* 4(2), Agra in ITA No. 118/Agra/2005, the copy of which is filed in the paper book also, which is available at pages 62 to 67. The assessee has also submitted the decision supporting his plea , mainly the decision of Gujarat High Court in the case of *CIT vs. Manu Engineering Works*, 122 ITR 306 (Guj) and that of Gauhati High Court in the case of *Padma Ram Bharali*, 110 ITR 54 (Gauhati). The decision of the Gujarat High Court in the case of *Manu Engineering Works*, 122 ITR 306 was duly approved by the Gujarat High Court in the subsequent judgement in the case of *New Sorathia Engineering Co. vs. CIT*, 282 ITR 642 (Guj). Even the decision of Gujarat High Court in the case of *CIT vs. Lakhdir Lalji*, 85 ITR 77 (Guj.) was also not considered in which it was held that if the proceedings are initiated on the charge of concealment, penalty cannot be levied on the charge of furnishing of inaccurate particulars of income and vise versa. The A.O. should have given specific finding about the charge of the penalty. The affidavit to that extent was also filed before us. Referring to the decision of the Hon'ble Supreme Court in the case of *CIT vs. Reliance Petroproducts Pvt. Ltd.*, 322 ITR 158 (SC), it was pointed out that both the offences i.e. concealment of particulars of income and furnishing of inaccurate particulars of income have different meanings. In both the offences one thing, i.e. particulars of income, is common. If the particulars are found to be inaccurate, the liability for the penalty arises. Similarly, if the assessee has concealed particulars, there may be liability towards the penalty. If the assessee had made explanation and if the explanation of the assessee is not accepted by the A.O., the explanation given by the assessee per se does not become to be a false explanation. Therefore, the A.O. should have given a clear cut finding whether the assessee has concealed the particulars of income or furnished inaccurate particulars of income. Explanation 1 to section 271(1)(c) is applicable in the case of concealment of particulars of the income not in the case of furnishing of the inaccurate particulars of income. The plea taken by the assessee was not at all considered by the Tribunal and non-consideration of such legal plea supported by the case law tantamounts to be a mistake apparent on record. In this regard, the ld. A.R. vehemently relied on the decision of *ACIT vs. Saurashtra Kutch Stock Exchange Limited*, 262 ITR 146 (Guj.) which was duly confirmed subsequently by the Hon'ble Supreme Court in the case of *ACIT vs. Saurashtra Kutch Stock Exchange Limited*, 305 ITR 227 (SC). Referring to page 155 of the judgement, it was pointed out that the Hon'ble High Court has held that the proposition that the contention has been raised by the party but not dealt with by the Tribunal should be held to have been negative is correct only upto a stage. Once a party brings to the notice of the Tribunal that an important point or contention raised by the party has not been dealt with it would be within the jurisdiction and power of Tribunal to decide whether the same constitute a mistake apparent from record and thereafter if necessary, reopen the

appeal. It was pointed out that such power is inherent in the Tribunal. Reliance was also placed on the decision of the jurisdictional High Court in the case of *ITO vs. ITAT*, 58 ITR 634 (Alld.) in which it was held that where, in a judgement or order of the Appellate Tribunal, an error has crept in, not as a result of any fault of the assessee, but attributable entirely to the Tribunal in having lost sight of a material fact at the time of writing its order or judgement, which fact was duly brought to its notice by the assessee, there would be an error apparent from the record which could be rectified under section 35 of the Indian Incometax Act. Reliance was also placed in this regard on the following judgments :-

Udhavdas Kewalram vs. CIT, 66 ITR 462 (SC)

K. Ashan Koya & Sons vs. CIT, 172 ITR 677 (Kerala)

CIT vs. ITAT, 172 ITR 158 (M.P.)

CIT vs. Ramesh Chand Modi, 249 ITR 323 (Raj.)

Dr. Harendra Kumar Gupta vs. ITO in ITA No. 125 to 128/Agra/2003.

3. It was also pointed out that in the case of *Hanuman Ram Audan Ram vs. CIT*, 110 ITR 712, it was held that the order of the Tribunal was vitiated on account of non-consideration of the evidence brought to the knowledge by the assessee.

4. Reliance was also placed on the decision of ITAT dated 30.09.2008 in the case of Shri Dinesh Kumar Jain in ITA No.314/Agr/2005 wherein at para-D of page 11 of the order the Hon'ble Tribunal has observed as under:–

> *"In fact the Hon'ble Supreme Court and various High Courts have been all along holding that it is a time of ITAT to consider all the evidences in favour of and against the assessee. In this regard reference can be made to the following judgment Shri Udhavdas Kewalram, 66 ITR 462 Supreme Court wherein it has held that it is obligatory for the ITAT to consider all relevant facts and give its findings on all pleas raised in the light of the evidences and application of law."*

5. Reliance was also placed on the decision of Jurisdictional High Court in the case of *Laxmi Electronic Corporation Ltd. vs. CIT*, 188 ITR 398 (All.). Thus, it was contended that the order of this Tribunal passed on 27.04.2007 is merged with mistake apparent on record and requires rectification as the legal contention of the assessee has not been considered. The case law relied on by the assessee were also not considered and even the judgment of this Tribunal, by which the case of the assessee was covered was not considered. The order, therefore, must be rectified.

6. Ld. D.R., on the other hand, has taken a plea that the Tribunal has considered all the submissions and the arguments taken by the

assessee. The normal principle of law is that once the Court or Tribunal pronounces a judgement/order, the Judgement/order is final and cannot be altered, changed, varied or modified. The ITAT is a Tribunal constituted under the Income-tax Act itself, it is not a Court having plenary powers, but a statutory Authority functioning under the Income-tax Act 1961. It, therefore, cannot go outside or de hors the Income-tax Act nor can exercise powers not expressly and specifically conferred by law. The power of review is not entrusted with the Tribunal. A right to seek review of an order is neither a natural nor a fundamental right of an aggrieved party. Law must confer such power. If there is no power entrusted with the Tribunal, the order cannot be reviewed by the Tribunal.

7. We have carefully considered the rivals submissions and perused the material on record along with the order of the Tribunal and noted that the assessee has challenged the imposition of the penalty before the Tribunal under section 271(1)(c). The Tribunal vide its order dated 27.04.07 has upheld the imposition of the penalty under section 271(1)(c) of the Act. Section 252 of the Act provides for constitution of the ITAT by the Central Government consisting of as many Judicial and Accountant Member as it thinks fit to exercise the power and discharge the functions conferred on such Tribunal under the Act. It also provides for qualification of Members. It enacts that the Central Government shall ordinarily appoint a judicial member of the Tribunal to be the President thereof. Section 253 enables an assessee aggrieved by any of the orders mentioned in the said section to appeal to the Tribunal. Section 254 deals with orders passed by the Tribunal and is relevant for the purpose of controversy raised in the M.A. before us. This section reads as under:–

> *"254. Orders of Appellate Tribunal. – (1) The Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit.*
>
> *(2) The Appellate Tribunal may, at any time, within four years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it under sub-section (1), and shall make such amendment if the mistake is brought to its notice by the assessee or the Assessing Officer:…..*
>
> *(4) Save as provided in section 256, orders passed by the Appellate Tribunal on appeal shall be final"*

8. Section 254(2) lays down that the Tribunal may, at any time within four years from the date of the order, with a view to rectifying any mistake apparent from the record suo motu can rectify such mistake. The tribunal can also rectify such mistake if it is brought to the notice of the Tribunal by the assessee or the A.O. Thus, there are two situations under

which an order under section 254(2) can be passed. The Tribunal can its own at any time within 4 years rectify any mistake apparent from record. In case such a mistake is brought to the notice of the Tribunal either by the assessee or by the A.O., the Tribunal is bound to rectify such mistake. Thus, the Tribunal has the power to rectify the mistake if there is a mistake apparent on record within the four corners of the said provision. The main question, therefore, is : what is a "mistake apparent from the record". Similar expression "error apparent on the face of the record" came up for consideration before the courts while exercising certiorari jurisdiction under articles 32 and 226 of the Constitution. In T.S. Balaram, ITO vs. Volkart Brothers, 2 SCC 526, it was held that "any mistake apparent from the record" is undoubtedly not more than that of the High Court to entertain a Writ Petition on the basis of an "error apparent on the face of the record". It was, however, conceded in all leading cases that it is very difficult to define an "error apparent on the face of the record" precisely, scientifically and with certainty. In the case of Hari Vishnu Kamath vs. Syed Ahmad Ishaque, 1 SCR 1104, the Constitution Bench of the Supreme Court quoted the observations of Chagla C.J. in *Batuk K. Vyas vs. Surat Borough Municipality*, ILR 1953 Bom 191; AIR 1953 Bom 133, that no error can be said to be apparent on the face of the record if it is not manifest or self-evident and requires an examination or argument to establish it. The Court in the said judgement admitted that though the said test might apply in a majority of cases satisfactorily, it proceeded to comment that there might be case in which it might not work in as much as an error of law might be considered by one judge as apparent, patent and selfevident, but night not be so considered by another judge. The Court, therefore, concluded that an error apparent on the face of the record cannot be defined exhaustively there being an element of indefiniteness inherent in its very nature and must be left to be determined judicially on the facts of each case. The Court stated:–

