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Editor-in-Chief
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Reforming judicial apparatus

by
Huzaima Bukhari & Dr. Ikramul Haq

In any society, administration and dispensation of justice should be the top most priority as without it 'representative democracy' cannot be established. A society without a trustworthy and speedy judicial system, which does not ensure effective dispensation of justice cannot progress—even may not survive for long. Administration and dispensation of justice in Pakistan need serious attention. There are serious concerns amongst Pakistani citizens about "justice", "rule of law", "fairness", "equity" and independence of judiciary.

The right of access to justice to all is a well-recognized inviolable right enshrined in the Constitution of Pakistan, but it is still a distant dream for the poor and weaker sections of society. Justice can only be done if there is reliable, competent and independent judicial apparatus. Goals, announced through the National Judicial Policy 2009, remain unfulfilled. The following short-term and long-term measures for early disposal of cases were announced under this policy:

1 All pre/post-arrest bail applications are to be decided within seven days. Criminal cases, punishable with imprisonment up to seven years registered after January 1, 2009, would be decided in the shortest period, which should not exceed six months and cases punishable with imprisonment exceeding seven years, including punishment of death, should be decided within one year.

2. Provincial governments to establish new jails at district level or enhance the capacity of existing jails by constructing new barracks. A High Court judge, along with District and Sessions judge, must carry out inspection of prisons periodically for ensuring compliance within prison rules and giving on the spot remedy/relief to prisoners according to the law.

3 In civil matters, all writ petitions under Article 199 of the Constitution should be fixed for preliminary hearing on the next date of its institution and disposed of as quickly as possible. Writ petitions involving service matters, including promotion, transfer and admission of students in professional colleges and allied matters, should be decided within 60 days. All stay matters under Order 39 Rule 1 & 2 read with section 151 CPC should be decided within 15 days of grant of interim injunction and in case of delay the reasons should be furnished to the high court.

4. Rent cases should be decided within four months in trial courts and appeals should be decided within two months. Family cases, including custody of minors, succession certificate, letter of administration, insolvency and maintenance, should be decided

within six months. Civil appeals arising out of family cases, custody of minors and against interim order should be decided within 30 days.

5. Cases filed under Order 37 of CPC regarding suits upon bill of exchange, *hundies* or promissory notes shall be decided through summary procedure within 90 days.
6. Cases relating to banking and different taxes and duties such as income tax, property tax, etc., should be decided within six months.
7. Labour and environmental cases should also be decided through fast track system. Judges of labour courts and tribunals should be appointed from amongst the lawyers qualified for appointment as district and sessions judge.
8. Priority should be given to quick disposal of women cases, juvenile cases, rent cases, stay orders, bail matters, small claims and minor offences under the Small Claims and Minor Offences Courts Ordinance 2002. The power of small claims and minor offences court may be conferred to all civil judges.
9. For clearing backlog under different categories, special benches are to be constituted for each category on the principal seat and branch registry of the Supreme Court and High Courts. There will be commitment of judges to decide the old civil and criminal cases up to 2008 within one year. District judges will also adopt such measures that ensure handling of 50% of cases from backlog (filed on or before Dec 31, 2008) and 50% from current cases.
10. For conducting elections, the services of judiciary in future will not be available. The focus of judiciary would be on disposal of cases to redress grievances of the people by dispensation of justice. If the government feels that the election should be held under the supervision of the judiciary, then a request may come and the NJPMC would decide as to what extent and in what form help can be extended in the conduct of elections.

Most of the goals set in Judicial Policy have not been implemented within the last two years. The huge back log still persists. There are no visible signs of improvement in the working of court system. Unless causes of litigation are not removed, the system will remain choked. More and more judges will be required for coping with the ever increasing number of cases at all levels. Everybody is totally dissatisfied with the existing socio-economic structure, which is the main root-cause of litigation. Those imparting justice complain of lack of facilities and huge number of cases with the complainants crying for early orders but having to wait for years (sometimes decades), and the Government keeps on worrying about the blockade of colossal amount of money because of slow litigation process.

The first and foremost need is ensuring socio-economic justice. Justice system cannot be improved in isolation. It is part and parcel of an ailing system. The slogan of “independence” of judiciary is meaningless if

divorced from empowering the weak and less privileged. The costly litigation process works against the poor and favours the rich. Separation of judiciary from administration is Constitutional command, but enforcement of Article 10A requires providing justice to all without any hindrance. The present system where vested interest dominates appointment of judges, destroys the very independence of the system. People's court is the only answer to ensure true implementation of Article 10A of the Constitution.

The right of access to justice to all is a well-recognized inviolable privilege—now re-emphasized under Article 10A inserted by the 18th Constitutional Amendment— enshrined in the Constitution of Pakistan. It concludes "the right to be treated according to law, the right to have a fair and proper trial and the right to have an impartial court or tribunal." Justice therefore can only be done if there is economic equality. Replacing existing courts with people's courts is the need of the hour. All judicial and quasi-judicial authorities should be appointed and supervised by a People's Judicial Commission, elected by voters. This is the only way to ensure dispensation of justice in its true substance and constitutional requirement.

Remembering Benazir Bhutto

by

Huzaima Bukhari & Dr. Ikramul Haq

December 27 will mark the fourth death anniversary of Shaheed Mohtarma Benazir Bhutto, the great visionary leader, who resisted with great courage the agenda of neo-colonial forces—pushing Pakistan to a theocratic State incapable of progressing towards an egalitarian and democratic polity. In recognition of her great services, she was awarded posthumously the prestigious UN Human Rights Award on December 10, 2008. The UN Human Rights Award is given every five years. The 2008 award was special as it coincided with 60th anniversary of Universal Declaration of Human Rights.

Professor Amin Mughal, a doyen of progressive humanistic thinking and great scholar, in his remarkable paper, *After Benazir Bhutto: Some reflections*, read at a meet organised by the Campaign against Martial Law, Khalili Lecture Theatre, SOAS, London commented, "I confess, in the least uncharitable terms, that I was never fond of Benazir Bhutto. In fact, I was inimical to her politics. In death, however, she has redeemed herself. In the imagination of the masses she has acquired a mystical significance that is destined to be a never-ending source of inspiration in their struggles ahead. Most authentic martyrs in history were reluctant to die. All of them were, however, prepared to accept death. Benazir went further. Her detractors have accused her of being foolhardy. That is not true. She only embraced what she had in the last

days of her life come to perceive to be her destiny. Hers was an act of courage steeled in deliberation and schooled in the imagination. It matters who killed her, but what matters more is that she knew she would be gunned down. Had she escaped death that day, the suicide bombers would have done her in sooner than later. Yet, she decided to take the risk. Again, it matters whether she died of the gun wound or was later levered down into death. But what matters more is that she was there, facing a possible killer. She did not flinch". This is perhaps the best tribute to Benazir Bhutto till today.

The act of great courage demonstrated by *Shaheed* (martyr) Mohtarma Benazir Bhutto praised by Amin Mughal and many others has changed the entire political scene of Pakistan for the worst. For resisting the agenda of forces of obscurantism—working on the dictates of neo-colonial masters—she lost her life. Her removal from the political scene paved the way for the United States to get rid of General Musharraf and install some elements more keen and willing to implement their agenda. Very few analysts and scholars have tried to view her assassination from this perspective. In her last book, *Reconciliation: Islam, Democracy & the West*, she "tried to trace the roots, causes, and potential solutions to the crisis within the Muslim world and the crisis between the Muslim World and the West". Benazir, in this work has unveiled the agenda of neo-colonialists and the obscurantists. She has quoted extensively from Al Qur'an to prove that Islam is a religion of peace, but it has been brutally abused by a handful of extremists throughout the Muslim history to create chaos and disorder. She traced the factors behind militant Islam and exposed the colonial and neo-colonial forces behind it. These views must have hit hard and annoyed the forces that want to keep the Muslim World in dark ages for their nefarious designs. They used their proxy—Islamic militants—to get rid of her.

In the wake of her brutal and ruthless assassination—still shrouded in mystery—there was great euphoria among Pakistani liberals over the presumed 'return to democracy'. Dr. Sachithanandam Sathananthan, a Visiting Research Scholar at the Jawaharlal Nehru University School of International Studies, in his paper, *The Great Game Continues*, noted with concern that "they are yet to discover 'Late Neo-colonialism'. He argues that removal of Benazir and thereafter, easily maneuvered victory for Asif Ali Zardari in the presidential election "brought to a high point the tortuous process of regime change in Pakistan. Anyone who has followed the 'colour revolutions' that installed pro-American rulers in Georgia (Rose Revolution, 2003), Ukraine (Orange Revolution, 2004) and Kyrgyzstan (Tulip Revolution, 2005) could surely not have missed the tell tale signs".

The theory propounded by Dr. Sachithanandam got credence in the wake of events took place after the assassination of Benazir. It was rightly highlighted by Dr. Sachithanandam that "the earliest foreboding surfaced in the backroom manoeuvres by United States (US) and British

intelligence services to engineer panic about the security of Pakistan's nuclear assets. It was a repeat of the duplicitous hysteria they generated over non-existent weapons of mass destruction that Iraq allegedly possessed. A carefully worded article, co-authored by former State Department officials Richard L. Armitage and Kara L. Bue, signalled the shift in US policy. After formally acknowledging the then President Pervez Musharraf's many achievements, the authors continued: 'much remains to be accomplished, particularly in terms of democratization. Pakistan must…eliminate the home-grown jihadists…And…it must prove itself a reliable partner on technology transfer and nuclear non-proliferation.' And the denouement: 'We believe General Musharraf…deserves our attention and support, no matter how frustrated we become at the pace of political change and the failure to eliminate Taliban fighters on the Afghan border.' Translation: Musharraf has to go".

It was 'Washington's renewed interest' in Zardari and Rehman Malik and not Benazir that forced Musharraf—once a close ally of Bush—to offer firm opposition to US Late Neo-colonialism to ravage Pakistan. According to Dr. Sachithanandam, "politically challenged Pakistani liberals — a motley crowd that includes members of human rights and civil liberties organisations, journalists, analysts, lawyers and assorted professionals — are utterly incapable of comprehending the geo-strategic context in which Musharraf maneuvered to defend Pakistan's interest". So they slandered him an 'American puppet', alleging he caved in to US pressure and withdrew support to the Afghan Taliban regime in the wake of 9/11 although in fact "he removed one excuse for the Bush Administration to 'bomb Pakistan into stone age', as a senior State Department official had threatened".

In view of above, it is understandable why Benazir decided to join hands with Musharraf to resist US Late Neo-colonialism. American discomfort with Musharraf's government was palpable by late 2003, after he dodged committing Pakistani troops to prop up the Anglo-American invasion of Iraq. When he offered to cooperate under the auspices of the Organisation of the Islamic Conference (OIC), naïve Pakistani media and analysts lunged for his jugular, condemning him once again for succumbing to US demands. But in fact he nimbly sidestepped American demands: he calculated that diverse ideological stances of the 57 Muslim member-counties would not allow the OIC to jointly initiate such controversial action and therefore Pakistan's participation could not arise, which proved correct.

Benazir was fully aware of the fact that Bush Administration had been becoming increasingly hostile to Musharraf's determination to prioritise Pakistan's interests when steering the ship of the state through the choppy waters of the unfolding New Great Game, which the West — led by the US — has been manoeuvring to contain growing Russian and Chinese influences in Central and West Asia. She decided to work with

Musharraf, precisely for resisting this agenda of Pakistan-hostile forces. She became the prime target of these forces and was hence eliminated. Since then events show and prove that under the "chosen" leadership, Pakistan would side with US and Britain. Benazir became victim of this Great Game in which her own party stalwarts betrayed her. Hers has been a legacy of continuous struggle. Pakistanis need to continue her legacy of resisting the ongoing Great Game of US Late Neo-colonialism—controlling South Asian region through the bogey of Islamic militants and Hindu extremism with the ultimate aim of containing China and getting hold of Pakistan's nuclear arsenals.

FBR to launch Risk Based Audit Plan

Federal Board of Revenue (FBR) has also decided to launch Risk Based Audit Plan based on central risk benchmarks for selection of income tax returns from January 2012, Salman Siddique, Chairman FBR informed group of reporters here on Monday.

This plan would remain under implementation for next six months and risk criteria would be forwarded to 21 regional income tax offices for selection of income tax returns for total audit of income tax returns and said that hopes are high that this audit would yield good results, he added.

Federal Board of Revenue (FBR) has decided to share data of those rich, who have been identified under broadening of tax base drive and have informed that they have created their assets from agriculture income so as to book them under provincial agriculture income tax net.

He also informed that a major step is being implemented from January 2012, under which no input tax adjustment would be allowed to GST registered persons who are not to demand and mention in their monthly returns CNIC and NTN of their un-registered buyers. This would help not only document the economy, but, would also help increase in revenues within this fiscal year, he added.

FBR chief said that during the broadening of tax base drive over 0.7 million had been identified and some 60 percent of them have declared that they have created these assets from agriculture income and remittances, 54 percent of them mentioned their income from agriculture and 6 percent of them were income from remittances. He said that once the verification of such details to be received from provinces for those who don't have agriculture income, than FBR would be taking next step to enforce Income Tax returns from them.

The Chairman was of the view that due to discriminatory tax system a huge population of the country, despite having wealth and assets is not paying their due taxes and there is dire need to bring such persons in income tax net or agriculture income tax net. Provinces are also making arrangements for improved agriculture income tax mechanism and Punjab has proposed unified rate and mechanism for this tax.

Chairman was of the view that FBR has collected Rs 712 billion till December 15, 2011 and in the remaining period Rs 1240 billion

would require to be collected to meet the annual tax collection target of 1952 billion. He informed that Rs 50 billion would be added in total collection through administrative measures, Rs 21 billion from flood surcharge arrears, Rs 10 billion from court cases, Rs 27 billion from withholding tax recovery out of which 14 billion have already been recovered from banks and telecommunication companies. Detection of wrong GST input tax adjust claims have reached at Rs 32 billion and FBR has managed to recover 12.2 billion last fiscal and Rs 1.2 billion this fiscal year. He also informed that revenue leakages are being plugged with the help of revenue advisory group's consultation.

Salman Siddique also informed that ECC in its last meeting has discussed the demand for restoration of GST exemption on tractors. The demand is being raised that the local manufacturers have decreased the production of tractors owing to low demand because of GST. He informed that FBR has held meeting with tractor manufacturers and they have negated this impression and said that ZTBL has frozen the credit line for purchase of tractors that is the main reason behind this as well as rumours of withdrawal of GST on tractors is also resulting in lower sales of tractors. He said that in next ECC meeting decision would be taken on this demand.

FBR Chief also informed that regime for five export oriented sectors is being revamped and soon a new regime with standard 5 percent concessional rate would be implemented and final consultation would held on the proposed regime on December 23, where representative the commercial importers would also be invited to remove their grievances.

The Chairman FBR also mentioned that major focus of FBR would be increasing direct taxes collection as well as increase in domestic GST collection. In this regard proper monitoring mechanism have been put in-place and this mechanism would help track the due tax realization in remaining second half of the ongoing fiscal year. – *Courtsy Daily Times.*

Agriculture sector/remittances: nearly 60 percent return filers claim nil income: FBR chief

The Federal Board of Revenue's exercise of broadening the tax base revealed that nearly 60 percent of income tax return filers claimed nil income earned from agriculture sector or remittances and the declared data on agricultural income has been shared with

the provinces to check the authenticity of their claims in the returns.

Federal Board of Revenue Chairman Salman Siddiq told reporters on Monday that during the broadening of tax base drive over 700,000 rich had been identified and around 60 percent of return filers have declared that they have created these assets from agriculture income and remittances, 50 percent of them mentioned their income from agriculture and 10 percent income from remittances.

Once the verification of such details to be received from provinces for those who don't have agriculture income, than FBR would be taking next step to enforce filing of income tax returns, who have submitted wrong data.

He said that the due to discriminatory tax system a major portion of the population, despite having wealth and assets is not paying their due taxes and there is dire need to bring such persons in income tax net or agriculture income tax net.

Provinces are also making arrangements for improved agriculture income tax mechanism and Punjab has proposed unified rate and mechanism for this tax.

In this connection, the FBR has decided to share data of those rich who have been identified under the drive of documentation and declared that they have created their assets from agriculture income so as to book them under provincial agriculture income tax net.

FBR Chairman further highlighted that the Board has found that nearly 60 percent of income tax returns filers claimed nil income earned from agriculture sector out of total 36,000 filed returns.

"Out of 60 percent showing nil income in their returns, there is 10 percent who have shown receiving money from abroad in shape of remittances," he added.

Sharing another major step to improve audit system, Salman Siddiq stated that the FBR has also decided to launch Risk Based Audit Plan based on central risk benchmarks for selection of income tax returns for Tax Year 2011 from January 2012.

This plan would remain under implementation for next six months and risk criteria would be forwarded to regional tax offices for selection of income tax returns for total audit of income tax returns and said that hopes are high that this audit would yield good results, he added.

He also informed that a major step is being implemented from January 2012 under which no input tax adjustment would be allowed to GST registered persons who would not mention CNIC and NTN of their un-registered buyers in the sales tax returns.

This would help not only to document the economy, but, would also help increase revenue in this fiscal year, he added. – *Courtsy Business Recorder*.

E&P companies tax rate, depletion allowance claim: tribunal's landmark judgement favours FBR

A five-member larger bench of the Appellate Tribunal, Inland Revenue has given a detailed landmark judgement in favour of the Federal Board of Revenue (FBR) on two issues regarding application of tax rate on Exploration & Production Companies (E&P) companies and claim of depletion allowance by the E&P companies.

Explaining implications of a judgement of Appellate Tribunal released in last week of November 2011, sources explained here on Monday that there was a controversy on the two pivotal tax issues between the E&P companies and the FBR.

Firstly, the application of tax rate on the E&P companies and the second issue is related to the claim of depletion allowance by the E&P companies.

This issue is related to the manner of calculation of the depletion allowance.

As per oil companies, such calculations has to be on gross receipts whereas the department contested that the amount of the royalty has to be deducted from the gross receipt before calculating the depletion allowance.

The revenue impact of these two issues in these cases is approximately Rs 35 to Rs 40 billion up to Tax Year 2010 having future repercussions.

Both the revenue and the E&P companies were involved in litigation before the Tribunal for about last five years.

Earlier, the issue of claim of depletion allowance was decided first by the Division Bench and then by the full Bench of the Appellate Tribunal, the highest fact finding authority in the hierarchy of appellate fora, in favour of revenue department and on the issue of application of tax rate in the cases of E&P companies there existed

two divergent decisions first one of the Islamabad Bench and later of Karachi Bench of equal strength.

In order to resolve the issues, a larger bench of five members (three judicial and two accountant members) was constituted.

This Bench of the Appellate Tribunal Inland Revenue after dilating upon the issues in detail has decided both the issues in favour of the department.

According to the sources, judgement of the Appellate Tribunal, Islamabad is a major achievement of the FBR legal team headed by Muhammad Aqil Usman, Member (Legal) which successfully pleaded the departmental case against the E&P companies and saved huge amount of revenue.

Sources said that the companies have filed petitions before the Islamabad High Court for implementation of an understanding between PPEPCA and FBR has reached through filing of MoU.

The court had granted the stay against recovery of tax demand in these cases.

Referring to judgement, sources said that the five-member larger bench of the Appellate Tribunal, Inland Revenue observed that the nut and shell of the discussions is that the royalty being the share of the GoP in the mineral resources and levy just like sales tax and excise duty with only difference that sales tax and excise duty are recoverable from the end user and royalty is recoverable at the time of production from the oil/gas producer.

The exclusion of sales tax, excise duty from the gross receipts representing the well head value for the purpose of depletion allowance has not been disputed by the E&P companies.

The royalty being share of the GoP in minerals and also a government levy for the purpose of the depletion allowance is liable to deduction from the gross receipts representing the well head value.

Further, the royalty paid to the government is an adjustable payment towards the income tax liability so opposing its deduction would be availing double benefit, something which is not provide in the law.

The concept of the depletion allowance is unique as it is percentage of the gross income.

The true concept and proper comprehension of the situation demands that to allow the depletion allowance of such gross

receipts which have been arrived at after the legally prescribe deduction, the judgement added. – *Courtsy Business Recorder.*

Approval/issuance of IT circular 6/09, exemption certificates: FTO directs FBR to take action against officials

The Federal Tax Ombudsman (FTO), Dr Muhammad Shoaib Suddle, has directed the Federal Board of Revenue (FBR) to initiate appropriate action against officials who approved/issued Income Tax Circular No 06 of 2009 (exclusion out of minimum tax on services rendered by corporate sector) and issued exemption certificates to give undue benefit to selected corporate entities.

The FTO on Monday issued these instructions to the FBR while deciding a complaint filed by Waheed Shahzad Butt Tax Resolution Services Company Lahore.

According to the findings of the FTO, it was clear that FBR's Circular No 06 of 2009 dated August 18, 2009 was wrongly issued and some Commissioners Inland Revenue issued exemption certificates contrary to law and in departure from FBR's earlier clarifications, which is tantamount to maladministration as defined under Section 2(3) of the FTO, Ordinance, 2000.

The FTO has recommended to the FBR to initiate appropriate action against officials who approved/issued Circular No 06 of 2009 dated August 18, 2009.

The FBR should also initiate appropriate action against officials who issued exemption certificates to unduly benefit the corporate entities.

The Board should ascertain the particulars and the amount of tax not withheld @ 6 percent from each service provider and take immediate measures to recover the revenue, as per law.

The FBR should also direct the concerned officials to take suitable action to ensure that the taxpayers, including certain service providers, issue bills/invoices without reference to exemption from withholding tax and report compliance within 60 days, FTO recommendations added.

Details of the case showed that the issue involved in the complaint, taken up under "own motion" jurisdiction conferred under Section 9(1) of the FTO Ordinance, 2000, was illegal issuance of exemption certificates, particularly by RTO, Karachi, and LTU Islamabad.

Under the Finance Act 2009, an amendment was made in Section 153 of the Income Tax Ordinance, 2001 (the Ordinance) rendering all service sector taxpayers subject to minimum withholding tax @ 6 percent of gross receipts.

It meant that neither a refund could be allowed nor an exemption certificate issued to such taxpayers if their assessed income tax was less than the amount withheld @ 6 percent of gross receipts.

After the amendment, the FBR issued letter C.No 1(6)WHT/2009 advising the Directors General, LTUs/RTOs, that the tax deducted under Section 153(1)(b) of the Ordinance would be the "minimum tax".

The FBR also issued a Circular No 3 of 2009 dated 17th July, 2009, advising the field formations that tax deducted under Section 153(1)(b) would be considered "minimum tax" and all taxpayers falling in the ambit of this provision of law shall file returns under the normal tax regime instead of statement under final tax regime.

However, despite the imposition of minimum withholding tax @ 6 percent, the Commissioners, Inland Revenue issued exemption certificates to taxpayers providing services and falling under the ambit of Section 153(1)(b) of the Ordinance.

In particular, the Commissioner, RTO, Karachi and Commissioner, LTU, Islamabad issued exemption certificates.

When the Commissioners, Inland Revenue, RTO, Karachi, and LTU, Islamabad, were informed of the illegality in issuance of exemption certificates, they withdrew the certificates on 05-8-2009 and 12-8-2009 respectively.

The ubiquitous maladministration of the Department further came to light when FBR issued Circular No 6 of 2009, stating that the status of corporate sector companies rendering services remained unchanged even after the amendment in Section 153 of the Ordinance, and so the corporate sector companies would remain subject to minimum tax @ 0.5 percent as provided under Section 113 of the Ordinance.

Thereafter, the LTUs and RTOs again started issuing the exemption certificates, reiterating that no tax would be deducted/withheld on payments made on account of providing/rendering services, FTO order said.

The FBR through e-mail dated October 20, 2010 was again informed of the inaccurate computation of tax on service sector

leviable under section 153(1)(b) of the Ordinance, using the software available on FBR website for filing of income tax return for tax year 2010.

Secretary (Withholding Tax), FBR, through letter C.No 1(10)WHT/2006-Part-III dated November 1, 2010 clarified that the law did not allow to club income on account of services rendered by professionals - on which minimum tax @ 6 percent had already been deducted - with other sources of income for further taxation under the normal tax regime.

Commenting on the prevalent confusion on the issue, the applicant, Butt, felt that FBR functionaries were either not fully aware of the changes made in Section 153 of the Ordinance, 2001, through the Finance Act, 2009, or were wrongly interpreting the law with ulterior motive.

He further alleged that the functionaries of FBR by not taking the applicability and enforcement of law seriously were guilty of negligence, inattention and arbitrariness in the discharge of their duties and responsibilities.

The applicant requested that FBR be directed to initiate disciplinary proceedings against its functionaries who had issued exemption certificates and Circular No 6 of 2009.

He also requested that loss of revenue had to be recouped either by amending the tax return form for Tax Year 2010 or by asking the taxpayers providing services to file revised returns on the new return form prescribed for Tax Year 2011.

The applicant also contended that many taxpayers, particularly some service provider companies, were still sending bills/invoices with a note that they were exempt from withholding tax deductible @ 6 percent on gross receipts.

Resultantly, no tax was being withheld by many recipients of services causing a huge loss of revenue.

The DR, Asif Rasool, Secretary, FBR, raised legal objections by stating that the FTO was not competent to decide the cases on the basis of applications for suo motu investigations in the public interest.

He, however, admitted that the applicant had raised valid objections and stated that the mistakes made by FBR were later rectified through clarificatory letters.

He stated that the income tax return form for the year 2010 could not be legally amended/re-issued as the benefit once given could not be withdrawn with retrospective effect.

The DR also claimed that the FBR was considering other alternatives to recoup the loss of revenue caused due to wrongly issued exemption certificates, Circular 06 of 2009 and faulty income tax return form for the year 2010.

Dr Muhammad Iqbal, Chief (ITP), FBR, who also appeared as departmental representative, admitted the maladministration by functionaries of FBR in issuing self-contradictory instructions and Circulars.

The DR stated that many taxpayers had challenged the withdrawal of Circular No 06 of 2009 dated 18-8-2009 in the Lahore High Court, and the matter being sub judice was out of the jurisdiction of FTO in terms of Section 9(2) of the FTO Ordinance, 2000.

The FTO observed that the record produced has been examined.

It is an admitted fact that the FBR through its letter C.No 1(6)WHT/2009 dated 4th July, 2009, had issued guidelines to all the Directors General of LTUs/RTOs in the country.

The FBR also placed income tax return form (IT-2) with built-in tax computation facility for the year 2010 on its web portal which calculated the tax on service sector as "minimum tax".

The income tax form prescribed by the FBR for tax year 2011 and placed currently on its web portal also calculates the withholding tax deducted from the service providers as a minimum tax.

The FTO said that the clarifications circulated by the FBR to its field formations are sufficient proof that the amendment made in section 153 of the Ordinance through the Finance Act, 2009 ousted all the NTN holders whether individuals, AOPs or Companies providing services from Normal Tax Regime (NTR)/Final Tax Regime (FTR) and brought them under the Minimum Tax Regime (MTR).

The exemption certificates issued by the Commissioners on the request of some corporate taxpayers prior to issuance of Circular No 06 of 2009 dated 18-8-2009 were withdrawn when the legal position was explained to the concerned Commissioners by the Applicant.

Prima facie, it seems that the corporate sector providing services thereafter approached the FBR and Circular No 06 of 2009 was then issued, ousting the corporate sector from Minimum Tax Regime of amended Section 153 of the Ordinance without withdrawing the Board's earlier clarifications issued through it letter dated 4th July 2009 and Circular No 03 of 2009 dated July 17, 2009.

The Exemption Certificates were wrongly issued in the month of July 2009, where changed position of applicability of Section 153(1)(b) was clear.

Clarification issued vide FBR's circular/letter C.No 1(6)WHT/2009 dated 04-07-2009 and Circular No 03 of 2009 dated 17-07-2009 were not followed while issuing these Exemption Certificates.

Moreover, an ambiguous clarification was issued through Circular No 06 of 2009 dated 18-08-2009 which was withdrawn on April 26, 2011.

The FTO order said that the departmental representatives have admitted that the public exchequer suffered losses because of issuance of Circular No 06 of 2009 and the Exemption Certificates issued by the Commissioners of Inland Revenue all over Pakistan.

No measure was taken by FBR to recoup the losses which according to the Applicant were several billion rupees because the corporate taxpayers were still issuing bills to their customers with a printed note that they were exempt from the deduction of withholding tax and the same was not being deducted by many service recipients, FTO added. – *Courtsy Business Recorder.*

OMCs, refineries deposit Rs 66.05 billion PL in fiscal year 2011

Petroleum Levy (PL) deposited by refineries on local products and by Oil Marketing Companies (OMCs) on import products for the year 2010-11 is Rs 66.05 billion.

"The Petroleum Levy is collected at the stage of de-bonding of the petroleum products from local refineries and imports," Minister for Petroleum and Natural Resources Dr Asim Hussain Monday told the National Assembly in a written reply.

He said that National Refinery Ltd deposited Rs 5.3 billion, Pakistan Refinery Limited, Rs 4.252 billion, Attock Refinery

Limited Rs 6.021 billion, Pak Arab Refinery Limited Rs 20.26 billion and Imports of OMCs is Rs 30.215 billion.

However, the minister said that PL deposited by refineries and OMCs (irrespective of province wise) is ultimately realised from all consumers of the petroleum products in the country.

Similarly, the minister said that in 2009-10, National Refinery Ltd deposited Rs 7.987 billion, Pakistan Refinery Limited Rs 6.25 billion, Rs 9.422 billion Pak Arab Refinery Limited, Rs 16.33 billion and imports of OMCs are Rs 42.554 billion.

He said that collection of PL on petroleum products is a source of revenue to Finance Division who is the authority for its utilisation.

In another reply, Dr Aism said that since 1st January, 2008 the price of petrol, diesel and kerosene have been increased 21, 24 and 21 times respectively.

He said that increase in prices was mainly made on account of increase in international prices.

He said that price of CNG has been increased 06 times since January 01, 2008. – *Courtsy Business Recorder.*

FBR admission before FTO: STARR lacks procedure for handling ST refund claims

The Federal Board of Revenue (FBR) has admitted before the Federal Tax Ombudsman (FTO) that the STARR refund automation system has no procedure for handling sales tax refund claims made on court orders, where verification of bills and invoices is not involved.

The departmental representative of the FBR has made these remarks while hearing the case of a manufacturer of fruit juices of Karachi, which has filed complaint against the department to the FTO for excessive delay in sanctioning due refund.

The DR, despite admitting the complainant's claim, showed inability to process the subject refund through the Refund Claim Counter (RCC) as no procedure for handling refund claims arising out of court orders, where verification of bills and invoices was not involved, was provided in the STARR software.

He stated that under the circumstance the DG Strategic Planning and Statistics (SP&R), FBR, had been again requested, vide letter dated 23.11.2011, to allow processing of claims of the complainant through generation of electronic Refund Processing Order (RPOs).

The department informed the FTO that claims arising out of appellate orders had to be refunded.

However, as per procedure laid down by the FBR, the claims could not be processed unless submitted through Refund Claim Processing System (RCPS) of STARR system.

It was contended that manual processing of the refund claims was no more permissible under the Sales Tax Act.

It was further contended that when the Officer concerned approached the Director General (SP&R), FBR, for permission to generate electronic Refund Processing Order (RPO), he was informed vide letter dated August 27, 2011 that claims u/s 66 of the Act could be lodged at Refund Claim Counter (RCC) functioning in the Regional Tax Offices (RTOs)

The authorised representative argued that the subject claims were not accepted at the RCC, as it required Refund Claim Processing System (RCPS) data ie invoices and bills etc which for the cases where refund arose out of appellate orders was not available.

In the instant case also the sales tax demand was created and the same was recovered by the Department through pay orders.

The refund claims remained unattended despite instructions of the DG (SP&R) conveyed to the officer concerned vide letter dated 27.8.2011 to generate electronic RPO.

He stressed that only method available in such cases was to process the same manually.

According to the FTO's findings, the delay in allowing appeal and settling refund claims tantamount to maladministration in terms of Section 2(3((ii) of the Establishment of the Office of Federal Tax Ombudsman Ordinance, 2000.

The FTO has recommended the FBR to revisit the instructions regarding refund processing through STARR so that payment of refund and maintenance of record are both clearly provided for.

The FBR should direct the concerned officials to allow appeal effect to appellate orders and issue refund due, as per law and report compliance within 30 days. – *Courtsy Business Recorder.*

Collection from steel sector: Sales tax audit of Discos initiated

The Federal Board of Revenue has started a countrywide sales tax audit of power distribution companies for the recovery of illegal adjustments of sales tax collected from steel sector including steel melters and re-rollers.

Sources told on Tuesday that the FBR has issued instructions to the Chief Commissioners of the Large Taxpayers Units (LTUs) and Regional Tax Offices (RTOs) for audit of the power distribution companies.

Under relevant provisions of the Sales Tax Act 1990, the power distribution companies cannot adjust their input tax against the final tax paid through electricity bill by steel melters and re-rollers. Any such adjustment made by power distribution companies is unlawful and contrary to the legal provisions.

According to the FBR instructions to the field formations, Chief Commissioner, RTO, Gujranwala has informed the Board that Lahore High Court vide writ petition No. 1835/2011 has decided the matter of illegal adjustment of input tax, collected under special procedure from steel melters and re-rollers, by power distribution companies against their output tax in favour of the tax department.

The FBR has, therefore, directed that necessary action may be taken in respective jurisdictions of the LTUs/RTOs and Board be apprised of the progress on audit and recovery made so far on the issue. The field formations should provide details including name of registered person (Power Distribution Company), amount of illegal adjustment of sales tax and amount recovered from the registered person, the FBR instructions added.

Sources said that all steel melters and re-rollers, except those opting to pay sales tax on ad valorem basis, are required to pay sales tax at the rate of six rupees per unit of electricity consumed for the production of steel billets, ingots and mild steel (MS) products which is considered as their final discharge of sales tax liability as provided in chapter XI of the Sales Tax Special Procedures Rules, 2007. This payment of sales tax by steel melters and re-rollers is made through electricity bills along with electricity charges and sales tax which is payable by all consumers of electricity including melters and re-rollers. Thus sales tax collected by Power Distribution Companies from steel sector through electricity bill consists of the following two components:

Firstly, sales tax at the standard rate of the value of electricity supplied by power distribution companies and secondly sales tax @ six rupees per unit of electricity consumed by the steel units against production and supply of steel billets, ingots and mild steel (MS) products.

On receipt of a reference from RTO, Gujranwala regarding admissibility of adjustment of sales tax paid by steel sector under chapter-XI ibid by power distribution companies, a meeting attended by members was held at the Board in the past to discuss the issue.

After threadbare discussions it was unanimously decided that component of sales tax (sales tax at the standard rate of the value of electricity supplied by power distribution companies) is the output tax of power distribution companies against supply of electricity and it is adjustable against their input tax on taxable purchases. The component of the sales tax mentioned (sales tax @ six rupees per unit of electricity) ante is not the output tax of power distribution companies. This tax is merely being collected by them on behalf of FBR as the final and net discharge of tax liability by steel melters and re-rollers.

Thus as per section 2(20)(a), section 7, section 8 and section 8B of the Sales Tax Act 1990 Power Distribution Companies cannot adjust their input tax against the final tax paid through electricity bill by steel melters and re-rollers. Any such adjustment made by Power Distribution Companies is unlawful and contrary to the legal provisions. It has, therefore, been decided with the approval of the Chairman, FBR, Islamabad that all concerned field formations of the Board will "conduct desk audit of the Power Distribution Companies and take steps for the recovery of the illegally adjusted amounts as per relevant provisions of the law".

It is, therefore, directed that the requisite single point desk audit of the power distribution companies located in your jurisdiction may be conducted immediately and the illegally adjusted amount of sales tax, if any, may be recovered from them as per law, besides taking steps to ensure that these companies do not make such adjustments henceforth, sources added. – *Courtsy Business Recorder.*

Isaf container case: over 18,000 issued notices, FBR chief tells Supreme Court

Our interest lies in bringing money back to the nation's kitty," Chief Justice Iftikhar Muhammad Chaudhry said while resuming hearing of suo motu action regarding International Security Assistance Force (ISAF) container scam on Tuesday.

The CJP remarked: "Tax evasion in ISAF container scam is just the tip of iceberg," citing Federal Tax Ombudsman's interview in which the latter claimed that the incidence of tax evasion in the country was alarming high.

A three-member bench of Chief Justice Iftikhar Muhammad Chaudhry directed Chairman Federal Board of Revenue (FBR), National Accountability Bureau (NAB) and Federal Tax Ombudsman (FTO) to devise a strategy for the recovery of money and prosecution of those involved in the scam.

It is worth mentioning that the SC was informed during the last hearing that the FBR had unearthed duties and taxes' evasion of over Rs 55 billion as 28,802 containers carrying ISAF commercial cargo under Afghan Transit Trade (ATT) from Karachi port to Afghanistan went missing.

Resultantly, the Chief Justice asked FBR Chairman to file a report pertaining to the development of his meeting with the NAB Chairman on ISAF containers scam, along with a performance report on the next date of hearing.

Counsel for FBR Raja M. Irshad, NLC's counsel Afnan Karim Khundi, Attorney General for Pakistan, Chairman FBR and Additional Prosecutor General NAB Akbar Tarar appeared before the bench.

During the course of hearing, Chairman FBR apprised the bench that proceedings against those involved in the scam had been initiated.

According to him, as many as 18,010 persons have been issued show cause notices so far.

Additional Prosecutor General NAB informed the bench that a day earlier NAB was contacted by the FBR.

According to him, the NAB is overburden due to several vacant posts.

The CJP asked the Chairman FBR to depute an officer from his office for providing assistance to NAB in investigating the matter

of tax evasion in ISAF container scam, adding that a forensic inquiry into the scam must be carried out.

He asked the Chairman FBR to oversee the cases on daily basis.

The counsel for FBR informed the bench that show cause notices to importers, clearing agents, border agents and the National Logistics Cell had been issued in most of the cases and the remaining, pertaining to 3398 Nato/ISAF containers were being issued now.

He added that FIRs were also being lodged for determining criminal liability of culprits and so far a list of about 580 containers had been forwarded to the Directorate General of Intelligence and Investigation - FBR for lodging FIRs against the culprits including customs official.

According to him, more cases are being analysed for fixing responsibility.

The bench adjourned the hearing of the case till January 2, 2012. – *Courtsy Business Recorder.*

Rs 55.81 million entertainment tax collected in 2009-2011: Sindh Assembly informed

The Sindh government has collected Rs 55.810 million of entertainment tax during 2009-2011, but no such tax is collected from cinemas since September 2005, the Sindh Excise and Taxation Minister, Mukesh Kumar Chawla told the Sindh Assembly on Tuesday.

These taxes are collected from amusement park, dramas/musical shows, exhibitions, meals/circus and sports events, the minister said during the question-answer session of the assembly, adding Karachi outnumbered the tax collection with Rs 52.671 million during July 1, 2009 to June 30, 2011.

Share in the entertainment tax by other areas of the province including Hyderabad Rs 2, 690,000, Mirpurkhas Rs 85, 000, Sukkur Rs 2, 49, 000, and Larkana Rs 70, 000, he added.

Collection of property tax during 2009-2011, he said, it was Rs 2524, 222 million from Karachi, Rs 104.96 million from Hyderabad region, Rs 62.524 million from Sukkur region, Rs 31.206 million from Larkana region and Rs 24.126 million. – *Courtsy Business Recorder.*

President upholds FTO ruling against FBR: denial of refund due to missing record

The President has confirmed the ruling of the Federal Tax Ombudsman (FTO) that non-maintenance of old assessment record by the tax department could not form basis of denying income tax refund payments to the taxpayers.

Sources told here on Tuesday that the President has rejected a representation of the Federal Board of Revenue (FBR), filed with the President under section 32 of the FTO Ordinance in complaint No 1620-L/2008.

In a latest decision by the President, the order of FTO on a complaint filed by Lahore based tax lawyer, has been confirmed while rejecting FBR's representation filed u/s 32 of the Federal Tax Ombudsman Ordinance, 2000.

The President's order has clearly said that representation of the FBR has not been able to improve its case and explain why the relevant record was not traceable in case of issuance of refund.

The President has endorsed the viewpoint of the FTO office in this case.

The FTO had earlier given its findings on the basis of income tax circulars and reported cases governing income tax refunds.

According to the order of the President, communicated through the Law and Justice Division, the matter relates to refund of income tax.

The ratification orders were passed under Section 221 of the Income Tax Ordinance 2001 on May 8, 2006 for refund relating to the assessment years 1994-95 to 2002-2003, which were partially processed under the repealed law ie Income Tax Ordinance 1979 and partially under the Income Ordinance 2001.

The refund application of the complainant was received by the FBR on June 30, 2006 along with the demand note/order/IT.30 Form.

The case of the FBR was that the verification having partially taken place, he was issued refund on September 29, 2008, whereas he was directed to provide further proof for the residual demand.

President's order further said that the complainant had arranged all relevant material, on the basis of which IT.30 Forms were issued.

But he was unable to provide further material as the company ceased to exist and that therefore, the determined refund on the basis of demand note/IT.30 Forms is to be issued to him.

The complainant produced the cheque of the partial refund amount which could not be encashed because no advice for its encashment was conveyed to the relevant bank.

The FTO thought that this factum established mala fide on the part of the Agency.

After investigation, the FTO recorded his findings, saying: "From documents produced by the complainant, it transpires that the Taxation Officers had determined refund for the tax year 1994-95 on the basis of relevant documents.

The case being old, the complainant can not be held responsible for non-production of original relevant documents, which were allegedly submitted to the Taxation Officer.

The respondents have not given any explanation for absence of the relevant record on the basis of which IT.30 Forms were issued.

They have also not mentioned if any effort was made to search the relevant papers from the file of the Department.

It has been observed that assessment records are not being properly maintained and invariably in case of refund their absence is pleaded to deny the relief".

Where-after the FTO made the following recommendations: "The respondents should issue, as per law, the refund claim of the complainant for the tax years in respect of each IT.30 form or order determining refund of the complainant."

Against the findings of the FTO, the FBR filed a review petition, which was duly considered by the President, and the following observations were made:"Recommendations in the instant complaint were made after due consideration and with conscious mind while dealing with all the objections and pleas raised by the Respondents and there was no error or omission apparent on the fact of record.

The negligence, inattention and arbitrariness in the discharge of duties and responsibilities on the part of the Respondent stood established.

In view of the above finding, the Review Application, being devoid of merits, is rejected."

President's order ruled that through this representation the FBR has not been able to improve its case or explain why the relevant record on the basis of which the IT.30 Forms were issued was not traceable.

Under the circumstances the findings of the FTO are fair and proper and do not call for any interference.

Accordingly, the President has been pleased to reject FBR's representation, Presidential order added. – *Courtsy Business Recorder.*

Complex Annexure-H: ST refund claimants unable to file complete returns

The sales tax refund claimants are unable to completely file their sales tax returns even after a lapse of almost five months due to practical problems in filing of the complex 'Annex-H' of the return.

Tax experts told here on Tuesday that the sales tax returns of the refund claimants remain incompletely filed despite passage of many months.

A long time has passed but a large number of taxpayers are unable to file their sales tax return completely with all the required annexures.

The Federal Board of Revenue (FBR) during current fiscal year has prescribed a new comprehensive format of sales tax return with different annexures.

Interestingly, each annexure has opened a new debate among the trade, and resultantly FBR was forced to take ad hoc measure like the date of return filing was extended up to October.

Amendment in Annex -F and annex-H was required to file within 120 days.

However, tax experts reported that taxpayers are yet unable to file annex-H and resultantly their returns from July 2011 remain incomplete.

When Saleem Parekh, a prominent exporter and trade leader, was questioned in this regard, he said that annex-H contains complex information and they can not understand why the FBR is pressing for such minute and petty details.

He said that the exporters required specialised accountant and senior production staff to first arrange all details according to the

required form and reconcile it with the accounts available with them and then seek advice from sales tax legal expert to file the statement.

He questioned that under such tough global business environment whether they should focus on their core business or divert all their attention towards such exercise in futility.

The same question was asked from Arshad Shehzad, a Karachi based prominent tax expert.

He contended that no particular format of stock statement is defined in the Sales Tax Act.

Hence, in his opinion, if the FBR intends to make the stock statement as integral part of the return then it should be a simple and easy form, so that each and every taxpayer may file without any hassle.

He further explained that details of HS code of each and every item, break-up of consumption in exports and local supply and stocks details of zero rated items in his opinion at this stage genuinely create problems.

According to his opinion, such detailed information could be sought with annual sales tax return.

Arshad added that the issue of complexity of Annex-H was particularly taken by him on behalf of apparel forum during their meeting with Chairman of FBR in Karachi and he found the Chairman of FBR very much convinced with the demand to simplify the form.

However, the issue unfortunately remains unattended and resultantly one of the significant sectors of taxpayers could not file their returns completely. – *Courtsy Business Recorder.*

Income tax details of real estate tycoon: Chairman Senate refers matter to concerned committee

After government inability to share the income tax details of Malik Riaz, chief executive Behria Town, Chairman Senate Farooq H.

Naik on Tuesday referred the matter to concerned committee of the house.

The Senate Standing Committee on Finance will take up the issue related to the income tax assessed and paid by the Bahria Town

chief executive during the last three years, which will submit its report to the house soon.

In a written reply to a question raised by Senator Zahid Khan, finance minister Dr Abdul Hafeez Sheikh said that under Section 216 of Income Tax Ordinance, read with clause (xv) of rule 47 of Rules of Procedure and Conduct of Business, 1988 debars disclosure 'in relation to any matter in respect of which, there is a constitutional or statutory obligation not to disclose the information.'

This infuriated some senators including Zahid Khan, who also revealed that Bahria Town chief executive had to pay Rs 2 billion as income tax to Federal Board of Revenue (FBR) as only Rs 280 million was paid by him.

Zahid further said that as a result of some illegal deal between FBR officials and the Behria town administration Rs 1.72 billion were written off by the government.

He came down hard on the government, saying if the politicians were bound to declare their assets, why information pertaining to a businessman could not be provided to the parliament.

State Minister for Production Khawaja Shiraz Mehmood, who was replying to the question, had nothing to say except that Income Tax Ordinance, read with clause (XV) of Rule 47 of the Rules of Procedure and Conduct of Business, 1988 debars disclosure and not to public such information.

Another ANP Senator Haji Adeel said that the minister should come fully prepare to answer the questions of lawmakers in the house as he has very little know-how of property law.

Senator Safder Abbasi of PPP said that government should declare details of assets pertaining to the property tycoons in light of 1973 Constitution, as every institution whether private or public was bound to declare its assets accordingly.

Senators across the party lines demanded the government to declare annexure pertaining to the property of Malik Riaz, chief executive Bahria Town.

Pakistan Muslim League-Nawaz Senator Raja Zafarul Haq said Senate must be briefed on the issue.

If the matter can be discussed in the committee, why not in the house, he questioned after Senator Zafar Ali Shah pointed out

some legal points which don't bar the government to make the property related matters public.

Meanwhile, chairman Senate prorogued the 76th session when ANP leaders wanted to move a resolution, asking international community to step in and force Israel to end its siege on Gaza.

The resolution demanded immediate action through all diplomatic, cultural and economic means on Israel for ending violation of human rights in Palestine.

"A consensus should be developed before passing the resolution," said Senate Chairman, asking Senator Haji Adeel, mover of the motion, to develop consensus with parliamentary leaders on the matter.

Now all parliamentary leaders will discuss the matter and likely to table the resolution in next session of Senate. – *Courtsy Business Recorder.*

Major FBR projects include customs stations

Some major projects of the Revenue Division under Public Sector Development Program (PSDP) include procurement, training and refurbishment of tax offices under Tax Administration Reform Project (TARP), purchase of land/establishment of Tax Facilitation Centres (TFCs), construction of Customs Stations, renovation of hostels and repair/maintenance of existing tax offices/buildings during 2011-12.

Sources told here on Wednesday that PSDP allocation for Revenue Division (FBR) was Rs 1.970 billion for 2011-12 against downward revised 2010-11 allocation of Rs 802 million.

The budgetary allocation of PSDP for Revenue Division was Rs 1.235 billion for 2010-11 which was slashed to Rs 802 million.

The major component of PSDP ie Rs 1.402 billion, has been allocated for the ongoing projects like procurement of hardware/IT equipment, refurbishment of tax departments and training under the Tax Administration Reform Project (TARP).

The component of GoP allocation under PSDP during 2011-12 has been increased due to corresponding increase in spending in terms of foreign exchange possible through TARP funds which is scheduled to close by the end of this calendar year.

