

CASE LAW**Foreign:**

Maruti Suzuki India Limited

v.

Deputy Commissioner of
Income Tax

Commissioner of Income Tax

v.

Arvind Kumar Jain

M/S Atma Ram Properties Private
Limited

v.

D.C.I.T.

I.T.A No.1262/Bang/2010
(Assessment Year : 2008-09)

C.I.T, Chennai

v.

M/S Bhari Information Tech.
SYS. P. Ltd.The Commissioner of Income Tax
Dehradun and another

v.

M/s BKI/HAM v.o.f.

C/o Arthur Anderson & Co.,
New Delh

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ARTICLES

Is Income From Software Taxable As "Royalty"?

Debate over asset disclosures

STATUTES

Sales Tax General Order No. 21 of 2011, dated November 01, 2011.

Sales Tax General Order No. 22 of 2011, dated November 01, 2011.

Customs General Order No. 02 of 2011, dated March 26, 2011.

Customs General Order No. 09 of 2011, dated November 14, 2011.

Customs General Order No. 10 of 2011, dated November 21, 2011.

Customs General Order No. 10 of 2011, dated November 24, 2011.

TAX NEWS

Essential edible items under APTTA:

FBR agrees to exempt goods from insurance guarantee

Supply to zero rated sectors manufacturers:
raw material importers to pay 19 percent ST

FBR decides to set up anti-money laundering wing

Tax administration project:

FBR yet to complete critical reforms: World Bank

Cut in security deposit charged by shipping lines:

FBR agrees to Afghan traders' proposal

ST Refund: FBR accepts demand of SCCI

FBR issues notices to 1,60,000 non-taxpayers in 5 months

Cabinet decides to withdraw subsidy on tube wells

CNG cylinders and kits: FBR proposes 25-35 percent customs duty

Section 235 of IT Ordinance 2001:

Supreme Court issues notices to advocates general, AGP

Restoration of ST zero-rating facility on tractors:

FBR opposes ministry's proposal

Compliance of Section 37A of IT Ordinance 2001:

KSE apprises FBR about brokers' problems

Public auction of confiscated goods on December 13

Exporters object to FBR notices

Afghan, Pakistan customs decision:

uncleared cargo may be disposed of by auction

Prime Minister briefed on tax collection, gas, oil supply

Barred from importing CNG cylinder: FBR notifies foreign companies

Tax return date expires: FBR starts penalising non-filers

Persons deriving taxable capital gain:

brokers should ensure advance tax payment: FBR

Tax incentives to be sought for listed companies

FBR union's rally against Nato attack

SECP, Bol to seek incentives for listed companies

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Is Income From Software Taxable As “Royalty”?

by

Mihir Naniwadekar, Advocate

The controversy over the interpretation of the term ‘royalty’ has come to the fore in light of two judgments of the Hon’ble Income Tax Appellate Tribunal in the past year, (1) the common judgment of the Hon’ble Delhi ‘H’ Bench (dated 26th October, 2010) in a set of cases (*Gracemac v. ADIT*, ITA Nos. 1331 - 1336/Del/2008, *Microsoft Corporation v. ADIT*, ITA Nos. 1392/Del/2005, *Microsoft Regional Sales Corporation v. ADIT*, ITA Nos. 1393 - 1395/Del/2005, the common judgment is hereinafter referred to as ‘*Gracemac*’); and (2) the judgment of the Hon’ble Mumbai ‘E’ Bench (dated 26th August, 2011) (*ADIT v. TII Team Telecom International*, ITA Nos. 3939/Mum/2010, hereinafter referred to as ‘TII Team’). The controversy – brewing now for quite some time – is essentially this: under what circumstances can the payment received for (what is loosely termed as) supply of software/rights in software be taxed as ‘royalty’ under Section 9 of the Income Tax Act, 1961, and under various Double Tax Avoidance Agreements.

Prior to the decision in *Gracemac*, decisions of the Tribunal (including a decision of the Special Bench) had drawn a distinction between “copyright” and “copyrighted article”; and had taken the view that when what is transferred is merely a “copyrighted article” and not rights in the “copyright” itself, then there is no question of the payment being characterized as royalty. In *Gracemac*, however, this distinction was doubted; and the Tribunal in *Gracemac* also cast some doubt over the extent to which a narrower definition of ‘royalty’ in a treaty would prevail over a subsequent retrospective definition of ‘royalty’ in the Income Tax Act. In *TII Team*, on the other hand, the Hon’ble Mumbai Bench has reaffirmed the distinction between “copyright” and “copyrighted article”, and has also reaffirmed the principle that the definition in a treaty would override the definition in the Act. Thus, the Mumbai Bench has refused to follow the decision of the coordinate Bench in *Gracemac*. An attempt is made in this article to humbly try to analyse these two conflicting decisions. The author respectfully submits that the view of the Mumbai Bench is the preferable one to take, and that the distinction between “copyright” and “copyrighted article” has a strong basis in law. Accordingly, in the first section of this article, the author proposes to examine how this distinction came to be applied in tax laws. In the second and third part, the decisions of the Tribunal in *Gracemac* and *TII Team* respectively will be discussed.

A. Background: The Distinction between “Copyright” and “Copyrighted Article”

Before looking at the reason why the distinction between “copyright” and “copyrighted article” is relevant, it is convenient to set out the relevant

part of Section 9 of the Act, which defines “royalty”. Explanation II to Section 9(1)(vi) states:

For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for –

- (i) *The transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;*
- (ii) *The imparting of any information concerning the working of or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;*
- (iii) *The use of any patent, invention, model, design, secret formula or process or trade mark or similar property;*
- (iv) *The imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;*
- (v) *The transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films; or*
- (vi) *The rendering of any services in connection with the activities referred to in sub - clauses (i) to (v)*

Thus, it will be seen that which sub - clauses (i) and (iii) also refer to various forms of intellectual property, a specific provision in respect of copyright is made under clause (v). (It may be contended that payment for software is payment in respect of a process – this argument is specifically addressed in detail in ***THI Team*** discussed below.) Under clause (v) of the Explanation, for a payment to be properly characterized as “royalty”, it must be for the transfer of “*all or any rights*” in respect of “*any copyright*”. Now, if one goes to a book - store and buys a book (a work which enjoys copyright protection), can it fairly be said that the money one pays to the shop - owner is for the transfer of all or any rights in respect of a *copyright*? Or is it merely a payment for using the particular copy of the *book* (i.e., the copy of the copyrighted article)? Clearly, just because I have bought the book does not mean that I can freely make copies and distribute or sell those copies of the book commercially. My rights are limited to the copy of the book which I have bought. Can it then be said that I have acquired any rights in the *copyright* itself? For answering this question, it is essential to briefly look at the definition of “copyright”, which is contained in the Copyright Act, 1957. Section 14 of the Copyright Act, 1957 states:

14. Meaning of copyright.—For the purposes of this Act, “copyright” means the exclusive right subject to the provisions of this Act, to do or authorize the doing of any of the following acts in respect of a work or any substantial part thereof, namely:—

- (a) *in the case of a literary, dramatic or musical work, not being a computer programme,—*
 - (i) *to reproduce the work in any material form including the storing of it in any medium by electronic means;*
 - (ii) *to issue copies of the work to the public not being copies already in circulation;*
 - (iii) *to perform the work in public, or communicate it to the public;*
 - (iv) *to make any cinematograph film or sound recording in respect of the work;*
 - (v) *to make any translation of the work;*
 - (vi) *to make any adaptation of the work;*
 - (vii) *to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub - clauses (i) to (vi);*
- (b) *in the case of a computer programme,—*
 - (i) *to do any of the acts specified in clause (a);*
 - (ii) *to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme:*
Provided that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental

Thus, from the above, it will be seen that for a transfer of a right in respect of a copyright, one or more of the above rights must be transferred. When one buys a book from a bookstore, none of the rights in respect of the copyright itself are transferred. For instance, on buying a book, one does not obtain any exclusive right to reproduce, make copies, translations or any of these.

Is the position any different when one buys a software product which is embedded in a CD? For instance, when one goes to a computer store and “buys” off - the - shelf a copy of an antivirus programme on a CD, one is really “buying” the disc. On loading the disc, one would typically have to agree with a non - exclusive end - user license agreement. In such a scenario, one does not obtain any exclusive right to sell or offer the anti - virus programme on commercial rentals, nor does one obtain any exclusive right listed under clause (a) of Section 14 of the Copyright Act. In such a case, the payment is in respect of a copyrighted article; not in respect of a copyright. Of course, finally, what the payment is for would depend on the specific agreement between the parties. At times, if the agreement is for purchase of specifically customized software, it may be

possible that one of the exclusive rights referred to in Section 14 is also obtained.

It may not be out of place here to mention that the Supreme Court has had the occasion to examine the nature of software in a slightly different context, when it was called on (in **Tata Consultancy Services v. State of Andhra Pradesh**, 271 ITR 401, hereinafter referred to as '**TCS v. AP**') to decide whether branded software amounts to "goods" for the purposes of sales tax legislation. The Court, in the course of examining this question, referred to several American judgments and stated, "*It has been held that by sale of the software programme the incorporeal right to the software is not transferred. It is held that the incorporeal right to software is the copyright which remains with the originator. What is sold is a copy of the software. It is held that the original copyright version is not the one which operates the computer of the customer but the physical copy of that software which has been transferred to the buyer. It has been held that when one buys a copy of a copyrighted novel in a bookstore or recording of a copyrighted song in a record store, one only acquires ownership of that particular copy of the novel or song but not the intellectual property in the novel or song... A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme. But the moment copies are made and marketed, it becomes goods, which are susceptible to sales tax...*"

Unquestionably, intellectual property may have been embedded in, and added value to, the "goods"; this does not mean that the intellectual property itself is transferred. In the income tax context, the argument that "copyright" and "copyrighted article" are one and the same, was raised by the Revenue in the case of **Motorola v. DCIT** (2005) 96 TTJ Delhi 1 (SB) (hereinafter referred to as 'Motorola'). The assessee, relying on **Lucent Technologies v. ITO** 82 TTJ 163, contended that while one cannot have a copyright without a copyrighted article, one can certainly have a copyrighted article without a copyright. The Hon'ble Special Bench specifically noted, "*We may now briefly deal with the objections of Mr. G.C. Sharma, the learned senior counsel for the Department. He contended that if a person owns a copyrighted article then he automatically has a right over the copyright also. With respect, this objection does not appear to us to be correct... we hold that the software supplied was a copyrighted article and not a copyright right, and the payment received by the assessee in respect of the software cannot be considered as royalty either under the Income - tax Act or the DTAA...*" Thus, the Special Bench expressly rejected the argument that copyright and copyrighted article are one and the same. Without labouring the point too much, it will suffice to say that following this Special Bench, until the decision in **Microsoft**, different Benches accepted the view that there is a distinction between "copyright" and "copyrighted article"; and a payment to be "royalty" must be in respect of the former and not the latter. Reference may be made to **DCIT v. Metapath Software Intl.**

(2006) 9 SOT 305, *Sonata Information Technology v. ACIT* (2006) 6 SOT 700, *Velankani Mauritius v. DDIT* ITA No. 985/Bang/2009, *Kansai Nerolac Paints v. ADIT* I.T.A. No.568/Mum/2009 etc. In this background, until the decision in *Gracemac*, the distinction between “copyright” and “copyrighted article” became entrenched in the law. We can now look at the decision in *Gracemac* to see why this accepted principle was not applied by the Hon’ble Tribunal.

B. The decision in Gracemac

As stated earlier, *Gracemac* was a common judgment in three connected appeals, of three different assessees. These three assessees were Microsoft, Gracemac, and Microsoft Regional Sales Corp. The case of *Gracemac* (ITA Nos. 1331 - 1336/Del/2008) was taken as the lead matter by the Tribunal. Briefly, the facts as recorded by the Hon’ble Bench in paras 3 to 5 of the common order are as under:

“3. Microsoft Corporation (MS Corp) in its return filed for AY 1996 - 97 offered its income from licensing of software to Original Equipment Manufacturers (OEM) to tax and did not offer to tax its income from sale of Microsoft software products to Indian Distributors. The assessing officer, however, taxed the payments received from Indian Distributors as ‘royalty’ under section 9(1)(vi) of Income Tax Act, 1961 and Indo - US DTAA. Against the said order MS Corp filed appeal before CIT(A) and while passing an order CIT(A) also confirmed the addition made to the income of MS Corp. Against this order assessee is in appeal before this Tribunal.

4. For AY 1999 - 00 to 2001 - 02 in case of MRSC, the payments received from Indian distributors on sale of Microsoft software products were not offered to tax as royalty. However, the assessing officer assessed the entire payments in the hands of MRSC as royalty income on the ground that payments have been received towards licensing of Microsoft software products which amounts to grant of right in Intellectual property Rights (IPRs). On appeal against the order of assessing officer, ld CIT(A) has considered that the software is being licensed and not sold and accordingly the consideration received for supply of software should be taxed as royalty. Against this order the assessee is in appeal before this Tribunal.

5. In case of Gracemac for assessment years 1999 - 2000 to 2004 - 05, the assessing officer had taxed the payments made by MO Singapore to Gracemac, USA @ 35%/40% of net sales consideration received by MRSC from Indian distributors in India under Section 9(1)(vi)(c) of the Act and Article 12(7) (b) of the Indo - US Double Taxation Avoidance Agreement (DTAA) on the ground that Gracemac’s source of royalty is MO which distributes Microsoft software products in India through MRSC and accordingly, Gracemac is getting royalty out of the licensing

of Microsoft software products carried out in India. The assessing officer also held that the royalty received from MO is taxable under Article 12(7)(b) of the India US DTAA as the payment to Gracemac is based on the number of users of intellectual property rights in India. Ld CIT(A), however enhanced the assessment by bringing the entire consideration received by MRSC from Indian distributors on the contention that MRSC and MO are legal façade. To this extent, the same revenue is being taxed in case of MRSC and Gracemac for the Assessment Years 1999 - 00 to 20001 - 02 and this according to assessee has resulted in double taxation for these Assessment Years.”

Gracemac's case was taken as the lead matter; and the Tribunal noted (in para 7) that the issue in all the cases was whether supply of off - the - shelf software by non - resident companies to Indian distributors is taxable in the hands of the non - resident companies as “royalty” u/s 9(1)(vi) of the Act and under Article 12 of the India - US DTAA. What was in issue was the payments made by the distributors to the non - resident companies. The business model used by Microsoft in these cases (particularly in the case of Gracemac) was that on 1/1/1999, Microsoft Corporation entered into an agreement with Gracemac (100% subsidiary of Microsoft) which granted Gracemac an exclusive license to manufacture and distribute MS software in accordance with the terms of the license. It was agreed that Gracemac would make no copies except as provided in the agreement, and the master - copy of the software would always be the property of Microsoft and would be returned to Microsoft on termination of the agreement. Gracemac in turn granted a non - exclusive license to Microsoft Operations (‘MO Singapore’) to reproduce the software and distribute the same to retailers/distributors or to Microsoft subsidiaries. MO paid Gracemac royalty calculated as a percentage of the price received from the distributors. MO in turn entered into a nonexclusive distribution agreement with MSRC. Under this, MO sold the copies to MSRC in Singapore, and MSRC further distributed the same to local distributors, who had the right to distribute the software in their respective countries. The distributor sold the products to Indian distributors, who in turn sold the same to end - users. Microsoft Corporation (the parent), the owner of the relevant intellectual property, entered into an end - user license agreements (EULAs) with the end - users. Thus, the copies of the software were purchased by the end - users, who also entered into EULAs with Microsoft Corporation. The end - user was never granted any right to make additional copies for commercial use. Before the AO, there was no dispute that the payment made by MO to Gracemac was in the nature of royalty, but the assessee contended that the same was not chargeable under the India - US treaty (as they were not royalty from an Indian source and were outside the scope of taxability under the treaty). The assessing officer however took the view that the payment made by the Indian end - user itself was in the nature of

royalty. As the source of the royalty on that view was the Indian end - user, the AO held that the sums would be taxable in India. The Tribunal pointed out (in para 76) that *“In the cases before us the taxation of payments made by end users for computer programme in the form of ‘shrink wrapped’ software through a distribution channel is involved.”* It then turned to the thrust of the assessee’s submissions that there is a distinction between “copyright” and “copyrighted article”.

The Bench noted that the expression “copyrighted article” is not defined anywhere in Indian law, and the decision of the Special Bench in *Motorola* had relied on American decisions and on OECD commentary to introduce this distinction. The Tribunal then purported to rely on the judgment of the Supreme Court in *CIT v. P.V. Kulandagan Chettiar* (2004) 137 Taxman 460 (SC) for the proposition that OECD commentary would not be a safe guide for interpreting provisions of the Income Tax Act. It is humbly submitted that it was not open to the Tribunal to examine the reasoning of the Special Bench in *Motorola*. It is one thing to say that the regular Bench of the Tribunal can interpret a Special bench judgment to find out the true ratio of that case, but it is quite another thing to say that it is open for the regular Bench to comment on the reasoning adopted by the Special Bench. Thus, once the Special Bench accepted that there is a distinction between “copyright” and “copyrighted article”, it was not open to the regular Bench to take the view that the said distinction does not find an existence in Indian law. Further, it may not be correct to say that the OECD commentary has no relevance whatsoever in interpreting the relevant provisions of law. The assessee never contended that the OECD commentary were conclusive on the point; as persuasive authority, however, the OECD commentary can certainly be relied on in appropriate cases. The decision of the Supreme Court in *Chettiar’s* case cannot be seen as an absolute bar against this practice. Indeed, the Supreme Court itself has relied on the OECD commentary: reference may be made to *Azadi Bachao Andolan v. Union of India* 263 ITR 706 (hereinafter “*Azadi Bachao Andolan*”), where the OECD commentary was relied on in support of the views of the Bench on the concept of “fiscal residence”.

Next, the Hon’ble Bench dealt with the judgment of the Supreme Court in *TCS v. AP*, and it held that the decision in *TCS* which was delivered in the context of sales tax proceedings, would not be of relevance in deciding the meaning of “royalty” in income tax proceedings. The Bench then referred to the EULA entered into between Microsoft Corp and the end - user, according to which, Microsoft products have been licensed and not sold. The Tribunal stated that *“conditions of End User Licence Agreement itself proves that the software is licenced and not sold. This fact is further buttressed by the wordings of clause 19 of EULA which states that ‘the product is protected by copyright and other intellectual property laws and treaties. Microsoft or its suppliers own the title, copyright, and other intellectual property rights in the product. The product is licensed and not sold.’* While this may be true, it must be noted that the *payment* made by

the users was in respect of the copyrighted article, while the EULA is typically entered into for protection of the copyright. Thus, if the Bench had accepted the distinction between “copyright” and “copyrighted article”, this language of the EULA would not have been relevant. This is where the judgment in *TCS v. AP* assumes importance: the Supreme Court has clarified that when an off-the-shelf software product is purchased, it must be held that there is a sale of goods and the payments taxable under sales tax laws would be the payments made for purchase of the CD. This clarifies that the payment is with respect to the copyrighted article itself. The Bench in *Gracemac* observed (in para 99), “*it is clear that the end users have not purchased copy of software products on electronic media as contended by the assessee but a licence to use such software products.*” It is submitted that this statement requires reconsideration: just because there is a EULA which grants a license to use software does not mean that the *payment* made is not for purchase of the license: as the Supreme Court has clarified, the purchase is of the copy of the software on the electronic media. The product or goods purchased, for which payment is made, is the CD. The value of the CD may be derived from the fact that there is a copyright - protected software: this does not, however, change the fact that what is purchased in the *CD* and not the copyright itself. For instance, let us assume that a company develops a new type of pencil, and obtains a patent for the same. One might pay a higher sum for such new type of pencil, and this higher value may be entirely derived from the patent - protected idea embodied in the pencil. This does not change the fact that the payment is made for the *pencil* itself, i.e. the article itself, and not for any right in respect of a patent. The contrary view would lead to almost all payments being royalty: in today’s world, it is hard to think of any product which does not derive value from some form of intellectual property. It is respectfully submitted that the Hon’ble Tribunal in *Gracemac* has not offered a completely convincing explanation for discarding the distinction between copyright and copyrighted article, and for distinguishing the decision in *TCS*. In this connection, it may also be relevant to note that this very issue of the applicability of *TCS* was considered by the Bangalore Bench in *Velankani Mauritius*. The Hon’ble Bangalore Bench had held that the decision in *TCS* assumed relevance even in this context because the Supreme Court had held that the transfer of a CD would result in a sale of goods, and (reasoned the Bangalore Bench) once there is an outright sale, there cannot be any question of royalty. (In *Sonata* also, the decision in *TCS* has been applied in this context.) Unfortunately, in *Gracemac*, the Hon’ble Bench has not considered this decision of a coordinate Bench in *Velankani Mauritius*.

The Tribunal also referred to several suits filed by Microsoft Corporation in the Delhi High Court in respect of alleged copyright infringement where the defendants (end - users) had indulged in multiple unlicensed usage of the software. The Tribunal held (see para 102) “*At one hand the assessee is contending that the Microsoft products sold to the end users are*

copyrighted articles are products and do not contain copyright. On the other hand, under Copyright Act they are enforcing their rights stating that the use of unlicensed/pirated copy of software products involves infringement of copyrights. The assessee is thus blowing hot and cold in the same breath on the same issue. When payment of tax is concerned, it is sale of "copyrighted" article and not a licence, but when question of infringement comes, complaints are filed before Hon'ble Delhi High Court claiming that the end users have indulged in use of unlicensed/pirated products." With respect, it is submitted that the assessee was not in fact blowing hot and cold in the same breath. Just because a suit for copyright infringement is commenced, this does not mean that the products sold are "copyrights". Nowhere did the assessee contend that the copyrighted articles did not derive value from the copyright: what was contended was that no copyright was transferred. Section 51 of the Copyright Act deals with infringement of copyright. In sum, when a third party does anything, the exclusive right to do which is conferred by the Act on the owner of the copyright, then he is said to have infringed the copyright. A license is typically something which makes legal an act which otherwise would have been illegal. Thus, when copies are made in violation of the EULA, this (making of the copies) is an act which infringes copyright. Bringing a suit for copyright infringement does not at all mean that the plaintiff accepts that the payment made by the end-user is for transfer of rights in the copyright itself. It is not clear why the Bench thought that Microsoft was "blowing hot and cold in the same breath".

Finally, on the issue of whether the assessee was entitled to benefits under the India - US DTAA, the Tribunal ruled against the assessee again. (The issues in connection with the interrelationship between treaties and domestic laws are discussed by Senior Advocate **Shri S.E. Dastur** in his article titled "**Principles of Interpretation of issues in Double Taxation Avoidance Treaties**" which can be accessed at <http://www.itatonline.org/interpretation/interpretation17.php>). The Tribunal noted that there is no difference in the definition of royalty between the India - US Treaty and hence, the assessee cannot get any benefit under the treaty. However, despite holding so, the tribunal went on to say that even if there was a conflict, the definition in the Act would prevail over the definition in the treaty. The Tribunal effectively held that in such a case, the Explanation to Section 9(1) inserted by the Finance Act 2007 with retrospective effect from 1976 would prevail over the Indo - US treaty, on the principle that the later legislation would prevail over the earlier treaty. In support of this proposition, the Tribunal relied on **Gramophone Company v. V.B. Pandey**, AIR 1984 SC 667 (hereinafter referred to as "**Gramophone Company**"). In this decision, however, there was no enabling provision such as Section 90 of the Act (the issue was whether an international convention which is not part of domestic law can prevail over the domestic legislation). As such, the reliance on **Gramophone Company** appears to require some reconsideration.

Thus, the Tribunal in **Gracemac** took a view contrary to that expressed by several other Benches, including the Special Bench, rejected the distinction between “*copyright*” and “*copyrighted article*”, and held that the payment made by end - users was in the nature of royalty. Thus, it will be seen that the decision in **Gracemac** raises new questions and increases uncertainties in the legal position. In this situation, the Mumbai Bench in **TII Team** had the occasion to clarify the law in this regard, and this decision can now be looked at.

C. TII Team: Clarity on the Legal position

In **TII Team**, the Mumbai Bench had the opportunity to consider in detail the decision of the Delhi Bench in **Gracemac**. The Revenue submitted that **Gracemac** being the later decision on the point, should be followed in preference to the other judgment on the issue. In this case, the assessee was entitled to the benefits of the Indo - Israel DTAA; and the issue arose as to whether the payment for supply of software would be royalty under the treaty. On the issue of whether the treaty provisions would prevail over the Act, the Tribunal firmly took the view that notwithstanding **Gracemac**, the treaty provisions would prevail. The decision in **Gramophone Company** was distinguished. The Mumbai Bench noted that the observations which had been relied on in **Gracemac** were actually “*in a situation in which an international convention and a bilateral treaty was being given effect to without there being any enabling provisions for such convention and treaty overriding the domestic legislation.*” Thus, it was clearly stated that the decision in **Gramophone Company** can have no application to the Income Tax Act, where a specific overriding measure is introduced through Section 90. Further, the Tribunal also noted that in **Gracemac**, the actual decision proceeded on the basis that there is no difference between the treaty provision and the Act, and hence, the coordinate bench observations in relation to application of the treaty were only *obiter dicta*. The Mumbai Bench instead preferred to follow the clear language of Section 90 of the Act and the decision of the Supreme Court in **Azadi Bachao Andolan**, which has settled the issue in the assessee’s favour.

Next, the Hon’ble Bench turned to the issue of whether the payments were in the nature of royalty or not. The term “royalties” is defined in Article 12(3) of the India - Israel DTAA as follows:

“The term royalties as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.”