> *"It may therefore be taken as settled that a writ of 'certiorari' could be issued to correct an error of law. But it is essential that it should be something more than a mere error; it must be one which must be manifest on the face of the record. The real difficulty with reference to this matter, however, is not so much in the statement of the principle as in its application to the facts of a particular case. When does an error cease to be mere error, and become an error apparent on the face of the record ? Learned counsel on either side were unable to suggest any clear-cut rule by which the boundary between the two classes of errors could be demarcated."*

9. In *Satyanarayan Laxminarayan Hegde vs. Mallikarjun Bhavanappa Tirumale* [1960] 1 SCR 890, this court referring to Batuk K.

Vyas and Hari Vishnu Kamath stated as to what cannot be said to be an error apparent on the face of the record. The court observed:

> *"An error which has to be established by a long drawn process of reasoning on points where there may conceivably be two opinions can hardly be said to be an error apparent on the face of the record. As the above discussion of the rival contentions show the alleged error in the present case is far from self evident and if it can be established, it has to be established by lengthy and complicated arguments. We do not think such an error can be cured by writ of certiorari according to the rule governing the powers of the superior court to issue such a writ."*

10. Thus, for an action under section 254(2) there had to be a mistake apparent from record. A look at the record must show that there has been an error and that error may be rectified as held by the Hon'ble Supreme Court in the case of *CIT vs. Keshri Metal Pvt. Ltd.* 237 ITR 165 (SC) only an apparent error or fact of law can be rectified. Non-consideration of material fact which goes to the root of the ground itself is the mistake apparent on record. The decision of the Hon'ble Supreme Court relied by the ld. A.R. in the case of *Udhavdas Kewalram vs. CIT*, 66 ITR 462 held that the Tribunal must, in deciding an appeal, consider with due care all the material facts and record its findings and all the contentions raised by the assessee and Revenue in the light of evidence and relevant law. A decision has to be made only on the basis of the facts involved therein. If the facts on the basis of which a decision is rendered itself are found to be different, in our opinion there is bound to be a mistake apparent on record and the provisions of section 254(2) are clearly applicable. The 'record' in opinion means the entire record consists of not only grounds of the appeal and the case laws relied on and referred to before the Tribunal but also the contentions, pleas and the arguments raised by the parties before the Tribunal. The word "record" has not been defined under section 254(2) or under section 2 of the Income Tax Act so as to restrict its meaning only to the grounds of appeal decided in the order of the tribunal. The provisions of section 254(2) could not be constituted in a manner that produce an anomaly or otherwise produce irrational or illogical result. It is one of the basic principle and legal policy that when there is a power for rectification of a mistake apparent from record that power should be allowed to be exercised rectifying a mistake and/ or error from the record and if the Tribunal feels that the Tribunal has committed an error, it would be against the concept of justice and fair play and also against the principle of legal policy not to allow Tribunal to exercise such power. Similar view has been taken by the jurisdictional High Court in the case of *ITO vs. ITAT*, 58 ITR 634 (Alld.) on which ld. A.R. vehemently relied, wherein the High Court has held that if an error creeps in an order solely due to Tribunal's omission to consider material facts on record, it is an error apparent from the

record and can be rectified under section 35 of the Income-tax Act, 1922 (Similar to Section 254(2)). Similar view has been taken by the Hon'ble Madhya Pradesh High Court in the case of *CIT vs. ITAT*, 172 ITR 158 in which it was held that material for determining the amount of tax is pressed and not considered, would certainly constitute a mistake apparent from the record within the meaning of section 254 (2) of the Act and if the said mistake being pointed out by the assessee, the Tribunal, in the circumstances referred to above, has to amend its order. Hon'ble Gujarat High Court in the case of *ACIT vs. Saurashtra Kutch Stock Exchange Limited*, 262 ITR 146 at page 155 has held as under:–

> *"The proposition that a contention raised but not dealt with by the Tribunal should be held to have been negative is correct only up to a stage. Once a party brings to the notice of the Tribunal that an important point or contention raised by the party has not been dealt with it would be within the jurisdiction and powers of the Tribunal to decide whether the same constitutes a mistake apparent from the record and thereafter it necessary, reopen the appeal. Such a power is inherent in the Tribunal, as a party has suffered prejudice due to a lapse on the part of the Tribunal and not on account of any fault of such a party. An act of the Tribunal should not prejudice a party so as to force the party into unwarranted litigation."*

11. We also noted that the Hon'ble Supreme Court in the case of *Honda Siel Power Products Limited vs. CIT*, 295 ITR 466 has observed the scope of power of rectification that one of the reason for giving the power of rectification the Tribunal is to see that no prejudice is caused to either of the parties appearing before the Tribunal by a decision based on mistake apparent from record. When prejudice results from an order attributable to the tribunal's mistake, error or omission, then it is the duty of the tribunal to set it right. Atonement to the wronged party by the court or the Tribunal for the wrong committed by it has nothing to do with the concept of inherent power of review. The ld. D.R. before us, no doubt, vehemently contended that recalling of the order will tantamount to review of the order but did not contend that the assessee is not raised the contention before the Tribunal at the time of hearing regarding the specific charge being levied by the A.O. for the purpose of levy of penalty under section 271(1)(c). The affidavit filed by the assessee also confirms the same. We also noted that the assessee has filed the copy of the case of this Bench in the case of *Mahesh Chand Gupta vs. ITO 4(2), Agra* in ITA No. 118/Agra/2005 which is available at page 62 to 67 of the paper book. This judgment, in our opinion, relates to the same issue, but has not been considered by this Tribunal. We have gone through the decision of the Gujarat High Court in the case of *Manu Engineering Works* 122 ITR 306 (Guj), *New Sorathia Engineering Co. vs. CIT*, 282 ITR 642 (Guj.) and that of Gauhati High Court in the case of *Padma Ram Bharali*, 110 ITR 54

(Gauhati) and in these decisions, it was held that it is incumbent upon the A.O. to state whether penalty was being levied for concealment of income or furnishing of inaccurate particulars of income. Even otherwise also, concealment of income is a different charge if compared with furnishing of inaccurate particular of income. Explanation 1 to section 271(1)(c) which creates a legal fiction raises presumption against the assessee relate to the concealment of the particulars of the income is not applicable in respect of furnishing of the inaccurate particulars of income. Hon'ble Supreme Court has also noted this fact in the decision of *Reliance Petroproduct*, 322 ITR 158 (SC) in which it was held mere making of the claim (which is not sustainable in law) will not amount to inaccurate claim or furnishing of inaccurate particulars regarding the income of the assessee. Explanation 1 to section 271(1)(c) cannot be applied where charge against the assessee for furnishing of inaccurate particulars of income since it provides a deeming fiction qua concealment of particulars of income only and consequently cannot be extended to a case where charge against the assessee is of furnishing inaccurate particulars of income. Where charge against the assessee is concealment of particulars of income, the A.O. has to establish that the assessee has not disclosed the particulars of income under the main provision for the case of the assessee falls within the deeming fiction created under explanation to section 271(1)(c). We have also gone through the decision of Allahabad High Court (Jurisdictional High Court) in the case of *Laxmi Electronic Corporation vs. CIT* (supra), on which the ld. AR vehemently relied. In this case, the Hon'ble Court has held as under :

> *"The Appellate Tribunal has no power to review. Its only power to is one of rectification conferred by sub-section (2) of section 254 of the Income-tax Act, 1961.*
>
> *It is a well-settled proposition that an act of court (which means and includes a tribunal of the nature of the Income-tax Appellate Tribunal) should not prejudice a party. In such a case, it would not be just to drive the party to a reference under section 256 of the Act. It must be left to the Tribunal to reopen an appeal if it finds that it has omitted to deal with an important ground urged by the party.*
>
> *Where the Tribunal fails or omits to deal with an important contention affecting the maintainability / merits of an appeal, it must be deemed to be a mistake apparent from the record which empowers the Tribunal to reopen the appeal and rectify the same if it is so satisfied.*
>
> *The expression "record" in the phrase "mistake apparent from the record" in section 254(2) does not mean only the judgment. The record means the record before the Tribunal.*