The PSPD data showed that construction of new Block in the FBR House would cost Rs 64.335 million during 2011-12; construction of

multi-storey office building for Customs House, Mutan, Rs 22.804 million and construction of covered car parking in FBR House would cost Rs 20.249 million during the period under review.

The FBR will spend Rs 30.832 million for addition/alteration/ partitions at Income Tax Office Building Karachi and an amount of Rs 22 million has been allocated for provision of sports facilities at the Directorate General Income Tax (Training and Research) Lahore.

The details of FBR projects further show that the FBR will spend Rs 20 million on construction of the office of Additional Director Intelligence and Investigation Regional office Peshawar, and expansion of Customs guest house Karachi would cost Rs 19.772 million during 2011-12.

The FBR has also allocated Rs 14.990 million on operation of Integrated Cargo/Container Control (IC3) Site at Port Muhammad Bin Qasim Karachi.

The acquisition of additional five acres of land for the expansion program of IC-3 at Port Qasim Karachi would cost Rs 12.866 million.

The data shows that construction of hostel adjacent to old Customs House Karachi would cost Rs 17.021 million during 2011-12 and construction of additional office block building for Income Tax Complex at Faisalabad would cost Rs 18.754 million.

The FBR is also in the process of constructing TFCs at Gwadar, Okara, Charsadda, Kasur, Rahim Yar Khan, Mandi Bahauddin, Toba Tek Sindh, Jhang, Ghotki, DI Khan and other cities.

The establishment of customs station at Badini at Pak-Afghan border would cost Rs 4.886 million and another customs station at Qamar-ud-Din Karez & Friendship gate would cost Rs 5.250 million during 2011-2012.

Beside other projects, construction of two additional floors at the RTO Karachi would cost Rs 20 million during 2011-12.

Under the PSDP allocation, the FBR would spend Rs 12 million on residential accommodation for Income Tax at Quetta during 2011-12. – *Courtsy Business Recorder*.

Use of HMTs resulted in Isaf container scam: FBR informs NAB

The Federal Board of Revenue has informed the National Accountability Bureau (NAB) that the frequent use of Hired Mechanical Transport (HMT) of private transporters to carry Afghan transit cargo and Isaf/Nato containers facilitated crime of missing containers under the 'Isaf Containers Scam.'

Sources told here on Wednesday that the FBR has submitted a report to the Director General NAB on the 'Isaf Containers Scam' for initiation of criminal investigation against the persons involved.

The FBR letter to the NAB elaborated serious loopholes in the customs clearance system, which resulted in missing of thousands of containers under the 'Isaf Containers Scam'.

The FBR informed the NAB that the HMT was allowed by the Board in January 2006, as an exception/one time measure.

The use of HMT was made a norm without any authorisation of the Board.

The investigation has revealed that the concept of HMTs was abused without putting into place proper system of checks and hence was a major factor facilitating the crime, as National Logistic Cell (NLC) reduced itself to a mere conduit of authorising private transporters to carry transit cargo on its behalf and the Preventive Collectorate, despite fully aware of the situation, did nothing to stop the malpractice.

Sources said the Pakistan Customs Container Security System (PaCCSS) notified vide Customs General Order (CGO) No 04/2007 had an in-built check to block reloading of cargo by such transport units which had earlier lifted transit cargo but the containers so lifted had not been desealed at border in PaCCSS.

It was a crucial pre-emptive check in the system to ensure that the system of sealing/desealing would help in ensuring due arrival of goods at destination.

This check was disabled in 2007 on the directions of the then Chief Collector (South) and Collector (Preventive) reducing the PaCCSS to a mere farce as far as pre-empting the stated mechanism of crime is concerned which rested on the malpractice of HMTs.

The FBR has further informed the NAB that thousands of containers transported through so-called HMTs still appear in the PaCCSS as have not been de-sealed in the system.

Non-desealing of containers in the PaCCSS was a major alarm regarding non-arrival of the cargo at the destination, It is shocking to see that no attention whatsoever was paid by the Preventive Collectorate, Karachi, which had the control and custody of PCCSS to this alarm in gross violation of PaCCSS and hence the crime continued in perpetuity on account of this willful failure.

Details of thousands of containers appearing as not de-sealed were also available to the border Collectorates on PaCCSS.

The border Collectorates should have immediately raised alarm regarding non-arrival of these containers at the designated border stations but if is astonishing to note that they wilfully opted inaction in this regard, thus effectively forestalling any detection of the crime on the one hand and enabling its perpetuation on the other, sources said.

The FBR has further informed the NAB authorities that it is also shocking to note that thousands of containers appear in the PaCCSS as de-sealed but their corresponding proof of arrival and cross-border at the exit stations is missing.

This proves that false entries were fed in the system to show arrival of thousands of containers at the border station, which never reached there and were in fact pilfered/smuggled en-route.

During the course of investigations numerous instances of serious illegalities, irregularities, wilful non-compliance and systemic issues have been identified which facilitated the commission and perpetuation of the crime on the one hand and its cover up on the other.

The FBR has informed the NAB that an unrelenting perpetuation of the crime where thousands of containers go missing before reaching the destination was not an accidental affair, but has all the bearings of an organised, planned crime.

The size and scale of the scam indicates that its commission and perpetuation was not possible without patronage and protection of the senior management in the field as well as FBR Headquarter.

The quantum of revenue loss and everyday occurrence of the crime indicates complete failure of command and control on the part of senior management and blatant disregard of assigned functions.

With some exceptions, the system mostly relied on manual procedures and lacked transparency.

No meaningful effort was ever made to put into place an integrated automated system.

At a time when a lot of investment was being made in automation of systems and procedures as part of FBR Reforms, the transit trade clearances continued to be handled through manual registers and Afghan Transit Trade Invoices.

Whatever modicum of automation introduced in transit trade handling, it was deliberately kept a compartmentalised patchwork of isolated software with no common interface between the Collectorates of Clearance at Karachi with the Collectorates of destination at Chaman/Torkhum, sources said.

The FBR has informed the NAB that the flawed and isolated automation ensured perpetual reliance on manual documentation.

This virtually eliminated any chance of conducting reasonable reconciliation of consignments originating from Karachi with those arriving at Chaman or Torkhum for proper accounting and finding the missing/en-route pilfered consignments.

This could not be attributed to bona tide oversight.

The Afghan Transit cargo unloaded in KICT/PICT/QICT was being unauthorizedly shifted to KPT.

No check was put into place to regulate this phenomenon.

The NAB was further informed by the FBR that there was unauthorised de-stuffing of AT cargo within port premises at Karachi.

The system (manual and computerised) in place did not record the crucial fact of cross-stuffing of the containers from original containers to altogether new containers.

There was no entry of the new containers on the GDs, ATTIs, etc, in the system.

This prevented any meaningful tracking and reconciliation of such cargo and helped commit and cover up the crime.

Basic framework of clearance and reconciliation was provided under Public Notices issued by Model Customs Collectorates of Appraisement and Port Qasim.

Serious violations of these instruments were committed which went unchecked.

It was pointed out that the Jawaznama (license of import issued by Afghan Government) linked the imports claimed to be transit goods with the Afghan importer.

No meaningful verification of the Jawaznamas was conducted to ascertain bona fides of the transit goods.

Under the Public Notices it was responsibility of the Appraisement or Port Qasim Collectorates to officially send three copies of the Allis to the border Collectorates for further processing.

However, in most of the detected missing containers, due dispatch of the Allis to border Collectorates could not be proven.

instead, these ATTIs were handed over to the criminals for forgery.

The forged ATTIs or cross border certificates (CBCs) were placed in the record of Appraisement and Port Qasim Collectorates to fraudulently prove that the consignments cleared there against had crossed the Pak-Afghan border.

This was meant to cover up the crime.

No manifest clearance of the Afghan Transit imports was conducted during the period January 1, 2007 to December 31, 2010 and failure on this crucial aspect kept the crime in dark.

Despite the fact that the issue of pilferage of AT cargo came up for discussion during various Collectors Conferences held in the Board, no any meaningful monitoring and reconciliation mechanism was put into place.

The failure on this account is deliberate and criminal.

The FBR has further informed the NAB that the commission and perpetuation of the crime at the massive scale is its own proof of an alarming management failure.

The crime could not have assumed the persistence and the scale had the higher management fulfilled its administrative and legal obligations with diligence, sense of responsibility and focus.

It goes without saying that such massive crimes thrive in an environment of corruption and nepotism.

Posting profiles of some of the officers/officials found involved in the Scam indicate patronage and protection of the upper hierarchy.

The Board has issued directions to the concerned offices for immediate transfer of complete record of aforesaid cases to the NAB, including the adjudged amount of duties/taxes and penalty, for further necessary action.

Moreover, the probe committee is fine tuning more cases for initiation of criminal proceedings, which would also be transferred to NAB in due course of time.

Sources added show cause notices to the importers, clearing agents, border agents and the National Logistics Cell (NLC) in most of the cases have been issued and the remaining, including 3398 Nato/Isaf containers, are being issued.

Besides FIRs are also being lodged for determining criminal liability of the culprits and so far a list of about 580 containers has been forwarded to the Directorate General of Intelligence & Investigation - FBR for lodging FIRs against the culprits including customs officials.

More cases are also being analysed for fixing criminal liability, the FBR letter to the NAB added. – *Courtsy Business Recorder*.

TARP unable to achieve results due to insufficient tax policy reforms: World Bank

The World Bank (WB) has observed that the Tax Administration Reform Project (TARP) of the Federal Board of Revenue (FBR) was unable to achieve its full results due to insufficient tax policy reforms to expand tax base and simplify tax system, as introduction of a modem value-added tax (VAT) or reformed general sales tax (RGST) and other tax policy measures did not materialise.

Sources told here on Wednesday that the WB review mission has issued its final supervision report on the TARP before the closure of the project on December 31, 2011.

According to the final supervision report, the original environment, which TARP was operating in, was more volatile than originally estimated.

There has been a mix of unfavourable economic circumstances, a challenging political environment with frequent changes of political authorities and FBR staff at senior levels, and problems with basic infrastructure such as electricity.

All these factors contributed to an environment that was not favourable to meeting the project's reform objectives.

It should be highlighted that the main risk factors identified during project design occurred during TARP execution and affected its results.

On the one hand, the project features that have positively impacted TARP were: (a) adequate resource allocation for improvement in physical and IT infrastructure; (b) emphasis on taxpayer services; and (c) precise identification of the risks to the project.

On the other hand, the project features that had negative impact on the project were: (a) carrying out both customs and domestic tax administration reforms at the same time was too ambitious (overestimated the local capacity to manage both reforms); (b) some of the project's tax policy assumptions were optimistic, such as the introduction of a VAT (RGST); (c) some of the project's performance indicators were inadequate; (d) the effect of some legal constraints had been underestimated (for both enforcement activities and FBR's restructuring of its organisation), and importantly (e) the resistance to FBR's integration initiatives from staff of the Customs and Excise Group (CEO) and the Income Tax Group (ITO) was underestimated.

The final supervision report of the WB said that the TARP was not able to achieve its full results due to inconclusive implementation of a functionally integrated organisation.

The organisational reforms introduced by FBR in early 2011 appeared to depart from the functional model envisioned by TARP.

The lack of an adequate framework to follow up the reform action plan, monitor progress, detect deviations and propose short-term corrective actions limited the effectiveness of the reform program.

Sharing the shortcomings in the TARP, the WB final supervision report said that the significant turnover in senior management, lack of follow-up on reform actions, and lack of co-ordination among areas at FBR House and field formations had undermined the effective implementation of the reform program at different stages.

The insufficient tax policy reforms to expand tax bases and simplify the tax system, along with a rigid and inappropriate legal framework - the introduction of a modern VAT--did not materialise, while restrictions to adequate assign core functions to the appropriate organisation level severely affected appointment of managers, it said.

The lack of management conviction to implement key institutional measures - reforms proposed and agreed to by FBR and Ministry of Finance were not fully implemented and lack of leadership and

accountability - relevant managers were not held accountable for implementing HQ instructions.

The report said that lack of ownership on the project had made it more difficult to hold staff accountable for progress on the TARP program tasks.

There were internal fights among FBR staff to bring their vision of TARP to the field, regardless of the sanctioned reform initiative, reflecting weak implementation capacity of the department to implement reforms.

The WB report further highlighted lessons learned from the TARP.

The report said that the policy assumptions should be carefully evaluated to ensure, as part of the project monitoring system, that policy assumptions are well documented and that effective mitigation strategies are in place to identify when one of these assumptions is proved incorrect.

The suggested corrective actions may be used to provide some guidance on how to minimise the impact of the change in the project's environment.

The policy changes were required to increase revenues - tax policy reforms may be indispensable to increase tax administration effectiveness and tax revenue.

If tax policy reforms cannot be introduced, mitigating measures should be planned, the WB report said.

It further said that legal constraints should be carefully evaluated as part of the project assumptions.

When organisations are being redesigned it is important to know ahead of time what constraints are in the law that would affect the anticipated changes.

The necessary legal changes need to be made early in the project to ensure that there are no legal impediments when structural changes are being introduced.

The final supervision report said that major increase in tax administration effectiveness required steady fundamental organisational change - a fundamental change in the way business is conducted within the organisation, especially when it affects field workers and the way they do their job has the potential to be extremely disruptive.

A plan that ensures that all staff are at least well informed and understand what changes are being made and addresses the

concerns of rank and seniority must be in place in the early stages of the program.

Ongoing monitoring to ensure buy-in or to find a way to address perceived or actual inequalities in the transition needs to be actively undertaken.

Corrective actions need senior management participation and a contingency plan should be in place if resistance to the change is indicated.

The WB observed that the new IT systems are ineffective unless they are complemented with new operating procedures and training.

The FBR should ensure, as part of the project monitoring system, that whenever a new IT application is being introduced into the field (a) it has been field tested, (b) adequate training in the use of the new procedures has been provided to the users, (c) the requirement to adopt the new procedures are identified in SOPs, and (d) that procedures to reward or recognise staff for adopting the new processes are in place.

The WB said that the centralised systems are easier to implement because, in the Pakistani context, they facilitate management monitoring and control - where technology permits, ensure that processing is done through a single central location.

The performance should be linked to staff compensation and merit in promotions -sending the right message to the staff with regard to changing the organisation is most effective when staff are rewarded for their change in behaviour.

The projects should have as part of their early objectives to implement a different compensation and promotion program that rewards staff based upon their performance in adopting the new processes and promotes staff based upon merit, it said.

The project risk mitigation measures should be identified as part of project design -in addition to identifying and rating potential risks that projects may face, recommended mitigation procedures and strategies should be included as part of the project design documentation.

The WB report said that the frequent technical supervision by the Bank helped to keep the project on track - if project tasks are not progressing as planned, the use of frequent technical visits will help the project break down the tasks into smaller steps and offer guidance on how to proceed with the tasks.

The final supervision report further stated that the TARP had made important strides during the last 2-3 years.

While TARP has not fully achieved all its objectives, it has made significant progress in enforcement, IT, organisation and HR, which have established the foundations for future and deeper reforms.

Before TARP, even with maximum political will and best management capabilities, the FBR would not have been able to increase tax administration effectiveness (ie to reduce the tax gap) due to technical constraints.

Now, once the main management and legal issues are resolved, the FBR is well positioned to jump ahead to significantly improve its operations and, as a result, increase tax revenues.

As far as achievements of the TARP are concerned, the report said, improvement in service to taxpayers by FBR has been significant and is changing the image of FBR in society.

The implementation of a new functionally integrated organisation, as opposed to the previous tax type based, will allow for improved operations at FBR.

A fully functional organisation will be achieved once training activities on new business processes are completed and the reforms introduced by FBR in early 2011 at field formations do not deviate from the functional approach envisioned and supported by TARP.

The amount of sales tax refunds processed increased dramatically.

Refund payments in 2010-11 were Rs 106.4 billion.

This represents an increase of 233 percent above the 2009-10 level and is equivalent to 0.59 percent of GDP (the highest in recent years).

It should be noted that improving the refund system is an indispensable precondition to the introduction of the RGST.

The enforcement activities have improved significantly.

This has been achieved by introducing the new taxpayer registration system, increasing the number of active registered taxpayers by 24.8 percent since 2008; substantially reducing non-filers for sales tax and corporate income tax as a result of the introduction of e-filing; reducing tax arrears (the total amount of arrears was reduced by 22 percent in 2011) and developing audit activities, which were virtually suspended at FBR for about four years.

Also, several measures, such as the implementation of withholding systems and the application of the 'Active Taxpayers List' (disallowance of input credits for sellers not on the Active Taxpayer List) have been implemented under TARP to reduce evasion, combat the underground economy and increase compliance.

The FBR infrastructure was drastically improved.

At the beginning of TARP, basic infrastructure was in severe need of improvement and TARP provided fundamental assistance to modernise buildings, furniture and expand communications and computerisation.

Today, FBR staff work in reasonably comfortable offices and the IT infrastructure has been improved considerably with the introduction of the 'Integrated Tax Management System' (ITMS), which is available to all field formations, the report said.

The Human Resource Management (HRM) policy framework was approved last year by the FBR Board.

It covers several areas and defines rules for working at FBR.

Draft job descriptions for positions at field formations reflecting the integrated structures of RTOs/LTUs have been prepared.

Training of staff has been slowly but continuously developed, final supervision report of the WB on the TARP concluded. – *Courtsy Business Recorder*.

Senate panel to look into Bahria Town taxes

A Senate panel will look into the issue of taxes paid by Bahria Town and give its opinion whether the details can be disclosed or not. The project is owned by real estate tycoon Malik Riaz Hussain.

A controversy over the issue surfaced in the house when Minister of State for Production Khwaja Shiraz, responding to a question about taxes paid by Bahria Town, said the law barred disclosure of information.

Senator Zahid Khan of the ANP had raised the question about taxes paid by the country's largest real estate developer in the past three years.

The minister cited section 216 of the Income Tax Ordinance 2001, read with Clause (XV) of Rule 47 of the Rules of Procedure and

Conduct of Business, 1988 which debars disclosure “in relation to any matter in matter of which there is a constitutional or statutory obligation not to disclose information”.

The reply, however, angered many members and Zahid Khan argued why the details could not be made public when statements of assets and liabilities of lawmakers could be made public.

Khwaja Shiraz said that details about assets of parliamentarians were published in official gazette under a law and pointed out that parliament had a right to frame more legislation.

Safdar Abbasi of the PPP said the law did not prohibit making public a tax related matter.

Ilyas Bilour of the ANP said: “We will uncover the whole thing”.

Raja Zafarul Haq of the PML-N said when the defence budget could be discussed in the house, why the details about a real estate tycoon’s taxes could be concealed.

Senate Chairman Farooq H. Naek referred the matter to the Senate’s standing committee on finance, which will see if the details could be made public under the law or not and submit its reply to the house. The Senate was informed that three officers of the National Highway Authority held responsible for the 2007 collapse of Shershah bridge in Karachi by the inquiry committee of the Prime Minister’s Inspection Commission were still working with the authority.

Communications Minister Arbab Alamgir said that disciplinary proceedings against officers, Altaf Chaudhry, Raja Nowsherwan Sultan and Mohammad Yousaf Barakazai, had been initiated and no action had been recommended against them in the inquiry report.

He said they were also facing criminal proceedings in the court of an additional sessions Judge in Karachi.

According to the inquiry report, the then NHA chairman, Maj-Gen (retd) Farrukh Javed, and former general-manager (construction) Col (retd) Tehisn ul Haq were also held responsible for showing completely irresponsible attitude.

The minister said that as many as 46 cases of corruption and misappropriation surfaced in the NHA during the past three years.

A parliamentary delegation from Afghanistan was welcomed by thumping of desks on arriving in the visitors’ gallery.

Members from different political parties said that parliaments of the two countries should play a role in further cementing the bilateral relationship, enabling the two countries to effectively counter the common enemy.

An interesting situation developed when Abdul Rahim Mandokhel tried to speak in Pashto asserting that it was his right.

The Senate chairman reminded him that under the rules the members can express themselves either in Urdu or English and permission of the chair was required to speak any other language.

He, however, allowed Mr Mandokhel to speak in Pashto to welcome the Afghan delegation. Two other members also made brief speeches in Pashto after that. – *Courtsy The Dawn.*

E-intermediary role sought for preventing bogus refund claims

The Karachi Tax Bar Association (KTBA) has sought e-intermediary representation in the tax laws for preventing bogus refund claims, a statement said on Thursday.

In a communication sent to the Member Inland Revenue (IR), Federal Board of Revenue (FBR) on Thursday, Anwar Kashif Mumtaz, President, KTBA, said that growing incidents of wrong issuance of sales tax refunds due to fake invoices resulted in the loss of billions of rupees to the government.

In one instance, the government reportedly incurred losses of Rs10 billion per month on account of fraudulent refunds, according to the communication."These types of unethical activities usually happen as a result of collusion between the unregistered agents and consultants and the FBR field officers who are responsible for mala fide and criminal act," said Mumtaz.

"There is no control or verification about the bona fide of unregistered agents and consultants," he said. Recognising the fact, the government amended Income Tax Rule in 2006 and inserted registration of e-intermediary, which allowed the permission of practice to only those consultants to act as an e-intermediary who are members of the Pakistan Tax Bar Association.

The KTBA suggested that the amendment made in rules should also be made in other tax laws to bring these in line with the condition of e-intermediary. "Through this bar(s) could easily

monitor, check and verify the data of the consultants and, on the other hand, the FBR will also be able to determine the role of the officer involved in this act of negligence and corruption," according to the communication. – *Courtsy The News.*

IT glitches cause billions of rupees refunds jam

Businesses have billions of rupees stuck up in sales tax refunds due to problems in IT programme prepared by Pakistan Revenue Automation (Pvt) Limited, official sources said on Thursday.

A communication was sent by a tax department to Member Inland Revenue (IR), Federal Board of Revenue (FBR), to say that taxpayers as well as tax officials are facing problems due to IT-related issues. "Refunds worth billions of rupees have been stuck due to these problems," said an official on condition that he would not to be named. The official said that problems surfaced after changes were made to online data submission procedure in this fiscal year.

Due to these changes, taxpayers are facing hardships in revising their returns and statements, the official said. Besides, the mandatory requirement of information against each invoice has also resulted in problems for taxpayers, the official added.

The tax officials are unhappy with the performance of PRAL in respect of IT support, the official said, adding that recently a detailed presentation was made before the high-ups of the revenue body about the issues.

PRAL was established in 1994 as a private limited company and is owned subsidiary and data arm of FBR. It is providing solutions pertaining to income tax, wealth tax, general sales tax, federal excise, customs, capital value tax, provincial cess and property tax.

The tax officials in the presentation stressed the need for improving infrastructure of PRAL, especially hardware, and removing problems with the main server. They expressed concerns about the security of the FBR data and said that the IT system is vulnerable to attacks.

The presentation also said system audit of PRAL should be conducted every six months as is done by banks. Besides, the tax officials sought that PRAL should be made responsible for software and hardware crashes. The FBR has been informed that people do not know whom to contact at PRAL in case of problem as no focal person is available. – *Courtsy The News.*

Traders want Form-D requirement withdrawn

Traders asked the federal government on Wednesday to ask the Federal Board of Revenue to withdraw the decision of including the Form-D in income tax returns.

At the Convention of All Pakistan Anjuman-e-Tajiran Pakistan, they threatened a country-wide campaign against the decision of the FBR if their demand was not accepted. They demanded establishment of chambers for small and medium traders and cottage industry.

They demanded that the government direct all banks to strictly keep their account details secret because traders have serious reservations regarding their accounts information. The traders also expressed annoyance over the deteriorating law and order situation of the country, increase in the prices of gas and electricity.

They also condemned target killings in Balochistan and demanded that the government provide education and health facilities to the people of Balochistan. President of Federation of Pakistan Chamber of Commerce and Industry (FPCCI) Senator Haji Ghulam Ali said on the occasion the bill pertaining to establishment of small chambers of commerce and cottage industry was in the standing committee of commerce.

He said that efforts should be made to increase trade with not only India, but also with other neighbouring countries. He also said that efforts should be made to enhance trade among SAARC and ASEAN countries. He added that efforts should be made for one currency of SAARC and ASEAN countries. – *Courtsy The News.*

Imposition of CGT on immovable property: TRCG meeting to discuss policy measures today

An important meeting of the Tax Reform Co-ordination Group (TRCG) of the Federal Board of Revenue (FBR) will be convened at FBR House here on Friday (December 23) to discuss policy measures for the imposition of the capital gains tax (CGT) on immovable property following 18th Amendment.

Sources told here on Thursday TRCG of the FBR would discuss the issue of Capital Gain Tax (CGT) on immovable property in its next meeting to be convened on December 23, 2011.

The 7th meeting of the TRGC would be convened at the FBR Headquarters to discuss key tax policy issues including CGT on immovable property following 18th Amendment.

Sources said that the exclusion of the 'immovable property' from the section 37 (Capital Gains) of the Income Tax Ordinance 2001 could empower the FBR to collect capital gain tax on property transactions without legal implications.

Presently, immovable property is exempted from capital gain tax under section 37 of the Ordinance 2001.

Sources said that the Parliament has the authority to legislate for empowering the federal government for collection of the capital gain tax (CGT) on immovable property after 18th Constitutional Amendment.

The CGT could be imposed on the immovable property after 18th Amendment.

Thus, Parliament can authorise the federal government to collect CGT on immovable property through legislation.

The TRCG would also finalise the redrafting of the SRO 1012(I)/2011.

The stakeholders are expected to give their input on the redrafted statutory regulatory order (SRO) on revised zero-rated regime.

The tax managers would give an update on the FBR's performance in fiscal 2011-12 including revenue collection, broadening the tax base and results of enforcement/administrative measures to improve collection in the remaining period of current fiscal year.The meeting will also discuss the issue of stamps on cigarette packs to help identify smuggled/non-excise paid cigarettes packs.

The TRCG will also discuss the issues of Centralised Audit, FBR's collection and reorganisation of the FBR.

The TRCG would also discuss measures for expanding the outreach and tax policy proposals of the TRCG members, sources added.

The TRCG is expected to give its comments on the proposed lottery scheme to encourage documentation.

Initially, the scheme would be restricted to the sales tax invoices of hotels and restaurants.

In case of approval, the pilot project would be launched in Islamabad. – *Courtsy Business Recorder.*

ST on Services Act: ICAP open house discussion on December 26

Southern Regional Committee of Institute of Chartered Accountants of Pakistan is holding an open house discussion on legal and procedural issues in Sindh Sales Tax on Services Act 2011 and Sindh Sales Tax on Services Rules 2011 on December 26, 2011 at ICAP House, here.

Keeping in view members' interest, the SRC has arranged an open house discussion on the subject where ICAP members' would discuss their views, issues, queries which they face or likely to encounter under Sindh Sales Tax on Services Act 2011 and allied rules.

The ICAP aims to consolidate all major issues and take up with SRB for resolution thereof.

The open house discussion would be chaired by Saqib Masood, FCA - Chairman, ICAP Taxation Committee while Adnan Mufti FCA, Chairman SRC and Adnan Zaman, FCA, ICAP Council Member would be the panellist.

The SRC had also organised a full day workshop on Sindh Sales Tax Law on November 1, 2011, which was attended by 220 members and non-members.

This workshop was also attended by Chairman, Members, Commissioners and field formations of Sindh Revenue Board (SRB).

In continuation of such an interaction, the SRB had solicited ICAP proposals/suggestions in improvement of Sindh Sales Tax Law. – *Courtsy Business Recorder.*

Making corporate laws more meaningful: KTBA urges SECP to materialise its Recommendations

Karachi Tax Bar Association (KTBA) has urged the Security and Exchange Commission of Pakistan (SECP) to materialise its recommendations to make the corporate laws more meaningful and relevant in the light of best practices.

In a statement issued here on the other day.

The KTBA said that several issues were raised by the participants at a workshop on corporate laws, which was organised in collaboration with SECP on December, 10 2011.

These issues, which were also presented before chairman SECP during his presence at the concluding session of the workshop, are as follow:

---- As per the instruction of Ministry of Interior regarding the foreign Director or shareholder of company the SECP will ensure the timely clearance of the foreigner.

---- In the Ordinance it is not clear that how a company as a shareholder can nominate a person as a director on its behalf in the board of directors of the company.

The Companies Ordinance should allow increase in number of directors before the election of directors.

---- There must be provision in the Companies Ordinance for the conversion of Public Company into NPO u/s 42.

---- Condition should be waived for members to deposit the money in case of Non-Profit Association u/s.

42 of the Companies Ordinance, 1984.

---- Rationalise of penal provisions in case of Non-Profit Association.

---- The Provision for unpaid shares/uncalled shares be omitted from Companies Ordinance as the urgent is only for fully paid up is operative.

---- Make easy exit scheme permanent part of Ordinance for inactive companies.

---- Provision shall be inserted for refund of fee wrongly deposited.

---- SECP should negotiate with FBR the rate of tax in case of single member company and small companies from the prescribed rate of AOP and threshold to become withholding agent should be at par with AOP.

---- The Dispute Resolution mechanism should be inserted under the Companies Ordinance to minimise the litigation.

In view of these recommendations, the KTBA has requested to the authority to ponder the same at earliest with the aim to address the problems being faced by the corporate sector. – *Courtsy Business Recorder.*

Additional identification types allowed for taxpayers

In order to facilitate withholding agents in electronic submission of withholding tax statements, the Federal Board of Revenue (FBR) has allowed additional identification types for the taxpayers which were earlier restricted to the National Tax Numbers (NTNs) and computerised national identity card numbers (CNICs).

It is learnt here on Thursday that now the new types of identification of taxpayers have been allowed including Free Tax Numbers (FTNs), central depository company (CDC) number, bank account number, telephone/mobile number, passport number etc.

These identification types have been allowed in addition to the NTN/CNIC in the withholding tax statements under special situations.

Sources said that a number of withholding agents were not able to file their withholding tax statements electronically due to non-availability of CNIC/NTN of the taxpayers especially in cases of dividend payment, profit on debt, non-resident persons etc.

Now, with the additional identification allowed by the FBR, the withholding agents would be able to timely file their statements and discharge their tax liability.

It is a major step of the FBR to facilitate the withholding agents for proper filing of statements.

Due to additional identification numbers, the taxpayers have been facilitated to ensure compliance.

Sources said that the agents are liable to file withholding tax statements under section 165 of the Income Tax Ordinance 2001.

The withholding tax statements can be prepared and submitted in any of the following modes ie Online Data Entry, Excel Based File attachment and .

Mixture of Online and Excel based.

In case of online data entry, the checks and performed in live mode and associated messages are displayed accordingly.

However, for preparing data of withholding tax statements in Excel format, the data should be provided in accordance with the FBR's instructions.

The data of withholding tax statements included taxpayer's ID type; taxpayer's NTN/FTN; taxpayer's CNIC; passport number; taxpayer's name; taxpayer's address; payment nature; payment

S.R.O. 1098(I)/2011, Islamabad, the 16th December, 2011.– In exercise of the powers conferred by sub-section (5) of section 18 of the Customs Act, 1969 (IV of 1969), the Federal Government is pleased to direct that the following further amendment shall be made in its Notification No. S.R.O. 693(I)/2006, dated the 1st July, 2006, namely:–

In the aforesaid Notification, after the TABLE, the following proviso shall be added, namely,–

> "Provided that in line with Auto Industry Investment Policy (AIIP) of the Auto Industry Development Programme (AIDP) approved by the Economic Coordination Committee (ECC) of the Cabinet in Case No.ECC-168/13/2007 dated 13.11.2007, the additional customs-duty leviable under this notification shall not be charged on sub-components and components, imported in any kit form by an assembler or manufacturer declared to be a new entrant by the Engineering Development Board (EDB) for the vehicles specified in the said Table for a period of three years from the start of assembly or manufacturing of respective vehicles, subject to following conditions, namely:–
>
> (i) the new entrant assembler or manufacturers shall chalk out a plan for progressive manufacturing of the vehicles spreading over a maximum period of three years within which he shall catch up with the localization or indigenization level of respective vehicles, as approved by Auto Industry Development Committee (AIDC) of the EDB;
>
> (ii) the continued non-levy of said additional customs-duty shall be contingent upon the achievement of progressive annual indigenization as determined by AIDC of the EDB. In case of any material deviation by the new entrant, the AIDC shall determine the stoppage or withdrawal of the incentive of non-levy of said additional customs-duty, allowed as such, retrospectively;
>
> (iii) the new entrant shall abide by all the terms and conditions laid down in the separate notifications issued by the Ministry of Industries and FBR for assembly or manufacturing of the said vehicles under Auto Industry Development Programme (AIDP) and Tariff Based System (TBS);
>
> (iv) the additional customs duty shall be levied on the sub-components and components which become indigenized by the New Entrant assembler or manufacturers, in accordance with the said plan for progressive manufacturing; and
>
> (v) the term "new entrant" shall bear the same meaning as declared or notified by the Ministry of Industries."

2011 PTR 1565 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "J" BENCH, MUMBAI

Pramod Kumar, Accountant Member and Vijay Pal Rao, Judicial Member

FACTS/HELD

1. **S. 263: AO's acceptance of Jurisdictional High Court view may be "erroneous & prejudicial" to interests of Revenue**
2. The AO passed an assessment order on 24.3.2006 in which he allowed deduction u/s 80HHF without setting off the brought forward losses. The CIT passed a revision order u/s 263 on 19.10.2007 in which he claimed that the loss had to be set-off in terms of the judgement dated 11.3.2004 of the Supreme Court in **IPCA Laboratories** 266 ITR 521. The assessee claimed that the action of the AO was in line with the judgement dated 24.7.2000 of the Bombay High Court in **Shirke Construction** 246 ITR 429 which held the field till it was overruled on 17.5.2007 (291 ITR 380 (SC)). It was pointed out that even after the SC ruling in **IPCA**, there were Tribunal judgements (**Infocon International** 2 SOT 444) which had followed **Shirke Construction** and held that s. 80HHF deduction was available without set-off of the losses. It was argued that (i) the law prevailing on the date of the assessment order had to be seen as per **G. M. Stainless Steel** 263 ITR 255 (SC) and in any event (ii) there were two views possible and the AO's view could not be termed erroneous as per **Malabar Industrial** 243 ITR 83 (SC). HELD by the Tribunal upholding the revision:

   (i) For the purpose of examining validity of revision proceedings, **the legal position prevailing at the time the revision powers are exercised by the CIT has to be seen** and not the position prevailing at the time the assessment order was passed. In **G.M. Stainless Steel** 263 ITR 255 (SC) the law at the date of assessment and the date of revision was the same though it was made clear that the law at the date of revision had to be seen (**Max India Ltd** 295 ITR 282 (SC) followed);

(ii) The argument that the AO's view was a "possible view" and therefore revision is not permissible as per **Malabar Industrial Co** is not acceptable because the AO's view should not only be "possible view" but also a view which is not "unsustainable in law". **A view contrary to the law laid down by the Supreme Court is unsustainable in law even though it may have been a "possible view" at the stage of passing the assessment order;**

(iii) The argument that the AO was bound to follow the jurisdictional High Court's order in **Shirke Construction** 246 ITR 429 till it was overruled is not acceptable because the AO, being part of the revenue machinery, should follow judicial decisions as long as he can do so without sacrificing the legitimate interests of the revenue. **If the AO does not raise demands on issues which have been decided in favour of the assessee by the jurisdictional High Court, even though the department is in appeal against the same, the interests of the revenue will be prejudiced and remain unprotected**. While the AO is bound by the higher judicial authorities and has to loyally execute the directions contained in those orders, he is not prevented from taking the same stand, as he took in those assessments though he cannot collect the demand.

Order accordingly.

ITA Nos. 7476/Mum/07 and 3201/Mum/10 (Assessment year: 2003-04) and ITA No. 3315/Mum/2010 (Assessment year 2003-04).

Heard on: 14th November, 2011.

Decided on: 30th November, 2011.

Present at hearing: Porus F Kaka, along with Divesh Chawla, for Appellant. Kusum Ingle, for Respondent in ITA Nos. 7476/Mum/07 and 3201/Mum/10 (Assessment year: 2003-04). Kusum Ingle, for Appellant. Porus F Kaka, along with Divesh Chawla, for Respondent in ITA No. 3315/Mum/2010 (Assessment year 2003-04).

JUDGMENT

Per Pramod Kumar:– (Accountant Member)

1. These three pertain to the same assessee. While in one appeal, the assessee has challenged correctness of the revision order dated 19th October 2007, passed by the learned CIT under section 263 r.w.s. 143(3)

of the Income Tax Act, 1961 for the assessment year 2003-04, the remaining two appeals are cross appeals against CIT(A)'s appellate order in the matter of assessment framed to give effect to learned CIT's revision order. As these appeals involve somewhat interconnected issues arising out of common set of facts and as these three appeals were heard together, al l the three appeals are being disposed of by way of this consolidated order.

2. We will first take up assessee's appeal against the revision order i.e. ITA No 7476/Mum/07.

3. While the assessee has raised as many as eleven grounds of appeal, the main grievances pressed before us pertain to CIT(A)'s initiating the revision proceedings (i) in respect of set of f of loss from eligible profits of business for the purpose of computing deduction under section 80 HHF of the Act , and thus denying deduction under section 80 HHF amounting to Rs 9,51,70,949; (ii) in respect of deductibility of expenses incurred in foreign currency from export turnover and total turnover, for the purpose of computing deduction under section 80 HHF of the Act; and (iii) in respect of al lowability of bad debts as a deduction.

4. To adjudicate on this appeal, only a few material facts need to be taken note of. The assessee is mainly engaged in the business of producing and procuring television programs and films/film rights for supplying the same to Star Group Limited and other overseas media companies. The assessee also carries on channel subscription business and acts as marketing agents for, and renders services to, Star Group Limited and other overseas media companies. Its assessment under section 143(3) of the Income Tax Act, 1961 was finalized by the Assessing Officer on 24th March 2006. However, on subsequently perusing the assessment records, the Commissioner was of the view that the assessment so framed was erroneous, insofar as it was prejudicial to the interest of the revenue, *inter alia* in respect of al lowing deduction under section 80 HHF before al lowing set of f of losses carried forward from earlier years. The view of the Commissioner was that , in view of Hon'ble Supreme Court 's decision in the case of *IPCA Laboratories Ltd Vs. DCIT* (266 ITR 521), which was available to the Assessing Officer at the point of time when assessment was finalized, as it was delivered before the date the assessment was finalized. While computing the deduction under section 80 HHF, the Assessing Officer had not taken into account the brought forward business loss. The view of the Commissioner was that this action was incorrect and contrary to the law laid down by Hon'ble Supreme Court in IPCA's case (supra), and that the Assessing Officer ought to have reduced the brought forward business losses before computing the deduction under section 80 HHF. In the course of the proceedings before the Commissioner, it was explained by the assessee that IPCA decision is not applicable on

the facts of this case inasmuch as the loss is not incurred in the business in the same year in some other activity, and is a brought forward business loss. It was explained that in respect of brought forward business losses, in view of Hon'ble Bombay High Court's judgment in the case of *CIT Vs Shirke Construction Equipment Ltd* (246 ITR 429) held field at the relevant point of time, and, for this reason, action of the Assessing Officer could not be said to be erroneous. I t was also pointed out that an assessment framed on the basis of legally binding decision of Hon'ble jurisdictional High Court could not be said to be erroneous. None of these submissions, however, impressed the Commissioner. He noted that Hon'ble Supreme Court had reversed the Shrike Equipment decision (supra) in the case reported as *CIT Vs Shrike Construction Equipment Ltd* (291 ITR 380) and held that deduction under section 80 HHC has to be al lowed only after set of f of earlier year losses. Learned Commissioner observed that "the decision of IPCA Laboratories, which again is a Supreme Court decision, when the AO passed the original assessment order, and, therefore, the order passed by the AO is both erroneous and prejudicial to the interest of the revenue on the issue of brought forward loss/ set of f of loss before al lowing the deduction under section 80 HHC". Learned Commissioner further noted that in IPCA's case "Supreme Court has held that deduction under section 80 HHC is to be al lowed after set of f of brought forward loss of earlier years", and also referred to Hon'ble MP High Court 's decision in the case of *Vippy Solvex Products Ltd Vs CIT* (273 ITR 107). With these observations, learned Commissioner rejected submissions of the assessee on this issue.

5. The next point which learned Commissioner picked up for revision proceedings, and which is being challenged before us now, was raised by the Commissioner during the course of the revision proceedings. Vide letter dated 24th September, 2007, learned Commissioner issued the show cause notice requiring the assessee to show cause as to why the assessment not be subjected to revision under section 263 on this point as well, and stated as follows:

> **In addition to the points covered by this of f ice letter of even no. dated 18.7.2006, the assessment order is considered erroneous insofar as it is prejudicial to the interest of the revenue on the following point also:**
>
> > **Perusal of the records indicate that while al lowing deduction under section 80 HHF of the Income Tax Act , the expenses incurred in foreign currency f or providing technical services outside India have not been reduced from export turnover and total turnover. The assessee has claimed expenses incurred in foreign currency in respect of advertisement/ licence fees, travel etc in foreign currency. In view of**

> **the specific definition of total turnover and export turnover given in Explanation below Section 80 HHF(6) – Explanations (c) and (j). The amount of expenditure incurred in foreign currency on this account is Rs. 18,01,10,000.**
>
> **Since the Assessing Officer has al lowed deduction under section 80 HHF in excess by Rs 22,04,96,097 due to ignoring such expenses in foreign currency, the order passed by the AO on this issue is also considered erroneous insofar as it is prejudicial to the interest of the revenue.**

6. In response to this show cause notice, it was *inter alia* submitted by the assessee that no income has been earned by providing technical services such as dubbing, post production, technical consultancy services etc, and that it has not incurred any expenditure in foreign currency for providing technical services outside India. It was also submitted that none of the expenditure incurred in foreign currency are expenditure in providing technical services outside India. It was also pointed out that "out of total expenditure in foreign currency of Rs 1,800,110,000 as stated in your notice, majority of the expenditure incurred is in relation to licence fees paid by SIPL (i.e. the assessee) amounting to Rs 1,762,898,000, which is relation to distribution business and not export business". Learned Commissioner's attention was also invited to note 19(d) of the financial statements to support the submission of the assessee. While learned Commissioner did not reject these submissions, he did not deal with the submissions either. He simply proceeded to exercise revision powers in respect of this issue either and held as follows:

> **On the last issue of expenditure in the foreign currency amounting to Rs 18,01,10,000 also, the AO will examine the applicability of provisions of Explanation c and j below Section 80 HHF(6) of the Income Tax Act . The export turnover and total turnover will be worked out after making adjustments as provided in Explanations c and j referred to above. Deduction under section 80 HHF will be worked out accordingly after al lowing the opportunity to the assessee.**

7. The third issue on which the assessment order was subjected to revision and which is challenged in this appeal is in respect of bad debts. The short reason for which the assessment was subjected to revision proceedings in respect of the Assessing Officer having allowed the bad debts was that "the assessee's claim of bad debt of Rs 13.82 crores was al lowed without making any enquiry into the circumstances leading to the write off" and that "the bad debt in respect of foreign exchange to be received was al lowed without proper inquiries". However, learned

representatives fairly agree that in view of Hon'ble Supreme Court in the case of *TRF Ltd Vs CIT* (323 ITR 397), it is no longer necessary for the assessee to establish that the debt has actually become unrecoverable and as long as the assessee has actually written of f the debt in the books of accounts, and upon fulfillment of other necessary preconditions – which are not subject matter of dispute before us anyway, the assessee is entitled to deduction in respect of the same. In this view of the matter, and for the reasons we will set out in a short while, it is not really necessary to go any deeper into the details so far as this issue is concerned. There were as well certain other issues in the impugned revision order, but learned counsel for the assessee has not disputed the same so far as challenge to revision proceedings is concerned. We, therefore, need not deal with the same. Aggrieved, *inter alia*, by the revision proceedings in respect of the above issues, the assessee is in appeal before us.

8. As far as issue in appeal, i.e. (i) in respect of set off of loss from eligible profits of business for the purpose of computing deduction under section 80 HHF of the Act , is concerned, the main plank of learned counsel 's argument is that what is to be considered, in the context of examining legality of revision proceedings, is the law prevailing as on the time of passing the revision order, and that , the law in view of the legal position as it stood at that point of time, it was a possible view of the matter that the deduction of Section 80 HHF is to be computed before al lowing the set of f of brought forward losses. Learned counsel points out that the judgment dated 24th July 2000 passed by Hon'ble jurisdictional High Court in the case of *CIT Vs Shrike Construction Equipment Ltd* (246 ITR 429) held field till 17th May 2007 when it was reversed by Hon'ble Supreme Court by judgment of the said date in the case of *CIT Vs Shirke Construction Equipment Ltd* (291 ITR 380). Learned counsel the points out that while Hon'ble Supreme Court 's decision in the case of *IPCA Laboratories Ltd Vs. DCIT* (266 ITR 521), was indeed delivered on a date earlier than the date on which assessment under section 143(3) was finalized on 24th March 2006, i.e. on 11th March 2004, but then there are decisions of the coordinate benches of this Tribunal to the effect that even after the IPCA decision (supra), Shrike Equipment decision (supra) by Hon'ble Bombay High Court held the field. Our attention is invited to this Tribunal's decision in the case of *JCIT Vs Infocon International Ltd* (2 SOT 444). In other words, even after IPCA decision, the view taken by the Assessing Officer, on this issue, could not be said to not a possible view of the matter. Not only this was a possible view of the matter, it was a view held by this Tribunal. It is submitted that the Assessing Officer cannot be said to be in error in taking the same view as was taken by a coordinate bench of this Tribunal, and the view taken by the coordinate bench of this Tribunal was that even post IPCA decision by Supreme Court, *Shirke Equipment* decision of Hon'ble Bombay High Court held

good in law. Learned counsel then fairly accepts that *Shrike Equipment decision* by Hon'ble Bombay High Court has since been disapproved by Hon'ble Supreme Court on 17th May 2007, but then this event took place much after the assessment order was framed. He, however, hastens to add that what is to be seen for the purpose of exercise of powers under section 263 is the law as it stood at the point of time when assessment was framed. In support of this legal plea, learned counsel relies upon the judgment of Hon'ble Supreme Court in the case of *CIT Vs G M Stainless Steel Pvt Ltd* (263 ITR 255) wherein it is held that "……Given the fact that the decision of the jurisdictional High Court was operative at the material time, the AO could not be said to have erred in law" and that "…The fact that this Court had subsequently reversed the decision of the High Court would not justify the CIT in treating the AO's decision as erroneous. The power of the CIT under s. 263 of the IT Act must be exercised on the basis of the material that was available to him when he exercised the power…". Learned counsel also took us through related judgments and tried to canvass the view that the issue before Hon'ble Bombay High Court in Shirke's case was altogether different and IPCA decision did not touch upon the same. In support of this distinction, he heavily relied upon the observations made by a coordinate bench in Infocon's case (supra), and made elaborate arguments on the actual issues which came up for consideration in these cases and how they were materially different. He, however, fairly accepted that this aspect of the matter is somewhat academic because the judgment of Hon'ble Supreme Court is binding anyway. Learned counsel then referred to Hon'ble Supreme Court 's judgment in the case of *CIT Vs Max India Ltd* (295 ITR 282) in support of the proposition that when two views on a legal issue are possible, and the Assessing Officer one of these views, Commissioner cannot substitute such views of the AO by his views. Learned counsel then contends that in any case the Assessing Officer was under an obligation to follow the law laid down by Hon'ble jurisdictional High Court, and he cannot, therefore, said to be in error when he does so. He, however, did not elaborate this point further because he felt deserves to succeed on other grounds only. Learned counsel submits that without going into the correctness of views, as long as the view held by the Assessing Officer can be said to be a possible view of the matter, and it should be held to be a possible view of the matter for the short reason that Tribunal too held this view in Infocon's case (supra), revision powers cannot be exercised in respect of the same. Learned counsel then points out that in the present case, the assessee was al l along a profit making company and the losses brought forward are not assessee's losses but that of another company as a result of demerger exercise. These losses, according to the learned counsel, can never form part of the computation of income, but have been taken into account in view of the provisions of Section 72. A reference is once again made to Infcon decision in support of the

contention that not al l types of brought forward losses are to be considered for the purpose of granting deduction. On the strength of these arguments, learned counsel urges to quash the impugned order on this point. Learned Departmental Representative, on the other hand, submits that IPCA decision was admittedly available to the Assessing Officer, and as a plain reading of the IPCA decision would show, post the stand so taken by Hon'ble Supreme Court, Shrike Equipment decision by Hon'ble Bombay High Court did not hold good law. It is also submitted than that all that Shirke Supreme Court decision does is to hold that in view of IPCA decision by Hon'ble Supreme Court, Shrike Equipment decision by Hon'ble Bombay High Court is no longer good law. In such a situation, according to the learned Departmental Representative, it could not be said that Bombay High Court's judgment in Shirke's case continued to be good law post IPCA decision. Learned counsel then submitted that the present revision order was not a frivolous revision order as evident from the fact that the assessee himself has conceded on some of the points. Once it is found that the revision order is sustainable in law at least on some grounds, we should not quash the same in respect of other parts also. It is a case in which revision was validly done, and we need not restrict the scope of the revision order. It is further submitted that in any event al l that the Commissioner has said that the Assessing Officer should examine the matter in accordance with the law, and there cannot be any infirmity in directions to follow the law of the land. Learned Departmental Representative then took us through the revision order passed by the Commissioner and vehemently relied upon the same. In his brief rejoinder, learned counsel reiterated his contentions. He also submitted that , unlike in the case of reassessment proceedings under section 147, in which once assessment is held to be validly reopened on any ground, the Assessing Officer can pick up any of the issues even though the reassessment may not have been reopened on that point , the revision proceedings are issue specific.