The Bench held that the issue was covered in favour of the assessee, and was no longer debatable, in view of the decision of the Special bench in **Motorola**. Further, it explained the law in the following sentences, “*Copyright is one thing, and copyrighted article is quite another thing...*

To give a simple example, when a person is using a music compact disc, that person is using the copyrighted article, i.e. the product itself, and not the copyright in that product. As held by the Special bench, in Motorola's case (supra), the four rights which, if acquired by the transferee, constitute him the owner of a copyright right, and these rights are: (i) The right to make copies of the computer programme for purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease, or lending. (ii) The right to prepare derivative computer programmes based upon the copyrighted computer programme. (iii) The right to make a public performance of the computer programme. (iv) The right to publicly display the computer programme."

It was then noticed that the decision in **Gracemac** was based on the wordings of Section 9 of the Act; but the wordings in the India - Israel treaty were different. In the definition in the treaty, the word "of" was present between 'copyright' and 'literary' ("*any copyright of literary, artistic...*") Thus, the distinction in **Gracemac** was distinguished. However, it is important to note that not only has the Mumbai Bench distinguished **Gracemac** (perhaps because being a coordinate Bench, it could not express complete disagreement), but also the discussion in the decision provides an extremely strong counter - rationale to the points which weighed with the Bench in **Gracemac**. To that extent, it can safely be said that the decision in **TII Team** clarifies the position even as a general matter. Much of the compelling logic in **TII Team** is based on the conceptual distinction between "*copyright*" and "*copyrighted article*". For instance, in dealing with the issue of whether the payment can be considered as payment for a process, the Tribunal notes that the relevant question to ask is not whether the software is a "process" or not. Instead, the more relevant question would be, "*what is it that a customer pays for?*" Thus (refer to para 17), "*it is akin to a situation in which a person hires a vehicle, and the question could be as to what does he pay for – for the use of the technical knowhow on the basis of which vehicle operates, or for the use of a product which carries passengers or goods from one place to another. The answer is obvious. When you pay for use of vehicle, you actually pay for a product which carries the passengers or goods from one place to another and not the technical knowhow on the basis of which such a product operates. Same is the case with the software, when someone pays for the software, he actually pays for a product which gives certain results, and not the process of execution of instructions embedded therein.*" In support of this, the Tribunal also relied on the decision of the Delhi High Court in **Asia Satellite v. DIT** 332 ITR 340.

Accordingly, the Tribunal in **TII Team** came to a conclusion different from that reached in **Gracemac**, giving strong reasons for the same.

D. Conclusion

From the above, it will be seen that the issue of whether payment of the above nature are royalty or not, is an issue which continues to present difficulties. While the issue appeared settled after the decision of the

Special Bench in *Motorola*, the decision of the Delhi Bench in *Gracemac* attempted to reopen the same controversy. It is respectfully submitted that the decision in *Gracemac* requires reconsideration, and being contrary to the clear decision of the Special Bench and several coordinate benches in this regard, is not binding judicial precedent. It needs to be seen in the facts of the particular case as to what exactly the payment is for: whether it is for copyright itself, or only for copyrighted article. Typically, in the case of an off - the - shelf purchase, the payment would be for the article, and not for the exploitation of the copyright as such. It is humbly submitted that the better approach to take would be that which was adopted by the Mumbai Bench in *TII Team*. Although in *TII Team*, the decision proceeded on the basis of the specific wording of the India - Israel treaty, it is respectfully submitted that the propositions laid down therein are of general application also. The Tribunal has placed the distinction between “copyright” and “copyrighted article” on a strong conceptual foundation. It has explained how such payments cannot be seen as payments in respect of “process”. It has also reaffirmed the sanctity of the Special bench decision, and has clarified that the decision in *Gracemac* being contrary to the law laid down by the Special Bench cannot be followed. It is hoped that the same view would be taken by the High Courts when the matter is carried in appeal.

Debate over asset disclosures

by

Huzaima Bukhari & Dr. Ikramul Haq

Pakistan has many laws concerning disclosures of assets and liabilities by the government servants, holders of public offices, elected members of assemblies and persons desirous of contesting elections. A government official faces inquiry under Efficiency and Disciplinary Rules, 1973 if charges mentioned in Rule 3—these include corruption, financial irregularities or living beyond known means—are made against him. Once inquiry is ordered, the inquiry officer can look into his/her annual declarations. Many civil servants faced criminal proceedings under the National Accountability Ordinance, 1999—see the list of beneficiaries under National Reconciliation Ordinance, 2007, declared void ab initio by the Supreme Court. Military hierarchy and judges of higher courts claim to have “foolproof internal system” for checking declarations of assets and liabilities. Rarely anybody is prosecuted for corruption in these institutions, giving an impression that financial integrity is not an issue with these powerful segments of society. As far as general public is concerned, the assets owned by generals, judges and high-ranking civil servants remain secret. This is not the case with elected representatives, their assets are to be notified by the Election Commission of Pakistan every year.

The political parties and politicians in Pakistan are subjected to various laws that require them to file annual accounts and declarations of assets and liabilities. Rule 4 of the Political Parties Rules, 2002 requires that “every political party shall maintain its accounts in the manner set-out in Form-I indicating its income and expenditure, sources of funds, assets and liabilities and shall, within sixty days from the close of each financial year (July-June), submit to the Election Commission a consolidated statement of accounts of the party audited by a Chartered Accountant, accompanied by a certificate, duly signed by the Party Leader to the effect that no funds from any source prohibited under the Order were received by the party and that the statement contains an accurate financial position of the party”. **It is painful to note that none of the political parties have displayed accounts submitted under Rule 4 of the Political Parties Rules, 2002 on its website. It is the duty of the Election Commission of Pakistan to enforce strict compliance of this rule and moral obligation—if not statutory—of all the political parties to publish the same in newspapers or post at websites so that party workers, donors and voters know about their financial matters.**

Section 42A of the Representation of People Act, 1976 and section 25A of the Senate (Election) Act, 1975 make it mandatory for the elected representatives to file in the prescribed manner details of their assets and liabilities on the closing date of each financial year, failure to fulfill this obligation leads to disqualification. Pakistan Institute of Legislative Development and Transparency (PILDAT) has published a comprehensive report about these legal provisions and their compliance (http://www.transparency.org.pk/jlc/mna/report_2010.pdf). **It is sad to note that there are gross violations of these laws by elected members. The Election Commission, through a notification on October 21, 2011 suspended as many as 222 lawmakers for failing to submit details of their assets till the submission of statements of assets and liabilities.**

Section 116 of Income Tax Ordinance, 2001 also requires filing of wealth statements and declarations of personal expenses in the prescribed manner for all individuals whose last assessed or declared income is rupees one million or more [up to tax year 2011 this limit was rupees 500,000]. It means that all persons in the service of Pakistan, holding public offices and elected representatives having this threshold of income must have filed wealth statements conforming to their declaration of assets and liabilities filed under the laws mentioned above. There is no mechanism to check it. This can only be done through parliamentary control as is the case in mature democracies.

A non-partisan Parliamentary Standing Committee on Asset Disclosures & Investigation should be formed to inquire into matters relating to assets disclosures by elected representatives. It should examine the data of the Federal Board of Revenue (FBR). For probing sources of acquisition

of assets, the Income Tax Ordinance, 2001 contains detailed provisions. At present unnecessary confusion has been created in media debates about laws relating to disclosure of assets by politicians. Nobody is clear about the applicability and interplay of various laws.

The ongoing tug of war between political parties on the issue of asset declarations should be resolved democratically. First of all, FBR should be obliged by law to convey to Parliamentary Standing Committee on Asset Disclosures & Investigation all declarations filed by persons in the service of Pakistan, holding public offices and elected representatives. The Committee can compare declarations filed under the Civil Servants Act, 1973, Army Act, 1952 and related rules, Representation of People Act, 1976, the Senate (Election) Act, 1975, Rule 4 of the Political Parties Rules, 2002 with those filed under the Income Tax Law. In case of any discrepancies or complaint of suppression and concealment, the Committee can ask FBR, NAB, FIA, MP, Military Court, as the case may be, to take action under the law. Election Commission has no power to investigate about veracity and sources of assets submitted to it.

For political parties there should be a provision in the Income Tax Ordinance, 2001 making it incumbent on them to file their tax returns. Their income should be exempt from tax, provided they file returns voluntarily and present audited accounts for scrutiny. Such provisions exist in tax laws of all the major democracies. In India not only does this law exist [section 13A of Income Tax Act, 1961] but recently Chief Election Commissioner of India, S Y Qureshi, asked the Indian Central Board of Direct Taxes (CBDT) to scrutinize accounts submitted by political parties. Earlier, the Central Information Commission of India directed Income Tax Department to disclose in public interest details of donors given by political parties in their tax returns. With this information in public domain, the Commission said, there would be transparency in the funding of both small and big parties, besides checking the flow of black money in the electoral process.

The starting point of across the board accountability in Pakistan should be scrutinizing of declaration of assets, liabilities and taxes paid by politicians, high-ranking civil and military officials and judges. The civil society and media should come forward to force the parliament to abolish all laws relating to secrecy and/or immunity and enact a comprehensive legislation for obtaining information by any citizen under Freedom of Information Law.

The slogan for accountability and reforms in Pakistan has assumed great public importance after the successful rallies by Pakistan Tehreek-e-Insaf. The issue should not be confined to public disclosures of assets by politicians alone. It should be extended to judges, generals and civil servants as well. The public and media should strive for an effective right-to-information legislation that alone can pave the way for true democracy. Information about the assets of close relatives and dependents is equally important in our context as most of the assets are

kept in their names. An affidavit should also be mandatory to the effect that no asset has been kept as *benami* (name-lender).

The accountability of powerful segments of society should be initiated through a law making it obligatory on the FBR to publish annual tax directory as was done in 1993 disclosing area-wise details of taxes paid by salaried and non-salaried persons for assessment year 1992-93. This step would expose the rich and mighty who have amassed enormous wealth, but are not filing their tax declarations under the law. Election laws should also be amended debarring tax delinquents from contesting elections.

Essential edible items under APTTA: FBR agrees to exempt goods from insurance guarantee

The Federal Board of Revenue (FBR) has principally agreed to exempt Afghan transit trade consignments of essential edible items including wheat, sugar and pulses from submission of insurance guarantee by the Afghan importers under the Afghanistan Pakistan Transit Trade Agreement (APTTA).

Sources told here on Sunday that the second extension of 30 days granted by the Board for waiver in submission of insurance guarantee for release of transit goods was expired on October 6, 2011.

The representatives of Afghan Consulate General and Afghan traders stressed upon the need to devise longer term policy on the issue instead of piecemeal extensions.

The FBR and the Afghan side agreed that as short term measure goods declarations filed till October 15, 2011 have been exempted from the requirements of insurance guarantee.

For the longer term, Collector of Customs Model Customs Collectorate (MCC) Appraisement has been given assignments to propose measures to streamline the issue by looking into the possibility of exempting edible items of essential nature such as wheat, sugar, pulses etc from the insurance guarantee requirements altogether and extending the 'PD account' facility for large Afghan importers to serve a revolving guarantee, instead of providing IG for each individual consignment.

The facility of exemption from submission of insurance guarantee during clearance of Afghan transit trade consignments of essential edible items including wheat, sugar and pulses and other similar kind of items would ensure timely availability of these basic commodities in Afghanistan.

It has also been noted that insurance companies were arbitrarily demanding premium of up to Rs 800,000 for issuance of insurance guarantee for sensitive items.

It was also decided that the Collector of Customs Model Customs Collectorate (MCC) Appraisement shall issue a list of items that may be classified as sensitive and the insurance companies shall charge not more than one percent of the duties and taxes involved therein as premium and 0.7 percent on other non-sensitive items.

Sources said that at present movement of transit cargo is being allowed only in original/shipper's containers by the clearance

Collectorates, which is greatly increasing the cost of the business for the Afghan importers.

The representatives of Afghan Consulate General and Afghan traders requested that the condition may not be applied on essential food items whose import into Pakistan even otherwise is duty free.

The Transit Trade Rules 2011 allow movement of transit cargo in loose condition in sealable trucks and for food items, this option may be preferred.

Customs authorities of both the sides have agreed to allow loose delivery of essential food items in sealable trucks in principal and directed the Collector of Customs MCC Appraisement to submit detailed recommendations to Board for across the board implementation of the instructions. – *Courtesy Business Recorder.*

Supply to zero rated sectors manufacturers: raw material importers to pay 19 percent ST

The FBR has proposed imposition of 19 percent sales tax ie 16 percent standard rate of sales tax and 3 percent sales tax on value-addition on the commercial importers engaged in import of raw materials and inputs in the name of five zero-rated sectors, but actually supplied to un-registered persons or manufacturers of non-zero rated sectors.

Sources told here on Saturday that the FBR has drafted a statutory regulatory order (SRO) on revised zero-rated regime and the concept was shared with the members of the Tax Reform Co-ordination Group.

The FBR has placed checks in the proposed notification to check abuse of the zero-rating regime by the commercial importers.

The FBR will consult all stakeholders including commercial importers before issuance of the notification.

The new notification is expected to take effect on and from December 15, 2011.

Under the new zero-rated scheme, the current facility of zero-rating shall be available at the time of import as well as for local supply chain except at the retail stage.

At the time of import, sales tax @ 0 percent shall be charged from registered persons of five zero-rated sectors.

At the time of import no sales tax shall be charged from commercial importers but guarantee (in form of good for payment cheque or pay order or bank guarantee or cash) shall be required.

Sources said that the guarantee shall be released on subsequent supply of the imported items to registered persons within the five zero-rated sectors.

An important condition of the notification is that if imported goods are supplied to unregistered persons or to manufacturers of non-zero-rated sectors, then sales tax @ 16 percent along with value-addition tax 3 percent shall be charged on such supplies and this amount of tax shall be deposited in exchequer and thereafter the guarantee shall be released.

The imports by manufacturers of non-zero-rated sectors shall be chargeable to sales tax @ 16 percent.

Sources said that the import of made-up articles of 5 sectors shall be charged sales tax @ 5 percent, irrespective of the fact whether they are imported by commercial importers or manufacturers of any sector.

All transactions within the registered persons of five zero-rated sectors shall remain zero-rated up to the wholesale stage.

Thereafter, supply of these goods to retailers and unregistered persons shall be chargeable to sales tax @ 5 percent.

The Input tax adjustment of all taxes paid shall be admissible under this scheme to avoid any double taxation.

No turnover tax shall be chargeable on the sale of final/finished goods of 5 zero-rated sectors, sources added.

According to the draft of the notification, the commercial importer shall submit good for payment cheque or bank guarantee or pay order or pay in cash the amount equal to the amount of sales tax at the rate of 16 percent payable at import stage and 3 percent value-addition sales tax.

This good for payment cheque or bank guarantee or pay order or cash would be returned back, or as the case may be, refunded after providing evidence of next supply.

In case where the commercial importer sells any imported goods to persons registered in the five sectors within subsequent three months, such supply shall be exempt from sales tax but the commercial importers shall be required to provide details of each and every invoice in the sales tax return.

On the basis of these details the good for payment cheque or bank guarantee or pay order or cash furnished shall be returned back or as the case may be refunded, it said.

In case where the commercial importer sells any imported goods to unregistered persons or persons registered in non-zero rated sectors (other than five sectors) within subsequent three months, he shall charge and pay sales tax at the rate of 16 percent of the value of such supply and value-addition tax at the rate of 3 percent of the import value at the time of such supply.

This amount shall be deposited on monthly basis along with the sales tax return.

On the basis of furnishing proof of such payment, the good for payment cheque or bank guarantee or pay order or cash shall be released.

The commercial importer shall be required to provide details of each such sale to the unregistered persons or persons registered in non-zero rated sectors in the sales tax return.

The draft notification further said that the goods imported by all other importers (other than registered manufacturers of five sectors and commercial importers) shall be charged at the rate of 16 percent.

It said that the facility of zero-rating shall be available to every such person engaged in manufacturing or trading in textile (including jute), carpets, leather, sports and surgical sectors who is registered for the purpose of sales tax other than as a retailer.

The imports made by registered manufacturers, importers and exporters of five sectors under this notification shall be exempt from sales tax.

However, all imports of made-up articles/finished products of the five sectors shall be charged sales tax at the rate of 5 percent and no value-addition sales tax shall be charged on such made-up articles/finished products, the draft notification said.

On local purchase or supply, this notification shall, in case of textile sector apply from ginning stage onwards (for synthetic sector from production of PTA and MEG) and in case of other sectors registration will start from tanneries (in leather industry) and manufacturers of surgical, sports and carpet goods including the persons engaged in ancillary industrial activities.

The supplies of these goods to registered persons of five zero-rated sectors up to wholesale stage shall be zero-rated.

The supplies of all finished products of the sectors specified in the condition (i) shall, if sold to the retailers (both registered and unregistered) or end consumers shall be charged to sales tax at the rate of 5 percent ad val.

Where a registered person has acquired goods on payment of sales tax at the rate of 5 percent or 16 percent ad.val, he shall be entitled to input tax adjustment or as the case may be, refund against the subsequent supplies made by him to registered persons either at the rate of 5 percent or 16 percent ad val or as the case may be, at zero rate, the notification said.

As per draft notification, a registered person who has consumed any other inputs acquired on payment of sales tax, whether covered in this notification or not, shall be entitled to input tax adjustment or, as the case may be, refund in respect of the supplies made by him either at the rate of 5 percent or 16 percent ad vat or at zero rate.

It further stated that the registered persons who are solely or otherwise engaged in the retail business of these goods or products shall pay sales tax at the rate of 5 percent ad vat on their retail sales and shall be entitled to input tax adjustment or, as the case may be, refund against such sales and they shall not be required to pay any other sales tax leviable on their such retail transactions. However, such retailers shall be liable to pay turnover tax as prescribed under Chapter III of Sales Tax Special Procedure Rules, 2007, and the goods supplied at the rate of 5 percent shall not constitute part of turnover on which the aforesaid turnover tax is to be paid.

Where in the case of a registered person falling under the provisions of this notification, amount of claimable refund exceeds the amount of tax payable by him, he may minus the tax liability from his refundable amount and claim refund of the balance amount, if any, draft notification said.

The registered manufacturers who process goods owned by unregistered persons shall charge sales tax at the rate of 5 percent ad vat on the processing charges received by them, provided that no tax shall be charged from the registered principals.

The registered manufacturers shall be entitled to the adjustment of input tax paid on machinery parts or spares and lubricants acquired by them for their own use.

Supply of electricity and gas to the registered manufacturers of the above mentioned sectors shall be zero rated in such manner and to such extent as may be specified by the FBR, the draft notification added. – *Courtesy Business Recorder.*

FBR decides to set up anti-money laundering wing

The Federal Board of Revenue for the first time decided to set up an Anti-Money Laundering Wing in the Directorate General of Intelligence and Investigation to exclusively detect, investigate and prosecute those involved in financial crimes and money laundering through transfer of unexplained funds or undisclosed income abroad.

Sources told here on Thursday that the proposed Anti-Money Laundering Wing of the intelligence directorate of FBR would play a key role in taking action against the organised gangs, involved in financial crimes and money laundering.

This is for the first time the customs intelligence department would be directly involved in detection and prosecution of the anti-money laundering cases.

The proposed Anti-Money Laundering Wing would directly investigate or co-ordinate inquiry into organised tax evasion, tax fraud, money laundering and financial crimes in close liaison with empowered agencies under any Pakistani law.

There are cases where huge amounts of foreign exchange has been seized or confiscated at airports or ports by the customs officials.

In such cases, two offences might have been simultaneously taking place ie violation of Customs Act, 1969/Foreign Exchange Regulations and Anti-Money Laundering Law.

On one side, the person has committed an offence of illegally transferring money aboard.

On the other hand, there might be case involving Anti-Money Laundering Law.

These offences could be simultaneously prosecuted under the Customs Act, 1969 and Anti-Money Laundering Law.

In order to check such cases, the intelligence arm of the FBR would establish an exclusive Anti-Money Laundering Wing, sources explained.

Sources said that the federal government, vide its notification dated August 24, 2010, made it clear that the Directorate General Intelligence & Investigation - FBR as one of the five leading agencies in Pakistan to deal with the cases of money laundering.

Accordingly, the Directorate General created Anti-Money Laundering Units at its HQ and all Regional Offices with in its given resources.

However, due to shortage of officers and staff anti-money laundering functions were assigned as an additional duty.

There is no denying the fact that unless financial crimes are interdicted through an effective anti-money laundering regime, the criminals would continue flourishing.

It is a proven fact that the countries leading in Anti-Money Laundering enforcement have, as a pre-requisite, a dedicated work force with adequate financial resources at their disposal.

The Directorate General Intelligence is trying its level best to enhance the capacity of its officers and staff in the field of Anti-Money Laundering through local and foreign training.

It is, however, felt that unless a specialised, dedicated work force is created for Anti-Money Laundering the results expected from us, under Vienna Convention and Palermo Convention ratified by Pakistan, can not be achieved fully, sources said.

In view of current circumstances, sources said that the Directorate General feels that a separate, dedicated Anti-Money Laundering Wing be created to exclusively handle investigation and prosecution of AML cases.

In this connection, the directorate has asked the Board to create the following posts in this Directorate General for the proposed AML Wing so that it becomes an effective and viable entity to deal with the menace of money laundering.

The directorate of intelligence customs has further requested the FBR to create new posts of Additional Directors and Deputy Directors at DG Intelligence Headquarters and Regional Offices of Karachi, Lahore, Peshawar and Quetta, sources added. – *Courtesy Business Recorder.*

Tax administration project: FBR yet to complete critical reforms: World Bank

The Federal Board of Revenue (FBR) has yet to complete some crucial reforms in the tax administration, including effective use of the information technology (IT) system, improved audit functions for sales tax and income tax and staff training under the Tax Administration Reforms Project (TARP) of the World Bank (WB).

Sources told here on Saturday that the WB-funded TARP would close on December 31, 2011.

The WB has observed that the successful conclusion of the TARP would create a good foundation for any follow-up actions, and the WB is ready to work with the FBR to develop a sound and feasible results-oriented strategy for such an operation.

According to sources, TARP implementation lags behind the intended achievements in terms of certain Project Development Objectives (PDOs).

Despite closure of the project in the coming few weeks, the FBR has not implemented the full-fledged Integrated Tax Management System (ITMS) for which training of tax officials needs to be conducted in the field formations.

The ultimate objective of reforms to ensure electronic integration of all federal taxes at the level of the field formations has not been achieved by the FBR.

At the same time, the field formations of the FBR have to ensure effective use of the IT systems for all federal taxes.

The ineffective audit and absence of a centralised selection system for desk and field audits based on risk profiling of taxpayers has also not been completed under the tax reforms project.

The lack of co-ordination between headquarters and field formations in administrative and tax matters still exists under the revised organisational structure of the Board.

Sources said that the FBR has to place a strong monitoring framework to assess operational performance to evaluate the overall adequacy of the reorganisation in the mid- and long-terms as well as to timely suggest corrective actions.

Under the reforms, the FBR has to ensure stable tenure at mid-management levels at the Board's level and the field formations.

The FBR was required to issue a customs notification, disallowing imports of registered persons being excluded from the list of 'Active

Taxpayers List' to ensure compliance by the business and trade community.

Under the reforms, the FBR should disallow imports by non-active taxpayers.

The 'non-active taxpayers' covers those non-compliant persons who have been excluded from the list of the 'Active Taxpayers'.

The legislation requires a person to be a registered sales taxpayer to be able to import.

The non-active taxpayer's registration would be considered to be suspended.

This requires an SRO/Customs notification and the FBR has to issue the SRO and Customs notification in this regard.

Under the reforms, the FBR was unable to complete the job description of positions and staff assignments as required by the new organisational structure in the field formations.

The FBR has to finalise the specification of the taxpayer ledger project and the automation of the recovery officers' tasks to be approved by Chairman FBR.

In its last report on TARP, the WB reportedly informed the tax authorities that the FBR's 'lower than expected overall performance' by end of fiscal year 2010-11 was associated with two major shortcomings previously discussed at length with FBR authorities during past supervision missions: (a) Under-utilisation of IT-related systems due to poor integration of the new systems into re-engineered business processes, weak management follow-up on implementation of systems, and opposition of FBR staff to adopt new business processes based on newly deployed systems at field formations; and (b) Continued weakness of the audit function, associated with 'lower than expected performance' by the audit program delivered by private accounting firms during the outsourcing program, lack of a centralised-based audit function in charge of planning, programming and monitoring of results, and poor training.

Giving a review on the TARP, the WB noted that another area of concern is net revenue collection as percentage of GDP.

Based on preliminary data, FBR's tax revenue for fiscal 2010-11 stood at 8.6 percent of GDP, compared to 9.0 percent for fiscal year 2009-10.

The modernised FBR organisational structure fully functional by end of project is facing critical challenges on account of the following factors: (i) possible adverse impact of the organisational changes, introduced in February 2011 on FBR's effectiveness and accountability goals originally pursued by the Government's endorsed organisational model along functional lines; (ii) lack of an appropriate co-ordination mechanism to oversee operations between headquarters and field formations, and (iii) an unstable tenure at mid-management levels undermining the efficiency and effectiveness of FBR to implement its reform action plan.

In its report in October 2011, the WB Implementation Review Mission observed that despite sustaining positive trends on some intermediate outcomes, overall performance continues to fall short of expectations, thereby risking the achievement of key development objectives by the end of project life.

Also, the fully functional FBR organisation envisioned by the end of the project faces critical challenges on account of the possible adverse impacts of the reorganisation introduced at the beginning of 2011, lack of co-ordination between FBR headquarters and field formations, and unstable tenure at FBR's mid-management levels, the WB said.