The Commissioner revised, under section 263, the orders of assessment relating to the assessment year 1981-82. On appeal to the Tribunal by the assessee, the Revenue raised a preliminary objection that the appeals were barred by time. The assessee contended that the orders of the Commissioner under section 263 were barred by time. The Tribunal disposed of the appeals. Both the Revenue and the assessee filed applications for reopening the appeals and for their rehearing. The Revenue contended that it had raised a preliminary objection as to the maintainable of the appeal on the ground of limitation, which the Tribunal had failed to deal with in its judgment. The assessee contended that it has raised several contentions, but the Tribunal dealt with only one of the contentions, namely, whether the Commissioner's orders were barred by time, and did not deal with the other contentions. The Tribunal found that the Revenue had raised a preliminary objection which was not noticed in its judgment and, therefore, reopened the appeals heard the parties and dismissed the appeals as barred by time. In that view of the matter, the Tribunal did not go into the merits of the contentions urged by the assessee. On a reference under section 256(2):

Held, *(i) that the proposition that a contention urged but not dealt with by the Tribunal can be taken as having been nagatived, is not inconsistent with the power of the Tribunal to reopen the appeal where it is brought to its notice that an important contention raised by the party was not dealt with by the Tribunal in its order. Such a power must be held to be inherent in the Tribunal, since it would be a case where the party has suffered prejudice for no fault of his and on account of a mistake or error on the part of the Tribunal.*

(ii) That the failure to deal with the preliminary objection relating to the maintainable of the appeal on the ground of limitation amounted to an error apparent on the face of the record which empowered the Tribunal to reopen the appeal and rectify the mistake if it was so satisfied."

12. We, there fore, in view of aforesaid binding precedents, are of the view that a mistake has crept into the order of this tribunal dt. 27.04.07 and accordingly we, rectify the order dated 27.04.2007 in the following manner by allowing the Misc. application filed by the assessee as under:–

13. In Para 8 of the order dated 27.04.2007, after the sentence "He also placed reliance on several other decisions of ITAT in support of his contention that penalty was not exigible in the cases where assessee surrendered the amount to buy peace" following paragraph be substituted:–

"The ld. A.R. before us further contended that the A.O. was not correct in imposing the penalty under section 271(1)(c). He referred to the notice issued under section 271(1)(c) of the Act and pointed out that the A.O. has not made out the specific charge for which the penalty has been levied. He has also drawn our attention towards the penalty order passed under section 271(1)(c) of the Act. Reliance was placed in this regard by him on the following decisions:–

1) *CIT vs. Manu Engineering Works*, 122 ITR 306 (Guj)
2) *New Sorathia Engineering Co. vs. CIT*, 282 ITR 642 (Guj)
3) *Mukesh Chandra A. Lakdawala vs. ITO* (2010) 4 ITR (Trib) 307 (Ahmedabad)
4) *Navinbhai M. Patel vs. ITO*, 31 TTJ (Ahd) 40
5) Decision of ITAT Agra Bench in the case of *Satnam Kalra vs. ACIT* in ITA No.53/Agrf/2006
6) Decision of ITAT Agra Bench (SMC) in the case of *Mahesh Chand Gupta vs. ITO* 4(2) in ITA No.118/Agrf/2006."

14. In para 15, after the sentence "In these cases, application of Explanation 1 has been approved by the Hon'ble Apex Court", following lines be deleted:

> "The facts of the case before us are, thus, squarely covered by the Explanation 1 of the Act. Accordingly, we are of the considered view that penalty u/s. 271(1)(c) is exigible. Accordingly, we do not find any infirmity in confirming of the penalty imposed by Assessing Officer."

15. In place of para 16, following paragraphs be substituted:

"16. Now coming to the contention of the assessee that the Assessing Officer must levy the specific charge on the assessee – whether the assessee has concealed the particulars of income or furnished inaccurate particulars of such income, we would like to refer to the provisions of section 271(1)(c) which lays down as under:

> *"271. (1) If the Assessing Officer or the Commissioner (Appeals) [or the Commissioner] in the course of any proceedings under this Act, is satisfied that any person–*
>
> *(a) …..*
>
> *(b) …..*
>
> *(c) has concealed the particulars of his income or furnished inaccurate particulars of such income, or*
>
> *(d) …..*
>
> *he may direct that such person shall pay by way of penalty,–*
>
> *Explanation 1- Where in respect of any facts material to the computation of the total income of any person under this Act,–*

(A) such person fails to offer an explanation or offers an explanation which is found by the Assessing Officer or the Commissioner (Appeals) or the Commissioner to be false or

(B) such person offers an explanation which he is not able to substantiate and [fails to prove that such explanation is bona fide and that all the facts relating to the same and material to the computation of his total income have been disclosed by him],

then, the amount added or disallowed in computing the total income of such person as a result thereof shall, for the purposes of clause (c) of this sub-section be deemed to represent the income in respect of which particulars have been concealed."

17. From the perusal of section 271(1)(c), it is necessary that the satisfaction should have been arrived at by the A.O. or the Commissioner (Appeals) or the Commissioner during the course of proceedings under the Income-tax Act that the assessee has concealed the particulars of his income or furnished inaccurate particular of such income. The penalty under this section can be levied on two charges i.e. for concealment of particulars of income or for furnishing of inaccurate particulars of income. If the penalty proceedings are initiated on the charge of concealment of particulars of income then penalty cannot be levied for charge of furnishing of inaccurate particulars of income and vise versa. This was so held by the Hon'ble Gujarat High Court in the case of *CIT vs. Lakhdir Lalji*, 85 ITR 77 (Guj.). In view of provisions of section 271(1)(c), we are of the view that there must be clear finding about the charge of the penalty. It is incumbent on the A.O. or the Officer imposing the penalty to state whether the penalty was being levied for concealment of particulars of income or for furnishing of inaccurate particulars of income. In the absence of such a finding, an order passed by the concerned authority imposing penalty under section 271(1)(c) will be void. This view has been taken in the following case by the High Courts:–

i) *CIT vs. Manu Engineering Works*, 122 ITR 306 (Guj)

ii) *New Sorathia Engineering Co. vs. CIT*, 282 ITR 642 (Guj)

iii) *Padma Ram Bharali vs. CIT*, 110 ITR 54 (Gauhati)

18. In this case, we noted from the penalty order placed before us that the A.O. has not brought out any specific charge for which the penalty has been imposed on the assessee under section 271(1)(c). He has simply mentioned that the assessee has committed default without any reasonable cause in concealing the income and furnishing inaccurate particulars of such income. This fact is apparent from the finding of the A.O. given at page 2 paragraph 3 of the order reproduced hereinabove. The word "conceal" as per Webster Dictionary means to hide, with draw or remove from observation, cover or keep away from sight, to keep secret, to avoid disclosing or divulging. That means non-disclosure of particulars of income, on the other hand, where the particulars are disclosed but such disclosure

is not correct and true or accurate, it would amount to furnishing of inaccurate particulars of income. For example, in a case of a businessman even the particular transaction of sale is not shown in the books it would amount to concealment of particulars of income while the sale is shown but added a lesser value, it would amount to furnishing of inaccurate particulars of income. It is pertinent to note that thrust of levy is upon the particulars of income which are either concealed or furnished inaccurately by the assessee. The expression particulars refer to the facts, details, specific or the information about someone or something. Thus, the details or information about the income would deal with factual details of the income and cannot be understood to areas which are subjective such as status of taxability of an income, admissibility of deduction and interpretation of law. The Hon'ble Supreme Court in the decision of *CIT vs. Reliance Petroproducts Pvt. Ltd.*, 322 ITR 158 (SC) has laid down that as per law lexicon the meaning of the word "particulars" is detail or details (in plural sense), the details of a claim or supporting items of an account. Thus, it was held that the meaning of the word "particulars" used in section 271(1)(c) would embrace the details of the claim made.