9. In our considered view, for the purpose of examining validity of revision proceedings, what we really need to examine is the legal position prevailing as on the time when revision powers are exercised by the Commissioner. In the case of Max India Ltd (supra), Hon'ble Supreme Court has said that , **"......we have to take into account the position of law as it stood at the point of time when CIT passed the order dated 5th March 1997 in purported exercise of his powers under section 263 of the Act.......".** In the case of GM Stainless Steel, on which so much of reliance is placed, the legal position as at the point of time when assessment order was finalized and as at the point of time when revision order was passed was materially the same, and the legal developments took place in between the time when revision order was passed and matter travel led in appeal before Their Lordships. However, so far as the crucial point of time on which legal position was to be

examined, it is clear that the relevant point of time is when the Commissioner exercised the power and not when the Assessing Officer passed the order, as Their Lordships have observed that "**.......The power of the CIT under s. 263 of the IT Act must be exercised on the basis of the material that was available to him when he exercised the power. At that time, there was no dispute that the issue whether the power subsidy should be treated as capital receipt had been concluded against the Revenue. The satisfaction of the CIT, therefore, was based on no material either legal or f actual which would have given him the jurisdiction to take action under s. 263 of the IT Act..........**". It is also specifically provided in the statute itself that the expression 'records' , for the purpose of Section 263, is deemed to include "al l records under any proceedings under this Act available at the time of examination by the Commissioner". It is, therefore, futile to suggest that legal decisions available at the point of time when Commissioner is examining the matter for exercise of powers under section 163 can be ignored. As regards learned counsel's reliance on this Tribunal's order in the case of *Gajendra Kumar T Agarwal Vs Income Tax Officer* (11 ITR Trib 640), that once again was a situation in which there was no material difference in the legal position between the points of time when assessment was finalized and the revision order was passed. As a matter of fact, the issue was decided, on merits, in favour of the assessee, and then it was held that, notwithstanding the decision on merits in favour of the assessee, it could not have been a f it case for revision proceedings for the reason that the view adopted by the Assessing Officer was at least a possible view of the matter. The sentence relied upon by the learned counsel, on these facts, was on altogether different facts, and, in any event, it was no more than an *obiter* which has at best a persuasive value. However, the wordings of Hon'ble Supreme Court are clear and admit no ambiguity, and the law so laid down by Hon'ble Supreme Court binds us under Article 141 of the Constitution of India. What is to be seen is the legal position prevailing as on the point of time when revision order is passed. It is, therefore, wholly immaterial as to what was the legal position as at the point of time when the assessment was framed – particularly when there is significant difference in the legal position between the point of time when assessment is framed and when it is revised. A lot of emphasis has then been placed on the suggestion that the view adopted by the Assessing Officer was a possible view of the matter, as the same view was taken by a coordinate bench of this Tribunal in Infocon's case (supra), and, as an analysis of the related decisions, would unambiguously show. We see no merits in this plea either. In the case of Max India (supra), Hon'ble Supreme Court has observed as follows:

> **"At this stage, we may clarify that in the case of Malabar Industrial Co. Ltd. (supra) this Court has taken the view that the phrase "prejudicial to the interest of the**

> **Revenue" under s. 263 has to be read in conjunction with the expression "erroneous" order passed by the AO. Every loss of revenue as a consequence of an order of the AO cannot be treated as prejudicial to the interest of the Revenue. For example, when the ITO adopted one of the courses permissible in law and it has resulted in loss of revenue; or where two views are possible and the ITO has taken one view with which the CIT does not agree, it cannot be treated as an erroneous order prejudicial to the interest of the Revenue, unless the view taken by the ITO is unsustainable in law"**

(Emphasis by underlining supplied by us)

10. The view taken by the Assessing Officer, therefore, need not only be a possible view of the matter but also a view which is not "unsustainable in law". A view which is clearly unsustainable in law, in our humble understanding, will include a view which is contrary to the law laid down by Hon'ble Supreme Court. Therefore, the view taken by the Assessing Officer, even though it may be a possible view of the matter at the point of time when the assessment order was passed, cannot be said to be a view which Commissioner cannot disturb in the revision proceedings.

11. As regards learned counsel's rather plea that the Assessing Officer was bound to follow Hon'ble Jurisdictional High Court judgment as long as the said judgment is not specifically overruled, we find no merits in this plea either. Learned counsel did not elaborate upon his arguments and we donot, therefore, have the benefit of his analysis of legal position. As we understand, an Assessing Officer is part of revenue machinery, even though his job involves exercise of certain quasi - judicial powers, and decisions of the appellate forums, in general, do not prevent him from raising demands on those issues, unless these decisions are accepted by the revenue. No doubt, the Assessing Officer should follow the judicial decisions as long as he can do so without sacrificing the legitimate interests of the revenue, but we cannot visualize a situation in which his not raising demands on those issues will not affect the interests of revenue. In case the Assessing Officer does not raise the demands on the issues which have been decided in favour of the assessee by jurisdictional High Court, even though the income tax department is in appeal against the same, interests of the revenue will be clearly prejudiced and remain unprotected. The orders of the higher judicial authorities bind the Assessing Officer to the extent that he is required to loyally execute the directions contained in these orders, but then these orders donot prevent him from taking the same stand, as he took in those assessments, in other cases; quite to the contrary, his abandoning that stand in other cases could prejudice his stand in the matters which are in appeal before the higher appellate

authorities. The only difference these judicial decisions, which are decided in favour of the assessee and are in challenge before higher authorities, make to the other cases is that, in terms of the guidelines issued by the Central Board of Direct Taxes, the Assessing Officer may not collect demands on those issues till these demands are examined by the appellant authorities, which are, being part of the judicial machinery, anyway bound by those decisions. In terms of the CBDT guidelines, stay is normally granted by the Assessing Officer "(a) if the demand in dispute relates to issues that have been decided in assessee's favour by an appellate authority or Court earlier; or (b) if the demand in dispute has arisen because the Assessing Officer had adopted an interpretation of law in respect of which there exist conflicting decisions of one or more High Courts (not of the High Court under whose jurisdiction the Assessing Officer is working); or (c) if the High Court having jurisdiction has adopted a contrary interpretation but the Department has not accepted that judgment". It will, however, be stretching the things too far to suggest that the Assessing Officer should not raise demands on those issues at all, because it will result in a situation that in the assessments so framed, tax revenues in respect of an issue on which revenue is vigorously justifying its earlier stand before the higher judicial authorities, will be lost forever. The position of the Assessing Officer is very different from a judicial or even quasi - judicial authority; he is not only an adjudicator but also an investigator and it is also his duty to defend legitimate interests of the revenue. Merely because another demand raised on the same issue has not been approved by a judicial body, as long as the decision of that judicial body is in challenge before the higher judicial authority, does not prevent the Assessing Officer from raising demands on those issues in the cases of other taxpayers, even though, as we have seen earlier, he may not be in a position to enforce recovery of tax demands in such cases. We, therefore, see no merits in this plea of the assessee either.

12. In view of the reasons set out above, we uphold the action of the Commissioner in invoking his revision powers in respect of in respect of set off of loss from eligible profits of business for the purpose of computing deduction under section 80 HHF of the Act.

13. As regards the second issue, i.e. in respect of deductibility of expenses incurred in foreign currency from export turnover and total turnover, for the purpose of computing deduction under section 80 HHF of the Act , we find that it has been a categorical stand of the assessee before the CIT that no income has been earned by providing technical services such as dubbing, post production, technical consultancy services etc, and that the assessee has not incurred any expenditure in foreign currency for providing technical services outside India. There are no findings by the CIT to the effect that any of these contentions are incorrect. We have also noted that while it

was pointed out to the CIT that "out of total expenditure in foreign currency of Rs 1,800,110,000 as stated in your notice, majority of the expenditure incurred is in relation to licence fees paid by SIPL (i.e. the assessee) amounting to Rs 1,762,898,000, which is relation to distribution business and not export business", learned Commissioner has not disputed this aspect of the matter either. However, he proceeds to simply brush aside all these contentions and proceeds to direct the Assessing Officer to **"examine the applicability of provisions of Explanation c and j below Section 80 HHF(6) of the Income Tax Act"**. While revision proceedings were initiated on the ground that these expenses were inadmissible, the revision order has been passed with a direction to the Assessing Officer that he should look into the applicability of Explanation c and j below Section 80 HHF, without there being any finding that these provisions can be invoked at all. Learned Commissioner has not rejected the submissions of the assessee on merits and yet al lowed the Assessing Officer to reexamine the matter. The show cause notice is issued on the ground that the computation is incorrect but the revision is exercised on the ground that the matter was not examined on merits. As to whether such an action can be upheld, we find guidance from a decision of a coordinate bench in the case of *Synergy Enterprenuer Solutions Pvt Ltd Vs DCIT* (ITA No 3076/Mum/10; order dated 31.3.2011). The reason which can be inferred from the revision order under section 263 (that the AO has not verified the issue) is different from the reason set out in the show cause notice (that such expenses cannot be al lowed). If a ground of revision is not mentioned in the show-cause notice, it cannot be made the basis of the order for the reason that the assessee would have had no opportunity to meet the point. We also find guidance from a coordinate bench decision in the case of *Maxpack Investments* 13 SOT 67 (Del), by Hon'ble AP High Court decision in the case of *CIT Vs G.K. Kabra* 211 ITR 336 and of Hon'ble P & H High Court decision in the case of *CIT Vs Jagadhri Electric Supply* (140 ITR 490). For this short reason, therefore, the revision proceedings are not legally sustainable on this issue, i.e. the notice is issued on the ground of inadmissibility of deduction, and the revision is done on the ground that the matter needs to examined even as there are no findings about shortcomings in the proceedings before the Assessing Officer. In any case, the CIT has not given any findings against the assessee at all and yet he has proceeded to direct the Assessing Officer to examine the issue again. Unless the CIT points out any defect in the stand of the Assessing Officer, it cannot be open to him to exercise the revision powers. Such defects cannot be assumed or inferred. As held by Hon'ble Bombay High Court in the case of *CIT Vs Gabriel India Ltd* (203 ITR 108), unless Commissioner points out specific defects in the order of the Assessing Officer, he can not simply proceed to direct the Assessing Officer to reexamine the matter. No

such defects have been pointed out in the impugned order. In this view of the matter, we see merits in the plea of the assessee on this issue and hold that revision of order, on this issue, was not justified.

14. We, therefore, quash the reassessment proceedings on the second issue, i.e. in respect of deductibility of expenses incurred in foreign currency from export turnover and total turnover, for the purpose of computing deduction under section 80 HHF of the Act. To this extent, the appellant indeed deserves to succeed.

15. As regards third issue which is agitated in appeal before us, i.e. in respect of allowability of bad debts as a deduction, learned representatives have fairly agreed that the issue is covered in favour of the assessee by Hon'ble Supreme Court's judgment in the case of *TRF Ltd* (supra). In this view of the matter, we vacate the revision order in respect of this issue as well.

16. In the result, ITA No. 7476/Mum/09, i.e. appeal against the revision order, is partly al lowed in the terms indicated above.

17. We now take up ITA No. 3201/Mum/2010, i.e. assessee's appeal against CIT(A)'s order dated 12th February 2010, in the matter of assessment under section 143(3) r.w.s. 263, for the assessment year 2003-04.

18. The only grievance raised in this appeal is against CIT(A)'s denying the deduction under section 80 HHF on the ground that brought forward loss of earlier years is required to be set of f from the eligible profits of the business.

19. Learned counsel for the assessee fairly admits that the issue is covered against him, on merits, by Hon'ble Supreme Court's judgment in the case of *Shrike Construction Equipment* (supra). His defence, however, is that since the CIT could not have subjected this deduction to the revisions proceedings, which are separately challenged in another appeal, the deduction cannot be disturbed in the impugned proceedings. As we have dismissed this challenge to the revision proceedings earlier in this order, that defence is not sustainable in law either. Learned Departmental Representative, on the other hand, submits that the issue being covered against the assessee by Hon'ble Supreme Court judgment in Shirke's case (supra), the grievance has no legally sustainable in merits.

20. In view of the above discussions, we see no merits in assessee's grievance. The challenge to revision proceedings on this issue has already been rejected, and, on merits, the issue is covered against the assessee by Hon'ble Supreme Court judgment in Shirke's case (supra). We, therefore, approve the conclusion arrived at by the CIT(A) and decline to interfere in the matter.

21. In the result, ITA No. 3201/Mum/10 is dismissed.

22. We now take up ITA No. 3315/Mum/2010.

23. Learned representatives fairly agree that the first four grounds of appeal, which deal with different facets of bad debts disallowance of Rs 13.82 crores, are now covered in favour of the assessee by Hon'ble Supreme Court's decision in the case of TRF Ltd (supra). In our order on assessee's challenge to revision proceedings on this issue, we have already upheld assessee's contentions on the issue of validity of revision proceedings and thus quashed the revision order to that extent. The quantum additions in respect of the said issue cannot, therefore, survive. The CIT(A) was, even on merits, justified in deleting the impugned addition.

24. Ground Nos. 1 to 4 are thus dismissed.

25. In the fourth ground of appeal, the Assessing Officer is aggrieved that the CIT(A) erred in deleting the addition of Rs 8,87,400.

26. The subject addition was made by the Assessing Officer on the ground that there was nothing on record to suggest that the said income was already taxed in an earlier assessment year. In the proceedings before the CIT(A), however, this aspect has been examined and it is found that this income has already been offered to tax in this assessment year itself. The addition is deleted on the short ground that if this taxability is upheld, it will amount to the same income being taxed twice. The Assessing Officer is aggrieved and is in appeal before us.

27. Learned Departmental Representative rather dutifully relies on the order of the Assessing Officer and does not really dispute that the said income has already been offered to tax in this very assessment year itself. There is thus no question of evidence of its having been taxed in an earlier year. When relevant entries were explained by the learned counsel, learned DR did not have much to say except to place reliance on the order of the Assessing Officer.

28. In view of the above discussions, as also bearing in mind the fact that the said income has already been offered to, and brought to, tax in this assessment year separately, we see no merits in grievance of the Assessing Officer. We approve the action of the CIT(A) and decline to interfere in the matter.

29. In the result, ITA No. 3315/Mum/2010 is dismissed.

30. To sum up, while ITA No. 7476/Mum/2007 is partly allowed, the ITA Nos. 3201/Mum/2010 and ITA No. 3315/Mum/2010 are dismissed.

Pronounced in the open court today on 30th day of November, 2011.

2011 PTR 1579 (H.C. Del.)

HIGH COURT OF NEW DELHI

Acting Chief Justice and Siddharth Mridul, J.

CIT
v.
Sumangal Overseas Ltd.

FACTS/HELD

1. **S. 271(1)(c): Despite conceding "bad debts", assessee can raise new plea of "trading loss"**
2. The assessee gave advances to its suppliers of which Rs. 2.05 crores was written off as "bad debts". The AO disallowed the claim on the ground that as the advances had never been treated as income, the conditions of s. 36(1)(vii) & 36(2) were not satisfied. The assessee accepted the disallowance. Penalty u/s 271(1)(c) was levied by relying on **Escort Finance** 328 ITR 44 (Del) on the ground that in the case of a corporate assessee whose accounts were duly audited by qualified Chartered Accounts, the claim of bona fide mistake is untenable. However, the Tribunal deleted the penalty on the ground that the write off, though not admissible as "bad debts" was allowable as a "trading loss". On appeal by the department, HELD dismissing the appeal:

   In penalty proceedings, it has to be seen whether the claim was bona fide or it was bogus and result of falsehood. On facts, there was no dispute on the genuineness of the advances. **A trading loss has a wider connotation than a bad debt. While a bad debt may also be a trading loss, a trading loss need not necessarily be a bad debt. A bad debt may not fall within the purview of s. 36(1)(vii) but may well be regarded as being eligible for deduction as being a "trading loss"**. Accordingly, the claim was neither mala fide nor false but was bona fide and made after disclosure

of facts (**CIT vs. Reliance Petroproducts** 322 ITR 158 (SC) followed).

Appeal dismissed.

ITA No. 174 of 2011.

Heard on: 13th October, 2011.

Decided on: 18th November, 2011.

Present at hearing: Sanjeev Sabharwal, Sr. Standing Counsel, for Appellant. Ved Jain, Advocate, for Respondent.

JUDGMENT

A.K. Sikri, Acting Chief Justice.–

1. Penalty of Rs.73,85,322/- imposed upon the respondent assessee by the Assessing Officer (AO) under Section 271(1)(c) of the Income Tax Act (hereinafter referred to as „the Act‟) was affirmed by the CIT (A). However, the Income Tax Appellate Tribunal („the Tribunal‟ for brevity) has reversed the view taken by the AO and the CIT (A) and deleted the said penalty. It is under these circumstances, present appeal is preferred by the Revenue questioning the wisdom of the Tribunal contained in its order dated 30.10.2009 and the appeal was admitted on the following substantial question of law:

> "Whether on the facts and in the circumstances of the case, the ITAT erred in law and on merits in deleting the penalty of Rs.73,85,322?- levied u/s 271(1)(c) of the Income Tax Act, 1961?"

2. The reason for initiating penalty proceedings was that the AO in the assessment order framed on 29.12.2006 in respect of assessment year 2004-05 held the view that the assessee had falsely claimed bad debts of Rs.2,05,86,262.75/-. The assessee had given various advances to its suppliers which amounts to Rs.2,89,56,836.75/-. Out of these amount, the aforesaid amount of Rs.2,05 Crores was written off as bad and doubtful advances. The AO took the view that the prerequisite conditions for writing off the amount as bad debts had not been satisfied, as it was included in the income of the previous year and therefore, there was no question of treating is as bad debts under provision of Section 36(1)(vii) and Section 36(2) of the Act. The assessee had not challenged the order of the AO.

3. In the penalty proceedings, the AO held that the aforesaid finding had become final and conclusive and it clearly reflected the falsity of claim preferred by the assessee.

4. The CIT(A) dismissed the appeal of the assessee by holding that undetection of the said claim, as 97% of the returns are not subjected to scrutiny, would have rendered such false claim to be untaxed. The claim on bad debts to be patently wrong and erroneous in law is manifest in the

conduct of the assessee in admitting the falsity of the claim and not preferring any further appeal. The CIT (A) observed that the assessee was a corporate whose accounts were duly audited by qualified Chartered Accounts and thus, the claim of *bona fide mistake*, due to lack of professional held is untenable on its very face. The CIT (A) rejected the claim of non-leviability of penalty on the ground that the assessment was a loss of Rs.76,61,830/- in view of the provisions of Explanation 4(a) to Section 271(1)(c) of the Act.

5. The Tribunal, however, while deleting the penalty has examined the matter from a different perspective altogether. It is observed that no doubt, the claim could not be written off as bad debt. At the same time, however, going by the nature of the transaction, viz., these were the loans and advances given by the assessee to the suppliers and were written off as unrecoverable, the same could have been allowed to be written off as business advance under Section 29 read with Section 37(1) of the Act, simply because the assessee made claim of deduction under a wrong head, viz., treating it as bad debt would not mean that the claim was false and therefore, penalty could not be imposed. This discussion is contained in the following paragraph of the Tribunal"s order:

> "8. We have heard the rival contentions and perused the material on record. It has not been disputed that assessee had filed its return of income accompanied with Schedule E of accounts making a claim of doubtful advances written off. AO himself had observed that loans and advances to suppliers have been shown in the books of account, therefore, the correct proposition was the allowability of claim of the assessee in respect of business advances written off will fall u/s 29 read with Section 37(1). AO, however, proposed the addition on the ground that the same was not allowable as "bad debt" since these advances were not included in income as income in earlier years. Assessee on the proposition of AO realized that they were not included as income in earlier years and were not allowable a bad debt, therefore, the same was offer to tax specifically on this ground. In our view, the decision of Hon"ble Delhi High Court in the case of Escort Finance (supra) is not applicable to assessee"s case as the same is applicable in the cases of allowances or claims, which are ex facie i.e. on the fact itself inadmissible. In this case, ex facie the assessee"s claim was of write off of advances and not of bad debt. AO proposed the disallowance and accepted by the assessee as non-allowable being bad debts. In our view, the learned counsel has made out a proper case that assessee"s specific claim was write off of business losses/advances which has not been examined at all. The learned counsel has relied on various case laws. In our view, the assessee had made proper disclosure of facts. The amount has

been disallowed not as business advance, which was the actual claim of assessee but the same has been disallowed as bad debt on an impression that it was not included in the income of all the earlier years whereas there is no said requirement for allowability of business advances. Penalty should not be levied merely because it is lawful to do so, has been held by Hon‟ble Supreme Court in the case of Hindustan Steels Ltd., 83 ITR 26. Relying on these facts and authorities, we hold that the penalty u/s 271(1) (c) is not impossible in assessee‟s case, which is deleted."

6. After hearing the counsel for the parties that we are of the opinion that it is a correct view taken by the Tribunal. Facts are not in dispute. The amount relates to advances to suppliers which were duly shown and declared by the assessee in the Profit & Loss account. The AO did not dispute the genuineness of these advances given. The stand of the assessee that the advances to the extent of Rs.2,05,86,262.75/- had become irrecoverable was also not disputed by the AO. However, the assessee had shown the same in Profit and Loss Account under the head "bad and doubtful advances written off" and did not use the words "bad debts written off". During the assessment proceedings, the AO treated the same as bad debts written off and for that reason applied the provisions of Section 36(1)(vii) of the Act and claiming that the conditions stipulated therein were not satisfied, viz., when it was not shown as income in the previous year, how it could be shown as debt written off.

7. It is trite law that during the penalty proceedings, it is open to the Tribunal to look into the transaction to see as to whether the claim was *bona fide* or it was bogus and result of falsehood. From that angle, when the Tribunal examined the matter, it found that on the facts of this case when advances given to the suppliers were not written off as irrecoverable, the same was allowable under Section 28 of the Act. A trading loss has a wider connotation than a bad debt. A bad debt may also be a trading loss, but a trading loss need not necessarily be a bad debt. There may be a bad debt which may not fall within the purview of Section 36(1)(vii) of the Act, but may well be regarded as one eligible for deduction incurred in the course of carrying on business will come under that category and will naturally enter into computing the net total income as the real profit chargeable to tax cannot be arrived at without setting off legitimate trading loss.

8. On these facts, it is apparent that the claim was neither mala fide nor false. It was a *bona fide* claim preferred by the assessee, who had also disclosed all the facts relating to and material to the computation of his income. In these circumstances, the assessee fulfilled both the conditions to be outside the purview of Explanation (1) to Section 271(1)(c) of the Act. The case of the assessee is covered by the judgment of the Supreme Court in the case of *CIT Vs. Reliance Petroproducts (P) Ltd.,* 322 ITR 158

(SC), where it was held that the assessee must be found to have failed to prove that his explanation is not only *bona fide*, but all the facts relating to the same and material to the computation of his income were also not disclosed by him. It was further held that the explanation must be preceded by finding as to how and in what manner the assessee had furnished inaccurate particulars of his income.

9. In fact, had the assessee pressed his claim in a proper manner during the assessment proceedings, he might have even succeeded in getting the said deduction allowed. Be as it may, in such a case, the assessee cannot be fastened with penalty also.

10. We, thus, answer the question in favour of the assessee and dismiss this appeal.

2011 PTR 1583 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
BANGALORE "B" BENCH, BANGALORE

N Barathvaja Sankar, Vice President and George George K, Judicial Member

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FACTS/HELD

1. **Transfer Pricing & Sale of IPRs: Important Principles of Law Explained**
2. The assessee sold its Intellectual Property Rights (IPRs) (*patents, copyrights and trade marks*) to its AE for a consideration of Rs. 38.50 crores. The sale price was justified on the basis that there were "inherent flaws" in the IPRs and "intense development inputs" were required to be done by the buyer. The TPO adopted the "*Excess Earning Method*" (as prescribed by the "*International Valuation Standard Council*") and determined the value of the IPR at Rs.260.63 crores which was upheld by the DRP. In appeal before the Tribunal, the assessee raised the following contentions: (a) that the AO had made a reference to the TPO without forming a "*considered opinion*" on the issues under reference; (b) the "*Excess Earning Method*" adopted by the TPO was not a prescribed method under the Act or Rules; (c) as there was no appropriate method for determination of ALP of IPR, the value declared by the assessee had to be accepted as ALP; (d) on merits, the TPO had relied on estimates and

surmises in projecting the future cash flows while disregarding evidence in the form of audited financial statements. HELD by the Tribunal:

(i) **There is nothing in s.92CA that requires the AO to first form a "*considered opinion*" before making a reference to the TPO**. It is sufficient if he forms a prima facie opinion that it is necessary and expedient to make such a reference. The making of the reference is a step in the collection of material for making the assessment and does not visit the assessee with civil consequences. There is a safeguard of seeking prior approval of the CIT. Moreover, by virtue of CBDT's Instruction No.3 of 2003 dated 20.5.2003 **it is mandatory for the AO to refer cases with aggregate value of international transactions more than Rs.5 crores** to the TPO (**Sony India** 288 ITR 52 (Del) & **Ranbaxy Laboratories** 299 ITR 175 (AT) (Del) followed);

(ii) **The argument that the "*Excess Earning Method*" adopted by the TPO is not a prescribed method is not acceptable**. A sale of IPR is not a routine transaction involving regular purchase and sale. There are no comparables available. The "*Excess Earning Method*" is an established method of valuation which is upheld by the U.S Courts in the context of software products. **The "*Excess Earning Method*" method supplements the CUP method and is used to arrive at the CUP price i.e. the price at which the assessee would have sold in an uncontrolled condition** (*method explained*, **Intel Asia Electronics Inc** followed);

(iii) On merits, the "*Excess Earning Method*" has to be applied using the projected sales (*and not actual sales*) because **when an intangible is sold, the risk of future income potential lies with the buyer**. However, in determining the projected sales and profits, the TPO committed several errors such as not excluding the sales-returns (*detailed directions given on how to apply the EEM*).

Appeal partly allowed.

ITA No.1235/Bang/2010 (Assessment year 2006-07).

Heard on: 15th September, 2011.

Decided on: 26th September, 2011.

Present at hearing: Arvind V Sonde, C.A., for Appellant. Etwa Munda, CIT-III, for Respondent.

JUDGMENT

Per George George K:– (Judicial Member)

This appeal instituted by the assessee company – *Tally Solutions Pvt. Ltd* – is directed against the order of the Ld. AO passed u/s 143(3) r.w.s.144C of the Act dated: 20.10.2010 for the assessment year 2006-07.

2) The assessee company in its grounds of appeal had raised **thirteen** grounds under various captions in an illustrative and extensive manner. However, on scrutinizing the same attentively, it was noticed that the grievances of the assessee are chiefly confined to the following issues, namely:

(i) that the impugned order passed by the Ld. AO requires to be quashed; or in the alternative–

(a) the deficiencies/shortcomings in the process be made good/rectified;

(b) the adjustments made by the TPO/AO and confirmed by the DRP varying the reported value of the international transaction be deleted; &

(c) interest charged u/s 234B and s.234D of the Act be deleted.

2.1) Charging of interest u/s 234B of the Act is mandatory and consequential in nature and, thus, this ground is not maintainable and, accordingly, dismissed as **not maintainable**. The levy of interest u/s 234D is a legal ground which is chargeable for the AY 2006-07, following the finding of the Hon'ble Delhi E Special Bench in the case of *ITO v. Ekta Promoters P. Ltd.* reported in (2008) 113 ITD 719. It is ordered accordingly.

2.2) The assessee company's assertions that the lower authorities erred in passing the impugned orders –

(i) without considering all the submissions and/or without appreciating properly the facts and circumstances of the case and the law applicable;

(ii) in a mechanical manner and without application of mind;

(iii) at the fag end of the limitation period; and

(iv) without affording a proper opportunity of being heard to the assessee

are found to be **wanting** as the records testify that the assessee company was provided with as many as eighteen opportunities during the course of assessment proceedings by the Ld. AO and at a glance at the impugned orders of the Ld. TPO as well as DRP, it was noticed that while passing the orders, the authorities concerned have duly taken cognizance of the relevant facts in arriving at such conclusions which cannot be merely termed as *the orders have since been passed in a mechanical manner without application of mind*. As no concrete evidence was forth-coming to suggest that the impugned orders were suffered from those short-comings, we venture to dismiss this ground of the assessee company as not sustainable.

3) We shall now proceed to deal with the primary issues raised by the assessee company in the following paragraphs:

4) Briefly stated, the assessee company ['the assessee' henceforth] has been engaged in the business of software development, marketing and sales of Tally Brand Financial Accounting and Management Software. The assessee has Associated Enterprises (AE) in UK, Dubai and other countries. In Dubai's AE, the assessee has 40% shareholding. During the year under dispute, the assessee sold intellectual property held by it including patent, copy rights and trade marks to Tally Solutions FZLLC, Dubai (Tally Dubai) on 31-1-2006 for a total consideration of Rs.38.50 crores. It was claimed that after restructuring, for the first 10 months of FY 2005-06, the assessee continued to carry on its business of sale of license for the right to use of its software products and later two months, it provided software services to Tally Dubai.

4.1) The assessee's case was referred to the TPO for computation of arm's length price u/s 92CA of the Act. After consideration of the details furnished by the assessee, the TPO proposed to adopt various comparables for software segments to determine the ALP with reference to sale of Intellectual Property Right (IPR) and brushing aside the assessee's objections in response to the said proposal, the TPO determined the ALP at Rs.501.46 crores [as enumerated at page 171 of his impugned order] with respect to sale of IPR to its AE at Dubai.

5) Aggrieved, the assessee took up the issue with the Dispute Resolution Panel [DRP] for relief. Taking cognizance of the assessee's contentions, the DRP in its impugned order directed the TPO to reconsider the objections of the assessee on the issue and submit a fresh valuation report with regard to the sale of IPR. The TPO furnished a revised valuation of the IPR at Rs.260.63 crores which was upheld by the DRP and, accordingly, directed the AO to make the adjustment on the basis of the revised working of the TPO at Rs.222.13 crores (260.63 crores

– ALP of Rs.38.50 crores). The AO passed the final order on 20.10.2010 in pursuance of the directions of the DRP dated 30-9-2010.

6) Agitated, the assessee has come up with the present appeal against the adjustment made by the TPO which was upheld by the DRP to the valuation of IPR sold by the assessee to its AE – Tally Dubai - and incorporated by the AO in his final order cited supra.

6.1) During the course of hearing, the submissions made by the Ld. A.R are summarized as under:

(1) <u>The assessee challenges the legality of reference to TPO the AO without forming 'a considered opinion':</u>

The assessee challenges the legality of the reference made by the AO to the TPO as according to the Ld. AR, a reference has been made by the AO to the TPO without forming "a considered opinion" on the issues under reference. The AO referred the matter to TPO, following CBDT Instruction No.3 of 2003 dated 20/5/2003. The said instruction provides that the AO after forming prima-facie belief on the details available on record with reference to the international transactions, refer the case to TPO, if the aggregate value of these transactions exceeds Rs.5 crores, after obtaining the approval of the CIT. The said instruction further provides that the AO shall give final opportunity to the assessee after receipt of the order of the TPO, that prior to the amendment made by the FA 2007 to sub-section (4) of sec 92CA of the Act, the AO could make reference to TPO on arriving at a "prima facie opinion" on the international transaction and could reach "a considered opinion" after receipt of the report from the TPO after providing opportunity to the assessee. As per sub-section (4) prior to its amendment, the AO could proceed to compute the total income of the assessee "having regard to the Arms Length Price determined under subsection (3) of the TPO". Thus, it was contended that there was always a scope for the assessee to put forth its objection before the AO concerning the contents of the TPO report and the AO, after considering the objection of the assessee, could either agree with the TPO report or agree with the objection of the assessee and reject or modify the TPO report while passing the assessment order u/s 143 of the I.T. Act.

– Under the circumstances, it was justified that the AO could make reference to the TPO u/s 92CA (1) merely by arriving at the "prima facie opinion" as he could reach "a considered opinion" after receipt of the TPO's report. This

aspect of forming prima facie opinion before a reference to TPO and considered the opinion after receipt of the TPO report.

– Relies on the ruling of the Hon'ble Delhi High Court in the case of Sony India P. Ltd. vs. CBDT And Another [288 ITR 52(2007)] (Del).

– However subsequent to the amendment in sub-section (4) of section 92CA of the Act by the FA, 2007, the AO has to pass the order "in conformity with the arms length price as so determined by the Transfer Pricing Officer" and, hence, post amendment, the AO has no option but to pass the assessment order in conformity with the ALP determined by the TPO.

Section 92CA reads as under:

92CA. (1) Where any person, being the assessee, has entered into an international transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction under section 92C to the Transfer Pricing Officer.

(2) ……………………

(3) ……………………

(4) On receipt of the order under sub-section (3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C in conformity with the arm's length price as so determined by the Transfer Pricing Officer.]

(5) ……………………..

(6) ………………………

(7) ………………………..

Sub-section(4) of section 92CA has been amended by Finance Act, 2007 w.e.f. 1.6.2007 and prior to its substitution, sub-section(4) read as under :

"(4) on receipt of the order under sub-section(3), the Assessing Officer shall proceed to compute the total income of the assessee under sub-section (4) of section 92C having regard to the arms length price determined under sub-section (3) by the Transfer Pricing Officer".

– The CBDT's Instruction No.3 of 2003 was challenged in Sony India (P) Ltd vs. CBDT & ANR [288 ITR 52(Del)].

The Hon'ble Delhi High Court after considering the provisions as they stood at the relevant time upheld the instructions as correct and consistent with section 119 of the IT Act and observed thus –

"The exercise of the discretion by the Assessing Officer is required to be preceded by the formation of an opinion by the Assessing Officer of the necessity or expediency of making such a reference. However, what is not apparent is the nature of such opinion. <u>Is this a prima facie opinion or a considered opinion after examining all available materials?</u> The answer to this will determine the stage at which the reference can be made to the Transfer Pricing Officer. This will have to be understood from the wording of the statute itself. A reading of section 92C and section 92CA does not indicate that the Assessing Officer is required to form a prior considered opinion after considering all the available materials even before making a reference to the Transfer Pricing Officer. For instance, section 92CA(1) can be contrasted with section 55A of the Act where again the Assessing Officer is empowered to refer to the Valuation Officer the question of ascertaining the fair market value of a capital asset. The wording of section 55A is unambiguous that the Assessing Officer has to first form an opinion that the value declared is less than the fair market value before he can refer the question to the Valuation Officer. If he does not, then the reference is itself bad. Turning to section 92CA, the question is whether the reference to the Transfer Pricing Officer by the Assessing Officer has to be made by the Assessing Officer only after he is satisfied by going through the steps enlisted at section 92C (1) to (3) and concluding that the price declared by the assessee is not to be accepted or can he make such a reference at an anterior stage?

There is nothing in section 92CA itself that requires the Assessing Officer to first form a considered opinion in the manner indicated in section 92C (3) before he can make a reference to the Transfer Pricing Officer. In our view, it is not possible to read such a requirement into section 92CA (1). However, it will suffice if the Assessing Officer forms a prima facie opinion that it is necessary and expedient to make such a reference. One possible reason for the absence of such a requirement of formation of a prior considered opinion by the Assessing Officer is that the

Transfer Pricing Officer is expected to perform the same exercise as envisaged under:

Section 92C (1) to (3) while determining the ALP under section 92CA (3). The latter part of section 92CA(3) unambiguously states that the Assessing Officer shall "by order in writing, determine the arm's length price in relation to the international transaction in accordance with sub-section (3) of the section 92C." It will be pointless to have a duplication of this exercise at two stages one after the other. On the other hand, the scheme is that after the Transfer Pricing Officer determines the ALP the matter revives before the ALP at section 92C(4) stage where, in terms of section 92CA(4) the Assessing Officer will compute the total income "having regard to" the ALP determined by the Transfer Pricing Officer.

The two aspects require to be taken note of in this context. The Assessing Officer will necessarily have to give an opportunity to the assessee after receiving the report of the Transfer Pricing Officer and before he finalizes the assessment computing the total income. Secondly, the provisions do not mandate that the Assessing Officer is bound to accept the ALP as determined by the Transfer Pricing Officer. And for good reason because the Assessing Officer has himself not made up his mind at the stage about the ALP. He has, in a sense, only "outsourced" this exercise to the Transfer Pricing Officer. He can always be persuaded by the assessee at that stage to reject the Transfer Pricing Officer's report and proceed to still determine the ALP himself. It must be recalled that it is the Assessing Officer who is the authority to finalize the assessment and that power cannot be usurped, as it were, by the Transfer Pricing Officer or any other authority contrary to the scheme of the Act. If on the other hand one were to interpret the provisions to require the Assessing Officer to first form a considered opinion on the ALP before referring the matter to the Transfer Pricing Officer, then the Assessing Officer will thereafter have no option but to accept the report of the Transfer Pricing Officer and to that extent the Assessing Officer's final say on the ALP while computing the total income gets diluted. By preserving the power of the Assessing Officer to determine the ALP even after the determination by the Transfer Pricing Officer, full effect can be given to the words "having regard to" occurring in both section 92C(4) and section 92CA(4).

………………………………………………………………………………..

"In view of the settled legal position, we are of the view that the expression "having regard to" in section 92C(4) and section 92CA(4) enables the Assessing Officer to consider not only the report of the Transfer Pricing Officer but any other material that may be placed before him by the assessee to arrive at a different conclusion. This also strengthens the position that the report of the Transfer Pricing Officer is not binding on the Assessing Officer".

………………………………………………………………………………..

The salient points emerging from the above discussion may be recapitulated thus:

(a) The discretion of the Assessing Officer to refer the matter of computation of ALP to the Transfer Pricing Officer is not unfettered. It is trite that any misuse of such exercise of discretion can be corrected by way of judicial review by statutory appellate authorities and ultimately the courts.

(b) The words "necessary and expedient" occurring in other provisions of the Act and other statutes have been interpreted judicially to admit of a strict construction permitting the power to be used only in the manner and subject to the conditions stipulated in the provision.

(c) The words "necessary and expedient" posit the formation of an opinion by the Assessing Officer of the need to make such a reference. However, a reading of section 92C and section 92CA does not indicate that the Assessing Officer is required to form a prior considered opinion after considering all the available materials even before making a reference to the Transfer Pricing Officer. A prima facie opinion would suffice at the stage of making the reference.

(d) The Transfer Pricing Officer is expected to perform the same exercise as envisaged under section 92C(1) to (3) while determining the ALP under section 92CA(3).

(e) The Assessing Officer is not bound to accept the ALP as determined by the Transfer Pricing Officer. He can always be persuaded by the assessee at that stage to reject the Transfer Pricing Officer's report and proceed to still determine the ALP himself. This is how the

expression "having regard to" occurring in both sections 92C (4) and 92CA(4) can be given full effect.

(f) This interpretation does not prejudice the assessee because in effect the assessee gets two opportunities to demonstrate that the ALP declared by it requires acceptance. The first is before the Transfer Pricing Officer in terms of section 92CA (3) and the second before the Assessing Officer under section 92C (4)' (emphasis supplied).

– On reading of sec 92CA of the Act and Delhi High Court judgment in the case of Sony India (P) Ltd, it is very clear that the AO can make reference to the TPO following the instructions of the CBDT by forming a prima facie opinion as he is not bound by the report of TPO and can form a considered opinion with reference to the issues under reference before finalizing the assessment. It is an admitted position in law that AO has the authority to finalize the assessment and his power cannot be usurped by the TPO or any other authority contrary to the Act. The AO can only outsource the exercise of determination of arms length price to the TPO by arriving at a prima facie opinion and can form the considered opinion after receipt of the TPO's order. However, there has been a change in the provisions of the law w.e.f 01.06.2007. The AO has to compute total income of the assessee in conformity with the arms length price determined by the TPO. Under these circumstances mere forming the prima facie opinion before making reference to the TPO is not sufficient as otherwise AO will have no opportunity to form a considered opinion on the issues under reference. AO has to pass the order 'in conformity with" the ALP determined by the TPO and if he has not formed any considered opinion before making reference to the TPO then the powers of AO have been usurped by the TPO. The Hon'ble Delhi High Court has upheld the instruction no.3 of 2003 and held that prima facie opinion would be sufficient for making reference to TPO as AO will have considered opinion on receipt of the TPO's order. But now after the amendment to sec 92CA (4), the AO has to pass the order in conformity with the order passed by the TPO and, hence, the AO has to have considered opinion before making reference to the TPO.

It is , therefore, submitted that the Hon'ble Bench shall ascertain whether the AO has formed a considered opinion before making reference to the TPO u/s.92CA(1) of

the Income-tax Act, 1961 and the Commissioner has accorded his approval for the reference after due consideration as the mechanical approval can not be considered to be valid approval under the Act.

(2) The TPO followed excess earning method which is not a prescribed method under the Act or Rules:

– that the TPO has followed excess earning method and not Comparable Uncontrolled Price Method (CUP) as there was no comparables available with reference to the IPR sold by the Assessee. The Excess Earning Method is part of the Draft guidance not issued by the International Valuation Standard Council in April, 2009, that the TPO determined the ALP following the Excess Earning Method and made adjustment to the sale value of the IPR. However, as per section 92C of the Act the ALP in relation to an international transaction has to be determined with reference to the prescribed method the relevant part of section 92C of the Act.

– The TPO has to determine the ALP only by following one or more of the most appropriate method referred to in section 92C(1) of the Act read with Rule 10B and in the manner prescribed under Rule 10C of the Rules. The Excess Earning Method followed by the TPO is not one of the methods specified in the Act read with the rules. The Assessee therefore submitted that however authentic and well accepted the Excess Earning Method may be, the AO could not adopt the same as it is not one of those method recognized by the Income Tax Act The assessee further submits that irrespective of the validity of the Excess Earning Method the same can not be applied for determination of ALP under the I.T. Act as it is not one of the specified method u/s 92C of the I.T. Act.

– that the ALP of IPR shall be accepted at Rs.38.50 cr. as stated by the assessee. Moreover since there was no comparable uncontrolled transaction of similar nature available and no other method can be taken to be most appropriate method for determination of ALP of the IPR u/s 92C(1) of the Act, the value of the IPR declared by the assessee shall be accepted to be the ALP of the International transaction by the AO.

– Reliance placed in the case of CA Computer Associates Pvt. Ltd. vs. DCIT (2010) 37 SOT 306(Mum)] wherein the Hon'ble Bench has held:

"The manner in which the ALP is to be determined by any of the method prescribed in section 92C is provided in rule 10B of the Income Tax Rules, 1962. After examining the parameters prescribed in rule 10B, it can be seen that bad debts written off can not be factor to determine the arm's length price of nay international transaction. In our opinion, the TPO has exceeded his limitation by following the method which is not authorized under the Act or Rules. We therefore, hold that the arm's length price determined by the TPO and adopted by the AO to the extent of royalty payable to the CA Inc Management, USA is not as per the procedure prescribed and same can not be sustained. We therefore direct the AO to adopt the arm's length price of the royalty payable to CA Inc Management, USA as declared by the assessee in both the years".

– that in the absence of appropriate method for determination of ALP of IPR, the provision cannot be applied and value of IPR declared by the assessee shall be accepted as ALP. The CUP presupposes an existence of comparable transaction and in the absence of any such comparable the CUP method cannot be applied for determination of ALP, that there is no other method which can be applied for determination of ALP, the provision relating to determination of ALP can not be applied to the transaction of the assessee.

– relies on the ruling of the Supreme Court in the case of CIT vs. Official Liquidator, Palai Central Bank Ltd.[150 ITR 544] wherein it was held that if the provision of a particular Act are incapable of its application, the charge of such section fails and the same can not be applied. The Hon'ble Court was dealing with application of provisions contained in Super Profits Tax Act, 1963 in respect of the company in liquidation subsequent to the date of its winding up. The court following its earlier judgment has held as under:

"In CIT v. B. C. Srinivasa Setty [1981] 128 ITR 294, this court pointed out that under the scheme of the I.T. Act, 1961, charge of tax will not get attracted unless the case or transaction falls under the governance of the relevant computation provisions."

The character of the computation provisions in each case bears a relationship to the nature of the charge. Thus, the charging section and the computation provisions together constitute an integrated code. When there is a case to

which the computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section. Otherwise, one would be driven to conclude that while a certain income seems to fall within the charging section, there is no scheme of computation for quantifying it. The legislative pattern discernible in the Act is against such a conclusion. "Exactly similar being the scheme of the Super Profits Tax Act, 1963, the above observations fully apply to the case before us. Hence, it has to be held that inasmuch as the provisions contained in the Act for computing the capital of the company and its reserves cannot have any application in respect of a company in liquidation and, consequently, the "standard deduction" is incapable of ascertainment, the charge of super profits tax under s. 4 of the Act is not attracted to such a case. The judgment of the High Court does not, therefore, call for any interference".

That in view of the above the sale value declared by the assessee at Rs.38.50 cr. of IPR transferred to Tally Dubai, shall be directed to be accepted as ALP for computation of income from international transaction.

(3) <u>On merits, it was contended that the Order of the TPO suffers from the following infirmities:</u>

(i) T he TPO has relied on estimates and surmises in projecting the future cash flows while completely disregarding documentary evidence in the form of audited financial statements that were available at the time of framing the order. Such documents emphatically rebut the presumptions made by the TPO

(ii) The TPO has erred in excluding license revenues for the period 01-4-2005 to 31-1-2006 in computing the value of the IPRs. Since the IPRs were sold on 31-1-2006, license revenues till the date of sale of IPRs have to be considered in determining the value of the IPRs

(iii) The TPO has erred in ignoring sales returns of AY 2005-06 amounting to Rs.111.,03 crores. Since the basis of the TPO's estimation of future revenues is sales of AY 2005-06, nonconsideration of such sales returns grossly inflates the future earnings potential derived from the model adopted by the TPO

(iv) ***Compounded Annual Growth Rate (CAGR) is a function of two variables in a given range, i.e the first and last variable. Values within the given range, i.e. other than the first and last value, do not have a bearing on the CAGR. This being the case, CAGR is not a good metric to measure growth, especially so in the case of the Appellant where growth has been uneven, erratic and also negative in a few years;***

(v) ***The choice of CAGR adopted by the learned TPO is whimsical, illogical and wholly unfounded***

(vi) ***Useful life of the IPR, which is inextricably linked with technology, has been wrongly estimated by the TPO to be six years whereas in reality, useful life is inarguably less than three years. Inherent flaws in the IPR, which could potentially cripple and further reduce the useful life of the IPR, have not been taken cognizance of by the TPO***

(vii) ***The TPO has followed the principles of convenience rather than established and well settled principles in determining the discount factor***

(viii) ***Working capital ratio has been incorrectly computed by the learned TPO***

In the light of the above, it was submitted that –

(a) ***WDV of the IPRs be considered the Arm's Length Price of such IPRs; or***

(b) ***The revenues of AY 2005-06 be reduced by the amount of subsequent sales returns of Rs.111.4 crores, implicit period for revenue projection be considered from 01-4-1999 to 31-1-2006, useful life of the IPR be taken at three years, discount factor of 23.14% be considered and in computing the return on working capital, all current assets and current liabilities be taken into consideration.***

The above contentions on merits were elaborated by giving the following submissions:

1. *<u>Computation of future cash flows:</u>*

– The learned TPO as a first step estimated the future turnover of the appellant. The TPO has estimated the future turnover till 2012 based on the past performance as well as data available in public domain (page 163 of the TP order). The appellant's past sales are considered as follows(page 165 of the TP order):

Table I
(Rs. in Crores)

Assessment Year	Total Operating Revenue
2000-01	7.84
2001-02	20.20
2002-03	26.22
2003-04	56.71
2004-05	35.27
2005-06	198.15
Total	**344.39**

Based on the above, the CAGR works out to 90.80% but the learned TPO has taken the CAGR at 20.39%. This growth rate is assumed for future years and accordingly future revenues as estimated by the learned TPO are as below:

Table 2
(Rs in Crores)

Assessment Year	**Total Operating Revenue**
2007-08	287.20
2008-09	345.75
2009-10	416.26
2010-11	501.13
2011-12	603.31
2012-13	726.32
Total	**2,879.97**

<u>with respect to computation of future revenues</u>

– The learned TPO has considered the sales of the appellant from A.Y 2000-01 to 2005-06. Based on this data, the TPO has computed CAGR and then estimated the future revenue, that the methodology adopted by the TPO gives absurd results. To demonstrate this, the figures of actual sales are tabulated below.