Positive results in fiscal year 2010-11 included (i) registered and active taxpayers increased by 6.2 percent from 2.984 million to 3.167 million; (ii) electronic return filers increased by 6 percent for sales tax, with income tax filers registering a 27 percent increase in fiscal year 2009-10; and (iii) registered and active taxpayers for income tax and sales tax CE-enrolled, liable to e-filing increased by 29 percent and 13 percent, respectively, the WB review mission added.

The basic objectives of reforms were to increase revenue collection and contribute to the achievement of fiscal targets; increase tax-to-GDP ratio; collect optimum tax revenues; broaden the tax base; strengthen audit and enforcement procedures; guarantee fairer and more equitable application of tax laws; increase transparency and integrity; improve effectiveness, responsiveness and efficiency; facilitate and promote voluntary compliance with tax laws and provide transparent and high quality tax services. – *Courtesy Business Recorder.*

Cut in security deposit charged by shipping lines: FBR agrees to Afghan traders' proposal

The Federal Board of Revenue has agreed to a proposal of the Afghan traders to reduce security deposits charged by shipping lines/companies for release of Afghan transit containers destined for Afghanistan.

Sources told here on Wednesday that shipping lines were charging exorbitant rates as security deposit for release of containers meant for Afghanistan.

The sum of money (up to Rs 600,000) was in addition to insurance, rental and detention charges which the trader is already bearing for release of containers for Afghanistan.

It has been agreed in principle by the Pakistani customs authorities that there was a need to streamline the tariff being currently charged by shipping lines.

The FBR has directed the Collector Model Customs Collectorate (Preventive), Karachi to convene a meeting with ship agents association to evolve an equitable mechanism in this regard, for which, among other proposals the possibility of securing revolving guarantees, actual value of the empty containers, etc, may also be looked into.

On the issue of fixation of tariff by bonded carriers, sources said that the bonded carriers were charging arbitrary rates for transportation of goods/containers through exit Collectorates during transit of Afghan consignments.

There was an urgent need to bring transparency in the system and streamline the tariff structure on the basis of weight/destination of the Afghan consignments.

One of the principal reasons for such arbitrary and exorbitant rates was the "captive registration" of vehicles by a few large bonded carriers, who were dictating their terms to the entire market.

The FBR has decided that the Collector MCC Appraisalment shall convene a meeting of the relevant association of bonded carriers to deliberate the issue thoroughly and propose measures to streamline the tariff structure without compromising the quality of service.

Sources said that the Afghan traders were of the view that private terminal operators (KICT, PICT, QICT) and Karachi Port Trust

(KPT) provide different number of demurrage free days to Afghan traders for clearance of cargo.

The difference in practice casts adverse impact on the business cycle and leads to various trade distortions.

In this regard KICT provides the least number of demurrage free days (5) while KPT provides the maximum (14, excluding holidays).

The FBR has decided that since the majority of transit cargo is imported through private terminals, there is a need to bring uniformity in the number of demurrage-free days provided by them to Afghan traders and the minimum benchmark in this regard would be the KPT's standard of 14 days (excluding holidays) for all terminals. – *Courtesy Business Recorder.*

ST Refund: FBR accepts demand of SCCI

Federal Board of Revenue (FBR) has accepted and resolved a long standing demand of Sarhad Chamber of Commerce and Industry (SCCI) relating to sales tax refund and appointment on the collector customs and some other vacant posts at Regional Tax Office (RTO), facilitating taxpayers.

The FBR withdrew the instructions hampering the sales tax refund process under the PM package.

Afan Aziz, SCCI president while thanking the FBR chief for resolving the chambers problems has expressed the hope that the other problems highlighted by the SCCI delegation would also be resolved soon.

Earlier, a SCCI delegation led by Aziz and Senator Ilyas Ahmed Bilour had forwarded its demands in a meeting held on November 28, 2011 at Islamabad.

The FBR chief on this occasion assured the delegation that their demands would soon be met.

The delegation apprised the FBR chief about the hurdles in implementation of the PM Financial Package announced in January 2010.

They listed the difficulties of the taxpayers with regard to withholding tax on export, turnover tax, sales tax rate/refund and difficulties in implementation of the said package due to lack of staff. – *Courtesy Business Recorder.*

FBR issues notices to 1,60,000 non-taxpayers in 5 months

In order to broaden the tax base of the country, the Federal Board of Revenue (FBR) has issued notices to 1,60,000 non-taxpayers during the first five months (July-November) of the current year, as it had planned to bring 0.7 million non-taxpayers into the tax net in the year 2011-2012.

Riffat Shaheen Qazi, member FATE and official spokesperson of the Federal Board of Revenue, has informed that FBR's drive for bringing non-taxpayers into the tax net is continuing. "Everyday we issue notices to those people who are not filing their returns".

On a query, she said, "Our first goal is to bring non-taxpayers into the tax net and after that we will estimate how much revenue will be generated from them".

It might be recalled here that government had traced 2.3 million non-taxpayers in the country, which would be brought to the tax net.

Out of 2.3 million, the FBR would issue notices to 0.7 million non-taxpayers in the ongoing financial year 2011-2012.

However, another official of the board has said that government had planned to collect Rs 70 billion during the ongoing fiscal year from identified 0.7 million people living in posh areas, have more than two foreign currency accounts and travel abroad every year but don't pay any tax.

Talking about the revenue collection of the FBR, the member FATE said that collection's has shown growth of 28 per cent during the first five months (July-November) of the current fiscal year 2011-2012 against the same period last year. The Federal Board of Revenue (FBR) has collected some Rs 640 billion during the first five months (July-November) of the current financial year 2011-2012, which is 28 per cent higher than the collection of Rs 500 billion in the same period last year.

The FBR has also surpassed the revenue collection target of Rs 632 billion set for the first five months of the ongoing fiscal year. The high ups of the FBR and Finance Ministry believed that government would reach the annual tax collection target of Rs 1952 billion at the end of June 30 keeping in view the current progress of the Federal Board of Revenue. – *Courtesy The Nation.*

Cabinet decides to withdraw subsidy on tube wells

The Cabinet has decided to withdraw subsidy on agricultural tube wells and refund the GST on uncollected electricity bills to the power sector in an effort to tackle the problem of circular debt.

Briefing media person here on Thursday after the Cabinet meeting presided over by Prime Minister Yousuf Raza Gilani, Minister for Information, Firdaus Ashiq Awan said that the meeting decided to install metering system on tube wells in Balochistan and adopt a uniform tariff policy across the country.

She said that a summary was presented to the Cabinet for the strengthening of National Electric Power Regulatory Authority (Nepra) so that it could implement a uniform power tariff across the country.

The minister said the Cabinet agreed to the demand of AJK government for not imposing GST on their electricity bills and also constituted a committee to settle issue of Karachi Electric Supply Company (KESC).

She said that a detailed discussion was held on the issue of energy sector reforms as well as restructuring of the State Owned Enterprises (SOEs) and it was decided that the Cabinet meeting would be held weekly to review the progress on each entity.

The minister said the government has been providing huge resources to the SOEs but their performance was not up to the mark.

Firdos said the meeting was informed that Pepco has been dissolved to set up Central Power Purchasing authority (CPPA) to take care of the issues in power sector.

The minister said that there would be positive and encouraging impact of Pepco dissolution on the power sector that would start appearing after some time.

She said inter-ministerial committee on energy sector informed the Cabinet about the drive against power defaulters that 0.2 million electricity connections of defaulters have so far been disconnected after the expiry of 45 days deadline and Rs 2.3 billion recovered.

The committee said that 43,000 electricity connections have been reconnected after clearance of dues by defaulters while the remaining are still disconnected.

The minister said a proposal for two hours load shedding in cities and four hours in rural areas was presented to the Cabinet for

approval and implementation after two months when the hydel power generation would decrease following decline in water reservoirs.

The Prime Minister, she said, opposed the unscheduled load management and directed for taking all the stakeholders on board and ensure that there is no unscheduled load shedding.

About gas load management, she said the Prime Minister directed on the conclusion of presentation by the Ministry of Petroleum and Natural Resources that domestic consumers should be provided with gas on priority basis.

The Cabinet meeting also directed the SNGPL and SSGCL to set their priorities and present a detailed plan in the next meeting, so that all the sectors should be treated equally.

The Cabinet reviewed the implementation status of the Cabinet decisions pertaining to Economic Affairs and Establishment Divisions and was informed that 6,118 contract and daily wages employees have been regularised and huge task of accommodating and adjusting over 60,000 employees of 17 devolved ministries has been accomplished and the prevalent ministries have been directed to ensure payment of their salaries.

The National Commission of Human Development (NCHD) employees are being paid their salaries as per the Supreme Court decision, she added.

She said the Prime Minister and the Cabinet prayed for speedy recovery of the President so that he could return to the country and perform his duties.

The Cabinet also hailed the interior ministry, provincial governments and law enforcement agencies for their co-ordination and ensuring peace on Ashura with the support of people.

The interior minister informed the Cabinet that as many as 21,143 Majalis and 5,180 processions were taken out across the country.

The federal government facilitated provincial governments by providing 8 helicopters for surveillance, 1018 Rangers, 924 FC personnel and 795 troops for security purposes. – *Courtesy Business Recorder.*

CNG cylinders and kits: FBR proposes 25-35 percent customs duty

The Federal Board of Revenue has proposed 25-35 percent customs duty on the import of CNG cylinders and conversion kits instead of total ban on the imports of such equipment as proposed by the ministry of petroleum and natural resources.

Sources told on Thursday that the proposal of the ministry of petroleum to impose ban on the import of CNG cylinders and conversion kits would be taken up in the meeting of the Economic Co-ordination Committee (ECC) of the Cabinet to be convened here on Friday (December 9).

According to the FBR viewpoint, the total ban on the import of CNG cylinders and conversion kits would encourage smuggling of these items and higher rate of 25-35 percent duty on the import of CNG cylinders/kits would be appropriate instead of clamping total ban as proposed by the Ministry of Petroleum.

The imposition of ban would also result in smuggling of substandard cylinders and kits which would be serious threat to the general public particularly transporters.

Sources said that the summary has been moved by Ministry of Petroleum & Natural Resources (Directorate General Gas) regarding "Ban on import of CNG Cylinders and Conversion Kits".

To discourage new conversion of vehicles to CNG, the following has been proposed by the Ministry: Firstly, a complete ban be imposed on company fitted CNG cylinders/kits in focally manufactured vehicles.

Secondly, Moratorium on import of CNG cylinders and conversion kits be imposed except where letter of credits have been established and CNG fitted public transport vehicles ie buses/vans may be exempted from this moratorium.

The CNG compressors, cylinders and kits imported by local assemblers of vehicles and companies having CNG licenses, are presently exempt from customs duty in excess of 5 percent and 0 percent, respectively, vide Sr. No 5 of SRO 575(1)/2006, dated 5.6.2006 whereas tariff rate of customs duty on cylinders is 0 percent and on CNG kits is 35 percent, sources maintained.

The issue of imposition of complete ban on import of items in question does not directly relate to the FBR but to ministry of industries, ministry of commerce and the ministry of environment.

The FBR, however, thinks that imposition of complete ban will induce smuggling as well as use of old and substandard items causing concern for public safety, as cylinders of lower specs and substandard kits may cause untoward incidents.

Keeping this in view and also to generate additional revenue, it may be proposed that instead of complete ban, the above items may be excluded from the exempt regime and subjected to higher rate of duty, say 25 percent or 35 percent, sources added. – *Courtesy Business Recorder.*

Section 235 of IT Ordinance 2001: Supreme Court issues notices to advocates general, AGP

A three-member bench of the Supreme Court (SC) on Thursday issued notices to Advocates General of all the provinces along with Attorney General for Pakistan to appear before the court while hearing identical appeals against Lahore High Court verdict relating to provisions of Section 235 of the Income Tax Ordinance, 2001.

Lahore Polypropylene Industries and others versus Federation of Pakistan through Secretary Ministry of Finance and others had filed writ petitions in Lahore High Court Lahore, requesting the court to declare Section 235 of ITO 2001 ultra vires.

A division bench of principal seat of Lahore High Court had dismissed writ petitions challenging provisions of the Section 235.

A three-member bench of the apex court comprising Justice Mian Shakirullah Jan, Justice Jawwad S.

Khawaja and Justice Ijaz Ahmed Chaudhry was hearing identical appeals filed by Lahore Polypropylene Industries and others versus Federation of Pakistan through Secretary Ministry of Finance and others.

During the course of preliminary hearing of the petitions, counsel for the appellants Mian Ashiq Hussain contended that tax imposed under provisions of Section 235 of ITO 2001 was a legislative trespass because the expenditure as subject of tax had not been enumerated in either of the two, rather the exclusion of expenditure as a subject of tax was explicit.

Hussain argued that the amount of an electricity bill could not be made the basis for the measurement of tax because certain factors

including the charges of MDI, which he said had no nexus with the capacity of production/sale/income and loadshedding.

He contended that electricity consumption had no link with the production, as it varied according to the components of generation cost, adding that the capacity of income depended upon the kind and quality of machinery so the cost of electricity as a proportion of the cost of production in case of industrial units could not be standardised in the case of commercial units on account of incredible variations.

After issuing notices to four provincial Advocates General and Attorney General for Pakistan the bench adjourned hearing for an indefinite period. – *Courtesy Business Recorder.*

Restoration of ST zero-rating facility on tractors: FBR opposes ministry's proposal

The Federal Board of Revenue has strongly opposed proposals of the Ministry of Industries to restore sales tax zero-rating facility on the agricultural tractors or impose a lower rate of 4 percent sales tax on it in view of government policy that exemptions and zero-ratings are major distortions in the Value Added Tax (VAT) regime.

Sources told here on Thursday that the meeting of the Economic Co-ordination Committee (ECC) of the Cabinet to be held here on Friday (December 9) would take the decision on the removal of levy of 16 percent sales tax on agricultural tractors.

Ministry of Industries has submitted three proposals for withdrawal of 16 percent sales tax on agricultural tractors.

The first option is that the sales tax zero-rating on agricultural tractors may be restored.

The second option is that the deemed price (say 25-30 percent of the actual price) may be fixed for sales tax purposes, as has been done in the case of sugar and fertilisers.

The third option is that the sales tax may be phased scattered on three to four years instead of imposition in one go ie @4 percent per year.

Responding to these proposals, the FBR has opposed all these proposals on the argument that it is not the government policy to give exemptions and zero-rating facility, which would create distortions in the supply chain.

In its summary to the ECC of the Cabinet, Ministry of Industries and Production observed that the Association of tractors manufacturers and Pakistan Association of Automotive Parts & Accessories Manufacturers (PAAPAM) approached the Ministry of Industries and submitted a representation on the subject matter.

The manufacturers protested against the imposition of 16 percent GST on tractors as it has affected the industry adversely, besides additional burden of price on the farmers, sources said.

In accordance with the policy laid down vide SRO 549(1)/2008, dated June 11, 2008, zero-rating of sales tax on agricultural tractors was provided with the intent to ensure availability of tractors to the farmers at affordable prices.

The same has however, been withdrawn in March, 2011, resulting into increase of prices of agricultural tractors by around Rs 90,000 to Rs 200,000.

Increase in prices of tractors has made it difficult for the farmers to purchase new tractors and convert traditional farming into mechanical farming for higher yield, especially when cost of other agriculture inputs has gone up substantially.

Furthermore, Zarai Taraqiati Bank Limited (ZTBL) has also not been extending loans for purchase of tractors since April 2010, creating another impediment for the farmers, sources said.

Sources said that the production data maintained by Engineering Development Board (EDB) indicates that production of tractors since March, 2011 has declined drastically from over 72000 units to around 20000 units per annum.

Economic Survey of Pakistan also emphasises that accelerated farm mechanisation is the only tool to speed-up the growth rate in the agriculture sector.

It further highlights that available farm power is inadequate with only 464,000 tractors in operation, which means that per hectare horse power (hp) availability is 0.9hp only, as opposed to required 1.4hp per hectare, as per Food and Agriculture Organisation (FAO) recommendations, sources said.

It is believed that the primary aim of levying sales tax on agricultural tractor is to enhance revenues.

It is submitted that last year over Rs 5 billion were paid by the industry in the form of taxes while around Rs 7-8 billion is

estimated by government in lieu of sales tax on expected production of 80000 units during the current financial year.

However due to decline in production, the tax collection will not exceed Rs 3.7 billion, which means less revenue as compared to last year.

Further, due to the declining trend in the production and sale of agricultural tractors from 80000 units per annum to around 20,000 to 25,000 units, the economy will suffer an additional loss of over Rs 35 billion by reduced sales, sources said.

Accordingly, for the revival of tractor industry and to provide an impetus to the agriculture sector, which is the backbone of the economy with 24 percent share of the National GoP, Ministry of Industries has proposed that the sales tax zero-rating on agricultural tractors may be restored or deemed price (say 25-30 percent of the actual price) may be fixed for sales tax purposes, as has been done in the case of sugar and fertilisers.

Another option is that the sales tax may be phased in three to four years instead of imposition in one go ie @4 percent per year.

The summary of the Ministry of Industries was circulated to Federal Board Revenue (FBR) for their views/comments.

The FBR regretted the request for exemption of sales tax on tractors for being a conscious policy decision of the government.

The Ministry of Industries has requested the ECC of the Cabinet to approve any of the above-mentioned proposals for withdrawal of sales tax on the agricultural tractors, sources added. – *Courtesy Business Recorder.*

Compliance of Section 37A of IT Ordinance 2001: KSE apprises FBR about brokers' problems

The Federal Board of Revenue and the Karachi Stock Exchange held preliminary discussions on the problems faced by the brokers community in compliance of Section 37A (capital gain on disposal of securities) of the Income Tax Ordinance 2001 and other issues raised by the Exchange.

Sources told here on Thursday that a delegation of KSE visited the FBR House to meet the tax authorities to discuss tax-related issues of brokers and investors of the stock exchanges.

The KSE delegation met FBR Member Inland Revenue Shahid Hussain Asad and other senior tax officials.

A representative of the Securities and Exchange Commission of Pakistan (SECP) was also present in the meeting to discuss the issue of the CGT.

According to sources, the FBR advised the KSE delegation to give their proposals in writing for having more viable discussion on the issues raised by the brokers community.

The KSE delegation conveyed the tax authorities their problems in proper compliance of Section 37A (capital gain on disposal of securities) of the Income Tax Ordinance 2001.

The problems in filing of statements by the stockbrokers under the relevant provisions of the Income Tax Ordinance 2001 were also discussed.

The reason behind low collection from the stockbrokers also came under discussion during the meeting between the tax authorities and KSE delegation.

Sources said the representatives of the brokers community also raised issues relating to the method of computation of capital gain on disposal of securities under Section 37A (capital gain on disposal of securities) of the Income Tax Ordinance 2001.

Under Section 37A, the provision that the 'gain under this section shall be treated as a separate block of income' was also discussed.

The representatives of the stockbrokers also discussed the CGT Rules issued by the Board.

Under the rules, every investor, other than individual investors of stock exchanges, shall e-file statement of advance tax on capital gain within seven days after the end of each quarter.

The FBR heard the viewpoint of the KSE members and assured the delegation that their genuine demands would be fulfilled without compromising the FBR drive of documentation.

It has also been agreed to have another meeting in presence of the FBR Chairman to discuss CGT-related issues between brokers and the tax authorities, sources added. – *Courtesy Business Recorder.*

Public auction of confiscated goods on December 13

Air Freight Unit of Model Customs Collectorate here is arranging public auction of confiscated goods on December 13, 2011 at the sheds situated in Allama Iqbal International Airport.

According to a spokesman of AFU, the goods confiscated will be put on auction on 'what and where as it is' basis.

However, interested parties can inspect the goods on December 12, 2011 at 10:30 am at Customs Imports Sheds.

Additional Collector of Customs, Dr Asif Mahmood Jah said that it wants to clear the sheds as some of the goods are there for the last 40 years.

He said that one lot of these good was also auctioned last month, fetching Rs 1.5 million and this time they will endeavour to sell maximum number of goods. – *Courtesy Business Recorder*.

Exporters object to FBR notices

Exporters have raised objections over notices being issued by the Federal Board of Revenue (FBR) seeking sales tax records under Section 25 of the Sales Tax Act 1990.

The notices issued by field offices of the FBR are seeking a long list of records, including purchase, supplies invoices and register, utility bills, export documents, monthly production report, etc.

However, exporters are of the view that being zero-rated sector the question about input and output does not arise, particularly when normal monthly sales tax returns showing details of sales and purchases are regularly filed. Muzzammil Husain, a leading exporter, told Dawn that under Section 25, the FBR could only issue notices for seeking records in case there was sufficient evidence showing that such registered person was involved in tax fraud or evasion of tax.

He also said that such notices as per law could not be issued by an official below the rank of assistant commissioner for conducting an inquiry or investigation under Section 38 of the Sales Tax Act 1990.

In case of tax fraud, the law even empowered the assistant commissioner to conduct audit of the records of the registered person even if it was earlier conducted by the office of the Auditor-General of Pakistan, he added.

Shabir Ahmed, chairman, Pakistan Bedwear Exporters Association (PBEA), said that issuance of such notices would only result in loss of revenue and earning of foreign exchange because exporters would have to put their energy in a futile exercise.

He said the FBR kept exporters involved in non-productive activities and wasted their time.

The current difficult economic conditions the world over are putting pressure on exporters who are already faced with enormous issues, such as power and gas shortages and law and order problems.

Shabir Ahmed suggested to the FBR to arrange payment of outstanding huge refunds against drawback on local taxes and levies (DLTL), and research and development (R&D).

The cash-starved export trade, he said, was faced with difficulty in fulfilling export commitments and already exports of textile goods had dropped during the first quarter of the current fiscal year.

It is ironic that when the government wants to recover its dues from trade and industry, harsh and coercive law under land revenue is used but when the government has to make payments, long delays are made which block huge funds of export trade. – *Courtesy The Dawn.*

Afghan, Pakistan customs decision: uncleared cargo may be disposed of by auction

Pakistan's customs officials and their Afghan counterpart have agreed for disposal of uncleared/stuck up Afghan cargo through public auction in cases where such unclaimed containers have not been cleared for a long time.

Sources told here on Friday that the Afghanistan-Pakistan Transit Trade Rules 2011 allow disposal of uncleared/stuck up Afghan cargo through public auction.

However, no such provision is available for the transit cargo imported under the erstwhile Transit Agreement of 1965.

As a result, a large number of un-cleared cargo is still lying at the ports and there is urgent need for the precious space at the ports.

The customs department requested the representatives of the Afghan Consulate General to grant NOC for auction of the long stuck up cargo.

The Consulate General's proposals will be forwarded to Board within 15 days' time.

In this regard, the Collectors of Appraisement/Port Qasim/Afghan Consulate General Karachi are co-ordinating.

According to sources, Pakistan's customs officials resolved a number of issues raised by the Afghan traders during clearance of their consignments under the new transit trade agreement and Transit Trade Rules 2011.

Afghan traders apprised the Pakistan customs officials that private terminal operators (KICT, PICT, QICT) and Karachi Port Trust (KPT) provided different number of demurrage-free days to Afghan traders for clearance of cargo.

The difference in practice casts an adverse impact on the business cycle and leads to various trade distortions.

In this regard KICT provides the least number of demurrage-free days (5) while KPT provides the maximum (14, excluding holidays).

It has been decided that since the majority of transit cargo is imported through private terminals, there is a need to bring uniformity in the number of demurrage-free days provided by them to Afghan traders and the minimum benchmark in this regard would be KPT's standard of 14 days (excluding holidays) for all terminals.

Sources said that Article 2 of the Afghanistan Pakistan Transit Trade Agreement (APTTA) 2010 calls for examination of 5 percent of transit goods by customs, whereas rule 603 (5) of Transit Rules 2011 envisages examination of 5 percent consignments.

There is a need to align the Customs Rules with the provision of the Agreement and to mark only 5 percent of the commercial goods/containers to examination by customs.

The FBR has informed the Afghan traders that the issue has already been resolved by MCC Appraisalment and instructions in this regard have been communicated to Pakistan Revenue Automation Limited (PRAL).

Sources said that importers of vehicles were facing great difficulty in examination as Transit Rules 2011 stipulate 100 percent examination in case the container is selected by the system.

For this purpose, customs requires de-stuffing of all vehicles from the containers, which are specially packed with elaborate lashing in a two-tier arrangement.

The entire process of de-stuffing and then re-stuffing the vehicles in the container entail huge extra cost.

Besides, the special arrangement for re-stuffing of vehicles is not readily available in Pakistan.

It was decided that in future containers comprising vehicles shall be scanned and, unless there is a specific complaint which cannot be substantiated through scanning, vehicles will not be de-stuffed from container for examination.

Moreover, all containers of vehicles which have been stuck at the ports for de-stuffing shall be entitled to waiver of port charges by the terminals on voluntary basis.

Sources said that the Transit Rules 2011 allow all types of amendments in the IGM vide rule 646.

It has been further pointed out that amendments entail cumbersome procedure whereby matters are referred from MCC PaCCS to Appraisement/Port Qasim Collectorates for NOC before correction of data.

The FBR has decided that all amendments shall be made by the relevant transit section of One-Customs Collectorate as per Rules and for this purpose the Index will be transferred to PRAL by PaCCS for decision on merit on case to case basis and without delay.

Sources said that the representatives of the bonded carriers apprised the FBR that due to delayed and/or non-feeding of de-sealing information in the PRAL system at the exit/en route Collectorates, close to 1000 vehicles of various bonded carriers are stuck up at Karachi Port/Port Qasim and are unable to undertake further trips because of blocking of vehicles in the system.

The Director (Automation) of PRAL confirmed this aspect and stated that the blocking of vehicles whose containers are not de-sealed in the system is a fail-safe measure to ensure that transit cargo reaches the destination Collectorate.

