B K KHARE & Co
CHARTERED ACCOUNTANTS

**Monthly Newsletter**
**Direct Tax**
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## Market Updates And Analysis


In this newsletter, we have covered some noteworthy decisions of the Hon’ble High Courts.

One such decision covers a matter where the Courts have commented on the allowability of write'off of bad debts and investments and the permissibility of the adjustment of seized cash against advance tax liability.

Additionally, decisions on the allowability of 60% depreciation on ATM, payment of non-compete fee to a non-resident employee that was formerly taxable as salary and the applicability of section 68 to an accommodation entry provider have been enumerated.Some more decisions covering matters such as the validity of the penalty proceeding not being validated if the assessing officer had not stuck the appropriate limb in the notice, the pre-deposit of 20 per cent of tax demand not being a pre-condition for the CIT(A) to decide appeal on merits etc.

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## Pre-2013, Allows Adjustment Of Advance Tax Liability Against Cash Seized In Search Proceedings

**Facts & Issues:**

Marble Centre International Pvt Ltd ("Assessee") was engaged in the business of trading in random slabs of marbles and granites. In March 2007, a search was conducted at the business premises of the assessee and residential premises of the Director and cash amounting to Rs. 4.77 crores was seized. The assessee disclosed additional income of Rs. 50 lakhs and stock of Rs. 1.40 crores for the AY 2007-08. In order to meet the advance tax liability for this assessment year, the assessee requested the AO (vide letter dated March 15, 2007) to adjust Rs. 50 lakhs of the seized cash towards the same .

The return of income filed for the AY 2007-08 was processed and notice was issued for assessment. In the assessment order, the AO made certain additions, but did not adjust the cash seized towards the assessee's advance tax; and also charged interest under sections 234B and 234C.

The CIT(A) and ITAT upheld the order of the AO. Aggrieved by the order, the assessee preferred an appeal before the Karnataka HC.

**Contentions of the Assessee:**

The assessee contended before the Court that it had requested the AO to adjust Rs. 50 lacs from the seized cash towards its advance tax liability for the AY 2007-08(vide letter dated March 15, 2007). The assessee submitted that under the prevalent provisions of the Act appplicable for the AY 2007-08, the seized cash can be adjusted towards the payment of advance tax instalment due from it.

The assessee contended that, Explanation 2 to section 132B of the Act had been inserted prospectively only with effect from June 1, 2013. This precludes the adjustment of seized cash towards advance tax liability. For the AY 2007-08, the adjustment was permissible. Explanation 2 to section 132B which became inserted w.e.f.June 1, 2013 reads as follows:

*“Explanation 2.—For the removal of doubts, it is hereby declared that the "existing liability" does not include advance tax payable in accordance with the provisions of Part C of Chapter XVII.”*

The assessee also relied upon circular no. 20/2017 dated June 12, 2017 issued by the CBDT, which clarified that Explanation 2 to section 132B was prospective.

**Contentions of the Revenue:**

The revenue submitted that the assessee did not make any computation of advance tax as required under section 209(1)(a) and section 210(1) of the Act. Also, advance tax is not an “existing liability”under section 132B of the Act. Hence, the same cannot be adjusted against seized cash under section 132B of the Act.

**Observations and Ruling of the HC:**

The Karnataka HC quashed the ITAT order and allowed the assessee's plea for adjusting the cash seized towards its advance tax liability. The HC accepted the assessee’s contention that Explanation 2 to section 132B is prospective in nature. It placed its reliance on the Allahabad HC ruling in the case of CIT v. Shri Sunil Chandra Gupta (2015 TIOL 673) and CBDT circular (supra), wherein, it has been specifically stated that Explanation 2 to Section 132B of the Act is prospective in nature.

Accordingly, the HC held that ITAT should have considered the date of payment of tax by the assessee as March 15, 2007, i.e. the date on which the request was made by the assessee, to adjust the cash seized against the advance tax payable for the impugned year.

**Citation:**

Marble Centre International Pvt Ltd v. ACIT (382 of 2011 (Kar HC) 2020)

**Our Comments:**

It is a now a well settled position that Explanation 2 to Section 132B of the Act is prospective in nature. However, the dispute continued as to whether the amendment was clarificatory in nature having retrospective applicability.

Several Courts, including P&H HC in case of Cosmos Builders & Promoters Ltd [TS-5967-HC-2015(PUNJAB & HARYANA)-O] (Hon'ble SC has dismissed the SLP filed by the revenue (TS-5198-SC-2016-O)), have held that the assessee was entitled to have the cash seized adjusted against its advance tax dues.

This judgement provides another legal precedent in line with the aforesaid decisions and would be useful for the assessments conducted under search proceedings, prior to the amendment of the law w.e.f. 1st June 2013.

## Write Off Of Bad Debts And Investment In Shares Of Sister Concern On Its Liquidation

**Fats & Issues:**

The assessee is a company engaged in the business of manufacture of field instrumentation. During the year under consideration, it wrote off certain advances to a sister concern and claimed the same as bad debt. It filed the return of income declaring a loss of Rs.7,40,96,877 for the A.Y. 2001-02. The assessee *inter-alia*, claimed –

- bad debt loss in the sum of Rs.3,50,81,381 on account of investment made for purchase of equity shares in Gujarat Instruments Ltd., a sister concern which went into liquidation; and

- loss of Rs.32,25,000 on account of diminution in the value of investment made by it in the shares of the said sister company under section 46(2) of the Act on the sister company going into liquidation.

The AO in the course of scrutiny assessment proceedings noted that the assessee had not furnished any details in respect of the investment / finance provided by it to M/s Gujarat Instruments Ltd., from time to time; and had also not explained the circumstances, which led to liquidation of the said company and how the funds provided by the assessee were utilized. It was also noted by the AO that no details were furnished by the assessee of its business interest in M/s Gujarat Instruments Ltd.; therefore, the loss suffered by the assessee to the tune of Rs.3,50,81,381/- was to be treated in the nature of a capital loss. The AO also disallowed a sum of Rs.32,25,000/- viz. the provision made for diminution in the value of investment in M/s Gujarat Instruments Ltd., on the ground that no particulars had been furnished.

The CIT(A) upheld the disallowances made by the AO. The assessee then preferred an appeal before the ITAT.