Table -3

COMPARISON OF ACTUAL REVENUES WITH TPO'S ESTIMATED REVENUES				
Assessment year	Indian License Revenue	Global Revenue	TPO's Estimates	No. of Times Overvalued
2007-08	18,63,30,924	27,73,70,160	287,19,63,050	10
2008-09	86,98,16,178	99,65,09,130	345,75,56,316	3
2009-10	94,66,53,438	102,48,61,182	416,25,52,049	4
2010-11	91,70,80,310	91,70,80,310	501,12,96,411	5

As can be seen from the above, as per the TPO, the assessee would have cumulative turnover of around Rs. 2,880 crores. As per the TPO in AY 10-11, the appellant would have had Rs.501 crores of turnovers. In reality the turnover is Rs.91.70 crores. There is no product company in India which has turnover of 500 crores to 700 crores. The figures being unrealistic are liable to be rejected; that instead of adopting unrealistic projections, the actual sales figure available from the audited financial statements should be adopted.

– With respect to appellant's contention that actual sales figure should be adopted, the TPO has contended that to arrive at sale price of IPR one needs to look at the revenue potential at the time of sale. He has further contended that the MD of the appellant has made a statement that the sales of the company would be Rs. 5,000 crore by March 2012. In this regard, the appellant submits that then if this is true the TPO has completely ignored the fact that the assessee sales have never shown a linear growth. The TPO has assumed that the sales of the appellant will keep growing despite the fact that appellant's revenues dipped in A.Y. 2004-05 and A.Y 2006-07. This aspect has not been factored in revenue projections. Further after stating that events after sale are not relevant, the TPO is relying on the statement of the MD of the appellant which is made on March 17, 2009 (page 146 of the TP Order). The appellant submits that same is not relevant for AY 2006-07. If the statement is relevant, then the actual sales figure are also relevant and should be considered while computing ALP of IPR sale. Even otherwise MD's statement is a vision and not reality. Such vision or dream cannot authorize the TPO to make incredibly high projections which are bereft of reality. The determination of ALP has to be based on the law prevailing and not vision or dream of the MD.

Accordingly, the appellant submits that the ALP should be computed based on actual sales and not projections.

The TPO has considered the sales of the appellant from A.Y. 2000-01 to 2005-06. Based on this data, the TPO has computed CAGR and then estimated the future revenue. The year under consideration is AY 2006-07. The IPR was sold on 31.01.06. The sales (license revenue) for 10 month period (April 05 to Jan 06) is Rs. 60,17,36,844, that since the sale of IPR is on 31.01.06, sales data of the current year should also be included to compute the future revenues. The appellant submits that considering appropriate sales data is vital for correct projections. The current year sales data is critical because it reflects the sales of period immediately preceding the sale of IP and therefore reflects the true earning potential of the IP at the time of sale.

– that the TPO in the remand report (page 11 of the remand report) has stated that current year data was not taken since the same involved the related party transactions and the transaction involving IPR took place in this year. In this regard, the appellant submits that the sale of Tally licenses is to third parties and not to related parties as contended by the TPO. What is sold by the appellant is IPR. IPR generates license revenues. Therefore to value IPR what needs to be considered is revenue from Tally licensees which are sold to third parties. The other related party transactions have no relevance for this purpose. The situation in AY 2006-07 is similar to situation in all the years considered by the TPO. Therefore this reason of the TPO is baseless. With respect to TPO's contention that the transaction involving IPR took place in this year and therefore current year data is excluded, the appellant submits that since the sale is in current year, it is more so important to consider current year sales. This is also in accordance with provisions of Rule 10B(4) which mandates use of current year data which should be used to estimate future revenues.

– that the sales for A.Y. 2005-06 are considered by the TPO at Rs.198.15 crores. The TPO has considered this year as the base for computing CAGR and future revenues. It can be noticed from the table above that there is a substantial jump in the turnover during the AY 2005-06. In the immediately preceding year and immediately succeeding year, there is a dip in

turnover. The TPO has completely ignored the extra-ordinary circumstances giving rise to this turnover.

– that the State Governments in India introduced VAT with effect from April 1, 2005. The appellant sensed a huge business opportunity with the proposed change in the business environment. With VAT being introduced, more and more traders would require automated systems to support the increased work. This also provided an opportunity to convert pirated users to licensed versions. The distributors were forced to off-take greater quantities of the software package. The same was accounted as turnover in the books of the appellant. In the last three months of A.Y. 2005-06, the sales accounted were almost 100% not received. In fact 95% of sales of A.Y. 2005-06 were in the month of March. The debtor outstanding as on March 31, 2005 was at Rs. 197.14 crores. Receivable constituted almost 100% of sales. The appellant had dumped the stock with the dealers in anticipation of good off- take due to introduction of VAT. Though the appellant's accounted revenues increased in A.Y. 2005-06, the dealers could not sell the whole stock. The same were returned by the dealers to the assessee. There was a sales return to the extent of Rs. 111.04 crores in the pertaining to sales made in A.Y. 2005-06. The turnover as reported did not materialize. To assume a growth rate on unrealized figures is bad in law. This is especially so when the CAGR is substantially influenced by the figure of turnover for the A.Y. 2005-06. When the "contributory figure" to the derivation of the rate of growth has not fructified, the very assumption of the TPO is vitiated. The projection of the future turnover on the basis of such vitiated turnover is therefore bad in law and, thus, the sales return must be excluded from the turnover of A.Y. 2005-06.

– With respect to this contention of the appellant, the TPO on page 10 of the remand report has contended that sales figures have been taken from annual report of the appellant and therefore sales return have been taken care of. The TPO has further contended that he has been very conservative and taken CAGR at 20.39% instead of 90.80%. The TPO has contended that lower CAGR takes care of all possible adverse effects on future cash flows.

– With respect to TPO's contention that sales return have been taken care of, the appellant submits that sales returns have not been reduced from the year to which they pertain.. Therefore the question of same being considered does not arise. Going by TPO's own admission that sales return and that sale of A.Y. 2005-06 should be accordingly adjusted.

– With respect to TPO's contention on CAGR, the appellant submits that if CAGR of 90.80% is adopted, the total sales projection as per TPO's method would be Rs. 37,535.55 crores. This reflects the absurdity of the TPO's calculation. CAGR of 90.80% is not possible in real life. This ought to have put the TPO on guard to make further analysis and investigation. Instead the TPO states that he has been lenient. The law of transfer pricing is not based on concession. Benevolence would not lend credence to an order otherwise bereft of legal substance or basis. The order is therefore bad in law.

– attention was drawn to Illustrative CAGR chart submitted during the course of hearing. The assessee submits that the CAGR varies drastically based on the value of first year and last year even though the total sales remain same. The high CAGR in appellant's case is attributed to sales in AY 2005-06, which never materialized. High CAGR has resulted in higher revenue projection for future years without considering ups and downs which is reality in appellant's case. This has resulted in high valuation of the IP. The appellant submits that the choice of CAGR adopted by the TPO is illogical and wholly unfounded

2) Useful Life:

– The TPO has estimated future revenues for six years. Why six years were selected has not been stated. No reason or rationale is available in the order justifying the adopting a six year period.

– Para 5.8 of the Exposure Draft (as relied by the TPO) states as follows:

"The forecast period needs to be assessed appropriately so that it is consistent with the expected useful life of the subject intangible asset. As the life of an intangible asset may be finite or assumed to be infinite, forecast cash flows may be for a finite period or may run into perpetuity."

As per the Exposure Draft, the value of intangible asset is to be determined based on the cash flows attributable to the subject intangible asset. It is to be based on expected useful life of the subject intangible asset.

The IPR was originally acquired by the appellant during the previous year relevant to A.Y. 2000-01. Tally is an accounting package which has to be updated year after year to suit the requirements of the market and the customer. Right from A.Y. 2000-01 upto A.Y. 2006-07 during which period the IPR was sold, various versions have been developed and marketed. Each version has been in the market for a very short period and most of the times for a span not exceeding a year. For example Tally version 3 or version 4 released in 1990's does not have any market today. Tabulated below are the release dates of newer versions:

Table 4

Version	Release Date
7.2	01.03.2005
8.1	07.07.2006
9.0	01.12.2006

As evident from the above Table, newer versions need to be released at regular intervals to suit the market requirements. In case newer versions are not released, the demand for the products will fall. What was transferred is IP of the existing products, i.e Tally 7.2. The market for the existing product is not six years. Its life is much shorter.

The base product without upgrades and newer versions would not sell in the market. The accounting packages have to continuously evolve. Continuous development is the key to ensure suitability of the package to adapt to changing requirements of the user. Their shelf life is very short. Competition in the field is intense. Obsolescence is fast paced. Client loyalty is fickle. Under the circumstances the IPR of an accounting package has hardly any value. The appellant therefore submits that useful life of IPR should be considered at three years and accordingly future revenues should be estimated for three years.

Attention was drawn to the preamble (also extracted by the TPO on page 142 of the TP Order) of the Intellectual Property Sale Agreement with the JV Partner (Global

Capital Partners, Dubai – an unrelated party and majority shareholder in Tally Dubai). The permeable reads as follows:

> ***"TSPL is convinced that 'Tally' as an accounting software product in the <u>current form has certain inherent flaws in its features and suffers from weak market acceptance</u> against several competing products presently available in the market; that <u>it calls for intense development inputs of very high magnitude on a continuous basis</u> on the product design, technology and security features and other value added modules; that <u>it necessitates deep study and greater insight into customer and geographical requirements</u> from the market standpoint; that the <u>development of its intellectual property in the current form has reached saturation point, requires fresh and innovative approach</u> in product design and development, either alone or in combination with other value added modules and features; <u>that there is need for greater penetration into markets, development of new market territories to drive bigger volumes to justify the increase in the development efforts undertaken; that it does not have the resources in terms of finance, technology, alternative value added features</u> for integrating with core product strengths and requisite know-how in terms of market knowledge."***

As can be seen from the above, there were various reasons for sale of IPR. The same are summarized below:

(i) The appellant was convinced that there were certain inherent flaws in the features of the existing product. When the Tally package was introduced, the appellant was the only player (or probably one of the very few) in the market. Over a period of time many other players entered the market with their packages. If the inherent flaws were not corrected the appellant would have lost the market share. For example, the existing product did not have security features leading to large scale piracy. The Tally package was amenable to copying as the security system in the product was weak. Many pirated versions came into the market which was available at a far lesser price.

(ii) To correct the above flaws intense development inputs of very high magnitude were required on a continuous basis on the product design, technology

and security features and other value added modules. The continuous development would necessitate deep study and greater insight into customer and geographical requirements from the market standpoint. The assessee's products targets small and medium businesses. Most of them are run by individuals or small firm. Understanding their individual and multitude requirements and preferences and translating that into product requires deep study.

(iii) In the initial years, the Tally product was just an accounting package. To expand the market, various others features were required to be integrated. Medium sized businesses require features like inventory, payroll, e-TDS, service tax returns, cost centres, FBT etc. The customers want one-stop solution for all the requirements. When assessee sold the IP, version 7.2 was in vogue. In the latter versions, the product consisting of FBT, VAT Returns, interest calculations, stock valuation, service tax returns etc feature were released. Adding these features required in depth study of requirements, innovative design and development techniques. The same required funds. The appellant therefore formed a JV with the Global Capital Partners. The JV partners arranged a loan of USD 5,110,500 to the Associated Enterprise of the Appellant. The same was used for development of newer versions. The appellant initially had a small team of software developers. The team was expanded to 332 employees by 31 March 2005. The team was further expanded to 814 employees by 31 January 2006. This would not have been possible without the funds and inputs provided by the JV partners.

As can be seen from the above, Tally software had various flaws at the time of the sale. The same required intense development inputs of very high magnitude on a continuous basis. Without these development efforts, the product would not be able to sell in the market. Therefore, the base product as sold on 31.01.06 would not last long in the market. Therefore, it would not be appropriate to consider the shelf life and revenue projection for six years. The appellant submits that in the facts and circumstances of the case, three year revenue projections would be appropriate.

3. <u>Calculation of Discount Factor</u>

<u>Beta</u>: 4.1.1 For computing the Beta, the learned TPO has adopted Beta of a "similar company". It is stated on page 163 of the TP order that Sankhya Infotech Limited is a similar company. The said company is engaged in development and sale of software products for aviation industry. It is difficult to fathom how a company developing software product for aviation industry can be compared to appellant which is developing software for accounting.

Further, the learned TPO has considered 3 companies as comparable to the appellant's segment of distribution of products. These companies are Lifetree Convergence Limited, Exensys Software Solutions Limited and Sankhya Infotech Limtied (page 139 of the TP order). Out of these three, only Sankhya Infotech's Beta has been considered. Why the other two companies are not considered is not clear. The appellant submits without prejudice that Beta should be computed after considering all the three companies. The average Beta of three companies would be 1 (computation of Beta on pages 408 to 414 of the paper book).

<u>Risk Premium</u>

While computing the discount rate, the learned TPO (page 166 of the TP Order) has taken the risk premium at 8.80%. It is stated that risk premium of Bench Mark BSE Index has been considered. In this regard, the appellant submits that it is engaged in the business of software development and comparing return of BSE Index which is composition of companies from various industries is not appropriate. The Risk Premium should be based on return of companies engaged in software industry. Therefore the appellant submits that "Market Return on Capital Employed" from Capitaline Database of software industry (Medium and Small Companies) being 11.61% should be adopted.

<u>Rate of Inflation</u>

The TPO has considered the average inflation rate at 4%. It is stated that the inflation rate is on the basis of RBI's future projection of inflation (page 167 of the TP Order). There is no further substantiation. In this regard, the appellant submits that the inflation rate as adopted by the TPO is on the lower side. The appellant submits that inflation rate should be considered at 5.45% being

average of A.Y. 2005-06 and 2006-07 . This is based on Economic Survey 2009-10

Calculation of Working Capital

While computing working capital (page 169 of the TP Order) the learned TPO has considered sundry debtors, work in progress and sundry creditors only. The learned TPO has not considered cash &bank balances, other current assets (except inter-corporate deposits) and provisions. The assessee submits that same should be considered while computing working capital ratio.

WDV is an appropriate ALP

Tally Dubai was JV between the appellant and Global Capital Partners. The JV partner is in no way related to the appellant. Global Capital Partners was not a minority shareholder. It was in fact a majority shareholder. The value for transfer of IPR was arrived at after due negotiations and deliberations. The JV partner had 60% stake in Tally Dubai. The appellant cannot be imputed with a motive to under sell the IPR's. This would have been a financial loss to the appellant. Nobody would invite an actual financial loss solely driven by tax avoidance motive, especially when the transaction involves a third party. In such circumstances paying taxes would be a far smaller cost then the loss of the money itself through an undervalued sale.

The OECD Guidelines indicate that the presence of minority shareholders as an indication of arm's length condition. This presumption would act much strengthened that in the instant case the third party is a majority shareholder.

In this regard, the assessee invites your honour's attention to the following extracts from the Proposed Amendments to OECD Guidelines:

> ***"3.26 The presence of minority shareholders may be one factor leading to the outcomes of a taxpayer's controlled transactions being closer to arm's length, but it is not determinative in and of itself. The influence of minority shareholders depends on a number of factors, including whether the minority shareholder has a participation in the capital of the parent company or in the capital of a subsidiary, and whether it has and actually exercises some influence on the pricing of intra-group transactions"***

The TPO has not appreciated the business, commercial and economic realities. In the facts and circumstances of the case, the IPR being transferred at WDV is to be considered as at arm's length.

To support its contention, the appellant relies on the Bangalore ITAT decision in the case of Intel Asia Electronic Inc v ADIT 2011-TII-14-ITAT-BANG-TP. In this case, the assessee had sold its PE as a going concern to its AE. The Hon'ble ITAT held that the only reasonable approach would be value the assets by applying the depreciation rates as provided by the Income Tax Act. The relevant extracts are as follows:

> ***"12. To break the ice in such a situation, the only reasonable approach would be to value the assets by applying the depreciation rates as provided by the Income Tax Act for it is more dynamic and so schemed to bring in a notional charge on the profit and loss account to arrive at the actual income of an assessee keeping in view of the depletion of the assets".***

Based on the above, the appellant submits that the IPR being transferred at WDV is to be considered as at arm's length.

During the course of hearing, the appellant submitted Chart containing 6 alternative computations. Method I is the computation as done by the TPO. In Method II, the computation proceeds taking the correct CAGR (90.80%). As per this method, the total sales come to Rs. 37,535.55 crores and value of IPR comes to Rs. 2,871.96. As already submitted this reflects the absurdity of TPO's method.

Assuming without admitting that the method adopted by TPO is correct, the appellant submits Method III to VI for consideration.

<u>Method III – Following changes made to TPO's computation:</u>

1. Subsequent sales return in AY 2007-08 reduced from sales of AY 2005-06.

Changes in working capital as detailed above made Discount rate considered at 23.14% after considering changes in Beta, Risk Premium and Inflation rate as detailed above.

Working capital changes as detailed above.

Based on the above changes, the ALP comes to Rs. 19.12 crores

<u>Method IV – Following changes made to TPO's computation:</u>

Implicit period changed 01.04.99 to 31.01.06 (upto date of sale of IPR).

Changes in working capital as detailed above made

Discount rate considered at 23.14% after considering changes in Beta, Risk Premium and Inflation rate as detailed above.

Working capital changes as detailed above.

Based on the above changes, the ALP comes to Rs. 30.77 crores

Method V – Following changes made to TPO's computation:

Actual sales (of Tally Dubai) figures for AY 2007-08 to 2010-11 considered. Sales for AY 2011-12 and AY 2012-13 are estimated based on CAGR computed based on AY 2000-01 to AY 2010-11.

Changes in working capital as detailed above made

Discount rate considered at 23.14% after considering changes in Beta, Risk Premium and Inflation rate as detailed above.

Working capital changes as detailed above

Based on the above changes, the ALP comes to Rs. 14.70 crores

Method VI – Following changes made to TPO's computation:

Implicit period changed 01.04.99 to 31.01.06 (upto date of sale of IPR). Actual sales (of Tally Dubai) figures for AY 2007-08 to 2010-11 considered. Sales for AY 2011-12 and AY 2012-13 are estimated based on CAGR computed based on AY 2000-01 to AY 2010-11.

Changes in working capital as detailed above made.

Discount rate considered at 23.14% after considering changes in Beta, Risk Premium and Inflation rate as detailed above.

Working capital changes as detailed above. Based on the above changes, the ALP comes to Rs. (12.64) crores

– that under every method the arm's length price is less than Rs. 38.50 crores being the price received (Rs. 11.81 crores being sale price + Rs. 26.69 crores amounts received towards improvement till the date of sale). Therefore, the additions made by the TPO are without basis.

6.2) The Ld. A R came up with various case laws in support of his stand and also furnished a voluminous paper book containing 1 – 414 pages which consist of inter alia copies of (i) extracts of financial statements, (iii) written submissions and correspondences with various authorities etc.,

6.3) On the other hand, the Ld. D R argued that the Ld.AO was within his realm to refer the assessee's case to the TPO for computation of ALP u/s 92C of the Act. Also, on his part, the TPO had, after due consideration of the issue at length and also analyzing the issue from various angles, arrived at a conclusion in a judicious manner which has

been upheld by the DRP with suitable modification as enumerated in its final directions. It was, therefore, pleaded that the impugned order of the Ld. AO u/s 143(3) r.w.s. 144C of the Act requires to be sustained in toto. The Revenue has given specific rebuttals to the certain points raised by the assessee which are extracted in the course of this order.

7) We have carefully examined the rival submissions, diligently perused the relevant case records and also the voluminous documentary evidences coupled with various case laws advanced by either party to drive home their respective stand.

8) We shall first take up the legal issues raised by the assessee.

I. Referring the case to TPO u/s 92CA of the Act.

8.1) It was the contention of the assessee that the reference of its case to the TPO by the AO was not in accordance with the law since, according to the assessee, as per the ruling of Hon'ble Delhi High Court in the case of *Sony India P. Ltd. v. CBDT* reported in [2007] 288 ITR 52 (Del), *a prima facie satisfaction is only applicable when the taxpayer is given a 'second innings' to explain his case before the AO after the TPO reference is received.'*

This was countered by the Revenue thus –

(1) In the case of Sony India referred supra, the Hon'ble Court clearly held that –

'A discretion is given to the assessing officer to refer the question of computation of the arm's length price to the Transfer Pricing Officer, if he considers that it is suitable, appropriate, profitable or convenient to the Revenue. The two words 'necessary or expedient' are separated by the word 'or' and not by the word 'and' and, therefore, should not be read as 'necessary and expedient'.

There is nothing in s.92CA itself that requires the AO to first form a considered opinion in the manner indicated in s. 92C (3) before he can make a reference to the TPO. In our view, it is not possible to read such a requirement into s.92CA(1). However, it will suffice, if the AO forms a prima facie opinion that it is necessary and expedient to make such a reference. One possible reason for the absence of such a requirement of formation of as prior considered opinion by the AO is that the TPO is expected to perform the same exercise as envisaged under s.92C(1) to (3) while determining the ALP under s.92CA(3). The latter part of s.92CA (3) unambiguously states that the AO shall by an order in writing; determine the arm's length price in relation to the international transaction in accordance with sub-section (3) of s.92C. it will be pointless to have a

duplication of this exercise at two stages one after the other. On the other hand, the scheme is that after the TPO determines the ALP the matter revives before the ALP at the s.92C (4) stage where in terms of s.92CA(4) the AO will compute the total income having regard to the ALP determined by the TPO".

(2) *Thus, even as per the decision of Sony India's case, the AO has to make only a prima facie opinion that it is necessary or expedient to refer as case to the TPO. This applies to all case immaterial or aggregate value of international transactions.*

(3) *As per Instruction No.3/2003 the CBDT decided that wherever the aggregate value of international transactions exceeds Rs.5 crores, the case should be picked up for scrutiny and reference u/s 92CA be made to the TPO. Thus, it is mandatory for the AO to refer all the cases wherever the aggregate value of international transactions is more than Rs.5 crores. These instructions are binding on all the AOs. In these cases, there is no need for the AO to make a prima facie opinion, except that he/she needs to examine the 3CEB report to see the aggregate value of international transactions. As the Board issued instruction u/s 119(2)(a), the CBDT felt it necessary and expedient to refer all the cases wherein the aggregate value of international transactions exceed Rs.5 crores. In the instant case, as the aggregate value of international transactions, based on 3CEB report filed by the taxpayer before the AO, exceeded Rs.5 crores, he referred the case to the TPO and is as per the law.*

(4) *Referring to the finding of the Hon'ble Delhi Tribunal in the case of Ranbaxy Laboratories Ltd. V. Addl. CIT - (2008) 299 ITR 175 (Delhi), it was argued that Instruction No.3/2003 of the CBDT is binding on the AO and there is no need to make any prima facie opinion before the AO can make a reference to the TPO in all cases where the aggregate value of international transactions exceed Rs.5 crores.*

8.2) We have attentively considered the rival submissions and also with due regards perused the ruling of Hon'ble Delhi High Court as well as the Hon'ble Delhi Tribunal cited supra on a similar issue. More significantly, the Hon'ble Tribunal held thus –

> *"71. We are astonished at the submission of Shri Vohra to the effect that it is still open to the assessing officer even in cases where value of international transaction exceeded Rs. 5 crore to refer or not to refer the matter to the TPO as the instructions did not affect discretion vested in the assessing officer. If it was so, then what was the need to challenge the instructions and its classifications before the Hon'ble High Court? Shri Vohra stated*

> *that perhaps the petitioner in that case did not correctly interpret the relevant statutory provision and instructions and, therefore, rushed to the Court. We are unable to agree with above submission of Shri Vohra. It is not possible for us to hold that instructions issued by CBDT u/s 119 of the Act to regulate assessment proceeding can be treated as a waste paper by officers functioning under the Board (CBDT). If such a view is taken, it would lead to chaos in the country. If various guidelines issued by CBDT for administration of Income-tax Department and for regulation of assessment etc., are not adhered to or made optional, then all schemes of assessment may fail and jeopardize the working of the department. This is neither the law of land not there is any justification to accept such an argument. We are, therefore, of the view that assessing officer, in the light of instruction of CBDT, was duty bound to refer the matter to TPO, having regard to the purpose of specialized cell created by the revenue department to deal with complicated and complex issue arising under the transfer pricing mechanism. This case itself is a good example as to how department can be hoodwinked unless case is properly examined by persons having knowledge of principles of transfer pricing…"*

8.3) Taking into account the submission of the assessee which was effectively countered by the Revenue we are of the view that the decision to make a reference does not in any manner visit the assessee with any civil consequence. The decision is to be taken by the assessing officer having regard to the question whether it will be proper for the assessing officer himself to determine the arm's length price or it will be expedient to have it determined by the Transfer Pricing Officer. There is the safeguard of seeking prior approval of the Commissioner. Whether computation of the arm's length price is made by one officer or by the other does not in any manner affect the assessee. Even though the assessing officer may in view of the latest amendment be bound by the computation by the Transfer Pricing Officer, the assessee has opportunity to challenge the same at higher levels as per hierarchy laid down in the Statute. There is nothing in section 92CA to suggest that the assessing officer should hear the assessee or record reasons before making a reference to the TPO nor is there anything in the section to suggest that the AO should ask the assessee whether he should himself proceed to determine the arm's length price or should involve the TPO for this purpose. The reference is a step in the collection of material which might be useful for making assessment. No violation of any civil rights of the assessee is involved here. Mere reference does not tantamount to any adverse assessment or use of adverse material. Moreover, by virtue of Board's Instruction No.3 of 2003 dated 20.5.2003 the CBDT decided that wherever the aggregate value of international transactions exceeds Rs.5 crores, the case should be picked up for scrutiny and reference u/s 92CA

be made to the TPO. Thus, it is mandatory for the AO to refer all the cases wherever the aggregate value of international transactions is more than Rs.5 crores. These instructions are binding on all the AOs. In these cases, there is no need for the AO to make a prima facie opinion, except that he/she needs to examine the 3CEB report to see the aggregate value of international transactions. In the instant case, as the aggregate value of international transactions, based on 3CEB report filed by the taxpayer before the AO, exceeded Rs.5 crores, he referred the case to the TPO. Therefore, we see no infirmity in referring the matter to TPO without forming "a considered opinion". In the light of the above reasoning, the first legal point raised by the assessee, namely, the reference to the TPO by the AO without forming "a considered opinion" does not stand the test of law and cannot be sustained, and, therefore, this plea of the assessee is rejected. It is ordered accordingly.

II. The TPO adopted a non-statutory method for valuating IPR, which is a method not known to law.

8.4) The other legal grievance of the assessee being that the TPO has followed Excess Earning Method and not Comparable Uncontrolled Price Method (CUP) as there was no comparables available with reference to the IPR sold by the Assessee. It was submitted that the TPO wrongly relied on an exposure draft of the International Valuation Standard, which is a non-statutory body, and moreover, the draft is dated 2009, after the date of sale of Tally by the assessee in 2006. It is further submitted that the TPO determined the ALP following the Excess Earning Method and made adjustment to the sale value of the IPR. However, as per section 92C of the Act, the ALP in relation to an international transaction has to be determined only with reference to the prescribed method.

8.5) When this was posed before the Revenue, it was explained by the Revenue that –

> *The IVSC is a well-recognised body for valuers, having been in existence for 25 years. It is recognized by several reputed agencies such as the UK Financial Services Authority, the Hongkong Securities and Futures Commission, the SEBI and the European Public Real Estate Association, among others.*
>
> *Moreover, the valuation method adopted is not part of Exposure Draft, but the final Guidance Note No.34 (Para 4.20) released in February, 2010.*
>
> ***Sale of an IPR is not a routine transaction involving regular purchases and sales. It is a highly specialized process and valuation is the key. In this case, the taxpayer itself admits that there are no comparables. So, the TPO has used an established method [Excess Earnings Method] which is recognized widely. In fact, this method***

supplements the valuation which in effect is done by the CUP method with the final valuation determined being the comparable.

The TPO applied only CUP method. Excess Earnings Method is used only to arrive at the CUP price, the price at which the taxpayer would have sold in an uncontrolled condition. For applying CUP method, we require comparable uncontrolled transaction (CUT). As in this case, there is no external comparable price available in the public domain, as no independent entity sold any software product similar to that of the taxpayer. In such circumstances, indirect method is used to see the price that would have been arrived at, if the taxpayer sold the same Tally Software Product to an independent entity. All the factors that are considered by an independent party, when it sells similar software product are considered by the TPO while arriving at the comparable uncontrolled price. What is important is the arm's length standard. The methods are only tools to see the arm's length standard. The methods should not bind the TPO while arriving at the arm's length price. The main issue to be seen here is whether the TPO applied arm's length principle correctly. The decisions quoted by the taxpayer are not relevant as in those cases, the TPO did not apply any method in this case, and the TPO applied CUP method.

With regard to the assessee's accusation that the arm's length price was determined without considering any comparable cases, for which, the Revenue came up with an answer that –

(i) In the absence of uncontrolled independent comparable companies, the TPO tried to apply internal CUP method, wherein it is seen what is the price for which the same product would have been sold by the taxpayer to an independent entity. All the data considered by the TPO from FY 1999-2000 to 2004-05 is based on uncontrolled transactions between the taxpayer and independent entities. For the same reason, the TPO did not consider the data for the FY 2005-06, as there are substantial related party transactions during FY 2005-06 with its associated enterprises;

(ii) in fact, the Hon'ble Tribunal upheld that valuation method can be adopted to arrive at the CUP price in the case of Intel Asia Electronics Inc. v. ADIT (2011-TII-14-ITAT-BANG-TP).

8.6) Rival submissions are carefully considered. It is to be pointed out in this case the sale of IPR is not a routine transaction involving regular purchase and sale. The assessee itself admits that there is no comparable and the assessee has arrived at the sale consideration at Rs.38.50 crores based on its own valuation. The TPO has used an established method (Excess Earning Method) and this kind of valuation is upheld by the U.S Courts. In fact, this method supplements the valuation which in effect done by CUP method, with a final valuation determined being the comparable. The Bangalore Bench of the Tribunal in the case of Intel Asia Electronics Inc. v. ADIT cited supra had upheld that the valuation method can be adopted to arrive at CUP price. The relevant finding of the Tribunal is extracted as under:

> ***"11. In the instant case, this is an isolated transaction of sale of then assessee's permanent establishment (PE) as a 'going concern' to the assessee's AE and, therefore, there are no similar transactions in an uncontrolled situation to compare with the controlled situation. However, the contentions of the assessee are justifiable that the actual market value of the asset has to be determined in an uncontrolled situation to determine the ALP in this case. In order to determine the actual market value, in the absence of any such identical transaction/transactions, as opted by the assessee, the valuation determined by the registered valuer could be the most appropriate means under CUP method."***

8.7) In the light of the above, it can be stated that the TPO had applied only the CUP method. The excess earning method is used only to arrive at the CUP price, the price at which the assessee would have sold in an uncontrolled condition. In the above circumstances, the second legal issue raised by the assessee - the TPO had adopted a method of valuation of IPR which is not a method prescribed under the Act or Rules – is dismissed.

9) **Let us now turn our attention to the issues raised by the assessee on merits.**

I. *The assessee's grievance was that the TPO should have considered the actual values of sale of software licenses during the future years as the data is available up-to March, 2010 and these figures are much lower than the figures adopted by the TPO.*

When this was placed before the Revenue, the Revenue came up with a claim that –

> ***Firstly, when an intangible is sold, the risk of future income potential lies with the buyer ie., the AE. Secondly, when the Tally software Product was sold in 2006, there was no forecast, not even any iota doubt about global***

> ***economic recession. That the subsequent dip in sales due to global economic slow down does not have relevance at the time of sale as this was not contemplated or comprehended at the time of sale. For example, if a mango orchard is sold to a buyer and there is a crop failure for the next two to three years due to heavy rains at the time of flowering, this risk is that of the buyer and in no way determines the price on the date of sale, as these events are not comprehended at the time of sale;***
>
> ***Further, even if the Hon'ble Tribunal considers actual revenues, the revenues of assessee company along cannot be considered as subsequent to the sale of Tally Software, the taxpayer is responsible for selling in Asia alone. As the taxpayer has distributors all over the world and these distributors are buying directly from the AE, after January, 2006, it was pleaded that the Bench be pleased to afford an opportunity to verify the figures submitted by the taxpayer.***

II. It was contended by the assessee that the TPO had erred in excluding license revenues for the period 1.4.2005 to 31.1.2006 in computing the value of the IPRs. Since the IPRs were sold on 31.1.2006, license revenues till the date of sale of IPRs have to be considered in determining the value of the IPRs.

It was countered by the Revenue that all the data considered by the TPO from FY 1999-2000 to 2004-05 is based on uncontrolled transactions between the taxpayer and independent entities. For the same reason, the TPO did not consider the data for the FY 2005-06, as there are substantial related party transactions during FY 2005-06 with its associated enterprises.

III. In respect of various alternative calculations suggested by the assessee for the valuation of the intangible, the Revenue submitted that –

(i) ***the taxpayer considered the data from the FY 1999- 2000 to FY 2005-06 whereas the TPO considered the data from the FY 1999-2000 to FY 2004-05 as the TPO consciously did not consider the data for the FY 2005-06 as in this year, there are substantial related party or controlled party transactions and, thus, the financials may not be reliable;***

(ii) ***the taxpayer considered the inflation for the FY 2003-04 and 2004-05. But, the relevant inflation rate is the rate for the prospective or future years. The TPO considered the projected inflation rate based on the study carried by the RBI;***

(iii) ***there are various other parameters that are tinkered by the taxpayer without giving any valid reasons; & (iv) It***

> ***was the plea of the Revenue that it may be afforded an opportunity to verify all the figures submitted by the taxpayer before any decision is taken on the quantum.***

10) We have duly considered the rival submissions and perused the materials on records. The TPO, by enumerating the EEM in his impugned order, the value of intangible asset was computed by applying the formula, namely:

The value of intangible asset = A-B-C-D-E = F

A = the future cash flows as reduced by the cost of improvement are discounted using WACC as discounting factor to arrive at total net present value of the cash flows of the business for the years from FY 2006-07 to FY 2011-12

B = Return of fixed assets: the discounted return on capital is computed based on average depreciation charge on sales for the period from FY 1999-2000 to 2004-05 and applying the same for the future years and discounted to the net present value of return on fixed assets;

C = Return on working capital: To consider the return on working capital, the average Working Capita levels as a percentage of sales have been computed for the years from FY 1999-00 to 2004-05. based on the past history, the same ratio is applied for the future years and discounted at the above discount rate [WACC] to arrive at the present value of working capital requirements. The SBI's PLR rate for short term working capital loans for the FY 2005-06 at 10.25% per annum is considered as return on working capital. Based on the above rate, the return on net present value on working capital value has been arrived at.

D = Return on human capital: The average employee cost as percentage of sales for the FY 1999-2000 to FY2004-05 has been considered and applied for future years to arrive at the estimated cost of human capital. Such exercise is done for the future years from FY2006-07 to 2011-1d2. The said cost of human capital is discounted to the present value using the above discounting factor (WACC) for each of the future years.

The value of intangible assets sold = Net discounted cash flow after considering the cost of improvement (A) – return on fixed assets(B) – return on working capital (C)-return on human capital (D).

Net discounted cash flow after considering the cost of improvement

(A)	Rs.666,92,37,810
Less: Return on fixed assets	100,27,51,104
Return on working capital(C)	57,32,27,882
Return on Human Capital (D)	7,86,25,072
The value of intangible	Rs.501,46,33,752

<u>Price received vis-à-vis the arms Length Price:</u>

The consideration received by the taxpayer = Rs.11,81,03,800/- (sale of intellectual property rights as per the agreement dated 31.3.2006)+Rs.26,69,43,026/- (expenditure incurred by the taxpayer on development of Tally ascent software during the period 1.4.2005to 31.1.2006 reimbursed by the AE). Thus, the total payments by the AE towards the purchase of the IPR were Rs.38,50-,46,826/-. The price charged by the tax payer to its Associated Enterprises is compared to the Arms Length price as under:

Arms Length price as arrived at	***Rs.501,46,33,752***
Price shown in the international transactions	***38,50,46,826***
Short fall being adjustment u/s 92CA	***Rs.462,95,86,926***

Total adjustment arrived at Rs.466,47,93,251/- has been brought down to Rs.260,63,921,602/- as per revised valuation dated: 23.9.2010 at the instance of DRP. Since there were, admittedly, no comparables available with reference to the IPR sold by the assessee, the TPO had determined the ALP following the Excess Earning Method and made adjustment to the sale value of the IPR.

10.1) The DRP initially rejected the TPO's conclusion in arriving at the adjustment of Rs.466.47 crores. On being directed by the DRP on the basis of the assessee's strong objection, the TPO came up with a revised valuation report which suggests that the adjustment to be made at Rs.222.13 crores. As the DRP was unable to bring the warring groups [as the Ld. TPO as well as the Ld. AR have disagreed to narrow down their differences to the revised valuation report of the TPO] to fore, it came up with a via media, according to which, the assessee was asked to submit its own valuation of the IPR. The assessee had arrived at the value on first method at Rs.40.42 crores and by a second method at Rs.64.05 crores with a fervent submission to adopt Rs.52.23 crores being average of the first and second methods which was, however, not found favour with the Revenue. Strangely, the DRP upheld the revised valuation report of the Ld. TPO by terming the valuation reports furnished by the assessee as '**extremely perfunctory**' with no illustration as to how the report of the assessee had become as such. The adjustment to be made on the basis of the revised working of the TPO was opted at Rs.222.13 crores as against Rs.466.47 crores adopted in the draft assessment order. To demonstrate further the genuineness in the transaction, the assessee, during the course of hearing, came up with alternative computation as detailed in its submission cited supra. According to various method adopted, the arm's length price was less than what was the price received as admitted by the assessee at Rs.38.50 crores. It is true that it is difficult to value business more particularly to value a closely-held concern because each company has its own unique characteristics. Often, consideration has to be given to the future profits the company will be able to earn. The valuation may be

influenced by the reason for it. For example, a different approach may be appropriate for divorce litigation compared to the price to pay for a targeted company compared to valuation for estate tax purposes. Thus, valuation depends on the purpose at hand. The valuation process is an art and not a science, since everyone's perception is slightly different. In litigation matters, the valuation method selected should be logically consistent, reasonable, costeffective and simply explained.

10.2) The excess earning method is the method that is adopted by the TPO. We see no infirmity in adoption of this method for the simple reason that the relevant data is available with reasonable accuracy, closing in on real valuation of a software product. This valuation is upheld by the US courts while arriving at the sale value of a software product. Further, the valuation under the method mainly revolves around discounted cash flow (DCF) analysis which is known to economists for the times immemorial. Thus, the TPO used a reasonable well accepted method of valuation of intangibles including software products and accepted by courts in the countries like in USA, where the TP regime is well developed. At the risk of repetition, the excess earning method followed by the TPO is summarized as under:–

- The excess earning method determines the value of an intangible asset as the present value of the cash flows attributable to the subject. Intangible asset after excluding the proportion of the cash flows that are attributable to the other assets.
- The method involves forecasting the cash flows expected to arise from the business or the businesses that uses the subject Intangible.
- From the above forecast of the cash flows a deduction is made in respect of the contribution of the cash flow that is made by the assets tangible or intangible and the financials, other than the subject intangible asset.
- Forecast cash flows are brought to the capital value by applying the present value techniques and the suitable discount rates.
- The contributory asset charges are derived as follows:–
  1. For the return on the tangible asset, a notional depreciation charge is used as a surrogate for the return of the asset.
  2. A fair return on the working capital is discounted to the present value.
  3. Return on the work force is determined as a return changed on the fair value of the work force asset. Work force asset is usually valued using the work cost approach.
  4. A fair return on the other Intangible assets by the way of hypothetical royalty rate that would be changed to lease the asset.

For discussing the net present value (NPV), a uniform discount rate is used to arrive at the discounted cash flow. Often the weighted average cost of the capital (WACC) is used as the discounting factor.

The WACC is the weighted average of the cost of the debt and the cost of the equity.

In the case of the taxpayer, there is no active market in identical or near similar intangible asset. Therefore, the IPR sold by the taxpayer is to be valued primarily using an income capitalization method. In the Income Capitalization method, the TPO used the Excess Earnings Method (EEM) as described above. This is because qualitative and subjective adjustments are required to apply the transaction data from the non-identical assets, which adversely affect reliability.

To sum up, the intangibles i.e. the sale of the *Tally* software products along with its copyright and trade marks are valued by the following steps under Excess Earnings Method:

Step 1 : Estimating future turnover till 2012 based on the past performance as well as the data available in the public domain.

Step 2 : The cash flows (EBIDTA – earning before interest-tax, depreciation and amortization) are estimated in the future years based on the performance of the taxpayer in terms of EBIDTA to sales from F.Y. 1999-2000 to F.Y. 2004-2005. The data for the FY 2005-2006 was not considered as the intangibles is transferred during the year and there are related party transactions during the year which may initiate the reliability of the data.

Step 3 : The future cash flow are discounted to the present value by using a constant discounting factor which is WACC

$WACC = We\ Ce + Wd\ Cd$

Where We = Weight of Equity

Ce = Cost of Equity

We = Weight of Debt

Cd = Cost of Debt

The $Ce = Rf + BxRf$

Where Rf = Risk Free Return or Return on long term Government Bonds

B = B of the taxpayer

As the taxpayer is not a listed company, the B of a similar company, Sankhya Infotech Ltd. has been considered. This company is in development and sale of software products for

aviation industry. B has been taken from BSE Index which is 0.58.

Rp = Risk Premium of the Index (that is BSI Index)

= 8.8 (as verified from the public sources).

Cost of Debt = prevalent PI R rate of SBI (10.57%)

Equity = average of paid of share capital and reserves & surpluses

Debt = average of long term borrowings (secured loans).

Step 4: PRESENT VALUE OF IMPROVEMENTS

The expected cost of improvement in the future years is computed based on the past expenditure on R&D on capital account. As the R&D on revenue account stands already considers while computing the cash flows in terms of EBIDA as the taxpayer is charging the entire R&D expenditure on revenue account to the Profit & Loss Account. Based on the average cost of improvement, the cost of improvement for the future years from FY 2006-07 to FY 2011-12 are estimated and discounted by the above discounting factor (WACC) to arrive at the present value of cost of improvement.

Step 5:(A) The above future cash flows as reduced by the cost of improvement are discounted using WACC as discounting factor to arrive at total net present value of the cash flows of the business for the years from FY 2006-07 to FY 2011-12.

Step 6:(B) RETURN ON FIXED ASSETS

The discounted return on capital is computed based on average depreciation charge on sales for the period from FY 1999-2000 to FY 2004-05 and applying the same for the future years and discounted to the net present value of return on fixed assets.

Step 7:(C) RETURN ON WORKING CAPITAL

To consider the return on working capital, the average working capital levels as a percentage of sales have been computed for the years from FY 1999-2000 to FY 2004-05. Based on the past history, the same ratio is applied for the future years and discounted at the above discount rate (WACC) to arrive at the present value of working capital requirements. The State Bank of India's PLR rate for short term working capital loans for the FY 2005-06 at 10.25% per annum is considered as return on working capital. Based on the above rate, the return on net present value on working capital value has been arrived at.

<u>Step 8</u>:(D) <u>RETURN ON HUMAN CAPITAL</u>

The average employee cost as percentage of sales for the FY 1999-2000 to FY 2004-05 has been considered and applied for future years to arrive at the estimated cost of human capital. Such exercise is done for the future years from FY 2006-07 to 2011-12. The said cost of human capital is discounted to the present value using the above discounting factor (WACC) for each of the future years.

To consider the return on human capital, various article have been read. As for the Annual Report of the Infosys Technology Ltd. for the FY 2005-06, the company earned 5% return on its human capital. The same return has been applied in the case of the tax payer on the above arrived value of human capial.

Thus, the value of intangible asset is computed as under:

The value of intangible asset = A-B-C-D-E = F

The arm's length price of the intangible asset is therefore F as computed above.

We agree with the TPO in adopting the above method and having concluded in the preceding paragraph that the excess earning method adopted by the TPO to arrive at the ALP is correct, we reject the assessee's contention that the ALP should be computed based on actual sales and not projection adopted by TPO. The reasons for rejecting the above contention of the assessee are as follows:

i) When an intangible is sold, the risk of future income potential lie with the buyer.

ii) When tally software was sold in 2006, there was no forecast about the global economy recession. The subsequent dip in sale due to global economic slow down does not have relevance at the time of sale as this is not contemplated or comprehended at the time of sale.

iii) The essence of excess earning method is to project the future revenue earning, based on past year data.

10.3) However, we disagree with certain figures adopted by the TPO in arriving at the value of ALP of the sale of IPR. To arrive at the ALP the TPO had taken the actual total operating revenue for the assessment years 2000-01 to 2005-06 and based on the same, he had computed CAGR at 20.39% and the projected expected revenue for the period from the AYs 2007-08 to 2011-12. The TPO had ignored the actual facts that the revenues for the AYs 2004-05 and 2006-07 were dipped, instead, the TPO assumed theoretically that the sales will keep growing. The IPR was sold only on 31.1.2006, therefore, the sales for ten months i.e., from 1.4.2005 to the date of sale should have been included for computing the future revenues. This has been ignored by the TPO. The TPO in his remand

report had stated that the current year [AY 2006-07] data was not taken since the same involved the related party transactions and the transaction involving IPR took place this year. This stand of the TPO was hotly contested by the assessee that the sales of tally licenses were to third parties and not to related parties as portrayed by the TPO. It was, further, claimed by the assessee that what was sold by assessee was IPR which generates license revenues and, thus, to value IPR what needs to be considered was revenue from Tally licenses which were sold to third parties. The other related party transactions have no relevance factors. The situation in the AY 2006-07 was similar to situation in all the years considered by the TPO. Therefore, it was claimed by the assessee that the reasoning of the TPO was baseless. Refuting the TPO's reasoning that the transaction involving IPR took place in this year and, therefore, current year data was excluded, the assessee submitted that since the sale was in the current year, it was more so important to consider the current year's sales which, according to the assessee, in consonance with the provisions of rule 10B (4) which mandate use of current year's data. It was, therefore, contended by the assessee that the current year data should have been used to estimate future revenues. There is force in the contention of the assessee that the sale data for the period from April, 2005 to Jan 2006 was vital to arrive at correct projection which reflects the true earning potential of the IPR at the time of sale. Therefore, in the course of this order, we are directing the TPO to include the figure for AY 2006-07 for arriving at the value of ALP.

10.4) In the AY 2005-06, it was the claim of the assessee that there has been a sale return of Rs. 111.04 crores. The sale return has to be reduced while calculating CAGR which is, in our view, reasonable and justifiable. This vital fact has been given a go-by. The TPO had considered the sales for the AY 2005-06 at Rs.198.15 crores which was termed by the TPO as the base for computing CAGR and future revenues. It was true that there was a substantial upward trend in the turnover during the AY 2005-06, however, in the immediately preceding and succeeding AYs there was plunge in the turnover [source: Figures supplied by the assessee]. This vital fact should have been taken cognizance of while computing CAGR and estimating future revenues by the TPO. During the course of hearing, it was submitted that with the introduction of VAT across the country w.e.f. 1.4.2005, more traders were required to automated systems to support the increased work and, thus, distributors were forced to off-take large quantities of software package which was accounted for as turnover in the assessee's books. However, in the last three months of the AY 2005-06, the sales accounted for were almost 100% not received and, in fact, 95% of sales for 2005-06 were in the month of March and the debtor outstanding as on 31.3.2005 was to the tune of Rs.197.14 crores. Though the assessee's accounted revenue increased in the AY 2005-06, the dealers could not sell the whole stocks which were dumped by the assessee with them in anticipation of

favourable climate in sales. There was a sale return to the tune of Rs.111.04 crores pertaining to the sales made in AY 2005-06. It was claimed that the turnover as reported did not materialize. These facts have not been taken care of by the TPO while assuming the future turnover projection. It was, further, contended that the TPO's contention that he was very conservative and taken CAGR at 20.39% instead of 90.80% that the lower CAGR takes care of all possible effects on future cash flows was termed by the assessee a mere assumption and presumption on the part of the TPO and nothing else. As stated earlier, we are of the view that sale return, as arrived above, has to be reduced while calculating CAGR. Further, we add that the actual CAGR is to be considered for projection without any discount.

