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The Chamber's Journal

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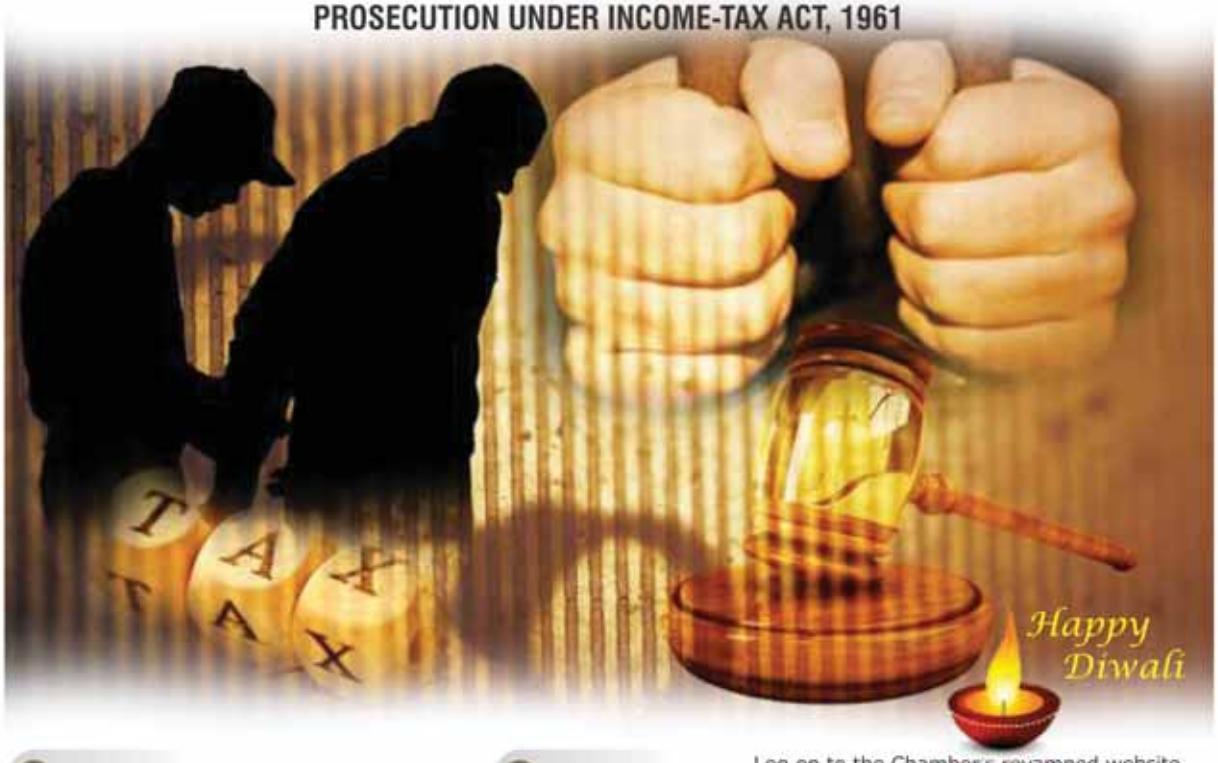
October - 2014 Vol . III | No. 1

PROSECUTION UNDER INCOME-TAX ACT, 1961



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INTERNATIONAL TAXATION COMMITTEE

Advanced FEMA Conference jointly with BCAS held on 6th September, 2014 at 4th Floor, Rangaswar Hall, Y. B. Chavan Pratishthan Chavan Centre, Mumbai – 400 021.

CA Paras K. Savla, President, CTC addressing the delegates. Seen from L to R : CA Gaurang Gandhi, Convenor, Intl. Taxation Committee, BCAS, CA Naresh Ajwani, Chairman, Intl. Taxation Committee, CTC, CA Dilip Thakkar, Moderator, CA Nitin Shingala, President, BCAS, Mr. G. Padmanabhan, Executive Director, Reserve Bank of India, Faculty, Mr. C. D. Srinivasan, CGM, Foreign Exchange Dept. RBI, Faculty, CA Gautam Nayak, Chairman, Intl. Taxation Committee, BCAS and CA Hinesh Doshi, Hon. Jt. Secretary, CTC.

Faculties

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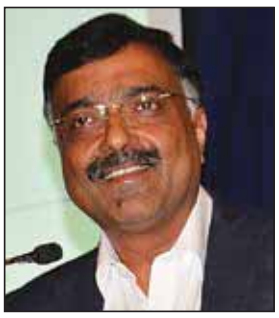

CA Vijay Gupta

Section of delegates.

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The Chamber's Journal

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Editorial

Wish you all a very happy festive season. I further wish all the professionals a very happy, peaceful and prosperous new year. Hope there are "Achhe Din" in the year ahead. All professionals who were involved in filing the Writ Petition seeking extension of time for filing returns need appreciation and specifically Dr. K. Shivaram, Senior Advocate, who once again proved that he is committed to the cause of the profession and the Chamber.

John Locke, 18th Century English Political Scientist in the context of "Separation of Powers" had said "since this division of Power, and there distinctive privileges constitute and maintains our Government, it follows that the confusion of them tends to destroy it, this Proposition is therefore true: that the Balance of the Parts consists in their mutual independency". The recent decision of the Apex Court in the case of *Madras Bar Association vs. UOI* transferred case (C) No. 150 of 2006 dated 25th September, 2014 has retained the balance as suggested above by John Locke.

In this decision the Hon'ble Court has observed in paragraph 54 that it is essential to examine the exact contours of "judicial review", in the frame work and scheme, of the concepts of "rule of law" and "Separation of Powers", which have been held to constitute the "Basic Structure" of the Constitution. And also, the essential ingredients, of an independent adjudicatory process. The Apex Court examined the issue at hand in the above-mentioned perspective and concluded that the creation of an independent machinery, for resolving disputes, was constitutionally vested with the judiciary. The judiciary is vested with the power of "judicial review", to determine the legality of executive action, and the validity of laws enacted by legislature. The power of "judicial review" was an integral part of Indian constitutional system, and without it, the "rule of law" would become a teasing illusion, and a promise of unreality. The Apex Court after analysing various decisions held that the power of "judicial review" of judiciary stands breached by with the promulgation of the NTT Act.

The Apex Court further observed that "since the power of judicial review exercised by the High Court under Articles 226 and 227 of the Constitution has remained unaltered, the power vested in High Courts to exercise Judicial Superintendence over the benches of the NTT within their respective Jurisdiction, has been consciously preserved. This position was confirmed by the learned Attorney General of India, during the course of hearing. Since the above jurisdiction of the High Court has not been ousted, the NTT will be deemed to be discharging a supplemental role, rather than a substitutional role. In the above view of the matter, the submission that the NTT Act violates the basic structure of the Constitution, cannot be acquiesced to." The Apex Court's larger bench's decision is very important and will have far reaching implications. The outcome of this decision is welcome.

I thank all the authors who have contributed to this issue of the Chamber's Journal. I once again wish you all the Happy Deepavali and Happy New Year.

K. GOPAL
Editor

From the President

Dear Members,

With the introduction of the revised Tax Audit Report during last week of July 2014, representations were made for postponing the implementation of TAR to the next financial year. Alternatively, it was also suggested that due date of filing return of income for non-corporate assessees liable for tax-audit, be extended by couple of months. The CBDT extended due date of filing of TAR without extending the date of filing of return of income for such assessees. Post partial extension, we at the Chamber again made representation followed by personal meeting with Revenue Secretary and TPL for appropriate extension of filing of return of Income. In absence of any logical output, favouring the members and taxpayers, the Chamber filed writ petition before the Hon'ble Bombay High Court. Learned judges observed that there will be substantial hardship caused to the assessees, if the date of filing of Return of Income is not suitably extended. It was also expressed that CBDT would look into the various practical difficulties enumerated in the petition and take a just and proper decision on the matter, before 30 September 2014. Pursuant the decisions of Bombay High Court and other High Courts, CBDT finally extended the due date of filing return of Income for the specified assessees. This brought much awaited relief to the members during the month of September, 2014. Filing of the writ and its outcome was welcomed by the members. At the Chamber, we received messages of appreciation for the same. Detailed note on the High Court decision is covered elsewhere in the Journal.

First week of October witnessed a series of holidays and these dates were just prior to the due dates for payment of various statutory dues. The Chamber made representation before CBDT and CBEC for the extension of due date for payment of TDS, Service tax and their returns. Pursuant to the representation, CBDT has extended date for payment of TDS. However, CBEC refused extension. The reason for the refusal was that w.e.f. October 1, 2014, e-payment is mandatory and under e-payment regime extension is not necessary. But it seems that they have lost sight on the fact that RBI has declared holidays for clearing as well as NEFT and as a result of which taxpayers cash-flow would be hampered.

On the birth anniversary of the Father of Nation Mahatma Gandhi, Prime Minister's dream project of 'Swachh Bharat Abhiyaan' was launched. Prime Minister himself took the broom in his hand to sweep away filth. This mission has received support from every quarter of the society and also internationally. It was also commented that this can bolter India's GDP at least by one per cent. At this juncture I remember tip from Kaushik Basu, Chief Economist to World Bank "A Small tip for the sake of our environment. When you leave a meeting take with you bottle of water you just opened to the next meeting."

E-commerce business portals have announced and some have completed massive discount sales for the festive season. This has received applause as well as complaints of unfair trade practices. This has made the Government to take notice of the phenomena and the concerned Minister was reported to have said that they are looking into complaints and shall take a call on whether more clarity is required on e-commerce retail business or a separate policy is required. Ironically, one of the most successful e-commerce business portals in India is the Government owned Railways' IRCTC. E-commerce business has already entered into rough weather in couple of States on indirect tax front. Everyone would appreciate that advancement of the technology would benefit both the consumers and businesses.

As I mentioned in earlier months communication at the Chamber various educational programmes and Residential Refresher Courses has been planned. Details of the same have been announced in the Newsletter. I would like to receive a feedback from the members on specific programmes. This month we would be celebrating the Diwali. Diwali is derived from the Sanskrit word Dīpāvali, formed from dīpa (oehe, "light" or "lamp") and āvalī (Deeke}e, "series, line, row"). Dīpāvali or Deepavalli thus meant a "row" or "series of lights". It's a festival of lights. Spiritually it signifies the victory of light over darkness, knowledge over ignorance, good over evil, and hope over despair. I wish all the readers Happy Diwali and Prosperous New Year.

Paras Savla
President

Chairman's Communication

Dear Esteemed Readers,

Let me take this opportunity to wish all of you a very Happy Diwali and a prosperous New Year. Diwali - the festival of lights – teaches us that we can dispel the darkness of ignorance with the light of knowledge. Our Journal does exactly that for all of us professionals.

Our Special Stories always have a lot to offer and this time our contributors have discussed the subject 'Prosecutions under Income-tax Act, 1961'. In an age of ever increasing prosecution, this is a subject never far from the minds of professionals and their clients everywhere. Especially when the process is neither short nor amicable for all parties. The authors have thought deep and written detailed articles which present everything in a nutshell. Ensuring that theory is well supported by practical insight, this is a story that should be read, remembered and assimilated into our memory. I would like to thank Shri Keshav Bhujle, Shri Paras S. Savla, Shri Dharam Gandhi, Shri Sameer Dalal, Shri Rahul Hakani, Shri Nimesh Chothani and Shri Vijay Garg for their sincere efforts in presenting a complicated subject in the simplest way possible. I also take this opportunity to thank the editor Shri K. Gopal for the design of this issues special story.

The 'Hot Spot' feature this month is an interesting exposition on 'Expenditure incurred for earning exempt income: Guide to law on Section 14A' by the eminent Dr. K. Shivaram and Shri Rahul Sarda.

After the strenuous previous month, I hope everyone takes some time off for rest and relaxation with their families during the festive time of Diwali. Again, I wish all the readers and their families a wonderful Diwali and a Happy New Year.

SANJEEV LALAN
Chairman – Journal Committee

The Chamber of Tax Consultants

Vision Statement

The Chamber of Tax Consultants (The Chamber) shall be a powerhouse of knowledge in the field of fiscal laws in the global economy.

The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre–eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.

Keshav B. Bhujle, *Advocate*

Introduction and Overview

1. Introduction

No law will be respected or obeyed unless sanction accompanies such law. Tax law is not an exception to this rule. For the effective and satisfactory implementation of a fiscal legislature it is necessary to provide for the consequences of non-compliance of the law. Compliance with the tax laws is enforced by providing three fold liability for non-performance of the obligations imposed on an assessee, viz. (i) interest, (ii) penalty and (iii) prosecution. To compensate the loss that the State may suffer on account of the non-compliance by the assessee the fiscal legislature provides for levy of interest which is mainly relating to payment of taxes. It is purely compensatory in nature and is normally mandatory. As against that, penalty is imposed with a view to deter the assessee by threat of punishment compelling him to pay substantial amount by way of penalty for non-compliance of tax laws. The object of imposing penalty is to make the assessee aware that the non observance of tax laws will lead to serious pecuniary liability. The prosecution provisions are deterrent not only to the assessee himself but also to all the other assessees. Chapter XXI of the Income-tax Act, 1961, deals with penalties imposable for defaults or non-compliance of obligations under the said Act. Chapter XXII of the Income-tax Act, 1961, deals with prosecution for offences.

2. General Principles

2.1 Burden of proof

It is the cardinal rule of our criminal jurisprudence that the burden of proof would always lie upon the prosecution to prove all the facts constituting the ingredients of offence beyond reasonable doubt. If there is any reasonable doubt, the accused is entitled to the benefit of the reasonable doubt. At no stage of the prosecution case, the burden to disprove the fact would rest on the defence. However, exceptions have been provided in ss. 105 and 106 of the Evidence Act. In a criminal case it would not matter if the accused is not able to establish his plea. The onus is on the prosecution to bring home the guilt of the accused.

2.2 Mens rea

The conditions of criminal liability are sufficiently indicated by the maxim, *'Actus non facit reum, nisi mens sit rea'* – a man is responsible not for his acts in themselves, but for his acts coupled with the *'mens rea'* or 'guilty mind' with which he does them. Before imposing punishment, the law must be satisfied of two things, first, that an act has been done which by reason of its harmful tendencies or results, is fit to be represented by way of penal discipline; and secondly, that the mental attitude of the doer towards his deed was such as to render punishment effective as a deterrent for the future, and, therefore, just.