The FBR took serious note of the delayed de-sealing and entrusted Collector (Preventive) to write to Collectors of the exit stations for expeditious feeding of de-sealing information.

For this purpose PRAL was directed to ensure quick feeding of acknowledgement and de-sealing information in future as containers not de-sealed in the software shall be treated as missing for all practical purposes.

However, as a matter of relief, Collectors Preventive and Port Qasim were directed to release the containers which have already entered the Karachi Port/Port Qasim area by October 15, 2011.

The FBR also directed that partial shipments shall also be allowed to ease the congestion at ports due to standing of cargo on this account.

Currently, movement of transit cargo is being allowed only in original/shipper's containers by the clearance Collectorates, which is greatly increasing the cost of business for the Afghan importers.

The representatives of Afghan Consulate General and Afghan traders requested that the condition may not be applied on essential food items whose import into Pakistan even otherwise is duty-free.

The Transit Rules 2011 allow movement of transit cargo in loose condition in sealable trucks and for food items, this option may be preferred.

The FBR has allowed loose delivery of essential food items in sealable trucks in principle and directed Collector (Appraisement) to submit detailed recommendations to Board for across the board implementation of the instructions.

The representatives of Afghan transit clearing agents association apprised the FBR that reefer containers are also being subjected to 100 percent examination in light of Transit Rules 2011 in case system selects such containers for examination.

The practice runs the risk of rendering the temperature-controlled-sensitive cargo stored therein unusable.

It was proposed that in case reefer containers are selected by the system for examination, the container may be scanned and only suspicious containers, if any, may be referred for 100 percent examination.

It has been agreed with the aforesaid contention in principle.

However, it was directed that clearance Collectorates should devise a mechanism whereby 10-15 percent of reefer cargo may be scanned before delivery, instead of only the containers which are marked by the system.

In cases of inconsistency in scanned images or prior information, the reefer containers will be examined by customs, expeditiously.

Sources said that the Afghanistan Pakistan Transit Trade Agreement 2010 and the Ministry of Communication have notified the laden weight of vehicles up to four-axle for plying on the road.

Apparently, this has been notified in view of the Afghan transport market as vehicles of even 5 and 6 axle are available in Pakistan but their laden weight is not mentioned in the above instructions.

It has also been decided that the laden weight of 5 and 6 axle vehicles shall be derived on pro rata basis and the notified laden weight of up to 4 axle vehicles shall be taken as the basis for such calculation.

Furthermore, the meeting noted that the Ministry of Communication/NHA had in-house enforcement mechanism to ensure compliance of the laden weight instructions.

Sources said that the Rule 564 (2) of Customs Rules 2001 notified vide SRO 450(I)/2001 stipulates that Transshipment Permit (TP) for Afghanistan shall be valid for 15 days which could be further extended for a period of 15 days.

The Afghan Traders/Bonded Carriers representatives requested that instead of the clearance Collector, the authority to issue 15 days extension may be transferred to the destination Collectors in view of the fact that the vehicles by then have already reached or are nearing the destination Collectorates and travelled beyond the territorial jurisdiction of the clearance Collectorate.

It was noted that the requisite change requires amendment in the Rules and decided that on arrival of the vehicle at the destination, the relevant Collector shall intimate the same in writing to the clearance Collector, who shall then issue the requisite extension.

At present, transmigration of transit cargo from sea to air and consolidation of loose transit cargo arriving by air and sea for onward journey to Afghanistan either by air or road is not being allowed because of various issues relating to sealing/de-sealing, reconciliation of data, sanctity and security of goods, etc.

The representatives of Afghan importers and clearing agents requested that such migration/consolidation may be allowed as sometimes goods arriving by sea are required to be airlifted due to time constraints.

The FBR decided that clearance Collectorates shall take action on such request on case to case basis. – *Courtesy Business Recorder.*

Prime Minister briefed on tax collection, gas, oil supply

Finance Minister Abdul Hafeez Sheikh, and Petroleum Minister Asim Hussain separately called on Prime Minister Yousuf Raza Gilani on Friday.

The Finance Minister informed the PM about tax collection of Rs 640 billion in five months of the current financial year.

It reflected 28 percent increase in the tax collection as compared to the corresponding period of last financial year.

Hafeez briefed the Prime Minister about the new mechanism formulated by the Cabinet Committee regarding restructuring of the public sector enterprises to make these organisations viable commercial entities by introducing corporate culture in them.

Asim briefed the Prime Minister about the steps taken by his Ministry regarding supply of oil and gas to IPPs, domestic and industrial sectors during the rest of the winter season. – *Courtesy Business Recorder.*

Barred from importing CNG cylinder: FBR notifies foreign companies

The Federal Board of Revenue (FBR) has notified the foreign companies, which have been disallowed import of Compressed Natural Gas (CNG) cylinders.

In this connection the Federal Board of Revenue (FBR) has amended Customs General Order (CGO) 12 of 2002 through another CGO issued here on Friday.

The FBR also issued the CGO to the Collectors of Customs, Model Customs Collectorates asking them to disallow imports of CNG cylinders being manufactured by notified foreign companies.

In order to ensure compliance by the field formations, the details have been communicated to the field formations by the FBR, sources added. – *Courtesy Business Recorder.*

Tax return date expires: FBR starts penalising non-filers

Large Tax-payer Units (LTUs) and Regional Tax Offices (RTOs) have started imposing penalty on non-filers of income tax returns (Tax Year 2011) where date of filing of returns has expired on November 30, 2011.

Sources told here on Friday that the field formations of the Federal Board of Revenue have started legal action against the non-filers of income tax returns for Tax Year 2011.

In this regard, field formations have started issuing legal notices to taxpayers, which is an effective enforcement measure for ensuring filing of returns in a timely manner.

It is expected that during the exercise FBR will generate additional revenue in the form of late filing penalty and default surcharge under the relevant provisions of the Income Tax Ordinance 2001.

This enforcement measure will improve the compliance not only in the area of income tax return filing but ensure filing of withholding tax statements and sales tax returns.

It is also learnt that the taxpayers who have filed their returns after receipt of e-intimations from the FBR system will not be penalised if the compliance has been made before issuance of the legal notice.

Through imposition of minimum penalty of Rs 5,000 under the relevant provisions of the Ordinance 2001, the FBR will take action against non-compliant persons.

Under the legal process, initially a show cause is being served for non-filing or late filing of filing returns for providing opportunity of hearing.

In case of non-filing or late filing of return, the tax department can impose minimum penalty of Rs 5,000.

The section 182 of the Income Tax Ordinance empowers the tax officials to impose the penalty for failure to submit return of income or statement under section 115 or wealth statement and wealth reconciliation statement and monthly statement.

The penalty could be maximum up to 25 percent of the tax payable under section 182 of the Income Tax Ordinance 2001. – *Courtesy Business Recorder.*

Persons deriving taxable capital gain: brokers should ensure advance tax payment: FBR

The Federal Board of Revenue has observed that brokerage houses and brokers of the stock exchanges have not been given any responsibility to ensure payment of advance tax on quarterly basis

by persons deriving taxable capital gain as per provisions of the sub-section (5B) of section 147 of the Income Tax Ordinance 2001.

Sources told here on Friday that most of the individual investors have not filed their income tax returns for the Tax Year 2011 and paid negligible amount of tax under Income Tax Ordinance 2001.

These individual persons are also not paying the advance tax under sub-section (5B) of section 147 of the Income Tax Ordinance 2001.

There is a need to amend the section 37A of the Income Tax Ordinance 2001 for holding stock exchanges and brokerage houses responsible to withhold tax from any amount of capital gain arising from sale of securities held for the periods as mentioned in the concerned provisions of the Income Tax Ordinance 2001.

Explaining the taxability of capital gains on disposal of securities under section 37A and section 147 of the Income Tax Ordinance 2001, sources said that the capital gain arising from sales of securities such as share of a public limited company, voucher of PTC, Modaraba certificates etc was subjected to tax by insertion of Section 37-A in the Income Tax Ordinance 2001 vide Finance Act 2010.

However, the tax was not levied on security which was held for the period of more than one year.

According to sources, the capital gain u/s 37-A of the Income Tax Ordinance 2001 is treated as a separate block of income.

The loss on disposal of securities in a tax year is adjustable against gain from any other securities chargeable to tax u/s 37-A, but the loss was not to be carried forward to the subsequent tax year.

For Tax Year 2011, where the security is held for less than six months, the rate of tax is 10 percent where the security is held for more than six months and less than one year, the rate of tax is 7.5 percent for Tax Year 2011.

As per provision of sub-section (5B) of Section 147 of the Income Tax Ordinance 2001, a person deriving taxable capital gain is required to pay advance tax @ 2% of the capital gain on quarterly basis where the security is held for less than 6 months and 1.5% of the capital gain on quarterly basis where the security is held for more than 6 months but less than 12 months.

However, there is no responsibility of the brokerage house or of the stock exchange in this respect.

This is the main lacuna in the provisions of Section 37-A because the market share of the individual persons in the stock market is more than 57% but are not paying advance tax u/s.147(B) of the Income Tax Ordinance and also most of them have not filed returns for the Tax Year 2011, sources explained.

Sources further said that the negligible tax has been paid on this score.

The tax department has sought information from the Karachi Stock Exchange (KSE) regarding capital gain earners during the period July 1, 2010 to 2011 to be submitted to FBR for circulation among field formations for necessary action.

There is an urgent need to change the provisions of law as contained in Section 37A and hold responsible stock exchange / brokerage houses to withhold tax from any amount of capital gain arising from sale of securities held for the periods as mentioned above, sources added. – *Courtesy Business Recorder.*

Tax incentives to be sought for listed companies

In pursuance of its mandate to encourage and facilitate investment in the country through listing on the stock exchanges, Imtiaz Haider, the SECP Commissioner for Securities Market, met Saleem H.

Mandviwalla, Chairman, Board of Investment (BOI) and compared notes on encouraging investment in the country.

According to a press release issued on Friday, the BOI chairman appreciated the SECP initiative, saying that being a regulator of the capital market and corporate sector it could play important role in the development of the economy.

He stated that investor-friendly policies and behaviour could boost investment in the country, which may help development of the capital market through public participation.

It was agreed that co-ordinated efforts shall be made for, encouragement of investment in the country through public participation, development of the capital market and encouragement of new listing on the domestic stock exchanges.

It was also decided in the meeting that in consultation with the FBR, joint proposals will be submitted to the federal government to seek some sort of tax incentives for listed companies.

Moreover, the SECP and its policies for facilitation of investors will be given appropriate projection in BOI's various publications, seminars and conferences.

Similarly, the BOI will be invited to road shows and seminars to be conducted by the SECP regarding its planned investors' awareness campaigns. – *Courtesy Business Recorder*.

FBR union's rally against Nato attack

The Federal Revenue Alliance Union (CBA) FBR on Friday held a protest rally against Nato attack on Pakistani check post.

A large number of people and workers of Federal Revenue Alliance Union participated in the rally and chanted slogans against the attackers. Addressing the rally, Federal Revenue Alliance Union central president Mian Abdul Qayyum strongly condemned the Nato attack on Pakistani check post . – *Courtesy The Nation*.

SECP, BoI to seek incentives for listed companies

The Securities and Exchange Commission of Pakistan (SECP) and the Board of Investment (BoI) on Friday decided to submit “joint proposals” to seek some tax incentives for listed companies to encourage investment through listing of companies on stock exchanges.

It was decided in a meeting of SECP's Commissioner for Securities Market Imtiaz Haider and BoI chairman Saleem H Mandviwalla. They agreed to make coordinated efforts for encouragement of investment in the country through public participation, development of the capital market and encouragement of new listings on the domestic stock exchanges.

Currently, there are about 60,000 companies incorporated with the SECP under the Companies Ordinance 1984, but the number of listed companies is only 638. The minimum threshold of the paid-up capital for listing of a company at the local bourses is Rs200m. The companies which meet the minimum requirements for listing may play major role in the development of the capital market, if listed on the local stock exchanges.

Through the Finance Act, 2011, the government announced a tax holiday for five years for new projects and expansion provided such projects are financed entirely through equity. Capital market

provides opportunity to such corporates to raise funds for meeting their equity needs.

The BoI chairman while appreciating the SECP initiative said that being a regulator of the capital market and corporate sector it can play an important role in the development of the economy. “Investor-friendly policies can boost investment in the country which may help development of the capital market through public participation.” – *Courtesy The News.*

C.No.4(12)ST-L&P/2011

Islamabad, the 1st November, 2011**SALES TAX GENERAL ORDER NO. 21/2011**Subject: **Amendment in STGO 18/2007 Dated 13-09-2007.**

In exercise of powers conferred by clause (d) of section 4 of the Sales Tax Act, 1990, the Federal Board of Revenue is pleased to make the following further amendments in its Sales Tax General Order No. 18 of 2007 dated 13th September, 2007, namely:-

In the aforesaid General Order,

- (a) in the preamble, in condition (c) the words, comma, full stop, figure and brackets "S.R.O. 509(I)/2007, dated the 9th June, 2007" shall be substituted by "S.R.O. 283(I)/2011, dated the 1st April, 2011".
- (b) In the table, after Serial Number 09, the following new Serial Numbers and corresponding entries relating thereto shall be **added**:

Table

(1)	(2)	(3)	(4)
S.No.	Name of Registered Person	Sales Tax Registration Number	Gas bill Reference No. or Consumer No. or Account No.
10.	Ahmed Textile	0100341711113	16469510008

C.No.4(1)ST-L&P/2011

Islamabad, the 1st November, 2011**SALES TAX GENERAL ORDER NO. 22/2011**

Subject: **Amendment in STGO 10/2007 Dated 13-09-2007 – Allowing Facility of Zero-Rating on Supply of Electricity.**

In exercise of powers conferred by clause (d) of section 4 of the Sales Tax Act, 1990, the Federal Board of Revenue is pleased to make the following further amendments in its Sales Tax General Order No. 10 of 2007 dated 13th September, 2007, namely:-

In the aforesaid General Order, in the table, after serial number 276 in column (1) and the entries relating thereto in columns (2), (3) and (4), the following new serial numbers and the entries relating thereto shall be added, namely:-

S. #	Name of Unit	Registration No.	Consumer No.
277.	Faisal Asad Textile Mills Limited	0402520202564	27157230337201

C.No.2 (10) Tar-II/97

Islamabad, the 26th March, 2011**CUSTOMS GENERAL ORDER NO. 02/2011**Subject: **Assessment of Motor Vehicles.**

The Federal Board of Revenue is pleased to direct that the following amendment shall be made in its Customs General Order No. 14/2005, dated the 6th June, 2005, namely:–

In the aforesaid CGO, in paragraph 2A, for the figure and symbol “50%”, the figures, symbol and words “60% for cars and 50% for other vehicles” shall be substituted.

C.No. 3/9/MACH./97

Islamabad, the 14th November, 2011**CUSTOMS GENERAL ORDER NO. 09/2011**

Subject: **List of Approved Brands, Models and 3rd Party Inspectors of CNG Machinery Importable under S.NO. 5 of Table of Notification S.R.O. 575(I)/2006, dated 5.6.2006.**

The Federal Board of Revenue is pleased to direct that the following further amendment shall be made in its Customs General Order No. 12/2002, dated the 15th June, 2002, namely:–

In the aforesaid CGO, in Chapter VII, in Sr. No. 21A,–

(i) In Table-I,–

(a) in column (1), after Sr. No.72, the following new serial number and the entries relating thereto in columns (2), (3) and (4) shall be added, namely:–

S.No.	Brand Name of Compressor	Model	Designated 3 rd Party Inspectors
73.	M/s Delta Compression S.R.I., Argentina	IODM70-5-4RG (Gas Driven Only) (Trade Mark Aspro)	Bureau Veritas

(b) in column (2), in Sr. Nos. 3, 33 & 65, for the words and letters :Comp Air UK Ltd., UK” the words and letters “Gardner Denver Ltd, UK” shall be substituted; and

(ii) in Table-IV, in column (1), after Sr.No.47, the following new serial number and the entries relating thereto in columns (2), (3) and (4) shall be added, namely:–

Sr. No.	Brand Name of CNG Vehicles Cylinders	Qualifying Standard	Designated 3 rd Party Inspector
48(I)	Associate High Pressure Technologies Pvt Ltd.		

	Sr #	Diameter (mm)	Volume (Ltr)	Length (mm)	NZS 5454:1989	SGS
	1.	232	22	730		
	2.	232	30	939		
48(II)	Associates High Pressure Technologies Pvt Ltd.				NZS 5454:1989	SGS
	Sr #	Diameter (mm)	Volume (Ltr)	Length (mm)		
	1.	267	40	967		
	2.	267	50	1165		
48(III)	Associate High Pressure Technologies Pvt Ltd.				NZS 5454:1989	SGS
	Sr #	Diameter (mm)	Volume (Ltr)	Length (mm)		
	1.	325	65	910		
	2.	325	60	990		

C.NO.3 (9) MACH./97-Pt. Islamabad, the 21st November, 2011

CUSTOMS GENERAL ORDER NO. 10/2011

Subject: List of Approved Brands, Models and 3rd Party Inspectors of CNG Machinery Importable under S.No. 5 of Table of Notification S.R.O. 575(I)/2006, dated 5.6.2006.

The Federal Board of Revenue is pleased to direct that the following further amendments shall be made in its Customs General Order No. 12/2002, dated the 15th June, 2002, namely:—

In the aforesaid CGO, in Chapter VII, in Sr. No. 21A, in Table-IV, the names of the following manufactures of vehicle cylinders and the entries relating thereto wherever appearing shall be deleted:—

- (i) M/s Cilbras, Brazil;
- (ii) M/s Beijing Tianhai Industrial Co., China (BTIC);
- (iii) M/s EKC International, UAE;
- (iv) M/s Everest Kanto Cylinder (EKC), India;
- (v) M/s Inflex S.A. Argentina; and
- (vi) M/s Dalmine, Itlay

C.NO. 3/9/MACH./97

Islamabad, the 24th November, 2011**CUSTOMS GENERAL ORDER NO. 11/2011**

Subject: **List of Approved Brands, Models and 3rd Party Inspectors of CNG Machinery Importable under S.No. 5 of Table of Notification S.R.O. 575(I)/2006, dated 5.6.2006.**

The Federal Board of Revenue is pleased to direct that the following further amendment shall be made in its Customs General Order No. 12/2002, dated the 15th June, 2002, namely:—

In the aforesaid CGO, in Chapter VII, in Sr. No. 21A, in Table-IV, in column (1), after Sr.No.48, the following new serial number and the entries relating thereto in columns (2), (3) and (4) shall be added, namely:—

Sr. No.	Brand Name of CNG Vehicles Cylinders				Qualifying Standard	Designated 3 rd Party Inspector
49(I)	Euro India Cylinders Limited, India					
	Sr #	Diameter (mm)	Volume (Ltr)	Length (mm)	NZS 5454:1989	SGS
	1.	267	40	925		
	2.	267	50	1125		
	3.	267	55	1225		
	4.	267	60	1325		
	5.	267	80	1720		
49(II)	Euro India Cylinders Limited, India				NZS 5454:1989	SGS
	Sr #	Diameter (mm)	Volume (Ltr)	Length (mm)		
	1.	316	50	840		
	2.	316	55	910		
	3.	316	60	980		
49(III)	Euro India Cylinders Limited, India				NZS 5454:1989	SGS
	Sr #	Diameter (mm)	Voluem (Ltr)	Length (mm)		
	1.	232	20	650		
	2.	232	22	700		

2011 PTR 1350 (H.C. Del.)

HIGH COURT OF NEW DELHI**Sanjiv Khanna and R. V. Easwar, JJ.***Maruti Suzuki India Limited*

v.

Deputy Commissioner of Income Tax

FACTS/HELD

1. **S. 245: Refund arising in earlier year on issue cannot be adjusted against demand on same issue in subsequent year**
2. Against an order passed u/s 144C/143(3), the assessee filed a stay application before the AO u/s 220(6) and also filed a stay application before the Tribunal. The Tribunal passed an interim order directing “status quo”. Despite the interim order, the AO passed an order u/s 245 (without giving prior notice) and adjusted refunds against the demand. Before the Tribunal, the department accepted that the 245 refund adjustment was not proper and said a proper order would be passed. The AO then passed an order u/s 220(6) in which he held that the adjustment of refunds was in order on the ground that (i) an adjustment of refunds was not a “recovery” and (ii) though some issues were covered in favour of the assessee, the decision had not become final as the department was in appeal. The Tribunal then passed a stay order in which it accepted the AO’s stand that an adjustment of refund was not a “recovery”. It was also held that action u/s 245 was not “mala fide”. The assessee filed a writ petition to challenge the adjustment of refunds. HELD allowing the Petition:
 - (i) **S. 220(6) has no application to a case where an appeal is filed before the Tribunal** though the Tribunal has inherent power to grant stay. The order passed u/s 220(6) is null and void. The Tribunal should have decided the stay application instead of calling upon the AO to dispose of the application u/s 220(6);

- (ii) **It is wrong to say that an adjustment of refund u/s 245 is not a “recovery”** only on the ground that s. 245 is placed in the Chapter of “Refunds”. **The term “recovery” is comprehensive and includes adjustment thereby reducing the demand.** In Circular No. 1914 dated 2.12.1993, even the CBDT did not regard ‘recovery’ as excluding ‘adjustment’ u/s 245. However, different parameters may apply in considering a request for stay against coercive measures to recover the demand and a stay against refund adjustment. It is permissible for the authority to direct stay of recovery by coercive methods but not grant stay of adjustment of refund. **However, when a simple & absolute order of stay of recovery is passed, it bars recover of the demand by way of adjustment of demand.** The revenue must be obedient and respect the stay order and not over-reach or circumvent the stay order. No deviancy or breach should be made;
- (iii) **It will be specious & illogical for the Revenue to contend that if an issue is decided in favour of the assessee giving rise to a refund in an earlier year, that refund can be adjusted u/s 245, on account of the demand on the same issue in a subsequent year.** While the AO can made an addition on the ground that the appellate order for an earlier year has not been accepted, he cannot make an adjustment towards a demand on an issue decided in favour of the assessee.
- (iv) The argument that as the assessment order has been passed u/s 144C after reference to the DRP, the orders passed by the CIT(A) and Tribunal in favour of the assessee have **lost significance and do not justify stay of demand in covered matters is not acceptable. The decisions of the CIT (A) & Tribunal in favour of the assessee should not be ignored and have not become inconsequential.** This is not a valid ground to ignore the decisions of the appellate authorities and is also not a good ground to not to stay demand or to allow adjustment u/s 245;

- (v) The respondents are officers of the State and the Law requires that they perform their duties with utmost objectivity and fairness, while keeping in mind the sanctity of the role and function assigned to them which at times requires tough steps. On facts, **the conduct and action of the Revenue in recovering the disputed tax in respect of additions on issues which are already covered against them by the earlier orders of the ITAT or CIT (A) is unjustified and contrary to law.** Directions issued to refund the tax.

Accordingly disposed of.

Writ Petition (Civil) No. 2252/2011.

Heard on: 21st October, 2011.

Decided on: 25th November, 2011.

Present at hearing: S. Ganesh, Sr. Advocate with S. Sukumaran, Anand Sukumar and Bhupesh Kumar Pathak, Advocates, for Petitioner. Kamal Sawhney, Sr. Standing Counsel, for Respondent.

JUDGMENT

Sanjiv Khanna, J.-

The present writ petition by Maruti Suzuki (India) Limited, a public limited company, is for direction against the Deputy Commissioner of Income Tax, Circle VI(1) and Additional Commissioner, Range VI. The said respondents, it is prayed, should be restrained from recovering any part of the demand raised for the assessment year 2006-07 pending final hearing and disposal of the petitioner's appeal before Income Tax Appellate Tribunal (ITAT, for short). The petitioner has also prayed for direction that the respondents should be directed to refund Rs.122.57 crores and Rs.107.42 crores relating to the assessment years 2003-04 and 2005-06 respectively, which as per the petitioner have been wrongly and illegally adjusted/appropriated by invoking Section 245 of the Income Tax Act, 1961 (Act, for short), vide order dated 2nd February, 2011 towards the demand for the Assessment Year 2006- 2007.

2. Factually, it is not in dispute that the petitioner was entitled to refund of Rs.122.57 crores and Rs.107.42 crores for the assessment years 2003-04 and 2005-06 respectively. In normal course, the said refunds should have to be paid by the respondents to the petitioner but for the adjustment against the demand for the Assessment Year 2006-07.

3. For the assessment year 2006-07, an assessment order under Section 143(3) read with Section 144C was passed on 20th October, 2010. This created an additional demand of Rs.266.61 crores, the breakup

being; income tax of Rs.169 crores and interest under Sections 234 B and 234C of Rs.95,49,06,432/- and Rs.1,91,31,933/- respectively. Against the said assessment order, the petitioner on 19th November, 2010 filed an appeal before the ITAT. Subsequently, on 30th November, 2010, an application for stay of demand was filed. This stay application came up for hearing before the ITAT on 9th December, 2010 and an interim order was passed directing status quo in respect of recovery till 14th December, 2010. The Departmental Representative (DR, for short) undertook to convey these directions to the concerned authorities. The petitioner also filed a letter before the respondent No. 1 informing the said respondent about the status quo order with copy to the Commissioner of Income Tax. On 13th December, 2010, one day before the date of hearing, respondent No. 1 informed the petitioner that refund of Rs.122.57 crores for assessment year 2003-04, stands adjusted against the demand for assessment year 2006-07 vide order dated 7th December, 2010. It is not disputed that this communication was made on 13th December, 2010, after the status quo order was passed on 9th December, 2010. Similarly, the Revenue vide order dated 22nd November, 2010, had made adjustments under Section 245 of the Act for refund of Rs.69.94 crores for assessment year 2005-06 and Rs.37.47 crores for the assessment year 2003-04. Adjustment of Rs.37.47 crores for the assessment year 2003-04 was subsequently reversed vide order dated 3rd December, 2010, in view of the stay order passed by the High Court in a separate proceeding.