10.5) We also find prima facie flaw in the calculation of discount factor given by the TPO. The TPO has considered 3 companies as comparable to the assessee's segment of distribution of products. These companies are Lifetree Convergence Limited, Exensys Software Solutions Limited and Sankhya Infotech Limited (page 139 of the TP order). Out of these three, only Sankhya Infotech's Beta has been considered. Why the other two companies are not considered is not clear. We are of the view that Beta should be computed after considering all the three companies. The average Beta of the three companies, it was submitted, would be 1 and the computation of Beta is furnished at page 408 to 414 of the paper book (submitted by the assessee). This computation needs to be examined by the TPO. While calculating the working capital, the TPO has not considered the cash and bank balances and other current assets (except inter-corporate deposits) and provisions. Further, it is directed that the sale returns of Rs.111.04 crores has to be reduced from the sundry debtors while calculating the working capital. We are of the view the same should also be considered while computing working capital ratio.

11) Taking into account the rival submissions, diligent perusal of the relevant records and also the documentary evidences adduced by either party, the TPO is directed to recalculate the ALP keeping in view the following specific directions of this Bench, namely:

I. Method of valuation of ALP:

(i) Considering the nature of transaction and in the absence of uncontrolled independent comparable companies, we are of the considered view that the Excess Earning Method [EEM] adopted by the TPO in the present circumstance is reasonable and, therefore, he is directed to adopt the same EEM while recalculating the ALP;

(ii) The reason for adopting EEM method that it is only an internal CUP method, wherein, it is seen what is the price for which the same product would have been sold by the assessee to an independent entity. This price also reflects the price at which

the assessee would have sold in an uncontrolled condition, but, as there were no comparable prices available in the public domain for sale of IPR produce similar to that of the assessee, this EEM is used to determine the price that would have been arrived at, if the assessee sold the IPR to an independent entity.

While calculating the ALP under EEM, the TPO is directed to adhere the following steps, namely:

II. <u>Estimating future turnover based on the past performance:</u>

(i) with reference to the actual operating revenue from the AY 1999-2000 to 2006-07, the sale return of Rs.111.04 crores for the AY 2005-06 has to be reduced from the operating revenue and only the net has to be taken as this is the correct accounting standard to be followed for arriving at CAGR. As can be seen from the records, the revenue for the AY 2005-06 looks abnormal compared to other AYs and there was also revenue to the extent of Rs.111.04 crores which did not materialize due to distributors being not able to sell the stocks which was forced on them in a greater quantity with an anticipation of good revenues due to introduction of VAT. In the same calculation, the revenue for the year 2006-07 has to be adopted. As the date of valuation of IPR was on 31.1.2006, the actual revenues upto January, 2006 has to be taken and the next two months will have to be projected based on the performance of the previous ten months. As the assessee had sold only IPR and the calculation of revenues are from Tally Licenses which were sold to third parties, the sale of IPR to a related party transaction has no relevance for this sale of Tally license. Hence, the current year data i.e., AY 2006-07 has to be included as they relate to third party transactions and the projections have to be made for the future years based on the revenues of AY 2006-07 which is also in accordance with the provisions of rule 10B(iv) which mandate the use of current year data. The projection has to be made for next six years which has rightly been adopted by the TPO. Further, the assessee's contention to adopt the actual revenues for the future years which are available now cannot be accepted now for a simple reason that the ALP was calculated on the date of sale which was in January, 2006 itself and also under EEM future revenues will be projected based on the previous year data keeping the current year's data as the base which has got no relevance on the actual revenues during the future years. We also make it clear that the actual CAGR shall be adopted by the TPO without any discount.

(ii) **Estimation of future cash flows**: We are in agreement with the method adopted by the TPO in estimating the cash flows

except that the revenues for the AY 2006-07 has to be considered and is to be taken as the base year for future projection of revenue for the reasons recorded supra [Para (i)].

(iii) **Estimation of discounted future cash flows**: We are in total agreement with the TPO in estimating of discounted future cash flows except in calculation of BETA where the TPO, even after having considered three companies as comparable to the assessee's segment of distribution of products, had wrongly took only one company's Beta which, in our considered view, was not reasonable. Therefore, an average of three companies' beta has to be taken for calculation.

(iv) **present value of improvement**: we agree with the TPO on this score.

(v) **Future cash flows**: We agree with the TPO on this point.

(vi) **Return on fixed assets**: We agree with the stand of the TPO on this issue.

(vii) **Return on working capital**: we do agree with the TPO's working except that the sale return of Rs.111.04 crores has to be reduced from sundry debtors for the AY 2005-06 and the cash, bank balances and other current assets have to be considered for calculation of 'current assets´ for all the years.

(viii) **Return on human capital**: We are in agreement with the TPO's working.

After following the above formulae, the TPO should calculate the ALP accordingly. If the amount so arrived at were to be higher than the total actual consideration [Rs.38.50 crores] received, the TPO should adopt the higher price arrived at.

With regard to the calculation of IPR as on 31.1.2006 as compared to repurchase of IPR by the assessee on **30.9.2008** for a sum of Rs.53,67,52,505/- [source: P 385 of PB AR], we are in agreement with the contention of the Revenue that the value paid by the assessee to AE for subsequent purchase of the same software product cannot be considered as uncontrolled transaction as the said transaction was between two associated enterprises. Further, as there was a long gap of almost three years between the two transactions; we are of the view that the point raised by the assessee for comparison is unreasonable due to the subsequent value additions made to the IPR and discounting factors.

12. In view of the above, the appeal filed by the assessee is partly allowed for statistical purposes.

The order pronounced on Monday, the 26th day of September, 2011 at Bangalore.

2011 PTR 1626 (S.C. Ind.)

SUPREME COURT OF INDIA

Hon'ble The Chief Justice, S.H. Kapadia, B. Sudershan Reddy, K.S. Radhakrishnan, Surinder Singh Nijjar and Swatanter Kumar, JJ

Brij Lal & Ors.
v.
Commissioner of Income Tax, Jalandhar

FACTS/HELD

1. **While interest u/ss 234A to 234C are applicable to settlement commission proceedings, it is payable only up to the s. 245D(1) order and cannot be levied u/s 154**
2. In the light of the divergent judgements of the Supreme Court in **Anjum Ghaswala** 252 ITR 1, **Hindustan Bulk Carrier** 259 ITR 449 and **Damani Brothers** 259 ITR 475, a reference was made to the Full Bench of the Supreme Court to answer the questions (i) whether ss. 234A, 234B & 234C were applicable to Settlement Commission proceedings, (ii) whether such interest is payable up to the date of the s. 245D(1) order or up to the date of the s. 245D (4) order and (iii) whether the Settlement Commission can re-open its concluded proceedings by having recourse to s. 154 so as to levy interest u/s 234B, if it was not done in the original proceedings?
3. HELD by the Full Bench:
   (i) Though Chapter XIX- A is a self-contained Code, the procedure to be followed by the Settlement Commission u/s 245C and 245D is nothing but assessment or computation of total income which takes place at the s. 245D(1) stage. *In that computation, provisions dealing with a regular assessment, self-assessment and levy and computation of interest for default in payment of advance tax, etc. are engrafted.* Accordingly, **ss. 234A to 234C are applicable;**
   (ii) **Interest under ss. 234A to 234C is payable only up to the date of the s. 245D (1) order and not up to the**

date of the s. 245D (4) order. In a case where 90% of the assessed tax is paid but on the basis of the Commission's order u/s 245D(4) the advance tax paid turns out to be less than 90% of the assessed tax as defined in the Explanation to s. 234B(1), no interest is payable for shortfall. **The Legislature has not contemplated levy of interest between the s. 245D (1) stage and the s. 245D (4) stage**. Interest u/s 234B is chargeable only till the order of the Settlement Commission u/s 245D(1), i.e., admission of the case;

(iii) In view of s. 245I which provides that the order of the Settlement Commission shall be final and conclusive and also in view of the controversy as to liability for interest, **the Settlement Commission cannot re-open concluded proceedings by having recourse to s. 154 to levy interest u/s 234B if it was not done in the original proceedings**.

Leave granted.

Civil Appellate/Original Jurisdiction Civil Appeal Nos. 516-527 of 2004 with Civil Appeal Nos. 280-286/2005, Civil Appeal No. 8324/2004, Civil Appeal Nos.8325-8328/2004, Civil Appeal No. 603/2005, Civil Appeal No. 990/2005, Civil Appeal No. 925/2005, Civil Appeal No. 924/2005, Writ Petition (C) No. 556/2004, Writ Petition(C)No. 555/2004, Civil Appeal Nos. 2247-2250/2005, Civil Appeal No. 923/2005, Civil Appeal No. 995/2005, Civil Appeal No. 994/2005, Writ Petition (C) No. 63/2005, Writ Petition (C) No. 61/2005, Writ Petition (C) No. 62/2005, Writ Petition (C) No. 60/2005, Civil Appeal No. 2246/2005, Civil Appeal Nos. 3231-3232/2005, Civil Appeal No. 3091/2004, Civil Appeal No. 3087/2004, Civil Appeal No. 3092/2004, Civil Appeal Nos.4599- 4601/2004, Civil Appeal Nos. 528-531/2004, Writ Petition (C) No. 325/2004, Writ Petition (C) No. 324/2004, Writ Petition (C) No. 326/2004, Civil Appeal No. 992/2007, Civil Appeal No.9174/2010 @ SLP (C) No. 20373/2009, Civil Appeal No. 532/2004, and Civil Appeal No. 604/2005.

Decided on: 21st October, 2010.

ORDER

S.H. Kapadia:– CJI

1. Leave granted.

2. Vide referral orders dated 14.12.2004 and 20.1.2005 the following questions have been referred to the Constitution Bench of this Court:

(i) Whether sections 234A, 234B and 234C of the Income Tax Act, 1961 (for short "the Act") are at all applicable to proceedings of the Settlement Commission under Chapter XIX-A of the Act?

(ii) Whether the Settlement Commission can reopen its concluded proceedings by having recourse to section 154 of the Act so as to levy interest under sections 234A, 234B and 234C of the Act, though it was not so done in the original proceedings?

(iii) Whether in the absence of period of limitation prescribed for making the order of the Settlement, the relevant date for determining the quantum of interest could be the date of the said order?

3. For the sake of convenience, after hearing learned counsel on both sides, we reframe the above questions.

(I) Whether section 234B applies to proceedings of the Settlement Commission under Chapter XIX-A of the said Act?

(II) If answer to the above question is in the affirmative, what is the terminal point for levy of such interest - Whether such interest should be computed up to the date of the Order under section 245D(1) or up to the date of the Order of the Commission under section 245D(4)?

(III) Whether the Settlement Commission could reopen its concluded proceedings by invoking section 154 of the said Act so as to levy interest under section 234B, though it was not so done in the original proceedings?

Relevant provisions of the Income Tax Act, 1961:

4. In order to answer the reframed questions, quoted above, it would be necessary for us to cite the relevant provisions of the Act and the Income Tax Rules, as they stood at the material time, which are as under:

Definitions

2(40) "regular assessment" means the assessment made under sub-section (3) of section 143 or section 144;

2(45) "total income" means the total amount of income referred to in section 5, computed in the manner laid down in this Act;

Chapter XIV - Procedure for Assessment Self-assessment

140A. (1) Where any tax is payable on the basis of any return required to be furnished under section 139 or section 142 or as the case may be, section 148, after taking into account the amount of tax, if any, already paid under any provision of this Act, the assessee shall be liable to pay such tax together with interest payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of

advance tax, before furnishing the return and the return shall be accompanied by proof of payment of such tax and interest.

Explanation.--Where the amount paid by the assessee under this sub-section falls short of the aggregate of the tax and interest as aforesaid, the amount so paid shall first be adjusted towards the interest payable as aforesaid and the balance, if any, shall be adjusted towards the tax payable.

(2) After a regular assessment under section 143 or section 144 has been made, any amount paid under sub-section (1) shall be deemed to have been paid towards such regular assessment.

Assessment

143. (1)(a) Where a return has been made under section 139, or in response to a notice under sub-section (1) of section 142,–

(i) if any tax or interest is found due on the basis of such return, after adjustment of any tax deducted at source, any advance tax paid and any amount paid otherwise by way of tax or interest, then, without prejudice to the provisions of sub- section (2), an intimation shall be sent to the assessee specifying the sum so payable, and such intimation shall be deemed to be a notice of demand issued under section 156 and all the provisions of this Act shall apply accordingly; *** *** *** Provided also that an intimation for any tax or interest due under this clause shall not be sent after the expiry of two years from the end of the assessment year in which the income was first assessable.

(b)Where as a result of an order made under sub-section (3) of this section or section 144 or section 147 or section 154 or section 155 or section 250 or section 254 or section 260 or section 262 or section 263 or section 264, or 6 any order of settlement made under subsection (4) of section 245D relating to any earlier assessment year and passed subsequent to the filing of the return referred to in clause (a), there is any variation in the carry forward loss, deduction, allowance or relief claimed in the return, and as a result of which,–

(i) if any tax or interest is found due, an intimation shall be sent to the assessee specifying the sum so payable, and such intimation shall be deemed to be a notice of demand issued under section 156 and all the provisions of this Act shall apply accordingly, and

(ii) if any refund is due, it shall be granted to the assessee: Provided that an intimation for any tax or interest due under this clause shall not be sent after the expiry of four years from the end of the financial year in which any such order was

passed. (4) Where a regular assessment under sub- section (3) of this section or section 144 is made,–

(a) any tax or interest paid by the assessee under sub-section (1) shall be deemed to have been paid towards such regular assessment;

Rectification of mistake.

154. (1) With a view to rectifying any mistake apparent from the record an income-tax authority referred to in section 116 may,-- (a) amend any order passed by it 7 under the provisions of this Act ; (b) amend any intimation sent by it under sub-section (1) of section 143. or enhance or reduce the amount of refund granted by it under that subsection.

(1A) Where any matter has been considered and decided in any proceeding by way of appeal or revision relating to an order referred to in sub-section (1), the authority passing such order may, notwithstanding anything contained in any law for the time being in force, amend the order under that sub-section in relation to any matter other than the matter which has been so considered and decided. (2) Subject to the other provisions of this section, the authority concerned-- (a) may make an amendment under sub-section (1) of its own motion, and (b) shall make such amendment for rectifying any such mistake which has been brought to its notice by the assessee, and where the authority concerned is the Deputy Commissioner (Appeals), or the Commissioner (Appeals) by the Assessing Officer also. (3) An amendment, which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee, shall not be made under this section unless the authority concerned has given notice to the assessee of its intention so to do and has allowed the assessee a reasonable opportunity of being heard.

Chapter XVII - Collection and Recovery of Tax Liability for payment of advance tax.

207. Tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following the financial year, such income being hereafter in this Chapter referred to as “current income”.

Computation of advance tax.

209. (1) The amount of advance tax payable by an assessee in the financial year shall, subject to the provisions of sub-sections (2) and (3), be computed as follows, namely:-- (a) where the

calculation is made by the assessee for the purposes of payment of advance tax under sub-section (1) or sub- section (2) or sub-section (5) or sub-section (6) of section 210, he shall first estimate his current income and income-tax thereon shall be calculated at the rates in force in the financial year; Payment of advance tax by the assessee of his own accord or in pursuance of order of Assessing Officer.

210. (1) Every person who is liable to pay advance tax under section 208 (whether or not he has been previously assessed by way of regular assessment) shall, of his own accord, pay, on or before each of the due dates specified in section 211, the appropriate percentage, specified in that section, of the advance tax on his current income, calculated in the manner laid down in section 209.

(2) A person who pays any instalment or instalments of advance tax under sub-section (1), may increase or reduce the amount of advance tax payable in the remaining instalment or instalments to accord with his estimate of his current income and the advance tax payable thereon, and make payment of the said amount in the remaining instalment or instalments accordingly. Interest payable by assessee.

215. (1) Where, in any financial year, an assessee has paid advance tax under section 209A or section 212 on the basis of his own estimate (including revised estimate), and the advance tax so paid is less than seventy-five per cent of the assessed tax, simple interest at the rate of fifteen per cent per annum from the 1st day of April next following the said financial year up to the date of the regular assessment shall be payable by the assessee upon the amount by which the advance tax so paid falls short of the assessed tax:

Provided that in the case of an assessee, being a company, the provisions of this subsection shall have effect as if for the words “seventy- five per cent', the words “eightythree and one- third per cent” had been substituted.

(2) Where before the date of completion of a regular assessment, tax is paid by the assessee under section 140A or otherwise,-- (i) interest shall be calculated in accordance with the foregoing provision up to the date on which the tax is so paid; and (ii) thereafter, interest shall be calculated at the rate aforesaid on the amount by which the tax as so paid (in so far as it relates to income subject to advance tax) falls short of the 1 assessed tax.

(3) Where as a result of an order under section 147 or section 154 or section 155 or section 250 or section 254 or section 260 or section 262 or section 263 or section 264 or an order of the

Settlement Commission under sub- section (4) of section 245D, the amount on which interest was payable under sub-section (1) has been increased or reduced, as the case may be, the interest shall be increased or reduced accordingly, and-- (i) in a case where the interest is increased, the Assessing Officer shall serve on the assessee, a notice of demand in the prescribed form specifying the sum payable, and such notice of demand shall be deemed to be a notice under section 156 and the provisions of this Act shall apply accordingly;

(ii) in a case where the interest is reduced, the excess interest paid, if any, shall be refunded.] (4) In such cases and under such circumstances as may be prescribed, the Assessing Officer may reduce or waive the interest payable by the assessee under this section. (5) In this section and sections 217 and 273, "assessed tax" means the tax determined on the basis of the regular assessment (reduced by the amount of tax deductible in accordance with the provisions of sections 192 to 194, section 194A, section 194C, section 194D, section 195 and section 196A so far as such tax relates to income subject to advance tax and so far as it is not due to variations in the rates of tax made by the Finance Act enacted for the year for which the regular assessment is made.

(6) Where, in relation to an assessment year, an assessment is made for the first time under 1 section 147, the assessment so made shall be regarded as a regular assessment for the purposes of this section and sections 216, 217 and 273. Interest for defaults in furnishing return of income.

234A. (1) Where the return of income for any assessment year under sub-section (1) or sub-section (4) of section 139, or in response to a notice under sub-section (1) of section 142, is furnished after the due date, or is not furnished, the assessee shall be liable to pay simple interest at the rate of two per cent for every month or part of a month comprised in the period commencing on the date immediately following the due date, and,-- (a) where the return is furnished after the due date, ending on the date of furnishing of the return; or (b) where no return has been furnished, ending on the date of completion of the assessment under section 144, on the amount of the tax on the total income as determined under sub-section (1) of section 143 or on regular assessment as reduced by the advance tax, if any, paid, and any tax deducted or collected at source;

Explanation 1.--In this section, "due date" means the date specified in sub-section (1) of section 139 as applicable in the case of the assessee.

Explanation 2.--In this sub-section, "tax on the total income as determined under subsection (1) of section 143" shall not include the additional income-tax, if any, payable under 1 section 143.

Explanation 3.--Where, in relation to an assessment year, an assessment is made for the first time under section 147, the assessment so made shall be regarded as a regular assessment for the purposes of this section.

Explanation 4. - In this sub-section, "tax on the total income as determined under subsection (1) of section 143 or on regular assessment" shall, for the purposes of computing the interest payable under section 140A, be deemed to be tax on total income as declared in the return.

(2) The interest payable under sub-section (1) shall be reduced by the interest, if any, paid under section 140A towards the interest chargeable under this section. *** *** ***

(4) Where as a result of an order under section 154 or section 155 or section 250 or section 254 or section 260 or section 262 or section 263 or section 264 or an order of the Settlement Commission under sub-section (4) of section 245D, the amount of tax on which interest was payable under sub-section (1) or sub-section (3) of this section has been increased or reduced, as the case may be, the interest shall be increased or reduced accordingly, and-- (i) in a case where the interest is increased, the Assessing Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum payable, and such notice of demand shall be deemed to 1 be a notice under section 156 and the provisions of this Act shall apply accordingly; (ii) in a case where the interest is reduced, the excess interest paid, if any, shall be refunded.

(5) The provisions of this section shall apply in respect of assessments for the assessment year commencing on the 1st day of April, 1989 and subsequent assessment years. Interest for defaults in payment of advance tax.

234B. (1) Subject to the other provisions of this section, where, in any financial year, an assessee who is liable to pay advance tax under section 208 has failed to pay such tax or, where the advance tax paid by such assessee under the provisions of section 210 is less than ninety per cent of the assessed tax, the assessee shall be liable to pay simple interest at the rate of two per cent for every month or part of a month comprised in the period from the 1st day of April next following such financial year to the date of determination of total income under sub- section (1) of section 143 and where a regular assessment is made, to the date of such regular assessment, on an amount equal to the assessed tax or, as

the case may be, on the amount by which the advance tax paid as aforesaid falls short of the assessed tax.

Explanation 1.--In this section, "assessed tax" means (a) for the purposes of computing the interest payable under section 140A the tax on the total income as declared in the return referred to in that section; 1 (b) in any other case, the tax on the total income determined under sub-section (1) of section 143 or on regular assessment, as reduced by the amount of tax deducted or collected at source in accordance with the provisions of Chapter XVII on any income which is subject to such deduction or collection and which is taken into account in computing such total income.

Explanation 2.--Where, in relation to an assessment year, an assessment is made for the first time under section 147, the assessment so made shall be regarded as a regular assessment for the purposes of this section. Explanation 3.--In Explanation 1 and in subsection (3) "tax on the total income determined under sub-section (1) of section 143" shall not include the additional income-tax, if any, payable under section 143.

(2) Where, before the date of determination of total income under sub-section (1) of section 143 or completion of a regular assessment, tax is paid by the assessee under section 140A or otherwise,-- (i) interest shall be calculated in accordance with the foregoing provisions of this section up to the date on which the tax is so paid, and reduced by the interest, if any, paid under section 140A towards the interest chargeable under this section; (ii) thereafter, interest shall be calculated at the rate aforesaid on the amount by which the tax so paid together with the advance tax paid falls short of the assessed tax.

(3) Where, as a result of an order of reassessment or recomputation under section 147, the amount on which interest was payable under sub-section (1) is increased, the assessee shall be liable to pay simple interest at the rate of two per cent for every month or part of a month comprised in the period commencing on the day following the date of determination of total income under sub- section (1) of section 143 and where a regular assessment is made as is referred to in sub- section (1) following the date of such regular assessment and ending on the date of the reassessment or recomputation under section 147, on the amount by which the tax on the total income determined on the basis of the reassessment or recomputation exceeds the tax on the total income determined under subsection (1) of section 143 or on the basis of the regular assessment aforesaid.

(4) Where, as a result of an order under section 154 or section 155 or section 250 or section 254 or section 260 or section 262 or section 263 or section 264 or an order of the Settlement Commission under sub-section (4) of section 245D, the amount on which interest was payable under sub-section (1) or sub- section (3) has been increased or reduced, as the case may be, the interest shall be increased or reduced accordingly, and-- (i) in a case where the interest is increased, the Assessing Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum payable and such notice of demand shall be deemed to be a notice under section 156 and the provisions of this Act shall apply accordingly; (ii) in a case where the interest is reduced, the excess interest paid, if any, 1 shall be refunded.

(5) The provisions of this section shall apply in respect of assessments for the assessment year commencing on the 1st day of April, 1989 and subsequent assessment years. Interest for deferment of advance tax.

234C. (1) Where in any financial year,-- (a) the company which is liable to pay advance tax under section 208 has failed to pay such tax or--

(i) the advance tax paid by the company on its current income on or before the 15th day of June is less than fifteen per cent of the tax due on the returned income or the amount of such advance tax paid on or before the 15th day of September is less than forty-five per cent of the tax due on the returned income or the amount of such advance tax paid on or before the 15th day of December is less than seventy-five per cent of the tax due on the returned income, then, the company shall be liable to pay simple interest at the rate of one and one-half per cent per month for a period of three months on the amount of the shortfall from fifteen per cent or forty-five per cent or seventy-five per cent, as the case may be, of the tax due on the returned income;

(ii) the advance tax paid by the company on its current income on or before the 15th day of March is less than the tax due on the returned income, then, the company shall be liable to pay simple interest at the rate of one and one-half per cent on the amount of the shortfall from the tax due on the returned income:

Explanation.--In this section, “tax due on the returned income” means the tax chargeable on the total income declared in the return of income furnished by the assessee for the assessment year commencing on the 1st day of April immediately following the financial year in which the advance tax is paid or payable, as reduced by the amount of tax deductible or collectible at

source in accordance with the provisions of Chapter XVII on any income which is subject to such deduction or collection and which is taken into account in computing such total income;

(2) The provisions of this section shall apply in respect of assessments for the assessment year commencing on the 1st day of April, 1989 and subsequent assessment years.

Chapter XIX-A - Settlement of Cases Definitions

245A. In this Chapter, unless the context otherwise requires,-- (b) “case” means any proceeding under this Act for the assessment or re- assessment of any person in respect of any year or years , or by way of appeal or revision in connection with such assessment or re- assessment, which may be pending before an Income Tax Authority on the date on which an application under sub-section (1) of section 245C is made:

Provided that where any appeal or application for revision has been preferred after the expiry of the period specified for the filing of such appeal or application for revision under this Act and which has not been admitted, such appeal or revision shall not be deemed to be a 1 proceeding pending within the meaning of this clause; Application for settlement of cases.

245C. (1) An assessee may, at any stage of a case relating to him, make an application in such form and in such manner as may be prescribed, and containing a full and true disclosure of his income which has not been disclosed before the Assessing Officer, the manner in which such income has been derived, the additional amount of income-tax payable on such income and such other particulars as may be prescribed, to the Settlement Commission to have the case settled and any such application shall be disposed of in the manner hereinafter provided:

Provided that no such application shall be made unless,-- (a) the assessee has furnished the return of income which he is or was required to furnish under any of the provisions of this Act; and (b) the additional amount of income tax payable on the income disclosed in the application exceeds one hundred thousand rupees.

(1A) For the purposes of sub-section (1) of this section and sub-section (2A) to (2D) of Section 245D, the additional amount of income-tax payable in respect of the income disclosed in an application made under sub-section (1) of this section shall be the amount calculated in 1 accordance with the provisions of sub-sections (1B) to (1D).

(1B) Where the income disclosed in the application relates to only one previous year,-- (i) if the applicant has not furnished a

return in respect of the total income of that year (whether or not an assessment has been made in respect of the total income of that year), then, except in a case covered by clause (iii), tax shall be calculated on the income disclosed in the application as if such income were the total income; (ii) if the applicant has furnished a return in respect of the total income of that year (whether or not an assessment has been made in pursuance of such return), tax shall be calculated on the aggregate of the total income returned and the income disclosed in the application as if such aggregate were the total income; (iii) if the proceeding pending before the incometax authority is in the nature of a proceeding for reassessment of the applicant under section 147 or by way of appeal or revision in connection with such reassessment, and the applicant has not furnished a return in respect of the total income of that year in the course of such proceeding for reassessment, tax shall be calculated on the aggregate of the total income as assessed in the earlier proceeding for assessment under section 143 or section 144 or section 147 and the income disclosed in the application as if such aggregate were the total income.

FORM NO. 34B [See rules 44C and 44CA] Form of application for settlement of case under section 245C(1) of the Income-tax Act, 1961

IN THE SETTLEMENT COMMISSION.......................................

Settlement application No. ....19.......-19.........

1. Full name and address of the applicant ....

2. Permanent Account Number ....

3. Status [See Note 4] ....

4. The Commissioner having jurisdiction over the applicant ....

5. Assessment year(s) in connection with which the application for settlement is made ....

6. Date of filing the return of income for assessment year(s) referred to in column 5 ....

7. Proceedings to which application for settlement relates, the date from which the proceedings are pending and the income-tax authority before whom the proceedings are pending [See Note 6] ....

8. Where any appeal or application for revision has been preferred after the expiry of the period specified for the filing of such appeal or application for revision, as the case may be,

whether such appeal or revision has been admitted. ....

9. Date of seizure, if any, under section 132 of the Income-tax Act ....

10. Particulars of the issues to be settled, nature and circumstances of the case and complexities of the investigation involved [See Note 7] ....

11. Full and true disclosure of income which has not been disclosed before the Assessing Officer, the manner in which such income has been derived and the additional amount of income-tax .... payable on such income [See Notes 9 and 10] ....

Signed (Applicant)

Verification I, ..., son/daughter/wife of .... do hereby solemnly declare that to the best of my knowledge and belief, 2 what is stated above and in the Annexure [including the statement(s) and documents accompanying such Annexure] is correct and complete. I further declare that I am making this application in my capacity as ....(designation) and that I am competent to make this application and to verify it.

Verified today the .... day of 19

Place ....

Signed (Applicant)

Procedure on receipt of an application under section 245C.

245D. (1) On receipt of an application under section 245C, the Settlement Commission shall call for a report from the Commissioner and on the basis of the materials contained in such report and having regard to the nature and circumstances of the case or the complexity of the investigation involved therein, the Settlement Commission may, by order, allow the application to be proceeded with or reject the application: Provided that an application shall not be rejected under this sub-section unless an opportunity has been given to the applicant of being heard: Provided further that the Commissioner shall furnish the report within a period of forty-five days of the receipt of communication from the Settlement Commission in case of all applications made under Section 245C on or after the 1st day of July, 1995 and if the Commissioner fails to furnish the report within the said period, the Settlement Commission may make the order without such report.

(2B) If the Settlement Commission is satisfied, on an application made in this behalf by the assessee, that he is unable for good and sufficient reasons to pay the additional amount of income tax referred to in sub- section (2A) within the time specified in that sub-section, it may extend the time for payment of the amount which remains unpaid or allow payment thereof by instalments if the assessee furnishes adequate security for the payment thereof.

(2C) Where the additional amount of income- tax is not paid within the time specified under sub-section (2A), then, whether or not the Settlement Commission has extended the time for payment of the amount which remains unpaid or has allowed payment thereof by instalments under sub-section (2B), the assessee shall be liable to pay simple interest at fifteen per cent per annum on the amount remaining unpaid from the date of expiry of the period of thirty-five days referred to in sub- section (2A).

(4) After examination of the records and the report of the Commissioner, received under sub-section (1), and the report, if any, of the Commissioner received under sub-section (3), and after giving an opportunity to the applicant and to the Commissioner to be heard, either in person or through a representative duly authorised in this behalf, and after examining such further evidence as may be placed before it or obtained by it, the Settlement Commission may, in accordance with the provisions of this Act, pass such order as it thinks fit on the matters covered by the application and any other matter relating to 2 the case not covered by the application, but referred to in the report of the Commissioner under sub-section (1) or sub-section (3).

(6) Every order passed under sub-section (4) shall provide for the terms of settlement including any demand by way of tax, penalty or interest, the manner in which any sum due under the settlement shall be paid and all other matters to make the settlement effective and shall also provide that the settlement shall be void if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

(6A) Where any tax payable in pursuance of an order under sub-section (4) is not paid by the assessee within thirty-five days of the receipt of a copy of the order by him, then, whether or not the Settlement Commission has extended the time for payment of such tax or has allowed payment thereof by instalments, the assessee shall be liable to pay simple interest at fifteen per cent

per annum on the amount remaining unpaid from the date of expiry of the period of thirty-five days aforesaid.

(7) Where a settlement becomes void as provided under sub-section (6), the proceedings with respect to the matters covered by the settlement shall be deemed to have been revived from the stage at which the application was allowed to be proceeded with by the Settlement Commission and the income-tax authority concerned, may, notwithstanding anything contained in any other provision of this Act, complete such proceedings at any time before the expiry of two years from the end of the financial year in 2 which the settlement became void. Power of Settlement Commission to reopen completed proceedings.

245E. If the Settlement Commission is of the opinion (the reasons for such opinion to be recorded by it in writing) that, for the proper disposal of the case pending before it, it is necessary or expedient to reopen any proceeding connected with the case but which has been completed under this Act by any income-tax authority before the application under section 245C was made, it may, with the concurrence of the applicant, reopen such proceeding and pass such order thereon as it thinks fit, as if the case in relation to which the application for settlement had been made by the applicant under that section covered such proceeding also:

Powers and procedure of Settlement Commission.

245F. (1) In addition to the powers conferred on the Settlement Commission under this Chapter, it shall have all the powers which are vested in an income-tax authority under this Act.

(2) Where an application made under section 245C has been allowed to be proceeded with under section 245D, the Settlement Commission shall, until an order is passed under sub-section (4) of section 245D, have, subject to the provisions of sub-section (3) of that section, exclusive jurisdiction to exercise the powers and perform the functions of an income-tax authority under this Act in relation to the case:

(3) Notwithstanding anything contained in sub-section (2) and in the absence of any express direction to the contrary by the Settlement Commission, nothing contained in this section shall affect the operation of any other provision of this Act requiring the applicant to pay tax on the basis of self- assessment in relation to the matters before the Settlement Commission.

(4) For the removal of doubt, it is hereby declared that, in the absence of any express direction by the Settlement Commission to the contrary, nothing in this Chapter shall affect the operation of the provisions of this Act in so far as they relate to

any matters other than those before the Settlement Commission. Order of settlement to be conclusive.

245-I. Every order of settlement passed under sub-section (4) of section 245D shall be conclusive as to the matters stated therein and no matter covered by such order shall, save as otherwise provided in this Chapter, be reopened in any proceeding under this Act or under any other law for the time being in force.

5. At this stage, it may be noted that section 245C stood substituted by Finance Act, 2007, w.e.f. 1.6.2007. Prior to its substitution, the proviso to section 245C(1), as substituted by the Finance Act, 1987, w.e.f. 1.6.1987 and later on amended by Finance Act, 1995, w.e.f. 1.7.1995, read as under:

"Provided that no such application shall be made unless,--

(a) the assessee has furnished the return of income which he is or was required to furnish under any of the provisions of this Act; and

(b) the additional amount of income tax payable on the income disclosed in the application exceeds one hundred thousand rupees."

6. Section 245C(1) read with the proviso thereto, as substituted by Finance Act, 2007 w.e.f. 1.6.2007, reads as under:

245C. (1) An assessee may, at any stage of a case relating to him, make an application in such form and in such manner as may be prescribed, and containing a full and true disclosure of his income which has not been disclosed before the Assessing Officer, the manner in which such income has been derived, the additional amount of income-tax payable on such income and such other particulars as may be prescribed, to the Settlement Commission to have the case settled and any such application shall be disposed of in the manner hereinafter provided:

Provided that no such application shall be made unless,-- (i)the additional amount of income tax 2 payable on the income disclosed in the application exceeds three lakh rupees; and (ii) such tax and the interest thereon, which would have been paid under the provisions of this Act had the income disclosed in the application been declared in the return of income before the Assessing Officer on the date of application, has been paid on or before the date of making the application and the proof of such payment is attached with the application.

Analysis of the Act

7. Liability to pay advance tax arises under section 207. The said section is based on the principle "pay as you earn". It requires tax to be paid during the financial year. It has to be in respect of the total income

of the assessee which would be chargeable to tax under the Act. The said total income is not as understood in section 2(45) but it is equated to "current income" for the purposes of Chapter XVII. After the Amending Act of 1987, advance tax is to be paid on the current income which would be chargeable to tax for the assessment year immediately following the financial year. Section 210 casts the responsibility of payment of advance tax on the assessee without requiring the assessee to submit his estimate of advance tax payable. Provision for payment of advance tax is mode of quick collection of tax. Thus, section 207 defines liability to pay advance tax in respect of incomes referred to in section 208. However, advance tax paid is adjustable towards the tax due. Advance tax is collected even before the income tax becomes due and payable. By its very nature, advance tax is pre-assessment collection of taxes either by deduction of tax at source or by payment of advance tax which has to be adjusted towards income tax levied on the total income. The above two methods of realization even before any assessment is authorized by section 4(2) are incorporated in Chapter XVII which deals with "collection and recovery". In fact, section 190(1) clarifies that this method of payment of tax will not prejudice the charge of tax under section 4(1) nor will it modify the liability of the assessee to pay income tax pursuant to an assessment order. [See *Modi Industries Limited, Modinagar and Others v. Commissioner of Income Tax, Delhi and Another*, 216 ITR 759 at 780] At one point of time, section 209(1)(a)(iii) (relating to computation of advance 2 tax) provided that the income tax calculated on the total income with reference to which the demand for advance tax was made should be reduced by the amount of income tax deductible in accordance with sections 192 to 194, 194A and 195 on any income included in the total income. The levy of interest under section 215 is part of the process of assessment. If the income tax liability on the first day of the assessment year is larger than the amount of advance tax standing to the credit of the assessee then interest will have to be paid under section 215 on 75% of the deficit amount of tax from the first day of the assessment year to the date of computation of total income vide assessment order. Interest under section 215 is chargeable from the first day of April next following the financial year wherein the advance tax was paid up to the date of regular assessment, if no tax has been paid under section 140A or otherwise. However, section 215(2) provides that where advance tax paid is less than 75% of the "assessed tax", but the assessee has paid tax under section 140A or otherwise before the date of completion of regular assessment then the interest shall be limited to the interest on 3 the shortfall between the "assessed tax" and the advance tax paid for the period from the first April next following the financial year up to date of payment under section 140A plus interest on the shortfall between "assessed tax" and "total tax paid" for the period from the day following the date of such payment under section 140A up to the date of regular assessment. Coming to section 140A, as a result of the amendment of

section 140A(1) by Direct Tax Laws Amendment Act, 1987 w.e.f. 1.4.1989 and vide Finance Act of 1999, the assessee is required to calculate the tax payable on the basis of the return to be furnished under section 139 or under section 142 or under section 148 after taking into account the amount of tax paid under the Act; to calculate also interest payable under section 234A or under section 234B/234C for any default or delay in payment of advance tax; to pay such tax with interest before the assessee furnishes his return. The Explanation to section 140A(1) inter alia provides that where the amount paid by the assessee under section 140A(1) falls short of the aggregate of the tax and interest thereon the amount so paid is first adjusted 3 towards interest payable and the balance, if any, is adjusted towards the tax payable. Thus, amount(s) paid under section 140A is deemed to have been paid towards regular assessment.

8. The liability to pay income tax is founded on sections 4 and 5 which are the charging sections. Sections 143, 144 and 147 are machinery sections to determine the amount of tax payable. Thus, whereas section 143(3) signifies computation of income, section 147 signifies computation of escaped income. As held in the case of *C.A. Abraham v. Income-Tax Officer, Kottayam and Another* [(1961) 41 ITR 425 (SC)], the expression "assessment" in a given provision must be determined on an examination of the relevant provisions in question and the fact that it is used in the narrower sense elsewhere will not mean that it is so used in the provision under examination. The word can be used to cover the whole procedure to ascertain the liability and the machinery for enforcement. Prior to 1.6.1999, section 143(1A)(a) inter alia provided that where the total income as a result of any adjustments made exceeded the total income declared in the return by any amount then it was open to the A.O. to increase the amount of tax payable under section 143(1) by additional income tax calculated at the specified rate. In brief, section 143(1A) provided for the levy of additional income tax of an amount equal to 20% of the tax payable on the amount of difference between the total income determined under section 143(1) and total income declared in the return. Where the additional income tax was increased, the A.O. had to serve a notice under section 156. Even under section 143(1B), as it stood before 1.6.1999, where an assessee furnished a revised return under section 139(5) after service of intimation, the assessee was liable to pay additional income tax in relation to adjustments made under section 143(1)(a) read with the proviso.

9. Now, Chapter XVII deals with "collection and recovery". It covers Tax Deduction at Source and Advance Payment of taxes (see section 190). Section C deals with advance payment of taxes. Section 207 refers to liability to pay advance tax whereas section 209 deals with computation of advance tax. Section 215 refers to interest payable by the assessee. Section 210(1) inter alia provides that every person who is liable to pay

interest under Section 208, shall of his own accord pay, on each of the due dates specified in section 211, the appropriate percentage of advance tax on his current income calculated in the manner under section 209. Under section 209(1)(a), the amount of advance tax payable by the assessee in any financial year is as follows: (a) where calculation is made by the assessee for the purposes of payment of advance tax under section 209(1), he shall first estimate his current income and the tax shall be computed at the rates in force in the financial year. Thus, liability and computation of advance tax is done under section C of Chapter XVII. On the other hand, interest for defaults in payment of advance tax falls under section 234B, apart from sections 234A and 234C, in section F of Chapter XVII. Thus, levy of interest is incidental to the liability and computation of advance tax. It is interesting to note that section 234A(4) in turn refers to the increase or reduction of interest subsequent to the Order of the Commission under section 245D(4) increasing or reducing the amount of tax payable and so also 3 section 234B(4). Under section 234B, where in any financial year an assessee who is liable to pay advance tax under section 208 fails to pay such tax or where the advance tax paid under section 210 is less than 90% of the assessed tax the assessee shall pay interest from the first day of April next following such financial year to the date of determination of total income under section 143(1) or to the date of regular assessment on the amount equal to the assessed tax which has been defined in Explanation 1 to mean tax on the total income as determined under section 143(1) as reduced by the amount of tax deducted at source in accordance with Chapter XVII on income which is subject to deduction and which is taken into account in computing total income. By Explanation 3, it is clarified that for default of short payment interest will be charged on the difference between "assessed tax" (as defined) and the advance tax paid by the assessee and that for the above purpose "additional income tax" if any payable under section 143 is not to be taken into account. However, section 234B(2) covers a situation where, before the date of determination of total income under section 143(1) or 3 completion of regular assessment, tax is paid by the assessee under section 140A or otherwise, interest shall be calculated under section 234B(1) up to the date on which tax was so paid and reduced by the interest, if any, paid under section 140A towards interest chargeable under section 234B.

10. Coming to Chapter XIX-A which deals with Settlement of Cases, it may be stated that the word "case" is defined under section 245A(b). It is an exhaustive definition. The definition makes it clear that an application for Settlement shall lie only when any proceedings for assessment or re- assessment is pending or an appeal or revision in connection with such assessment or reassessment is pending before the Income Tax Authority. Under section 245C(1), such application for settlement will not be maintainable without full and true disclosure of the income by the applicant, the manner in which such undisclosed

income was derived and that the applicant had furnished his return of income and that the additional tax payable on such income exceeds the specified amount. This was the position prior to Finance Act of 2007. However, section 245C(1A) inter alia provides that 3 additional amount of income tax payable in respect of the income disclosed shall be calculated in accordance with the provisions of section 245C(1B). Under sub-section (1B) if the applicant has furnished his return in respect of his total income and no assessment is made, the tax shall be calculated on the aggregate of the total income returned and the income disclosed in the application as if such aggregate was the total income. The words "regular assessment" are not there in section 245C(1B)(ii). However, under section 245C(1C)(b), it is provided that the additional tax calculated under section 245C(1B)(ii) shall be reduced by the aggregate of the tax deducted at source or tax paid in advance and the amount of tax paid under section 140A. The resultant amount is the additional tax payable by the assessee. Thus, section 245C incorporates within it the provisions of Chapters XVIIB, XVIIC and section 140A of the Act. It may be noted that section 245C(1B)(iii), as it stood before 1.6.1987, required income tax to be calculated on the aggregate of the total income as assessed plus the income disclosed in the application as if such aggregate was the total income. But 3 after 1.6.1987, the tax is required to be worked out on the returned total income plus the income disclosed in the application as if the aggregate is the total income. Under section 245D(2A) the applicant is required to pay the additional amount of income tax payable on the income disclosed in the application within 35 days of the receipt of the copy of the order passed by the Settlement Commission under section 245D(1) allowing such application to be proceeded with. Under section 245D(2A) the applicant shall, within 35 days of the receipt of the order under section 245D(1) allowing the application to be proceeded with, pay the additional amount of income tax payable on the income disclosed. Under section 245D(4) on compliance of sections 245D(2A) and (2C) and on examination of relevant records and reports, the Settlement Commission may pass such orders as it thinks fit on the matters covered by the application and any other matter relating to the "case" referred to in the report of the Commissioner of Income Tax. If one carefully analyses the provisions of sections 245D(1) and 245D(4), one finds two distinct stages - one allowing the application to be proceeded 3 with (or rejected) and the other of disposal of the application by appropriate orders being passed by the Settlement Commission. In between the two stages, we have provisions which require the applicant to pay the additional income tax and interest. Even under section 245D(7) it is provided that where the settlement becomes void under section 245D(6) the proceedings with respect to the matters covered by the settlement shall be deemed to have revived from the stage at which the application was allowed to be proceeded with by the Settlement Commission and the income tax authority may complete the proceedings

within the period mentioned therein. Thus, section 245D(7) brings out the difference between section 245D(1) stage and section 245D(4) stage. Under section 245D(6), it is laid down that every order under section 245D(4) shall provide for the Terms of Settlement including any demand by way of tax, penalty or interest. In the case of C.I.T. v. Damani Brothers reported in 259 ITR 475, a 3- Judge Bench of this Court, while analyzing the scheme of Chapter XIX-A, has held that section 234B, section 245D(2C) and section 245D(6A) operate in different fields. Section 234B 3 comes into operation when there is default in payment of advance tax whereas liability to pay interest under section 245D(2C) arises when the additional amount of income tax is not paid within time specified under section 245D(2A). Section 245D(6A), on the other hand, imposes liability to pay interest only when the tax payable in pursuance of an order of Settlement Commission under section 245D(4) is not made within the specified time. Consequently, section 234B, section 245D(2C) and section 245D(6A) in Chapter XIX-A operate in different fields. To this extent, we agree with the view expressed in Damani Brothers case (supra). Descriptively, it can be stated that assessment in law is different from assessment by way of settlement. If one reads section 245D(6) with section 245I, it becomes clear that every order of settlement passed under section 245D(4) shall be final and conclusive as to the matters contained therein and that the same shall not be re-opened except in the case of fraud and misrepresentation. Under section 245F(1), in addition to the powers conferred on the Settlement Commission under Chapter XIX-A, it shall also have all the powers which are 4 vested in the income tax authority under the Act. In this connection, however, we need to keep in mind the difference between "procedure for assessment" under Chapter XIV and "procedure for settlement" under Chapter XIX-A (see section 245D). Under section 245F(4), it is clarified that nothing in Chapter XIX-A shall affect the operation of any other provision of the Act requiring the applicant to pay tax on the basis of self-assessment in relation to matters before the Settlement Commission. The point to be noted on the basis of the above analysis is that several provisions of the Act like section 140A; furnishing of the return of income by the applicant as indicated in the proviso (a) to section 245C(1); provisions of the Act governing liability and computation to pay additional income tax as indicated by proviso (b) to section 245C(1); aggregation of total income inter alia in terms of sections 143, 144 or 147 as indicated by section 245C(1B)(iii); aggregation of total income as returned plus income disclosed in the application for settlement as indicated in section 245C(1B)(ii); the deductions in section 245C(1C); increase of interest under section 215(3) pursuant to the orders of the Settlement 4 Commission and the levy of interest under sections 234A(4) and 234B(4) all bring into Chapter XIX-A various provisions of the Act. Thus, when we read the provisions of Sections 245C and 245D one has to keep in mind various above provisions of the Act and the concepts of self assessment, assessment, regular assessment and

computation of total income which have been engrafted in Chapter XIX-A.

(I) Whether Sections 234A, 234B and 234C are applicable to Chapter XIX-A proceedings?

11. Our detailed analysis shows that though Chapter XIX- A is a self-contained Code, the procedure to be followed by the Settlement Commission under sections 245C and 245D in the matter of computation of undisclosed income; in the matter of computation of additional income tax payable on such income with interest thereon; the filing of settlement application indicating the amount of income returned in the return of income and the additional income tax payable on the undisclosed income to be aggregated as total income shows that Chapter XIX-A indicates aggregation of incomes so as to constitute total income which indicates that the special procedure under Chapter XIX-A has inbuilt mechanism of computing total income which is nothing but assessment (computation of total income). To elaborate, under section 245C(1B), if the applicant has furnished a return in respect of his total income, tax shall be calculated on the aggregate of total income returned and the income disclosed in the settlement application as if such aggregate were total income. Under the Act, tax is payable on the total income as computed in accordance with the provisions of the Act. Thus, section 143(3) provision is sought to be incorporated in section 245C. When Parliament uses the words "as if such aggregate would constitute total income", it presupposes that under the special procedure the aggregation of the returned income plus income disclosed would result in computation of total income which is the basis for the levy of tax on the undisclosed income which is nothing but "assessment". Similarly, section 245C(1C) provides for deductions from the total income computed in terms of section 245C(1B). Thus, the special procedure under sections 245C and 245D in Chapter XIX-A shows that a special type of computation of total income is engrafted in the said provisions which is nothing but assessment which takes place at section 245D(1) stage. However, in that computation, one finds that provisions dealing with a regular assessment, self-assessment and levy and computation of interest for default in payment of advance tax, etc. are engrafted. [See sections 245C(1B), 245C(1C), 245D(6), 245F(3) in addition to sections 215(3), 234A(4) and 234B(4)]

(II) Terminal point for the levy of interest - Whether interest is payable under Chapter XIX-A up to the date of the order under section 245D(1) or up to the date of the order under section 245D(4)?