It is well settled principle of common law that '*mens rea*' is an essential ingredient of criminal offence. A statute can exclude that element, but it is a sound rule of construction adopted in England and also accepted in India to construe a statutory provision creating an offence in conformity with the common law rather than against it unless the statute expressly or by necessary implication excludes '*mens rea*'. In this respect, the following observations of Justice Subba Rao in the case of State of *Maharashtra vs. Mayer Hans George AIR 1965 SC 722* are relevant:

> "It is a well settled principle of common law that *mens rea* is an essential ingredient of a criminal offence. Doubtless a statute can exclude that element, but it is a sound rule of construction adopted in England and also accepted in India to construe a statutory provision creating an offence in conformity with the common law rather than against it unless the statute expressly or by necessary implication excluded mens rea. To put it differently, there is a presumption that *mens rea* is an essential ingredient of a statutory offence; but this may be rebutted by the express words of a statute creating the offence or by necessary implication. But the mere fact that the object of a statute is to promote welfare activities or to eradicate grave social evils is in itself not decisive of the question whether the element of guilty mind is excluded from the ingredients of the offence. It is also necessary to enquire whether a statute by putting a person under strict liability helps him to assist the State in the enforcement of the law: can he do anything to promote the observance of the law? *Mens rea* by necessary implication can be excluded from a statute only where it is absolutely clear that the implementation of the object of a statute would otherwise be defeated and its exclusion enables those put under strict liability by their act or omission to assist the promotion of the law. The nature of *mens rea* that will be implied in a statute creating an offence depends upon the object of the Act and the provisions thereof."

3. Prosecution proceedings

The Income-tax Act, 1961, though provides the procedure for the assessment proceedings it does not provide any special procedure for prosecution proceedings. Therefore, once the complaint is filed before a Magistrate the procedure to be followed is the general procedure followed by the Criminal Courts, which is laid down by the Code of Criminal Procedure, 1973. In *State vs. Awtar Krishna (1957) 8 STC 244 (All)* the Allahabad High Court has held that the relevant provisions of the Code of Criminal Procedure are applicable to the trial of an accused for an offence under the Revenue Acts and they have to be given effect to.

Section 292 of the Income-tax Act, 1961, provides that only the Metropolitan (formerly Presidency) Magistrate or a Magistrate of the First Class has jurisdiction to try and convict a person of an offence under the Act. Therefore, the department has to file a complaint before a Metropolitan Magistrate or a Magistrate of the First Class and such court is the first authority to try the offences under the Act.

4. Penalty and prosecution

4.1 It is well established principle of law that mere addition to the total income does not justify penal interest, penalty and prosecution, It is also well established that where penal interest is not justified penalty and prosecution cannot be justified and further that where penalty is not justified prosecution cannot be justified. As such where penal interest is deleted and penalty is dropped/cancelled prosecution for corresponding offences would not be justified.

4.2 The proceedings for penalty are departmental proceedings which are civil in

nature. The Income Tax Authorities and the Appellate Authorities under the Act decide the validity of the penalty and the penalty proceedings under the Act. The trial for offences under the Act is conducted by the Criminal Courts as noted above. Under the Income-tax Act, 1961, the proceedings for penalty and prosecution, though arising out of the same default, are not substitutes for each other. The outcome of one proceeding may be relevant for the other proceeding. For example, where penalty is not justified in a case, prosecution would not be justified. Therefore, the question arises as to whether the findings and the conclusion arrived at by the Departmental and Appellate Authorities in penalty proceedings is binding on Courts conducting the trial for offences in respect of the corresponding defaults. Strictly speaking, the finding and the conclusions of the Departmental Authorities are not binding on the Courts. The Courts will have to take an independent decision in the criminal proceedings. If in a Departmental proceeding the assessee is held to have committed a default and is penalised that would not be binding on a Court trying for an offence. The Court will have to make an independent enquiry and arrive at an independent conclusion. The fact that the accused has been penalised in the Departmental proceedings will be one of the relevant evidences.

4.3 On the other hand, where the penalty is held to be not justified in the Departmental proceeding, the situation is different. In a trial before the Court for an offence under the Act, the complainant is the Department. Therefore, where, in a Departmental proceeding the finding and conclusion is that it is not a fit case for penalty, it will have to accepted by the Criminal Court, since it is contrary to the complaint itself. In such a situation, it is well established principle that the prosecution proceedings/ conviction are/is dropped/cancelled. In *Uttam Chand vs. I.T.O. 133 ITR 909 (S.C.)* the Hon'ble Supreme Court held that in view of the findings (favourable to the assessee) recorded by the Appellate Tribunal the assessee could not be prosecuted for filing false returns. In *P. Jayappan vs. I.T.O. 149 ITR 696 (S.C.)* the Hon'ble Supreme Court reiterated the principle and observed.

"It is true that, as observed by this Court in *Uttam Chand vs. I.T.O. 133 ITR 909* the prosecution once initiated may be quashed in the light of a finding favourable to the assessee recorded by an authority under an Act subsequently in respect of the relevant assessment proceedings."

The Hon'ble Court further observed:–

"The criminal court no doubt has to give due regard to the result of any proceeding under the Act having a bearing on the question in issue and in an appropriate case it may drop the proceedings in the light of an order passed under the Act."

4.4 This principle has been followed by the Hon'ble Supreme Court in S.P. *Sales Corporation vs. S.R. Sikdar (1993) 113 Taxation 203 (S.C.)* and in *G.L. Didwania vs. I.T.O. (1995 Supp (2) S.C.C. 724); 224 ITR 687 (S.C.).* Following this principle the Courts have quashed the prosecution proceedings on the basis of the cancellation of penalty by the Appellate Authority. Few such cases are:-

i) M/s. Shastri Sales Corporation vs. I.T.O. (1996) Cr.L.J. 449 (Bom).

ii) Shashichand Jain & Ors. vs. Union of India & Ors. (1995) 213 ITR 184 (Bom).

iii) Jamnadas Madhavji & Co. vs. Shri D.C. Sreedhar 1996(1) All MR 444 (Bom).

iv) V. Rajasekharan Nair vs. C.I.T. 204 ITR 783 (Ker).

v) C.I.T. vs. V. Rajasekharan Nair 207 ITR 33 (st) (S.C.)

vi) Premier Breweries Ltd. vs. Dy. C.I.T. 207 ITR 871 (Ker).

vii) Madras Spinners Ltd. vs. Dy. C.I.T. 203 ITR 282 (Ker).

viii) Prakash Chand vs. I.T.O. 134 ITR 8 (P&H).

ix) *Kanshiram Wadhwa vs. ITO. 145 ITR 109 (P&H).*

x) *I.T.O. vs. Rulia Ram Dewan Chand Thanesar & Ors. 194 ITR 562 (P & H).*

xi) *Surinder & Co. vs. A. K. Thati 195 ITR 189 (P & H).*

xii) *I.T.O. vs. B. B. Mittal 199 ITR 805 (P&H).*

xiii) *Sequoia Construction Co. Pvt. Ltd. vs. I.T.O. 158 ITR 496 (Del).*

xiv) *Asstt. CIT vs. Belco Engineers (P) Ltd. 87 C.T.R. 1 (Del).*

xv) *Umayal Ramanathan vs. ITO 194 ITR 462 (Mad).*

xvi) *Mohammed I. Unjawala vs. Asstt. CIT 213 ITR 190 (Mad).*

xvii) *Banwarilal Satyanarayan and Ors. vs. Stat of Bihar 179 ITR 387 (Pat).*

xviii) *Gopalji Shaw vs. ITO 173 ITR 554 (Cal.).*

4.5 Recently, this principle has been reiterated by the Hon'ble Supreme Court in *K.C. Builders vs. A.C.I.T. 265 ITR 562 (S.C.)*, wherein the Hon'ble Supreme Court held as under:

"i) Once penalties imposed on the assessee u/s 271(1)(c) of the Income-tax Act, 1961, are cancelled on the basis of the conclusive finding of the Appellate Tribunal that there is no concealment of income, prosecution of the assessee for an offence u/s 276C for wilful evasion of tax cannot be proceeded with thereafter : quashing of the prosecution is automatic.

ii) The finding of the Appellate Tribunal was conclusive and the prosecution could not be sustained since the penalty was cancelled following the Tribunal's order and no offence survived under the Income-tax Act thereafter. Quashing of the prosecution was automatic. Allowing the trial to proceed further would be an idle and empty formality."

5. Presumption and shift of burden of proof

Penalty proceedings are quasi-criminal in nature and as such the principles applicable to penalty proceedings were similar to those applicable to criminal proceedings. The legislature felt that the burden cast on the revenue in such penal proceedings is too heavy and for this reason many defaulters have escaped punishment. Therefore, so as to make the provisions workable, certain provisions providing for presumptions and shift in the burden of proof have been introduced. As for example, Explanation 1 to section 271(1)(c) provides for presumption of concealment of income in respect of the amount added or disallowed in computing the total income. This Explanation shifts the burden on the assessee to show that the addition to the total income does not represent concealed income. Before the introduction of this Explanation the burden was on the revenue to prove that the addition to the total income represents concealed income. However, the burden cast on the assessee is that applicable in civil proceedings i.e. on the basis of preponderance of probabilities. The Explanation requires the assessee to offer an explanation as regards the addition to show that the amount of addition does not represent concealed income. If the Explanation is *bona fide* the presumption of concealment is rebutted. If the Explanation is proved to be false by the Assessing Officer then the presumption of concealment would be applicable.

Section 278E provides for presumption of *mens rea* and also provides for shift of burden of proof from revenue to the assessee. According to this new section the accused is required to prove that there is no *"mens rea"* and sub-section (2) therein requires the accused to prove the absence of *'mens rea'* beyond reasonable doubt. The section further provides that the mere proof by a preponderance of probability would not be sufficient. This provision is unreasonable, illogical and too harsh. It requires the assessee to do an impractical and almost impossible thing. It is contrary to the general principles of law and the criminal jurisprudence. The provision of presumption has

been introduced for the reason that it is difficult for the revenue to establish the existence of *'mens rea'* which is a positive factor to be established. To prove the absence of *'mens rea'* is still more difficult being a negative factor. As such it is much more difficult to prove the absence of 'mens rea'. Further, the section requires such a proof to be beyond reasonable doubt. Such a burden on the accused is highly unjust being practically impossible. It is also illogical. The legislature has mechanically introduced this provision without any application of mind. In the case of penalty for concealment, the burden cast on the assessee is reasonable and workable. The proof required therein is by preponderance of probabilities. Similar proof would have been sufficient in respect of the presumption of *"mens rea"* in section 278E. The provisions of section 278E would lead to unintended and dangerous consequences.

6. Limitation

The Income-tax Act, 1961 does not prescribe any period of limitation for initiation of prosecution proceedings. Chapter XXXVI of the Code of Criminal Procedure, 1973 lays down the period of limitation beyond which no court can take cognisance of an offence which is punishable with fine only or with imprisonment not exceeding three years. But the Economic Offences (Inapplicability of Limitation) Act, 1974, provides that nothing in the aforesaid Chapter XXXVI of the Code of Criminal Procedure, 1973 shall apply to any offence punishable under any of the enactments specified in the schedule. The schedule referred to therein contains various enactments, including the Indian Income-tax Act, 1922 and the Income-tax Act, 1961. The Kerala High Court dealing with section 277 of the Act, held that the bar of limitation specified in section 468 of the Code of Criminal Procedure, 1973 would not apply to a prosecution under the Income-tax Act.

Accordingly, there is no period of limitation for initiation of prosecution proceedings for offences under the Act. Therefore, once the offence is committed under the Act, then the proceedings for that offence may be initiated at any time thereafter. Thus the sword of prosecution can always be hanging over the head of the assessee throughout his life. It may be noted, that this may result in an injustice to the assessee because a person who is in a better position to explain the issue or things in the initial stage, may not be able to do so later if he is confronted with after a lapse of time.

7. Power to grant immunity

7.1 Section 245H – Power of Settlement Commission to grant immunity

Sub-section (1) of section 245H empowers the Settlement Commission, under the specified circumstances, to grant immunity to the assessee from prosecution for any offence under this Act, subject to such conditions as it may think fit to impose. However, sub-section (2) of section 245H also empowers the Settlement Commission to withdraw the immunity so granted if it is satisfied that such person had not complied with the conditions subject to which the immunity was granted or that such person had, in the course of the settlement proceedings, concealed any particulars material to the settlement or had given false evidence.

7.2 Section 291 – Power of Central Government to grant immunity

Sub-section (1) of section 291 confers on the Central Government a power, under specified circumstances, to grant immunity to the assessee from prosecution for any offence under the Act on condition of his making a full and true disclosure of the whole circumstances relating to the concealment of income or evasion of payment of tax on income. However, sub-section (3) of that section empowers the Central Government to withdraw the immunity so granted if such person has not complied with condition on which immunity was granted or is wilfully concealing anything or is giving false evidence.

8. Compounding

Sub-section (2) of section 279 of the Income-tax Act, 1961 empowers the Chief Commissioner/ Director General to compound the offences. Sub-

section (2) of section 279 provides that the Chief Commissioner/Director General may, either before or after the institution of prosecution proceedings compound any such offence. Composition means in general an arrangement or settlement of differences between the injured party and the person against whom the complaint is made. In particular, composition is a bilateral act as a result of agreement between the Department and the accused.

Section 279(2) does not say that the offence can be compounded only if it is proved to have been committed. If there is a proceeding or charge for any offence, a composition may well be effected. Where the prosecution proceedings on a charge were compounded and the composition money paid, the assessee thereafter cannot claim a refund of the composition fee on the ground that he had really committed no offence – *Shamrao Bhagwantrao Deshmukh vs. Dominion of India (1955) 27 ITR 30 (S.C.).*

It is not necessary that an actual proceeding against the accused must be going on. All that is necessary is that the person applying for a composition must be alleged to have committed an offence. Even a formal notice of show cause has not been made a condition precedent. On the other hand, even if a prosecution has ended in conviction and the accused has preferred an appeal, there seems to be no bar to effect a composition during the pendency of such appeal and the accused shall not have to undergo the sentence awarded if he pays the composition money.

9. Conclusion

The law expects that prosecution proceedings are not initiated in each and every case of default but should be initiated only in exceptional cases where it is found by the higher authorities (Chief Commissioner) that it is a fit case for initiation of prosecution proceedings. However, many cases are filed mechanically without considering as to whether initiation of prosecution proceedings is justified. Unlike the assessment proceedings and the appellate proceedings before the Tribunal or the higher courts the trial proceedings in the criminal courts take a long time. The accused is required to be present in the Court at each and every date unless he is exempted, irrespective of whether the complainant is present or not. This results in loss of time, energy and business to an assessee. Thus the initiation of criminal proceedings itself amounts to the punishment much more than what the default deserved. Therefore, many a times the assessees preferred to compound the prosecution proceedings by paying reasonable compounding fees, to avoid such consequences of the prosecution proceedings even if no offence is committed by them. The loss of business on account of attending in the prosecution proceedings also compels the assessees to prefer compounding the proceedings by paying reasonable compounding fees. Particularly in the case of technical offences composition is the best solution for the assessees and the revenue. However, the compounding fees fixed by the revenue in such cases are exceptionally high and unreasonable. Further, the compounding applications made by the accused are not disposed of for a long time. There are many such cases pending before the authorities for finalising the compounding applications. If these cases are disposed of it would save the assessees' time wasted in the Court which they would otherwise be using for the growth of their business. There are many cases of technical defaults which have not yet come to the notice of the department. Any compliance by such assessees in any year would result in detection of such default of the earlier years and it would result in harsh punishment of those who wish to comply in the future. Therefore, it is advisable that the Government comes out with an immunity scheme whereby the assessees are allowed to come forward to disclose the defaults committed in the past and pay a reasonable composition fees so that they would feel free to comply with the provisions and there would be no technical defaults in the future.