The ITAT held that -

- the assessee was entitled to write off the amount of Rs.3,50,81,381/- as bad debt, as writing off bad debt as irrecoverable in the accounts of the assessee was sufficient in view of law laid down by Supreme Court in T.R.F LTD. v. CIT, 323 ITR 397;
- the aforesaid loss was also in the nature of a capital loss U/s46(2)
- loss of Rs.32,25,000/- viz. for diminution in the value of investment made in the equity shares of the sister company Gujarat Instruments Ltd., should be treated as capital loss under section 46(2) of the Act in view of the decision in the case of 'CIT v. JAI KRISHNA', 231 ITR 108 (Guj).

Aggrieved, the revenue filed an appeal before the HC.

**Contentions of the Assessee:**

<u>Bad debt losson account of investment made for purchase of equity shares</u>

- The burden to prove that the debt is a bad debt has been removed with effect from April 1, 1989.It is sufficient if the debt is written off as bad debt in the accounts of the assessee.

- The SC decision in the case of TRF Ltd. vs. CIT (323 ITR 397) was accepted by the revenue. CBDT Circular No.12/2016 dated May 30, 2016 was issued, wherein it was clarified that after May 1, 1989, for allowing deduction for amount of any bad debt or part thereof under section 36(1)(vii) of the Act, it is not necessary for the assessee to establish that the debt in fact has become irrecoverable; and it is enough if bad debt is written off as irrecoverable in the books of account.

- The aforesaid SC decision was subsequently explained in the case of Vijaya Bank vs. CIT (323 ITR 166 SC).

Write off of investment in shares of a sister company on its liquidation

- The assessee relied on the ITAT order with respect to the aforesaid issue.

**Contentions of the Revenue:**

- The assessee had not adhered to the manner of requirement of writing off the bad debt. The ITAT also had failed to examine whether writing off of debt had taken place in the manner laid down by theSC decision in the case of TRF Ltd. vs. CIT (*supra*). Thus, the matter should be remitted back to the AO.

- The revenue also submitted that business relations were not established and the fact that loss incurred by the assessee had been incurred during the course of business had also not been proved.

- Any loss incurred in setting up of a business / company of a sister concern is a capital expenditure and therefore, the same has to be treated as capital loss.

- The assessee had failed to explain commercial expediency. The revenue also stated that bad debt should occur during the course of business to claim benefit under section 36 of the Act.

- Even though the ITAT remanded the matter to the AO, yet it erred in recording a finding that assessee was entitled to capital loss on the ground that the assessee had invested in equity shares, even though, neither the nature of investment was disclosed nor any particulars were furnished.

- The ITAT should not have remitted the matter to the AO by holding that assessee was entitled to avail of the benefit of capital loss.

**Observations & Ruling of the HC:**

Bad debt loss on account of investment made for purchase of equity shares on liquidation of investee company

- The HC referred to the above SC decision, wherein it was held that after April 1, 1989, it is not necessary for the assessee to establish that the debt in fact had become irrecoverable and it is enough if the bad debt is written off as irrecoverable in the accounts of assessee.

- The HC also observed that based on the aforesaid decision, the CBDT had issued circular No.12/2016 dated May 30, 2016, wherein it was clarified that claim for any debt or part thereof in any previous year shall be admissible under section 36(1)(vii) of the Act, if it is written off as irrecoverable in the books of account of the assessee for that previous year, and it fulfils the condition stipulated in section 36(2) of the Act.

- The HC observed that undoubtedly, the judgment rendered by the SC and the Circular had been issued subsequent to the orders passed in the instant case. However, the fact remains that the SC has interpreted the provision of law, which was incorporated by the Legislature with effect from April 1, 1989. Therefore, such an interpretation would relate back to the date when such a provision came into existence.

- However, the HC noted that the lower authorities had not examined whether or not the assessee had written off the amount as bad debt in its books; and accordingly, remitted the matter back to the AO.

<u>Write off of investment in shares of a sister company on its liquidation</u>

- The HC noted the reliance placed by the ITAT on the Gujarat HC decision in the case of CIT vs. Jaykrishna Harivallabhdas(231 ITR 108) and held that when a person who gets nothing from the investment in shares of a company on its liquidation and suffers loss, his loss has to be treated as capital loss by virtue of Section 46(2) of the Act.

- The HC, however, noted even though the ITAT had finally remanded the matter back to the AO, it should not, in the absence of proof of write off, have noted that the assessee was entitled to claim the capital loss of Rs.3,50,81,381/-..  In the light of the aforesaid facts, the HC remanded the matter back to the A. O. who was directed to decide the matter de novo in the light of the decision of the Supreme Court in the case of TRF Ltd. vs. CIT (*supra*).

**Citation:**

CIT and others vs. ABB Ltd.[Reported in TS-290-HC-2020(Kar)]

**Our Comments:**

The HC has taken note of and reiterated the ratio laid down by Honourable Supreme Court with respect to allowability of bad debts under section 36(1)(vii) in the case of TRF Ltd. vs. CIT (supra), where the Honourable Supreme Court held that write off in the books is the only condition precedent for claiming bad debts; and it is not necessary for the taxpayers to establish that the debt become irrecoverable for allowance of deduction.

Readers' attention is invited to the proviso inserted by the Finance Act 2015 w.e.f. April 1, 2016. A proviso has been inserted in section 36(1)(vii) of the Income-tax Act. This provides that for claiming deduction under section 36(1)(vii) of the Income-tax Act, an income

- which has been recognised as per the provisions of Income Computation and Disclosure Standards notified under section145(2) of the Act (ICDS) without having been recorded in accounts; and
- which is required to be written off as irrecoverable as per the provisions of ICDS,

shall be deemed to be written off as irrecoverable in the accounts.