19. We may point out at this stage that the exaplanation-1 to section 271(1)(c) is applicable only for concealment of particulars of income. It cannot be applied where charge against the assessee is for furnishing of inaccurate particulars of income. Where the charge against the assessee is concealment of particulars of income, the onus is on the A.O. to establish either that the assessee has not disclosed the particulars of income under the main provisions or the case of the assessee falls within the Explanation given under section 271(1)(c). Explanation 1 to Section 271(1)(c) states that the amount added or disallowed in computing the total income of the assessee shall be deemed to be the income in respect of which particulars have been concealed. This deeming provision is not absolute one but is rebut table one. It only shifts the onus on the assessee. Explanation 1 refers to the two situations in which presumption of the concealment of the particulars of income is deemed. The first situation is where the assessee in respect of any fact material to the computation of his total income fails to offer an explanation or offers an explanation, which is found by the A.O. or the Commissioner to be false. The second situation is where the assessee in respect of any facts material to the computation of his total income offers an explanation, which the assessee is not able to substantiate and also fails to prove that such explanation was bonafide one and that all the facts relating to the computation of total income have been disclosed by him. The presumption available under explanation to section 271(1)(c), cannot be drawn unless the case of the assessee falls under either of the clauses (a) or (b). This explanation, therefore, does not and cannot apply to the case where addition/disallowance has been made by rejection of legal claim made by the A.O. Bonafide of legal claim is not the subject matter of the Exaplanation-1. Therefore, Hon'ble Supreme Court in the case of Reliance Petroproducts (supra) has held that mere rejection of legal claim would not

invite penalty. This would also apply where the charge against the assessee is concealment of particulars of income. If we look at the provisions of section 271(1)(c) and Explanation-1 from a different angle, the A.O. is bound to bring on record specific charge against the assessee whether the assessee has concealed the particulars of income or furnished inaccurate particulars of income. In the case of concealment of particulars of income, initial onus will get shifted on the assessee to prove that he has not concealed the particulars of income due to the applicability of explanation I. While, in the case of furnishing of inaccurate particulars of income, the onus remains on the Revenue to prove that the assessee has furnished inaccurate particulars of income. If the A.O. failed to bring out or levy specific charge on the assessee, the penalty imposed cannot be sustained. Our aforesaid view is duly supported by the decision of the Hon'ble Gujarat High Court in the case of *New Sorathia Engineering Co. Ltd.*, 282 ITR 642 in which it was held as under:–

> *"It is incumbent upon the assessing officer to state whether the penalty was being levied for concealment of particulars of income by the assessee or whether any inaccurate particulars of income had been furnished by the assessee.*
>
> --
>
> --
>
> *Held, that the penalty order and the order of the Commissioner (Appeals) showed that no clear cut finding had been reached. The tribunal had failed to appreciate this legal. Issue. The ratio in CIT V. Manu Engineering Works 122 ITR 306(Guj) was applicable and the order of penalty could not be upheld by the tribunal. The order was invalid."*

Similar view has been taken by the Tribunal in the following cases:–

i) *ITO vs. Smt. Lalita* in ITA No.433/Agr/2009 for A.Y. 1998-99

ii) *Km. Ruchi Rathore vs. ITO* in ITA No.97/Agr/2007 for A.Y. 1998-99

iii) *Smt. Raj Rani Mittal vs. ITO* in ITA No.2275/Del/2009 of ITAT Delhi Bench 'A'

iv) *ACIT vs. Dr. S.D. Maurya* in ITA No.619/Agr/2008 for A.Y. 2003-04

v) *Mukesh Chandra A. Lakdawala vs. ITO* (2010) 4 ITR (Trib) 307 (Ahmedabad)

vi) *Navinbhai M. Patel vs. ITO*, 31 TTJ (Ahd) 40

vii) Decision of ITAT, Agra Bench in the case of *Satnam Kalra vs. ACIT* in ITA No.53/Agrf/2006

viii) Decision of ITAT, Agra Bench (SMC) in the case of *Mahesh Chand Gupta vs. ITO* 4(2) in ITA No.118/Agrf/2006

ix) Decision of ITAT, Agra Bench in the case of *M/s. Bajwa Rubber Industries vs. DCIT* in ITA Nos.01/Agr/2010 & 478/Agr/2009.

x) Decision of Itat , Agra Bench in the case of ITO 4 (2) , *Agra vs. Dr. Harendra Kumar Gupta* in ITA Nos. 125 to 128 /Agr/2003.

20. On the basis of the aforesaid cases, we are of the view that the penalty is liable to be annulled. We accordingly cancel the penalty imposed under section 271(1)(c).

21. In the result the appeal of the assessee is allowed"

22. In the result, the Miscellaneous application filed by assessee is allowed by rectifying the order dt. 27.4.2007 in the aforesaid manner.

Order pronounced in the open court on 28.07.11.

2013 TRI 1485 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
LUCKNOW "A" BENCH, LUCKNOW

Sunil K Yadav, Judicial Member and Pramod Kumar, Accountant Member

FACTS/HELD

Section 80-IB: Though Duty Drawback & DEPB were held not eligible for deduction in Liberty India 317 ITR 218 (SC), answer could be different if business model shows dependence on Duty Drawback & DEPB for survival

1. The assessee claimed that the "duty drawback" receipt of Rs. 1.53 crores was eligible for deduction u/s 80-IB on the ground that the said duty drawback refund was a refund of customs and central excise duty on inputs used in manufacturing of its products. The AO & CIT(A) rejected the claim by relying on Liberty India 317 ITR 218 (SC) where it was held that duty drawback was not "derived" from the industrial undertaking. On appeal by the assessee to the Tribunal HELD:

    Though in Liberty India it was held that duty drawback and DEPB arises from an independent source and is not "derived" from the industrial undertaking, in Dharam Pal Premchand 317 ITR 353 (Del) (SLP dismissed) it was held that refund of excise duty had a

direct nexus with the manufacturing activity & was eligible for s. 80-IB deduction. Accordingly, though duty drawback & DEPB was held in Liberty India to be an independent source of income and to not have a "first degree" nexus with the undertaking, this was in the context of a fact-situation where the duty drawback & DEPB did not arise from core activities of the undertaking and was an additional, ancillary or supplemental profit. There can be situations in which duty drawback itself could be more than the overall profits and in such situations, the duty drawback may not be seen on standalone basis or as an independent source of income because the overall profit is only a part of the duty drawback receipt, and the commercial motivation of running the industrial undertaking is earning only that part of duty drawback receipts. On the present facts, the duty drawback was more than the entire operational profit and so it cannot be an open and shut inference that the duty drawback receipts are an independent source of income and have no first degree nexus with the business activity of the industrial undertaking. There is still room for consideration of the plea that but for the duty drawback the assessee would not have carried out the business activity in the industrial undertaking, because, that would have meant carrying out business for incurring losses. If that be so, the duty drawback receipts can be said to derived from the undertaking and to be eligible for s. 80-IB deduction. The question whether the duty drawback is an incidental profit or a profit of the first degree depends on the business model followed by the assessee.

Appeals allowed.

ITA No. 363/Luck /2010, 435 to 437/Luck/2011 Assessment Year: 2006-07, 05-06, 04-05 and 03-04.

Heard on: 6th June, 2013.

Decided on: 27th August, 2013.

Present at hearing: Abhinav Mehrotra, for Appellant. Ranu Biswas, for Respondent.

JUDGMENT

Per Pramod Kumar:– (Accountant Member)

1. These four appeals pertain to the same assessee, involve a common issue arising out of same set of facts, and were heard together. As a matter of convenience, therefore, we will dispose of all the four appeals together by way of this consolidated order.

2. However, for the sake of convenience, we will take up the facts of ITA No. 363/Luck/2010 which pertains to the assessment year 2006-07.

3. In this appeal, the assessee appellant has challenged correctness of learned Commissioner (Appeals)'s order dated 4th March 2010, in the matter of assessment under section 143(3) of the Income Tax Act, 1961, for the assessment year 2006-07.

4. The assessee has raised as many as seven grounds of appeal. However, as learned representatives fairly agree, the two issues really requiring our adjudication is whether or not the learned Commissioner (Appeals) was justified in declining deduction under section 80 IB of the Act in respect of duty drawback received aggregating of Rs 1,53,94,403, and whether or not the learned Commissioner (Appeals) was justified in upholding the disallowance of the expenses to the tune of Rs 36,000 under section 14A of the Act. In view of the smallness of the amount, learned counsel did not really press the second issue beyond stating the facts and leaving the issue to us.