Paras S. Savla, *Advocate* & CA Dharan V. Gandhi

Prosecution for obstructing recovery and failure to pay to Government

1. Introduction

The concept of appropriate legal punishment has been around for a long time. Marcus Tullius Cicero, Roman philosopher, statesman and orator, had coined the Latin maxim '*Noxiae poena par esto*' which means "Let the punishment be equal with the offence". Apart from businessmen, even professionals generally believe that levy of monetary penalty is a sufficient punishment for any tax offence. In fact, levy of maximum monetary penalty i.e. 300% of tax u/s. 271(1)(c) of the Income-tax Act, 1961, ('Act'), itself is considered too harsh as a punishment. Thus, launching of any criminal proceeding against an assessee are considered to be severe.

However, in wake of increased tax evasions, same view was not shared by the Special Committee set up by the Government called the Wanchoo Committee. Wanchoo Committee recommended vigorous prosecution policy. They justified it by saying that the monetary penalties are not enough and public tends to lose faith in the administration if they find that the tax-evaders are let away after levying only monetary penalty. The recommendations of this committee led to a sea of changes in the Act which expanded the scope of prosecution.

Currently, issue of notices for prosecuting a defaulter under the Act have substantially increased, which makes the issue of prosecution under Act all the more important. We appreciate the efforts of the Chamber for having considered the subject of 'Prosecution' under the Act for the special story of the Journal.

In the present article, we are dealing with the provisions of Sections 275A, 275B, 276, 276A, 276B and 276BB of the Act.

2. Section 275A – Contravention of order made under sub-section (3) of section 132

Section 275A introduced w.e.f 12-3-1965, deals with a situation where prohibitory orders under section 132 are not followed. In case where search operations have taken place u/s. 132(1) and seizure of the books, documents, money, bullion or any other valuable article or thing is not practicable or possible for any reasons, then the Authorized Officer may, under 2nd proviso to section 132(1) or u/s. 132(3), serve an order upon the person in possession of such things, restricting him to deal with such things in any manner except with the previous permission of such Officer.

Section 275A provides that when a person contravenes such prohibitory order, then such person shall be punishable with the rigorous imprisonment which may extend to two years and shall also be liable to fine. Thus, an act of

the assessee in opening the almirah in question by effecting cuts at two places and removing things was derogatory to the direction contained in the prohibitory order, which made him liable for offence punishable u/s. 275A. *(State of Maharashtra vs. Narayan Champalal Bajaj and Ors., 201 ITR 315 (Bom)].*

However, dealing in a bank account which was not covered by the prohibitory order as specified above will not constitute an offence u/s. 275A of the Act *[Sanjay Sinha vs. UOI, 271 ITR 465 (Pat.)].*

In the peculiar case of *State vs. Rakesh Aggarwal (80 Taxman 539)*, the Metropolitan Magistrate, Delhi quashed the prosecution proceedings on the grounds that neither the premises were raided nor sealed in the presence of the assessee; further, no notice u/s. 132(3) was served on the assessee, there was no eyewitness showing assessee entering its premises that were sealed and there was no details of the documents that were missing.

3. Section 275B – Failure to comply with the provisions of clause (iib) of sub-section (1) of section 132

Vide Finance Act, 2002, sub-clause (iia) was inserted under section 132(1) which required a person in possession or control of any books or other documents maintained in the electronic form to afford necessary facilities to the Authorized Officer to inspect the same, during search and seizure operations. Simultaneously, section 275B was introduced, which invites prosecution on failure of such person to afford the Officer, necessary facilities to inspect the computerised records and make such offence punishable with the rigorous imprisonment which may extend to two years and also be liable to fine. Considering the recent technological developments, failure to grant access to documents on e-mails and cloud servers would amount to a punishable offence under this section.

4. Section 276 – Removal, concealment, transfer or delivery of property to thwart tax recovery

Section 276 of the Act, inserted w.e.f. 1-4-1989, provides for punishment of a person who intentionally alienates any property or any interest in the property to thwart recovery of the tax.

Where an assessee fails to pay requisite taxes and is in default or deemed to be in default, Tax Recovery Officer can issue a Certificate u/s. 222(1) for recovery of the amount mentioned in the Certificate. Such amount can be recovered only as per the procedures given under Second Schedule to the Act. *[Moni Senan vs. CIT, 248 ITR 452 (Ker)].*

As per rule 2 of the Second Schedule, the Tax Recovery Officer shall, after issue of the aforementioned certificate, issue a notice to the defaulter to pay the amount mentioned in the certificate with 15 days of receipt of such service. If he fails to pay the amount within such period of 15 days, the Tax Recovery Officer, then, can take steps to execute the certificate issued and recover the tax due by modes given u/s. 222(1) which, *inter alia*, includes attachment and sale of assessee's movable or immovable property or by appointing a receiver for management of the assessee's properties. Further, assessee's properties, as per the Explanation to section 222(1), also includes any property transferred directly or indirectly, to his spouse or minor child or son's wife or son's minor child, otherwise than for adequate consideration.

In such cases, the assessee may, to avoid the attachment of the properties, try to alienate properties. Section 276 deals with such kind of offences. It provides that where an assessee fraudulently removes, conceals, transfers or delivers any property or any interest therein to any person with the intention to prevent the property or interest being taken over by the Tax Department for recovering taxes due, then such assessee shall be made punishable with the

rigorous imprisonment which may extend to two years and shall also be liable to a fine.

From the provisions of this section, one can deduce that, for invoking provisions of section 276, assessee must be an assessee-in-default and there has to be a certificate issued u/s. 222 by the Tax Recovery Officer. Prior to that, if assessee, whether intentionally or unintentionally, parts with his assets, then he should not be held guilty of breaching the provisions of section 276. However in such cases, during the pendency of any assessment proceedings, AO can restrict the assessee from parting with the asset u/s. 281B, by making provisional attachment of the property to protect the interest of the Revenue. The Income-tax Act, as well as the Rules, are silent on the consequences on account of breach of such provisional attachment. Such breach may not be punishable. However, such transfer may not be recognised for the purpose recovery of law.

It may be noted that element of fraud and *mens rea* is an essential ingredient of this section.

(Note: Erstwhile section 276 inserted w.e.f. 1-4-1968 dealt with four different kinds of offences/ contraventions which was omitted w.e.f. 1-4-1976 and the offences mentioned therein were then incorporated by way of new sections either under the Chapter XXII i.e. chapter dealing with prosecution or under the Chapter XXI i.e. chapter containing the penalty provisions.)

5. Section 276A – Failure to comply with the provisions of sub-sections (1) and (3) of section 178

Section 178 contains provisions with regards to the liquidation of a company. Section 178(1) requires the person appointed as the liquidator or the receiver (hereinafter referred to as 'liquidator') of the company to inform the AO about such appointment within 30 days of his appointment. Thereafter, the AO, under sub-section (2), shall notify the liquidator, after making necessary inquiries, the amount to be provided for the taxes to be paid by such company. Until such notification by the AO, as per section 178(3), liquidator cannot part with the assets of the company without the prior permission of CCIT or CIT and where such amount has been notified by the AO, the liquidator shall set aside the amount of tax payable as notified by the AO before parting with the assets of the company.

The above provisions *prima facie* deals with the duties of the liquidator of a company undergoing liquidation. These, provisions are to ensure that the Tax Department receives their due share of tax before the company closes. In the event of failure of the liquidator to abide by the aforementioned provisions section 178(4) holds the liquidator personally liable for the payment of the tax due from the company.

Section 276A of the Act provides for prosecution of liquidator in case of contravention of the provisions of sub-sections (1) and (3) of section 178. Section 276A mandates that in case of any breach, the person responsible i.e. liquidator shall be made punishable with rigorous imprisonment which may extend to two years and also be liable to fine. Further, to ensure imprisonment for a longer term, proviso to section 276A provides that only on special or adequate reasons to be recorded in judgment, can the imprisonment be less than for a period of 6 months.

However, section 278AA comes to rescue, which provides that no person shall be punished if he proves existence of reasonable cause.

6. Section 276B – Failure to pay tax to the credit of Central Government under Chapter XII-D or XVII-B

Section 276B of the Act, standing as on date and introduced w.e.f. 1-6-1997, deals with 3 types of offences given hereunder:

a. Failure of person to pay to the credit of the Central Government tax already deducted at source,

b. Failure of person to pay Divided Distribution Tax (DDT), payable u/s. 115-O(2) to the credit of the Central Government, and

c. Failure of person to pay to the credit of the Central Government tax payable by him as required under Second Proviso to section 194B.

Above-mentioned offences are made punishable with rigorous imprisonment for a term which is not less than 3 months but may extend to 7 years and with fine.

Firstly, we'll deal with the offence mentioned in point 'b' above i.e. failure of the person to pay DDT to the credit of Central Government u/s. 115-O(2). Under section 115-O, a domestic company is liable to pay DDT on any dividends declared, distributed or paid at rates mentioned therein. Further, as per section 115-O(3), liability of payment of tax is on the company and the principal officer of the company. On failure to comply with the provisions of section 115-O, company and the principal officer of the company, are treated as assessee-in-default u/s. 115Q. In addition to that, such persons are also liable for monetary penalty u/s. 271C and for prosecution u/s. 276B. Thus, when a domestic company declares, distributes or pays dividend to its shareholders and when the Company fails to pay DDT to the credit of Central Government within the due date, then principal officer of the company as well as the Company shall be treated as guilty of offence u/s. 276B and can be made punishable thereunder.

Other two offences enumerated u/s. 276B are in relation to deduction of tax at source. In so far as third limb of offence is concerned, same deals with non-withholding of tax under Second Proviso to section 194B on payment of winnings from lottery or crossword puzzle or card game or other games of any sort (hereinafter referred to as 'winnings').

Section 194B imposes obligation on the person responsible for paying any person, any income by way of winnings, to deduct tax at source from such winnings at the rates mentioned therein. Second Proviso to the said section deals with the situation where the winnings are partly or wholly in kind and where the cash part of the winnings is not sufficient to meet the liability of deduction of tax at source. In such case, Second Proviso, requires the person responsible for paying such winnings to make payment of tax before releasing the winnings. Third limb of Section 276B specifically deals with the Second Proviso to section 194B and provides that an act of a person of releasing the winnings before making payment of tax shall be treated as an offence. Here, since the winnings is wholly or partly in kind and the cash part of the winnings is not sufficient to make payment of tax therefore, question of deduction of tax at source does not arise at all. The person responsible for paying the winnings has to either pay the tax from his own pocket or he can collect the requisite tax amount from the recipient of the winnings and then make payment. In either case he cannot release the winnings before payment of tax at source, failure of which shall invite prosecution u/s. 276B. This act is also penalised u/s. 271C of the Act.

However, in case of a situation, where the either the winnings are wholly in cash or partly in cash and partly in kind, and where the cash part of the winnings is sufficient to make payment of tax, then the same is covered by the main provisions of section 194B and not by the Second Proviso to the said section and consequently, the offence in relation to the same gets covered by the 1st limb of section 276B and not by the 3rd limb. In that case, non-deduction of tax at source will not invite any prosecution u/s. 276B, but only non-payment of tax after deducting the same would invite prosecution (dealt with in detail in the subsequent paragraphs).

Now, coming to the 1st type of offence mentioned in section 276B. It deals with a situation where a tax is already deducted by any person under the provisions of chapter XVII-B like sections 192, 194, 194C, 194I, 194J,

195 etc., but the same has not been paid by such person to the credit of Central Government. Offence of non-deduction of tax at source is not covered here. If any person fails to deduct tax at source itself, then the same is liable to monetary penalty u/s. 271C of the Act, whereas where a person deducts tax but fails to pay the same to the Government, then he is liable for prosecution u/s. 276B of the Act. Up to 31-3-1989, non-deduction of tax at source was also an offence u/s. 276B of the Act. It was only vide the Direct Tax Law (Amendment) Act, 1987 that the act of non-deduction of tax at source was brought outside the ambit of prosecution and was made liable for monetary penalty u/s. 271C. *(See Salwan Construction Co. vs. Union of India, 245 ITR 175 (Delhi)* and *Kaushal Kishore Biyani vs. Union of India through ITO, 256 ITR 679 (MP)]*

Now, the question which comes for consideration is whether section applies to non-payment of tax or can also apply to late payment of tax. The question whether late payment of tax can still trigger the provision of section 276B has been answered in affirmative by the Hon'ble Supreme Court in case of *Madhumilan Syntex Ltd. vs. UOI [290 ITR 199(SC)]*.

But, where the amount involved is insignificant, prosecution proceedings cannot be sustained *[Bee Gee Motors & Tractors vs. ITO, 218 ITR 155(P&H)* and *Hanuman Rice & Oil Mills vs. State of Bihar, 96 Taxman 69 (Patna)]*. In view of the peculiar facts of the case, it was held by the Hon'ble Madhya Pradesh High Court, that where delay in depositing amount of TDS was not substantial and amount involved was not very huge and amount in default had also been deposited, department in its discretion could not launch prosecution under section 276B. *[Vijaysingh vs. Union of India (278 ITR 467)]*. In the above cases Courts have relied upon CBDT instructions dated 28th May, 1980 which stated that "The prosecution under s. 276B should not normally be proposed when the amount involved and/or the period of default is not substantial and the amount in default has also been deposited in the meantime to the credit of the Government".

Recently, the Ministry of Finance, on 6th August, 2013, issued a press release wherein it was mentioned that the guidelines to pick up cases for launching prosecution has been modified and the criterion of minimum retention period of 12 months have been dispensed with. Thus, now, prosecution can be launched even for a delay of 1 day.

Section 278AA, however, can be relied upon by the accused, if he provides reasonable cause for failure of offence u/s. 276B. Further, Courts have held that, *mens rea* is an essential ingredient for inviting the consequences of section 276B *[Vinar & Co. vs. ITO 193 ITR 300 (Cal.)]*. Contrary view was taken in case of *DCIT vs. Modern Motor Works [220 ITR 415(P&H)]* and *Rishikesh Balkishandas and Ors. vs. ITO [167 ITR 49 (Del.)]*. But, one can rely upon the judgment of the Hon'ble Supreme Court in case of *Dharmendra Textile Processors [295 ITR 244]* where the court has held that *mens rea* is essential ingredient in the matter of prosecution under s. 276C. It is apt to mention here section 278E, where *mens rea* is presumed and onus to prove the contrary is shifted on the accused.