4. The two orders under Section 245 of the Act making adjustment of refunds of Rs.69.94 crores for the assessment year 2005-06, dated 22nd November, 2010 and Rs.122.57 crores for assessment year 2003-04 vide order dated 7th December, 2010 but communicated on 13 December, 2010, were made without prior intimation as mandated and required by law.

5. Dispute/question arose before the ITAT, whether the additions and disallowances made in the assessment year 2006-07, resulting in additional demand of income tax of Rs.169 crores plus interest, was in respect of issues and contentions that have already been decided by the ITAT or the Commissioner of Income Tax (Appeals) (CIT(Appeals), for short) in favour of the petitioner in earlier years. The contention of the petitioner was that the additions or disallowances made in the assessment order dated 20th October, 2010, for assessment year 2006-07, were partly covered by decisions of the ITAT and the CIT (Appeals) in favour of the petitioner and thus demands should not be recovered and there should be an absolute or blanket stay from recovery of the demand in respect of at least the issues which have been decided by the appellate authorities in favour of the petitioner. The ITAT instead of examining the said questions while considering the stay application on 20th January, 2011, recorded the statement made by the DR that he had received a letter dated 19th January, 2010 accepting that the earlier action under Section 245 of the Act was bad and proper proceedings under Section 245

would be initiated. Accordingly, the matter was adjourned to 4th February, 2011 “on the request of both the parties”.

6. The petitioner appeared before the respondent No. 1 and filed written submissions dated 27th January, 2011, along with the chart indicating how and in what manner, as per the assessee, several issues which had resulted in the additional demand for the assessment year 2006-07, were covered in their favour by the orders of the appellate authorities in earlier years.

7. It may be also noted here that the petitioner had filed an application under Section 220(6) of the Act before the Assessing Officer on 8th November, 2010, that the petitioner should not be treated as an assessee in default and the demand should be kept in abeyance till disposal of the appeal before the ITAT. It is also apparent that the ITAT while dealing with the applications was of the opinion that the respondent No. 1 should first dispose of the application under Section 220(6) of the Act.

8. Respondent No. 1, vide order dated 2nd February, 2011, disposed of the ‘stay application’ and substantially dismissed the same stating inter alia, that refund of Rs.107.41 crores for the assessment year 2005-06 and Rs.122.57 crores for the assessment year 2003-04 stand adjusted and that there would be a stay of the balance amount of Rs.36.61 crores pending decision of the appeal before the ITAT, for the assessment year 2006-07. Another order dated 2nd February, 2011 was passed by the respondent No. 1 under Section 245 of the Act. The factum that adjustment under Section 245 of the Act was made by the order dated 2nd February, 2011, has been mentioned in the writ petition but this order under section 245 of the Act dated 2nd February, 2011, has not been filed with the writ petition and has been filed by the respondents along with the counter affidavit. The relevant portion of the said order under section 245 of the Act reads as under:—

“3. You have relied on instruction No.1914 of Hon“ble CBDT and submitted that the demand of Rs.47.20 crores and interest u/s. 234B of 27.17 crores is relating to the covered issues, in which the order has been passed by Appellate Authorities in earlier years in favour of the assessee. The submission has also been made that in some issues, disallowances have been made, though in the earlier relating to the same were rejected and hence in this year i.e. A Y 2006-07, the claims were made us. 43B of IT Act. It has also been submitted that some issues are covered by the decisions of jurisdictional Delhi High Court and CBDT Circular. The submission made by you has been considered but the same has not been found correct. IN the body of assessment order, detailed observations have been made by the Assessing Officer in all the issues and the relied judgments have been distinguished by the Assessing Officer. In the earlier

years, the issues have not reached to the finality and the appeals of department are pending before Hon“ble High Court against the order of Hon“ble ITAT and before Hon“ble ITAT against the order of Ld. CIT(A). IN AY 2006-07, Ld. DRP-II, New Delhi has confirmed additions by examining all the issues therefore the additions have withstood the test of first appellate authority, therefore, the relied instruction, i.e.. Instruction No.1914 is not applicable. In the matter of issues covered by decisions of Hon“ble High Court in other cases, the Assessing Officer has distinguished the facts of the case of the assessee from the relied cases in the body of assessment order itself. Therefore, in the matter of disallowance of „Royalty on sales“ amounting to Rs.95.98 crores and „Sales tax subsidy“ amounting to Rs. 32.26 crores, the submission made by you is not acceptable.

4. The department is not making recovery of the outstanding demand but simply adjusting the refund arising out in the earlier years wherein the effect has been given to the order of Ld. CIT(A). The issues on which, Ld. CIT(A) has given relief have not become final so far and the department is contesting the same before Hon“ble ITAT in A Y 2003-04. It might be the case that the additions are confirmed by Hon“ble ITAT, then the assessee may be required to make the payment .

5. The submission of the assessee that some of the issues are covered by the decisions of Hon“ble ITAT in earlier years, may be given importance, if forceful recovery is made. But in case of adjustment of refund of the amount which was already lying with the department cannot be refunded back to the assessee since the issues have not attained finality so far in A Y 2006-07.

6. Huge demand is relating to the fresh issues like capital subsidy (disallowance of Rs.32.26 crores), royalty payment (disallowance of Rs.105.55 crores), disallowance on identical issues have been made in AY 2007-08, wherein the assessee has again filed appeal before Hon“ble DRP, i.e. the first appellate authority, which has confirmed the issues in AY 2006-07. Therefore, it is most likely that the assessee may be required to make payments in subsequent years on these issues. Therefore, refunding the amount is not a very viable proposition.”

9. The stay application filed by the petitioner thereafter came up for hearing before the ITAT on 11th February, 2011 and the same was disposed of after recording the factual position noticed above with the following observation and reasoning:–

“7.1 We find merit in the argument of learned DR that this section occurs under the chapter of „refunds“ and not

„recovery“. Section mandates that if some refund is found to be due to any person, the AO shall set off such amount before refund against any sum remaining payable by the person under this Act. No conditions are prescribed except that assessee should be given an intimation of the proposed action. We find that the earlier action u/s 245 dated 7-12-2010 in short intimation has been corrected by the department vide fresh order u/s 245 dated 2-2-2011. Looking at the language of section 245, it cannot be held that department has acted in a mala fide manner. We find no infirmity in action u/s 245 dated 2-2-2011, the issue which thus remains for our consideration is the balance outstanding demand against assessee which both parties contend be around Rs. 22 crores.

7.2 In our view, assessee has made out a prima facie case inasmuch as various issues have been proposed to be covered in favour of the assessee by earlier orders of appellate authorities which shall be taken at the time of hearing of appeal on merits. The balance of convenience qua this outstanding demand lies in favour of the assessee. After considering all the facts and circumstances we stay the balance outstanding demand against assessee subject to usual condition of not seeking undue adjournments by the assessee.”

10. On the basis of submissions made by the parties, we have thought it appropriate to discuss aspects raised and our decision under separate headings:

A. Whether writ petition should be dismissed as the petitioner has not filed order dated 2nd February, 2011, under Section 245 of the Act and, therefore, is guilty of concealment and which disentitles them to obtain discretionary relief?

11. This contention has been examined first as the learned counsel for the Revenue has raised this issue vehemently. This contention of the Revenue is without merit and has to be rejected. In the writ petition itself, it is mentioned that vide order dated 2nd February, 2011, there was adjustment of refund of Rs.122.57 crores and Rs.107.42 crores for the assessment year 2003-04 and 2005-06 respectively. This factum is also mentioned in the order under Section 220(6) of the Act which has been enclosed with the writ petition. The assessee has nothing to gain and has not tried to seek any advantage/benefit by not filing the order dated 2nd February, 2011, under Section 245 of the Act. It is obvious that the writ petition of this nature could not have been decided without notice to the respondents who would have referred to this order. We are not satisfied that there is concealment, misstatement or suppression of a material fact or the petitioner had any motive or cause not to file the order dated 2nd February, 2011 with their writ petition. The relevant and material facts have been stated in the writ petition. We may reproduce the following

observations of the Supreme Court in *S.J.S. Business Enterprises (P) Ltd. v. State of Bihar*, (2004) 7 SCC 166 :

“13. As a general rule, suppression of a material fact by a litigant disqualifies such litigant from obtaining any relief. This rule has been evolved out of the need of the courts to deter a litigant from abusing the process of court by deceiving it. But the suppressed fact must be a material one in the sense that had it not been suppressed it would have had an effect on the merits of the case. It must be a matter which was material for the consideration of the court, whatever view the court may have taken.”

B. Whether the stay application under Section 220(6) was maintainable?

12. It may be noted here that the petitioner and Revenue have proceeded on the assumption that the said Section was applicable to the present case though the petitioner had filed an appeal before the ITAT and no appeal was filed before the CIT (Appeals) under Section 246A. The learned counsel for the Revenue has submitted and in our opinion rightly that Section 220(6) is not applicable when an appeal is preferred before the ITAT, as it applies only when an assessee has filed an appeal under Section 246 or Section 246A of the Act. Section 220(6) of the Act reads as under:—

“(6) Where an assessee has presented an appeal under Section 246[or Section 246-A] the Assessing Officer may, in his discretion, and subject to such conditions as he may think fit to impose in the circumstances of the case, treat the assessee as not being in default in respect of the amount in dispute in the appeal, even though the time for payment has expired, as long as such appeal remains undisposed of.”

13. An assessee is required to file an appeal before the ITAT against an assessment order under Section 143 (3) read with Section 144C. Appeal under Section 246 or 246A is not maintainable. As per Section 253(1d), against an order under sub-section 3 of Section 143 in pursuance to the direction of the Dispute Resolution Panel an appeal is maintainable before the ITAT. It may be noted that the ITAT has power to grant stay as an inherent power vested in the appellate authority as well as under Section 254 and the Rules.

C. Whether adjustment under Section 245 can be regarded as recovery and the orders passed by the authorities/tribunal?

14. ITAT by its order dated 11th February, 2011, has held that recovery cannot be equated with adjustment or refund under Section 245. ITAT in this regard has stated that Section 245 does not occur under the Chapter “refund” and, therefore, cannot be equated with recovery. It also appears that the Revenue was of the view that the status quo order

passed on 9th December, 2010 or filing of the applications for stay did not prevent them or bar them from making adjustment of refund under Section 245 of the Act.

15. It is not possible to agree with the contention of the Revenue that the word “recovery” cannot and would not include adjustment under Section 245. Recovery can be made by various modes including adjustments. Each Assessment Year is treated as separate and independent under the Act. Section 245 of the Act permits the Revenue to recover demand of one year which is pending by adjusting the refund due for another year. The term ‘refund’ has not been defined in the Act and, therefore, it has to be understood and interpreted in the manner in which it is understood in day to day life. The term ‘recovery’ in common parlance includes adjustments. The word ‘Recovery’ has been defined as

Black’s Law Dictionary:

In its most extensive sense, the restoration or vindication of a right existing in a person, by the formal judgment or decree of a competent court, at his instance and suit, or the obtaining, by such judgment, of some right or property which has been taken or withhold from him. *St. Paul Fire & Marine Ins. Co. v. Wood*, 242 Ark.879, 416 S.W.2d 322, 327. This is also called a “true” recovery, to distinguish it from a “feigned” or “common” recovery.

The obtaining of thing by the judgment of a court, as the result of an action brought for that purpose. The amount finally collected, or the amount of judgment. *In re Lahm*, 1979 App.Div. 757 167 N.Y.S. 217, 219. To be successful in a suit to obtain a judgment. *Garza v. Chicago Health Clubs, Inc.*, D.C.Ill., 347 F.Supp. 955, 962.

P. Ramanatha Aiyar Law Lexicon:

The actual possession of anything, or its value, by judgment of a legal tribunal ; the obtaining of anything by judgment or trial at law; the obtaining of a thing as the result of an action brought for the purpose; the obtaining of right to something by a verdict and the judgment of a Court from an opposing party in suit.”

16. Marginal note or chapter heading can be used as interpretative aids but with care and caution as they are necessarily brief and therefore there is a possibility that they may be of inaccurate nature. It is proper to consider them when ambiguity exists to gather guidance but weight to be attached has to be judged. (see *Tata Power Company Ltd. Vs. Reliance Energy Limited*, (2009) 16 SCC 659, *Chandroji Rao Vs. CIT*, (1970) 2 SCC 23 and *Pioneer Silk Mills Pvt. Ltd. Vs. Union of India*, ILR (1972) 1 Del. 433.). Chapter XVII of the Act deals with “collection and recovery of tax”. The said chapter is divided in various

parts including deduction of tax at source, payment of advance tax and Part-D is also given the same heading as Chapter XVII “collection and recovery”. Chapter XIX deals with refund and Section 245 deals with adjustment/set off of refund of the tax remaining payable in other years. Placement of Section 245 in Chapter XIX relating to refund is a matter of convenience. The provisions relating to ‘collection and recovery’ have been put in an earlier Chapter i.e. Chapter XVII, whereas “refunds” have been placed in a subsequent Chapter XIX. While dealing with the question of refund, the Legislature has provided that the refund can be adjusted or set off against a pending demand. We do not think that set off or adjustment cannot be regarded as a mode of recovery or is not a recovery mechanism. The term “recovery” is comprehensive and includes adjustment thereby reducing the demand.

17. At the same time, different parameters and requisites may apply when the appellate authority considers the request for stay against coercive measures to recover the demand and when stay of adjustment under Section 245 of the Act is prayed for. In the first case, coercive steps are taken with the idea to compel the assessee to pay up or by issue of garnishee notice to recover the amount. In the second case, money is with the Revenue and is refundable but adjusted towards the demand. Thus, while granting stay, the appellate authority or the ITAT (for that matter, even under Section 220(6)), the authority can direct stay of recovery by coercive methods but may not grant stay of adjustment of refund. However, when an order of stay of recovery in simplistic and absolute terms is passed, it would be improper and inappropriate on the part of the Revenue to recover the demand by way of adjustment. In case of doubt or ambiguity, an application for clarification or vacation/modification of stay to allow adjustment can be, and should be filed. But no attempt should be made and it should not appear that the Revenue has tried to over-reach and circumvent the stay order. Obedience and compliance with the stay order in letter and spirit is mandatory. A stay order passed by an appellate/higher authority must be respected. No deviancy or breach should be made.

18. We do not, in the present case, intend to lay down propositions or broad principles when and in what case there should be total stay of demand, or stay of recovery through coercive steps but no stay of adjustment under Section 245 of the Act. We would like to restrict ourselves to the facts of the present case and the contentions raised by the petitioner that when an issue or contention has been decided in favour of the assessee in earlier years whether adjustment under Section 245 of the Act is permissible in respect of arrears pertaining to the same issue or subject matter.

19. The Act provides for a right to appeal after the assessing officer has passed an assessment order and has made additions or

disallowances. An order of the appellate authority is binding on the assessing officer. Once the appellate authority has passed an order in favour of the assessee, the appeal effect must be given by the assessing officer. Section 241 of the Act is an express provision when the assessing officer may not refund an amount which is due. However, the section postulates pre-conditions before the said power is exercised. Justifiability and validity when power under section 241 is exercised with reference to the pre-conditions can be made subject matter of judicial review in writ proceedings.

20. It will be odd for the Revenue to contend that if an issue or contention is decided in favour of the assessee then for the said year refund has to be paid but the refund can be adjusted under Section 245 of the Act, on account of the demand on the same issue in a subsequent year. The broad contention is specious and illogical to be accepted. Similar or same additions can be made in a subsequent year for justifiable cause including contention of the Revenue that they have not accepted the earlier decision but it cannot be accepted as a principle that the Revenue can in ordinary course make adjustments towards a demand on an issue or contention which is already decided in favour of the assessee, though it may be a subject matter of appeal or challenge by the Revenue. Normally in such circumstances, the appellate forum should not permit the Revenue to adjust the demand, for it will be unjust, unequitable and unfair. However, while examining the issue of grant of stay including adjustment, the appellate authority for good grounds and justification made by the Revenue can refuse to grant stay of the adjustment of the refund. In such cases, adjustment can be permitted in exceptional situations pointed out by the Revenue but not as a matter of routine. It may not be possible or proper to postulate and elucidate all such situations but grounds mentioned under Section 241 of the Act are indicative. In this connection, we may reproduce the observations of a Division Bench of this Court in *Glaxo Smith Kline Asia P. Ltd. vs. Commissioner of Income-Tax and Ors.*, [2007] 290 ITR 37. In the said case, the Division Bench noticed the difference between Sections 241 and 245 in respect of procedure as well as the width and scope of the power but has observed as under:—

“26. In our view, the power under section 245 of the Act, is a discretionary power given to each of the tax officers in the higher echelons to “set off the amount to be refunded or any part of that amount against the same, if any, remaining payable under this Act by the person to whom the refund is due.” That this power is discretionary and not mandatory is indicated by the word “may”. Secondly, the set off is in lieu of payment of refund. Thirdly, before invoking the power, the officer is expected to give an intimation in writing to the assessee to

whom the refund is due informing him of the action proposed to be taken under this section.

27. We reiterate that the restrictions on the power under section 241, as explained judicially, would apply with equal, if not greater, force to section 245. A mechanical invocation of the power under section 245 irrespective of the fact situation, can lead to misuse of the power by the Revenue in order to delay the refund till such time a fresh demand for the subsequent assessment years is finalized. If reasonable time limits are not set for the processing of and disposal of an application for refund by the Revenue, it may result in the assessee not being able to get the refund at all. Also, the statute by stipulating the payment of interest on refunds (section 244A) and interest on delayed refunds (section 243) has underscored the importance of timely processing of refund claims.”

21. In subsequent portion, while dealing with the power under Section 245 of the Act, it was held as under:

“35. If the Department has decided to issue a refund voucher for the assessment year 2000-01, by the same yardstick it should also be willing to make the refund for the subsequent the assessment year 2001-02. The mere fact that appeals in respect of the two assessment years are pending in this court is not by itself a sufficient ground for denying the refund. The fact remains that the procedure contemplated under section 245 of the Act has not been invoked. It is not without significance that the order dated February 15, 2006, by this court only restrained the Revenue from making any adjustment of the amount of refund “without the leave of this court.” This did not mean that the procedure under section 245 was to be dispensed with. It is, therefore, strange that by the application filed, the Revenue was seeking permission from this court to straightaway set off the refund against the outstanding demand without following the procedure under section 245. The Revenue seeks to justify invoking the power under section 245 only on the ground that its appeals for the two assessment years are pending in this court. However, having issued the refund voucher for the assessment year 2000-01 in respect of which also the appeal is pending in this court, there appears to be no justifiable reason for withholding the refund due in respect of the other assessment year 2001-02.”

Thus pendency of appellate proceedings by itself alone cannot be a ground to not to refund the amount due and payable and is not sufficient to pass an order of the adjustment for demand on issues which have been decided against the Revenue.

22. Learned counsel for the Revenue had submitted that in the said case, reference was made to Circular No. 530 dated 6th March, 1989, but the said circular has been superseded by Circular No. 1914 dated 2nd December, 1993, reported in [2010] 236 CTR 137 (St.). This to our mind does not affect the observations made in the above paragraphs in Glaxo Smith Kline (supra) and the principles enunciated.

23. Learned counsel for the Revenue had drawn our attention to the Circular dated 2nd December, 1993, heading (C) - "guidelines for stay of demand" which under sub-clause (e) states that the Assessing Officer may "reserve a right to adjust refund arising, if any, against the demand" and clause (iv) stating inter-alia that the expression 'stay of demand' does not occur in Section 220(6) and the expression used is that the assessing officer would not to treat the assessee as in default. The second contention drawing distinction between stay of demand and the language in Section 220(6) which uses the expression 'assessee being in default' does not help the Revenue. Circular No. 1914 dated 2nd December, 1993 has been issued by Central Board of Direct Taxes with reference to Section 220(6) of the Act. These are guidelines, when and in what circumstances the demand should not be recovered. This is a reason why in clause (iv), it is mentioned that the words 'stay of demand' does not occur under Section 220(6) and the Assessing Officer should always use the expression 'assessee in default' in consonance with the language of section 220(6). Clause (e) occurs and is a sub-clause of clause (ii) of the circular dated 2nd December, 1993. Sub-clause (e) read with (ii) will read as - "In granting stay, the Assessing Officer may impose such condition as he may think fit" and "he may reserve a right to adjust refund arising, if any, against the demand." The use of word 'may' and the expression 'reserve a right' clearly shows that the Board itself did not postulate and regard 'recovery' as excluding and not covering 'adjustment' under Section 245 of the Act. As per the said circular, the Assessing Officer may reserve a right to adjust, if the circumstances so warrant. In a given case, the assessing officer may not reserve right to refund. Further, reserving a right is different from exercise of right or justification for exercise of a discretionary right/power. Moreover, the circular is not binding on the ITAT.

24. Contention of the Revenue in the counter affidavit that adjustment of refund for assessment year 2005-06 was made with approval of the Commissioner of Income Tax-II on 26th October, 2010, i.e. before the stay order was passed by the ITAT on 9th December, 2010, is specious and incorrect. In fact during the course of hearing this point was not pressed. The respondents have placed on record letter dated 26/27th October, 2010, written by Income Tax Officer, Headquarter-II, to the Additional Commissioner of Income Tax, the respondent No. 2 herein, that the administrative approval had been granted by the Commissioner for issue of refund for assessment year 2003-04, but was subject to the

condition that demand of Rs.266 crores for assessment year 2006-07 and other demand, if any, should be first adjusted. The date on which this letter was received in the office of the respondents 1 and 2 is not stated. Senior standing counsel for the respondent was specifically asked to state the said date but information has not been furnished. The said letter cannot be construed and is not an order under Section 245 of the Act. Commissioner has referred to the power to make adjustment but adjustment must be as per and in accordance with law. It was the duty of the respondents 1 and 2 to bring to the notice of the Commissioner, if required, the stay order passed by the ITAT on 9th December, 2010. Order/direction of the ITAT must be obeyed and not violated.

25. In the light of the aforesaid discussions, the following conclusions emerge:-

- (i) Order dated 2nd February, 2011 under Section 220(6) of the Act is null and void as the said provision is not applicable as the petitioner has filed an appeal before the ITAT and no appeal has been preferred under Section 246 or 246A of the Act.
- (ii) ITAT should have decided and disposed of the stay application filed by the petitioner and should not have called upon the Assessing Officer to dispose of the application under Section 220(6) of the Act or left it to the Assessing Officer to decide whether or not to make recovery.
- (iii) Word 'Recovery' is comprehensive and includes both coercive steps to recover the demand and adjustment of refund to recover the demand. Adjustment under Section 245 of the Act is a form/method of recovery.
- (iv) ITAT is competent to stay recovery of the impugned demand and if an order for "stay of recovery" is passed, the Assessing Officer would be well advised and should not pass an order of adjustment under Section 245 to recover the demand. In such cases, it is open to the Assessing Officer to ask for modification or clarification of the stay order to enable him to pass an order of adjustment under Section 245 of the Act.
- (v) Different parameters and considerations can be applied when a stay order is passed, against use of coercive methods for recovery of demand and when adjustment is stayed. Therefore, ITAT can stay adoption of coercive steps for recovery of demand but may permit adjustment under Section 245.
- (vi) When and in what cases, adjustment under Section 245 of the Act should be stayed would depend upon facts and circumstances of each case. The discretion is to be exercised judiciously. Nature of addition resulting in the demand is a relevant consideration. Normally, if the same addition/disallowance/issue has already been decided in favour

of the assessee by the appellate authority, the Revenue should not be permitted to adjust and recover the demand on the same ground. In exceptional cases, which include the parameters stated in Section 241 of the Act, adjustment can be permitted/allowed by the ITAT.

Additions/Amount covered by earlier orders

26. The petitioner has filed calculations and has drawn our attention to a chart summarizing the issues on which additions/ disallowances have been made by the Assessing Officer and has high-lighted that several additions or disallowances have already been decided or adjudicated in favour of the petitioner by the CIT (Appeals) or by the ITAT. As noticed above, this is a relevant factor, while deciding the stay application. We do not agree with the stand of the Revenue that in the present year, assessment order has been passed under Section 144C, i.e. after reference to the Dispute Resolution Panel, therefore the orders passed by the CIT(Appeals) and ITAT in favour of the petitioner have lost significance and do not justify stay of demand in matters covered in favour of the assessee. Decisions of the CIT (Appeals) or the ITAT in favour of the assessee should not be ignored and have not become inconsequential. This is not a valid or good ground to ignore the decisions of the appellate authorities and is also not a good ground to not to stay demand or to allow adjustment under Section 245 of the Act. Revenue has not made out a good cause or reason why adjustment should allowed to recover demand on issues that have been decided in favour of the petitioner in other years.

27. Revenue in the affidavit filed on 19th October, 2011, has admitted that additions/disallowances to the tune of Rs.96 crores are already covered against them by orders of the ITAT or CIT (Appeals). The petitioner has submitted that the aforesaid affidavit in fact conceals and does not specifically deal with some of additions like sales tax subsidy, disallowance of claim for withdrawl of amount added back etc. The petitioner has submitted that attempt of the Revenue is to deliberately make additions so that refunds due in the earlier year do not become payable but can be adjusted. The allegation is that attempt by the respondents is that statistics and collection figures can be maintained. We are not examining the said aspects but in a case and if it is found that the contention of the assessee is correct then appropriate orders can certainly be passed. However, no assumptions should be drawn. The respondents are officers of the State and the Law requires that they perform their duties with utmost objectivity and fairness, while keeping in mind the sanctity of the role and function assigned to them which at times requires tough steps.