12. In our view the answer to the above question lies in the provisions of the proviso to Sections 245C(1), 245C(1B) and 245C(1C), 245D(4) and 245F(3) which bring in the concepts of returned income, self-assessment, aggregation of income returned and income disclosed as if it is total income; levy of interest under section 215(3) read with section 245D(4); increase of

interest under sections 234A(4) and 234B(4) read with section 245D(4) as also sections 140A(1A) and (1B) read with sections 234A and 234B. For example, section 140A deals with self-assessment which is different from regular assessment. Under section 140A(1) where tax is payable on the basis of any return furnished by the assessee [see proviso (a) to section 245C(1)], after taking into account tax paid, the assessee shall be liable to pay such tax with interest payable for default under section 234B in payment of advance tax before furnishing the return. This position is clarified by sections 140A(1A) and (1B) under which inter alia interest payable for default in payment of advance tax under section 234A shall be computed on the amount of tax on the total income as declared in the return minus the advance tax paid. Similarly, it is clarified vide subsection (1B) to section 140A that interest payable under section 234B for default in payment of advance tax shall be computed on an amount equal to the assessed tax [same words are used in section 234B(1)] or on the amount by which the advance tax falls short of the assessed tax. However, what is "assessed tax" for the purposes of section 140A is explained by Explanation. It says that assessed tax will be tax on the total income as declared in the return minus the amount of tax deducted at 4 source or collected at source in accordance with the provisions of Chapter XVII (which covers sections 207, 209 and 215 of the Act). Now, section 245C(1) is voluntary disclosure by the assessee of his undisclosed income. Under section 245C(1), the assessee has to mention in his settlement application the additional amount of tax payable by him on such undisclosed income. Under proviso (a), the application for settlement shall not be entertained till the assessee has furnished the return of income which he was required to file under the Act to the extent of his income. Under proviso (b), the assessee has to declare the additional amount of tax payable. Thus, the two provisos to section 245C(1) show that Chapter XIX-A, which prescribes a special procedure for assessment by settlement, contemplates a pre-assessment collection of tax. With the filing of the settlement application and after such application is allowed to be proceeded with under section 245D(1), intimation under section 143(1), regular assessment under sections 143(3)/144 and re-assessment under section 147 lose their existence as under sections 245C(1A) and (1B) it is only the income disclosed in the return of income before the A.O. alone which survives for consideration by the Settlement Commission for settling the amount of income which is not disclosed in the return. Under section 245C(1B)(ii), if the applicant has furnished a return in respect of the total income, whether or not assessment is made in pursuance of the return, the additional amount of income tax payable in respect of the total income disclosed shall be on the aggregate of the total income returned and the income disclosed in his application for settlement as if such aggregate was his total income. This is pre-assessment collection of tax. Such preassessment is based on the estimation of the current income and tax thereon by the applicant himself. Now, when the Settlement Commission accepts the Voluntary

Disclosure vide the application for settlement, section 234B(2) steps in. It is important to remember that the assessee is liable to pay advance tax, he commits default in payment to the extent of the undisclosed income but he offers to pay additional income tax then interest has to be calculated in accordance with sections 207, 208 and 234B(2) up to the date on which such tax is paid. This is not the interest which assessee has to pay 4 after assessment under section 245D(4). Under sections 245C(1B) and (1C) the additional amount of income tax payable on the undisclosed income shall be on the total income as calculated under section 245C(1B). On computation of total income under sections 245C(1B) and (1C), interest follows such computation. It is important to note that interest follows computation of total income. Once such computation takes place under section 245C(1B) then section 234B(2) applies. The said sub-section deals with the situation where before determination of total income under section 143(1) or 143(3) tax is paid under section 140A or otherwise interest shall be calculated in accordance with section 234B(1) up to the date on which tax is so paid. In that sense an application under section 245C(1) is a return. Section 245C(1) deals with computation of total income. There is one more way of looking at the Act. Chapter XIX-A refers to procedure of settlement (see section 245D(1)). As stated above, section 245D(1) provides for expeditious recovery of tax by way of pre-assessment collection. Interest on default in payment of advance tax comes under sections 234A, 234B, 234C, which fall in Chapter XVII which deals with collection and recovery of tax. It is important to note that interest follows computation of additional payment of income tax under sections 245C(1B) and (1C). This is how sections 234A, 234B and 234C get engrafted into Chapter XIX-A at the stage of section 245D(1). As stated, till the Settlement Commission decides to admit the case under section 245D(1) the proceedings under the normal provisions remain open. But, once the Commission admits the case after being satisfied that the disclosure is full and true then the proceedings commence with the Settlement Commission. In the meantime, applicant has to pay the additional amount of tax with interest without which the application for settlement would not be maintainable. Thus, interest under section 234B would be payable up to the stage of section 245D(1). Our view is supported by the amendment made by Finance Act of 2007 w.e.f. 1.6.2007 in which interest is required to be paid for maintainability of the Application for Settlement.

13. The question is - what happens in cases where 90% of the assessed tax is paid but on the basis of the Commission's order under section 245D(4) the advance tax paid turns out to be less than 90% of the assessed tax as defined in the Explanation to Section 234B(1)?

14. As held hereinabove, under section 245C(1) read with section 245C(1B)(ii) and section 245C(1C)(b), the additional amount of income tax payable is to be calculated on the aggregate of total income returned and the income disclosed in the settlement application as if

such aggregate is the total income. Thus, the scheme of the said sections is based on computation of total income and in that sense we have stated that such application for settlement is akin to a return of income. The said provision deals with "total income". Thus, as stated above, sections 234A, B and C are applicable up to the stage of section 245D(1) order passed by the Settlement Commission. However, Parliament has not extended the provisions and the liability to pay interest beyond the date of application for settlement. This is the position even after Finance Act of 2007. Once this position is taken, section 140A is attracted. When an assessee has paid interest under sections 234A, B and C in self-assessment under section 5 140A, which is similar to the scheme of section 245C(1), and once the Settlement Commission admits the application for settlement, one finds that even under section 140A(1B) interest payable under section 234B has to be computed on an amount equal to the assessed tax as defined in the Explanation to mean tax on the total income as declared in the return. Under sub-section (1B) to Section 140A interest payable under section 234B can also be computed on an amount by which the advance tax paid falls short of the assessed tax as defined in the Explanation thereto. Thus, there is no provision under Chapter XIX-A or even under section 140A (dealing with self-assessment) to charge interest beyond the date of application for settlement after the same is admitted by the Commission under Section 245D(1). Moreover, as stated above, under the Act, there is a difference between assessment in law [regular assessment or assessment under section 143(1)] and assessment by settlement under Chapter XIX-A. The order under section 245D(4) is not an order of regular assessment. It is neither an order under section 143(1) or 143(3) or 144. Under sections 139 to 158, 5 the process of assessment involves the filing of the return under section 139 or under section 142; inquiry by the A.O. under sections 142 and 143 and making of the order of assessment by the A.O. under section 143(3) or under section 144 and issuing of notice of demand under section 156 on the basis of the assessment order. The making of the order of assessment is an integral part of the process of assessment. No such steps are required to be followed in the case of proceedings under Chapter XIX-A. The said Chapter contemplates the taxability determined with respect to undisclosed income only by the process of settlement/ arbitration. Thus, the nature of the orders under sections 143(1), 143(3) and 144 is different from the orders of the Settlement Commission under section 245D(4). Even in Commissioner of Income Tax v. Anjum M.H. Ghaswala and others [252 ITR 1] there is no finding by this Court that the order of Settlement Commission under section 245D(4) is an order of assessment under section 143(3) or under section 144. In Ghaswala's case the only question decided by this Court is that the interest under section 234B is mandatory in 5 nature and that Settlement Commission, therefore,

had no authority to waive it. Further, as stated above, the jurisdiction of the A.O. is not fettered merely because the applicant has filed the Settlement Application. The Act does not contemplate stay of the proceedings during that period, i.e., when the Settlement Commission is deciding whether to proceed or reject the settlement application. The jurisdiction of the Settlement Commission to proceed commences only after an order is passed under section 245D(1). That, after making an application for settlement the applicant is not allowed to withdraw it [see section 245C(3)]. Once the case stands admitted, the Settlement Commission shall have exclusive jurisdiction to exercise the powers of the Income Tax Authority. The order of Settlement Commission under section 245D(4) shall be final and conclusive under section 245I subject to two qualifications under which it can be recalled, viz., fraud and misrepresentation but even here it is important to note that under section 245D(7) where the settlement becomes void on account of fraud and misrepresentation the proceedings with respect to the matters covered by the settlement shall be deemed to have been revived from the stage at which the application was allowed to be proceeded with by the Settlement Commission. This further supports our view that there are two distinct stages under Chapter XIX- A and that the Legislature has not contemplated the levy of interest between order under section 245D(1) stage and section 245D(4) stage. Thus, interest under section 234B will be chargeable till the order of the Settlement Commission under section 245D(1), i.e., admission of the case. Lastly, the expression "interest" in section 245(6A) fastens the liability to pay interest only when the tax payable in pursuance of an order under section 245D(4) is not paid within the specified time and which levy is different from liability to pay interest under section 234B or under section 245D(2C). [See Damani Brothers (supra) at page 485]

III. Whether the Settlement Commission can re-open its concluded proceedings by having recourse to Section 154 of the Act so as to levy interest under section 234B, if it was not done in the original proceedings?

15. As stated, proceedings before Settlement Commission are similar to arbitration proceedings. It contemplates assessment by settlement and not by way of regular assessment or assessment under section 143(1) or under section 143(3) or under section 144 of the Act. In that sense, it is a Code by itself. It does not begin with the filing of the return but by filing the application for settlement. As stated above, under the Act, procedure for assessment falls in Chapter XIV (in which section 154 falls) which is different from procedure for settlement in Chapter XIX-A in which sections 245C and 245D fall. Provision for levy of interest for default in payment of advance tax under section 234B falls in Chapter XVII [Section F] which deals with collection and

recovery of tax which as stated above is incidental to the liability to pay advance tax under section 207 (which is also in Chapter XVII) and to the computation of total income in the manner indicated under Chapter XIX-A vide sections 245C(1B) and 245C(1C) read with the provisos to section 245C(1) on the additional income tax payable on the undisclosed income. Further, if one examines the provisions of sections 245C(1B) and 245C(1C), one finds that various situations are taken into account while computing the additional amount of tax payable, viz., if the applicant has not filed his returns, if he has filed but orders of assessment are not passed or if the proceedings are pending for re-assessment under section 147 (again in Chapter XIV) or by way of appeal or revision in connection with such re-assessment and the applicant has not furnished his return of total income in which case tax has to be calculated on the aggregate of total income as assessed in the earlier proceedings for assessment under section 143 or under section 144 or under section 147 [see section 245C(1B)]. The point to be noted is that in computation of additional income tax payable by the assessee, there is no mention of section 154. On the contrary, under section 245I the order of the Settlement Commission is made final and conclusive on matters mentioned in the application for settlement except in the two cases of fraud and misrepresentation in which case the matter could be re- opened by way of review or recall. Like ITAT, the Settlement Commission is a quasi-judicial body. Under section 254(2), the ITAT is given the power to rectify but no such power is given to the Settlement Commission. Thus, we hold that 5 Settlement Commission cannot reopen its concluded proceedings by invoking section 154 of the Act. Lastly, one must keep in mind the difference between review/ recall of the order and rectification under section 154. The Schedule of Chapter XIX-A does not contemplate invocation of section 154 otherwise there would be no finality to the assessment by settlement which is different from assessment under Chapter XIV where there is an appeal, revision, etc. Settlement of liability and not determination of liability is the object of Chapter XIX-A. Even otherwise, invocation of section 154 on facts of this batch of cases is not justified. In this batch of cases, the situation which prevailed when the Settlement Commission waived or reduced interest chargeable under sections 234A and 234B was that a debate was on as to whether the Settlement Commission has the power to reduce or waive interest. It is only after Ghaswala's case that the law got settled that the nature and the character of the interest was compensatory and mandatory and that the Commission had no such power. But even in Ghaswala, the question as to whether such interest under section 234B should run up to 5 the order under section 245D(1) or up to the date of the order under section 234D(4) was not decided. In fact, that was the reason for the Orders of Reference to the Constitution Bench of this Court vide orders dated 14.12.2004 and 20.1.2005. There is one more reason for this Reference. In the case of CIT v. Hindustan

Bulk Carrier [(2003) 259 ITR 449], a 3- Judge Bench of this Court, by majority, held that where, upon the Order of the Settlement Commission under section 245D(4), there arises a deficit in the payment of advance tax under section 208, the end point or the terminus of the period for which interest has to be paid under section 234B on the deficit is the date on which the Settlement Commission passes the order under section 245D(4). This decision was delivered on 17.12.2002 after the judgment of this Court in Ghaswala (supra). On the same day, the same Bench in the case of Damani Brothers (supra) held that interest charged under section 234B becomes payable on the income disclosed in the return and the income disclosed before the Settlement Commission; that, such interest is chargeable till the Commission acts in terms of section 245D(1) and that after 5 the Settlement Commission allows the application for settlement to be proceeded with there will be no further charge of interest under section 234B. Thus, even on the question of terminus there was lot of controversy and in the circumstances, we are of the view that invocation of section 154 (held to be inapplicable to Chapter XIX-A proceedings) cannot be justified.

Conclusions:

16. (1) Sections 234A, 234B and 234C are applicable to the proceedings of the Settlement Commission under Chapter XIX-A of the Act to the extent indicated hereinabove.

(2) Consequent upon conclusion (1), the terminal point for the levy of interest under section 234B would be up to the date of the order under section 245D(1) and not up to the date of the Order of Settlement under section 245D(4).

(3) The Settlement Commission cannot re-open its concluded proceedings by invoking section 154 of the Act so as to levy interest under section 234B, particularly, in view of section 245I.

17. Accordingly, Reference to the Constitution Bench vide orders dated 14.12.2004 and 20.1.2005 stands duly answered and the matters are accordingly disposed of.

2011 PTR 1654 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "H" BENCH, MUMBAI

Pramod Kumar, Accountant Member and
Vijay Pal Rao, Judicial Member

FACTS/HELD

1. **Section 194-I TDS: To be "rent", payee must have "control" over asset**
2. The assessee, a SEB, entered into an agreement with NTPC for purchase of power and another with Power Grid Corporation for transmission of the power from NTPC's 'bus bars' to the delivery point. The AO & CIT (A) took the view that the *transmission charges paid by the assessee to Power Grid was "rent for use of plant" and tax ought to have been deducted u/s 194-I.* The argument that *as the payee had been assessed, no recovery could be made from the payer* was also rejected. The assessee was held liable for failure to deduct TDS. On appeal by the assessee, HELD allowing the appeal:
   (i) S. 194-I defines "*rent*" to include any payment, by whatever name called, under any lease, agreement or arrangement "*for the use of*" any machinery or plant. **For a payment to be construed as "rent", it is a condition precedent that the payer should have some control over the asset.** ***There is a distinction between 'the use of an asset' and the 'benefit derived from an asset'***. In a transaction of hire/ leasing, the possession of the goods and its effective control is given to the customer and the customer has the freedom and choice of how to use the asset. On the other hand, if the customer entrusts to the assessee the work of achieving a certain desired result and that involves the use of goods belonging to the owner, the control of the asset remains with the owner and there is no "use" by the customer (**Asia Satellite** 332 ITR 340 (Del) followed, **Japan Airlines** 325 ITR 298 (Del) & **Krishna Oberoi** 257 ITR 105 (AP) distinguished;

(ii) On facts, **the transmission lines were under the possession & control** of Power Grid. The assessee was **merely enabled to use the services of transmission of electricity** and not the use of transmission wires per se. The assessee was **not involved in the in the actual operations of the transmission lines**. The transmission wires were also used by other customers of Power Grid. Consequently, the payments were not "*rent*" u/s 194-I;

(iii) Under the Explanation to s. 191, **a person can be treated as an assessee in default u/s 201(1) only when, apart from the lapse in deduction of tax at source, the recipient of income has failed to pay such tax directly**. S. 201(1) imposes vicarious (and not penal) liability on the payer to make good the shortfall in tax collection. **If the tax liability is discharged by the recipient of income, the vicarious liability cannot be invoked.**

Appeal allowed.

ITA Nos. 20 TO 23/BLPR/2010 (Assessment year: 2006-07 to 2009-2010).

Heard on: 20th and 24th October, 2011.

Decided on: 30th November, 2011.

Present at hearing: Soli E. Dastur, for Appellant. Goli Srinivas Rao, for Respondent.

JUDGMENT

Per Pramod Kumar:– (Accountnat Member)

1. In this bunch of four appeals, which are directed against common order dated 7th October 2009 passed by the CIT(A), the assessee appellant has challenged correctness of CIT (A)'s up holding the following demands raised on the assessee under section 201(1) and 201(1A) r.w.s. 194 I of the Income Tax Act, 1961, for alleged non compliance with tax withholding requirements in respect of payments for electricity transmission charges:

Sl	Assessment Year	Demand u/s 201(1)-TDS	Demand u/s 201(1A)-Interest*	Total
1	2006-07	2,08,63,979	81,63,158	2,90,27,137
2	2007-08	4,85,23,892	1,37,75,324	6,22,99,216
3	2008-09	4,69,51,547	77,31,511	5,46,83,058
4	2009-10	6,56,98,260	31,77,291	6,88,75,551
				21,48,84,962

* *As computed for the period up to the date of demands having been raised by the Assessing Officer.*

2. Let us take a look at the relevant material facts and the developments leading to this litigation before us. The appellant before us is Chattaisgarh State Electricity Board, through its successor *CG State Power Holding Co Ltd* (referred to as 'CSEB', in short). Chattisgarh State Electricity Board, a public sector undertaking owned by the Government of Chattisgarh, was formed under Section 5 of the Electricity Supply Act, 1948, and, with effect from 1st January 2009, it was divided into five separate companies, including CG State Power Holding Co Ltd – which was its successor in the present appeal. CSEB is engaged, inter alia, in the business of distribution of electricity to consumers within Chattisgarh.

3. The activity of distributing electricity to end consumers is preceded by two important intermediate steps – namely production of electricity, and its transmission from point of production to the point of distribution, and it is here that two significant players, namely National Thermal Power Corporation Ltd (NTPC, in short) and Power Grid Corporation of India Ltd (PGCIL, in short) come into play.

4. NTPC, a Government of India owned PSU, generates electric power and is one of the major sources of electrical power in the country. However, when CSEB, or for that purpose any other state electricity board, buys the electrical power, NTP C's obligation ends with availability of the electrical power at delivery points, which are technically termed as 'busbars', of the power generating station. It is for the CSEB to organize that electrical power so purchased from the NTPC is transmitted from such delivery points to the points where CSEB needs electrical power. This transmission of electrical power, termed as 'wheeling' in technical parlance, can only be done by the persons duly authorized by the Government of India in this behalf.

5. PGCIL, another Government of India PSU, is engaged in the business of transmitting the power, and is duly authorized for the purposes of transmitting power from delivery points to the bulk beneficiaries like assessee before us. It operates and maintains inter - state transmission system and operation of Regional Power Grids, and it has also been notified as the Central Transmission Utility (CTU) of the country. In addition to the facilities set up by PGCIL, it has been controlling the existing load despatch centres in the country with a view to achieve better grid management and operation. CSEB buys from the power from NTPC and the power so purchased by the CSEB is transmitted to by PGCIL.

6. It is in this backdrop, and during the course of verification of tax deduction at source returns, that the Assessing Officer noted that CSEB has entered into an agreement with NTPC and PGCIL for use of transmission system owned by the PGCIL and expressed the view that the assessee was required to deduct tax at source from such payments, in terms of the provisions of Section 194 I of the Act. The Assessing Officer

was of the view that, as evident from the agreement that the assessee entered into with PGCIL, the PGCIL had developed the national power grid to ensure transmission of power within, and across, the different regions of the country. The Assessing Officer noted that the assessee had made the payment for transmission charges for use of transmission system. He noted that the "the plain reading of various clauses of the agreement clarify that the transmission charges are collected on account of use of transmission system" and that "the western grid is made exclusively for CSEB to transmit the power". The Assessing Officer further observed that "the utilization of transmission system implies existence of some equipment or physical body and does not indicate the involvement of the manpower in the form of professional, technician or any labour to run the electric current". He also noted that "the access line consisting of circuits is within the reach of the CSEB and it is through that private line/access line and related equipment placed at PGCIL station that the transmission of electricity takes place ……". The Assessing Officer also noted that there is dedicated machinery and equipment identified and allowed to be used in the hands of the CSEB. It was noted that PGCIL is mainly responsible for transmitting power from production centre to the consumers, and, in the process, in coverts DC into AC power. It requires transformers and other electrical apparatus for this process and transmission. The stand of the Assessing Officer was that the payments made by the assessee to PGCIL, for the purpose of transmitting power from NTP C's delivery point to assessee's facilities, can be said to be payments in the nature of rent for transmission facilities, and, accordingly, be hit by the provisions of Section 194 I of the Act. A reference was made to Hon'ble Allahabad High Court's judgment in the case of *CIT vs. Indian Turpentine and Resin Co Ltd* (75 I ITR 533) in support of the contention that transmission equipment constitute plant and machinery, and, therefore, payment for transmission charges should be construed as payment for use of plant and machinery.

7. The Assessing Officer, rejecting the elaborate arguments of the assessee in support of the contention that the payment for transmission charges is not in the nature of rent for transmission equipment, observed that the absence of expression 'rent' in the agreement does not alter the factual situation in this case, and that the expression 'rent' has a much wider connotation under Explanation (i) to Section 194 I. It was noted that the as long as payment is made, by whatever name called, for use of equipment, plant, machinery, the same will be covered by the definition of rent for the purpose of this section. As regards the assessee's contention that the assessee does not have any liability under section 201(1), in view of the fact that the PGCIL has paid the taxes directly and in the light of Explanation (i) to Section 191, the Assessing Officer rejected this contention as well and observed that 'the payment of advance tax by deductee cannot be treated as discharge of tax liability under section 194I of the Act, as it is liability of the assessee tax deductor'. He was of the view that both these liabilities, i.e. of the tax withholding liability of the person

making the payment and of tax liability of recipient of income, are independent liabilities and cannot be equated with each other. He held that "one of the basic intentions to introduce the TDS provisions of the Act is to provide Government regular cash flow for development works to prevent the revenue loss caused in cases where the department fails to tap the revenue from deductee later on", that this "claim of exemption for non deduction hits adversely the basic intention of the legislature, which is against the law", and, therefore, this "argument put forth by the learned counsel has no force". The assessee was, accordingly, treated as in default in respect of the amounts which the assessee ought to have deducted at source under section 194 I of the Act. Consequent demands, under section 201(1) and 201(1A), aggregating to Rs 21,48,84,970 (after rounding off) were raised on the assessee.

8. Aggrieved, assessee carried the matter in appeal but without any success. While learned CIT(A) meticulously recorded written submissions of the assessee, he preferred not to deal with these very erudite and detailed submissions in detail, and rejected the same rather summarily by observing as follows:

> I have gone through the order of the AO and submission of the appellant. I have also perused the Bulk Power Transmission Agreement (BPTA) between PGCIL and MPSEB and also the Power Purchase Agreement (PPA) between NTPC and CSEB. The appellant has not furnished annexure 'C' to BPTA which provides for transmission tariff. It is an undisputed fact that the PGCIL has established power transmission system/lines which have been used by the appellant for transmission of power, in consideration of monthly charges paid. The issue arises whether the transmission charges paid by the appellant is rent within definition provided under section 194 I and liable to TDS. As per ITO(TDS), it is an arrangement for use of transmission assets owned and developed by PGCIL and thus monthly charges paid by the appellant is rent within the definition provided in Explanation to Section 194I.The ITO TDS has further held that the definition of rent has been substituted by Taxation Laws (Amendment) Act 2006, and is also applicable since inception of Section 194 I being clarificatory in nature. The ITO (TDS) has also rejected plea of the appellant that for transmission charges paid, Section 194C is applicable instead of Section 194 I (Refer para 9; page 10 of the order). Accordingly, ITO(TDS) has held that the appellant has failed to deduct tax at source, as per provisions of Section 194 I, and, therefore, deemed to be an assessee in default under section 201 and also liable to interest under section 201(1A). The appellant contended before the ITO (TDS) that transmission charges paid by the appellant is in the nature of service charges and do not fall within the ambit of

> rent. It was further submitted that the definition of rent has been substituted with effect from 13.07.2006 and, therefore, is not applicable prior to that since it is not clarificatory in nature. By amendment, scope of rent has been enlarged. Finally, it was submitted that the deductee, i.e. PGCIL, has already paid tax on transmission charges received by it, and, therefore, no demand under section 201(1) should be enforced. Perusal of Explanation to Section 194 I, i.e. definition of rent, reveals that any arrangement for use of land or building or plant or machinery or equipment or furniture or fitting shall be treated as rent for the purpose of Section 194 I. Perusal of Clause 5 of BPTA and 3.4 of PPA reveals that transmission charges is payable for utilization of transmission system owned by PGCIL and, therefore, is in the nature of rent. In fact, the charges paid are for facility provided for transmission of power and not for any services rendered, and, therefore, the transmission charges are payments in consideration for arrangement for facility provided for transmission of power. Accordingly, the appellant was obligated to deduct TDS on such payment, as per the provisions of Section 194 I of the Income Tax Act, which he has failed. As regards the applicability of amendment, w.e.f. 13.07.2006 or from inception, to Section 194 I, I agree with the contention of the AO that the amendment is clarificatory in nature and, therefore, the same is applicable in all the years under consideration. Thus the appellant has failed to deduct TDS as required under Income Tax Act, and, therefore, is deemed to be in default in respect of tax to be deducted and consequently also liable to pay interest under section 201(1A).

9. The assessee is not satisfied by the stand so taken by the CIT(A) as well, and is in further appeal before us.

10. We have heard the rival contentions, perused the material on record and duly considered factual matrix of the case as also the applicable legal position.

11. We find that the Power Purchase Agreement entered in to by the assessee with NTPC, (copy placed before us at pages 15-27 of the paper-book), specifically provides that "powers hall be made available by the NTPC at the busbars of the Station and it shall be obligation and responsibility of the CSEB to make the required arrangement for evacuation of power from such delivery points of NTPC". It is pursuant to these obligations that the assessee, along with other bulk power beneficiaries – namely MP State Electricity Board, Gujarat Electricity Board, Maharashtra State Electricity Board, Electricity Department – Government of Goa, Administration of Daman & Diu, and Electricity Department – Administration of Dadra and Nagar Haveli, has entered into a 'Bulk Power Transmission Agreement' with PGCIL. The preamble of this

agreement, inter alia, notes that the PGCIL "is desirous to transmit energy from the Central Sector Power Station(s) to the Bulk Power Beneficiaries and that the said Bulk Power Beneficiaries are desirous of receiving the same through POWERGRID transmission system on mutually agreed terms and conditions". This agreement provides that "POWER GRID shall operate and maintain the transmission system belonging to it in the Western Region as per agreed guidelines and the directives of the Western Regional Electricity Board and the Regional Load Dispatch Centers, and cooperate with the Bulk Power Beneficiaries of the Region, so as to maintain the system parameters within acceptable/reasonable limits except where it is necessary to take measures to prevent imminent damage to any equipment". In respect of these services, the bulk power beneficiaries are to pay to PGCIL a monthly charges computed in the manner set out in clause 9 of the said agreement. This clause, in turn, refers to formula set out in A.4 of Annexure 1 which refers to the same ratio of agreed annual charges divided by 12 as is between power transmitted to each beneficiary to total sales from that particular point of delivery. In other words, while the annual charges are fixed, these are divided between the beneficiaries in the same ratio as is ratio of power evacuated by a beneficiary to the total sale of power from that delivery point. It is, however, not in dispute that the transmission lines are in the physical control of PGCIL, these are maintained and operated by the PGCIL and, so far as the assessee is concerned, its interest in the transmission lines is restricted to the fact that electrical power purchased by the assessee, simultaneously alongwith electrical power purchased by other bulk power beneficiaries, is transmitted through these transmission lines. The way it works is like this. The power available at the delivery points, collectively for al l t he bulk power beneficiaries, is loaded for transmission on these transmission lines or powergrid and each of the beneficiaries is al lowed to utilize the power to the extent al located to him. It is not the case that purchases by each of the bulk beneficiary can be physically identified and that particular beneficiary is only allowed to use that physically identified portion of power. Strictly speaking, therefore, it is not the transmission of power from one point to another but availability of power on the entire power grid or transmission lines enabling the beneficiary to utilize the power to the extent of his al location. On these facts, the question that requires our adjudication is whether or not the payment for transmission charges can be termed as 'rent' for the purposes of Section 194 I of the Act.

12. Let us now take a look at the statutory provision with regard to tax withholding from rent payments, which is set out in Section 194 I of the Act, and analyze the same. Section 194I provides as follows:

> Any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any income by way of rent, shall, at the time of credit of such income to the

account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of— (a) two per cent. for the use of any machinery or plant or equipment; and (b) ten per cent. for the use of any land or building (including factory building) or land appurtenant to a building (including factory building) or furniture or fittings:

Provided that no deduction shall be made under this section where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year by the aforesaid person to the account of, or to, the payee, does not exceed [one hundred eighty thousand rupees]:

Provided further that an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such income by way of rent is credited or paid, shall be liable to deduct income-tax under this section.

Explanation : For the purposes of this section, [(i) "rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any, –,

(a) land; or
(b) building (including factory building); or
(c) land appurtenant to a building (including factory building); or
(d) machinery; or
(e) plant; or
(f) equipment; or
(g) furniture; or
(h) fittings,

whether or not any or all of the above are owned by the payee;]

(ii) where any income is credited to any account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

13. The case of the Assessing Officer, which has been sustained in the first appeal, is that since expression "rent", for the purpose of Section

19 4 I, includes "any payment, by whatever name called, under any lease, sub-lease , tenancy or any other agreement or arrangement" for the use of machinery, plant or equipment, and since the assessee has made the payments towards transmission charges for use of the machinery, plant and equipment collectively constituting mode of transmission of power, the provisions of Sect ion 194 I come into play on the facts of this case.

14. The core issue that we must deal with is whether the present arrangement under the Bulk Power Transmission Agreement can be termed can be covered by the scope of expression any other agreement or arrangement 'for the use of' appearing in Explanation (i) to Section 194 I.

15. Explanation (i) to Section 194 I, as we have noted above, defines rent as any payment, by whatever name called, under any lease, sub - lease, or tenancy or any other agreement or arrangement "***for the use of***" land, building, plant, machinery or equipment etc. As evident from a plain reading of the agreements under which impugned payments have been made, the payments have been made for the services of transmission of electricity and not the use of transmission wires per se. It is a significant fact that these transmission lines are not only being used for transmission of electricity to the assessee but also for transmission to electricity to various other entities. The transmission lines continue to be not only under control and possession of the PGCIL in legal terms, but, what is more important, these transmission lines are effectively in the control of PGCIL, without any involvement of the assessee in actual operations of the same. On these facts, in our humble understanding, the assessee has made the payments for transmission of electricity in which transmission lines have been used rather than for the use of transmission lines *per se*. The payments could be said to have been made for "the use of transmission lines" in a case in which the object of consideration for which payments are made was the use of transmission lines *simplictor*, and such a use by the assessee does not extend beyond the transmission of electricity through such lines in the sense that the same transmission lines continue to be in the control of PGCIL for transmission of electricity for other entities and for all practical purposes. Even as electricity purchased by the assessee is transmitted to the assessee from the NTPC busbar to its landing points, the same transmission lines continue to be engaged in similar transmission of electricity for other entities and the assessee has no say in the manner in which such transmission lines can be controlled and used by the PGCIL. Undoubtedly, for the purpose of an arrangement being termed as in the nature of rent for the purpose of Section 194 I, the 'control' and 'possession', in legal terms, of an asset may not needed to be with the person benefiting from the asset in question, it is a condition precedent for invoking Section 194 I that the asset, for the use of which the payment in question is made, should have some element of its control by the assessee. Here is a case in which the assessee has no control over the operations of the transmission lines, and

all that he gets from the arrangements is that he can draw the electrical power purchased from PGCIL's transmission lines in an agreed manner.

16. While on the issue of distinction between use of an asset and benefit from an asset, we may usefully refer to the following distinction brought out by the Karnataka High Court between leasing out of equipment and the use of equipment by its customer. This was done in the case of *Lakshmi Audio Visual Inc. vs. Asstt. Commr. of Commercial Taxes* (124 STC 426), which has been followed by Hon'ble Delhi High Court in the case of *Asia Satellite Telecommunications Ltd* (332 ITR 340), in the following terms:

> *"9. Thus if the transaction is one of leasing/hiring/letting simpliciter under which the possession of the goods, i.e., effective and general control of the goods is to be given to the customer and the customer has the freedom and choice of selecting the manner, time and nature of use and enjoyment, though within the framework of the agreement, then it would be a transfer of the right to use the goods and fall under the extended definition of "sale". On the other hand, if the customer entrusts to the assessee the work of achieving a certain desired result and that involves the use of goods belonging to the assessee and rendering of several other services and the goods used by the assessee to achieve the desired result continue to be in the effective and general control of the assessee, then, the transaction will not be a transfer of the right to use goods falling within the extended definition of "sale". Let me now clarify the position further, with an illustration which is a variation of the illustration used by the Andhra Pradesh High Court in the case of Rashtriya Ispat Nigam Ltd. vs. CTO.*
>
> *(i) A customer engages a carrier (transport operator) to transport one consignment (a fulllorry load) from place A to B, for an agreed consideration which is called freight charges or lorry hire. The carrier sends its lorry to the customer's depot, picks up the consignment and proceeds to the destination for delivery of the consignment. The lorry is used exclusively for the customer's consignment from the time of loading, to the time of unloading at destination. Can it be said that right to use of the lorry has been transferred by the carrier to the customer? The answer is obviously in the negative, as there is no transfer of the "use of the lorry" for the following reasons: (i) The lorry is never in the control, let alone effective control of the customer; (ii) the carrier decides how, when and where the lorry moves to the destination, and continues to be in effective control of the lorry; (iii) the carrier can at any point (of time or place) transfer the consignment in the lorry to another lorry; or the carrier may unload the consignment enroute in any of his godowns, to be*

picked up later by some other lorry assigned by the carrier for further transportation and delivery at destination.

(ii) On the other hand, let us consider the case of a customer (say a factory) entering into a contract with the transport operator, under which the transport operator has to provide a lorry to the customer, between the hours 8 a.m. to 8 p.m. at the customer's factory for its use, at a fixed hire per day or hire per km. subject to an assured minimum, for a period of one month or one week or even one day; and under the contract, the transport operator is responsible for making repairs apart from providing a driver to drive the lorry and filling the vehicle with diesel for running the lorry. The transaction involves an identified vehicle belonging to the transport operator being delivered to the customer and the customer is given the exclusive and effective control of the vehicle to be used in any manner as it deems fit; and during the period when the lorry is with the customer, the transport operator has no control over it. The transport operator renders no other service to the customer. ....”

17. It is thus clear that in a situation in which the payment in made for the use of an asset simpliciter, whether with control and possession in its legal sense or not, the payment could be said to be for the use of an asset. However, in a situation in which the payment is made only for the purpose a specific act, i.e. power transmission in this case, and even if an asset is used in the said process, the payment cannot be said to be for the use of an asset. When control of the asset (transmission lines in the present case) always remains with the PGCIL, any payment made to the PGCIL for transmission of power on the transmission lines and infrastructure owned controlled and in physical possession of PGCIL can be said to have been made for 'the use of' these transmission lines or other related infrastructure. Viewed in this perspective, Section 194 I has no application so far as the impugned payments for transmission of electricity is concerned. For this short reason alone the impugned demands must be held to unsustainable in law.

18. We have taken note of learned Departmental Representative 's reliance on Hon'ble Delhi High Court's judgment in the case of *DCIT vs. Japan Airlines* (325 ITR 298), which in turn follows its earlier decision in the case of *United Airlines vs. CIT* (287 ITR 281), in support of the proposition that even in a situation in which landing and parking charges are paid by airlines to the Airport Authority, and when such charges are not in respect of the specific area of land, the provisions of Section 194 I come into play. By the same logic, according to the learned Departmental Representative, transmission charges are paid by the assessee, even though the same may not pertain to specific transmission lines which may be simultaneously used by more than one persons, the provisions for tax deduction at source from rent under section 194 I be held to be applicable.

We are unable to see any merits in this submission. When an aircraft is parked in a portion of land in the airport, such a portion of land could still be viewed as being effectively used by the airlines owning the aircraft, and the same is the position with regard to the landing strip. Learned Departmental Representative has also referred to the decision of Hon'ble Andhra Pradesh High Court in the case of *Krishna Oberoi vs. Union of India* (257 ITR 105) but we see no merits in this defence either. This case only deals with the question whether payment for hotel rooms will be covered by the definition of rent, but then it was not, and could not have been, in dispute that the payment for hotel room constitutes payment for 'the use of ' an asset – the precise point of controversy in the present decision. Clearly, a hotel customer pays for the use of, or the right to the use of, the hotel room. It is for the same distinguishing feature that decisions in the cases of *JC Bansal vs. TRO* (123 ITD 245) and *CIT vs. Rebook India Co* (163 Taxman 61) are not relevant in the present context.

19. It is also important to bear in mind the fact that by the virtue of insertion of Explanation to Section 191 with effect from 1st June 2003, a person can be treated as an assessee in default under section 201(1) only when there is lapse in deduction of tax at source on his part and, in addition to this lapse, the recipient of income has also failed to pay such tax directly. The reasons are not difficult to fathom. Proceedings under section 201(1) are not penal proceedings. These are vicarious proceedings to make good the shortfall in tax collection, and when the tax liability is duly discharged by the recipient of income embedded in the payment, such a vicarious liability cannot be invoked. The lapse of non deduction or short deduction of tax at source is to be visited with several consequences. The first and foremost consequence is that the tax deductor has to make good the shortfall in tax deduction and the tax deductor also has to compensate the Revenue by way of interest for the period of late realization of this tax to the Revenue authorities. These provisions, contained in s. 201(1) and 201(1A), are set out in Chapter XVII-B titled as 'Collection and Recovery of Tax'. The next set of consequences are contained in s. 271C and s. 276B, covered by Chapter XXI—' Penalties Imposable' and Chapter XXII—'Offences and Prosecutions' respectively. Sec. 27 6B, as it stands now, is not applicable on the facts of this case which comes to the play only when the assessee has deducted the tax at source but he does not pay, or does not pay in time, the taxes so deducted at source. Sec. 271C deals with levy of penalty for total or partial failure to deduct tax at source i.e., for non-deduction and short-deduction of tax at source. This provision is clearly a penalty provision which is applicable for the cases of tax de ductor's not discharging, wholly or partially, statutory obligations of deducting taxes at source, but then considerations which are relevant for examining a case having been made out for imposition of penalty are, as is the settled legal position, altogether different and the different yardsticks for such a case apply. However, unlike Section 271C, Section 201(1) is not of the penalty nature, and, therefore, the core consideration for invoking Section 201(1) is not the lapse on the part of the tax deductor, but

loss of revenue to the exchequer. As long as taxes payable by the recipient of income are paid, the provisions of Section 201(1) cannot be pressed into service. The authorities below were thus quite unjustified in brushing aside the assessee's contentions to the effect that since PGCIL has already discharged all his income tax obligations, demands under section 201(1) cannot be raised at all. However, now that we have held, on merits, that payments made for transmission of electricity by the transmission lines owned by PGCIL donot constitute payment for rent under section 194 I, it is not really necessary to go into this aspect of the matter. The question as to whether the definition of expression 'rent', introduced in section 194 I with effect from July 2006, is prospective or clarificatory is also, given our findings that, even on the touchstone of the definition of rent under the aforesaid provision, the payment for transmission of power will not constitute 'rent', not really relevant in the present context, and we see no need to deal with the same either.

20. In view of the above discussions, and bearing in mind entirety of the case, we are of the considered view that the provisions of Section 194 I cannot apply in respect of payments made for transmission of power by the PGCIL, on the facts of the case before us. Accordingly, the impugned demands raised under sections 201(1) r.w.s. 194 I and 201(1A) r.w.s. 201(1A) are cancelled. The assessee gets the relief accordingly.

21. In the result, the appeals are allowed. Pronounced in the open court today on 30th day of November, 2011.

2011 PTR 1666 (H.C. ALL.)

HIGH COURT OF ALLAHABAD

Sunil Ambwani and K.N. Pandey, JJ.

Commissioner of Income-tax (Central), Kanpur
v.
Smt. Shaila Agarwal

FACTS/HELD

1. **Section 153A: Assessments pending in appeal do not abate**
2. For AY 2002-03, an addition of Rs. 99 lakhs was made by the AO & confirmed by the CIT (A). During the pendency of the appeal before the Tribunal, a search under s. 132 was conducted and s. 153A proceedings were initiated. The Tribunal held that

in view of the s. 153A notice, the assessments of the six preceding assessment years prior to the date of searchabated and that assessments pending in appeal would stand merged in the fresh assessment to be made by the AO u/s 153A pursuant of the search. The AO was directed to reconsider the additions in the s. 153A assessment. On appeal by the department, HELD reversing the Tribunal.

Appeal allowed.

Income Tax Appeal No.241 of 2008.

Heard on: 10th October, 2011.

Decided on: 25th November, 2011.

Present at hearing: Bharat Ji Agarwal assisted by A.N. Mahajan, for Appellant. Ashish Bansal, for Respondent.

JUDGMENT

Sunil Ambwani, J.–

1. We have heard Shri Bharat Ji Agarwal assisted by Shri A.N. Mahajan, learned counsel for the department. Shri Ashish Bansal appears for the assessere.

2. The Commissioner of Income Tax (Central), Kanpur has preferred this appeal under Section 260A of the Income Tax Act, 1961 (the Act) against the order of the Income Tax Appellate Tribunal "B" Bench, Lucknow dated 31.10.2007 in ITA No.801/Luc/2006 (Assessment Year 2002-03) by which it had allowing the appeal for statistical purposes and has held that irrespective of any material discovered in search under Section 132 of the Income Tax Act, 1961 (the Act), relating to any period, an assessment is required to be made for block period of six assessment years, and consequently, the assessments, which have been completed, are also liable to be restored to the file of the Assessing Officer to consider the additions in the assessments under Section 153 A, as well. The Tribunal further observed that in the event the search is declared illegal by any Court, or assessment under Section 153A is held invalid, the appeal in relation to regular assessment will revive at the instance of the department, on an application to the Tribunal.

3. The appeal was admitted on the questions of law as follows:–

> "Whether on the facts and in the circumstances of the case, the Hon'ble Income tax Appellate Tribunal was justified in law in setting aside the case and restore to the file of A.O. without appreciating that as per provisions of section 153 A, "only assessment pending" as on the date of search are abated and not the "assessment completed" or 'appeal pending'?"

4. Brief facts given to this income tax appeal are as follows:–

5. The assessee filed a return for the assessment year 2002-03 on 31.12.2002 declaring income of Rs.3,66,438/-. The case was selected for scrutiny, on which a notice under Section 143 (2) of the Act was issued. On 10.11.2004 the assessee was required to produce the doners along with evidence, the source of gifts and the relationship between the donors and the donee in respect of gifts of Rs.99,00,000/-. On 30.3.2005 an assessment of Rs.1,16,65,376/- was made under Section 143 (3) of the Act. The CIT (A) dismissed the appeal on 22.5.2006, and confirmed the addition of Rs.99,99,000/-, as unexplained credit on account of bogus gifts. A relief of Rs.1,20,000/- was given on account of low withdrawals out of Rs.2,40,000/-, which was added by the Assessing Officer.

6. After the decision of the appeal by CIT (A) on 22.5.2006 proceedings a search under Section 132 of the Income Tax Act was carried out on 17.10.2006. The search and seizure operation was challenged by the assessee in a writ petition filed before the Lucknow Bench of the High Court in July, 2007. The writ petition is still pending.

7. A notice under Section 153 (A) was issued to the assessee on 26.9.2007, as a result of search and seizure, calling the assessee to file return for six assessment years including assessment year 2002-03.

8. The Tribunal, hearing the appeal against the order of CIT (A) dated 22.5.2006 allowed the appeals accepting the arguments made on behalf of appellant-assessee that once a notice under Section 153A has been issued after search and seizure operations, as per the provisions of Section 153A, all the assessments of the six preceding assessment years prior to the date of search have to abate and that even the completed and concluded assessments should stand merged in the fresh assessment to be made by the Assessing Officer under Section 153A in pursuance of the search. The Tribunal observed in para 7 to 9 of its order:–

> "The present appeal arises out of the assessment made prior to the date of the search. The intention of the legislature is to make a combined assessment of all the income disclosed or assessed in regular assessment and discovered in search. We accordingly restore the assessment to the file of the Assessing Officer to consider these additions in the assessment u/s 153A as well. However, in an event where search is declared illegal by any court or assessment u/s 153A is held invalid, then this appeal in relation to regular assessment will revive at the instance of the department if an application is moved to the Tribunal in this behalf. Accordingly, the appeal of the assessee is allowed but for statistical purposes and subject to the observations made above. In the result, the appeal of the assessee is allowed for statistical purposes. Order is pronounced in the open court on 31.10.2007."

9. Shri Bharat Ji Agrawal appearing for the department submits that the assessment was completed, the assessment order was passed on 31.3.2005. The appeal was also decided by CIT (A) on 22.5.2006 much before the initiation of search under Section 132 on 17.10.2006. The proceedings for assessment or reassessment were not pending on 17.10.2006 and thus according to the second proviso of Section 153A, only the pending assessment or reassessment is to abate. The assessments, which had become final are not liable to abate. The second appeal filed before the ITAT is not continuation of the proceedings of assessment. He submits that in pursuance to the assessment order under Section 143 (3) a penalty of Rs.97,85,925/- was imposed under Section 271 (1) (c) of the Act. If the interpretation given by the ITAT is to be accepted, the entire proceedings of penalty will also abate giving an unreasonable advantage to the assessee, insptie of adverse findings inviting penalty.

10. Shri Bharat Ji Agarwal submits that the order of the Income Tax Appellate Tribunal is not acceptable as it is not in accordance with the provisions of the Act. A plain reading of the second proviso of Section 153A of the Act would show that only the assessment pending on the date of initiation of the search shall abate.

11. The second proviso of Section 153A reads as under:–

> "Provided further that assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years referred to in this section pending on the date of initiation of the search under section 132 or making of requisition under section 132A, as the case may be, shall abate."

12. A plain reading of Section 153A would show that where notice under this Section is issued as result of any search under Section 132, assessment or reassessment if any relating to any assessment year falling within the period of six assessment years referred to under Section 153, pending on the date of initiation of search under Section 132 or requisition under Section 132A shall abate. The words, pending on the date of initiation of search under Section 132, or making of requisition under Section 132A, as the case may be, has to be assigned simple and plain meaning. Where the assessment or reassessment is finalised, there are no pending proceedings to be abated, and restored to the file of the assessing officer. To abate means to diminish or to take away. The word 'abatement' has been defined in the Concise Law Dictionary (P. Ramanatha Aiyer) as follows:–

> "Abatement. "Abatement" means, in respect of any chargeable accounting period, ending on or before the 31st day of March, 1947 a sum which bears to a sum equal to-
>
> (a) in the case of a company, not being a company deemed for the purposes of Section 9 to be a firm, six per cent of the capital of the company on the first day of the said period

computed in accordance with Schedule II, or one lakh of rupees, whichever is greater, or

(b) in the case of a firm having-

(i) nor more than two working partners, one lakh of rupees, or

(ii) three working partners, one and a half of rupees, or

(iii) four or more working partners, two lakh of rupees, or

(c) in the case of a Hindu undivided family, two lakhs of rupees, or

(d) in any other case, one lakh of rupees,–

The same proportion as the said period bears to the period of one year and, in respect of any chargeable accounting period beginning after the 31st day of March, 1947, such sum as may be fixed by the annual Finance Act. [Business Profits Tax Act (21 of 1947), S.2 (1)]

Removal or destruction, (as) of a nuisance; failure; premature end, suspension or diminution, (as) of an action or of a legacy.

The action of abating; being abated. {O.XXII, R.1, CPC (5 of 1908)]; decrease [S.12 (3) (b) (i), Specific Relief Act (47 of 1963)].

Of An Action Or Suit: In civil law an abatement of a suit is a complete termination of it. Abatement of a matter or cause is caused by the same becoming defective on account of the death of the parties materially interested. (Ency. of the Laws of England)

A suspension or termination of proceedings for want of proper parties or due to some technical defect.