To justify the offence, paucity of funds and financial stringency are considered as reasonable causes for delayed payment of TDS *[ITO vs. Roshni Cold Storage (P.) Ltd. 245 ITR 322 (Mad.)]*. However, non-availability of Director to sign the cheque to make payment of tax deducted at source could not be accepted as reasonable cause for quashing prosecution *[ITO vs. Rayala Corpn. (P.) Ltd. 206 ITR 381 (Mad.)]*.

As far as personal appearance of the accused is concerned, in a peculiar case, it is held that, since there was no allegation that petitioners, after deducting taxes misappropriated same for their personal use instead of depositing same with Government, it could be said that allegations made against petitioners constituted a technical offence and, therefore, Court below should have allowed their application under section 205 of the Code of Criminal Procedure, for exemption of personal appearance and representation

through their advocates *[G.P. Pandey vs. Union of India 275 ITR 212 (Jharkhand)]*.

On survival of prosecution proceedings, one can say that where the Hon'ble ITAT has held that assessee was not liable to deduct tax at source, there can be no prosecution *[Detecon Indian Project Office vs. ITO, 210 ITR 260 (Delhi)]*. Further, quashing of penalty is sufficient ground for quashing prosecution proceedings *[Harkawat and Co. vs. UOI, 302 ITR 7 (MP)]*. However, charging of interest u/s. 201(1A) and mere absence of levy of penalty cannot obliterate prosecution *[Universal Supply Corporation vs. State of Rajasthan 206 ITR 222(Raj.)]*. Further, pendency of proceedings under section 201(1) and 201(1A) cannot act as a bar to institution and continuance of criminal prosecution. *[Kingfisher Airlines Ltd. vs. Income Tax Department, 265 ITR 240 (Kar.)]*.

Further, prosecution must be launched within reasonable time *[Vinar & Co. vs. ITO (193 ITR 300 Cal.)]*. Contrary view was taken by the Hon'ble Bombay High Court in case of *UOI vs. Gupta Builders P. Ltd. [297 ITR 310 (Bom.)]*.

7. Section 276BB – Failure to pay the tax collected at source

Section 206C of the Act, imposes obligation on sellers dealing in certain goods as mentioned therein or on persons granting lease or license of any toll plaza or parking lot or mine or quarry, to collect tax at source, at rates given therein, from the buyer of the goods or the lessee or licensee as the case may be, and pay the same to the credit of the Government. Such taxes paid shall be deemed to be paid on behalf of the person from whom the amount has been collected and consequently, he shall be eligible for claiming tax credit in respect of the same.

On such failure there are ample penal consequences such as levy of interest on such tax amount u/s. 206C(7) at the rate of 1% p.m. or part thereof, penalty u/s. 221 and penalty u/s. 271CA of the Act. Section 271CA provides for monetary penalty in case of non-collection of tax at source.

Under section 276BB, non-payment of tax already collected at source is made punishable with rigorous imprisonment for a term which shall not be less than 3 months but may extend to 7 years and with fine. However, prosecution can be initiated only when a person collects the tax at source and fails to deposit the same with the Government. Non-collection of tax at source itself is not an offence u/s. 276BB.

Thus, if one fails to collect tax at source, then he shall be subjected to monetary penalty u/s. 271CA and when one fails to pay the tax after collecting the tax, then there arises no monetary penalty u/s. 271CA but such an act shall constitute an offence u/s. 276BB of the Act and consequently, he shall be prosecuted thereunder.

8. Conclusion

To curb the practice of a tax deductor deliberately delaying the remittance of TDS and deploying the funds for business, the CBDT, *vide* press release dated 6th August, 2013, withdrew the tolerance period, for initiating prosecution proceedings. Treating this as command from CBDT, the tax officers have started initiating prosecution proceedings in each and every case, indiscriminatingly. Not only the ultimate sentence, but the prosecution process itself causes much trauma and mental agony to an assessee. Imagine a situation, where the Assessing Officer has unlimited powers to arrest or detain any defaulter! Such a scenario can boggle one's mind. The need of the hour is to apply proper mechanism to filter and prosecute only impervious tax dodgers.

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Prosecution – Wilful attempt to evade tax, etc.

Introduction

Prosecution means – Institution and / or conducting of legal proceedings against someone in respect of a criminal charge. Chapter XXII of the Income – tax, 1961 ("the Act") deals with Offences and Prosecutions. Section 275A to Section 278A of the Act enumerated various offences for which an assessee is liable to be prosecuted before a criminal court. The prosecution launched under the provisions of this Chapter of the Act would be tried by the magistrate in a criminal court and the procedure therefore would be governed by the provisions of the Indian Penal Code, 1860 as well as the rules in the Code of Criminal Procedure Code, 1973.

Punishments under the economic laws / statutes act as a deterrent. The primary object of providing prosecuting provisions in an statute is to show the futility of crime and teach a lesson to other. Deterrence acts on the motive of the offenders, whether actual or potential. The object of punishment is to show that, in final analysis, crime is never profitable to the offender. The idea behind deterrent punishment is that of preventing crime by inflicting exemplary sentence on the offender. By this the State seeks to create fear in its citizens, thereby deterring them from committing the offence through fear psychology. The rigours of penal consequence is acts as a warning to the offenders and also to others.

There is a marked distinction between prosecution for an offence punishable under the Act and proceedings to impose penalties under Chapter XXI of the Act. The Act itself makes distinction in using the phraseology in the relevant provisions for prosecution of penalty like section 276(1) 'wilful attempt to evade tax', section 276CC 'wilful failure to furnish particulars', etc. But under section 271(1)(c) of the Act, mere concealment is sufficient to impose penalty. In the present article I would deal with sections 276C to 278 of the Act.

Besides penalties imposable for different defaults, the Revenue authorities under the Act are empowered to initiate prosecution proceedings for offence committed by a taxpayer (assessee) or any other person. Various offences which attracts prosecution under the Act are:

S. 276C Wilful attempt to evade taxes etc.:

Section 276C was substituted by Taxation Laws (Amendment) Act, 1975, with effect from 01st October, 1975. The new section 276C made a wilful attempt by an assessee to evade any tax, penalty or interest chargeable or imposable under the Act a punishable offence. Further, section made any wilful attempt to evade payment of any tax, penalty or interest also a punishable offence. This section was enacted

with a view to prevent wilful attempts to evade taxes and payment of taxes determined. The section was introduce as a direct consequence of recommendation of the Wanchoo Committee.

Section 276C(1) of the Act punishes the person who wilfully attempts in any manner whatsoever to evade tax, penalty or interest chargeable or imposable under the Act. The section provides that the persons shall be punishable as under:

Section	Offence	Punishment	
		Minimum	Maximum
276C(1)	Wilful attempt to evade tax, penalty or interest chargeable or imposable under the Act:		
	(a) if the tax evaded is more than 2,50,000/-	Rigorous imprisonment for a term of six (6) months with fine	Rigorous imprisonment for a term of seven (7) years with fine
	(b) in any other case	Rigorous imprisonment for a term of three (3) months with fine	Rigorous imprisonment for a term of two (2) years with fine

Section 276C(2) of the Act punishes the person who wilfully attempts in any manner whatsoever to evade the payment of any tax, penalty or interest under the Act. The section provides that the persons shall be punishable as under:

Section	Offence	Punishment	
		Minimum	Maximum
276C(2)	Wilful attempt to evade payment tax, penalty or interest under the Act.	Rigorous imprisonment for a term of three (3) months and shall in discretion of the court be liable to fine also.	Rigorous imprisonment for a term of two (2) years and shall in discretion of the court be liable to fine also.

Sub-sections (1) and (2) of section 276C of the Act deal with two different situations. Sub section (1) deals with wilful evasion of tax, penalty or interest chargeable or imposable under the Act. Thus, sub-section (1) contemplates evasion before charging or imposing tax, penalty or interest. In other words it includes act of wilful suppression of income chargeable to tax in returns before completion of assessment. On the other hand sub – section (2) deals with evading the payment of tax, penalty or interest under the Act. Thus, sub – section (2) contemplates cases of evasion after charging or imposition. Evasion of tax, penalty or interest after completion of assessment comes within the ambit of sub-section (2). Here it may be noted that non payment of advance tax does not fall within the ambit of sub-section (2) as the sub-section refers to cases of tax evasion after charging or imposition, that is, evasion after completion of assessment comes within the purview of this sub-section. – *Vinaychandra Chandulal Shah vs. State of Gujarat [(1995) 213 ITR 307 (Guj.)].*

The Explanation below section 276C of the Act defines a wilful attempt to evade any tax, penalty or interest chargeable or imposable under the Act or the payment thereof. The Explanation to section 276C which deals with examples of wilful attempt to evade any tax is only inclusive and does not catalogue all instance of wilful evasion – *K.A. Khaja vs. Sixth ITO [(1992) 196 ITR 627 (Mad.)]. The definition encompasses the following:*

A. Where any person has in his possession or control any books of account or other documents (being books of account or documents relevant to any proceedings under the Act), containing false entry or statement, a wilful attempt to evade tax is committed. However, mere possession or control of any books of account or document containing a false entry would not constitutes an offence – *Thakasi Satyanarayana vs. State of Andhra Pradesh [(1985) 153 ITR 818 (AP)]*. The books must be relevant to the proceedings under the Act. Thus, if the books relate to the period for which no action can possibly be taken under the Act for the reason of expiry of limitation, there will be no offence. Though the provision does not say that the books should belong to the person in whose possession or control they are found, it implies that he should be the owner thereof or they should relate to him. This inference is drawn from the language of sub-section (1) which refers to the tax, penalty or interest imposable upon him and not on any other person. However, such a person not being an owner can be proceeded for abetment under section 278 of the Act.

B. Where a person makes or causes to be made any false entry or statement in such books of account or other documents, an offence is committed. An entry can be made in the books by the assessee himself or by his agent for and on behalf of the assessee. However, a simple writer of the books may if he is not aware of the falsehood contained in the entry which has been written by him will not be prosecuted under the section, but once the knowledge or belief or awareness of the falsehood of an entry or statement is established on the part of the writer of the books of account, he can as well be proceeded against for abetment under section 278 of the Act.

C. Where any person wilfully omits or causes to be omitted by relevant entry or statement in such books of account or other documents, he commits an offence. Incomplete books not containing all the transactions entered into by the assessee during the relevant period would be sufficient to prima facie establish the guilt. Thus, if on comparison with the accounts of the other party it is found that certain transactions have been omitted, the offence is committed.

D. Any person who causes any other circumstance to exist which will have the effect of enabling such person to evade any tax, penalty or interest chargeable or imposable under the Act or the payment thereof. This clause is of the widest import. Thus, doing business or entering into the transaction in benami name may fall under this clause.

Burden of Proof/Onus

The standard of proof required in criminal proceedings is much more than required in penalty proceedings. The fundamental principle of penal liability is that an act alone does not amount to a crime, it must be accompanied by a guilty mind, as laid down by the maxim, 'Actus Non Facit Reum Nisi Mens Sit Rea', there must be a guilty mind behind an act for the completion of a crime. Thus if a person is punished under criminal law, it is generally agreed that he must have done such act with a guilty mind. The

word 'wilful' used in section 276C of the Act and other section of Chapter XXII of the Act generally means an act done with a bad purpose, with a evil motive as a constituent element of the offence and it should be established beyond reasonable doubt and there should be presence of mens rea a bad motive and a guilty mind. Thus, mens rea, (culpable mental state) is an important ingredient of the offences under the act also. The word 'wilful' imports the concept of '*mens rea*' in contrast to the expression 'without reasonable cause' as used in section 271(1) of the Act.

The Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 inserted with effect from 10th September, 1986 section 278E of the Act, according to which, in any prosecution for any offence under this Act which requires culpable mental state on the part of the accused, the Court shall presume the existence of such mental state. However, section 278E also provides that it shall be for the defence of the accused to prove the fact that he had no such mental state with respect to the act charged as an offence. Thus, it is a rule of evidence which has shifted the burden of proof to the accused. This legal presumption is justified on the ground that the assessee is in full possession of the facts relating to his affairs. Thus, it is they who are in a position to prove the non-existence of a culpable mental state. Here, however, it is important to note that the legal presumption contained in section 278E is limited to the existence of mens rea alone and it does not absolve the prosecution of its responsibility to prove the facts which *prima facie* establish the charge before cognisance of an offence is taken. A *prima facie* case for prosecution should be made out against the accused by the Department. A suspicion however, strong against the accused may be, but, if there is a reasonable possibility of innocence the accused would be entitled to acquittal.

Illustration

a. Before prosecuting a person under the provisions of section 276C read with section 278 B of the Act, prosecution must prove that the person was in charge of and responsible to the firm or company

   K. Subramanyam vs. ITO [(1993) 199 ITR 723 (Mad)]

b. Where the assessee requested time for payment of taxes levied on him and had also made part payment with balance paid subsequently, non payment of taxes in time cannot justify the inference of wilful attempt to evade payment of tax so as to attract prosecution under section 276 C (2) of the Act.

   Sushil Kumar Saboo vs. State of Bihar [(2011) 336 ITR 202 (Pat)]

c. Where amount due for A.Y. 1989-90 was paid in March 1992. There was no evidence that the assessee had resource by failed to pay the taxes. IT was held that prosecution under section 276(2) was not justified.

   ITO vs. Chiranjilal Cotton Industries [(2002) 254 ITR 181 (P&H)]

d. Failure to disclose the source of income in contradistinction to the failure or refusal to disclose the corpus/income itself, is not punishable under section 276C(1).

   Patna Guinea House vs. CIT [(2000) 243 ITR 274 (Pat.)]

Effect of finding in assessment / penalty proceedings

Where a finding is recorded by an appellate authority that there is no concealment of income, in the penalty proceedings before it, the criminal proceedings launched against ought to be quashed. In other words when the assessment or the finding of assessing officer or penalty is set aside the criminal proceedings are also not sustainable. *The Apex court in K.C. Builders & Anr. vs. ACIT [(2004) 265 ITR 562 (SC)]* held that levy of penalty under section 271(1)(c) of the

Act and prosecution under section 276C of the Act are simultaneous. Once the penalty levied under section 271(1)(c) of the Act has been cancelled / deleted on the ground that there was no concealment of income, the quashing of prosecution was automatic. Following the decision of the Apex Court in the case of K.C. Builder (supra) the Hon'ble Bombay High Court in the case of, *Indian Plywood Manufacturing Co. Ltd. vs. Dave (PS) [(2007) 291 ITR 430 (Bom)]* held that where penalty imposed on assessee under section 271(1)(c) was set aside by Commissioner (Appeals) holding that no case for concealment of income was made out, having regard to provisions of section 279(1A), criminal proceedings initiated against assessee under sections 276C and 277 and pending before Metropolitan Magistrate were also liable to be quashed. Also: *ITO vs. Nandlal and Co. [(2012) 341 ITR 646 (Bom)].* The Hon'ble Andhra Pradesh High Court in the case of, *ITO vs. Siddique (K.A.) [(1997) 227 ITR 677 (AP)]* held that a criminal court has to give due regard to the result of any proceedings under the Act having a bearing on the question in issue and in suitable cases it may drop the proceedings in the light of an order passed under the Act. Although the criminal court has to judge the case independently on the evidence placed before it, the finding of facts recorded by the ultimate income-tax authority is conclusive and binding on the criminal court. Further the Hon'ble Madras High Court in the case of, *Mohammed I. Unjawala vs. CIT [(1995) 213 ITR 190 (Mad)]* held that Criminal Court is bound to accept the findings of Tribunal on questions of fact more so when such findings are in favour of assessee.