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## ATMs eligible for depreciation @ 60% as computer; further, revenue recognition methodology changed by the assessee cannot be denied unless proved otherwise

**Facts & Issue:**

The assessee is engaged in the business of manufacture of automated teller machines (ATMs) and distribution of NCR book products and commissions in India. During the relevant previous year, it took a premises on lease for a period of three years. It incurred an expenditure of Rs.89,23,817/- on account of leasehold improvements which it claimed was on revenue account in its computation of income. The A.O. held that these expenses were incurred on purchase of workstations, improvement of interiors and electrical works, fees paid to the architect and cabling work for networking of computers in connection with setting up of the office. According to him, such expenses brought into existence an asset or an advantage of enduring nature. Accordingly, they were disallowed; and depreciation @ 15% was on allowed on the same, after holding that it was for acquisition of new furniture and fixtures. The AO also held that the ATMs are not in the nature of computers but can be considered as part of that plant and machinery which was eligible for depreciation @ 25%. It was also held that it was difficult to assess the true profits of the assessee due to change in the method of revenue recognition; and thus the same should be disregarded. CIT(A) upheld the order passed by the AO. However, the ITAT deleted the additions made by the AO.

**Contentions of the Revenue:**

The revenue relied upon the order passed by the AO and as confirmed by CIT(A).

The revenue urged that the expenses incurred had created an asset resulting in enduring benefit for business; and were capital in nature. It was also urged that change of the accounting method is impermissible as the same resulted in a loss to the Revenue.

**Contentions of the Assessee:**

The AR submitted that the assessee only derived business advantage on account of expenditure incurred on leasehold property for improvements.

The AR submitted that it is open for the assessee to change the method of accounting; and the burden is on the department to prove that the method in vogue is not correct, and distorts the profits of a particular year. The said burden had not been discharged by the Revenue.

**Observations & Ruling of the HC:**

The Karnataka HC referred to the decision of the SC in the case of Assam Bengal Cement Co. Ltd. v. CIT reported in (1955) 27 ITR 34, to distinguish capital expenditure from revenue expenditure. The following parameters were laid down to treat an expenditure as capital expenditure:

- An expenditure will be on capital account, if is incurred for initiation of a business, for extension of a business, or for a substantial replacement of equipment;
- It will also be on capital account, if it is incurred not only once and for all, but also brings into existence an asset or an advantage for the enduring benefit of a trade;
- Finally, it would be on capital account, if it was part of, or is referable to the fixed capital of the business. If it was referable to its circulating capital, it would be on revenue account.

The HC held that the expenditure did not bring into existence any capital asset for the assessee. It was directed towards improvement of leasehold property and appears to have been incurred for conducting the business more profitably. As such, it could be inferred that it was on revenue account.

Reliance was placed on the decision of the Bombay High Court in the case of DCIT VS. Data Craft India Ltd. reported in (2010) 40 SOT 295. It was held that so long as ATMs perform functions of a computer together with other functions; and such other functions are also dependent on the functions of the computer, ATMs are to be treated as computers; and will be entitled to a higher rate of depreciation of 60%. This is also so because a computer is fully integral to the functioning of an ATM. The HC thus held that the ATMs would be eligible for a higher rate of depreciation of 60%.

Further, on the issue of rejection of change in the methodology for revenue recognition, the HC referred to the decision of the SC in the case of Bilahari Investments (P) Ltd. reported in (2008) 168 TAXMAN 95. It held that in every case of substitution of one method by another method, the burden is on the department to prove that the method in vogue is not correct, and distorts the profit of a particular year. Since the revenue had failed to discharge this onus, the HC refused to intervene in the accounting methodology adopted by the assessee.

**Citation:**

CIT v. NCR Corporation Pvt. Ltd.[TS-287-HC-2020(Kar)]

**Our Comments:**

Whether on the facts and circumstances of a case, an expenditure is revenue or capital in nature is always a tricky question, notwithstanding a spate of of judicial decisions from the Supreme Court and the House of Lords. This is because application of broad principles to a given set of facts may not always result in the same interpretation by different minds. Further, the findings that ATMs could be treated as computers for the purpose of claiming depreciation would be welcomed by banks and other assesses operating such machines.

## Non-Compete Fees Payable To Employees Holding Key Strategic Positions For Services Rendered Outside India Is In The Nature Of Salary

**Facts & Issue:**

The assessee is an Indian company. Two of its key employees were in employment of a subsidiary of and were employed as Chief Executive Officer and Chief Operating Officer. The subsidiary company merged with the assessee. The assessee therefore, offered employment to both the employees. The aforesaid employees accepted the offers of employment with the assessee. Non-compete agreements were entered into with the aforesaid employees. Payments to the tune of $5,63,000 (Rs 2,46,53,77 each) were made to the aforesaid employees after they had become the employees of the assessee. Three contracts were executed between the aforesaid two employees and the assessee viz. Employer agreement, Non-disclosure agreement and Employee non-compete agreement.

The assessee filed the CA certificate with the remitter bank with the endorsement that no tax is required to be deducted at source, since the remittance is towards consideration under the Non-compete agreement, and is covered by Article 16(1) of the India-USA tax treaty. The AO initiated the proceedings under section 201 with respect to the aforesaid payments. The AO held that agreements and the payment made thereunder to the two employees of the assessee were sham; and created for the purposes of avoiding payment of tax in India. Therefore, it was held that TDS should have been deducted by holding the assessee as an assessee in default, and interest should have been under section 201(1A) of the Act.

Against the aforesaid order, the assessee preferred an appeal before the CIT(A). The CIT(A) confirmed the action of the AO. On an appeal before the ITAT, the latter allowed the assessee's appeal; and held that amount paid to both the employees by the assessee under the non-compete agreement would fall under the term 'salary' or 'profit in lieu of salary' which is taxable only in the USA.

Aggrieved, the revenue filed an appeal before the HC.

**Contentions of the Assessee:**

- The amount paid to the employees was not chargeable to tax in India under the Act. Under the India-USA tax treaty, tax, if any, has to be levied in the USA, as both the employees had not rendered any services in India.
- The ITAT on the basis of meticulous appreciation of evidence on record, had recorded the findings of fact; and there was neither any pleading nor any material placed on record to show that these findings were perverse. In fact, there were no substantial questions of law for consideration in this appeal and the matter stands concluded by findings of fact.

- The assessee relied on the observations of the ITAT's order and stated that non-disclosure agreement and non-compete agreement were different inasmuch as the former applies in case of an employee who is in employment whereas, the latter applies in the case where the employment ceases to exist.

- The payer was bound to deduct tax at source only if the tax is assessable in India.

**Contentions of the Revenue:**

- The assessee had already executed the non-disclosure agreement; and therefore, there was no need to separately execute the Employee non-compete agreement.