5. So far as the first issue is concerned, the relevant material facts are like this. The assessee before us is engaged in the business of manufacturing and export of footwear. On 21st January 2006, the assessee filed a return ofincome disclosing an income of Rs 1,21,94,653. This return was subjected to scrutiny assessment proceedings, during which it was, inter alia, noticed thatthe assessee had claimed deduction under section 80 IB in respect of entire business profits, including duty drawback receipts amounting to Rs 1,53,94,403. It was in this backdrop that the assessee was required to show cause as to why the duty drawback receipt not be excluded from the computation of deduction under section 80 IB, as it was, in the opinion of the Assessing Officer, not in the nature of business income derived from industrial undertaking. In response to this requisition, it was mainly contended by the assessee that the duty drawback refund is nothing but a refund of customs and central excise duty on the inputs used in manufacturing of its products. Elaborate submissions, on this aspect of the matter, were made by the assessee. Reliance was also placed judicial precedents in the cases of *CIT vs Madras Motors Ltd* (257 ITR 60), *CIT vs Indian Gellative and Commercials Ltd* (272 ITR 284) and *CIT vs Elteck SGS Pvt Ltd* (300 ITR 6). None of these submissions, however, impressed the Assessing Officer. He was of the view that deduction under section 80 IB could be allowed only in respect of the profits from activities which are derived from

industrial undertaking. It was also observed that "the deduction under section 80 IB could not be allowed on the amount of duty drawback in view of the fact that the duty drawback was received on account of export promotion scheme of the Government of India, and not due to any manufacturing or industrial activity of industrial unit established in a prescribed area". The Assessing Officer also referred to, and relied upon, Hon'ble Delhi High Court's judgment in the case of *CIT Vs Ritesh Industries* (274 ITR 324) in support of the proposition that duty drawback is not a profit derived from industrial activity, and, therefore, cannot be treated as eligible profit for allowing deduction under section 80 IB. It was in this backdrop that the Assessing Officer declined deduction in respect of the duty drawback received by the assessee. As a result of the stand so taken by the Assessing Officer, the deduction of Rs 50,74,656 claimed by the assessee under section 80 IB, the deduction was actually allowed at Rs 4,56,335. Aggrieved, assessee carried the matter in appeal before the CIT(A) but without any success. Learned CIT(A) confirmed the action of the Assessing Officer by a one sentence order which said "This issue is squarely covered against the assessee by the decision of Hon'ble Supreme Court's order in the case of *Liberty India vs CIT* 317 ITR 218 (and) thus the addition/disallowance made by the AO is confirmed". The assessee is not satisfied, and is in further appeal before us.

6. Learned counsel for the assessee has laid a lot of emphasis on the nature of duty drawback and contended that the duty drawback receipts actually end up subsidizing the cost of production inasmuch as these receipts represent refund of excise duty and custom duty on the inputs used in products exported. It is contended that the duty drawback receipts, being integral part of the realizations on exports, are inherent part of the overall profits and, therefore, these receipts cannot be considered on standalone basis. It is submitted that on the facts of this case, particularly as duty drawback receipts are as much as almost 7.5% of turnover, and as, but for this duty drawback receipt, there will be virtually no profits or commercial sense of running the industrial undertaking, it cannot be said that duty drawback receipts are incidental receipts or ancillary profits not derived from industrial undertaking. It is then submitted that since duty drawback receipts are de facto refund of excise duty and custom duty paid, and following the principle laid down by Hon'ble Delhi High Court in the case of *CIT vs Dharmpal Premchand Ltd* (317 ITR 353), such a refund of duties is eligible for deduction under section 80 IB. Learned counsel submits Hon'ble Supreme Court has dismissed an SLP against this judgment of Hon'ble Delhi High Court, and, as such, Liberty India decision is to be read in harmony with the Dharmpal Premchand decision. Our attention is also invited to the order dated 29th April 2011 passed by a coordinate bench in the case of *J.K. Aluminum Co. vs ITO*, wherein, on the same lines, refund of excise duty is held to be eligible for deduction under section 80 IB. Learned counsel distinguishes Liberty India decision (supra) on the ground that at present

we are dealing with a refund of duties, and, in support of this contention, he invites our attention to copies of several purchase invoice, which were placed before us in the paperbook, disclosing separate charges for excise duty paid on purchases. It is his contention that the duty drawback receipt is nothing but refund of these, and other, duty payments. Learned counsel submits that the present case is distinct to the extent separate payments of excise duty has been demonstrated by the assessee. Without prejudice, he contends that, in any event, duty drawback receipts are includible in the computation of deduction under section 80 IB at least to the extent of these refunds. Learned counsel contends that in today's highly competitive international market, duty drawback is integral part of the export pricing of products and it cannot be seen as standalone incentive for exports. He submits that in any many cases overall profits of an exporter is even less than duty drawback receipt, and it cannot, therefore, be said that the duty drawback receipts are excluded in computation of export prices. Once it is an accepted position that duty drawback receipts are taken into account in computation of export prices, as is his claim, the duty drawback receipts cannot but be viewed as related to profits derived by the undertaking as first degree source. On the strength of these submissions, it is contended that deduction under section 80 IB must take into account the duty drawback receipts as well. Learned Departmental Representative, on the other hand, submits that this issue is no longer res integra, as Hon'ble Supreme Court, in Liberty India's case (supra), have categorically held that duty drawback cannot be taken into account in computation of deduction admissible under section 80 IB. Our attention is also invited to Hon'ble Gauhati High Court's judgment in the case of *CIT vs Meghalaya Steels Ltd* (332 ITR 91) wherein it rise held that even transport subsidy and interest subsidy cannot be said to be 'derived from industrial undertaking', and, accordingly, these receipts are not eligible for deduction under section 80 IB. She submits that learned counsel's erudite arguments, even if these are taken as correct on the first principles, are of no avail at this stage. She further submits that it is not a case of refund of duties but rather a case of payment of export incentive, by whatever name called, for encouraging the exports and thus contributing to augmentation of foreign exchange reserves. An export incentive, according to the learned Departmental Representative, cannot be said to related, with first degree nexus, to the 'profits derived by the undertaking'. We are thus urged to confirm the action of the authorities below and decline to interfere in the matter.

7. Learned counsel indeed has an uphill task. No matter how convincing his argument seem to be on the first principles, and no matter how strong a conceptual support he can canvass for his claim, he has judicial precedents, including from the highest judicial forum in this country, which may dissuade many, and must have dissuaded many, from even attempting to argue in support of this ambitious claim. Let us,

therefore, begun by examining these judicial precedents and appreciate what has been said, and much more important than that in what context it has been so said, in these judicial precedents.

8. In the case of *CIT vs Sterling Foods* (237 ITR 579), Hon'ble Supreme Court was in seisin of a situation in which the assessee, engaged in the business of processing and exporting prawns and other sea food, "earned some import entitlements granted by the Central Government under an export promotion scheme". The assessee was entitled to use the import entitlements itself or sell the same to others. It sold the import entitlements that it had earned to others. Its total income for the relevant assessment years included the sale proceeds of such import entitlements, and it claimed relief under section 80 HH in respect of the import entitlements on such import entitlements. It was in this backdrop that the question which fell for adjudication before Their Lordships was whether the income derived by the assessee on sale of these import entitlements was "profit and gain derived from its industrial undertaking of processing sea food". Their Lordships held that the sale proceeds on import entitlement could not be said to be derived from the industrial undertaking, and, while holding so, observed as follows:

> We do not think that the source of the import entitlements can be said to be the industrial undertaking of the assessee. The source of the import entitlements can, in the circumstances, only be said to be the Export Promotion Scheme of the Central Government whereunder the export entitlements become available, **There must be, for the application of the words "derived from", a direct nexus between the profits and gains and the industrial undertaking. In the instant case, the nexus is not direct but only incidental**. The industrial undertaking exports processed sea food. By reason of such export, the Export Promotion Scheme applies. Thereunder, the assessee is entitled to import entitlements, which it can sell. The sale consideration therefrom cannot, in our view, be held to constitute a profit and gain derived from the assessee's industrial undertaking.