Final Directions

28. In view of the findings recorded above, we have no hesitation in holding that conduct and action of the respondent-Revenue in recovering the disputed tax in respect of additions to the extent of Rs.96 crores on issues which are already covered against them by the earlier orders of the ITAT or CIT (Appeals) is unjustified and contrary to law. Accordingly, directions are issued to the respondents to refund Rs.30 crores, which will be approximately the tax due on Rs.96 crores. The said refund shall be made within one month from the date when a copy of this order is made available to the respondents.

29. With regard to the interest under Section 234B and 234C recovered on the said Rs.30 crores, we are not issuing direction for refund as the respondents have not recovered the full demand. The allegation of the petitioner that several other disputed additions are also covered by the earlier orders of the ITAT/CIT (Appeals) prima facie has merit but it is not possible to quantify and calculate the exact amount. We have already recorded above that the order passed by the ITAT substantially dismissing the stay application is not correct. One option available is that the ITAT should be asked to examine the said questions and decide the stay application afresh. However, we prefer the second option i.e. to direct the ITAT to hear the appeal filed by the petitioner expeditiously and preferably within a period of four months from the date copy of this order is served in their registry.

30. The writ petition is accordingly disposed of, without any orders as to costs.

2011 PTR 1365 (H.C. Del.)

HIGH COURT OF NEW DELHI

A.K. Sikri and Siddharth Mridul, JJ.

Commissioner of Income Tax

v.

Arvind Kumar Jain

FACTS/HELD

1. **S. 2(22)(e): “Trade Advances” are not “loans & advances”**
2. The assessee held 50% of the shares of a closely held company. The assessee’s books showed that he had taken an “*unsecured loan*” of Rs. 47 lakhs from the company. The AO assessed the said amount as “*deemed dividend*” u/s 2(22)(e) though the CIT (A)

& Tribunal deleted it on the ground that there was a *running business relationship between the assessee and the company and the said amount was not a loan but was the result of those business transactions*. The department filed an appeal before the High Court. HELD dismissing the appeal:

- (i) S. 2(22)(e) provides that any “loan or advance” by a closely held company to a substantial shareholder shall be assessed as “*deemed dividend*”. The purpose is to tax accumulated profits distributed in the form of loans. Bearing this purpose in mind, **the word “advance” has to be read in conjunction with the word “loan”**. The attributes of a loan are that it involves a positive act of lending coupled with acceptance by the other side of the money as loan: it generally carries interest and there is an obligation of re-payment. The term “advance” may or may not include lending. The word “advance” if not found in conjunction with the word “loan” may or may not include the obligation of repayment. If it does then it would be a loan. Applying the doctrine of *noscitur a sociis*, **the word “advance” means such advance which carries with it an obligation of repayment. Trade advance which are in the nature of money transacted to give effect to a commercial transactions do not fall within the ambit of s. 2(22)(e) (CIT Vs. Raj Kumar 318 ITR 462 followed)**;
- (ii) The fact that the assessee has himself shown the amount in his books of accounts as “unsecured loan”, is not determinative of the true nature of transaction. (**India Discount Co Ltd 75 ITR 191 (SC) followed**).

Appeal dismissed.

ITA No. 589 of 2011.

Heard on: 19th September, 2011.

Decided on: 30th September, 2011.

Present at hearing: Abhishek Maratha, Sr. Standing Counsel with Anshul Sharma, Advocate, for Appellant. Ved Jain, Advocate, for Respondent.

JUDGMENT

A.K. Sikri, J.-

1. The assessee is in the business of trading i.e. purchase and sale of books and journals. During the assessment proceedings, the Assessing Officer found that the assessee is a shareholder in a company called A & A Periodical Subscription Agency Pvt. Ltd. (hereinafter referred to as the A & A Periodicals). The paid up share capital of A & A Periodicals was 50,2000/- [50,200 shares of Rs. 10 each]. The assessee was holding 50% shares in this company and remaining 50% shares were held by Smt. Sunita Jain. The AO further found that in the books of accounts the assessee had shown taking unsecured loan of Rs. 47,23,5318/- from A & A Periodicals. The assessee being 50% shareholder in the said company, the aforesaid purported loan received by the assessee was treated as „deemed dividend“ under Section 2 (22) (e) of the Act.

2. We may note that explanation furnished by the assessee was that the aforesaid amount was not a loan and in fact there was a business transaction between the assessee and A & A Periodicals and the amount reflected running business relationship and there was a running account maintained by the assessee showing those transactions. This explanation was, however, not accepted by the Assessing Officer as in the books of accounts, the amount was shown as “unsecured loan”.

3. The assessee challenged the said addition by filing appeal before the CIT (A) who accepted the explanation furnished by the assessee. It was found, as a fact, that both the assessee as well as the A & A Periodicals were in the business of trading i.e. purchase and sale of books and journals; there were business transactions between the assessee and the A & A Periodicals; a running account was being maintained reflecting the regular transactions between the two business entities; and the amount of Rs. 47,25,318.80 paise was the result of those business transactions. From this, the CIT (A) concluded that the amount was not given by A & A Periodicals to the assessee by way of loan but on this basis, allowing the appeal of the assessee, the CIT (A) deleted the additions. The matter was taken in further appeal before the ITAT by the Revenue. However, the appeal of the Revenue has been dismissed by the Tribunal vide impugned order dated 16.7.2010 holding that the payment made by the A & A Periodicals to the assessee is not in the nature of loan or advance. The finding of the CIT (A) is affirmed by the ITAT, on the basis of books of accounts produced before the Assessing Officer and shown to the Tribunal as well that all the transactions between the two entities are recorded in the current account maintained by the parties and outstanding in the said account was merely because of the trade transaction and did not represent any advance or loan.

4. It is not in dispute that Section 2 (22) (e) of the Act creates a fiction of making such loan and advance under circumstances, as deemed dividend, would be attracted only when some loan or advance is given by the company to another person who is having particular shareholding in the said company. However, in the present case, two authorities below have arrived at a finding of fact that the amount in question represented the credit balance as a result of transactions between A & A Periodicals and the assessee on account of business relations and payment was not in the nature of „loan or advance”.

5. In *CIT Vs. Raj Kumar* (2009) 318 ITR 462, this Court has held that if the payments are made by such a company to even its shareholder having substantial interest but are the result of business transactions between the parties, then such payments cannot be treated as loan or advance and the money so received cannot be treated as deemed dividend within the meaning of Section 2 (22)(e) of the Act. The following discussion in the said judgment spells out the conditions which are to be fulfilled before the amount paid is treated as deemed dividend as well as the principle that trade advance does not fall within the ambit of provisions of Section 2 (22) (e) of the Act:—

“(i) The company making the payment is one in which public are not substantially interested.

(ii) money should be paid by the company to a shareholder holding not less than ten per cent (10%) of the voting power of the said company. It would make no difference if the payment was out of the assets of the company or otherwise.

(iii) The money should be paid either by way of an advance or loan or it may be “any payment” which the company may make on behalf of, or for the individual benefit of, any share holder or also to any concern in which such shareholder is a member or a partner and in which it is substantially interested.

(iv) And, lastly, the limiting factor being that these payments must be to the extent of accumulated profits, possessed by such a company.”

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Therefore, if the said background is kept in mind, it is clear that Sub-clause (e) of Section 2(22) of the Act, which is pari-materia with Clause (e) of Section 2(6A) of the 1922 Act, plainly seeks to bring within the tax net accumulated profits which are distributed by closely held companies to its shareholders in the form of loans. The purpose being that persons who manage such closely held companies should not arrange their affairs in a manner that they assist the shareholders in avoiding the

payment of taxes by having these companies pay or distribute, what would legitimately be dividend in the hands of the shareholders, money in the form of an advance or loan.

If this purpose is kept in mind then, in our view, the word 'advance' has to be read in conjunction with the word 'loan'. Usually attributes of a loan are that it involves positive act of lending coupled with acceptance by the other side of the money as loan: it generally carries an interest and there is an obligation of re-payment. On the other hand, in its widest meaning the term 'advance' may or may not include lending. The word 'advance' if not found in the company of or in conjunction with a word 'loan' may or may not include the obligation of repayment. If it does then it would be a loan. Thus, arises the conundrum as to what meaning one would attribute to the term 'advance'. The rule of construction to our minds which answers this conundrum is *noscitur a sociis*. The said rule has been explained both by the Privy Council in the case of *Angus Robertson v. George Day* (1879) 5 AC 63 by observing "it is a legitimate rule of construction to construe words in an Act of Parliament with reference to words found in immediate connection with them" and our Supreme Court in the case of *Rohit Pulp & Paper Mills Ltd v. CCE*, AIR 1991 SC 754 and *State of Bombay v. Hospital Mazdoor Sabha*, AIR 1960 SC 610.

It is important to note that *Rohit Pulp* (supra) was the case dealing with taxation. In brief in the said case the assessee was seeking to take benefit of an exemption notification. The Department denied the benefit of the 'notification' on the ground that the paper manufactured by the assessee was 'coated paper' to which as per the proviso to the said notification the concession was not available. The Supreme Court in coming to the conclusion that the assessee's case did not fall within the proviso and was thus entitled to the benefit of the notification applied the rule of construction of *noscitur a sociis*.

Importantly, the broad principles which emerge from the judgment of the Supreme Court with regard to the applicability of the said rule of construction are briefly as follows:

- (i) does the term in issue have more than one meaning attributed to it i.e., based on the setting or the context one could apply the narrower or wider meaning;
- (ii) are words or terms used found in a group totally 'dissimilar' or is there a 'common thread' running through them;

(iii) the purpose behind insertion of the term.

Let's examine as to whether based on the aforesaid tests the said rule of construction "noscitur a sociis" ought to be applied in the instant case.

(i) the term "advance" has undoubtedly more than one meaning depending on the context in which it is used;

(ii) both the terms, that is, advance or loan are related to the "accumulated profits" of the company;

(iii) and last but not the least the purpose behind insertion of the term advance was to bring within the tax net payments made in guise of loan to shareholders by companies in which they have a substantial interest so as to avoid payment of tax by the shareholders;

Keeping the aforesaid rule in mind we are of the opinion that the word "advance" which appears in the company of the word "loan" could only mean such advance which carries with it an obligation of repayment. Trade advance which are in the nature of money transacted to give effect to a commercial transactions would not, in our view, fall within the ambit of the provisions of Section 2(22)(e) of the Act. This interpretation would allow the rule of purposive construction with *noscitur a sociis*, as was done by the Supreme Court in the case of *LIC of India v. Retd. LIC Officers Assn.* [2008] 3 SCC 321.”

6. Learned counsel for the appellant hammered the fact that the amount was shown by the assessee himself in his books of accounts as “unsecured loan” and, therefore, the order of the Assessing Officer was correct.

7. It is trite law that mere nomenclature of entry in the books of accounts is not determinative of the true nature of transaction. See *Commissioner of Income Tax Vs. India Discount Co. Ltd.* 75 ITR 191 (SC), *Commissioner of Income Tax Vs. Provincial Farmers (P) Ltd.* 108 ITR 219 (Cal) and *KCP Ltd. Vs. CIT*, 245 ITR 421. In the present case after going through the relevant evidence as well as current account maintained between the parties, it has been established that the payment made were the result of trading transaction between the parties and the amount was not given by way of loan or advance.

7. We thus, find that no question of law arises in this appeal which is accordingly dismissed.

2011 PTR 1371 (H.C. Del.)

HIGH COURT OF NEW DELHI

Sanjiv Khanna and R.V. Easwar, JJ.

M/S Atma Ram Properties Private Limited

v.
D.C.I.T.

FACTS/HELD

1. **S. 147: AO must specify what facts are failed to be disclosed. Lapse by AO no ground for reopening if primary facts disclosed**
2. In AY 2001-02, the AO assessed advances of Rs. 1.56 crores received from a group concern as “deemed dividend” u/s 2(22)(e). In appeal, the CIT (A) held that the advances received in earlier years could not be assessed. The AO thereafter reopened the assessment for AY 1999-00 (after 4 years from the end of the AY). Though the AO alleged that there was a failure on the part of the assessee to disclose full and true material facts, he did not specify what that failure was. The reopening was upheld by the CIT (A) & the Tribunal. On appeal to the High Court, HELD allowing the appeal:
 - (i) In AY 1999-00, the AO inquired into the details of advances received but did not make any addition u/s 2(22)(e). **If the AO fails to apply legal provisions, no fault can be attributed to the assessee. The assessee is merely required to make a full and true disclosure of material facts but is not required to disclose, state or explain the law. A lapse or error on the part of the AO cannot be regarded as a failure on the part of the assessee to make a full and true disclosure of material facts;**
 - (ii) **Though the recorded reasons state that the assessee had failed to fully and truly disclose the facts, they do not indicate why and how there was this failure. Mere repetition or quoting the language of the proviso is not**

sufficient. The basis of the averment should be either stated or be apparent from the record;

- (iii) Explanation (1) to s. 147 which states that mere production of books is not sufficient does not apply a case where the AO failed to apply the law to admitted facts on record.
- (iv) The allegation that the assessee did not disclose the true and correct nature of payment received from the sister concern nor disclosed the extent of holding of the sister concern so as to enable the AO to apply his mind regarding s. 2(22)(e) is not acceptable. The assessee had filed statement of accounts of each creditor and indicated them to be sister concerns. **The primary facts were furnished. The law does not impose any further obligation of disclosure on the assessee** (CIT vs. Burlop Dealers Ltd 79 ITR 609 (SC) followed)

Appeal dismissed.

Income Tax Appeal Nos. 52/2010 & 87/2010.

Heard on: 17th October, 2011.

Decided on: 11th November, 2011.

**Present at hearing: Kaanan Kapur, Advocate, for Appellant.
Kamal Sawhney, Sr. Standing Counsel, for Respondent.**

JUDGMENT

Sanjiv Khanna, J.-

These two appeals under Section 260A of the Income Tax Act, 1961 (Act, for short) have been filed by Atma Ram Properties Private Limited, the appellant and relate to assessment years 1999-00 and 2000-01. For the said years, the appellant had filed returns of income on 10th December, 1999 and 30th November, 2000 declaring income of Rs.49,85,970/- and Rs.39,87,710/-, respectively. Return for the assessment year 1999-2000 was taken up for scrutiny and the total income was assessed at Rs.1,11,76,124/-. Return for the assessment year 2000-2001 was not taken up for scrutiny and was processed and the returned income as declared was not enhanced/modified.

2. For the assessment year 2001-02, the Assessing Officer made an addition of Rs.1,56,51,570/- as deemed dividend under Section 2(22)(e) of the Act. This amount reflected the advance given by a group company, i.e. *Atma Ram Builders Pvt. Ltd.*, to the appellant-assessee. On appeal, the Commissioner of Income Tax (Appeals), [CIT (Appeals), for short], rejected the argument of the appellant that the aforesaid amount of

2011 Tax Review

Rs.1,56,51,530/- reflected only a current account entry and no loan or advance was taken. However, he restricted the addition to Rs.19,51,725/- as the said amount was advanced to the appellant during the assessment year 2001-02. He deleted the balance addition of Rs.1,36,99,845.14 as the said amount was the opening balance and had not been advanced or given as a loan/advance during the assessment year in question, i.e., assessment year 2001-02. The CIT (Appeals) further observed that the Assessing Officer was free to take remedial action as per law.

3. The Assessing Officer thereupon initiated reassessment proceedings recording identical reasons for the two assessment years in question. The relevant portion of the reasons read as under:-

“ Appeal order in the case of *M/s Atma Ram Properties Pvt. Ltd.* for A.Y. 2001-02 was passed by the Ld. CIT(A) vide order No.206/03-04 dated 28.06.2004 wherein addition of Rs.1,56,51,570/- on account deemed dividend u/s 2(22)(e) of the I.T. Act, 1961 was restricted to Rs.19,51,725/-. The Ld. CIT(A) held that addition to the extent of Rs.1,36,99,845/- was to be made in earlier years. On perusal of record it was found that the advance for *M/s Atma Ram Builders Pvt. Ltd.* was received by the assessee in various assessment years as per following details:-

A.Y.	Opening balance	Amount received during the year	Closing balance
1	2	3	4
1999-00	2,22,617.34	79,23,834.00	77,00,182.66
2000-01	77,00,182.66	60,00,000.00	1,36,97,582.66

In view of the fact that the addition on the issue of deemed dividend for advance received by the assessee from *M/s Atma Ram Builders Pvt. Ltd.* has been confirmed by the Ld. CIT(A) in A.Y. 2001-02, I have reason to believe that income of the assessee as shown in Col. (3) has escaped assessment for A.Y., shown in col. (1).

The assessee has failed to disclose fully & truly all material facts necessary for its assessment. The income in this case has been under assessed in terms of clause (e) of explanation 2 to sec. 147 of the I.T. Act, 1961.”

4. Reassessment orders were thereafter passed making addition, under Section 2(22)(e) of the Act of Rs.79,23,834/- and Rs.60,00,000/- for the assessment years 1999-2000 and 2000-01 respectively. The said additions were sustained by the CIT (Appeals) and the Income Tax Appellate Tribunal (tribunal, for short).

5. On 17th October, 2011, the following substantial question of law was framed and the learned counsel for the parties were heard:-

“1) Whether the Assessing Officer was justified and correct in law in initiating the reassessment proceedings for reasons recorded in Annexure A2.”

6. Learned counsel for the appellant-assessee has submitted that the reassessment proceedings were initiated after four years but the tribunal has erroneously held that there was failure/omission on the part of the assessee to make full and true disclosure. Secondly, it is a case of change of opinion.

7. Section 147 of the Act reads as under:–

“147. Income escaping assessment.-- If the Assessing Officer, has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned (hereafter in this section and in sections 148 to 153 referred to as the relevant assessment year):

Provided that where an assessment under sub-section (3) of section 143 or this section has been made for the relevant assessment year, no action shall be taken under this section after the expiry of four years from the end of the relevant assessment year, unless any income chargeable to tax has escaped assessment for such assessment year by reason of the failure on the part of the assessee to make a return under section 139 or in response to a notice issued under sub-section (1) of section 142 or section 148 or to disclose fully and truly all material facts necessary for his assessment for that assessment year.

Explanation 1.--Production before the Assessing officer of account books or other evidence from which material evidence could with due diligence have been discovered by the Assessing officer will not necessarily amount to disclosure within the meaning of the foregoing proviso.

Explanation 2.--For the purposes of this section, the following shall also be deemed to be cases where income chargeable to tax has escaped assessment, namely:–

(a) where no return of income has been furnished by the assessee although his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax;

(b) where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return;

(c) where an assessment has been made, but—

(i) income chargeable to tax has been under assessed; or

(ii) such income has been assessed at too low a rate; or

(iii) such income has been made the subject of excessive relief under this Act; or

(iv) excessive loss or depreciation allowance or any other allowance under this Act has been computed.

Explanation 3.— For the purpose of assessment or reassessment under this section, the Assessing Officer may assess or reassess the income in respect of any issue, which has escaped assessment, and such issue comes to his notice subsequently in the course of the proceedings under this section, notwithstanding that the reasons for such issue have not been included in the reasons recorded under sub-section (2) of section 148.”

Assessment year 1999-2000. (ITA No. 87/2010)

8. In the assessment year 1999-00, the undisputed position is that the appellant had answered queries raised by the Assessing Officer vide letter dated 8th February, 2002. The said letter reads as under:—

“Dated 08 Feb, 2002
The assessing Officer,
Circle 2(1), CR Building,
IP estate New Delhi.

Sub:-Atma Ram Properties (P) Limited, Assessment Year 1999-2000 Completion of assessment

Sir,

In continuation of our discussion with you, copies of sister concerns mentioned below are enclosed:

Creditors:

Indian cine cosmos Pvt. Limited	Rs.45,50,585.65
Kulvinder Distributors P Ltd.	Rs.9,13,582.49
Mrs. Poonam Sawhney	Rs.1,39,480.21
Ashwin & Co. Pvt Limited	Rs.7,83,350.00
Sadoon Builders P Limited	Rs.1,43,473.83

CL. 1376*Caselaw Section (Foreign)*

Smt. Sadhna Chadha	Rs.12,17,630.99
M/s AR Chadha & Co. (I) P Ltd.	Rs.47,41,429.50
Atma Ram Builders Pvt. Limited	Rs.77,00,182.66
Atma Ram Construction P limited	Rs.87,323.77

Debtors:

Mrs Archana mamgain	Rs.54,29,342.52
ARSD Endowment trust	Rs.14,690.00
ARC Cement Ltd.	Rs.27,98,461.76
AR Chadha	Rs.14,26,761.62
AR Chadha & Co.	Rs.75,04,916.62
Atma Ram Trust	Rs.7,44,592.37
Mr. CM Chadha	Rs.24,11,088.69
Smt. Chuniwati Chadha	Rs.16,42,963.63
Smt. Kamlesh Sawhney	Rs.11,73,376.87

Yours faithfully,
For Atma Ram Properties P limited
(C M Chadha)
(Director)"

9. The aforesaid letter refers to the discussion with the Assessing Officer and also mentions enclosing a copy of accounts of sister concerns as creditors or debtors. The said letter refers to Atma Ram Builders Private Limited to whom Rs.77,00,182.66 was due and payable.

10. It is not disputed that after this letter was filed, the Assessing Officer passed the assessment order under Section 143(3) dated 15th February, 2002 making some enhancements and assessed the income of the appellant at Rs.1,11,76,124.88 instead of declared return income of Rs.49,89,970/-. However, no addition was made under Section 2(22)(e) of the Act on the ground of deemed dividend.

11. The Revenue has produced the original file before us. Vide order dated 7th February, 2002 the appellant-assessee was asked to file confirmations of sundry creditors and loan/advances. The order sheet dated 14th February, 2002 states that an advocate had attended and filed submissions vide letter dated 8th February, 2002. The letter dated 8th February, 2002 is on record along with a detailed annexure which sets out names of the creditors and debtors, who it is stated were sister concerns of the appellant-assessee. The annexure to the said letter contains a statement mentioning the opening balance, entries made during the year in respect of each one of the creditors and debtors and the closing balance. Notings on the said letter indicates that the Assessing

Officer had examined whether these were old entries or there were also deposits or payments during the year in question.

12. In view of what we have stated above, it is apparent that the Assessing Officer at the time of original proceedings had gone into the question of loans and advances from sister concerns. Figures and details were furnished and given along with an annexure which had particulars like opening and closing balance as well as entries/transactions during the year in question. Account of *Atma Ram Builders Pvt. Ltd.* was enclosed.

13. Revenue has debated and stated that the Assessing Officer had not examined and gone into the question whether or not provisions of Section 2(22)(e) of the Act were attracted to the present case and therefore re-assessment proceedings have been validly initiated.

14. No doubt Section 2(22)(e) of the Act is not mentioned in the order sheet or in the assessment order but this does not help the case of the Revenue for the reason that the assessee cannot be faulted. If the Assessing Officer had failed to apply legal provisions/section of the Act, the fault cannot be attributed to the appellant assessee. The requirement is that the assessee should have failed or omitted to make full and true disclosure of material facts. The assessee is not required to disclose, state or explain the law. It cannot be said that the appellant-assessee had failed to make full and true disclosure of material facts. Full and true facts were stated by the assessee. Full and true details were furnished but as per the case of the Revenue there was a lapse on the part of the assessing officer in not applying and invoking Section 2(22)(e) of the Act. This lapse or error on the part of the Assessing Officer cannot be attributed and regarded as a failure on the part of the assessee to make full and true disclosure of the material facts in the original assessment proceedings. The aforesaid error or failure of the assessing officer in not applying Section 2(22)(e) could have been corrected by exercise of power of revision as the original order may have been erroneous and prejudicial to the interest of Revenue, but limitation period for exercise of the said power had expired. The said error in applying a provision cannot be corrected in the present case due to the factual matrix, by exercise of power under Section 147 of the Act. It is not that the Revenue was remediless or the error could not be corrected or rectified. Due to delay and limitation, the remedial action cannot be taken under the applicable provision. Scope and ambit of each provision/remedy available under the Act is circumscribed and stipulated. Sometimes two or more provisions/remedies may be applicable and recourse to any one of the remedy may be proper but scope and ambit of a provision/remedy cannot be expanded beyond the legislative mandate. The jurisdictional preconditions, if stipulated in the enactment, must be satisfied before recourse to a remedy/provision can be invoked.

15. The reasons recorded above do state that the appellant assessee had failed to fully and truly disclose the facts but do not indicate why and how the assessee had failed to make full and true disclosure of the material facts. Mere repetition or quoting the language of the proviso is not sufficient. The basis of the averment/statement should be either stated or should be apparent/ lucid/explained from the record.

16. In the present appeal, Explanation (1) to Section 147 also does not help or assist the Revenue. All material facts were available on record and no material facts had to be inferred or discovered by the assessing officer. The assessing officer in spite of being aware of the facts, failed to apply or, at best failed to consider whether Section 2(22)(e) of the Act was attracted. Failure to apply law or a section to admitted facts on record is not covered by Explanation (1). Explanation (1) applies when the assessing officer on the basis of account books or other evidence fails to discover or infer material facts which with due diligence could have been discovered. Explanation (1) deals with failure of the assessing officer to discover or infer all material facts on the basis of books of accounts or other evidence produced by the assessee. Difference between facts and law is well recognized and understood. Explanation (1) reflects the said difference.