- The clause in non-compete agreement creates a prohibition with regard to employment in respect of the companies situate in India. Therefore, the rights and obligations of the parties under the non-compete agreement were to take effect in India; as such, the amount paid to the employees under the non-compete agreement is covered under section 5(2) of the Act.

- The lump sum payment made under a restrictive covenant before acceptance of payment could not be treated as salary.

- The assessee had entered into sham transactions with its employees for the purposes of tax evasion.

**Observations & Ruling of the HC:**

- The HC held that income in the hands of the employees was salary / profit in lieu of salary and the same was taxable in the USA as per Article 16 of the India-USA tax treaty. Accordingly, the HC held that where the payments were in nature of salary, the payer need not approach the appropriate authority under Section 195(2) of the Act.

- The HC observed that it was evident that an income shall be treated as salaryliable to tax if it is earned in India and for services rendered in India. The definition of the expression 'salary' is inclusive and it includes any fees, commissions,perquisites or profits in lieu of ,or in addition to, any salary or wages. Further, the expression 'profits in lieu of salary' includes any amount lumpsum or otherwise, received by an assessee, from any person before his joining any employment from that person, or after cessation of his employment with that person. The HC also referred to Article 16(1) of the India-USA tax treaty, which deals with Dependent Personal Services.

- The HC also stated that it is the cardinal principle of law that the ITAT is a fact finding authority; and a decision on facts by it can be gone into by the HC, only if a question has been referred to it, which says that the finding of the ITAT is perverse.

- The HC noted that the findings of fact recorded by the ITAT had not been assailed as perverse. It is also pertinent to mention here that even in the memo of appeal neither any grounds have been urged, nor any material has been placed on record to demonstrate that the findings of fact recorded by the ITAT were perverse. Therefore, no substantial questions of law arose for consideration in this appeal.

**Citation:**

DIT(International Taxation) and othersvs. Sasken Communication Technologies Ltd.[Reported in TS-285-HC-2020(Kar)]

**Our Comments:**

The decision has given due weightage to, and upheld the well recognised principles of source-based taxation and territorial nexus. The provisions of section5(2) of the Act, subject to other provisions of the Act, bring to tax income in the hands of a non-resident which is derived from any source which has accrued/ arisen/ been received or deemed to have accrued or arisen in India. The HC has on analysis of the relevant provisions of section 5(2) and the other relevant sections viz. sections 9(1)(ii) and 90(2) of the Act as also the relevant applicable Article 16 of the India-USA tax treaty, concluded that the non-compete fees received by the employees is part of salary. Since the employees were employed and were rendering service outside India *viz*, in the USA, the amount of non-compete fees received by them was not chargeable to tax in India and did not therefore attract withholding tax obligations.

## Sales Of Shares Held As Investment (Converted From Stock-In-Trade) At The Point Of Sale, Chargeable Under The Head Capital Gains

The issue before the Karnataka HC was whether certain shares (converted from stock-In-trade0 but held as investments at the point of sale,were chargeable under the head 'business income' or as capital gains.

**Facts& Issue:**

The assessee, an NBFC, held certain investments acquired under a portfolio management scheme and treated the same as stock in trade. This treatment was accepted by the tax department in earlier assessment years.

On April 1 2004, the assessee converted this portfolio of investments of Rs.1,30,98,529/- into a capital asset and classified the same as Investments in its books of account. For this purpose, it passed a Board resolution also resolving therein to discontinue the business of trading in shares. In the very year of such conversion, certain investments were sold and the assessee offered the gain to tax as short term capital gains.

The AO brought the surplus to tax under the head business income. He held that mere interchange of portfolio in the books could not result in change of head of income.

The CIT (A) and the Tribunal upheld the views of the AO

**Contentions of the Assessee:**

Pleadings before the lower authorities were repeated before the HC. It was submitted on behalf of the assessee that the surplus did not arise on conversion of the shares into a capital asset but on sale of converted stock in trade; and therefore the correct head of income was capital gains. The amendment by the Finance Act 2018, w-e-f AY 2019-20 was referred to.

**Observations & Ruling of the High Court**

Following Sir Kikabhai Premchand vs. CIT', (1953) 24ITR 506 (SC ) and a plethora of other High Court decisions, the Karnataka High Court held that a person cannot trade with himself and therefore no profit arises when stock in trade is converted into investment. This is because "a person cannot be supposed to sell some thing to himself and making a profit out of the transaction. which, on the face of it, is not only absurd but against all canons of mercantile and income tax law." It is also well settled that prior to the amendment of the law w.e.f 1st April, 2019, income from sale of shares held as investment converted from stock in trade is to be treated as capital gain and not as business income.

The HC allowed the appeal followied a plethora of decisions of various high courts on the subject

**Citation:**

Kemfin Services Pvt. Ltd (TS-284-HC-2020(KAR))

**Our Comments:**

The HC was constrained to allow the assessee's appeal in the absence of any statutory provisions to bring the notional gain to tax. The amendment by the Finance Act 2018 plugs this precise loophole. S 28(via) now provides that the fair market value of inventory, as on the date on which such inventory is converted into or treated as a capital asset, determined in accordance with Rule 11UAB of the Income Tax Rules 1962, is deemed to be business income of the year in which such conversion takes place. Needless to say, cost of such inventory would be deductible there against. Correspondingly, s 49(9) has been inserted to provide that such fair market value shall be deemed to be the cost of acquisition of such converted inventory in the year of its transfer as a capital asset. In the case before the HC, such notional gain was also taxed at the lower rate applicable to capital gains. This provision is somewhat in line with the provisions of s 45(2) of the Act which provides for a two-stage taxation in the event of conversion of capital asset into stock in trade. Rule 11UAB provides for separate rules of valuation for items of inventory being immovable property, jewellery, works of art etc. (applying Rule 11UA) and other items(the price which they would fetch if sold in the open market).

## No Cash Credit Addition Under Section 68 For Accommodation Entry Provider Earning Only Commission Thereon

**Facts& Issue:**

Alag Securities Pvt. Ltd.,the assessee in the present case, was engaged in the business of providing accommodation entries to various businesses.. In a search operation Shri Mukesh Choksi and Shri Jayesh K. Sampat, directors in Mahasagar Group of Companies- to which the assessee belonged- admitted that this group of companies was involved *inter alia* in laundering unaccounted cash of various clients by having the cash deposited in the bank accounts of various companies, transferring funds between various group companies, issuing of cheques, etc. to clients against bogus bills, showing making of speculation profit / loss or short term capital gains / loss etc. For the accommodation entries the assessee charged a commission of 0.15%, which was offered to tax. It seems that the assessee had merely accounted for the commission in its books of accounts and not the entire deposit.