9. In the case of *Liberty India vs CIT* (293 ITR 520), the question which came up for adjudication before Hon'ble Punjab & (aryana High Court was whether or not deduction under section 80 IB was righty declined, in respect of DEPB and duty drawback, by the Tribunal. Their Lordships held that deduction under section 80 IB was not admissible in respect of the DEPB and duty drawback as following the reasoning adopted by Hon'ble Supreme Court in Sterling Food's case (supra), which has been reproduced above, "**income of the assessee from duty drawback cannot be held to be 'income derived from' specified business**". The efforts of the assessee to distinguish the two situations, i.e. in the case of Sterling Foods and in the case of Liberty India, did not

yield any results, as Their Lordships further observed that, "**Distinction sought to be made by learned counsel for the assessee, in income derived from duty drawback and sale of import entitlements, cannot be accepted as relevant distinction as core question before the Court was that such income was derived from specified business, which reasoning is fully applicable to the present situation**". On the matter being carried in further appeal, Hon'ble Supreme Court, speaking through Hon'ble Justice S H Kapadia for the division bench (in the case of **Liberty India vs CIT** 317 ITR 218) also confirmed this stand and observed as follows:

> …….The words "derived from" is narrower in connotation as compared to the words "attributable to". **In other words, by using the expression "derived from", Parliament intended to cover sources not beyond the first degree. In the present batch of cases, the controversy which arises for determination is: whether the DEPB credit/Duty drawback receipt comes within the first degree sources?** According to the assessee(s), DEPB credit/duty drawback receipt reduces the value of purchases (cost neutralization), hence, it comes within first degree source as it increases the net profit proportionately. On the other hand, according to the Department, DEPB credit/duty drawback receipt do not come within first degree source as the said incentives flow from Incentive Schemes enacted by the Government of India or from Section 75 of the Customs Act, 1962. Hence, according to the Department, in the present cases, the first degree source is the incentive scheme/provisions of the Customs Act. In this connection, Department places heavy reliance on the judgment of this Court in Sterling Food (supra). Therefore, in the present cases, in which we are required to examine the eligible business of an industrial undertaking, we need to trace the source of the profits to manufacture. (see *CIT v. Kirloskar Oil Engines Ltd.* reported in [1986] 157 ITR 762)
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> 15. Continuing our analysis of Sections 80-IA/80-IB it may be mentioned that sub-section (13) of Section 80-IB provides for applicability of the provisions of sub-section (5) and sub-sections (7) to (12) of Section 80-IA, so far as may be, applicable to the eligible business under Section 80-IB. Therefore, at the outset, we stated that one needs to read Sections 80I, 80-IA and 80-IB as having a common Scheme. On perusal of sub-section(5) of Section 80-IA, it is noticed that it provides for manner of computation of profits of an eligible business. Accordingly, such profits are to be computed as if such eligible business is the only source of income of the assessee. Therefore, the devices adopted to reduce or inflate the profits of eligible business has got to be

rejected in view of the overriding provisions of sub- section (5) of Section 80-IA, which are also required to be read into Section 80-IB. [see Section 80-IB(13)]. We may reiterate that Sections 80I, 80-IA and 80-IB have a common scheme and if so read it is clear that the said sections provide for incentives in the form of deduction(s) which are linked to profits and not to investment. On analysis of Sections 80-IA and 80-IB it becomes clear that any industrial undertaking, which becomes eligible on satisfying sub-section(2), would be entitled to deduction under sub-section (1) only to the extent of profits derived from such industrial undertaking after specified date(s). Hence, apart from eligibility, sub-section(1) purports to restrict the quantum of deduction to a specified percentage of profits. This is the importance of the words "derived from industrial undertaking" as against "profits attributable to industrial undertaking".

16. DEPB is an incentive. It is given under Duty Exemption Remission Scheme. Essentially, it is an export incentive. No doubt, the object behind DEPB is to neutralize the incidence of customs duty payment on the import content of export product. This neutralization is provided for by credit to customs duty against export product. Under DEPB, an exporter may apply for credit as percentage of FOB value of exports made in freely convertible currency. Credit is available only against the export product and at rates specified by DGFT for import of raw materials, components etc.. DEPB credit under the Scheme has to be calculated by taking into account the deemed import content of the export product as per basic customs duty and special additional duty payable on such deemed imports. Therefore, **in our view, DEPB/Duty Drawback are incentives which flow from the Schemes framed by Central Government or from Section 75 of the Customs Act, 1962, hence, incentives profits are not profits derived from the eligible business under Section 80-IB. They belong to the category of ancillary profits of such Undertakings.**

17. The next question is - what is duty drawback? Section 75 of the Customs Act, 1962 and Section 37 of the Central Excise Act, 1944 empower Government of India to provide for repayment of customs and excise duty paid by an assessee. The refund is of the average amount of duty paid on materials of any particular class or description of goods used in the manufacture of export goods of specified class. The Rules do not envisage a refund of an amount arithmetically equal to customs duty or central excise duty actually paid by an individual importer-cum-manufacturer. Sub-section (2) of Section 75 of the Customs Act

> requires the amount of drawback to be determined on a consideration of all the circumstances prevalent in a particular trade and also based on the facts situation relevant in respect of each of various classes of goods imported. Basically, the source of duty drawback receipt lies in Section 75 of the Customs Act and Section 37 of the Central Excise Act.
>
> 18. Analysing the concept of remission of duty drawback and DEPB, we are satisfied that the remission of duty is on account of the statutory/policy provisions in the Customs Act/Scheme(s) framed by the Government of India. In the circumstances, we hold that profits derived by way of such incentives do not fall within the expression "profits derived from industrial undertaking" in Section 80-IB.

10. In the illustration given by Their Lordships in this judgment, it was noted that in a situation in which overall profit of the assessee was Rs 200 and duty drawback receipt of the assessee was Rs 100, the revenue was justified in granting deduction under section 80 IB only in respect of Rs 100 and that "we are of the view that duty drawback, DEPB benefits, rebates etc. cannot be credited against the cost of manufacture of goods debited in the Profit & Loss account for purposes of Sections 80-IA/80-IB as **such remissions (credits) would constitute independent source of income beyond the first degree nexus between profits and the industrial undertaking.**" As we take note of these observations, and in order to ensure that things are put in the right perspective, we must also take note of another judicial precedent which has the approval of the Hon'ble Supreme Court. In the case of Dharam Pal Premchand Ltd (supra), Hon'ble Delhi High Court had an occasion to deal with the impact of Sterling Food decision by Hon'ble Supreme Court and to deal with the question as to whether deduction under section 80 IB was available with respect to refund of excise duty. Their Lordships decided the issue in favour of the assessee, and, in coming to this conclusion, held as follows:

> In the case of CIT vs. Sterling Foods (supra), the Supreme Court was interpreting the provisions of s. 80HH of the Act. The Supreme Court was called upon to adjudicate income derived from the sale of import entitlements granted by the Central Government under the Export Promotion Scheme which the assessee could use itself or sell the same to others. The issue before the Supreme Court was whether the income from such import entitlements could be included in the total income for the purposes of claiming relief under s. 80HH of the Act. The Supreme Court came to the conclusion in the said case that the source of import entitlements was not the industrial undertaking of the assessee. According to the Supreme Court, the source of import entitlement in the circumstances was

> Export Promotion Scheme of the Central Government whereunder the export entitlements became available. **The Supreme Court further went on to hold that the expression 'derived from' entailed a direct nexus between profit and gains and the industrial undertaking. In that case, the Supreme Court found that the nexus was not direct but only incidental. According to us, the ratio of this judgment has no application to the case in the instant case. In the instant case both the CIT(A), as well as, the Tribunal found that the refund of excise duty had a direct nexus with the manufacturing activity carried out by the assessee**.
>
> (Emphasis by underlining supplied by us)

Vide judgment dated 22.2.2010, the SLP against the above judgment was dismissed by Hon'ble Supreme Court another's division bench, headed by Hon'ble Justice S (Kapadia- who was incidentally also author of Liberty India decision by the same court and which constitutes bedrock of revenue's case.