17. The assessing officer in the re-assessment order has not discussed the said aspect but the CIT (Appeals) in his order has accepted that the list of creditors and debtors was furnished by the appellant assessee but the assessee had tried to conceal the fact that the sister concerns' balances included balances in respect of transactions and loans. There is no basis or ground for recording the said finding. As noticed above, in the course of original assessment proceedings, the assessee was required to file compilations of sundry creditors, loans and advances as per order sheet dated 7th February, 2002 and pursuant to the said direction, the letter dated 8th February, 2002 was filed. The details included details of loans and advances. The Tribunal in the impugned decision dated 3rd July, 2009, has again recorded as under:—

“On reading the aforesaid letter dated 08.02.2002, it is seen that the assessee has shown sum of Rs.77,00,18,266/- against M/s. Atmaram Builders Pvt. Ltd. under the head “creditors”. The nature of the transaction made with M/s. Atmaram Builders Pvt. Ltd. has nowhere been disclosed. In the said letter, the assessee has nowhere stated that the sum of Rs. 77,00,182/- represents loans and advances taken from sister concerns having specified percentage of holding of shares in the share capital of the assessee company. We, thus find that the Id. CIT(A) has rightly noted that the fact that the assessee has categorized the amount payable to M/s. M/s. Atmaram Builders Pvt. Ltd. under the head “creditors” without indicating that the assessee has taken loans and advances from the sister concern

having share holding the share capital of the assessee company. From the details so filed and the assessment order originally made u/s 143(3), it is clear that the issue as to whether the amount shown under the head “creditors” in the name of M/s. Atmaram Builders Pvt. Ltd. was covered by the provisions contained in section 2(22)(e) was never a subject matter of assessment originally made u/s 143(3) of the Act nor any deliberation or discussion was made in that proceedings, and no basic and primary facts and details necessary to decide the applicability of section 2(22)(e) of the Act were furnished by the assessee. The assessee did not disclose the true and correct nature of payment received from M/s. Atmaram Builders Pvt. Ltd. nor disclosed the extent of holding of M/s. Atmaram Builders Pvt. Ltd. in the share capital of the assessee company so as to enable the A.O. to apply his mind regarding the applicability of the provisions contained in section 2(22)(e) of the Act to amount taken from M/s. Atmaram Builders Pvt. Ltd.”

18. The aforesaid reasoning is incorrect and cannot be accepted as the letter dated 8th February, 2002, was filed in response to the noting dated 7th February, 2002, made by the assessing officer requiring the assessee to file compilation of sundry creditors, loans and advances. They were described and mentioned as sister concerns. Further along with the letter dated 8th February, 2002, the assessee had filed statement of accounts of each creditor/debtor including the opening balance, closing balance or transaction or entries during the year. We do not think that the law/ statute requires or imposes any further obligation on the appellant. The disclosure in the present case by the appellant was full and true.

19. In *CIT versus Burlop Dealers Ltd.*, [1971] 79 ITR 609 (SC), a similar provision in Section 34(1) of the Income Tax Act, 1922 was examined and it was held that the said provision did not impose a more onerous obligation than disclosing the primary facts relevant to the assessment. It was observed as under:

“We are of the view that under section 34(1)(a) if the assessee has disclosed primary facts relevant to the assessment, he is under no obligation to instruct the Income-tax Officer. about the inference which the Income tax Officer may raise from those facts. The terms of the Explanation to section 34(1) also do not impose a more onerous obligation. Mere production of the books of account or other evidence from which material facts could with due diligence have been discovered does not necessarily amount to disclosure within the meaning of section 34(1), but where on the evidence and the materials produced the Income-tax Officer could have reached a conclusion other than the one which he has reached, a proceeding under section 34(1)(a) will

not lie merely on the ground that the Income-tax Officer has raised an inference which he may later regard as erroneous.

The assessee had disclosed his books of account and evidence from which material facts could be discovered : it was under no obligation to inform the Income-tax Officer about the possible inferences which may be raised against him. It was for the Income-tax Officer to raise such an inference and if he did not do so the income which has escaped assessment cannot be brought to tax under section 34(1)(a)”

20. The aforesaid decision of the Supreme Court was elucidated and explained in *Phool Chand Bajral Lal versus I.T.O.*, [1993] 203 ITR 456 (SC) and it was held that where the Assessing Officer gets fresh information that was not available at the time of original assessment, i.e. after the conclusion of the original assessment proceedings, which enables him to form a reasonable belief that income had escaped assessment because of omission or failure of the assessee to disclose full and true facts, reassessment proceedings could be validly initiated. It has to be, therefore, examined whether the assessing officer had received information from any other external source after conclusion of the first/ original assessment proceedings to show that the assessee had not made true and full disclosure of the facts. It was held as under:

“Thus, it is seen that in *Burlop Dealers'* case [1971] 79 ITR 609 (SC), apart from the Income-tax Officer holding during the assessment proceedings of the same assessee for a subsequent year, that the alleged agreement between the assessee and Ratiram was bogus, there was no other information or material from any other external source which came to the notice of the Income-tax Officer after the assessment proceedings which could enable the Income-tax Officer to form a reasonable belief that the income of the assessee had escaped assessment in the earlier year. As a matter of fact, after the conclusion of the original assessment proceedings, there was no fresh material at all available with the Income-tax Officer in *Burlop Dealers'* case [1971] 79 ITR 609 (SC) which could have enabled the Income-tax Officer to entertain any reason to believe that the income of the assessee had escaped assessment for the assessment year 1949-50. An assessment order for the subsequent year could not by itself lead to any inference, much less to the formation of a reasonable belief that income chargeable to tax had escaped assessment in the previous year, on account of the failure on the part of the assessee to make a true and full disclosure of the primary facts during the proceedings of the concluded assessment. The judgment in *Burlop Dealers'* case [1971] 79 ITR 609 (SC) cannot be understood as laying down any such proposition that even where the Income-tax Officer gets some

fresh information which was not available at the time of the original assessment, subsequent to the conclusion of the original assessment proceedings, which enables him to form a reasonable belief that the income of the assessee had escaped assessment because of the omission or failure of the assessee to disclose true and full facts during the assessment proceedings, he cannot reopen the assessment. The observations in Burlop's case [1971] 79 ITR 609 (SC), noticed above, were made in the peculiar fact-situation of that case and cannot be construed to be of universal application irrespective of the facts and circumstances of the particular case.

In the present case, as already noticed, the Income-tax Officer, Azamgarh, subsequent to the completion of the original assessment proceedings, on making an enquiry from the jurisdictional Income-tax Officer at Calcutta, learnt that the Calcutta company from whom the assessee claimed to have borrowed the loan of Rs. 50,000 in cash had not really lent any money but only its name to cover up a bogus transaction and, after recording his satisfaction as required by the provisions of section 147 of the Act, proposed to reopen the assessment proceedings. The present is thus not a case where the Income-tax Officer sought to draw any fresh inference which could have been raised at the time of the original assessment on the basis of the material placed before him by the assessee relating to the loan from the Calcutta company and which he failed to draw at that time. Acquiring fresh information, specific in nature and reliable in character, relating to the concluded assessment which goes to expose the falsity of the statement made by the assessee at the time of the original assessment is different from drawing a fresh inference from the same facts and material which were available with the Income-tax Officer at the time of the original assessment proceedings. The two situations are distinct and different. Thus, where the transaction itself, on the basis of subsequent information, is found to be a bogus transaction, the mere disclosure of that transaction at the time of original assessment proceedings cannot be said to be a disclosure of the "true" and "full" facts in the case and the Income-tax Officer would have the jurisdiction to reopen the concluded assessment in such a case. It is correct that the assessing authority could have deferred the completion of the original assessment proceedings for further enquiry and investigation into the genuineness of the loan transaction but, in our opinion, his failure to do so and complete the original assessment proceedings would not take away his jurisdiction to act under section 147 of the Act, on receipt of the information subsequently. The subsequent information on the basis of which the Incometax Officer acquired reasons to believe

that income chargeable to tax had escaped assessment on account of the omission of the assessee to make a full and true disclosure of the primary facts was relevant, reliable and specific. It was not at all vague or non-specific.”

21. In the assessment year 1999-2000, no information or material in the form of facts was furnished from any external source. The facts were already on record furnished by the letter dated 8th February, 2002. In the subsequent year i.e. assessment year 2001-02, an addition under Section 2(22)(e) of the Act, was made but was partly deleted by the CIT (Appeals) on the ground that loans and advances pertaining to other years with the observation that the assessing officer was entitled to take remedial action as per law in the relevant years. This is not factual information or material which can be covered by the Explanation (1). The facts were already known and on record and were not brought to the notice of the department by virtue of the order passed by the CIT (Appeals) in the assessment year 2001-02.

22. In view of the aforesaid discussion, the substantial question of law, raised by the assessee in Assessment Year 1999- 2000, is decided in favour of the appellant and against the respondent. The appeal is accordingly allowed and the reassessment proceedings are set aside.

Assessment year 2000-2001. (ITA No. 52/2010)

23. As far as assessment year 2000-01 is concerned, the return was not taken up for scrutiny and no order under Section 143(3) of the Act was passed. Therefore, the contention that there was change of opinion cannot be accepted. The contention of the appellant that the letter dated 8th February, 2002 was filed during the course of assessment proceedings for the assessment year 1999-00 and the said letter should be read and treated as a part of the records relating to the assessment year 2000-01, cannot be accepted. It is well settled that each assessment year is treated as a separate and independent. Letter dated 8th February, 2002, which was filed in the proceedings for the assessment year 1990-00, cannot be read and treated as was filed in the proceedings relating to the assessment year 2000-01. As noticed above, proceedings for assessment year 2000-01 were never initiated and the return for the said year was not made subject matter of the scrutiny. The other contention of the appellant that they had made full and true disclosure in the said year must necessarily fail for the same reasoning. Clause (b) to the Explanation 2 is clearly applicable. In this case, books of accounts and other material were not produced and no letter was filed. Accordingly, order passed by the CIT (Appeals) in the assessment year 2001-02 would constitute information or material from any external source and the decision of the Supreme Court in *Phool Chand Bajrang Lal's case* (supra) would be applicable and supports the stand of the Revenue.

24. Reliance placed by the appellant assessee on *Commissioner of Income Tax, Delhi – XI versus Batra Bhatta Company*, 2008 (106) DRJ 389 (DB) is not apposite. In the said case, in the reasons for reopening recorded by the assessing officer, it was stated that the “issue/contentions raised in the case requires much deeper scrutiny”. Thus, it was held that the facts of the case did not satisfy the requirement of Section 147 i.e. “if the assessing officer has reason to believe”. Reason to believe do not mean reason to suspect and the said pre-condition was missing.

25. Thus, present appeal for the assessment year 2000-01 has to be dismissed and the question of law mentioned above answered against the appellant and in favour of the respondent.

ITA No. 52/2010 is accordingly dismissed.

2011 PTR 1383 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
BANGALORE “A” BENCH, BANGALORE

DR. O. K. Narayanan, Vice President and
SMT. P. Madhavi Devi, Judicial Member

FACTS/HELD

1. **S. 80IA(5): Loss & Depreciation of eligible unit prior to “initial assessment year”, if set-off against other income, not notionally carried forward**
2. In AY 2006-07 the assessee installed a windmill, the profits of which were eligible for 100% deduction u/s 80-IA. Owing to depreciation and loss, the assessee did not claim s. 80-IA deduction in AY 2006-07 & 2007-08 and set-off the loss and depreciation against other income. In AY 2008-09, the assessee earned profits from the windmill and claimed deduction u/s 80-IA. The AO & CIT (A) relied on the Special Bench decision in *ACIT vs. Gold Mines Shares & Finance 116 TTJ (Ahd) (SB) 705* and held that in view of s. 80IA(5), the loss and unabsorbed depreciation of the eligible unit, though set-off against the other income, had to be “notionally” carried forward for set-off against the profits of the eligible undertaking. On appeal by the assessee, HELD allowing the appeal:

Though in *Gold Mines Shares & Finance 116 TTJ (Ahd) (SB) 705* it was held that in view of s. 80IA(5), the eligible

unit had to be treated as the only source of income and the profits had to be computed after deduction of the notionally brought forward losses and depreciation of the eligible business even though they were in fact set-off against other income in the earlier years, the Madras High Court held in *Velayudhaswamy Spinning Mills P. Ltd. v. ACIT 38 DTR 57* that such a notional exercise was not contemplated by s. 80IA (5). It was held that the fiction in s. 80-IA (5) that the eligible unit is the only source of income begins from the “initial assessment year” which is not the same thing as the year of commencement of activity. **The law contemplates looking forward to a period of ten years from the initial assessment and does not allow the Revenue to look backward and find out if there is any loss of earlier years and bring forward notionally even though the same were set off against other income of the assessee and the set off against the current income of the eligible business. Once the set off has taken place in an earlier year against the other income, the Revenue cannot rework the set off amount and bring it notionally. The fiction in s. 80-IA(5) is for a limited purpose and does not contemplate to bring set off amount notionally. The judgement of a constitutional court has overriding effect over the decision of a Special Bench of the Tribunal and the latter cannot be followed.**

Appeal partly allowed.

I.T.A No.1262/Bang/2010 (Assessment Year : 2008-09).

Decided on: 7th January, 2011.

Present at hearing: V. Srinivasan, CA, for Appellant. G. V. Gopala Rao, Commissioner of Income-tax-I, for Respondent.

JUDGMENT

Per DR. O. K. Narayanan:– (Vice President)

This is an appeal filed by the assessee. The relevant assessment year is 2008-09. The appeal is directed against the order of the Commissioner of Income-tax(A)-VI at Bangalore, dated.29.10.2010 and arises out of the assessment completed u/s.143(3) r.w.s.153A of the IT Act, 1961.

2. The assessee was the proprietor of M/s.VSL Mining Company, till the financial year preceding to the relevant assessment year involved in

the present appeal. The proprietary concern of the assessee was taken over by a company named M/s. VSL Mining Company P. Ltd., in the previous year relevant to the assessment year under appeal. However, the assessee continued to remain as partner of M/s. V. S. Lad and Sons which carries on the business of mining operations of extractions, processing and export of iron ore. The assessee filed the return of income on a total income of Rs. 4,41,22,030/- after claiming a sum of Rs. 1,97,73,931/- as deduction u/s.80IA of the Act.

3. There was a search and survey action in assessee's concerns as well as the associate concerns. In the back drop of the search action, assessment was made by the assessing authority u/s.153A. Naturally, 153A assessments covered even the earlier assessment years. In the course of the assessment proceedings for the impugned assessment year 2008-09, the Assessing Officer disallowed the deduction of Rs. 1,97,73,931/- claimed by the assessee as deduction u/s.80IA. The Assessing Officer has also made an addition of Rs. 24,06,700/- on the ground of seizure of cash at the time of search. He has further made an addition of Rs. 1,68,43,841/- by way of 50% of the disallowance of expenses incurred on running and maintenance of helicopter. The disallowance was made on the ground of personal user. Accordingly, the Assessing Officer determined a total income of Rs. 8,31,46,500/- as against a total income of Rs. 4,41,22,030/- returned by the assessee.

4. The assessment was taken in first appeal. The Commissioner of Income-tax(A) confirmed the order of the assessing authority disallowed the claim made by the assessee u/s.80IA and upheld the addition of Rs. 1,97,73,931/-. The Commissioner of Income-tax(A) also confirmed the addition of Rs. 24,06,700/- made by the assessing authority on the basis of seizure of cash in the course of search carried out u/s.132. Regarding the 50% disallowance of helicopter expenses, the Commissioner of Income-tax(A) set aside the disallowance and deleted the addition of Rs. 1,68,43,841/-. The grounds raised on levy of interest was disposed off as consequential.

5. The assessee is aggrieved on the two additions sustained by the Commissioner of Income-tax(A) and also in respect of levy of interest u/s.234B and 234C.

6. The relevant grounds raised by the assessee in the above background read as below:

- i) The learned Commissioner of Income-tax(A) is not justified in upholding the denial of the deduction claimed u/s.80IA of the Act amounting to Rs. 1,97,73,931/- under the facts and in the circumstances of the appellant's case.*
- ii) The learned Commissioner of Income-tax(A) is not justified in upholding the addition of Rs. 24,06,700/- being the cash seized*

by the department under the facts and in the circumstances of the appellant's case.

- iii) *Without prejudice to the right to seek waiver with the Hon'ble CCIT/DG the appellant denies himself liable to be charged to interest u/s.234B and 234C of the Act, which under the facts and in the circumstances of the appellant's case and the levy deserves to be cancelled.*

7. First we will consider the issue of deduction u/s.80IA of the IT Act, 1961.

8. The assessee had installed a windmill in the financial year 2005-06 relevant to the assessment year 2006-07. The assessee had claimed depreciation allowance to the extent of Rs. 33,66,68,484/- on the windmill in the assessment year 2006-07. Therefore, there was no profit to claim further deduction u/s.80IA. In the following assessment year 2007-08, again the assessee could not make out a claim for deduction u/s.80IA as there was a loss of Rs. 3,23,59,655/- for that assessment year. In short even though the wind mill was installed in the period relevant to assessment year 2006-07, the assessee could not avail the benefit of deduction u/s.80IA for assessment years 2006-07 and 2007-08 for the reason stated above.

9. Therefore, the assessee claimed the deduction for the impugned assessment year 2008-09. The assessee derived a profit of Rs. 1,97,73,931/- from the operation of windmill and claimed the entire amount as deduction u/s.80IA. The depreciation and loss pertaining to the earlier assessment years 2006-07 and 2007-08 were in fact set off by the assessee against the profit generated from other business including mining business carried on by the assessee. Even though the assessee could not claim the deduction u/s.80IA for those assessment years 2006-07 and 2007-08, the depreciation and loss relating to those assessment years have already been set off against the profits generated from other business carried on by the assessee. Therefore, according to the assessee, there was no unabsorbed depreciation and loss to be set off against the profit of Rs. 1,97,73,931/- pertaining to the impugned assessment year 2008-09 and it is therefore that the assessee has claimed the entire profit of the impugned assessment year as deduction u/s.80IA.

10. But the Assessing Officer held that even though the depreciation and loss relating to the earlier assessment years have already been set off against the profit of the assessee generated from other businesses, it is necessary for the purpose of deduction u/s.80IA to carry forward those depreciation and business loss in a notional manner to set off against the profit of the impugned assessment year and if so set off, there is no profit available in the hands of the assessee to claim deduction u/s. 80IA, even for the impugned assessment year 2008-09. In order to make out the

proposition of notional carry forward and set off, the assessing authority has relied on sub-section 5 of Section 80IA.

11. Sub-section 5 of section 80IA reads as follows:

(5) Notwithstanding anything contained in any other provision of this Act, the profits and gains of an eligible business to which the provisions of sub-section (1) apply shall, for the purposes of determining the quantum of deduction under that sub-section for the assessment year immediately succeeding the initial assessment year or any subsequent assessment year, be computed as if such eligible business were the only source of income of the assessee during the previous year relevant to the initial assessment year and to every subsequent assessment year up to and including the assessment year for which the determination is to be made.

12. On the basis of the above statutory provision, the Assessing Officer came to the following two grounds:

- (i) That the income or loss of the eligible unit has to be worked out on stand alone basis and as only source of income.
- (ii) The computation of the deduction u/s.80IA should start with the initial assessment year and the unabsorbed depreciation and loss relating to the initial assessment year and subsequent assessment years up to the eligible assessment year has to be set off against the profit and loss account of the eligible assessment year for which the assessee had made the claim of deduction.

13. On the basis of the above grounds, the Assessing Officer came to a finding that the initial assessment year in the case of the assessee is 2006-07 and the eligible assessment year opted by the assessee to claim deduction is 2008-09 and therefore, the unabsorbed depreciation and loss relating to assessment years 2006-07 and 2007-08 has to be set off against the profit of the impugned assessment year 2008-09. As the unabsorbed depreciation and loss of those assessment years 2006-07 and 2007-08 have already been set off against the profits of other business of the assessee carried on by the assessee for those assessment years, the Assessing Officer further held that the carry forward and set off has to be exercised on a notional basis. In other words, even though no amount is available as unabsorbed depreciation and loss by virtue of the fact that they have been set off against the profits of other business of the assessee for those assessment years, still for the purpose of section 80IA(5), carry forward and set off has to be exercised on a theoretical basis through the medium of notional carry forward and set off. In coming to the above finding the Assessing Officer has relied on the judgement of the Bombay High Court in the case of Indian Rayon Corporation v. Commissioner of Income-tax (261 ITR 98), for the proposition that the special deduction

under Chapter VIA should be restricted to the profits derived from the newly established undertakings.

14. The assessee placed before the Commissioner of Income-tax(A) decision of the Hon'ble Madras High Court in the case of *Velayudhaswamy Spinning Mills P. Ltd. v. ACIT* (38 DTR 57), where the court has held that there was no need of any such notional exercise of carry forward and set off of earlier period depreciation and loss in the process of computing the deduction u/s.80IA. But the Commissioner of Income-tax(A) observed that the facts and circumstances considered by the Hon'ble Madras High Court in the above case are different from the present case and the present case is squarely covered by the Special Bench decision of the ITAT, Ahmedabad, rendered in the case of *ACIT v. Gold Mines Shares & Finance P. Ltd* (116 TTJ (Ahd) (SB) 705). It has been held by the Special Bench in the said case that in view of the specific provisions of section 80IA(5) of the IT Act, 1961, profit from eligible business for the purpose of determination of the quantum of deduction u/s.80IA of the Act has to be computed after deduction of the notionally brought forward losses and depreciation of eligible business even though they have been allowed to be set off against other income in the earlier years. Accordingly, the Commissioner of Income-tax(A) dismissed the contentions of the assessee and confirmed the addition of Rs. 1,97,73,931/-.

15. The assessee as well as the Revenue have raised the same set of contentions before us which were already placed before the Commissioner of Income-tax(A) and before the assessing authority.

16. It is a fact that the Special Bench of the ITAT, Ahmedabad in *ACIT v. Gold Mines Shares & Finance P. Ltd* (116 TTJ (Ahd) (SB) 705), has held that the notional exercise is called for in computing the quantum of deduction u/s.80IA which supports the stand taken by the Revenue.

17. But we find that the decision of the Hon'ble Madras High Court in the case of *Velayudhaswamy Spinning Mills P. Ltd. v. ACIT* (38 DTR 57) has dealt with exactly the same issue and has held that such a notional exercise is not contemplated in the provisions of law contained in section 80IA(5). Even though the Commissioner of Income-tax(A) has made an attempt to distinguish the facts of the case considered by the Hon'ble Madras High Court, we are afraid that the Commissioner of Income-tax(A) has misconstrued the nature of facts involved in all these cases and he is not justified in distinguishing the facts of the case.

18. To make the matter more clear it is to be stated that the issue considered by the Special Bench of the ITAT, Ahmedabad in *ACIT v. Gold Mines Shares & Finance P. Ltd* (116 TTJ (Ahd) (SB) 705), and by the Hon'ble Madras High Court in the case of *Velayudhaswamy Spinning Mills P. Ltd. v. ACIT* (38 DTR 57) and the issue involved in the impugned appeal are all one and the same that whether the exercise of notionally carried forward and set off of depreciation and loss of the eligible

business relating to the earlier assessment years is called for when the depreciation and loss of those assessment years have already been allowed to be set off against other income of those assessment years.

19. As the issue raised in all the three cases including the present one is one and the same, we cannot over look the judgement of the Hon'ble Madras High Court only on the basis of a feeble argument that the facts and circumstances of that case are different from the present case in hand.

20. It is needless to say that the judgement of a constitutional court has got an overriding effect on the decision of a Special Bench of the Appellate Tribunal. Therefore, in the present case, the relevance of the judgement of the Hon'ble Madras High Court in the case of *Velayudhaswamy Spinning Mills P. Ltd. v. ACIT* (38 DTR 57) need not be over emphasized. Therefore, we have to first examine that how far the said judgement of the Hon'ble Madras High Court in the case of *Velayudhaswamy Spinning Mills P. Ltd. v. ACIT* (38 DTR 57) governs the issue in hand.

21. The facts relevant in the case of *Velayudhaswamy Spinning Mills* are as follows. The assessee in that case is engaged in the business of manufacture of yarn and electricity generation through wind electric generator. It filed its return of income for the relevant assessment year 2005-06 admitting a total income of Rs.1,36,36,470/- in normal computation and total income of Rs. 2,95,73,840/- as book profit u/s.115 JB. In the course of scrutiny assessment, the Assessing Officer disallowed the claim of deduction made by the assessee u/s.80IA amounting to Rs. 1,70,76,945/-. The disallowance was made on the ground that the eligible income of the unit for the impugned assessment year is a negative figure. The negative figure was worked out by the assessing authority by notionally setting off the depreciation and loss of the earlier assessment years treating the year of commencement of business as initial assessment year. In fact, the depreciation and loss of those assessment years have been set off against the income arising from other business carried on by the assessee. In first appeal the Commissioner of Income-tax(A) held that the year of commencement need not be the "initial assessment year" and the initial assessment year is the year in which the assessee makes an effective claim of deduction. As the assessment year 2005-06 is the assessment year in which the effective claim by the assessee has been made, the same should be the initial assessment year and therefore unabsorbed depreciation of earlier years which had already been absorbed against the income arising from other income of the business of the assessee cannot be notionally carried forward and taken into consideration for computing the deduction u/s.80IA. The matter was again taken up by the Revenue before the ITAT, Chennai. The Tribunal reversed the order of the Commissioner of Income-tax(A) and upheld the notional adjustment made by the assessing authority in the light of the Special Bench of the ITAT, Ahmedabad in *ACIT v. Gold Mines Shares & Finance P. Ltd* (116 TTJ (Ahd) (SB) 705). The Tribunal allowed the Departmental appeal.