However, if the assessee is acquitted in a prosecution proceedings, penalty proceedings need not be quashed / terminated as the degree of evidence required in penalty proceedings is less than what is required in prosecution proceedings – *Mahadeva Naidu Sons vs. CIT – [(2002) 255 ITR 208 (Mad.)].*

Effect of pendency of appeal / assessment

Pendency of appeal from assessment does not invalidate prosecution. A complaint can be filed even when appeal against the assessment is pending before the Appellate authority. Law does not bar levy of penalty and prosecution on the same facts as both are independently justified. Thus, pendency of appeal against penalty proceedings under section 271(1)(c) of the Act was held not bar to launching of prosecution under the Act – *C.R. Balasubramaniam vs. CIT [(1999) 235 ITR 35 (Mad)].* However, hearing in the prosecution proceedings can be postponed / stayed till the finality of assessment / penalty proceeding - *Gauri Shankar Prasad vs. UOI [(2003) 261 ITR 522 (Pat)] and Prabhava Organics P. Ltd. vs. DCIT [(2008) 297 ITR 392 (AP)].*

Notice before launching prosecution

Section 276C of the Act does not contemplate any notice to the assessee before the filing of criminal complaint, however, the principle of natural justice requires that the accused must be given an opportunity of being heard – *Tip Top Plastic Industries P. Ltd. vs. ITO [(1995) 214 ITR 778 (Mad)].*

Delay in prosecution proceedings

Chapter XXXVI of the Code of Criminal Procedure, 1973 provides for limitation for taking cognisance of certain offences. However, offences under the Act by their very nature, do not come to light as soon as they are committed and require long period of investigations. Thus, Economic Offences (Inapplicability of Limitation) Act, 1974 was enacted to provide for inapplicability of the provisions of Chapter XXXVI of the Code of Civil Procedure, 1973. However, courts have always frown upon unnecessary delay in filing complaints before the courts. The Hon'ble Bombay High Court in the case of, *K.M.A. Ltd. vs. ITO [(1996) Tax LR 248 (Bom.)]* held that complaint filed after 13 to 14 years after the date of alleged offence was liable to be quashed on the ground of

inordinate and unreasonable delay. The Hon'ble Patna High Court in the case of, *Gajanand vs. State [(1986) 159 ITR 101 (Pat.)]* set aside the prosecution under section 276C of the Act holding that if the department lets proceedings drag for years without making any serious efforts to proceed with it, the same is liable to be quashed. The Hon'ble Apex Court in the case of, *State of Maharashtra vs. Natwarlal Damodardas Soni [AIR 1980 SC 593]* held that a long delay in prosecution is a factor which should along with the other circumstance, be taken into consideration in mitigation of the sentence.

S. 276CC Failure to furnish returns of income:

Section 276CC of the Act was substituted for old section 276C by the Taxation Laws (Amendment) Act, 1975 with effect from 1-10-1975. This section punishes the person who wilfully fails to furnish in due time, the return of fringe benefits which he is required to furnish under section 115WD (1) or under a notice issued under section 115 WD (2) or section 115 WH or the return of income which he is required to furnish under section 139(1) or under a notice issued under section 142(1) or section 148 or section 153A of the Act. The punishment provided under section 276 CC of the Act is as under:

Section	Offence	Punishment	
		Minimum	Maximum
276CC	Wilful failure to file return of income u/s. 139 (1) or return of fringe benefit u/s. 115WD (1) or in response to notice u/s. 115WD (2), 115WH, 142 (1), 148 or 153 A of the Act:		
	(a) if the tax evaded is more than 2,50,000/-	Rigorous imprisonment for a term of six (6) months with fine.	Rigorous imprisonment for a term of seven (7) years with fine.
	(b) in any other case	Simple imprisonment for a term of three (3) months with fine.	Simple imprisonment for a term of two (2) years with fine.

Proviso to section 276CC provides that the provision will not be applicable for failure to furnish in due time the return of income under section 139(1) of the Act in following cases:

1 for any assessment year commencing prior to the 1-4-1975; or

2 for any assessment year commencing on or after the 1-4-1975, if:

a. the return is furnished by him before the expiry of the assessment year; or

b. the tax payable by the assessee on the total income determined on regular assessment, as reduced by the advance tax, if any, paid, and any tax deducted at source, does not exceed ` 3,000.

The object of section 276CC of the Act is to take effective preventive measure not only against evasion of tax but also against avoidance of tax. Evasion of tax by failure to file return of income

under section 276CC Act has been treated on par with evasion of tax by those who file return and attempt to evade tax under section 276 C of the Act by the Finance Act, 2012.

The conviction under section 276CC of the Act is an extreme and exceptional resort and gets warranted only when wilfulness in failure to submit return in time is established beyond all reasonable doubt and there should be presence of *mens rea*, a bad motive. In absence of this no conviction shall follow prosecution under section 276CC of the Act – *ITO vs. Autofil [(1990) 184 ITR 47 (AP)]*.

The Hon'ble Patna High Court in the case of, *Naresh Prasad vs. UOI [(2005) 276 633 (Pat)]* held that when the appeal is pending against the assessment criminal proceedings under section 276CC of the Act should not be launched against the assessee till the disposal of the appeal.

Section 276CC of the Act does not prescribe time limit for launching of prosecution. However, the Hon'ble Bombay High Court in the case of, *Vishnoo Kamat vs. First ITO [(1994) 207 ITR 1040 (Bom)]* quashed the criminal proceedings initiated before the Magistrate on the facts that penalty was already imposed on the accused and the criminal proceedings were instituted after a long delay of about ten years reckoned from due date of return.

Illustration

a. Where documents were seized by the Department and permission to take copies was given after the expiry of due date for filing the return. It was held that there was no wilful failure on the part of the assessee to furnish return – *Lal Saraf vs. State of Bihar [(1999) 235 ITR 116 (Pat)]*.

b. Prosecution under section 276CC is not valid in case where return is filed under Amnesty Scheme – *Mohini Bhutani vs. State [(2002) 256 ITR 799 (Del)]*.

c. Prosecution of partner who was not in-charge of affairs of the firm was held to be invalid – *S.N.P. Punj vs. DCIT [(2008) 301 ITR 76 (Del.)]*.

d. A member of Hindu Undivided Family (HUF) cannot be held liable for delay in filing of return of HUF, even though he had participated in the assessment proceedings – *Roshan Lal vs. Special Chief Magistrate [(2010) 322 ITR 353 (All)]*.

S. 276CCC failure to furnish returns of income in search cases

Section 276CCC was inserted by Income tax (Amendment) Act, 1997 with effect from 1-1-1997. This section punishes the persons who wilfully fails to furnish in due time the return of total income which he is required to furnish in response to a notice issued under clause (a) of section 158BC of the Act .

The punishment provided under section 276CCC of the Act is as under:

Section	*Offence*	*Punishment*	
		Minimum	*Maximum*
276CCC	Wilful failure to furnish in due time return in response to notice under section 158 BC	Simple imprisonment for a term of three (3) months with fine.	Simple imprisonment for a term of three (3) years with fine.

Proviso to section 276 CCC of the Act provides that no person shall be punished under the section for any failure under this section in respect of search initiated under section 132 of the Act or books of account, other documents or any assets requisitioned under section 132A of the Act, after the 30-6-1995 but before the 1-1-1997.

S. 277 False statement in verification, etc:

Section 277 of the Act is applicable in the following cases:

(i) If a person makes a statement in any verification under the Act or under any Rule framed under the Act, which is false or which he knows to be false or which he does not believe to be true;

(ii) If a person delivers an account or statement which is false or which he knows to be false or which he does not believe to be true.

In both the cases above, the punishment is as under:

Section	*Offence*	*Punishment*	
		Minimum	*Maximum*
277	Making a false statement in verification or delivering false accounts or statement:		
	(a) if the tax evaded is more than ` 2,50,000/-	Rigorous imprisonment for a term of six (6) months with fine.	Rigorous imprisonment for a term of seven (7) years with fine.
	(b) in any other case	Rigorous imprisonment for a term of three (3) months with fine.	Rigorous imprisonment for a term of two (2) years with fine.

The object of enacting the provision is to punish a person for providing the assessing authority information which is false or he knows to be false or which he does not believe to be true and thereby the person induces the assessing authority to frame a incorrect assessment resulting in short levy of income tax than properly due from an assessee.

As the assessment order is a 'public document' and is 'a property' and also 'a valuable security' within the meaning of section 420 of the Indian Penal Code, 1860 – *Ishwarlal Girdharilal Parekh vs. State of Maharashtra [(1968) 70 ITR 95 (SC)]*, there can also be a simultaneous prosecution under section 420 of the Indian Penal Code, 1860 against such person making such a false statement in verification.

Ingredients of offence under section 277 of the Act

Ingredients of offence under section 277 of the Act are:

a. A person makes a statement in any verification which was necessary under the Act or Rules made under the Act; or

b. Delivers an account or statement,

which is false or which he believes / knows to be false or which he does not believe to be true.

Who can be prosecuted under section 277 of the Act

Section 277 of the Act makes it clear that any person who makes false statement or which he believes / knows to be false or which he does not believe to be true shall be punished. The word 'person' used under section 277 of the Act is not used in the same sense as in section 2 (31) of the Act – *Kapurchand Shrimal vs. TRO [(1969) 72 ITR 623 (SC)]*. The word 'person' used in section 277 of the Act refers not only to an income tax assessee but also to any person who has made verification on behalf of the assessee. Section 277 of the Act uses the phrase 'if a person makes' and not 'if an assessee

makes', thus, section 277 of the Act applies in respect of any person and is not confined merely to an income tax assessees only. Even if return is verified by only one partner of the firm and the other partners have only signed the balance sheet annexed to the return they would be liable for any false statement in the accounts – *Bhagat Singh vs. ITO [(1985) 152 ITR 82 (P&H)].* However, those partners of the firm who have never signed the verification of the impugned return nor made any statement before the assessing authority or produces any accounts are not liable under section 277 of the Act – *Jasbir Singh vs. ITO [(1987) 168 ITR 770 (P&H)].*

Whether evasion of tax necessary for punishment under section 277 of the Act

Under section 277 punishment can be imposed only if there is any evasion of tax, otherwise the question of imposing punishment even under section 277(ii) does not arise – *ITO vs. Gadamsetty Nagamaiah Chetty [(1996) 219 ITR 263 (AP)].*

Effect of finding in assessment / penalty proceedings

Generally when assessment itself is set aside by the appellate authority, then when the assessment order is not in existence the question of maintaining criminal prosecution under section 277 of the Act does not arise – *G.L. Didwania vs. ITO [(1997) 224 ITR 687 (SC)].* The Apex Court in the above case observed, ' the assessing authority held that the appellant-assessee made a false statement in respect of income of Young India and Transport Company and that finding has been set aside by the Income-tax Appellant Tribunal. If that is the position then we are unable to see as to how criminal proceedings can be sustained'.

However, where the prosecution has been not been launched on the basis of assessment order, setting aside the assessment order by appellate authority could not be a ground for quashing the prosecution under section 277 of the Act as prosecution initiated by the officer has independent existence irrespective of what happens in the assessment proceedings – *C.G. Balakrishnan vs. ITO [(1988) 171 ITR 1 (Ker.)].*

Further, initiation of penalty proceedings is not a condition precedent to institution of a complaint under section 277 of the Act – *Rajinder Nath vs. M.L. Khosla, ITO [(1982) 134 ITR 397 (Del)].*

Place of trial:

The offence under section 277 of the Act is said to be committed at a place where false statement is delivered. Irrespective of place of penalty or assessment proceedings. Thus, offence under section 277 of the Act can be tried only at the place where the false statement is delivered – *J.K. Synthetics vs. ITO [(1987) 168 ITR 467 (Del.)] Special Leave Petition also rejected [(1988) 173 ITR 98 (St)].*

S. 277A Falsification of books of accounts or documents:

Section 277A was inserted by Finance Act, 2004. Section 277A of the Act provides for punishment in case of a person who wilfully and with intent to enable any person to evade any tax or interest or penalty chargeable and imposable under this Act:

(i) Makes or causes to be made any entry or statement which is false and which the abettor either knows to be false or does not believe to be true,

(ii) In any books of account or other document relevant to or useful in any proceedings against the him or the any other person, under the Act.

The punishment provided for a offence under section 277 A of the Act is as under:

Section	*Offence*	*Punishment*	
		Minimum	**Maximum**
277A	Falsification of books of account or documents	Rigorous imprisonment for a term of three (3) months with fine.	Rigorous imprisonment for a term of two (2) years with fine.

The Explanation appended to the section clarifies that to establish charge under this section, it is not necessary to prove that the other person has actually evaded any tax, penalty or interest chargeable or imposable under this Act.

The object of the section is to provide for adequate deterrence to a person who makes false entries in the books of account or documents with an intent to enable another person to evade tax even though there is no evasion of tax by the other person.

The section may cover an auditor or any consultant who is privy to the false document or statement.

S. 278 Abetment of false return, etc.

Section 278 of the Act is applicable in following case:

(i) If a person abets or induces in any manner another person to make and deliver an account or a statement or declaration relating to any income or any fringe benefits chargeable to tax which is false and which he either knows to be false or does not believe to be true;

(ii) If a person abets or induces in any manner another person to commit an offence under sub-section (1) of section 276C.

The punishment provided for a offence under section 277 A of the Act is as under:

Section	*Offence*	*Punishment*	
		Minimum	***Maximum***
278	Abatement to make false statement or declaration in respect of any income or fringe benefit chargeable to tax:		
	(a) if the tax evaded is more than ` 2,50,000/-	Rigorous imprisonment for a term of six (6) months with fine.	Rigorous imprisonment for a term of seven (7) years with fine.
	(b)in any other case	Rigorous imprisonment for a term of three (3) months with fine.	Rigorous imprisonment for a term of two (2) years with fine.