11. A plain look at the above analysis of judicial precedents would show that what is really material is whether or not the duty drawback receipts are directly linked, which is sometimes also referred to as first degree nexus, with the profits of the industrial undertaking, or whether such receipts are only "**ancillary profits of industrial undertakings**" and are "**independent sources of income**". The question that Hon'ble Supreme Court had posed for adjudication by itself, in the case of Liberty India, was "**whether the DEPB credit/ Duty drawback receipt comes within the first degree sources** (*of such industrial undertaking*) ? In answering this question, Their Lordships did examine whether these receipts constitute "**ancillary profits of industrial undertakings**" and are "**independent sources of income**". In the case of Sterling Foods (supra) also, Hon'ble Supreme Court had laid down the principle that "**(t)here must be, for the application of the words 'derived from', a direct nexus between the profits and gains and the industrial undertaking**" and, on the facts of the said case, held that "**In the instant case, the nexus is not direct but only incidental**". It is also important to bear in mind the fact that the import entitlement scheme, as it then stood, entitled the exporter to certain imports, not necessarily of the manufacturing inputs but even, for example, of entirely unrelated things such as office equipments etc. The profit or advantage on account of such import entitlements was essentially in the realm of such uncertainties that it could hardly get into costing of the production or pricing of the product. In Liberty India's case, Hon'ble Punjab & Haryana High Court relied upon the principle laid down in Sterling Food decision (supra), and observed that distinction sought to be made by learned counsel for the assessee, in income derived

from duty drawback and sale of import entitlements, could not be accepted as relevant distinction since "**core question before the Court was that such income was derived from specified business, which reasoning is fully applicable to the present situation**". What was thus implicitly held was that the duty drawback receipts were not from core activities of specified business – something which was upheld by Hon'ble Supreme Court as well. Hon'ble Supreme Court did hold that DEPB/ duty drawback receipts would "**constitute independent source of income beyond the first degree nexus between profits and the industrial undertaking**". Even in the illustration taken by Hon'ble Supreme Court, in the case of Liberty India (supra), overall profit is Rs 200, out of which Rs 100 is profit by way of receipt of duty drawback receipts and the other Rs 100 is profit by way of normal business profits. Such examples, however, hold good on the premises that duty drawback receipt is an additional, ancillary or supplemental profit. There can, on the other extreme, be situations in which duty drawback itself could be more than the overall profits, and, in such cases, the approach implicit in the above illustration may not hold good. In these situations, the duty drawback receipts may not be seen on standalone basis or as an independent source of income because the overall profit is only a part of the duty drawback receipt, and the commercial motivation of running the industrial undertaking is earning only that part of duty drawback receipts. In today's competitive world, and somewhat perfect market conditions, such situations are not rare at all. Let us take the case of the assessee before us itself. As per the financial statements filed before us, entire operational before tax for the assessment year 2003—04 is year is Rs 51,56,169 whereas duty drawback receipts aggregate to Rs 82,27,439. Similarly, so far as assessment year 2004-05 is concerned, the entire operational profit before tax is Rs 55,76,307 whereas duty drawback receipts amount to Rs 1,08,64,469. In the next assessment year, i.e. 2005-06, the overall profits of the assessee are only Rs 1,05,27,484 whereas duty drawback receipts during the year come to Rs 1,31,08,550. It is only in the assessment year 2006-07 that overall profits before tax at Rs 1,80,44,357 are marginally more than duty drawback receipts of Rs 1,53,94,403. On these facts, as learned counsel rightly pleads, it cannot be an open and shut inference that the duty drawback receipts are independent sources of income on standalone basis and that these receipts have no first degree nexus with the business activity of the industrial undertaking. There is still a room for the consideration of the plea that but for the duty drawback, the assessee would not have carri ed out the business activity in the industrial undertaking, because, that would have meant carrying out business for incurring losses. If that be so, the duty drawback receipts cannot be said to be 'not direct but only incidental' income, an 'independent source of income' or 'ancillary profit of the industrial undertaking'. It is also important to bear in mind the fact that the very distinguished Hon'ble Justice, who authored judgment in

Liberty India's case (supra), also dismissed special leave petition against the judgment of Hon'ble Delhi high Court in Lakahnpal Premchand Ltd's case (supra)'s observations to the effect, "In that case (i.e. Sterling Food), **the Supreme Court found that the nexus was not direct but only incidental. According to us, the ratio of this judgment has no application to the case in the instant case. In the instant case both the CIT(A), as well as, the Tribunal found that the refund of excise duty had a direct nexus with the manufacturing activity carried out by the assessee**". The views expressed in Sterling Food (supra) which is the basic foundation of revenue's case, therefore, remain confined to the those facts. When facts can shown to be materially different and when a receipt can be shown to have direct nexus with the manufacturing activity, such a receipt can indeed be included in computation of deduction under section 80 IB.

12. It is thus the nexus which was found to be missing in the case of Liberty India's case, but when nexus was found to be existing, as in Premchand Lakhanpal's case, the amounts were held to be eligible for deduction 80 IB. The true test, therefore, is not the nexus that the duty drawback has with the operations of business.

13. As we deal with this aspect of the matter, let us not lose sight of the fact that the expression '**first degree nexus between profits and industrial undertaking**' has been used, by Hon'ble Supreme Court itself in the decisions referred to above, interchangeably with '**independent source of income', 'not direct but only incidental**' and '**ancillary profits of industrial undertakings**'. Let us also not forget that in the case before the Hon'ble Supreme Court, in the case of Liberty India (supra), it was nobody's case that duty drawback was such a significant part of the receipts that but for duty drawback, even the business operations of the industrial undertaking would not make any commercial sense. In Their Lordship's illustration, set out in the judgment itself, the overall profits were twice the amount of duty drawback receipts as against the factual situation we are in seisin of in which there will be virtually no commercial profits if duty drawback is to be ignored.

14. There is one more important aspect of this matter. The assessee is virtually a one hundred percent export oriented undertaking. As evident from the financial statements filed before us, the assessee had direct exports of Rs 16,95,65,561, indirect exports of Rs 3,85,17,858 and domestic sales of only Rs 16,144 – that too in respect of the factory disposables. Broadly the same has been the position in the other years before us, though, of course, there are deviations in the figures. What clearly emerges from these facts is that the industrial undertaking was used only for the purpose of manufacturing and exporting the export products. In a situation in which an important part of the revenues generated as a result of the exports, which is as high as almost 7.4% of

total turnover, is duty drawback itself, it may not really be correct to say that duty drawback receipt is an incidental, unintended, ancillary or independent benefit, which can be seen as a standalone or independent source of income. Quite to the contrary, in such a situation, this receipt appears to be so much a part of the integral profits of the industrial undertaking that the absence of duty drawback receipt may take away the raison d'être of the industrial undertaking being put into business. This factual matrix is in sharp contrast with a situation in which, as was perhaps found, perceived or visualized by Hon'ble Supreme Court, the industrial undertaking is engaged in manufacturing of a product for domestic sales as also exports, and the export incentives are nothing more than an incidental, additional and ancillary sources of profits, in view of the position that de-hors such export incentives also the industrial undertakings make commercial sense.

15. To up a question to ourselves, what are the options open to us in this situation and on the facts of this case. On the one hand, the words employed in Hon'ble Supreme Court's judgment in Liberty India's case (supra) leave little doubt about the fact that, in the esteemed views of Hon'ble Supreme Court, the duty drawback receipts donot have first degree nexus with the profits of the industrial undertaking, but then there is no warrant for the assumption that this approach must remain valid in all factual situations. Of course, it is tempting to proceed on the basis that this lack of first degree nexus is a legal principle, but then an issue like that of degree of nexus between nature of receipts vis-a-vis the industrial undertaking cannot be decided in vacuum; it has to depend on the facts, and business situations can never be so static or uniform that lack of nexus in one factual matrix must essential ly imply lack of that nexus in all factual matrixes. On the other hand, on the peculiar facts of this case, duty drawback receipts, at least at the first sight, appear to be integral part of the business receipts, but for which even running of industrial undertaking does not make sense, and, therefore, it cannot be viewed as ancillary or incidental profits of industrial undertaking or a standalone and independent source of income. As we face this dilemma, we are reminded of the words of guidance by Hon'ble Supreme Court in *Mumbai Kamgar Sabha vs Abdulbahi Faizullbhai* (AIR 1976 SC 1455) wherein legendary Justice V Krishna Iyer, in his inimitable and felicitous words observed thus, "**It is trite, going by Anglophonic principles that a ruling of a superior court is binding law. It is not of scriptural sanctity but of ratio wise luminosity within the edifice of facts where the judicial lamp plays the legal flame. Beyond those walls and de hors the milieu we cannot impart eternal vernal value to the decisions, exalting the precedents into a prison house of bigotry, regardless of the varying circumstances and myriad developments.**" Of course, one has to balance these observations of Hon'ble Supreme Court about duties of the courts below with what another bench of this very Hon'ble Supreme Court has said, in

the case of *Assistant Controller of Central Excise vs. Dunlop India Ltd.* (154 ITR 172). In this case, Hon'ble Court has itself quoted from the decision of House of Lords as follows: "**We desire to add and as was said in Cassell & Co. Ltd. v. Broome [1972] AC 1027 (HL), we hope it will never be necessary for us to say so again that "in the hierarchical system of courts" which exists in our country, "it is necessary for each lower tier", including the High Court, "to accept loyally the decision of the higher tiers". "It is inevitable in hierarchical system of courts that there are decisions of the Supreme appellate Tribunal which do not attract the unanimous approval of all members of the judiciary... But the judicial system only works if someone is allowed to have the last word, and that last word, once spoken, is loyally accepted. "... The better wisdom of the Court below must yield to the higher wisdom of the Court above. That is the strength of the hierarchical judicial system.**" As we perform our pious judicial duties, we have to strive to find that point of equilibrium when a fine balance between these two observations of Hon'ble Supreme Court can be arrived at. This is by no means an easy task and, being highly as subjective as it is, it is perhaps incapable of unanimity in approach, but then that cannot be a ground enough to deal with the matters at a superficial level.