The abatement of the main action abates proceedings ancillary or collateral to it.

In Criminal Law: Abatement of proceedings connotes their termination without any decision on merits and without the assent of the prosecutor. (Ency. of the Laws of England)

In Revenue Law: Abatement is a deduction from or refunding of duties on goods damaged during importation or in store."

13. The word 'abatement' is referable to something, which is pending alive, or is subject to deduction. The abatement refers to suspension or termination of the proceedings either of the main action, or the proceedings ancillary or collateral to it. The word is commonly used in the legislations, which provide for abatement of action/ suit; abatement of legacies; abatement of nuisance; and all actions for such nature, which have the pendency or continuance. The proceedings, which have already

terminated are not liable for abatement unless statute expressly provides for such consequence thereof.

14. The word 'pending' occurring in the second proviso to Section 153A of the Act, is also significant. It is qualified by the words 'on the date of initiation of the search', and makes it abundantly clear that only such assessment or reassessment proceedings are liable to abate.

15. The pendency of an appeal in the Tribunal against the order of assessment against which an appeal has been decided by CIT (A) is not a continuation of the proceedings of assessment. An appeal under the Income Tax Act lies to the Appellate Tribunal on a question of law. Even if it is pending on the date of search, no such intention has indicated by the Tribunal arises out of the provisions of second proviso to Section 153A, to abate the proceedings, which have been completed, or concluded, and to restore assessment to the file of the Assessing Officer.

16. We do not find force in the submission of Shri Ashish Bansal that where a notice under Section 153A has been given after the search operations under Section 132, for filing assessment for the block period of 6 years, and if such period includes any of the assessment year, the abatement of assessment and re-assessment proceedings, to give way to reassessment considering the additions in the assessment under Section 153A, will also include the assessment or re-assessment, which has been completed. If as a result of search, some undisclosed income is found to have escaped assessment, the Assessing Officer, may initiate steps for reassessment after sanction of competent authority, within the prescribed period of limitation.

17. A Circular No.7 of 2003 dated 5.9.2003 issued by the Commissioner of Income Tax has clarified the position in para 65.5 as follows:–

> “The Assessing Officer shall assess or reassess the total income of each of these six assessment years. Assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years pending on the date of initiation of the search under section 132 or requisition under section 132A, as the case may be, shall abate. It is clarified that the appeal, revision or rectification proceedings pending on the date of initiation of search under section 132 or requisition shall not abate. Save as otherwise provided in the proposed section 153A, section 153B and section 153C, all other provisions of this Act shall apply to the assessment or reassessment made under section 153A. It is also clarified that assessment or reassessment made under section 153A shall be subject to interest, penalty and prosecution, if applicable. In the assessment or reassessment made in respect of an assessment

> year under this section, the tax shall be chargeable at the rate or rates as applicable to such assessment year."

18. In *State of Rajasthan & Ors. vs. Khandaka Jain Jewellers*, (2007) 14 SCC 339 the Supreme Court reiterating the principles of interpretation of taxing statutes held in para 24 as follows:–

> "A taxing statute has to be construed as it is all these contingencies that the matter was under litigation and the value of the property by that time shot up cannot be taken into account for interpreting the provisions of a taxing statute. As already mentioned above a taxing statute has to be construed strictly and if it is construed strictly then the plea that the incumbent took a long time to get a decree for execution against the vendor that consideration cannot weigh with the Court for interpreting the provisions of the taxing statutes."

19. The second proviso to Section 153A of the Act, refers to abatement of the pending asssessment or re-assessment proceedings. The word 'pending' does not operate any such interpretation, that wherever the appeal against such assessment or reassessment is pending, the same alongwith assessment or reassessment proceedings is liable to be abated. The principles of interpretation of taxing statutes do not permit the Court to interpret the Second Proviso to Section 153A in a manner that where the assessment or reassessment proceedings are complete, and the matter is pending in appeal in the Tribunal, the entire proceedings will abate.

20. There is another aspect to the matter, namely that the abatement of any proceedings has serious causes and effect in as much as the abatement of the proceedings, takes away all the consequences that arise thereafter. In the present case after deducting bogus gifts in the regular assessment proceedings, the proceedings for penalty were drawn under Section 271 (1) (c) of the Act. The material found in the search may be a ground for notice and assessment under Section 153A of the Act but that would not efface or terminate all the consequence, which has arisen out of the regular assessment or reassessment resulting into the demand or proceedings of penalty.

21. For the aforesaid reasons, we are of the opinion that the Income Tax Appellate Tribunal erred in law in abating the regular assessment proceedings, which had become final, and restoring them as a consequence of search under Section 132, and notice under Section 153A of the Act to the file of the Assessing Officer.

22. The appeal is allowed. The order of the Income Tax Appellate Tribunal dated 31st October, 2007 is set aside. The question of law is decided in favour of the revenue and against the assessee. The Tribunal will decide the appeal on merits in accordance with law.

2011 PTR 1673 (S.C. Nor.)

SUPREME COURT OF NORWAY

Øie, Kallerud, Falkanger and Tjomsland, JJ

Dell Products
v.
The State v/ Tax

FACTS/HELD

1. **In absence of "legal right" to bind principal, Dependent Agent is not "PE"**
2. The assessee, a company registered in the Netherlands but resident in Ireland for tax purposes appointed Dell AS, a Norwegian company, as its "commissionaire" for sales to customers in Norway. Dell AS entered into agreements in its own name and its acts (under the commission agreement and Commission Act) did not bind the principal. The assessee claimed that it was not taxable in Norway in respect of the products sold through Dell AS on the ground that Dell AS was not its "Dependent Agent Permanent Establishment" (DAPE) under Article 5(5) of the Norway-Ireland DTAA on the ground that (a) the agent had no authority to enter into contracts "in the name of the assessee" and legally bind the assessee and (b) the agent was not a "dependent" agent. However, the income-tax department took the view that Dell AS constituted a PE under Article 5(5) of the DTAA and that 60 percent of Dell Products' net profit on sales in Norway was attributable to the PE. This was confirmed by the Oslo District Court. On appeal by the assessee, the **Court of Appeal** held that for Article 5(5) of the DTAA, the question whether the agent has the authority to conclude contracts on behalf of the enterprise had to be considered, not from a literal sense whether the contracts are "in the name of the enterprise", but from a functional sense whether the agent "in reality" binds the principal. On further appeal, HELD reversing the Court of Appeal:

   Article 5(5) of the DTAA provides that "when a person, not an independent status to whom paragraph 6 applies,

acting on behalf of an enterprise and has and habitually exercises in a Contracting State authority to conclude contracts on behalf of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State for any activities which that person undertakes for the enterprise." There is no dispute that Dell AS is not an independent agent. The expressions "on behalf" and "have authority to conclude contracts on behalf of" in Article 5(5) mean that the **contracts must be legally binding**. These expressions must be given their normal meaning as per the Vienna Convention. This is also supported by the Commentary on the OECD Model Convention on which the DTAA is based. A similar view has been taken by the Conseil d'Etat of France in **Zimmer** (included with the Appeal Court's order). As the language of the Article is clear, it is **not possible to adopt the "functional approach" proposed by the Revenue**. Consequently, Dell Products does not have permanent establishment in Norway.

Order accordingly.

HR-2011-02245-A, (Case No. 2011/755).

Decided on: 2nd December, 2011.

Present at hearing: Stale R. Kristiansen - to try, for Appellant. Morten Goller, for Respondent.

ORDER

(1) judge Utgård: The case debt-examination of tax decisions in which the Irish company Dell Products are taxed in Norway for the years 2003 to 2006. The spring duck point is whether Dell Products had a permanent place in this country after the tax treaty between Ireland and Norway of 22 November 2000 Article 7, paragraph 1, cf Article 5, paragraph 5.

(2) Dell Group produce and sell computers and computer equipment all over the world. Dell Computer Corporation is the tip of the group and belong in the United States. The other companies that are presented, the whole-owned group company. When I identify as the organization in group, do I do it out from the situation in the relevant skatteåra.

(3) Dell Products (Europe) BV is a company with limited liability which is founded and registered in Netherlands, but that does not drive activities there. The company has production facilities in Ireland, is controlled from there and taxes there. Dell Products (Europe) BV is the

daughter company Dell Products, which the corresponding way as the parent company is a company with limited liability registered in Netherlands, and the rest belong in Ireland. Dell Products, the Group's unit for distribution of Dell products in Europe, the Middle East and Africa. The company buys product from Dell Products (Europe) BV and also supplementary products from other suppliers.

(4) In the relevant years had Dell Products are not employees, but bought services from the parent company and others. It is stated that the parent company had about 4,000 employees.

(5) Dell Products sales as the principal product of special commissioners in the respective countries, who then sell to end users. Commissioner of Norway AS is Dell, who is also a company in the group. Sales by Commissioner debt sale to private companies with more than 200 employees and the public. Dell Products (Europe) BV companies to smaller companies and to the private sector in Norway using the Internet and telephone from an office in Denmark.

(6) To show the extent of activity in Norway I mention that the annual report for Dell AS for 2003 show a gross revenue of more than 1.4 billion and a taxable income of 10.1 million. For 2004 the corresponding figures in excess of 1 billion and at just under 10.3 million.

(7) Dell AS have calculated the tax liability to Norway for income gained by the agency as Commissioner and has been taxed in accordance with it. The Irish company Dell Products is not considered as taxable to Norway, and send therefore originally not tax return. Following orders from the Norwegian tax authorities have Dell Products later sent tax return for the relevant years, where it was brought up 0 in income.

(8) Akershus County Tax Office started in 2002 tax audit at Dell AS, which led to a final tax audit report in 2005. As a result of tax audit was Dell Products in September 2005 announced that the tax authorities had come to the lay the tax liability to Norway. It was also given notice of change of the equations for 2003 and 2004. After a comprehensive case management did tax Appeals for the Tax Office decision 8 October 2008. The equations were based on the Dell Products in 2003 and 2004 had a permanent place in Norway the tax treaty article 5, paragraph 5, so that the company was liable to tax here. 60 percent of Dell Products, net earnings on the part of production that was sold here, were assigned to the permanent site in Norway.

(9) In a letter dated 8 September 2008 was Dell Products announced a change of equations for income wounded 2005, 2006 and 2007. Tax Administration stated in a letter dated 10 February 2009 on the the company still would not be assessed for income in Norway for tax year 2007. The decision of 25. February 2009, later amended on 1 July 2009, was the taxable income in Norway for Dell Products set to 10.0 million and 7.8 million for the fiscal 2005 and wounded 2006. The decision was

based on the same right understanding and factual basis that the decision for the two first years.

(10) Dell Products rose 24 April 2009 issue of the Oslo District Court for review of assessment decisions.

(11) Oslo District Court said the ruling 16 December 2009 with the following rendition:

> "1 The State v/ Tax East acquitted.
>
> 2. The costs will pay Dell Products to the State v / Tax East 707 314 - syvhundreogsyvtusentrehundreogfjorten - million within 2 - two - weeks from proclamation of the verdict. "

(12) The District Court found that Dell Inc. - the commissioner - was entitled to conclude contracts that in real terms was binding on Dell Products - principal - and that this satisfied the conditions the tax treaty article 5, paragraph 5 The court came on to the Dell AS clearly was not any independent, so that this part of the conditions in Article 5, paragraph 5 were met.

(13) How the district court saw it, was it not done any wrong to assign the proportion of Dell Products, their income tax would be added in the country.

(14) Dell Products appealed to the High Court. The Court of Appeal said the sentence 2 March 2011 with the following rendition:

> "1 The appeal is dismissed.
>
> 2. The legal costs of the appellate court will pay Dell Products 369 312 - trehundreogsekstinitusentrehundreogtolv - allocated to the state v / Tax in East two weeks after service of this sentence."

(15) The Court of Appeal looked at primarily medical in the same way the questions that the court had done.

(16) Dell Products appealed further to the Supreme Court and made current, the same synsmåtane such the former bodies, however, that it was not appealed, that the Court of Appeal was come to the Dell AS was not an independent agent. The Appeals Committee pictured promoting the appeal related to the question of the low cause permanent place and about the general interpretation of Article 7 of tax treaty, see HR-2011-01127-U.

(17) Appeals majority - Dell Products - has essentially continue:

(18) The tax treaty shall be interpreted according to ordinary principles of conventional interpretation. The tax treaty Article 5, paragraph 5 can not be understood so that Dell Products has a permanent place in the country.

The starting point is the wording. Both the Norwegian and the English language version must understood so that it only lies the permanent place where the main man legally speaking, restricted to third parties. It is therefore not under the provisions of the treaty when Dell AS acted in its own name, and it was not established any legal relation between the person concerned a third party and Dell Products, which is principal.

(19) Objectives views - who else goes in both directions - can not have particular importance in a situation where a negotiated agreement is so clear. Such views have limited importance in and that the understanding of Article 5, paragraph 5 can clarify through other legal sources.

(20) It must be added emphasis on the tax treaty is in accordance with the OECD Model Convention.

Beliefs in other OECD countries must also be emphasized. Dell Products has the same arrangement in 15 states, and it is only Norway, which has meant that the company has a permanent place in Commissioner country. The situation in Spain is unclear yet

(21) A ruling from the French administrative supreme add due to the view that Dell Products has.

Case law from other countries' supreme courts should be weighted by interpretation.

(22) Although the Supreme Court would come to that Dell Products has a permanent place in Norway, the However, the decision not to stand when it comes to the attribution of income to the country.

(23) Assignment of the proceeds must be made by a functional analysis. First is the question of what which takes place in each of the states. Secondly, there are questions about how the revenue should distributed by the tax treaty article 7 As long as it does not happen any more in Norway than happens through Dell AS, the value of the sales function to be assigned.

Use of the principle of the tax treaty article 7, paragraph 4 assign in this case proceeds to incorrect tax entity.

(24) Dell Products has set the following claim:

> "1 The equation of Dell Products for the fiscal years 2003-2006 is repealed.
>
> 2. Dell Products awarded costs for the District Court, Court of Appeal and The Supreme Court. "

(25) The respondent - the state by Tax - have largely contended:

(26) principles of interpretation of the Vienna Convention, Article 31 must be founded on the interpretation of tax treaty. This is where the importance that it should be a purposeoriented text understanding.

(27) The tax treaty article 5, paragraph 5 uses the phrase "on behalf". This is an open text. The is not in the wording required for authorization to enter into agreements that are legally binding or like. This speaks for a functional assessment of the principal in reality bound by the agreement.

(28) The purpose of this provision is that an enterprise should tax where value is created. This source principle also supports the purpose of preventing Bypass. The rules must not interpreted as the tax for a permanent place can be avoided by a formality. Pervasive need interpretation be such that it provides a sensible and rational solution to the omgåingsproblemet, also from the legal traditions of each country.

(29) OECD comments are based on the Commissioner must involve the principal in the current state of the appearance of a permanent place. It speaks of a functional understanding. The comment shows that the OECD is aware that the commission agreements can represent a problem.

(30) The French Supreme Court verdict can not have a particular weight. Among other things, it is in France - Unlike with us - not allowed to lay emphasis on recent changes in OECDkommentaren.

And it is also unclear whether kommisjonslovgivinga is similar in France and Norway.

(31) The right springs shows the total observed that there must be a functional assessment on the concrete foundation.

It must, as the Court of Appeal did, assessed the association between the parties is such that terms of the treaty article 5, paragraph 5 are met. In this case, there is no real difference to an arrangement with one branch - the only difference is that it is said in the agreement AS between Dell and Dell Products, there is a commission agreement. It can not be NOK.

(32) Dell AS volumes thus, in reality, Dell Products. All sales occur under the brand Dell. Sales occurs after the standard set of Dell Products unless the case is negotiated special terms, which also must be approved by Dell Products. In practice, the not Noka testing at Dell Products of the individual sala, and the reality is when the sala in economic and practical sense, the final when Dell AS has implemented them.

(33) When Dell Products has a permanent place in Norway, the income allocated to Norway. The tax treaty Article 7 paragraph 4 opens to use the indirect method with the distribution of discretion. Dell Products have no problem creator that makes it possible to use a direct method. How distribution at the discretion is common in Norway. The method provides a solution in accordance with arm's length.

(34) State the Tax Office has set up such a claim:

"1 The appeal is dismissed.

2. The State v / Tax awarded the costs of the Supreme Court. "

(35) I will then to explain my views on the matter.

(36) Tax liability to Norway for persons and companies that do not belong in this country, is governed by the Tax Act § 2-3. After the provision, first paragraph b shall pay tax on

> "Wealth and income of the business which he carries on or participates in and operated here or managed from here." The right to Norwegian taxation can be limited by tax agreements In other countries, cf double tax agreement Act of 28 July 1949 No. 15 § 1 Such an agreement is concluded between Norway and Ireland. The agreement signed on 22 November 2000, made in two equivalent versions, in Norwegian and English. Tax duty under tax law is more extensive than under the tax treaty, and the content of the treaty is therefore crucial for Dell Products's tax liability to Norway.

(37) It follows from the tax treaty article 7, paragraph 1 that an enterprise in Ireland may tax be added only where, unless the enterprise commercial business activities "through a permanent establishment" in the country.

The question of a permanent place is regulated in Article 5The parties agree that the question on Dell Products has a permanent place in Norway must be settled based on an interpretation of Tax Treaty Article 5, paragraph 5, first sentence, which reads as follows:

> "When a person, not an independent status to whom paragraph 6 applies, acting on behalf of an enterprise and has and habitually exercises in a Contracting State authority to conclude contracts on behalf of the enterprise, that enterprise shall be provisions of paragraphs 1 and 2 are considered to have a permanent establishment in that State for any activities which that person undertakes for the enterprise. "

(38) The Supreme Court is not disputed that Dell AS is not an independent mediator.

The question is how the expressions "on behalf" and "have authority to conclude contracts on behalf of "in Article 5, paragraph 5 shall be understood. As I have worked out for, says Dell Products that in this lies a requirement that contracts must be legally binding. The State believes that it must be founded on a functional understanding between different based on the purpose of tax treaty, and that the crucial need to be if there is a an agreement that actually - but not necessarily legal - is binding. In the mainly medical state has acceded to explained in the grounds of appeal. For the record, I put her to the state either did current that lies the pro forma or that there is a basis for the tax legally through the intersection.

(39) It is the pure and not disputed that Dell Products are not legally bound by the agreements Dell AS do with customers. Between Dell Products and Dell AS lies cause a commission agreement, dated 1 February 1995. By agreement, we show that the relationship between principal and commissioner are regulated by the Norwegian Commission Act of 1916. After this Act is an agreement with the Commissioner makes a third party is not binding for principal. It is not arrived at anything that points in the direction of the commission agreement has a content that deviate from the normal situation after the Commission Act. Dell AS has agreements with customers not informed that there was talk of a kommisjonssal and thus neither that Dell Products was principal.

(40) The State has made the current that the condition is that Dell AS effectively bind Dell Products. I walk not now on what the case must be the critical factor in an assessment for such a Criterion. The appeal must, in fact, lead treaty if Article 5, paragraph 5 must be understood so he set up a condition that Dell Products must be legally bound.

(41) It is therefore the understanding of the tax treaty article 5, paragraph 5, which is crucial. The interpretation of tax agreements satisfied I myself preliminary to refer to what is said in the Rt. 2008 page 577, see later on Rt. 2011 page 755 paragraph 36 It is called the 2008-sentence:

> "46) Tax Agreement shall be construed in accordance with international law rules on interpretation of Treaties. Although Norway has not ratified the Vienna Convention on treaty law, must it be founded on the Vienna Convention, Article 31, paragraph 1 gives expressions for international legal custom, cf. 2004 page 957 The article reads:
>
> > 'A treaty Shall ask interpreted in good faith in accordance with the ordinary meaning to Be merry to the terms of the treaty in Their context and in the light of its object and purpose.'
>
> 47) After the Vienna Convention, Article 31, paragraph 2, 3 and 4 will also be placed on second circumstances related to the agreement. After practice,'s comments on the articles weight made by interpretation, cf. 1994 page 752, Rt.1997 page 653 and Rt. 2004 page 957 Also comments that are newer than the current double tax treaty is tillagde weight.

As point out in the Rt. 2004 page 957 paragraph 49 will change in the comments seek to provide expression of changed practices among OECD countries, even where the articles themselves are prominent unchanged."

(42) I have already quoted the Norwegian version of the tax treaty. After this is it - for it to be a permanent place - required that the intermediary has acted "on behalf of an entity" and have "authority to

conclude contracts on behalf of the entity." In the English language version is the equivalent figures for "acting Wed behalf of an enterprise" and "Authority two conclude contracts in the name of the enterprise".

(43) In my view, speak a pure language understanding of these expressions clearly that it is set demands for legally binding agreements for the enterprise as the intermediary is working with.

This applies to the Norwegian version, where "on behalf of" directly translated closest equivalent to "On behalf of". But it also applies to the English, where the expression is "in the name of". It is not said anything at the agreement included no between Ireland and Norway to suggest that it was accused of a deviant opinion. The question is if there is a other legal sources that speak of a other solution than the wording alone indicates.

(44) The tax treaty between Ireland and Norway is based on the OECD Model Convention for tax income and capital. The English language version of the tax treaty article 5, paragraph 5 is completely out identical to the pattern agreement, Article 5, paragraph 5 Thus it must be founded on the the two Contracting States have not had any wish for a deviant regime with regard to pattern agreement.

(45) comments on the articles have emphasized the interpretation, see it quoted from the Rt. 2008 page 577, see further Rt. 2004 page 957 paragraph 46 I start by referring to the commentary to pattern agreement dated 1 September 1992. It is called there in paragraph 32:

> "It Would not have been in the interest of international economic relations Provide two That the maintenance of Any dependent person Would lead to a permanent establishment for the enterprise. Such treatment is to Be limited to individual WHO in view of the scope of Their authority or the nature of Their activity involved in the matter the enterprise to a Particular Extent in business activities in the State Concerned. Therefore, paragraph 5 proceed Wed the basis That only person HAVING the authority conclude two contracts Can lead to a permanent establishment of the enterprise Maintaining retardation. In such a case the person Has Sufficient authority two volumes the enterprise's Participation in the business activity in the State Concerned."

(46) These formulations appear in later editions, also from 2010. Comment focuses on what will be the best for the sake of international economic relations. At this point it is pronounced that only activities from the "person HAVING the authority two conclude contracts "may provide a basis for a permanent place.

(47) By a decision from the Council of the OECD 28January 2003 received comment on the articles A new section 32.1, which reads as follows:

> "Also, the phrase 'authority two conclude contracts in the name of the enterprise' does not Confine the application of the paragraph two possible agent WHO patients' into contracts small rally in the name of the enterprise; the paragraph applie equally two possible agent WHO Which concludes contracts are binding on the enterprise even if Those contracts are not Actually in the name of the enterprise. Lack of active involvement by an enterprise in transactions May Be Indicative of a grant of authority two an agent. For example, an agent May Be Considered two possess Actual authority two conclude contracts elsewhere he solicits and receiver (but does not formally finalize) Which orders are sent Directly to a warehouse from Which goods are Delivered and elsewhere the foreign enterprise routinely approve the transactions."

(48) Addition of the first sentence up to the semicolon relate to a note from the United Kingdom where it was made aware that the common law principal is bound by an agreement made by the Commissioner, regardless of whether a sale has taken place in the name only to Commissioner. It's worked out for the circumstances of this in an article by John F. Avery Jones and David A. Ward in European Taxation, IBFD, 1993, p. 154 The reason for and purpose of the note was thus mainly to clarify the special problems commission concept in common law travels, and which thus have a different content than the Norwegian law.

(49) For taxation in Norway to "commission" understood based on the content of the concept of Norwegian legislation, see the tax treaty article 3 No. 2 I reminiscent of what I have said before about The Norwegian scheme. It appears to be in accordance with what is known as civil law.

(50) The remainder of Section 32.1 debts middlemen - "agents" - pure public. I perceive it as is said there that a discussion of the evidence required for other situations than ours - especially where a sales agent takes up orders for enterprise he is dependent. There is thus no question of a change in what is required to make a dependent mediator to bind enterprise the person concerned represents, but what is pure concrete necessary for the binding to lie lead.

(51) The understanding of tax agreements that are based on the OECD Model Convention, it is naturally also of interest how the person concerned article is understood in other countries. And not least debt a case where lies the decisions from the highest courts in a state. For the Supreme Court is informed of such a verdict, the verdict in the so-called Zimmer-matter of 31. March 2010, Decision 304715, from the administration's highest court in France, the Conseil d'Etat. An unofficial translation into English is income in International Tax Law Reports

(52) Judgement debts a commission opportunity, and it is a question of factual circumstances that greatly are parallel to those in our case.

Conseil d'Etat to assume that a commissioner can not bind a principal in relation to third parties in the meaning of the Convention, but has a additional remark. In the French text shows that these clarifications debt where "des Termes memes you contrat de commission, soit de tout autre élément de l'instruction" gives basis for authorization to third parties. The unofficial English translation is correspondingly shown that the principle of non-bond debt "unless it Appears Either from the express terms of the contract of commission, or from Other Factual elements Relating to its appointment." I perceive this precise definitions to apply to situations where the authority follows from the wording of the commission agreement or the actual circumstances relate to conclude no of this. It must thus the French Supreme Court's vision come to some agreement in the relationship between commissioner and principal out of a regular commission agreement, that the Commissioner should be able to bind the principal legal in relation to third parties.

(53) After the illuminated, in many other states been made similar assessments of us about the tax liability of Dell. It follows from the District Court ruling that Dell Group similar agreements in 15 states, without any of the others has meant that commission arrangement formed the basis for a permanent place in the state commissioner. It is still unclear how the tax authorities in Spain considering the question. In particular, it must mentioned that the Tax Agency in Sweden in the decision of 24 November 2010 found that Dell AB should be taxed for revenue commissioner, unless the question of a permanent place was taken up.

(54) The State has the power emphasized that the purpose of Article 5, paragraph 5 of the particular degree is to ensure tax base for the source state. For this I will say that the agreement states here have chosen a scheme which is crucial if there is a legally binding one. It is also chosen the same arrangement as found in the articles. The wording is clear and the solution also supports other the right sources. For my part I can not see that førsemålssynsmåtar here can break through in compared to the clear legal source image that lies lead.

(55) When I thus have come to that appeal leads, I also put a certain emphasis on forensic and practical considerations. An alternative criterion would have to be established without support in the text of tax treaty or in the articles. It would in itself be uncertain. I point out that the is a question of formulations that must be considered to go back in very many tax agreements. With such a fairly loose definition of the criteria, it would be great practical and right technical difficulties with getting to a fairly uniform practice.

(56) Tax authorities have chosen not to resemble Dell Products for a permanent place for the tax year 2007. It appears from the letter dated 10 February 2009 from the Tax Office that this was done "on the basis an overall assessment of the information in the case, with particular emphasis on the actual conditions in 2007. "The actual change in 2007

was that the organization in Ireland was changed by Dell Products, had been transferred from the parent company responsible for the staff there as worked for Dell Products. The state has made the current Dell Products in Ireland emerged as a "gjennomstrøymingsselskap" no independent activity. Given my legal opinion do I need not go further into this. But I add that it is not easy to see that a changed organization in Ireland to have effects on whether it is a permanent place in the country.

This also shows the problem in establishing a real bond, or real economic binding, as the decisive criterion.

(57) It is then not necessary to go into the other issues raised in the case.

(58) With the legal vision I have, the result without further be that Dell Products, did not have permanent place in the country. I am therefore come to that appeal leads.

(59) Dell Products should then be awarded legal costs to all bodies, cf Disputes Act § 20-2 first paragraph. Dell Products has demanded legal costs plus VAT. It must be founded on that Dell Products, which are foreign-employed, are entitled to a refund the input current value added tax by VAT Act § 10-1. VAT should be therefore not be awarded, cf. 2011 page 852

(60) Scissor cost requirement for the district court is in all the 893 918 million, with 834 100 million is fees and 59 818 million outlay. Respondent has not had any objections to the amount not deviations particularly from the government demanded and got accepted your in court. The demand from Dell Products for court should accept the roll.

(61) The Court of Appeal, Dell Products, demanded a total of 1,021,380 million, with 993 000 million debt premium and 28 NOK 380 court fees. As you can tell by the end described in detail in the Court of Appeal, demanded the state in which substantially less. I have come to that amount goes beyond what is reasonable and necessary, and that the fee should be reduced to 600 000. It is then taken into account that Dell Products found it necessary to go deeper into some opportunities for appellate court than the court, and also that Dell Products are of no organization in this country that could support the legal representative. The Court of Appeal is Thus, legal costs are set to 628 380 crowns.

(62) The Supreme Court is demanded 203,220 crowns, where 180 000 is the fee and the rest court fees. The requirement should accept the roll.

(63) After this, the legal costs be set at 1,725,518 crowns.

(64) I vote for this for so

D O M:

1. The equations of Dell Products for the fiscal wounds 2003-2006 is repealed.

2. The legal costs for the District Court, Court of Appeal and Supreme Court, the central government at the Tax Office to Dell Products 1,725,518 million within 2 - two -weeks from the preaching of this sentence.

(65) Judge Øie: I am in essence and in the decision with the first Justice.

(66) Judge Kallerud: Likewise.

(67) Judge Falkanger: Likewise.

(68) Judge Tjomsland: Likewise.

(69) After the referendum said the Supreme Court to

D O M:

1. The equations of Dell Products for the fiscal wounds 2003-2006 is repealed.

2. The legal costs for the District Court, Court of Appeal and Supreme Court, the central government at the Tax Office to Dell Products 1,725,518 million within 2 - two - weeks from the preaching of this sentence.

2011 PTR 1685 (H.C. Del.)

HIGH COURT OF NEW DELHI

Badar Durrez Ahmed and Siddharth Mridul, JJ.

ITA 687/2009
Maxopp Investment Ltd.
v.
Commissioner o Income-Tax, New Delhi

ITA 112/2010
Eicher Goodearth Ltd.
v.
Commissioner of Income Tax, New Delhi

ITA 263/2010
Mohair Investment & Trading Co. (P) Ltd.
v.
Commissioner of Income Tax, New Delhi

ITA 805/2009
Eicher Ltd.
v.
Commissioner of Income Tax, New Delhi

ITA 98/2009
Commissioner of Income Tax, Delhi-IV
v.
Escorts Finance Ltd.

ITA 853/2009
Cheminvest Ltd.
v.
Commissioner of Income Tax, New Delhi

ITA 856/2009
Cheminvest Ltd.
v.
Commissioner of Income Tax, New Delhi

ITA 932/2009
Commissioner of Income Tax, Delhi-V
v.
Nalwa Investments Ltd.

ITA 958/2009
Minda Industries Ltd.
v.
Commissioner of Income Tax, New Delhi

ITA 1060/2009
Maxpak Investment Ltd.
v.
Commissioner of Income Tax, New Delhi

ITA 1096/2009
Jagatjit Industries Ltd.
v.
Commissioner of Income Tax & Anr

ITA 1114/2009
Commissioner of Income Tax, LTU
v.
Sharda Motors Industries Ltd.

ITA 936/2009
Eicher Ltd.
v.
Commissioner of Income Tax, New Delhi

ITA 416/2010
Medicare Investments Ltd.
v.
Commissioner of Income Tax, New Delhi

ITA 57/2008
Commissioner of Income Tax, Delhi-VI
v.
Vou Investment Pvt. Ltd.

ITA 139/2009
Commissioner of Income Tax, Delhi-V
v.
HCL Perot Systems Ltd.

ITA 77/2009
Commissioner of Income Tax, Delhi-V
v.
HCL Perot Systems Ltd.

ITA 683/2008
Commissioner of Income Tax, Delhi-IV
v.
ICRA Ltd.

ITA 702/2008
Commissioner of Income Tax, Delhi-IV
v.
ICRA Ltd.

ITA 217/2009
Commissioner of Income Tax, Delhi-I
v.
Glad Investments Pvt Ltd
(Now merged with AKM Systems Pvt. Ltd.

ITA 389/2010
The Commissioner of Income Tax (LTU)
v.
Sharda Motors Industries Ltd.

FACTS/HELD

1. **No S. 14A or Rule 8D Disallowance without showing how assessee's is calculation wrong. Only real expenditure can be disallowed**
2. The High Court had to consider two issues: (a) whether interest paid on funds borrowed to acquire "trading shares" is hit by s. 14A given that the profits there from are assessable to tax as "business profits" and the dividend is incidental and (b) whether Rule 8D has retrospective operation. HELD by the Court:

(i) **The argument that if the dominant and main objective of the expenditure was not the earning of 'exempt' income then, the expenditure cannot be disallowed u/s 14A is not acceptable**. The expression "in relation to" cannot be given a narrow meaning and simply means "in connection with" or "pertaining to". If the expenditure has a relation or connection with or pertains to exempt income, it cannot be allowed as a deduction even if it otherwise qualifies under the other provisions of the Act;

(ii) The expression "expenditure incurred" in s. 14A refers to actual expenditure and not to some imagined expenditure. **If no expenditure is incurred in relation to the exempt income, no disallowance can be made u/s 14A (Hero Cycles Ltd** 323 ITR 518 referred).

(iii) **The AO cannot proceed to determine the amount of expenditure incurred in relation to exempt income without recording a finding that he is not satisfied with the correctness of the claim of the assessee**. This is a **condition precedent**. While rejecting the claim of the assessee with regard to the expenditure or no expenditure in relation to exempt income, the AO will have to **indicate cogent reasons** for the same;

(iv) **Rule 8D comes into play only when the AO records a finding that he is not satisfied with the assessee's method**. Though s. 14A(2) & (3) were inserted w.e.f. 1.4.1962, Rule 8D was inserted on 24.03.2008. Accordingly, **Rule 8D would operate prospectively**. (**Godrej and Boyce Mfg. Co. Ltd** 328 ITR 81 (Bom) followed);

(v) For periods prior to Rule 8D, the AO will have to adopt a **reasonable method on the basis of objective criteria** to determine the expenditure. However, here also, he will have to show **why he is not satisfied** with the correctness of the assessee's claim (argument that Rule 8D exceeds the mandate of s. 14A left open).

Appeals disposed of.

ITA Nos. 687/2009, 112/2010, 263/2010, 805/2009, 98/2009, 853/2009, 856/2009, 932/2009, 958/2009, 1060/2009, 1096/2009, 1114/2009, 936/2009, 416/2010, 57/2008, 139/2009, 77/2009, 683/2008, 702/2008, 217/2009 and 389/2010.

Decided on: 18th November, 2011.

Present at hearing: Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Appellant. Sanjeev Sabharwal with P. L. Bansal and Sonia Mathur for Respondnets in ITA 687/2009. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Appellant. Sanjeev Sabharwal with Utpal Saha for Respondent in ITA 112/2010. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Appellant. Sanjeev Sabharwal with Utpal Saha for Respondent in ITA 263/2010. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Appellant. Sanjeev Sabharwal with Utpal Saha in ITA 805/2009. Sanjeev Sabharwal with Utpal Saha for Appellant. R. M. Mehta for Respondent in ITA 98/2009. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Appellant. Sanjeev Sabharwal with Utpal Saha for Respondent in ITA 853/2009. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Appellant. Sanjeev Sabharwal with Utpal Saha for Respondent in ITA 856/2009. Sonia Mathur for Appellant. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Respondent in ITA 932/2009. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Appellant. Sanjeev Sabharwal with Utpal Saha for Respondent in ITA 958/2009. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Appellant. Sanjeev Sabharwal with Utpal Saha for Respondent in ITA 1060/2009. Satyen Sethi with Arta Trana Panda for Appellant. P.L. Bansal for Respondent in ITA 1096/2009. Sanjeev Sabharwal with r Utpal Saha for Appellant. Satyen Sethi with Arta Trana Panda for Respondent in ITA 1114/2009. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Appellant. Sanjeev Sabharwal with Utpal Saha for Respondent in ITA 936/2009. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Appellant. Sanjeev Sabharwal with Utpal Saha for Respondent in ITA 416/2010. P. L. Bansal for Appellant. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Respondent in ITA 57/2008. P. L. Bansal and Sonia Mathur for Appellant. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Respondent in ITA 139/2009. P. L. Bansal and Sonia Mathur for Appellant. Ajay Vohra with Kavita Jha, Akanksha Aggarwal and Amit Sachdeva for Respondent in ITA 77/2009. Prem Lata Bansal for Appellant. Dr Rakesh Gupta with Poonam Ahuja and Johnson Bara for

Respondent in ITA 683/2008. Prem Lata Bansal for Appellant. Dr Rakesh Gupta with Poonam Ahuja and Johnson Bara for Respondent in ITA 702/2008. P. L. Bansal with Anshul Sharma for Appellant. Ajay Nair with Rajat Joneja for Respondent in ITA 217/2009. Sanjeev Sabharwal with Utpal Saha for Appellant. Satyen Sethi with Arta Trana Panda for Respondent in ITA 389/2010.

JUDGMENT

Badar Durrez Ahmed, J.–

1. This is a batch of twenty one (21) appeals under section 260A of the Income Tax Act, 1961. Eleven (11) of these have been filed by assessees and ten (10) by the revenue. Eight of these appeals – four by assessees and four by the revenue – have been admitted and questions have been framed in them. The other appeals were tagged along therewith. It was, however, clearly understood by all the counsel appearing on both sides that the appeals which had not been formally admitted would be deemed to have been admitted for hearing and it was on this basis that arguments were addressed. All these appeals are concerned with section 14A of the Income Tax Act, 1961 and Rule 8D of the Income Tax Rules, 1962. In particular, we are called upon to examine as to whether interest paid on funds borrowed for investing in shares of operating companies for acquiring and retaining a controlling interest therein is allowable under section 36(1)(iii) and is not hit by section 14A of the Income tax Act, 1961? And, consequently, we are also required to examine the retrospective applicability of the sub-sections (2) & (3) of the said section 14A and of the said Rule 8D to the assessment years in question which range from 1998-99 to 2005-06.

Questions

2. Since, across these appeals, there were some minor differences in language insofar as the admitted and/or proposed questions were concerned, it was agreed that the following substantial questions of law would, in general, cover all the cases before us:–

1. Whether expenditure (including interest paid on funds borrowed) in respect of investment in shares of operating companies for acquiring and retaining a controlling interest therein is hit by section 14A of the Income tax Act, 1961 inasmuch as the dividend received on such shares does not form part of the total income?
2. Whether the provisions of sub-section (2) and sub-section (3) of section 14A inserted by the Finance Act, 2006 with effect from 01/04/2007, would apply retrospectively to all pending proceedings?

3. Whether Rule 8D inserted by the Income -tax (Fifth Amendment) Rules, 2008 with effect from 24/03/2008 was procedural in nature and hence would apply retrospectively to all pending proceedings?

3. In order to provide some factual basis behind the above mentioned questions, we shall refer to the appeal in the case of *Maxopp Investment Limited v. CIT* [ITA No.687/2009]. The assessee company is in the business of finance, investment and of dealing in shares and securities. The assessee held shares and securities, partly as investments on the "capital account" and partly as "trading assets" for the purpose of acquiring and retaining control over its group companies, primarily Max India Ltd. As per the assessee, any profit resulting on the sale of shares held as trading assets was duly offered to tax as business income of the assessee. During the previous year relevant to the assessment year 2002-03, the assessee incurred total interest expenditure of Rs. 1,61,21,168/-, which was claimed as business expenditure under section 36 (1) (iii) of the Income Tax Act, 1961 (hereinafter referred to as "the said act"). According to the assessee, the expenditure claimed was not hit by section 14A of the said act, on the ground that although borrowed funds were partly utilised for investment in shares held as trading assets, such investment was made with the intention to acquire and retain a controlling interest in the aforesaid company and that the receipt of dividend thereon was merely incidental.

4. In respect of the said assessment year 2002-03, the assessee had filed a return of income declaring an income of Rs.78,90,430/-. The assessee had received the following incomes:–

1.	Interest on loans advanced	Rs. 1,94,70,181
2.	Dividend received	Rs. 49,90,860
3.	Profit on sale of shares	Rs. 1,49,285

The aforesaid dividend of Rs. 49,90,860/- was received on the shares of Max India Ltd, held by the assessee as "trading assets". By an order dated 27/08/2004, the assessing officer, invoking section 14A of the said act, apportioned the said interest expenditure in the ratio of investment in shares of Max India Ltd, on which dividend was received, to the principal amount of unsecured loans, which worked out to Rs. 67,74,175/-. However, the assessing officer restricted the disallowance under section 14A of the said act to Rs. 49,90,860/-, being the amount of dividend received. On appeal, the CIT (A), by the order dated 12/01/2005, upheld the order of the assessing officer. Thereafter, the case of the assessee was heard by a Special Bench constituted in the case of Daga Capital Management (P) Ltd. The Special Bench of the Tribunal held that the expenditure claimed was hit by the provisions of section 14A of the said Act. Pursuant to the majority decision of the Special Bench of the Tribunal, the issue of quantum of expenditure to be disallowed was

restored to the assessing officer to be recomputed in terms of Rule 8D of the Income Tax Rules, 1961 (hereinafter referred to as "the said rules"), which was held to be retrospective.

5. As regards Question 1, it has been contended on behalf of the assessees that holding of shares for acquiring and retaining control of operating companies amounts to business and, consequently, dividend income on such shares is in the nature of business income. It was further submitted that the intention behind acquiring such shares was not to earn dividend but to acquire and retain a controlling interest in the operating companies. Dividend was merely incidental. It was thus contended that the interest paid on the funds borrowed to acquire such shares was allowable as a business expenditure as it was not directed at earning dividend income, which was incidental.

Legislative History of Section 14A and Rule 8D

6. Before we delve deeper into the questions at hand it would be appropriate to not only examine the provisions of section 14A of the said act but also to notice its legislative history. Section 14A was inserted into the said Act by the Finance Act, 2001 with retrospective effect from 01/04/1962.

> **"Expenditure incurred in relation to income not includible in total income.**
>
> **14A**. For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act."

7. By virtue of the Finance Act, 2002, the following proviso was inserted in section 14A and was deemed to have been inserted with effect from 11/05/2001:–

> "**Provided** that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001."

8. As a result of the insertion of the said proviso, Section 14A was as follows:–

> **"Expenditure incurred in relation to income not includible in total income.**
>
> **14A**. For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.

> **Provided** that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001."

9. Then, by the Finance Act, 2006, Section 14A was numbered as sub-section (1) thereof and after sub-section (1) as so numbered, the following sub-sections were inserted, with effect from 01/04/2007:–

> "(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.
>
> (3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act."

10. Consequent upon the Finance Act, 2006, section 14A as it now stands is as under:–

> **"Expenditure incurred in relation to income not includible in total income.**
>
> **14A**. (1) For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.
>
> (2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.
>
> (3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act.
>
> **Provided** that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or

pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001."

11. By Notification No.45/2008 dated 24/03/2008, the Central Board of Direct Taxes (CBDT), in exercise of its powers under section 295 of the said Act read with sub-section (2) of section 14A of the said Act, made the "Income-tax (Fifth Amendment) Rules, 2008" to further amend the said Rules (i.e., the Income-tax Rules, 1962) by introducing Rule 8D therein. Clause 1(2) of the Income-tax (Fifth Amendment) Rules, 2008 clearly stipulated that the rules would come into force from the date of publication in the Official Gazette. The said Rule 8D is as under:–

"Method for determining amount of expenditure in relation to income not includible in total income.

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

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

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

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

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

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

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

$$A \times \frac{B}{C}$$

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

B = the average of value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the

assessee, on the first day and the last day of the previous year ;

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

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

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

The law prior to insertion of Section 14A

12. Prior to the introduction of section 14A in the said Act, the position in law was as laid down by the Supreme Court in *CIT v. Maharashtra Sugar Mills Ltd:* 82 ITR 452 (SC) and *Rajasthan State Warehousing Corporation v. CIT*: 242 ITR 450 (SC). In Maharashtra sugar Mills Ltd (supra) the assessee's business comprised of two parts, namely, (1) cultivation of sugar cane and (2) the manufacture of sugar. The revenue had contended that as the income from the cultivation of sugar cane, being the result of an agricultural operation, was not exigible to tax, therefore, any expenditure incurred in respect of that activity was not deductible. The Supreme Court repelled this contention in the following manner:–

> "This contention proceeds on the basis that only expenditure incurred in respect of a business activity giving rise to income, profit or gains taxable under the Act can be given deduction to and not otherwise. We see no basis for this contention. *To find out whether the deduction claimed is permissible under the Act or not, all that we have to do is to examine the relevant provisions of the Act. Equitable considerations are wholly out of place in construing the provisions of a taxing statute. We have to take the provisions of the statute as they stand. If the amount claimed is permissible under the Act then the same has to be deducted from the gross profit. If it is not permissible under the Act, it has to be rejected*. As mentioned earlier, it is not disputed that the cultivation of sugar-cane and the manufacture of sugar constituted one single and indivisible business. Section 10(2) says that profits under section 10(1) in respect of a business should be computed after deducting the allowances mentioned therein. One of the allowances allowed is that mentioned in section 10(2)(xv) which says that any expenditure laid out or

expended wholly an exclusively for the purpose of such business shall be deducted as an allowance. The mandate of section 10(2) (xv) is plain and unambiguous. *Undoubtedly, the allowance claimed in this case was laid out or expended for the purpose of the business carried on by the assessee. The fact that the income arising from a part of that business is not exigible to tax under the act is not a relevant circumstance*."

(Emphasis supplied)

13. In *Rajasthan State warehousing Corporation* (supra), the Supreme Court after, inter alia, considering its earlier decisions in *CIT v. Indian bank Ltd:* 56 ITR 77 (SC) and *Maharashtra Sugar Mills Ltd* (supra) laid down the following principles:–

"(i) if income of an assessee is derived from various heads of income, he is entitled to claim deduction admissible under the respective head whether or not computation under each head results in taxable income;

(ii) if income of an assessee arises under any of the heads of income but from different items, e.g., different house properties or different securities, etc., and income from one or more items alone is taxable whereas income from the other item is exempt under the Act, the entire permissible expenditure in earning the income from that head is deductible; and

(iii) in computing "profits and gains of business or profession" when an assessee is carrying on business in various ventures and some among them yield taxable income and the others do not, the question of allowability of the expenditure under section 37 of the Act will depend on:

(a) fulfilment of requirements of that provision noted above; and

(b) on the facts whether all the ventures carried on by him constituted one indivisible business or not; if they do, the entire expenditure will be a permissible deduction but if they do not, the principle of apportionment of the expenditure will apply because there will be no nexus between the expenditure attributable to the venture not forming an integral part of the business and the expenditure sought to be deducted as the business expenditure of the assessee."

14. Thus, prior to the introduction of section 14A in the said Act, the law was that when an assessee had a composite and indivisible business which had elements of both taxable and non-taxable income, the entire expenditure in respect of the said business was deductible and, in such a case, the principle of apportionment of the expenditure relating to the non-taxable income did not apply. However, where the business was divisible, the principle of apportionment of the expenditure was

applicable and the expenditure apportioned to the 'exempt' income or income not exigible to tax, was not allowable as a deduction.