The section makes abetment or inducement in any manner in making or delivery of a false accounts, statement or declaration relating to any taxable income an offence.

The section is wide enough to cover professional persons who acts as a abettor. A professional person engaged in advising persons in income tax matters who abets or induces any person to make

or deliver a false return would also be liable to be prosecuted under section 278 of the Act. However, a charge of abetment or conspiracy against a professional cannot be founded merely because he acted on the basis of the statement and accounts provided to him. There should be a specific allegation that a professional prepared a false statement to be placed before the income tax authority in spite of being aware of its falsity – *Navarathna & Co. vs. State [(1987) 168 ITR 788 (Mad)]*.

Departmental Circular

The Central Board of Direct Taxes *vide* Instruction F. No. 285/160/90-IT(Inv), dated 7-2-1991, while laying down guidelines for selecting cases for filing prosecution complaints among other laid down following guidelines:

(i) A notice to the defaulter intimating the nature of offence committed and requiring the assessee to show cause why prosecution proceedings may not be initiated. However, no notice will be sent in any case, where the offence committed is under sections 276C(1) and 277 of the Act;

(ii) Prosecution need not normally be initiated against persons who have attained the age of 70 years at the time of commission of offence;

(iii) Prosecution under section 276C(1) of the Act or the corresponding provision of the Wealth-tax Act 1957, need not be initiated if:

  (a) the income sought to be evaded is less than ` 25,000/-;

  (b) the net wealth sought to be evaded is less than ` 50,000/-.

(iv) The same will apply to an offence under section 277 of the Act for false statement in verification, etc

(v) Prosecution under section 276C(2) of the Act need not be initiated if:

  (a) The aggregate amount of tax interest and penalty involved is less than ` 10,000/-;

  (b) This limit would be ` 1,000/- for the corresponding provision under the Wealth-tax Act, 1957.

(vi) Prosecution need not be launched for an offence u/s. 276CC of the Act if;

  (a) The net tax involved is less than ` 5,000/-; and

  (b) The tax payer is not a habitual defaulter.

The above instruction is followed by the Courts in following pronouncements while quashing prosecution under section 276C(1) read with section 277 and 276CC of the Act :

- *Madan Lal vs. ITO [(1998) 98 Taxman 395 (Raj)]*
- *Patna Guinea House vs. CIT [(2000) 243 ITR 274 (Pat)]*
- *Staya Narain Dalmia vs. State of Bihar [(2000) 110 Taxman 28 (Pat)]*
- *K. Inba Sagaran vs. Asst. CIT [(2000) 108 Taxman 387 (Mad)]*

Religion as a science, as a study, is the greatest and healthiest exercise that the human mind can have.

— *Swami Vivekananda*

Rahul Hakani, *Advocate*

Exemption from punishment, immunity from prosecution in case of juristic entities

A. SECTION 278AA – PUNISHMENT NOT TO BE IMPOSED IN SOME CASES

Introduction

Section 278AA begins with a non-obstante clause and provides that no person shall be punishable for any failure referred to in Section 276A, Section 276AB or Section 276B if he proves that there was a "reasonable cause" for such failure.

Under Section 276A a person is punished with rigorous imprisonment for a term which may extend to two years for failure to comply with the provisions of sub-section (1) and sub-section (3) of section 178 which section deals with the responsibility of a Liquidator in case of a Company in Liquidation. Under Section 276AB, a person is punished with rigorous imprisonment for a term which may extend to two years and shall also be liable to fine for failure to comply with the provisions of Sections 269UC, 269UE and 269UL which sections deal with restrictions on transfer of immovable property, vesting of property in Central Government and restrictions on registration etc. of documents in respect of transfer of immovable property etc. respectively. Under Section 276B a person shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine for failure to pay tax to the credit of Central Government .

Legislative history

Section 278AA was inserted by The Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 w.e.f. 10-9-1986 reported in (1986) 161 ITR 111(ST). The said Act at the same time deleted the words "without reasonable cause or excuse" from the provisions of Sections 276A, 276AB, 276B etc. As per the Explanatory Notes on the provisions of The Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 contained in Circular No. 469 dated 23-9-1986 reported in (1986) 162 ITR 21(ST) relevant P. 39 the deletion of the words "without reasonable cause or excuse" would mean that committing of the *actus reus* by itself will attract prosecution but at the same time by inserting new Section 278AA the amendment has secured that the assessee has to prove the existence of a reasonable cause for the failures as specified therein. The Patna High Court in *Banwarilal Satyanarain vs. State of Bihar (1989) 179 ITR 387* has held that Section 278AA was a separate section carrying out the same mandate which was earlier carried out by the sections contained in Section 278AA i.e. the failure has to satisfy the test of without any reasonable cause for prosecution. It may be noted that the

said section in its original avatar also covered offences punishable under Section 276DD and Section 276E (dealing with violation of Sections 269SS and 268T) which sections were omitted by the Direct Tax Laws (Amendment) Act, 1987 w.e.f. 1-4-1989.

Reasonable cause – Meaning

The words 'reasonable cause' have not been defined under the Act. Following are some of the Judicial pronouncements dealing with the expression "reasonable cause".

a. *Azadi Bachao Andolan vs. U.O.I. (2001) 252 ITR 471(Del.)*

Reasonable cause, as applied to human action, is that which would constrain a person of average intelligence and ordinary prudence. The expression 'reasonable' is not susceptible to a clear and precise definition; for an attempt to give a specific meaning to the word 'reasonable' is trying to count what is not number and measure what is not space. It can be described as rational according to the dictates of reason and is not excessive or immoderate. The word 'reasonable' has in law the *prima facie* meaning of reasonable with regard to those circumstances of which the actor, called on to act reasonably, knows or ought to know. Reasonable cause can be reasonably said to be a cause which prevents a man of average intelligence and ordinary prudence, acting under normal circumstances, without negligence or inaction or want of *bona fides*.

b. *Woodward Governors India (P.) Ltd. vs. CIT [2002] 253 ITR 745 (Delhi)*

It can be described as a probable cause. It means an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which, assuming them to be true, would reasonably lead any ordinary prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do.

c. *Kalakrithi vs. ITO (2002) 253 ITR 754 (Mad.) (H.C.)*

The words 'reasonable cause' in the section must necessarily have a relation to the failure on the part of the assessee to comply with the requirements of the law which he had failed to comply with

d. *Banwarilal Satyanarain vs. State of Bihar* (supra)

Reasonable cause or excuse is that which is fair, not absurd, not irrational and not ridiculous. A cause which is reasonable within the meaning of sections 276B and 278AA may not be sufficient and good reason within the meaning of sections 201 and 221 as sufficient reason would mean a substantial reason or a reason of good standard and good reason would mean a reason which is adequate, reliable and sound. A cause may be reasonable but the same may not be necessarily good and sufficient. On the other hand, if a reason is good and sufficient, the same would necessarily be a reasonable cause. Obligation which an accused has to discharge in a criminal prosecution under section 276B in showing that he had reasonable cause for not deducting the tax or paying the same within time is much more lighter than the obligation to be discharged by him in a penalty proceeding under section 201 read with section 221.

e. *Sequoia Construction Co. (P) Ltd. vs. ITO (1986) 158 ITR 496 (Del.)*

While assessing 'reasonable cause' within the meaning of section 276B, it must be taken that the milder proof of reasonable cause should be taken to have been established and in the circumstances it would be a sheer exercise in futility and harassment of the accused to allow criminal prosecution proceeding.

f. *In S.G. Kale vs. U.O.I. (2002) 256 ITR 148 (Raj.)(H.C.)*

Prosecution was launched for failure to deposit the tax deducted at source. The explanation

of the assessee that he did not have sufficient funds was accepted by the Assessing Officer as a reasonable cause under section 201 and did not impose penalty. It was held that notwithstanding the shift of burden of proof under section 278AA, if the material available on record about reasonable cause as part of finding in proceedings under section 201 is already on record the same becomes an integral part of the record to be considered before sanction could have been issued. In the facts of the case it was held that as penalty was not imposable, sanction for prosecution was bad in law.

Reasonable cause – Matter of evidence

In *Madhumilan syntax Limited vs. U.O.I (2007) 290 ITR 199 (SC)* the Apex Court held that reasonable cause for failure should be decided on the basis of evidence adduced before court and not earlier at the stage of application for discharge.

In *Shaw Wallace & Co. Ltd. vs. CIT [2003] 264 ITR 243 (Kolkata)* it was held that it was for appellant to produce sufficient evidence for non-deposit of tax deducted at source during criminal trial to avail of benefit of section 278AA and since except for pleading financial hardship, there was no other reason provided by appellant for such default, Single Judge was justified in not entertaining writ petition of appellant.

B. SECTION 278AB – POWER OF PRINCIPAL COMMISSIONER OR COMMISSIONER TO GRANT IMMUNITY

Introduction

Section 278AB of the Income-tax Act deals with Power of Principal Commissioner or Commissioner to grant immunity from prosecution when the proceedings for settlement have abated under section 245HA. Section 278AB was inserted by Finance Act, 2008 w.e.f. 1-4-2008. Section 245HA inserted by Finance Act, 2007, w.e.f. 1-6-2007 deals with abatement of proceeding before Settlement Commission. The said section provides for four situations when the proceedings before the Settlement Commission abate. Post abatement the Assessing Officer has to undertake assessment as if no application under section 245C had been made. The Assessing Officer is entitled to use all the material and information before the Settlement Commission for completion of the assessment. As post abatement, the Assessing Officer is also privy to confidential information which was produced by the assessee before the Settlement Commission, section 278AB has been inserted to enable the Assessee to seek immunity from prosecution.

As per sub-section (1) of section 278AB a person may make an application to the Principal Commissioner or Commissioner for granting immunity from prosecution, if he has made an application for settlement under section 245C and the proceedings for settlement have abated under section 245HA. As per sub-section (2) the application to the Commissioner under sub-section (1) shall not be made after institution of the prosecution proceedings after abatement. As per sub-section (3) the Commissioner may, subject to such conditions as he may think fit to impose, grant to the person immunity from prosecution for any offence under this Act, if he is satisfied that the person has, after the abatement, co-operated with the Income-tax authority in the proceedings before him and has made a full and true disclosure of his income and the manner in which such income has been derived. The proviso to sub-section (3) provides that where the application for settlement under section 245C had been made before the 1st day of June, 2007, the Commissioner may grant immunity from prosecution for any offence under this Act or under the Indian Penal Code (45 of 1860) or under any other Central Act for the time being in force. As per sub-section (4) the immunity granted to a person under sub-section (3) shall stand withdrawn, if such person fails to comply with any condition subject to which the immunity was granted and

thereupon the provisions of this Act shall apply as if such immunity had not been granted. As per sub-section (5) the immunity granted to a person under sub-section (3) may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, concealed any particulars material to the assessment from the income-tax authority or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the proceedings.

Scope and effect

The scope and effect of the above section was explained by the Board in its Circular No. 1 dt. 27-3-2009 reported in (2009) 310 ITR 42(ST) at para 37.3 as under:

"37.3 Similarly the salient features of the scheme for granting immunity from prosecution are as under:—

- The application for the immunity must be made by the assessee [person whose case has been abated under section 245(HA)] to the Commissioner of Income-tax before institution of the prosecution proceedings after abatement.
- If prosecution proceedings were instituted before or during the pendency of settlement proceedings, then the assessee can approach the Commissioner for immunity any time. However if the assessee has received any notice etc. from the Income-tax authority for institution of prosecution, then he must apply to the Commissioner for immunity, before actual institution of prosecution.
- Immunity can be granted by the Commissioner on his satisfaction.
- The satisfaction is required to be that the assessee has co-operated in the proceedings after abatement and has made a full and true disclosure of his income and the manner in which such income has been derived.
- Where application for settlement under section 245C had been made before the 1st day of June, 2007, the Commissioner can also grant immunity from prosecution for any offence under this Act or under the Indian Penal Code or under any other Central Act.
- Immunity can be subject to such conditions as the Commissioner may think to impose.
- The immunity granted shall stand withdrawn, if such assessee fails to comply with any condition subject to which the immunity was granted.
- The immunity granted may be withdrawn by the Commissioner, if he is satisfied that the assessee had, in the course of proceedings, after abatement, concealed any particulars from the Income-tax authority or had given false evidence."

Whether section 278AB provides effective remedy

Before the Bombay High Court in *Star Television News Ltd. vs. U.O.I. (2009) 317 ITR 66(Bom.) (H.C.)* the Petitioner which was a non-resident company engaged in broadcasting of satellite T.V. channels. It was engaged in a large number of litigations with the department on the quantum of taxability in respect of advertisement and subscription revenue repatriated from India. For a speedy resolution of the various litigations, the assessee approached the Settlement Commission, by filing settlement application on 5-3-2007. The application was placed before the Special Bench, which declared same as valid and allowed it for final settlement. The assessee alleged that for no fault of it, the Commission could not proceed to dispose of the application in spite of various dates that were given. The assessee, therefore, was under reasonable apprehension that the application

would not be disposed of and in the light of that, it approached the High Court challenging constitutional validity and legality of the provisions of section 245HA(1)(iv) and section 245HA(3) as inserted by the Finance Act, 2007 with effect from 1-6-2007 as being *ultra vires* and violative of Article 14 of the Constitution of India. According to the assessee, on a true and harmonious interpretation, the section ought to be read as providing for abatement only in respect of such applications wherein the applicant has in any manner prevented the Settlement Commission from discharging its mandatory statutory duty/obligation in passing an order under section 245HA(1)(iv) on or before 31-3-2008. The Bombay High court considered the provisions relating to immunity from prosecution under section 278B also and held as under

- The purported remedy under section 278AB is completely illusory and ineffective as the grant of immunity from penalty/prosecution is conditional upon the Commissioner after the application has abated in the proceedings before the IT Authority being satisfied that the person "has made a full and true disclosure of his income and the manner in which such income has been derived".

- The Commissioner according to the petitioner in most cases takes a stand before the Settlement Commission that the disclosure by the applicant is not full and true. In proceedings before the Settlement Commission, the Commission takes an independent view, from the stand of the Department and often did, overrule such objection of the Commissioner.

- Whilst however, introducing section 273AA and section 278AB, it is the Commissioner who will sit in judgment over an issue which most cases he has already prejudged by taking a stand before the Commission.

- It is inconceivable that the same Commissioner, who may have already objected before the Settlement Commission in most pending cases that the disclosure by an applicant is not full and true, will in purporting to exercise the aforesaid powers do a volte face and declare such disclosure as full and true even if now what he considers is full and true disclosure before the I.T. Authorities the true and full disclosure is before proceedings before the I.T. Authorities.

- The Commissioner, by the very nature of his post, is a part of taxing machinery. The Commissioner, who may have taken a stand on the application before the Settlement Commission, has now become the judge as in the Petitioner's own case by filing a Petition challenging the order to proceed with the application. This would violate the basic principles of natural justice which is inherent in the said provisions of the Act and the purported exercise of power thereunder will result in a flood of litigation impugning such purported exercise.