The case of the assessee was reopened pursuant to a search operation. The AO framed the reassessment and made an addition under section 68 on the ground that the assessee had neither provided the identity and creditworthiness of the parties (accommodating parties) involved in the transactions nor proved the genuineness of the transactions to the satisfaction of the AO.

The Assessee preferred an appeal before the CIT(A). The CIT(A) relying on the decision of ITO Vs. Mihir Agencies Pvt.Ltd. (ITA No.4912/Mumbai/2005) held that the addition be restricted to the element of income i.e. 0.15% of total deposit as commission.

The decision of CIT(A) was challenged by the AO before the Tribunal. The Tribunal relying on its own order in the case of another group company upheld the order of the CIT(A). This decision of the Tribunal was challenged by the tax authorities before the Hon'ble High Court.

**Contention of the Assessee:**

It was contended that the assessee had deposited the cash received from the customers / beneficiaries and issued corresponding cheques to them for which it earned commission. Thus, Section 68 of the Act would not be attracted in such a case because the cash credits did not belong to or formed part of the income of the assessee.

**Contentions of the Revenue:**

The Departmental Representative relied on the decision of CIT vs NRA Iron & Steel Private Limited (2019) 103 Taxmann.com 48 to contend that the assessee had failed to discharge the primary onus cast on it by satisfactorily explaining these cash deposits. The Assessing Officer had recorded a clear finding that assessee could not satisfactorily explain the source, nature, genuineness and credit worthiness of the creditors of these transactions. Thus, the CIT(A) and Tribunal were not justified in restricting the addition to the percentage of commission to 0.15%.

**Observations & Ruling of the High Court:**

The Hon'ble High Court pursued the fact of the case and the order of the CIT(A) and Tribunal. The High Court held that section 68 would not apply to the instant case, since the business of the assessee centered around customers / beneficiaries making deposits in cash amounts and in lieu thereof taking cheques from the assessee for amounts slightly lesser than the quantum of deposits, the difference representing the commission realized by the assessee.

The High Court also noted that the cash amounts deposited by the customers i.e., the beneficiaries had been accounted for in the assessment orders of these beneficiaries. Therefore, the question of adding such cash credits to the income of the assessee- more so, when the assessee was only concerned with the commission earned on providing accommodation entries- did not arise.

The High Court also noted that the decision of the Supreme Court in the case of CIT vs NRA Iron & Steel Private Limited (supra) was not applicable because in that case the entire transaction was found to be bogus. However, in the instant case, the assessee had not claimed the cash credit as its income. It was an admitted fact that assessee's business was to provide accommodation entries. In return for the cash credits it used to issue cheques to the customers / beneficiaries for slightly lesser amounts, the balance being its commission. Moreover, the cash credits had been accounted for in the respective assessment of the beneficiaries.

On a thorough consideration of all relevant facts, the Court had no hesitation to hold that the order of the Tribunal did not suffer from any error or infirmity to warrant interference and no substantial question of law arose therefrom.

**Citation:**

AlagSecuritiesPvt.Ltd[TS-278-HC-2020(BOM)]

**Our Comments:**

The vital point to note in this judgement is that the Hon'ble High Court has held that section 68 is not applicable in case of cash deposits, which were explained and did not part of the income of the assessee. The Court also kept in mind the nature of business of the assessee. It seems that the assessee had provided an explanation with regard to the cash deposited with group companies. The principle emanating from this judgment is that section 68 could only be triggered when the assessee provided no explanation or the explanation provided by the assessee was unsatisfactory.

It is worth noting that the decision of the Honourable High Court is for the A.Y. 2003-04.

Readers' attention is invited to the provisions of Section 115BBE and Penalty u/s 271 AAC introduced by the Finance Act 2016 with effect from 1st April, 2017.

The provisions of Section 115BBE lay down that no deduction in respect of any expenditure or allowance or set off of loss is permitted in computing the income; and a flat rate of tax of sixty per cent is leviable on income referred to in Section 68 or 69 or 69A/B/C/D. Penalty u/s 271 AAC is also leviable at the rate of ten percent of the tax payable u/s 1115 BBE.

The main import of the amendment is that the sums viz. cash credit or money/ investments/ expenditure which are unexplained (or are in the AO's opinion not satisfactorily explained), will not merely be includible in the total income under the aforesaid provisions of Section 68 or Section 69 to 69D, but will also under section 115 BBE, attract a flat rate of tax of sixty percent without any deduction of any expenditure/ allowance / set off of loss. This is apart from the penalty of 10% u/s 271AAC.

## Specific Limb For Levy Of Penalty Is Conveyed To The Assessee Under The Assessment Order Is Sufficient Even If There Is Mechanical Error To Not Strike Off The Appropriate Limb In The Notice

**Facts & Issue:**

The assessee filed its return of income for AY 2003-04 declaring a loss of Rs. 4,66,68,740. A deduction was claimed for the expenditure of Rs. 62,47,460 which was debited under the head 'selling and distribution expenses'. The said amount was claimed as bad debt u/s 36(1)(vii) of the Act. Subsequently, it was found that the aforesaid amount was paid to M/s JCT Ltd. as compensation for the supply of inferior quality of goods. The AO held that the said amount was therefore not related to any debt which was due to the assessee. Accordingly, the said amount was added back to the total income.

The AO initiated proceedings u/s 271(1)(c) of the Act alleging that the assessee had furnished inaccurate particulars of income. The AO levied 100% penalty contending that if the case was not selected for scrutiny, income to that extent would have escaped assessment. Further, the AO stated that the assessee had wilfully reduced its incidence of taxation, thereby concealing its income as well as furnishing inaccurate particulars of income. CIT(A) decided the issue against the assessee. ITAT also confirmed the levy of penalty holding that the assessee had furnished inaccurate particulars of income which had resulted into concealment. It may be highlighted that the quantum appeal was pending for disposal.

Aggrieved by the order of the lower authorities, the assessee filed an appeal before the HC.