Objective behind insertion of section 14A

15. The object behind the insertion of section 14A in the said Act is apparent from the Memorandum explaining the provisions of the Finance Bill 2001 which is to the following effect:–

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

16. As observed by the Supreme Court in the case of *CIT v. Walfort Share and Stock Brokers P Ltd*: 326 ITR 1 (SC), the insertion of section 14 A with retrospective effect reflects the serious attempt on the part of Parliament not to allow deduction in respect of any expenditure incurred by the assessee in relation to income, which does not form part of the total income under the said act against the taxable income. The Supreme Court further observed as under:–

> ".. In other words, section 14 A clarifies that expenses incurred can be allowed only to the extent that they are relatable to the earning of taxable income. In many cases the nature of expenses incurred by the assessee may be relatable partly to the exempt income and partly to the taxable income. In the absence of section 14A, the expenditure incurred in respect of exempt income was being claimed against taxable income. *The mandate of section 14A is clear. It desires to curb the practice to claim deduction of expenses incurred in relation to exempt income*

> *against taxable income and at the same time avail of the tax incentive by way of an exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income…"*
>
> "..Expenses allowed can only be in respect of earning taxable income. This is the purport of section 14A. In section 14A, the first phrase is "for the purposes of computing the total income under this Chapter" which makes it clear that various heads of income as prescribed in the Chapter IV would fall within section 14A. *The next phrase is, "in relation to income which does not form part of total income under the Act". It means that if an income does not form part of total income, then the related expenditure is outside the ambit of the applicability of section 14A.."*

(Emphasis supplied)

17. The Supreme Court also clearly held that in the case of an income like dividend income which does not form part of the total income, any expenditure/deduction relatable to such (exempt or non-taxable) income, even if it is of the nature specified in sections 15 to 59 of the said Act, cannot be allowed against any other income which is includable in the total income. The exact words used by the Supreme Court are as under:–

> "Further, section 14 specifies five heads of income which are chargeable to tax. In order to be chargeable, an income has to be brought under one of the five heads. Sections 15 to 59 lay down the rules for computing income for the purpose of chargeability to tax under those heads. Sections 15 to 59 quantify the total income chargeable to tax. *The permissible deductions enumerated in sections 15 to 59 are now to be allowed only with reference to income which is brought under one of the above heads and is chargeable to tax*. If an income like dividend income is not a part of the total income, the expenditure/deduction though of the nature specified in sections 15 to 59 but related to the income not forming part of the total income could not be allowed against other income includable in the total income for the purpose of chargeability to tax. *The theory of apportionment of expenditure between taxable and nontaxable has, in principle, been now widened under section 14 A."*

(emphasis supplied)

Analysis of section 14A

18. Sub-section (1) of section 14A clearly stipulates that for the purposes of computing total income under Chapter IV (Computation of Total Income), no deduction shall be allowed in respect of expenditure

"*incurred*" by the assessee "*in relation to*" income which does not form part of the total income under the said Act. A lot of emphasis was laid on the expressions "incurred" and "in relation to". It was contended by Mr Ajay Vohra, who appeared on behalf of most of the assesses, that the word "incurred" must be taken literally in the sense that the expenditure must have actually taken place. Moreover, the expenditure must also have taken place in relation to income which does not form part of total income. Mr Vohra contended that the expression "in relation to" implies that there must be a direct and proximate connection with the subject matter. In other words, according to Mr Vohra, only that actual expenditure which is made directly and for the object of earning exempt income (in the present appeals – dividend income) could be disallowed under section 14A. He submitted that if the dominant and main objective of spending was not the earning of 'exempt' income then, the expenditure could not be disallowed under section 14A provided it was otherwise allowable under sections 15 to 59 of the said Act. Mr Satyen Sethi and Dr Rakesh Gupta, who appeared for some of the assesses, also adopted the arguments of Mr Vohra and emphasized that the expenditure must be actual and cannot be computed on the basis of some formula as stipulated under Rule 8D read with sub-sections (2) & (3) of section 14A.

"in relation to"

19. Let us examine the expression "in relation to". Mr Vohra had referred to the Supreme Court decision in *Madhav Rao Scindia v. Union of India*: AIR 1971 SC 530 where, in paragraph 134, it is observed as under:–

> ".. The expression "provisions of this Constitution relating to" in article 363 means provisions having a dominant and immediate connection with: it does not mean merely having a reference to."

20. According to Mr Vohra, the expression "in relation to" appearing in section 14A of the said Act has to be considered in similar light. He submitted that the expenditure incurred must have a dominant and immediate connection with the exempt income. Thus, according to him, since the shares were acquired for the purpose of acquiring and retaining control of the operating company, the expenditure in respect of such acquisition of shares would not have a dominant and immediate connection with the dividend income, which was merely incidental. As such, Mr Vohra submitted, the expenditure could not be disallowed under section 14 A of the said act.

21. There are several difficulties with the argument advanced by Mr Vohra. The first of them is that in *Madhavrao Scindia* (*supra*) the Supreme Court was concerned with the interpretation of a constitutional provision dealing with the jurisdiction of courts, inter alia, concerning any dispute in respect of any right accruing under or any liability or obligation arising out of any of the provisions of the Constitution relating

to a treaty, agreement, covenant, engagement, sanad or other similar instrument which was entered into or executed before the commencement of the Constitution by any Ruler of an Indian State and to which the Government of the Dominion of India or any of its predecessor governments was a party and which is or has been continued in operation after such commencement. In the present appeals we are not concerned with a provision of the Constitution and that too dealing with the jurisdiction of a court. Secondly, what needs to be emphasised is that in the very same paragraph 134, the Supreme Court observed that the meaning of a word or expression used in the Constitution often is coloured by the context in which it occurs and that the simpler and more common the word or expression, the more meanings and shades of meaning it has. The Supreme Court further held that it is the duty of the court to determine in what particular meaning and particular shade of meaning the word or expression was used by the Constitution makers and in discharging the duty the court will take into account the context in which it occurs, the object to serve which it was used, it's collocation, the general congruity with the concept or object it was intended to articulate and a host of other considerations. It is in this backdrop that the Supreme Court concluded that the expression "provisions of this Constitution relating to" in Article 363 meant provisions having a dominant an immediate connection with and the said expression did not mean merely having a reference to. The Supreme Court clearly explained that a wide meaning of the expression might exclude disputes from the jurisdiction of the courts in respect of rights or obligations, however indirect or tenuous the connection between the constitutional provision and the covenant may be. It is therefore clear that the expression "relating to" would depend upon the context in which it occurs.

22. In *Doypack Systems Pvt Ltd v. Union of India*: AIR 1988 SC 782, the Supreme Court observed that the expressions "pertaining to", "in relation to" and "arising out of", used in the deeming provision, are used in the expansive sense. The Supreme Court further observed as under:-

> "49. *The expression "in relation to" (so also "pertaining to"), is a very broad expression which presupposes another subject matter. These are words of comprehensiveness which might both have a direct significance as well as an indirect significance depending on the context*..."
>
> "... In this connection reference may be made to 76 Corpus Juris Secundum at pages 620 and 621 where it is stated that the term "relate" is also defined as meaning to bring into association or connection with. *It has been clearly mentioned that " relating to" has been held to be equivalent to or synonymous with as to "concerning with" and "pertaining to". The expression "pertaining to" is an expression of expansion and not of contraction."*

(emphasis supplied)

23. Mr Vohra also placed reliance on *Navin Chemicals Manufacturing and Trading Co Ltd v. Collector of Customs*: 1993 (68) the LT 3 (SC). In the said decision the controversy was with regard to the meaning to be given to the expression "*determination of any question having* ***a relation to*** *the rate of duty of customs or to the value of goods for the purposes of assessment*". The Supreme Court was of the view that the key was to be found in the words "for purposes of assessment". It held that where the appeal involved the determination of any question which had a relation to the rate of customs duty for the purposes of assessment, that appeal must be heard by a Special Bench. It further held that, similarly, where the appeal involved the determination of any question which had a relation to the value of goods for the purposes of assessment, that appeal must also be heard by a Special Bench. In this context the Supreme Court observed as under:–

> "The phrase "relation to" is, ordinarily, of wide import but, in the context of its use in the said expression in section 129C, it must be read as meaning a direct and proximate relationship to the rate of duty and to the value of goods for the purposes of assessment."

This decision also makes it clear that the expression "in relation to" is, ordinarily, of wide import. In the normal course, the said expression would have an expansive meaning unless, of course, the context would otherwise suggest.

24. We do not agree with the submission of the learned counsel appearing on behalf of the assessees that a narrow meaning ought to be ascribed to the expression "in relation to" appearing in section 14A of the said act. The context does not suggest that a narrow meaning ought to be given to the said expression. It is pertinent to note that the provision was inserted by virtue of the Finance Act, 2001 with retrospective effect from 01/04/1962. In other words, it was the intention of Parliament that it should appear in the statute book, from its inception, that expenditure incurred in connection with income which does not form part of total income ought not to be allowed as a deduction. The factum of making the said provision retrospective makes it clear that Parliament wanted that it should be understood by all that from the very beginning, such expenditure was not allowable as a deduction. Of course, by introducing the proviso it made it clear that there was no intention to reopen finalized assessments prior to the assessment year beginning on 01/04/2001. Furthermore, as observed by the Supreme Court in *Walfort* (supra), the basic principle of taxation is to tax the net income, i.e., gross income minus the expenditure and on the same analogy the exemption is also in respect of net income. In other words, where the gross income would not form part of total income, it's associated or related expenditure would also not be permitted to be debited against other taxable income.

25. We are of the view that the expression "in relation to" appearing in Section 14 A of the said act cannot be ascribed a narrow or constricted meaning. If we were to accept the submission made on behalf of the assessees then sub-section (1) would have to be read as follows:–

> "For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee **with the main object of earning** income which does not form part of the total income under this Act."

That is certainly not the purport of the said provision. The expression "in relation to" does not have any embedded object. It simply means "in connection with" or "pertaining to". If the expenditure in question has a relation or connection with or pertains to exempt income, it cannot be allowed as a deduction even if it otherwise qualifies under the other provisions of the said Act. In *Walfort* (supra), the Supreme Court made it very clear that the permissible deductions enumerated in sections 15 to 59 are now to be allowed **only** with reference to income which is brought under one of the heads of income and is chargeable to tax. The Supreme Court further clarified that if an income like dividend income is not part of the total income, the expenditure/deduction related to such income, though of the nature specified in sections 15 to 59, cannot be allowed against other income which is includable in the total income for the purpose of chargeability to tax.

"expenditure incurred"

26. It was contended by the learned counsel for the assessees that the words "expenditure incurred" as appearing in section 14A(1) clearly mean that there must be actual expenditure. Of course, the actual expenditure must be for earning the exempt income. We have already pointed out above, that we do not subscribe to the narrow interpretation sought to given to the words "in relation to" which the learned counsel for the assessees are espousing. Thus, we will have to consider the argument of the asssessees in respect of the expression "expenditure incurred" in the context of the expenditure being in connection with or pertaining to income which does not form part of the total income under the said Act.

27. A reference was made to the decision of the Punjab & Haryana High Court in the case of *CIT-II v. Hero Cycles Ltd* [ITA No. 331/2009 (O&M): decided on 4/11/2009] wherein it was observed that:–

> "Disallowance under Section 14A requires finding of incurring expenditure where it is found that for earning exempted income no expenditure has been incurred, disallowance under Section 14A cannot stand."

28. It was contended that unless and until there was actual expenditure for earning the exempted income, there could not be any disallowance under section 14A. While we agree that the expression

"expenditure incurred" refers to actual expenditure and not to some imagined expenditure we would like to make it clear that the 'actual' expenditure that is in contemplation under section 14A(1) of the said Act is the 'actual' expenditure in relation to or in connection with or pertaining to exempt income. The corollary to this is that if no expenditure is incurred in relation to the exempt income, no disallowance can be made under section 14A of the said Act.

Scope of sub-sections (2) and (3) of Section 14A

29. Sub-section (2) of Section 14 A of the said Act provides the manner in which the Assessing Officer is to determine the amount of expenditure incurred in relation to income which does not form part of the total income. However, if we examine the provision carefully, we would find that the Assessing Officer is required to determine the amount of such expenditure only if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under the said Act. In other words, the requirement of the Assessing Officer embarking upon a determination of the amount of expenditure incurred in relation to exempt income would be triggered only if the Assessing Officer returns a finding that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. Therefore, the condition precedent for the Assessing Officer entering upon a determination of the amount of the expenditure incurred in relation to exempt income is that the Assessing Officer must record that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. Sub-section (3) is nothing but an offshoot of sub-section (2) of Section 14A. Sub-section (3) applies to cases where the assessee claims that no expenditure has been incurred in relation to income which does not form part of the total income under the said Act. In other words, sub-section (2) deals with cases where the assessee specifies a positive amount of expenditure in relation to income which does not form part of the total income under the said Act and sub-section (3) applies to cases where the assessee asserts that no expenditure had been incurred in relation to exempt income. In both cases, the Assessing Officer, if satisfied with the correctness of the claim of the assessee in respect of such expenditure or no expenditure, as the case may be, cannot embark upon a determination of the amount of expenditure in accordance with any prescribed method, as mentioned in sub-section (2) of Section 14A of the said Act. It is only if the Assessing Officer is not satisfied with the correctness of the claim of the assessee, in both cases, that the Assessing Officer gets jurisdiction to determine the amount of expenditure incurred in relation to such income which does not form part of the total income under the said Act in accordance with the prescribed method. The prescribed method being the method stipulated in Rule 8D of the said Rules. While rejecting the claim

of the assessee with regard to the expenditure or no expenditure, as the case may be, in relation to exempt income, the Assessing Officer would have to indicate cogent reasons for the same.

Rule 8D

30. As we have already noticed, sub-section (2) of Section 14A of the said Act refers to the method of determination of the amount of expenditure incurred in relation to exempt income. The expression used is – "such method as may be prescribed". We have already mentioned above that by virtue of Notification No.45/2008 dated 24/03/2008, the Central Board of Direct Taxes introduced Rule 8D in the said Rules. The said Rule 8D also makes it clear that where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with (a) the correctness of the claim of expenditure made by the assessee; or (b) the claim made by the assessee that no expenditure has been incurred in relation to income which does not form part of the total income under the said Act for such previous year, the Assessing Officer shall determine the amount of the expenditure in relation to such income in accordance with the provisions of sub-rule (2) of Rule 8D. We may observe that Rule 8D(1) places the provisions of Section 14A(2) and (3) in the correct perspective. As we have already seen, while discussing the provisions of Sub-sections (2) and (3) of Section 14A, the condition precedent for the Assessing Officer to himself determine the amount of expenditure is that he must record his dissatisfaction with the correctness of the claim of expenditure made by the assessee or with the correctness of the claim made by the assessee that no expenditure has been incurred. It is only when this condition precedent is satisfied that the Assessing Officer is required to determine the amount of expenditure in relation to income not includable in total income in the manner indicated in sub-rule (2) of Rule 8D of the said Rules.

31. It is, therefore, clear that determination of the amount of expenditure in relation to exempt income under Rule 8D would only come into play when the Assessing Officer rejects the claim of the assessee in this regard. If one examines sub-rule (2) of Rule 8D, we find that the method for determining the expenditure in relation to exempt income has three components. The first component being the amount of expenditure directly relating to income which does not form part of the total income. The second component being computed on the basis of the formula given therein in a case where the assessee incurs expenditure by way of interest which is not directly attributable to any particular income or receipt. The formula essentially apportions the amount of expenditure by way of interest [other than the amount of interest included in clause (i)] incurred during the previous year in the ratio of the average value of investment, income from which does not or shall not form part of the total income, to the average of the total assets of the assessee. The third component is an artificial figure – one half percent of the average value of

the investment, income from which does not or shall not form part of the total income, as appearing in the balance sheets of the assessee, on the first day and the last day of the previous year. It is the aggregate of these three components which would constitute the expenditure in relation to exempt income and it is this amount of expenditure which would be disallowed under Section 14A of the said Act. It is, therefore, clear that in terms of the said Rule, the amount of expenditure in relation to exempt income has two aspects – (a) direct and (b) indirect. The direct expenditure is straightaway taken into account by virtue of clause (i) of sub-rule (2) of Rule 8D. The indirect expenditure, where it is by way of interest, is computed through the principle of apportionment, as indicated above. And, in cases where the indirect expenditure is not by way of interest, a rule of thumb figure of one half percent of the average value of the investment, income from which does not or shall not form part of the total income, is taken.

Do sub-sections (2) and (3) of Section 14A and Rule 8D apply retrospectively ?

32. While examining the legislative history of Section 14A and Rule 8D, we have already noted that Section 14A, as introduced by virtue of the Finance Act, 2001, was with retrospective effect from 01.04.1962. The proviso was inserted by virtue of the Finance Act, 2002 and it was made clear that nothing in Section 14A empowered the Assessing Officer to either re-assess under Section 147 or pass an order enhancing the assessment or reducing the refund already made or otherwise increasing the liability of the assessee under Section 154, for any assessment year beginning on or before the first day of April, 2001. Thus, in respect of all the assessment years prior to the assessment year beginning on or before the 1st day of April, 2001, concluded assessments could not be disturbed despite the fact that Section 14A had been expressly made retrospective with effect from 01.04.1962. The provisions of Section 14A, which were retrospective with effect from 01.04.1962 are now encapsulated in sub-section (1) of Section 14A. It is also clear that sub-sections (2) and (3) of Section 14A were introduced subsequently by virtue of the Finance Act, 2006 and were introduced with effect from 01.04.2007. However, although sub-sections (2) and (3) had been introduced with effect from 01.04.2007, they remained empty shells inasmuch as the expression "such method as may be prescribed" got meaning only by the introduction of Rule 8D by virtue of the Income-tax (Fifth Amendment) Rules, 2008 which was notified by the Central Board of Direct Taxes by its notification No.45/2008 dated 24/03/2008.

33. Dr Rakesh Gupta, the learned counsel, who had appeared for some of the assessees, submitted that Section 295 of the said Act empowered the Central Board of Direct Taxes to make rules for the whole or any part of India for carrying out the purpose of the said Act. He referred to sub-section (4) of Section 295 and submitted that the power to

make rules conferred on the Central Board of Direct Taxes included the power to give retrospective effect, from a date not earlier than the date of the commencement of the said Act, to the rules or any of them and, unless the contrary was permitted (whether expressly or by necessary implication), no retrospective effect was to be given to any rule so as to prejudicially affect the interests of the assessees. He further submitted that Rule 8D was inserted in the said rules, but the Central Board of Direct Taxes did not make it retrospective. He submitted that whenever the CBDT felt it necessary to introduce a rule with retrospective effect, it did so by making the rule expressly retrospective. As an example, he referred to Rule 11EA which was inserted by the Income-tax (Ninth Amendment) Rules, 1997 with retrospective effect, from 01/10/1994.

34. On the other hand, it was contended on behalf of the revenue and, particularly, by Mr Sanjeev Sabharwal that since Section 14A was introduced with retrospective effect from 01.04.1962, the principles of Section 14A would have to be considered as having always been a part of the said Act and, therefore, sub-sections (2) and (3) of Section 14 A and Rule 8D of the said Rules were only machinery provisions and ought to be read retrospectively so as to give meaning to Section 14A(1).

35. We are of the view that Rule 8D would operate prospectively. We agree with the submissions made by Dr Rakesh Gupta that if the said Rule were to have retrospective effect, nothing prevented the Central Board of Direct Taxes from saying so, particularly, in view of the fact that it had the power to make a rule retrospective by virtue of Section 295(4) of the said Act. Instead of making Rule 8D retrospective, clause 1(2) of the Income-tax (Fifth Amendment) Rules, 2008 made it clear that the rules would come into force from the date of their publication in the Official Gazette. It is, therefore, clear that Rule 8D, which was introduced by virtue of the Notification No.45/2008 dated 24.03.2008, was prospective in operation and cannot be regarded as being retrospective. We may also point out that we have had the benefit of the decision of the Bombay High Court in *Godrej and Boyce Mfg. Co. Ltd v DCIT*: (2010) 328 ITR 81 (Bom), wherein it has, inter alia, been held that the provisions of Rule 8D of the said Rules has prospective effect and shall apply with effect from assessment year 2008-09 onwards.

36. Insofar as sub-sections (2) and (3) of Section 14A are concerned, they have also been introduced by virtue of the Finance Act, 2006 with effect from 01.04.2007. This is apparent, first of all, from the Notes on Clauses of the Finance Bill, 2006 [Reported in 281 ITR (ST) at pages 139-140]. The said Notes on Clauses refers to clause 7 of the Bill which had sought to amend Section 14A of the said Act. It is specifically mentioned in the said Notes on Clauses that:-

> "This amendment will take effect from 1st April, 2007 and will, accordingly, apply in relation to the assessment year 2007-08 and subsequent years."

37. Furthermore, in the Memorandum explaining the provisions in the Finance Bill, 2006 [281 ITR (ST) at pages 281-281], it is once again stated with reference to clause 7 which pertains to the amendment to Section 14A of the said Act that:–

> "This amendment will take effect from 1st April, 2007 and will, accordingly, apply in relation to the assessment year 2007-08 and subsequent years."

38. We may also refer to the CBDT Circular No.14/2006 dated 28.12.2006 and to paragraphs 11 to 11.3 thereof. Paragraph 11 dealt with the method for allocating expenditure in relation to exempt income and paragraphs 11.1 and 11.2 explained the basis and logic behind the introduction of sub-section (2) of Section 14A of the said Act. Paragraph 11.3 specifically provided for applicability of the provisions of subsection (2) and it clearly indicated that it would be applicable "from the assessment year 2007-08 onwards".

39. It is, therefore, clear that sub-sections (2) and (3) of Section 14A were introduced with prospective effect from the assessment year 2007-08 onwards. However, sub-section (2) of Section 14A remained an empty shell until the introduction of Rule 8D on 24.03.2008 which gave content to the expression "such method as may be prescribed" appearing in Section 14A(2) of the said Act.

40. From the above discussion, it is clear that, in effect, the provisions of subsections (2) and (3) of Section 14A would be workable only with effect from the date of introduction of Rule 8D. This is so because prior to that date, there was no prescribed method and sub-sections (2) and (3) of Section 14A remained unworkable.

How is Section 14A to be worked for the period prior to the introduction of Rule 8D?

41. Sub-section (2) of section 14A, as we have seen, stipulates that the Assessing Officer shall determine the amount of expenditure incurred in relation to income which does not form part of the total income "in accordance with such method as may be prescribed". Of course, this determination can only be undertaken if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. This part of section 14A(2) which explicitly requires the fulfillment of a condition precedent is also implicit in section 14A(1) [as it now stands] as also in its initial *avatar* as section 14A. It is only the prescription with regard to the method of determining such expenditure which is new and which will operate prospectively. In other words, section 14A, even prior to the introduction of sub-sections (2) & (3) would require the assessing officer to first reject the claim of the assessee with regard to the extent of such expenditure and such rejection must be for disclosed cogent reasons. It is then that the question of determination of such expenditure by the assessing officer would arise. The requirement of

adopting a specific method of determining such expenditure has been introduced by virtue of sub-section (2) of section 14A. Prior to that, the assessing was free to adopt any reasonable and acceptable method.

42. Thus, the fact that we have held that sub-sections (2) & (3) of section 14A and Rule 8D would operate prospectively (and, not retrospectively) does not mean that the assessing officer is not to satisfy himself with the correctness of the claim of the assessee with regard to such expenditure. If he is satisfied that the assessee has correctly reflected the amount of such expenditure, he has to do nothing further. On the other hand, if he is satisfied on an objective analysis and for cogent reasons that the amount of such expenditure as claimed by the assessee is not correct, he is required to determine the amount of such expenditure on the basis of a reasonable and acceptable method of apportionment. It would be appropriate to recall the words of the Supreme Court in *Walfort* (supra) to the following effect:-

> "The theory of apportionment of expenditure between taxable and non-taxable has, in principle, been now widened under section 14 A."

So, even for the pre-Rule8D period, whenever the issue of section 14A arises before an Assessing Officer, he has, first of all, to ascertain the correctness of the claim of the assessee in respect of the expenditure incurred in relation to income which does not form part of the total income under the said Act. Even where the assessee claims that no expenditure has been incuured in relation to income which does not form part of total income, the assessing officer will have to verify the correcteness of such claim. In case, the assessing officer is satisfied with the claim of the assessee with regard to the expenditure or no expenditure, as the case may be, the assessing officer is to accept the claim of the assessee insofar as the quantum of disallowance under section 14A is concerned. In such eventuality, the assessing officer cannot embark upon a determination of the amount of expenditure for the purposes of section14A(1). In case, the assessing officer is not, on the basis of objective criteria and after giving the assessee a reasonable opportunity, satisfied with the correctness of the claim of the assessee, he shall have to reject the claim and state the reasons for doing so. Having done so, the assessing officer will have to determine the amount of expenditure incurred in relation to income which does not form part of the total income under the said Act. He is required to do so on the basis of a reasonable and acceptable method of apportionment.

43. At this juncture, we must make it clear that Dr Rakesh Gupta's arguments that Rule 8D of the said Rules exceeds the mandate of section 14A, have not been considered by us because the appeals before us are in respect of assessment years prior to the introduction of Rule 8D. We therefore refrain from expressing any opinion on the issue as to whether

Rule 8D (and, to what extent, if at all) is *ultra vires* section 14A of the said Act.

Answers to the questions

44. In view of the foregoing, Question 1 is answered in the affirmative and Questions 2 & 3, in the negative.

Assessees' appeals

45. The appeals on behalf of the assessees are:–

ITA No.	Cause Title	Assessment year
853/2009	*Cheminvest Ltd vs. CIT*	2001-02
1060/2009	*Maxpak Investment Ltd vs. CIT*	2001-02
687/2009	*Maxopp Investment Ltd vs. CIT*	2002-03
856/2009	*Cheminvest Ltd vs. CIT*	2002-03
805/2009	*Eicher Ltd vs. CIT*	2002-03
936/2009	*Eicher Ltd vs. CIT*	2001-02
112/2009	*Eicher Goodearth Ltd vs. CIT*	2004-05
263/2010	*Mohair Investments Ltd vs. CIT*	2002-03
416/2010	*Medicare Investments Ltd vs. CIT*	2002-03
958/2009	*Minda Industries Ltd vs. CIT*	2002-03
1096/2009	*Jagatjit Industries Ltd vs. CIT*	2004-05

In all these appeals, the Income Tax Appellate Tribunal had, after upholding the disallowance under section 14A of the said Act, restored the matters to the respective files of the concerned Assessing Officers with the direction to re-compute the said disallowance in accordance with Rule 8D of the said Rules. However, since we have held that Rule 8D would be inapplicable to the assessment years prior to 2008-2009, the assessing officers would now have to follow the steps outlined in paragraph 42 above.

Revenue's appeals

46. The appeals filed by the revenue are disposed of as below:–

ITA No. 77/2009 [*CIT v. HCL Perot Systems Ltd*](AY 2000-01)

ITA No. 139/2009 [*CIT v. HCL Perot Systems Ltd*](AY 2001-02)

The Tribunal did not sustain the disallowance made by the Assessing Officer under Section 14 A and directed the Assessing Officer to re-compute the disallowance in terms of the method of working given by the assessee. The revenue is aggrieved inasmuch as the Tribunal did not direct the Assessing Officer to re-compute the disallowance in terms of Rule 8D read with sub-sections (2) & (3) of section 14A. While Rule 8D

would be inapplicable, the assessing officer would now have to follow the steps outlined in paragraph 42 above.

ITA No.57/2008 [*CIT v. Vou Investment Pvt Ltd*](AY 1998-99)

The Tribunal deleted the disallowance under section 14A by holding that the earning of dividend was merely incidental to holding of shares and that the Assessing Officer had also failed to pinpoint the expenditure actually incurred in respect of the dividend income. The Tribunal's judgment and order to the extent it deleted the disallowance under section 14A is set aside and the matter is restored to the file of the assessing officer who is to follow the steps outlined in paragraph 42 above.

ITA No.932/2009 [*CIT v. Nalwa Investments Ltd*](AY 2004-05)

The Tribunal restored the matter to the file of the Assessing Officer to re-compute the disallowance under section 14A and directed the Assessing Officer to identify if any expenditure had been incurred for earning exempt income and to disallow only such expenditure. In view of the discussion above, the assessing officer shall now have to follow the steps outlined in paragraph 42 above.

ITA No.98/2009 [*CIT v. Escorts Finance Ltd*](2001-02)

The Tribunal confirmed the deletion by the CIT(A) of the disallowance made by the Assessing Officer on account of administrative expenses and interest on loan by invoking section 14A of the said Act. The Tribunal's judgment and order, to the extent it deleted the disallowance under section 14A, is set aside and the matter is restored to the file of the assessing officer who is to follow the steps outlined in paragraph 42 above.

ITA No.683/2008 [*CIT v. ICRA Ltd*](AY 2001-02)

ITA No.702/2008 [*CIT v. ICRA Ltd*](AY 2003-04)

The Tribunal deleted the addition made by the Assessing Officer who had disallowed proportionate expenditure under section 14A of the said Act by apportioning the administrative expenses in respect of exempt income. In both cases, the Tribunal's judgment and order, to the extent it deleted the disallowance under section 14A, is set aside and the matter is restored to the file of the assessing officer who is to follow the steps outlined in paragraph 42 above.

ITA No.389/2009 [*CIT v. Sharda Motors Industries Ltd*](AY 2004-05)

ITA No.1114/2009 [*CIT v. Sharda Motors Industries Ltd*](AY 2005-06)

The Tribunal had, inter alia, deleted the disallowance made by the Assessing Officer under section 14A of the said Act being the proportionate expenditure incurred in relation to earning dividend income. In both cases, the Tribunal's judgment and order, to the extent it deleted the disallowance under section 14A, is set aside and the matter is

restored to the file of the assessing officer who is to follow the steps outlined in paragraph 42 above.

ITA No.217/2009 [*CIT v. AKM Systems Pvt Ltd*](AY 2001-02)

The assessee company received dividend of Rs 81,87,432/- in respect of the assessment year 2001-02. The Assessing Officer invoked the provisions of section 14A of the said Act and disallowed the entire office and administrative expenses of Rs 25,35,482/-. The Tribunal estimated the expenditure in relation to dividend income at 10% of the dividend income and sustained the addition of Rs 8,18,743/- only. The revenue is aggrieved by the fact that the entire expenditure of Rs 25,35,482/- was not disallowed and that the Tribunal estimated the disallowable expenditure by adopting a formula of 10% of the dividend income. The Tribunal's judgment and order, to the extent it partially deleted the disallowance under section 14A, is set aside and the matter is restored to the file of the assessing officer who is to follow the steps outlined in paragraph 42 above.

The appeals stand disposed of as above.

2011 PTR 1711 (H.C. Chat.)

HIGH COURT OF CHATTISGARH

Satish K Agnihotri and Radhe Shyam Sharma, JJ.

Assistant Commissioner Income Tax Raipur
v.
Major Deepak Mehta

FACTS/HELD

1. **S. 147: AO cannot assess other "escaped income" if reason for issue of s. 148 notice dropped**
2. The AO reopened the assessment u/s 148 on the ground that certain income had escaped assessment. However, in the reassessment order, the AO did not assess the income which was referred to in the reasons but instead assessed other income which had escaped assessment. The Tribunal quashed the reassessment order on the ground that if the AO did not assess the income for which he had reopened the assessment, he had

no jurisdiction to assess other escaped income. The Department challenged the Tribunal's order by relying on Explanation 3 to s. 147 & **Sun Engineering** 198 ITR 297 (SC). HELD dismissing the appeal:

> **If the AO does not assess the income in respect of which the s. 148 notice was issued, it means there was no 'reason to believe' that income had escaped assessment. If so, the AO has no jurisdiction to assess any other escaped income that comes to his notice during the reassessment proceedings**. Though in **Sun Engineering** 198 ITR 297 (SC), it was held that the AO had jurisdiction to assess other income, it was not a case where the AO had not assessed the income in respect of which the s. 148 notice was issued. Explanation 3 to s. 147 also contemplates that the income in respect of which the s. 148 notice is issued is assessed (**Jet Airways** 331 ITR 236 (Bom) & **Ranbaxy Lab** 60 DTR 77 (Del) followed).

Appeal dismissed.

Income Tax Appeal No. 04 of 2006.

Decided on: 8th November, 2011.

Present at hearing: Rajeev Shrivastava with Sameer Shrivastava Advocate, for Appellant. Shashank Dubey Sr Advocate with Neelabh Dubey Advocate, for Respondent.

JUDGMENT

Satish K Agnihotri, J.–

1. The instant appeal filed by the Revenue under Section 260A of the Income Tax Act, 1961 (for short "the Act, 1961") is against the order dated 7-10-2005 passed by the Income Tax Appellate Tribunal (for short "the Tribunal") wherein the Tribunal has dismissed the appeal filed by the Revenue and partly allowed the cross objection filed by the assessee.

2. This Court vide order dated 18-8-2011 admitted the appeal on the following substantial question of law:

> "Whether on facts and in the circumstances of the case the Tribunal was justified in annulling the assessment framed u/s 143 (3)/147 by the assessing officer."

3. The facts, in brief, are that the assessee was engaged in the business of poultry farming in the name & style of Royal Poultry Farm. The assessee filed the income return for the AY 1997 - 98 on 22-12-1997 declaring its income of Rs.1,49,854/-. The return was processed under

Section 143 (1) on the finding that the capital work in progress under the head building as per scheduled `c' shown in the balance sheet as on 31-3-1996 for a sum of Rs.15,35,551/- was not carried forward to the balance sheet as on 1-4-1996. The total fixed assets on closing balance as on 31-3-1996 was Rs.52,51,629/- whereas the opening balance as on 1-4-1996 was shown at Rs.31,35,246/-, showing the difference of Rs.20,16,383/- (sic Rs.21,16,383/-).

4. With regard to validity of the notice, as reasons were not informed to the assessee a notice under Section 143 (2) (i) of the Act, 1961 was served on the assessee on 28-2-2001. As projected by the Revenue, none appeared on behalf of the assessee in compliance with the said notice. The assessee along with its Chartered Accountant appeared before the Assessing Officer (for short "the AO") on 12-3-2001 wherein the assessee was directed to file reply on the basis of the return. Thereafter, several notices were issued. The assessee failed to appear and, as such, a detailed enquiry was conducted and it was found that there was the total income of Rs.12,13,240/- and accordingly the order under Section 143 (3) read with Section 147 was passed on 28-3-2002 by the AO.

5. Being aggrieved, the assessee preferred an appeal before the Commissioner, Income Tax (Appeals) {for short "the CIT (A)"} wherein it was contended that notice under Section 148 was bad in law and the proceedings so initiated against the assessee be dropped under sub-section (2) Section 152 of the IT Act, 1961.

6. The CIT (A) held that "taking the whole view of the case, if the appellant is able to prove that there was no under assessment, then alone provisions of Section 152 (2) will come into play and the AO will be obliged to drop the proceedings. In the present case, the AO found items of under assessment other than the one for which he had issued notice. Therefore, he could not take action u/s 152 (2) of the Act. I hold that the action of the AO in issuing notice u/s 148 and continuing with the re-assessment proceedings there- after is valid and well within his jurisdiction. This ground of appeal is, accordingly, dismissed."

7. The appeal was partly allowed, as on the question of preparation of demand notice under Section 156 of the Act, 1961 the AO was directed to recompute the interest under Sections 234-A, 234-B and 234-C after giving relief of Rs.7,83,047/-.

8. The Revenue preferred the appeal before the Tribunal wherein the assessee also filed a cross- objection. The main question raised by the assessee was that the CIT (A) has considered the provisions of Section 152 (2) of the Act, 1961 but without assigning any reason considered that the AO was right in continuing with the proceedings under Section 148 of the Act, 1961 as valid and within his jurisdiction. Under the notice issued under Section 148 the reasons supplied, which are as under:

> "During the A.Yr. 97-98 the assessee has filed return by Dec. 1997. This return the `a' has enclosed audit report. In this audit report particulars of fixed assets has been mentioned in the schedule `D" Dherain head of Bldg. shown is 20,37,781/- as opening. Whereas the details of fixed assets for A.Yr. 96-97 closing was Rs.2037781/- which is shown in fixed assets in schedule `c' of audit report for A.Yr.96-97. It is seen that bldg. (work-in- progress) was Rs.15,35,551/- in above schedule `c' for A.Yr. 96-97. This work-in- progress is not carried forward in schedule `D' of fixed assets for A.Yr. 97-98. The total of fixed assets closing for A.Yr. 96-97 was Rs.52,51,629/- which should be obviously carried forward for next year but in A.Yr. 97-98 the total net block assets (opening) was Rs.31,35,246/-. So there is a difference of Rs.20,16,383/-. On the above facts I have reason to believe that the above discrepancies of fixed assets at Rs.20,16,383/- is escaped from taxation. Hence, notice u/s 148 should be issued."

9. The Tribunal held that "the assessee, therefore, rightly proceeded to invoke the provisions of Section 152 (2) in so far as having been confronted with the notice under Section 147 to resist the AO to reopen the whole assessment and show that income alleged to have escaped assessment has in truth and in fact not escaped assessment but has been brought in under some inappropriate head." It was further held that the AO proceeded in framing assessment under Section 143 (3) read with Section 147 beyond the provisions of law. The CIT (A) was also not able to adjudicate as to how the provisions of Section 152 (2) of the Act, 1961 were not applicable to the case of the assessee. In any case the addition to the building shown as work in progress has been disposed of in the impugned assessment year, which fact was noted otherwise by the AO as net block indicating the same in assessment year 1996-97 not forming part of the block having been disposed of was not in pursuance of records for assessment year 1996-97 not available to the AO but total of fixed assets remaining the same. The objection was accepted declaring the proceedings of reopening of the assessment as invalid. Thus, this appeal.

10. Shri Rajeev Shrivastava appearing with Shri Sameer Shrivastava, learned counsel for the appellant, would submit that Explanation 2 to Section 147 provides that the following shall also be deemed to be cases where the income chargeable to tax has escaped assessment: Firstly; 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; Secondly; where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the AO that the assessee has understated the income or has claimed excessive

loss, deduction, allowance or relief in the return; Thirdly; 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."

11. Shri Shrivastava would further submit that the Income Tax Officer may bring to charge items of income which had escaped assessment other than or in addition to that item or items which have led to the issuance of notice under Section 148. The jurisdiction of the AO is not confined to only such income, but other incomes also, which have escaped tax. Thus, reopening or reconsidering the whole assessment was just and proper.

12. In support of his contention, Shri Shrivastava placed reliance upon the decision of the Supreme Court in *Commissioner of Income Tax v. Sun Engineering Works* (P) Ltd.1.

13. On the other hand, Shri Shashank Dubey, learned senior counsel appearing with Shri Neelabh Dubey, learned counsel for the respondent, would submit that in the present case the department issued notice under Section 148 against the assessee for income under a particular head. The notice did not pertain to income under different heads, but which were discovered in the course of reassessment proceedings. The original ground for issuing reassessment notice was no where taken up and was in effect dropped.

14. Shri Dubey would further submit that in the case on hand the case was reopened on the basis of a belief that income `x' had escaped assessment. But in the reassessment order passed under Section 147 by the AO no addition was made in respect of the `x' income, but an addition was made for `y' income, which was said to have escaped assessment. Such addition of `y' income cannot be sustained when no addition was made for `x' income. There is indeed a power with for AO to assess escaped income other than those on the basis of which notice under Section 148 is issued.

15. Shri Dubey would next submit that as per the assessment order, notice under Section 148 dated 4-1- 2001 was issued because in the audit report of the years 1996-97 & 1997-98 there was a difference in figures relating to work in progress. However, the assessment order does not point out that reply to this was already submitted on 12-3-2001. Nowhere in the assessment order has any mention being made about this head of income nor has any assessment been made or any addition made on this count and, as such, the assessment order is totally silent on this issue. Thus, it is clear that it did not constitute reason to believe. The reassessment was bad since it related to all other items except those on the basis of which the reassessment notice was issued.

16. Shri Dubey would next submit that Tribunal was right in holding that the AO had the jurisdiction to reassess the issues other than the issues in respect of which proceedings are initiated but he was not so justified when the reasons for initiation of those proceedings ceased to survive. Learned counsel placed reliance upon the decision of the Supreme Court rendered in *S. Sundaram Pillai and Others vs. V.R. Pattabiraman and Others* 2 and upon the decision of Bombay High Court in *Commissioner of Income-Tax vs. Jet Airways* (I) Ltd.3 & upon the decision of High Court of Delhi in Ranbaxy Laboratories Limited v. Commissioner of Income Tax4.

17. We have heard learned counsel appearing for the parties, perused the pleadings and the documents appended thereto.

18. Sections 147, 148 & 152 (2) of the Act, 1961 read 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: Provided further that the Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment.
>
> 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 underassessed; 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."

"148. Issue of notice where income has escaped assessment.-(1) Before making the assessment, reassessment or recomputation under Section 147, the Assessing Officer shall serve on the assessee a notice requiring him to furnish within such period, as may be specified in the notice, a return of his income or the income of any other person in respect of which he is assessable under this Act during the previous year corresponding to the relevant assessment year, in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed; and the provisions of this Act shall, so far as may be, apply accordingly as if such return were a return required to be furnished under Section 139:

Provided that in a case- (a) where a return has been furnished during the period commencing on the 1st day of October, 1991 and ending on the 30th day of September, 2005 in response to a notice served under this section, and (b) subsequently a notice has been served under sub- section (2) of Section 143 after the expiry of twelve months specified in the proviso to sub- section (2) of Section 143, as it stood immediately before the amendment of said sub-section by the Finance Act, 2002 (20 of

2002) but before the expiry of the time limit for making the assessment, reassessment or recomputation as specified in sub-section (2) of Section 153, every such notice referred to in this clause shall be deemed to be a valid notice: Provided further that in a case- (a) where a return has been furnished during the period commencing on the 1st day of October, 1991 and ending on the 30th day of September, 2005, in response to a notice served under this section, and (b) subsequently a notice has been served under clause (ii) of sub-section (2) of Section 143 after the expiry of twelve months specified in the proviso to clause (ii) of sub-section (2) of Section 143, but before the expiry of the time limit for making the assessment, reassessment or recomputation as specified in subsection (2) of Section 153, every such notice referred to in this clause shall be deemed to be a valid notice.

Explanation.-For the removal of doubts, it is hereby declared that nothing contained in the first proviso or the second proviso shall apply to any return which has been furnished on or after the 1st day of October, 2005 in response to a notice served under this section. (2) The Assessing Officer shall, before issuing any notice under this section, record his reasons for doing so."

"152. Other provisions.- xxx xxx xxx xxx xxx xxx xxx xxx xxx (2) Where an assessment is reopened under Section 147, the assessee may, if he has not impugned any part of the original assessment order for that year either under Sections 246 to 248 or under Section 264, claim that the proceedings under Section 147 shall be dropped on his showing that he had been assessed on an amount or to a sum not lower than what he would be rightly liable for even if the income alleged to have escaped assessment had been taken into account, or the assessment or computation had been properly made: Provided that in so doing he shall not be entitled to reopen matters concluded by an order under Sections 154, 155, 260, 262 or 263."

19. Provisions of Section 147 of the Act, 1961 makes it clear that the AO may reassess any income chargeable to tax, which has escaped assessment for any assessment or there was under assessment or the claimed excessive loss, deduction, allowance or relief in the return, subject to provisions of Sections 148 to 153. The pre- condition to reopen the assessment or recomputation is that the AO should have reason to believe that no income chargeable tax has escaped assessment or under assessment or the claimed excessive loss, deduction, allowance or relief in the return. Thereafter, a notice under Section 148 shall be served on the assessee requiring him to furnish return of the income or income of any other person in respect of which he is assessable under this Act.

20. Sub-section (2) Section 148 provides that before issuing any notice under Section 148 (1), the AO shall record his reasons for doing so. Section 152 (2) provides that the assessee may claim that the proceedings under Section 147 should be dropped on his showing that he had been assessed not lower than what he would be rightly liable for even if the income alleged to have escaped assessment had been taken into account, or the assessment or computation had been properly made.

21. Explanation 3 to Section 147, which was inserted by Finance (No.2) Act, 2009, w.e.r.f. 1-4-1989, provides that the AO 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 Section 147 of the Act, 1961, notwithstanding that the reasons for such issue have not been included in the reasons recorded under sub-section (2) of Section 148.

22. From bare perusal of the entire provisions, it is clear that the AO should have reason to believe to reopen assessment under the provisions of Section 147 before making the assessment, reassessment or recomputation.

23. The assessee has a right to inform the AO that the income which has allegedly escaped assessment was shown and had been taken into account and the assessment had been properly made. In that event the AO has an obligation to drop the proceedings of the said income, under the provisions of Section 152 (2) of the Act, 1961.

24. Explanation 3 to Section 147 of the Act, 1961 provides that if the proceedings on the basis of reasons recorded under sub-section (2) Section 148 in the course of proceedings of the income reasons have been recorded under Section 148 (2), the other income may also be included, which has escaped assessment for the purpose of assessment or reassessment under Section 147 of the Act, 1961, in the same proceeding.

25. The Supreme Court in Sun Engineering Works (P) Ltd. (supra) held as under:

> "41....we find that in proceedings under Section 147 of the Act, the Income Tax Officer may bring to charge items of income which had escaped assessment other than or in addition to that item or items which have led to the issuance of notice under Section 148 and where reassessment is made under Section 147 in respect of income which has escaped tax, the Income Tax Officer's jurisdiction is confined to only such income which has escaped tax or has been under- assessed and does not extend to revising, reopening or reconsidering the whole assessment or permitting the assessee to reagitate questions which had been decided in the original assessment proceedings. It is only the under-assessment which is set aside and not the entire assessment when reassessment proceedings are initiated. The

> Income Tax Officer cannot make an order of reassessment inconsistent with the original order of assessment in respect of matters which are not the subject-matter of proceedings under Section 147. An assessee cannot resist validly initiated reassessment proceedings under this section merely by showing that other income which had been assessed originally was at too high a figure except in cases under Section 152(2). The words `such income' in Section 147 clearly refer to the income which is chargeable to tax but has "escaped assessment" and the Income Tax Officers' jurisdiction under the section is confined only to such income which has escaped assessment...."

26. In *S. Sundaram Pillai* (supra), relied on by the learned counsel appearing for the respondent, the Supreme Court has dealt with the Explanation to a statutory provision as under:

> "(a) to explain the meaning and intendment of the Act itself, (b) where there is any obscurity or vagueness in the main enactment, to clarify the same so as to make it consistent with the dominant object which it seems to subserve, (c) to provide an additional support to the dominant object of the Act in order to make it meaningful and purposeful, (d) an Explanation cannot in any way interfere with or change the enactment or any part thereof but where some gap is left which is relevant for the purpose of the Explanation, in order to suppress the mischief and advance the object of the Act it can help or assist the Court in interpreting the true purport and intendment of the enactment, and (e) it cannot, however, take away a statutory right with which any person under a statute has been clothed or set at naught the working of an Act by becoming an hindrance in the interpretation of the same."

27. The Bombay High Court in Jet Airways (supra) observed that after issuing a notice under Section 148, the income which has initially formed a reason to believe that the income has escaped assessment, but as a matter of fact has not escaped assessment. The AO cannot proceed to assess some other income independently, however, it was observed that it is open for the AO to issue a fresh notice under Section 148 and proceed thereafter.

28. The High Court of Delhi in Ranbaxy Laboratories Limited (supra), has taken the similar view.

29. In the facts of the case, the income in respect of building to the tune of Rs.20,16,383/- (sic Rs.21,16,383/-) formed reason to believe that the same had escaped assessment, as in the notice issued under Section 148, as aforestated, in the preceding para 8. In the course of proceeding other incomes were also found to have escaped assessment.

30. The assessee filed his reply under Section 152 (2) stating therein that the said income which had formed reasons in the notice under Section 148 had not escaped assessment, as the same was disposed of in the same assessment year itself and for that no details were given.

31. The Tribunal has also come to the conclusion that, in fact, there was no escapement of assessment or no assessment in respect of the said head, which formed the reason to believe in the notice. In respect of other incomes no notice was issued and the assessee had no opportunity to put forward his case under Section 152 (2) of the Act, 1961, to avail benefit of the said Section for dropping the proceedings. Thus, the Revenue cannot take advantage of the Explanation 3 to Section 147, as the same is not available in the facts of the case.

32. Explanation 3 is applicable only in the event the income was formed opinion in the notice has been found correct and the proceeding in the respect of the said income was not dropped under Section 152 (2) of the Act, 1961.

33. The Supreme Court in *Sun Engineering Works (P) Ltd.* (supra) held that the issue was in respect of inclusion of other incomes in addition to that item or items which have led to the issuance of notice under Section 148 and it was found that the AO was right in including other incomes. On the issue as to when the item or items which have led to the issuance of notice under Section 148 has been dropped under Section 152 (2), what would be the stand of the AO was not in issue in the said case. It was further held that the AO cannot reopen the entire assessment except the unescaped income for which the proceedings have been initiated.

34. The Supreme Court in S. Sundaram Pillai (supra), had held, inter alia, that an Explanation cannot in any way interfere with or change the enactment or any part thereof but where some gap is left which is relevant for the purpose of the Explanation, in order to suppress the mischief and advance the object of the Act it can help or assist the Court in interpreting the true purport and intendment of the enactment.

35. In the case on hand, the main object and purpose of Section 147 read with Section 148 is that if there is any escaped assessment and the AO has reason to form the opinion a notice must be given to the assessee to file returns or to show that there was no escaped income and under Section 152 (2) the proceedings may be dropped. In that context, explanation provides that along with the proceedings for the escaped income which had formed reason to believe and the assessee has been properly intimated to show his case, proceedings of the other incomes may also be examined along with the said income.

36. We are in respectful agreement with the view taken by the Bombay High Court in Jet Airways (supra) and the High Court of Delhi in Ranbaxy Laboratories Limited (supra).

37. Applying the well settled principles of law to the facts of the present case and for the reasons mentioned hereinabove, the question raised herein is answered in affirmation.

38. As an upshot, the appeal, being bereft of merit, is liable to be and is hereby dismissed.

39. There shall be no order as to costs.

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section code; payment date; payment amount; tax rate; tax amount; is tax deducted; tax deposited amount; deposit date; CPR number; provision of law; exemption certificate number; certificate date and certificate authority. – *Courtsy Business Recorder.*