16. The question that we must, therefore, deal with, to ascertain whether or not duty drawback receipt in includible in computation of deduction under section 80 IB, is whether this particular receipt is an ancillary or additional profit and can be seen as an income on standalone basis or whether it is an integral part of the profits of the industrial undertaking. In our humble understanding, the answer to this question does depend more on the factual matrix of a case essentially because whether or not duty drawback receipts are additional incentive receipt or an integral part of the business receipt may vary on several factual factors. In a situation in which the duty drawback receipts are nothing but additional or incidental profits, and when even in the absence of duty drawback receipts, operations of industrial undertaking make business sense, as was the case before Their Lordships in Liberty India or as was visualized or perceived by Their Lordships, the situation will be different. However, the same may not be the situation in which duty drawback receipts are so significant and substantial that they drive the business model and are constitute justifications for the commercial operations. While on this issue, we may also make reference to the Cost Accounting Standards formulated by the Cost Accounting Standards Board set up by the Institute of Cost Accountants of India, which, in turn, is established by a special Act of the Parliament. The official website of Cost Accounting Standards Board states that, "**The Institute of Cost Accountants of India, recognizing the need for structured approach to the measurement of cost in manufacture or service sector and to provide guidance to the user organizations, government bodies,**

regulators, research agencies and academic institutions to achieve uniformity and consistency in classification, measurement and assignment of cost to product and services, has constituted Cost Accounting Standards Board (CASB) with the objective of formulating the Cost Accounting Standards. The Expert Group constituted by Ministry of Corporate Affairs has specifically highlighted the need for developing Cost Accounting Standards on the basis of Generally Accepted Cost Accounting Principles". The cost accounting standards thus provide important insight into the generally accepted standards so far as cost accounting is concerned. This is in sharp contrast with AS 2 issued by the Institute of Chartered Accountants of India which deals with, as the AS 2 itself states, "the determination of the value at which inventories are carried in the financial statements until the related revenues are recognised". In other words while AS 2 deals with how the inventories are to be reflected in the yearend financial statements, which has nothing to do with determination of costs, CAS 1 deals with, as it specifically so states, "classification of costs for ascertainment of cost of a product or service and preparation of cost statements on a consistent and uniform basis with a view to effect the comparability of the same of an enterprise with that of previous periods and of other enterprise". While CAS 1 thus provides good guidance on what constitutes 'cost' from the management point of view, AS 2 provides guidance on how should the inventories be valued and reflected in the yearend financial statements. Let us in this backdrop take a look at the CAB 1 (Cost Accounting Standard 1) issued by the Institute of Cost Accountants of India, which deals with the question as to how the costs should be recognised, which states as follows:

> **6.1.2 Material Cost is the cost of material of any nature used for the purpose of production of a product or a service.**
>
> **6.1.3 Material cost includes cost of procurement, freight inwards, taxes and duties, insurance etc directly attributable to the acquisition. Trade discounts, rebates, <u>duty drawbacks, refunds on account of modvat, cenvat, salex tax and other similar items are deducted in determining the costs of material</u>.**

http://casbicwai.org/CASB/casb-resources-download.asp
(Emphasis by underlining supplied by us)

17. It is thus clear that in a particular fact situation, even material cost may be required to be adjusted for duty drawback. Of course, the crucial question is whether the duty drawback is an incidental profit or a profit of the first degree which, in turn, depends on the business models. Take for example a situation in which an assessee is manufacturing precision equipments and selling the same in domestic as well as international markets. The industrial undertaking so manufacturing

precision equipments is a commercial venture for making profits, and exports or no exports, the industrial undertaking is in business anyway. In such a situation, in case the assessee is able to make some exports of the same product on the similar price, the duty drawback income is an incidental or standalone income. However, in another situation, in which, for example, the assessee is a one hundred percent exporter, and he is operating on the basis of costs duly adjusted by duty drawback, as evident from the fact that but for duty drawback receipts, he will have virtually no profits, the duty drawback receipts could as well have the first degree nexus since these cannot be viewed as incidental or ancillary profits or standalone income.

18. Everything thus hinges on the findings about the degree of nexus between duty drawback receipts and the industrial undertaking, and it is only when there is a clear finding on this aspect that the correctness of assessee's claim can be tested on the principles of law. There is no finding on this aspect by any of the authorities below. The Assessing Officer, as also the CIT(A), have proceeded on the implicit basis that in the light of observations made in Hon'ble Supreme Court's judgment in Liberty India's case (supra), there can never situations in which duty drawback receipts have first degree nexus with operations of industrial undertaking. Legal principles, which have been relied upon by the authorities below, do bind us but these legal principles are related to factual matrix and when factual matrix has significant and material variations vis-à-vis the factual matrix on which the legal principles were laid down, the entire scenario changes. What is thus equally, if not more, important thus is the factual matrix and as to what extent the legal principles in one fact situation will find application in another seemingly similar, but materially different, fact situation. What should have been really examined by the authorities below is whether or not, on the facts of this case, the duty drawback receipts can be said to have first degree nexus with the industrial undertaking or whether these profits can be said to be ancillary, incidental or standalone income. In our considered view, this aspect of the matter ought to have been examined in detail and by way of a speaking order. That exercise has not been carried out at all. We, therefore, remit the matter to the file of the CIT(A) for adjudication de novo by way of a speaking order, in the light of our above observations, in accordance with the law, and, after giving yet another opportunity of hearing to the assessee. While doing so, learned CIT(A) will also deal with alternate contention of the assessee to the effect that, in any event, to the extent the duty drawback receipts represent refund of duties by the assessee, which assessee can demonstrate and establish, the same shall be includible in profits of the assessee eligible for deduction under section 80 IB. In the event, however, of the basic plea being accepted, this aspect of the matter will be rendered academic.

19. To the extent above, grievance of the assessee is upheld to the extent that the matter regarding the duty drawback receipts being includible in computation of deduction under section 80 IB deserves to be

re-examined by the CIT(A) as directed above. What we have decided for the assessment year 2006-07, learned representatives fairly agree, will also apply mutatis mutandis for the three other assessment years, i.e. assessment year2002-03, 2003-04 and 2004-05. No other issues were pressed before us.

20. However, as we remit the matter back to the file of the CIT(A), we make it clear that we have only remitted the matter, for a finding on a factual aspect, to the file of the CIT(A). This direction should not be construed as any adjudication on the legal issue which remains open and which is to be adjudicated, in the light of binding judicial precedents as available now and as may be available at the relevant point of time, after findings on foundational factual aspects referred to earlier in this order. We are alive to the fact that even in the event of the DEPB receipts not being in the nature of incidental profits, separate source of income or ancillary gains, there are categorical observations in Liberty India decision which may end up deciding the issue against the assessee but that is not material at present. This adjudication by us is certainly not the end of the road but when the matter travels to higher forums, it is certainly appropriate that all the relevant facts are before Their Lordships. In any event, whatever we say is, and shall always remain, subject to the law laid down by the Hon'ble Courts above and we have to apply the same in letter, and also in, spirit. A judgment of Hon'ble Supreme Court does bind all of us under article 141 of the Constitution of India but it does not prevent us from discharging our duty of ensuring that all the relevant and material facts are placed on record. In any case, as Hon'ble Justice V R Krishna Iyer has said, in his inimitable words, that "**....de hors the milieu we cannot impart eternal vernal value to the decisions, exalting the precedents into a prison house of bigotry, regardless of the varying circumstances and myriad developments**". In our humble understanding, the expression 'milieu' in this context not only refers to the actual facts of the case but also as perceived, envisioned or visualized by Their Lordships, based on which the judgment is rendered. Our endeavour is to keep all the relevant material aspects on the record so that Hon'ble Courts above can view the things in the proper perspective and be pleased to take a just and proper legal view on the same, as and when the occasion so arises. Ascertaining and presenting the facts in proper perspective does contribute to efficacious and healthy development in this dynamic field. As a final fact finding authority, it is our most important duty to do so. With utmost humility and highest reverence to the judgments of Hon'ble Courts above, and within our limited abilities, we have attempted to do so. Our observations may be viewed in this light.

21. In the result, all the four appeals are allowed for statistical purposes in the terms indicated above. Pronounced today on 27th day of August, 2013.