**Contentions of the Assessee:**

The AR submitted that the AO had not indicated in the notice as to whether the penalty was proposed to be imposed for furnishing inaccurate particulars of income or towards concealment of income. The AR further submitted that this argument was not taken before the lower authorities; however, being a pure question of law pertaining to jurisdiction, the same could be raised for the first time before the HC.

The AR further submitted that, in the notice, the AO had not struck off the inapplicable limb – furnishing inaccurate particulars of income or for concealment of income. Thus, the notice was invalid and consequentially the penalty order was untenable in law. In addition to the same, it was submitted that even though the specific limb had been mentioned in the assessment order, a penalty proceeding is initiated only through the show cause notice. It was contended that mentioning of the particular limb in the notice under which penalty is initiated is essential.

The AR also contended that mere disallowance of claim in a bonafide manner would not amount to concealment or furnishing inaccurate particulars of income.

**Contentions of the Revenue:**

The Revenue submitted that the assessee had made an improper and unsubstantiated claim of bad debt of Rs.62,47,460; the assessee had wilfully reduced its incidence of taxation, thereby concealing its income as well as furnishing inaccurate particulars of income.

It was the contention of the Revenue that had the case of the assessee not being selected for scrutiny, such an inadmissible claim would have escaped assessment.

**Observations & Ruling of the HC:**

The HC held that even though the issue of jurisdiction was not raised before the ITAT, it would not preclude the HC from entertaining such issue. Further, the present case of not striking off the appropriate limb in the notice could be said to be a jurisdictional issue as it goes to the root of the penalty levied.

The HC observed that, in the notice, it was essential to strike off the limb under which penalty was not intended to be imposed. Failure to do so would lead to an inference as to non-application of mind. In such a case, penalty would not be sustainable.

The HC however noticed that it was specifically mentioned in the assessment order that penalty proceedings were being initiated for furnishing inaccurate particulars of income. At the same time, the HC appreciated the fact that there was a mechanical approach and non-application of mind by the AO while issuing the notice.

To deal with the said issue, the HC referred to the various definitions of the term 'notice'. The inference drawn was that it was important to convey to the assessee under which limb the penalty was proposed to be levied. If the assessment order and the notice for levy of penalty were issued on the same date, a view could reasonably be taken that notwithstanding the defective notice, the assessee was aware of the reason for initiation of penalty proceedings. The contention taken by the assessee was therefore rejected.

The HC also observed that though the penalty was initiated for furnishing inaccurate particulars of income, it was actually levied for concealment of particulars of income. Thus, the penalty order passed in this case could be interfered with on this ground itself.

The HC also analysed the merits of the case as to whether there was a situation of furnishing inaccurate particulars of income. It was held that the assessee had declared the full facts; the factual matrix were before the AO. It was another matter that the claim based on such facts was found to be inadmissible. Thus this was not a case of furnishing inaccurate particulars of income.

**Citation:**

Ventura Textiles Limitedv. CIT [TS-277-HC-2020(Bom)]

**Our Comments:**

In various rulings the Bombay HC has taken a view that not striking off one of the two limbs in the show cause notice u/s 271(1)(c) was fatal to penalty proceedings. This decision tempers the said view in cases where the assessment order clearly indicates the mind of the AO; and the assessee thus has a clear notice of the precise charge against it.

In this case however the AO compounded the issue by first alleging in the assessment order that the assessee had furnished inaccurate particulars of his income; but later, while levying penalty he also held that the assessee had concealed particulars of his income. The HC has held that this itself showed non-application of mind on the part of the AO meriting cancellation of the order. Further, challenge to the validity of the penalty notice on purely legal grounds, being a jurisdictional issue, can be raised for the first time before the High Court.

## Change In The Status Of Indian Taxpayers As A Result Of Foreign Law Be Accepted Under Indian Tax Laws

**Facts& Issue:**

The assessees in the present case , three sub-funds of Aberdeen Institutional Commingled Funds, LLC ("AICFL"), a Delaware (USA) based limited liability company,invested in securities across several countries including India. AICFL and its three sub-funds were registered as foreign Institutional Investors with SEBI. For tax purposes the three sub funds were treated as separate taxable units. AICFL was originally constituted as Aberdeen Delaware Business Trust under the laws of Delaware, USA., with three sub-trusts. In 2010, this Business Trust was converted into AICFL . As against its earlier status of trust, it now became an LLC. Accordingly, the three assessees in the present case were converted from sub-trusts of the old entity, Aberdeen Delaware Business Trust, into sub-funds of the new entity, Aberdeen Institutional Commingled Funds,LLC.. As per the Trust Act and the LLC Act in the State of Delaware, USA., Aberdeen Institutional Commingled Funds,LLC was deemed to be the same entity as the erstwhile Aberdeen Delaware Business Trust.

At the time of conversion, the three sub-funds had accumulated capital losses which AICFL intended to carry forward in accordance the IT Act. AICFL therefore filed an application before the Authority for Advance Rulings ("**AAR**") to determine whether such carry forward of losses was permissible or not under the IT Act. The AAR held that the IT Act does not allow carry forward of loss to a taxpayer if it has not incurred the same. Since AICFL was not an assessable unit in India, it could not be permitted to carry forward and set off the losses incurred by the sub-trusts of Aberdeen Delaware Business Trust.

Aggrieved by the order of the AAR, AICFL and three sub-funds filed an appeal before the Bombay HC. The HC did not permit the appeals of the three sub-funds on the ground that these three funds were not parties before AAR. However, on merits, the HC held that since, under

Delaware law, Aberdeen Delaware Business Trust, as a trust and post re-organisation, AICFL,as LLC, continue to be the same person, this position must be accepted in India. Therefore, any gains or losses incurred by the sub-funds in the earlier form of a trust could not be denied only because of change to LLC.. In spite of the rulings of the HC, which supposedly supported the claim of sub-funds of carry forward of losses, revenue authorities initiated re-assessment proceedings against the three sub-funds.