- A further anomaly is that in cases where the Settlement Commission has allowed the application to be proceeded with on a decision that the applicant's disclosure is full and true, the Commissioner will now sit in effect as an appellate authority over such decision of the Settlement Commission, which is a superior independent authority created by the Act with far more extensive powers and authority. It is true that the language used in section 278AB(3) is satisfaction after abatement if the person has co-operated with the Income-tax Authority in the proceedings before him and has made a full and true disclosure of his income and the manner in which said income has been derived. If before the Settlement Commission a stand has already been

taken it is impossible to conceive that the Income-tax Authority will take a view different from the view taken before the Settlement Commission.

The Bombay High Court concluded by holding that "In our opinion, the amendment made by the Finance Act, 2008 in no way will remedy the unconstitutionality and the arbitrariness of the impugned provisions and in fact disclose the harshness of the consequences thereunder by attempting to create an illusory remedy." Thus a great injustice has been done to the citizens by effectively placing a Commissioner at the same level as a Settlement Commission for really no fault of the asseseee. In fact the applicability of provisions of section 245HA are challenged across the length and breadth of the country time and again and the Courts in almost all cases have directed the Settlement Commission to dispose of the abated applications. The best solution appears to repeal section 245HA.

C. SECTION 278B – OFFENCES BY COMPANIES

Introduction

As per sub-section (1) of section 278B, where an offence under this Act has been committed by a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. The proviso to sub-section (1) provides that nothing contained in this sub-section shall render any such person liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence. Sub-section (2) provides that notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly. As per sub-section (3) where an offence under this Act has been committed by a person, being a company, and the punishment for such offence is imprisonment and fine, then, without prejudice to the provisions contained in sub-section (1) or sub-section (2), such company shall be punished with fine and every person, referred to in sub-section (1), or the director, manager, secretary or other officer of the company referred to in sub-section (2), shall be liable to be proceeded against and punished in accordance with the provisions of this Act. The Explanation to section 278B provides that for the purposes of section 278B —

(a) "company" means a body corporate, and includes—

  (i) a firm; and

  (ii) an association of persons or a body of individuals whether incorporated or not; and

(b) "director", in relation to—

  (i) a firm, means a partner in the firm;

  (ii) any association of persons or a body of individuals, means any member controlling the affairs thereof.

Legislative history and analysis of the section

Section 278B was inserted by the Taxation Laws (Amendment) Act, 1975 reported in (1975) 100 ITR 33 (ST) w.e.f. 1-10-1975. The object and scope of this section was explained by the Board in its Circular No. 179 dated 30-9-1975 reported in (1976) 102 ITR 26 (ST).

Under sub-section (1) the essential ingredient for implicating a person is his being "in charge

of" and "responsible to" the company for the conduct of the business of the company. The term responsible is defined in the Blacks Law dictionary to mean accountable. Hence, the initial burden is on the prosecution to prove that the accused persons at the time when the offence was committed were "in charge of" and "was responsible" to the company for its business and only when the same is proved that the accused persons are required to prove that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence. Both the ingredients "in charge of" and "was responsible to" have to be satisfied as the word used is "and" *[Subramanyam vs. ITO (1993) 199 ITR 723 (Mad.)]*. Under sub-section (2) emphasis is on the holding of an office and consent, connivance or negligence of such officer irrespective of his being or not being actually in charge of and responsible to the company in the conduct of the business. Also, while all the persons under sub-section (1) and sub-section (2) are liable to be proceeded against it is only persons covered under sub-section (1) who by virtue of the proviso escape punishment if he proves that the offence was committed without his knowledge or despite his due-diligence. From the language of both the sub-sections it is also clear that the complaint must allege that the accused persons were responsible to the firm / company for the conduct of its business at the time of the alleged commission of the business to sustain their prosecution. *[Jai Gopal Mehra vs. ITO (1986) 161 ITR 453 (P&H)]*.

Insertion of sub-section (3) by the Finance (No.) Act, 2004 w.e.f. 1-10-2004 was explained by Circular No. 5 dated 15th July 2005 reported in (2005) 276 ITR 151 (ST). The said amendment was brought to resolve a judicial controversy as to whether a company, being a juristic person, can be punished with imprisonment where the statute refers to punishment of imprisonment and fine. The apex court in *Javali (M.V.) vs. Mahajan Borewell and Co. (1998) 230 ITR 1* held that a company which cannot be punished with imprisonment can be punished with only. However, in a subsequent decision by majority in the case of *ACIT vs. Veliappa Textiles Ltd. (2003) 263 ITR 550 (SC)* it was held that where punishment is by way of imprisonment then prosecution against the company would fail. In order to plug loopholes pointed by the apex cout in Veliappa Textiles (supra) sub-section (3) was introduced whereby company would be punished with fine and other person in charge of or conniving officers of the company would be punished with imprisonment and fine. It is also to be noted that the legal position laid down in the case of Veliappa Textiles (supra) was overruled by the Apex Court decision rendered in *Standard Chartered Bank vs. Directorate of Enforcement (2005) 275 ITR 81 (SC).*

Nature of liability

The principal liability under section 278B is that of the company. The other persons mentioned in sub-section(1) and sub-section (2) are vicariously liable i.e. they could be held liable only if it is proved that the company is guilty of the offence alleged. The Apex Court in *Sheoratan Agarwal vs. State of Madhya Pradesh AIR 1984 S.C. 1824* while dealing with the provisions of section 10 of the Essential Commodities Act which are similar to section 278B has held that the company alone may be prosecuted. The person-in-charge only may be prosecuted. The conniving officer may individually be prosecuted. The Apex Court in *Anil Hada vs. Indian Acrylic Ltd A.I.R 2000 S.C. 145* while dealing with section 141 of the Negotiable Instruments Act held that where Company is not prosecuted but only persons in-charge or conniving officer are prosecuted then such prosecution is valid provided the prosecution proves that the company was guilty of the offence.

Mens rea

Section 278B is a deeming provision and hence it does not require the prosecution to establish *mens rea* on the part of the accused. In *B. Mohan Krishna vs. Union of India 1996 Cr.L.J. 638 (A.P.)* it

is held that exclusion of *mens rea* as a necessary ingredient of an offence is not violative of Article 14 of the Constitution of India.

Proprietary concern

In *S.K. Real Estates (2002) Cr.L.J. 1689 (Mad.)* it was held that prosecution against a proprietary concern is not maintainable as it is not a legal entity or juridical person.

Society

In *Dharma Pratisthan vs. Mandal (1988) 173 ITR 487 (Del.)* it is held that a Society being a AOP and its members can be prosecuted.

Liability of Directors, Managing Directors, Manager, Partners, etc.

Firm and partners

The Apex Court in *State of Karnataka vs. Pratap Chand & Ors. (1981) 2 SCC 335* has while dealing with prosecution of partners of a Firm held that 'person in charge' would mean a person in overall control of day-to-day business. A person who is not in overall control of such business cannot be held liable and convicted for the act of firm.

In *Monaben Ketanbhai Shah & Anr. vs. State of Gujarat & Ors. (2004) 7 SCC 15 (SC*) the Apex Court while dealing with the provisions of ss. 138 and 141 of the Negotiable Instruments Act, 1881, it was observed that when a complaint is filed against a firm, it must be alleged in the complaint that the partners were in active business. Filing of the partnership deed would be of no consequence for determining the question. Criminal liability can be fastened only on those who at the time of commission of offence were in charge of and responsible for the conduct of business of the firm. The Court proceeded to observe that it was because of the fact that there may be sleeping partners who were not required to take any part in the business of the firm; there may be ladies and others who may not be knowing anything about such business. The primary responsibility is on the complainant to make necessary averments in the complaint so as to make the accused vicariously liable. In Krishna Pipe and Tubes vs. UOI (1998) 99 Taxman 568 (All) it was held that sleeping partners cannot be held liable for offence.

Manager

In *Municipal Corporation of Delhi vs. Ram Kishan Rohtagi & Ors. AIR 1983 SC 67*, the accused invoked the jurisdiction of the High Court under s. 482 of the Code praying for quashing of criminal proceedings initiated against them under the Prevention of Food Adulteration Act, 1947. Whereas accused No. 1 was manager of the company, accused Nos. 2-5 were directors. A complaint was filed by the Food Inspector of the Municipal Corporation, *inter alia*, alleging that 'Morton Toffees' sold by the accused did not conform to the standards prescribed for the commodity. The Metropolitan Magistrate issued summons to all the accused for violating the provisions of the Act. It was contended on behalf of the accused that proceedings were liable to be quashed as it was not shown that accused persons were in-charge of and responsible for the conduct of business. The High Court allowed the petition and quashed the proceedings. Aggrieved Municipal Corporation challenged the decision. The Apex Court held that so far as the manager is concerned, we are satisfied that from the very nature of his duties it can be safely inferred that he would undoubtedly be vicariously liable for the offence, vicarious liability being an incident of an offence under the Act

Company and Directors etc.

In *Jamshedpur Engineering & Machine Manufacturing Co. Ltd. & Ors. vs. Union of India & Ors. (1995) 214 ITR 556 (Pat.)*, the High Court of Patna (Ranchi Bench) held that no vicarious liability can be fastened on all directors of a company. If there are no averments in the complaint that any director was 'in charge of' or

'responsible for' conduct of business, prosecution against those directors cannot be sustained.

In *S.M.S. Pharmaceuticals Ltd. vs. Neeta Bhalla & Anr. [2005] 148 Taxman 128 (SC)* wherein this Court while dealing provisions of section 141 of the Negotiable Instruments Act which is similar to section 278B laid down following important law relating to liability of Directors:

(a) It is necessary to specifically aver in a complaint under section 141 that at the time the offence was committed, the person accused was in charge of, and responsible for the conduct of business of the company. This averment is an essential requirement of Section 141 and has to be made in a complaint. Without this averment being made in a complaint, the requirements of section 141 cannot be said to be satisfied.

(b) Merely being a director of a company is not sufficient to make the person liable under section 141 of the Act. A director in a company cannot be deemed to be in charge of and responsible to the company for conduct of its business. The requirement of Section 141 is that the person sought to be made liable should be in charge of and responsible for the conduct of the business of the company at the relevant time. This has to be averred as a fact as there is no deemed liability of a director in such cases.

(c) The Managing Director or Joint Managing Director would be admittedly in charge of the company and responsible to the company for conduct of its business. When that is so, holders of such positions in a company become liable under section 141 of the Act. By virtue of the office they hold as Managing Director or Joint Managing Director, these persons are in charge of and responsible for the conduct of business of the company. Therefore, they get covered under section 141.

In *Madhumilan Syntex Ltd. vs. UOI (2007) 290 ITR 199 (SC)* assessee had deducted TDS but credited the same to the account of the Central Government after the expiry of the prescribed time limit thereby constituting an offence under section 276B r.w.s. 278B. A show cause notice was issued against the company as well as its four Directors as "principal officers". The accused pleaded that the ground of "Reasonable cause". However sanction for prosecution was granted a complaint was filed against the appellants on 26th Feb., 1992 in the Court of the Addl. Chief Judicial Magistrate (Economic Crime), Indore. The accused filed applications under s. 245 of the Cr. PC, 1973 (hereinafter referred to as 'the Code') for discharge from the case contending that they had not committed any offence and the provisions of the Act had no application to the case. It was alleged that proceedings were initiated *mala fide*. In several other similar cases, no prosecution was ordered and the action was arbitrary as also discriminatory. Moreover, there was 'reasonable cause' for delay in making payment and the case was covered by s. 278AA of the Act. The directors further stated that they could not be treated as 'principal officers' under s. 2(35) of the Act and it was not shown that they were 'in charge' of and were 'responsible for' the conduct of business of the company. No material was placed by the complainant as to how the directors participated in the conduct of business of the company and for that reason also, they should be discharged. However the prayers of the accused were rejected. Against this rejection a Revision petition was filed which was also rejected. Against the same Criminal petition was filed before the High Court which was also dismissed. Hence the accused approached the Supreme Court. Following were the important points of law laid down by the Apex Court:

1. Wherever a company is required to deduct tax at source and to pay it to the account of the Central Government, failure on the part of the company in deducting or in paying such amount is an offence under

the Act and has been made punishable. It, therefore, cannot be said that the prosecution against a company or its directors in default of deducting or paying tax is not envisaged by the Act.

2. From the statutory provisions, it is clear that to hold a person responsible under the Act, it must be shown that he/she is a 'principal officer' under s. 2(35) of the Act or is 'in charge of' and 'responsible for' the business of the company or firm. Where necessary averments have been made in the complaint, initiation of criminal proceedings, issuance of summons or framing of charge, cannot be held illegal and the Court would not inquire into or decide correctness or otherwise of the allegations levelled or averments made by the complainant. It is a matter of evidence and an appropriate order can be passed at the trial.

3. No independent and separate notice that the directors were to be treated as principal officers under the Act is necessary and when in the showcause notice it was stated that the directors were to be considered as principal officers under the Act and a complaint was filed, such complaint is entertainable by a Court provided it is otherwise maintainable.

4. Once a statute requires to pay tax and stipulates period within which such payment is to be made, the payment must be made within that period. If the payment is not made within that period, there is default and an appropriate action can be taken under the Act.

5. It is true that the Act provides for imposition of penalty for non-payment of tax. That, however, does not take away the power to prosecute accused persons if an offence has been committed by them.

Though the Apex Court did not go into the merits of the case and decided the issue in respect of maintainability of criminal complaint, the decision has given a clear warning to the corporates and their principal officers, the need for strict adherence to time schedules in the matter of payment of taxes, especially TDS. It is time that the taxpayers also realise they have to be extra careful when it comes to remittance of the TDS, as it is money due to the Government, which they have withheld from paying to a third party. However it is important that the Revenue do not take shelter of this decision and launch criminal prosecution even in case of few months of delayed remittance of tax deducted at source.

Accountant

In *Dev vs. State of A.P. 2002 Cri.L.J 4770 (Andhra Pradesh)* it was held that an Accountant is in charge of and was responsible to the company for the conduct of its business.

D. SECTION 278C – OFFENCES BY HINDU UNDIVIDED FAMILY

Introduction

As per sub-section (1) of section 278C where an offence under this Act has been committed by a Hindu undivided family, the Karta thereof shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. The proviso to sub-section (1) provides that nothing contained in this sub-section shall render the karta liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence. Sub-section (2) provides that notwithstanding anything contained in sub-section (1), where an offence under this Act, has been committed by a Hindu undivided family and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any member of the Hindu undivided

family, such member shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Legislative history

Section 278C was inserted by the Taxation Laws (Amendment) Act,1975 w.e.f. 1-10-1975. The scope and effect of the Section was explained by the Bord in its circular Nos. 179 dated 30-10-1975 reported in (1976) 102 ITR 26 (ST). According to the said Circular the object of inserting section 278C was to provide for criminal liability of the Karta or members of HUF for the offences committed by the HUF.