22. It was in this context the matter was further taken up before the Hon'ble Madras High Court by the assessee in an appeal filed u/s.260A, by which the substantial questions of law were framed for consideration of the Hon'ble court, as below:

- (a) *Whether on the facts and circumstances of the case, the Tribunal is right in law in holding that the appellant is not entitled to claim deduction under s.80IA ?*
- (b) *Whether on the facts and circumstances of the case, the Tribunal is right in law in holding that initial assessment year in s. 80IA(5) would only mean the year of commencement and not the year of claim ?*
- (c) *Whether on the facts and circumstances of the case, the Tribunal is right in law in saying that unabsorbed depreciation of earlier years before the first year of claim, which has already been absorbed, could be notionally carried forward and taken into consideration for computation of deduction under s. 80IA ?*
- (d) *Whether on the facts and circumstances of the case, the Tribunal is right in law in following the decision of the Special Bench in the case of Gold Mines Shares & Finance P. Ltd (supra) when admittedly the said decision was rendered prior to the amendment to s. 80-IA by Finance Act, 1999 ?”*

23. From the above questions placed before and considered by the Hon'ble Madras High Court, it is clear that the issue raised in the present appeal is exactly the same issue adjudicated by the Hon'ble Madras High Court.

24. The Hon'ble Madras High Court while considering the said issue referred to the judgement of the same court dated.23.12.2009 in a Tax Case (Appeal) No.298 of 2004 rendered in the context of section 80I(6). It was held in the said unreported judgement that the cumulative consideration of the principles set out in the decisions considered by the Court that where admittedly the entire depreciation allowance and development rebate for the earlier years were fully set off against the total income of the assessee for those assessment years and no further depreciation allowance or development rebate remained unabsorbed and nothing could be deducted in respect of the set off while determining the deduction u/s.80I of the Act.

25. The above finding was given by the Hon'ble High Court in the said unreported case in reply to the following question placed before their lordships:

“Whether the Tribunal was right in holding that for the purpose of allowing deduction under s. 80-I, the brought forward losses and unabsorbed depreciation etc., of the new industrial undertaking need not be taken into consideration, once they have

been set off against other sources of income, especially in view of the clear provisions of sub-s.6 of s. 80-I, the application of which is mandatory ?”

26. By making a reference to the above unreported judgement and further examining the statutory provisions of section 80IA(5), the Hon'ble Madras High Court has held as follows:

“From a reading of the above, it is clear that the benefit is given to the profits and gains derived from the business of the hotel or business of repairs to ocean-going vessels or other powered craft. The deduction is allowed to the extent of 20 per cent from the profits and gains of the assessee. Sub-s. (5) gives deduction for the period of seven assessment years immediately succeeding the initial assessment year. Sub-s. (6) deals with computing the deduction under sub-s. (1) and it starts with non obstante clause and also it is a deeming provision. The fiction created by the undertaking was the only source of income during the previous year initially and subsequent assessment years. Sub-s. (6) was the subject-matter before this Court in the above-mentioned unreported judgement, wherein this Court had held that while interpreting the above provision, for the purpose of allowing deduction under s. 80-I brought forward losses and unabsorbed depreciation of the new industry need not be taken into consideration once they have been set off from other sources of income earlier. In the present case, we are concerned with the provisions of s. 80-IA. The said provision was introduced by Finance Act, 1999 w.e.f. 1st April, 2000. Provisions of ss.80-I and 80-IA are also more or less identically worded. Secs. 80-I and 80-IA come in Chapter VI-A of the IT Act.....”

“Where any deduction is required to be made or allowed under any section included in this chapter under the head 'CDeductions in respect of certain incomes' in respect of any income of the nature specified in that section which is included in the gross total income of the assessee, then, notwithstanding anything contained in that section, for the purpose of computing the deduction under that section, the amount of income of that nature as computed in accordance with the provisions of this Act (before making any deduction under this chapter) shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income.”

A mere reading of the above provision makes it clear that any income of the nature specified in that section, which is included in the gross total income of the assessee for the purpose of computing the deduction under that section, the amount of income of that nature as computed in accordance with the

provision of this Act shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in the gross total income. Sec.80AB defines “gross total income” which means the total income has to be computed in accordance with the Act before making deduction under this chapter. Heading 'B' deals with “deductions in respect of certain payments” which consists of ss. 80C to 80GGC. Heading 'C' deals with “deductions in respect of certain incomes”, which consists of ss. 80H to 80TT. The last heading 'D' deals with 'other deductions', which consists of ss. 80U to 80VV. Heading 'C' is relevant for considering the issue in these appeals. The relevant provisions that are to be considered are ss. 80-I, 80-IA and 80-IB. In the case of Liberty India v. Commissioner of Income-tax (2009) 225 CTR (SC) 233; (2009) 28 DTR (SC) 73 ; (2009) 317 ITR 218 (SC), the apex Court considered the scope of ss. 80-I, 80-IA and also s. 80-IB of the Act, wherein, it has been held that Chapter VI-A provides for incentives in the form of tax deductions essentially belong to the category of “profit-linked incentives”. Therefore, when s. 80-IA/80-IB refers to profits derived from eligible business, it is not the ownership of that business which attracts the incentives. Further, it has been held that ss. 80-IB/80-IA are the code by themselves as they contain both substantive as well as procedural provisions. The Supreme Court further observed in the said judgement that subs. (5) of s. 80-IA 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.....

From reading of sub-s. (1), it is clear that it provides that where the gross total income of an assessee includes any profits and gains derived by an undertaking of an enterprise from any business referred t in sub-s. (4) i.e. referred to as the eligible business, there shall, in accordance with and subject to the provisions of the section, be allowed, in computing the total income of the assessee, a deduction of an amount equal to 100 per cent of the profits and gains derived from such business for ten consecutive assessment years. Deduction is given to eligible business and the same is defined in sub-s. (4), Sub-s. (2) provides option to the assessee to choose 10 consecutive assessment years out of 15 years. Option has to be exercised. If it is not exercised, the assessee will not be getting the benefit. Fifteen years is outer limit and the same is beginning from the year in which the undertaking or the enterprise develops and begins to operate any infrastructure activity etc. Sub-s. (5) deals with quantum of deduction for an eligible business. The words “initial assessment year” are used in sub-s. (5) and the same is not defined under the provisions. It is to be noted that 'initial assessment year'

employed in sub-s. (5) is different from the words "beginning from the year" referred to in sub-s. (2). Important factors are to be noted in sub-s. (5) and they are as under :

- “(1) It starts with non obstante clause which means it overrides all the provisions of the Act and other provisions are to be ignored ;*
- (2) It is for the purpose of determining the quantum of deduction ;*
- (3) For the assessment year immediately succeeding the initial assessment year ;*
- (4) It is a deeming provision ;*
- (5) Fiction created that the eligible business is the only source of income ; and*
- (6) During the previous year relevant to the initial assessment year and every subsequent assessment year*

From reading of the above, it is clear that the eligible business were the only source of income, during the previous year relevant to initial assessment year and every subsequent assessment years. When the assessee exercises the option, the only losses of the years beginning from initial assessment year alone are to be brought forward and no losses of earlier years which were already set off against the income of the assessee. Looking forward to a period of ten years from the initial assessment is contemplated. It does not allow the Revenue to look backward and find out if there is any loss of earlier years and bring forward notionally even though the same were set off against other income of the assessee and the set off is taken place in earlier year against the other income of the assessee, the Revenue cannot rework the set off amount and bring it notionally. Fiction created in sub-section does not contemplates to bring set off amount notionally. Fiction is created only for the limited purpose and the same cannot be extended beyond the purpose for which it is created.”

27. Thus the Hon'ble Madras High Court has clearly held that where the depreciation and loss of earlier assessment years have already been set off against other business income of those assessment years, there is no need for notionally carrying forward and setting off of the same depreciation and loss in computing the quantum of deduction available u/s.80I. The Hon'ble Court has held further that the year of commencement alone need not be the “initial year”, but depending upon the facts of the case and the option exercised by the assessee, the year of claim also can be considered as “initial assessment year”. The court has

also examined the issue from a different legal angle and held that the proposition argued by the Revenue is not compatible with the scheme of gross total income conceptualized in the IT Act, especially in the light of section 80AB which are all relevant while considering the deduction u/s.80IA which is falling under Chapter VIA of the IT Act, 1961. Where the earlier depreciation and losses have already been set off, those loss and depreciation do not go to reduce the gross total income of an assessee within the meaning of section 80AB and therefore bringing the notional concept of carrying forward and set off will be contrary to the scheme of section 80AB and concept of gross total income.

28. Now it is clear as we find that this issue is squarely covered by the above discussed judgement of the Hon'ble Madras High Court in the case of *Velayudhaswamy Spinning Mills P. Ltd. v. ACIT* (38 DTR 57). Where such an overriding judgement of the constitutional court is governing the issue, we are not permitted to rely on the decision of the Special Bench of the Ahmedabad Tribunal.

29. Therefore, following the above judgement of the Hon'ble High Court of Madras, we accept the contention of the assessee and reverse the order of the Commissioner of Income-tax(A) on this point and direct the assessing authority to grant deduction to the assessee u/s.80IA for the quantum claimed by the assessee without diluting the same by the notional deduction of earlier loss and depreciation.

30. This ground is decided in favour of the assessee.

31. The next issue is the addition of Rs. 24,06,700/- in the nature of cash seized in the course of search. We have gone through the detailed submissions made by the assessee before the lower authorities as well as before the Tribunal. The assessee has not explained anywhere the source of this much amount as discernible from the books of account or any other documents. Therefore, the said amount remains as unexplained. Naturally, the assessing authority is justified in adding the said amount of Rs. 24,06,700/- as the income of the assessee. The said addition is accordingly upheld and the issue is decided against the assessee.

32. The third ground is in respect of levy of interest u/s.234B and 234C. This is consequential and the assessing authority shall modify the computation of interest.

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

Order pronounced on Friday, the 07th day of January, 2011, at Bangalore.

2011 PTR 1395 (S.C. Ind.)

SUPREME COURT OF INDIA

**Hon'ble The Chief Justice,
K.S. Radhakrishnan and Swatanter Kumar, JJ**

C.I.T, Chennai

v.

M/S Bhari Information Tech. SYS. P. Ltd.

FACTS/HELD

1. **For s. 115JA/JB s. 80HHC deduction to be computed as per P&L Profits & not normal provisions**
2. The assessee had a loss as per the normal computation though it had a profit as per the P&L A/c. In computing the book profits u/s 115JA, the assessee claimed deduction u/s 80HHE. The AO rejected the claim on the basis that as the assessee had no income under the regular provisions of the Act, it was not eligible for s. 80HHE deduction in computing the s. 115JA book profits. This was upheld by the CIT (A) though the Tribunal gave relief by following the judgement of the Special Bench of the Tribunal in **DCIT vs. Syncome Formulations** 106 ITD 193. This was upheld by the High Court. On appeal by the department, HELD dismissing the appeal:

In **DCIT vs. Syncome Formulations** 106 ITD 193 the Special Bench held in the context of s. 80HHC that the deduction is to be worked out not on the basis of regular income tax profits but it has to be worked out on the basis of the adjusted book profits in a case where s. 115JA is applicable. In the said judgment, the dichotomy between regular income tax profits and adjusted book profits u/s 115JA was clearly brought out and it was rightly held that in s. 115JA relief has to be computed u/s 80HHC(3)/(3A). It was held that once the law itself declares that the adjusted book profit is amenable for further deductions on specified grounds, in a case where s. 80HHC (80HHE in the present case) is operational, it

becomes clear that computation for the deduction under those sections needs to be worked out on the basis of the adjusted book profit. Accordingly, **the deduction claimed by the assessee u/s 80HHC & 80HHE has to be worked out on the basis of adjusted book profit u/s 115JA and not on the basis of the profits computed under regular provisions of law applicable to computation of profits and gains of business.** We agree with the view taken by the Special Bench of the Tribunal.

Petition dismissed.

Petition(s) for Special Leave to Appeal (Civil) No(s).33750/2009.

Decided on: 20th October, 2011.

Present at hearing: Bishwajit Bhattacharya, ASG, Arijit Prasad, Vikas Malhotra, Ajay Singh, Judy James, N. Swarup and B.V. Balaram Das, Advocates, for Petitioner(s). Ramesh Singh, Pratap Venugopal and Namrata Sood, Advocates, for M/s. K.J. John & Co., Advocates for Respondents.

(From the judgement and order dated 17/04/2009 in TCA No.1191/2008 of The High Court of Madras)

JUDGMENT

Assessee filed its return of income for assessment year 2000 - 01. Assessee claimed deduction under Section 80HHE to the extent of Rs.1,56,33,719/- against net profit as per profit and loss account amounting to Rs.3,07,84,105/- to arrive at the book profit of Rs.1,51,50,386/- under Section 115JA of the Income - tax Act, 1961 [See: Vol.R/1 of I.A. paper book page 6]. This claim for deduction made by the assessee was rejected by the A.O. saying that since in normal computation there is no profit after carry - forward loss, deduction under Section 80HHE to the extent of Rs.1,56,33,719/- for computing book profit under Section 115JA was not admissible.

According to the A.O. since in the present case in normal computation no net profit was left after the brought - forward losses of the earlier years got adjusted against the current year's profit, the assessee was not entitled to deduction under Section 80HHE to the extent of Rs.1,56,33,719/- . In Appeal, the CIT (A) upheld the order of the A.O.

The assessee went in appeal, against the order of the CIT(A), before the Tribunal which, following the judgment of the Special Bench of the Tribunal in the case of Deputy Commissioner of Income Tax, Range 8(3) v. Syncome Formulations (I) Limited (2007) 106 ITD 193, took the view

that the MAT scheme which includes Section 115JA did not take away the benefits given under Section 80HHE. The said judgment of the Special Bench was with regard to computation of deduction under Section 80HHC which, like Section 80HHE, falls under Chapter VI - A of the Income Tax Act, 1961.

In the said judgment of Special Bench, which squarely applies to the facts of the present case, the Tribunal held that the deduction under Section 80HHC (Section 80HHE also falls in Chapter VI - A) is to be worked out not on the basis of regular income tax profits but it has to be worked out on the basis of the adjusted book profits in a case where Section 115JA is applicable. In the said judgment the dichotomy between regular income tax profits and adjusted book profits under Section 115JA is clearly brought out. The Tribunal in the said judgment rightly held that in Section 115JA relief has to be computed under Section 80HHC(3)/(3A). According to the Tribunal, once the law itself declares that the adjusted book profit is amenable for further deductions on specified grounds, in a case where Section 80HHC (80HHE in the present case) is operational, it becomes clear that computation for the deduction under those sections needs to be worked out on the basis of the adjusted book profit [See: para 61 of the judgment of the Tribunal in *Syncome Formulations* (supra)]. In the present case we are concerned with Section 80HHE which is referred to in the Explanation to Section 115JA, clause (ix). In our view, the judgment of the Special Bench of the Tribunal in *Syncome Formulations* (supra) squarely applies to the present case. Following the view taken by the Special Bench in *Syncome Formulations* (supra), the Tribunal in the present case came to the conclusion that deduction claimed by the assessee under Section 80HHE has to be worked out on the basis of adjusted book profit under Section 115JA and not on the basis of the profits computed under regular provisions of law applicable to computation of profits and gains of business.

The judgment of the Tribunal has been upheld by the High Court. We see no reason to interfere with the impugned judgment. We agree with the view taken by the Special Bench of the Tribunal in the case of *Syncome Formulations* (supra) vide para 61 of the judgment.

Accordingly, the special leave petition filed by the Department stands dismissed with no order as to costs.

2011 PTR 1398 (H.C. Ukd.)

HIGH COURT OF UTTARAKHAND AT NAINITAL**Tarun Agarwala, A.C.J. and U.C. Dhyani, J.***The Commissioner of Income Tax Dehradun and another**v.**M/s BKI/HAM v.o.f.**C/o Arthur Anderson & Co., New Delhi*

FACTS/HELD

1. **Fact of “Office PE” under Article 5(2) irrelevant if there is no “Construction Site PE” under Article 5(3)**
2. The assessee, a Netherlands company, obtained a contract for dredging a trench for which it opened an office at Mumbai. The dredging activity was completed in two months. The assessee claimed that whether it had a ‘permanent establishment’ (PE) in India or not had to be decided as per Article 5(3) of the DTAA which provided that a “building site” or “construction project” would be a PE only if continued for more than 6 months. However, the AO held that as the assessee had an office in Mumbai, it had an “office” or a “place of management” which constituted a PE under Article 5(2) of the DTAA. This was reversed by the CIT(A) & Tribunal. On appeal by the department, HELD dismissing the appeal:

The assessee had a “site” or “project” in India. Under Article 5 (3) of the treaty, such a “site” or “project” is a PE only if it continues for a period of more than six months. **As the assessee’s contract was completed in two months, there was no PE under Article 5(3).** The argument that the Mumbai office was a PE under Article 5(2) is not acceptable because **while Article 5(2) is a general provision, Article 5 (3) is a specific provision which prevails over Article 5(2).**

Appeal dismissed.

Income Tax Appeal No. 34 of 2007.**Decided on: 14th October, 2011.**

**Present at hearing: Arvind Vashisth, Advocate, for the Appellant.
S.K. Post, Advocate, for Respondent.**

JUDGMENT

Per Tarun Agarwala, A.C.J.–

Heard Shri Arvind Vashistha, the learned counsel for the appellants and Shri S.K. Posti, the learned counsel for the respondent-assessee.

The present appeal has been filed by the Revenue u/S 260-A of the Income Tax Act, 1961 for the assessment year 1994-95. The facts, in brief, is that the assessee is a partnership firm consisting of Boskalis International B.V. and Hollansche Aanneming Maatschappij B.V. (BKI/HAM) incorporated under the laws of Netherlands on 24th November, 1993 with a limited liability. During the assessment year 1994-95, the assessee entered into a sub-contract for dredging and back filling works with Hyundai Heavy Industries in respect of the second Basin Hazira Trunk Pipeline Project. The contract comprised of dredging a trench for laying the pipeline and back filling of the trench after the pipeline had been laid. The dredging activities commenced in India w.e.f. 27th December, 1993 and was completed on 12th June, 1994. It may be noted here that the contract was spilled over two assessment years, i.e., 1994-95 and 1995-96 and that the entire duration of the work was less than six months.

For the assessment year 1994-95, the appellant submitted its return declaring nil income. The assessee had claimed in its return that its revenue was not taxable in India as it did not have a permanent establishment in India as defined under Article 5 of the Double Taxation Avoidance Agreement between India and Netherlands. It was claimed that in view of clause (3) of Article 5 of the treaty, a building site or construction, installation or assembly project constituted a permanent establishment only where such project continue for a period of more than six months. It was claimed that the dredging activity was covered under Article 5 (3) of the treaty and, the activity in India, under the said contract, did not exceed more than six months, as such, the appellant did not have a permanent establishment in India and, therefore, no portion of its income was chargeable in India.

Subsequently, notice u/S 148 of the Act was issued to the assessee on 25th May, 1998 and the assessment proceedings were reopened on the basis of the assessment year 1995-96, in which it was concluded that the assessee had a permanent establishment in India and hence was taxable in India. The assessment order for the assessment year 1995-96 placed reliance on Article 5 (2) of the treaty. The Assessing Officer, on the basis of the assessment order for the assessment year 1995-96, passed the assessment order for the assessment year 1994-95 holding that the assessee had a permanent establishment in India.

The assessee, being aggrieved by the assessment order under Section 148 of the Act, filed an appeal before the Commissioner of Income Tax (Appeals). The learned Commissioner by an order dated 4th February, 2002 allowed the appeal and held that no permanent establishment of the assessee existed in the year under consideration and, consequently, no part of the revenue was taxable in India. The Commissioner of Income Tax (Appeals) found that the contract was for less than 180 days and was spilled over two assessment years, i.e., for the assessment year 1994-95 and 1995-96. The appellate authority found that for the assessment year 1995-96, the assessee was taxed in India on the ground that it had a permanent establishment in India. The assessee preferred an appeal which was eventually allowed by the Tribunal. The Tribunal found that in terms of the provision of Article 5 (3) of the treaty, no permanent establishment of the assessee existed for the year under consideration and that the entire duration of the contract did not exceed six months period and, consequently, no permanent establishment was created.

The Commissioner of Income Tax (Appeals) not only relied upon the order of the Income Tax Appellate Tribunal for the assessment year 1995-96 but also analysed the provision of the treaty and concluded that the entire duration of the contract was less than six months and, as such, no permanent establishment was constituted in India and that the provision of Article 5 (2) of the treaty, being a general provision, would not apply in view of the specific provision being provided under Article 5 (3) of the treaty which provided for the existence of a permanent establishment. The Commissioner of Income Tax (Appeals) further found that the basic requirement of a permanent establishment, as per the provision of 5 (1) of the treaty, was completely absent in the Bombay Office of the assessee and that the facts of the case for the assessment year 1994-95 were the same as that of assessment year 1995-96 and since the contract spilled over two assessment years, the finding of the Tribunal for the assessment year 1995-96 was equally applicable for the assessment year 1994-95.

The revenue, being aggrieved by the aforesaid order, filed an appeal before the Tribunal which was dismissed by an order dated 23rd June, 2006. The revenue, being aggrieved by the said order, filed the present appeal u/S 260 A of the Act which was admitted on the following substantial question of law:—

- “1. Whether the Hon’ble I.T.A.T. was legally correct in upholding the decision of CIT (A) on facts in his finding that the assessee did not have permanent establishment in India within the meaning of Article 5 of the DTAA between India and the Netherlands?
2. Whether the Hon’ble ITAT was legally correct in upholding the decision of CIT (A)-1, Dehradun on facts in his decision that no part of the revenue earned by the assessee is taxable in India.”

The learned counsel for the appellant stressed that the Commissioner of Income Tax (Appeals) as well as the Tribunal committed an error in holding that no permanent establishment is existed in India in view of the provision of Article 5 (2) of the treaty and that the Tribunal committed an error in not considering this provision and relying upon the provision of Article 5 (3) of the treaty. On the other hand, the learned counsel for the assessee submitted that the findings of the Commissioner of Income Tax (Appeals) as well as of the Tribunal are based on the findings of fact which cannot be interfered in the present appeal and that no substantial question of law arises for consideration.

In order to appreciate the submission of the learned counsel for the parties, it would be appropriate to extract sub-clause 1, 2 and 3 of Article 5 of the treaty entered between India and Netherlands which are applicable.

“PERMANENT ESTABLISHMENT

1. For the purpose of this Convention, the terms “permanent establishment” means a fixed place of business through which the business of the enterprise is wholly or partly carried on.
2. The term “permanent establishment” includes especially:
 - (a) a place of management;
 - (b) a branch;
 - (c) an office;
 - (d) a factory;
 - (e) a workshop;
 - (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
 - (g) a warehouse in relation to a persons providing storage facilities for others;
 - (h) a premises used as a sales outlet;
 - (i) an installation or structure used for exploration of natural resources provided that the activities continue for more than 183 days.
- (3) A building site or construction, installation or assembly project constitutes a permanent establishment only where such site or project continues for a period of more than six months.”

A perusal of Article 5 (1) of the treaty indicates that a “permanent establishment” means a fixed place of business through which the business of the enterprise is wholly or partly carried on. Article 5 (2) of the treaty includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources, a warehouse in relation to a persons

providing storage facilities for others, a premises used as a sales outlet, an installation or structure used for exploration of natural resources provided that the activities continue for more than 183 days. Article 5 (3) provides that a building site or construction, installation or assembly project constitutes a permanent establishment only where such site or project continues for a period of more than six months.

In the light of the aforesaid provisions, the learned counsel for the assessee submitted that the assessee had a permanent establishment under the provision of Article 5 (2) and had an office at Bombay and, consequently, had a permanent establishment which has not been considered by the appellate authority as well as by the Tribunal. The learned counsel for the appellant submitted that in view of the fact that the assessee had an office at Bombay, the provision of Article 5 (3) was immaterial.

The submission of the learned counsel for the appellant is patently erroneous and mis-conceived. The Tribunal in the assessment order 1995-96 as well as the appellate authority in the assessment order 1994-95 have categorically given a finding of fact that the entire duration of the contract was from 27th December, 1993 till 26th June, 1994, i.e., less than six months. Article 5 (3) of the treaty provided that in order to constitute a permanent establishment such site or project should continue for a period of more than six months. Such site or project, in our opinion, is provided under Article 5 (2) of the treaty and, therefore, the site or project provided under Article 5 (2) should continue for a period of more than six months in order to constitute a permanent establishment. Since a categorical finding of fact has been given by the appellate authority that the contract was for less than six months, it becomes absolutely clear that the assessee did not have a permanent establishment in India as per Article 5 (3) of the treaty. The court is of the opinion that Article 5 (3) provides a specific provision which covers the provision of Article 5 (2) of the treaty. The Court is of the opinion that the specific provision would prevail over the general provision. Consequently, the court is of the opinion that no permanent establishment was constituted by the assessee in India during the assessment year in question.

Further, the Court finds from a reading of the order of the Tribunal that the counsel for the revenue also agreed that the controversy involved was squarely covered by the decision of the Tribunal in the assessee's own case for the assessment year 1995-96. Once this fact has been admitted and agreed by the learned counsel for the Revenue, it was no longer open to the revenue to file the appeal before this Court.

In the light of the aforesaid, we are of the opinion that the assessee did not have any permanent establishment in India within the meaning of Article 5 of the Double Taxation Avoidance Agreement entered between India and Netherlands and no part of the revenue earned by the

assessee was taxable in India. The questions of law are answered accordingly.

For the reasons stated aforesaid, we do not find any merit in the appeal and is dismissed. In the circumstances, there shall be no order as to cost.