**Observations & Ruling of the HC:**

Aggrieved by the order of the AO, the three sub-funds –filed a writ petition before the HC. The HC rejected the arguments of the AO that the assessees as-sub funds of AICFL were distinct from the sub-trusts of Aberdeen Delaware Business Trust, and that the losses incurred by the aforesaid sub-trusts were not losses of the aforesaid sub-funds

The HC also observed that the AO had previously taken the stand that AICFL wasnot entitled to carry forward the losses as it had not incurred such losses. He cannot now take the same stand when the sub-funds are claiming the carry forward of losses ,as they are very much taxable units in India and incurred losses as well. Also, the assessees as-sub funds of AICFL who claimed the carry forward of losses were the same as the sub-trusts of Aberdeen Delaware Business Trust who incurred the losses. “If this be so,” observed the Court, “then by extension, gain and loss earned by the present petitioner in its earlier avatar would not be denied only because of change in status from sub-trust of the Trust to 'series' (funds) of LLC.”

The HC, in its earlier order, in the case of the appeal filed by AICFL, had already held that in terms of the laws of Delaware sub-trusts and sub-funds remained the same . Based on these, the HC held that reason for re-opening the assessments of the sub-funds was erroneous in law. It consequently quashed the re-assessment proceedings against the three sub-funds.

**Citation:**

Aberdeen Asia Pacific Including Japan Equity Fund Vs. DCIT (W.P. No. 2796 of 2019)

**Our Comments**

Under Indian tax law there are specific provisions which confer the benefit of carry forward of losses in situations when one legal entity is converted into another, e.g.. .from partnership firm to LLC. However, the case under consideration deals with a situation where an entity changed its legal form under a foreign law and that foreign law deemed the new and the old entity to be the same .Basing its judgment on an earlier Supreme Court judgment in Technip SA Vs. SMS Holding (P) Ltd., (2005) 5 SCC 465, the HC has delivered a very important decision and it is expected to ease foreign institutional investment in India.

## Kerala HC Holds Pre-Deposit of 20 Per Cent of Tax Demanded is not a Condition Precedent ForThe CIT (A) to decide Appeal on Merits

**Facts& Issue:**

The assessee, Aranattukara Oriental Service Co-Operative Bank Ltd., was a primary Co-operative Agricultural Credit Society registered under the Kerala Co-operative Societies Act. Aggrieved by the assessment order for the assessment year2017-18, the assessee preferred an appeal before the CIT Appeals along with a stay application.

Neither the appeal northe stay petition was considered by the CIT (A). Apprehending coercive action, the assessee approached the Honourable Kerala High Court invoking the latter's writ jurisdiction.

**Contentions of the Assessee:**

The counsel for the petitioner assessee relied upon the judgment of the Division Bench of Kerala High Court in Angadippuram Service Co-op. Bank Ltd. v. CIT [writ appeal No.1536 of 2019 dated 1.7.2019] wherein the Honourable High Court in turn referred to the Full Bench decision of the High Court in Mavilayi Service Co-operative Bank Ltd. v. CIT 2019 (2) KHC 287, and held that the payment of twenty percent of tax demand is not a condition precedent for the CIT(A) to entertain and decide the appeal on merits.

**Contentions of the Revenue:**

The Counsel for the Revenue referred to the Circular dt 31.07.2017 issued by the CBDT and argued that deposit of amount at least to the extent of twenty percent of the tax demanded is mandatory for the purpose of entertaining and adjudication of an appeal by CIT(A).

**Observations & Ruling of the HC:**

The condition that that the payment of 20% of the demand amount could be dispensed with ,if there is an order of the high court, would not be limited to the assessee's own case. A judgment of the Full Bench of the High Court on an identical issue, followed by the Division Bench, would have an enuring effect on all authorities.

The honourable High Court directed the CIT (A) to decide the appeal on merits and pass a speaking order within a period of six months, without asking for payment of 20% of the demanded amount, after affording an opportunity of hearing to the petitioner assessee and the revenue r.

**Citation:**

Aranattukara Oriental Service Co-Operative Bank Ltd.v.Commissioner of Income-tax[116 taxmann.com 900 (Kerala)

**Our Comments:**

The decision of the High Court has once again emphasised the principle that administrative directions for fulfilling targets ofrevenue collection should not be at the expense of foreclosing remedies which are available to assesses for challenging the correctness of a demand.

The Honourable High Court has also *inter alia* adhered to the well settled principle that judgments of the Supreme Court and the High Courts are binding within their respective jurisdictions and will supersede Board Circulars on the same issues. The clarifications/circulars issued by the Board represent merely their understanding of the statutory provisions. They are not binding upon the Courts.

## Accidental Discovery Of Contraband Substance During Income-tax Search Does Not Amount To Seizure Under The Narcotic Drugs And Psychotropic Substances Act, 1985

The High Court was dealing with a criminal revision application filed by the applicant. The applicant had assailed the legality, propriety and correctness of an order passed by the learned Special Judge, NDPS, Greater Bombay, rejecting the application for discharge in a NDPS Complaint Case. The learned Special Judge did not accept the argument that there was no material which warranted framing of the charge against the accused.

**Facts & Issue:**

A search and seizure operation was conducted by the Income Tax Department at a hotel room in Mumbai in connection with the affairs of Y Group of Companies. The applicant, who was President of Corporate Affairs of said the group was found in this room along with the co-accused.

In the course of the said search and seizure operation, the co-accused was found in possession of eight small self-knotted transparent polythene pouches containing white powdery substance in white paper envelopes. The officers collected these pouches and kept them in a safe, which was available in the hotel room, in the presence of public witnesses, who had been summoned for the said search and seizure operation. Superior officers of Income Tax Department thereafter informed the Narcotics Control Bureau (NCB) on 10-1-2014 about the occurrence of this event.

Thereafter, the empowered officers of NCB came to the room on the same day and the isolated substance was checked. It transpired that it was cocaine weighing about 4.5 grams. The officers of NCB seized the contraband material in accordance with their own procedures. After completion of investigation, a charge- sheet was filed against the accused for an offence punishable under section 8(*c*) read with section 21(*b*) of the Narcotic Drugs and Psychotropic Substances Act, 1985 (NDPS Act).

The applicant filed an application for discharge on the ground that the officers, who were not empowered under the NDPS Act, could not have conducted seizure of the contraband. The Special Judge rejected the application holding that there was strong *prima facie* evidence against the applicant which warranted framing of charges.

**Contentions of the Assessee:**

In his revision application, the applicant submitted that seizure of contraband by the Income Tax Officers on 7-1-2014 was not legal and the same having being done by officers neither armed with a warrant nor authorization and empowerment under the provisions of sections 41 and 42 of the NDPS Act, prosecution was wholly untenable.

**Observations & Ruling of the HC**:

The principal issue which concerned the HC was whether the act of the Income Tax Officers of collecting and keeping the contraband in safe custody on 7-1-2014 constituted a seizure? If it did, such seizure would have been contrary to the provisions of 41 and 42 of NDPS Act, as in that case, the power of seizure could be said to have been exercised by an officer, viz. the ITO, who was not properly empowered or authorized. The HC examined the said provisions as also certain decisions of the SC dealing with these sections. The HC noted the difference between a search and seizure under the NPS Act and an accidental or chance discovery of contraband during the course of some other action under some other enactment. The HC held that when the officers stumbled upon the contraband substance in the possession of a person in totally different proceedings, such as the income tax search at hand, different considerations ought to come into play. The ground of non-compliance with the provisions of sections 41 and 42 of the NDPS Act, in the case of an accidental recovery of contraband substance, should not cause serious prejudice to the cause of administration of criminal justice.

The HC held that action of the officers of the Income Tax Department, in the given circumstances, could not be said to be unjustified. Their response in taking over and keeping the suspicious substance, , could not be clothed with the character of 'seizure', in the juristic sense. Neither could the requisite intent to carry out the search to find out a contraband substance be attributed to them. At that stage, competence and authority to draw a definitive inference that the substance found was indeed contraband, could also not be attributed to them.

The HC accordingly upheld the order of the Special Judge in recording a finding that there was adequate material to justify a strong suspicion that the accused/applicant had committed an offence punishable under section 8(*c*) read with section 21(*b*) of NDPS Act.

**Citation**:

Anant Vardhan Pathak [2020] 116 taxmann.com 729 (Bombay)

**Our Comments:**

The HC has left open the issue whether the 3 delay in communication by the income tax authority with the authority under the NPS Act affected the credibility of the claim of the prosecution witnesses; this matter was left to be tested during the trial.

It is interesting to note that in their statement the raiding officers had used the word ‘isolated’ in the context of the suspicious material that they had stumbled upon during the course of the income tax search. It therefore appears that the tax department had handled the matter in a very careful and informed manner. If, instead of the word ‘isolated’ the word ‘seized’ had been used by the raiding party, the case of the prosecution would have fallen apart., Tthe end result of this action would, of course be decided by the courts at a later point of time.

## High Court Did Not Accept Finding Of Tribunal That For Purpose Of Section 115JB, Net Profits Had To Be Determined As Per Provisions Of Companies Act And Thereafter Adjustments Had To Be Made, And That Assessee Could Not Adjust Book Profit Except As Provided Under Companies Act

**Facts and Issues**

The assessee was engaged in the business of manufacture, trading and distribution of processed control instruments. During the course of assessment proceedings for the assessment year 2005-06, the AO found that the assessee had for the purposes of S.80JB adjusted depreciation of Rs.8,44,51,767 against its profit. The A.O. did not accept this computation .According to him, Rs.209.30 Lakhs was the total unabsorbed depreciation of the previous year which was to be considered for the purposes of Section 115JB of the Act. The AO held that the aforesaid amount of Rs.209.30 had no element of brought forward business loss in it; therefore, no amount of brought forward loss had to be reduced in the MAT computation. The AO further held that, a sum of Rs. 8,44,51,767 being unabsorbed depreciation claimed by the assessee ought not to be reduced from MAT computation.

Aggrieved, the assessee filed an appeal before the CIT(A). The CIT(A) affirmed the assessment order and held that one does not need to go beyond the loss indicated in the assessee's books of accounts.

In the appeal before the Tribunal, the latterl dismissed the assessee's appeal and held that the assessee cannot adjust the book profit except as provided under the Companies Act; and in the instant case, the assessee tried to compute the brought forward losses under the income tax provisions and not under the Companies Act, which is not permissible.

**Contentions of the Assessee**

Referring to section 10A and section 115JB, the assessee contended that effect of income and expenses of section 10A ought to be reduced while computing profit under section 115JB. Thus, the past profits of section 10A units could not be adjusted against non-section 10A losses.

The assessee contended that loss brought forward and unabsorbed depreciation has to be taken as per books of accounts and not as per balance sheet. It was submitted that the lower of the brought forward loss and unabsorbed depreciation as per books of account relating to non-eligible section 10A unit should be reduced while arriving at book profit for the purposes of Section 115JB of the Act.

**Contention of the Revenue**

The department representative placed reliance on the decision of the Supreme Court in the case of Apollo Tyres Ltd. V.CIT [2002] 122 TAXMAN 562 (SC) to contend that there cannot be two incomes, one for the purposes of Companies Act and another for the purposes of IncomeTax Act. It was submitted that the provisions of Minimum Alternate Tax are a self-contained code in itself. Thus, the profit computed as per the books of accounts as required by the Companies Act is to be considered for MAT levy and not after making adjustment of unabsorbed depreciation.

**Observations & Ruling of the High Court**

The High Court having regard to the provisions of section 115J, section 115JB, section 10A and the decision of the Supreme Court in the case of Apollo Tyres Limited (supra), held that the Tribunal had misconstrued the provisions, when it held that net profits have to be determined as per the provisions of the Companies Act; and only thereafter, adjustments have to be made. The High Court noted that the Tribunal had not dealt with the claim of the assessee for deduction under Section 10A of the Act; it therefore remanded the matter to the Tribunal for a decision afresh.

**Citation**

Yokogawa India Ltd.[2020] 117 taxmann.com 72 (Karnataka)

**Comments**

It may be noted that until AY 2006 -07 the profits under section 10A were not subject to MAT. Thus, it is argued that while an adjustment of lower of unabsorbed depreciation or unabsorbed loss was to be allowed while computing MAT profits, the effect of section 10A profits has to be removed; and if there is any loss from a non-eligible section 10A unit, the same has to be taken note of.

The profit of a section 10A unit, being exempt for the purposes of MAT, should not be adjusted against losses of non-eligible section 10A units. Such grossed-up losses/depreciation should be considered for the purpose of reducing book profits under section 115JB. The logic seems to be that section 10A profits should be kept completely out of the tax net for all purposes including determination of the amount of brought forward losses and depreciation.