Analysis of the section

Section 278C places a vicarious liability on the Karta of HUF and other family members where an offence under the act is committed by the HUF. Under sub-section(1) the Karta of the HUF is liable. Under sub-section (2) any other member of the HUF is liable if such member responsible for the offence committed by the HUF. In *Roshanlal vs. Special Chief Judicial Magistrate (2010) 322 ITR 353(All)* the court was dealing with the liability of member of the HUF. In the said case there had been a Hindu undivided family whose Karta was 'R'. Accused No. 2, 'RL' was, admittedly, the son of 'R'. The allegation in the complaint was that the returns of income on behalf of the HUF were not submitted well within the time for the assessment years 1980-81 and 1981-82 and, therefore, the offence punishable under section 276CC had been committed. It was also the case of the complainant, i.e., the Department that 'R', who was the Karta of the HUF and his son, accused No. 2, 'RL' were responsible for the commission of the aforesaid offence. 'RL' was tagged with the responsibility under section 278C(2) as the offence had been committed with his consent and connivance. 'RL', thus, filed instant application under section 482 of the Code of Criminal Procedure, 1973, wherein a request was made that the proceedings pending against him in the complaint case be quashed. Quashing the complaint it was held as under:

"It does not appear from the complaints that the complainant came with this allegation that the Karta of the HUF was ill up to the time when the returns were required to be filed and the Karta had transferred his liability in this regard to the applicant, hence the applicant cannot be said to have consented or connived with the Karta of the HUF in the late filing of the returns. The complainant had averred only this much in both the complaints that the applicant Roshan Lal had connived and consented for the offence committed by the Karta of the HUF as he appeared in the income-tax proceedings for the HUF and filed the statements on behalf of the HUF. Even if this allegation is accepted as true, it would only show that the applicant appeared in the picture only after the date fixed for the filing of returns and the proceedings were undertaken by the department. As the offence shall be deemed to have been committed on the date when the returns were required to be filed, hence the involvement of the applicant after this date cannot be sufficient to show that he consented or connived in the late filing of the returns. Mere participation of the applicant in the income-tax proceedings cannot be a ground to tag him with the commission of any offence under the Income-tax Act as the offence had already been committed."

The idea of perfect womanhood is perfect independence.

— *Swami Vivekananda*


Nimesh Chothani, *Advocate* & CA Dharan V. Gandhi

Procedure before sanction of prosecution and compounding

Elizabeth Fry, an English prison reformer said that "Punishment is not for revenge, but to lessen crime and reform the criminal". Main purpose behind the major amendments of prosecution provisions under the Income-tax Act, 1961 ('Act') was also to lessen tax crimes. Wanchoo Committee in their report insisted on having stringent prosecution provisions in order to prevent and discourage the people from engaging in tax offences.

Rampant issuance of prosecution notices, in recent times, have made this subject very important for consideration by all. We thank the Chamber for giving us this opportunity to share our thoughts on this increasingly important issue of prosecution. In the present write-up, we're dealing with the provisions of sections 278A, 278E, 279, 279A, 279B, 280 and sections 280A to 280B of the Act.

1. Punishment for second and subsequent offences – Section 278A

Second 278A deals with second and subsequent offences. If any person is convicted of an offence for second time or for every subsequent offence under any of the sections enumerated in the table below then he shall be punishable with the corresponding minimum and maximum penalties given therein:

Section	*Offence*	*Minimum Penalty*	*Maximum Penalty*
276B	Failure to pay tax to the credit of the Central Govt. under chapter XIID or XVII-B	6 months rigorous imprisonment and fine	7 years rigorous imprisonment and fines
276C(1)	Wilful attempt to evade tax		
276CC	Failure to furnish the return of income		
277	False statement in verification, etc.		
278	Abatement of false returns etc.		

Thus, section 278A provides that once a person is convicted of any offence under any of the sections mentioned in the table gets again convicted of any offence under any of the same sections, then for every second and subsequent offence he shall be liable for a more serious punishment u/s 278A. Here, it is not necessary to commit offence under the same section again for triggering the

provisions of section 278A of the Act. So if a person is convicted of an offence u/s. 276B and then he again gets convicted of offence, not under the same section but, under other section, say 276CC, then in such case also, provisions of section 278A shall get attracted and he shall be made punishable thereunder. In case of *K.V. Narsimhan vs. ITO [209 ITR 797 (Mad)]*, the Hon'ble Court held that accused already convicted u/s. 278, and now committed an offence u/s. 277, was liable for punishment u/s. 278A of the Act.

List of sections mentioned in section 278A is exhaustive. Further, section 276C contains two sub-sections, sub-section (1) dealing with wilful attempt to evade tax and secondly sub-section (2) dealing with wilful attempt to evade any payment of tax (the difference between the two sub-sections is already explained in earlier topic). However, section 278A only deals with an offence under sub-section (1) of section 276C and not under sub-section (2). Thus, if one is convicted of an offence u/s. 276C(2) and again gets convicted of an offence under any of the section mentioned in the above table or vice versa, then in such a scenario provisions of section 278A are not attracted.

2. Presumption as to culpable mental state – Section 278E

Mens rea is a Latin word for "guilty mind". In criminal law, it is viewed as one of the necessary elements of crimes. The standard common law test of criminal liability is usually expressed in the Latin phrase, '*actus non facit reum nisi mens sit rea*' which means that the Act is not culpable unless the mind is guilty. As a general rule, criminal liability does not attach to a person who merely acted with the absence of mental fault. Thus, onus is always on the prosecution to prove *mens rea* on the part of the accused to charge him with any offence. Even, under the Income-tax Act, 1961, as held by Hon'ble Supreme Court in case of *Dharmendra Textile Processors (295 ITR 244)*, *mens rea* is held as an essential ingredient in the matter of prosecution.

Section 278E of the Act was inserted w.e.f. 10-9-1986. It provides for statutory presumption of existence of culpable mental state on the part of the accused. However, such presumption is not absolute and irrebuttable; accused can prove that there was no such mental state with respect to the act charged in such prosecution. Thus, requirement of *mens rea*, *per se*, is not dispensed with, only onus on the tax department, to prove *mens rea*, has now been shifted on the accused to prove the contrary. Further, section 278E(2) provides that accused, in order to discharge its burden, must prove beyond reasonable doubt, based on valid factual evidences, non-existence of culpable mental state; merely establishing non-existence of *mens rea* based on preponderance of probability won't suffice to get one outside the clutches of Chapter XXII of the Act.

Introduction of section 278E is seen as a stern step by the Government to enforce the law in a more stringent manner in view of the serious nature of fiscal offences, consistent with the objectives of the long term fiscal policy. As such prosecution under the Act are *pari materia* with criminal proceedings under the other criminal acts and therefore, introduction of provisions of section 278E has turned the entire table around regarding the burden of proof.

Constitutionality of the said section was challenged before the Hon'ble Madras High Court in case of *Selvi J. Jayalaitha vs. Union of India (169 Taxman 408)*. Hon'ble Court, upholding the constitutionality of the said section, held that *mens rea* is *sine qua non* for prosecution even after the introduction of section 278E; only the burden of proof of culpable mental state has been shifted to accused from Department. On appeal, Hon'ble Apex Court held that in every prosecution case, the Court shall always presume culpable mental state and it is for the accused to prove the contrary and that too beyond reasonable doubt *[Sasi Enterprises vs. ACIT, 361 ITR 163 (SC)]*.

Further, in view of the provision of section 278E, which presumes culpable mental state, many

courts have refused to quash the complaints or prosecution made against the accused at the threshold by holding that in a prosecution of an offence under the Act, it is for the accused to prove his defence which he can do by cross examining the prosecution witnesses or by leading defence evidence. *[N. K. Jain vs. UOI; 254 ITR 388 (Del.), Jiyajeerao Cotton Mills Ltd. & Ors. vs. ACIT; 197 ITR 639 (Cal.)]*

There exist hullabaloo regarding the requirement of *mens rea* for imposing penalty. However, in so far as prosecution is concerned, requirement of *mens rea* is indispensable. Thus, a natural conclusion can be derived that when penalty has been deleted, prosecution proceedings have no locus standi *[Harkawat and Co. vs. UOI, 302 ITR 7 (MP)]*. However, a contrary view has been taken by Hon'ble Delhi High Court in case of *Bandhu Machinery Pvt. Ltd. vs. Addl. Chief Metropolitan Magistrate [259 ITR 703 (Del.)]*. Further, in case, where no order itself, is passed, imposing penalty, prosecution does not become untenable. *[Raghunath Pandey vs. State of Bihar – 232 ITR 908 (Pat)]*.

Reference can be made to section 278AA which provides that provision of reasonable cause for failure mentioned u/s. 276A or 276B would suffice to save the person from the punishment under the said sections. Section 278AA, when looked in contradistinction with the provisions of section 278E, it can be inferred that section 278AA has much milder requirements, where one has to prove only reasonable cause of failure, whereas section 278E requires accused to prove beyond reasonable doubt that there was no *mens rea*. Further, section 278E is applicable to all the sections of prosecution including sections 276A and 276B. Thus, provisions of both sections 278AA and 278E are overlapping in so far as the offences u/s 276A or 276B are concerned. If one takes a harmonious view of both the sections, then it can be concluded that one can provide reasonable cause of failure to avoid getting punished u/ss. 276A and 276B, whereas in respect of all other provisions one needs to prove absence of *mens rea* beyond reasonable doubt.

3. Sanction before prosecution – Section 279(1)

Sections 275A to 280 provides for various types of offences under which the Department can prosecute a person in the Court of Law. Section 279(1) of the Act lays down that a person shall not be proceeded against for the offences enumerated in the sections except with the previous sanction of the Commissioner or Commissioner (Appeals) or the appropriate authority (hereinafter referred to as 'Commissioner') . Thus, grant of sanction by Commissioner is *sine qua non* for launching any prosecution under the Act.

The basic idea behind such provision is to protect persons from unnecessary prosecutions and consequent harassment. Therefore, the sanction to prosecute is undoubtedly an important matter and it constitutes a condition precedent to the institution of the prosecution. For a valid sanction, it must be proved that the sanction was given in respect of the facts constituting the offence charged and must be offence specific. In case if the sanction is granted for any specific offence, then prosecution under other section would be invalid *[Champala Girdharilal vs. Emperor – 1 ITR 384 (Nag.)]*.

The authority giving the sanction should *prima facie* consider the evidence and all other attending circumstances before he comes to a conclusion that the prosecution in the circumstances be sanctioned or forbidden. Thus, the sanctioning authority needs to apply his mind to the facts of the case and then has to accord sanction for prosecution *[ITO vs. Abdul Razack, 181 ITR 414 (AP)]*. However, grant of sanction being an administrative act, there is no need to provide an opportunity of hearing to the accused before according sanction, since an order of sanction, by itself, does not have the effect of a conviction or imposing a penalty causing any injury of any kind on the accused and the

accused will get full opportunity to defend himself in the trial. Therefore, the order of sanction will not get vitiated by violation of the principles of natural justice. *[ACIT vs. Velliappa Textiles Ltd., 132 Taxman 165 (SC)].*

The section mandates that prosecution should be launched at the instance of the Commissioner. However, nowhere it is specified that the complaint should be filed by the Commissioner himself. Prosecution launched by any officer with the sanction of the Commissioner would suffice *[V. Halley Matthew vs. State of Kerala-79 ITR 72 (Ker.), Veerakistiah vs. ITO 139 ITR 113 (AP), Taraknath Gupta vs. UOI-180 ITR 71 (Cal)].*

Commissioner can *suo motu* launch prosecution proceedings and there is no need for any proposal to be submitted by the Officer for launch of prosecution *[Gopal vs. ACIT – 207 ITR 971 (Mad)]*, but there has to be a proper sanction and mere issue of show cause notice by the Department cannot be treated as a valid sanction u/s 279 of the Act *[Raj Kumar Sodera vs. CCIT-229 ITR 626 (Pat)].*

Proviso to section 279(1) provides that the Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or the Director General, as the case may be, may issue such instructions or directions to the aforesaid Income-tax authorities as he may deem fit for institution of proceedings. Thus, Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General can also instruct the Commissioners to institute prosecution proceedings. However, proviso to sub-section (1) of section 279 is not a condition precedent for issue of an order of sanction by the Commissioner under section 279(1) and, therefore, it is not necessary for the Commissioner to issue sanction only on instructions or directions of the Chief Commissioner or the Director General *[Kingfisher Airlines Ltd. vs. Income Tax Department. – 43 taxmann.com 201 (Kar.)].*

4. No prosecution if penalty waived or reduced u/s 273A – Section 279(1A)

Section 271(1)(c) of the Act provides for imposition of penalty when an assessee has concealed particulars or furnished inaccurate particulars of his income. Quantum of such penalty is specified u/s 271(1)(iii) of the Act. Under section 273A, a Commissioner can waive or reduce the amount of penalty imposed u/s 271(1)(iii), if he is satisfied that (i) before detection by the AO of the concealment or inaccuracy of particulars, assessee had voluntarily and in good faith made full and true disclosure to the AO, (ii) assessee has also co-operated in any enquiry in relation to the same and (iii) has paid or has made satisfactory arrangement for payment of the tax due. When such an order has been passed by a Commissioner u/s 273A of the Act, then as per the provisions of section 279(1A), such person shall not be prosecuted against u/s 276C (wilful attempt to evade tax) or 277 (false statement in verification etc.) of the Act.

Prerequisite condition for section 279(1A) to apply is, Commissioner should pass an order u/s 273A to waive or reduce the penalty. Thus, when an assessee is granted relief in an appeal either by CIT(A) or by ITAT, provisions of section 279(1A) does not get attracted *[ITO vs. Achhpal Singh – 238 ITR 75 (P&H), Friends Union Oil Mills vs. ITO – 106 ITR 571 (Ke.), Dr. D. N. Munshi vs. N. B. Singh – 112 ITR 173 (All)].* Similarly, where no proceedings u/s 273A is initiated at all, prosecution cannot be quashed *[Vijay Kumar vs. ITO - 150 ITR 126 (P&H)].*

5. Compounding of offences – Section 279(2)

As per the Black's Law Dictionary, 'Compound' means 'to settle a matter by a money payment, in lieu of other liability'. Compounding of an offence is a settlement mechanism, by which, one is given an option to pay money in lieu of his prosecution, thereby avoiding a prolonged litigation.

However, it must be noted here that only the aggrieved party or the victim has the right to compound an offence and nobody else, not even the public prosecutor has the power to compound an offence. Under the Act, the aggrieved party is the Government or the Tax Department and therefore, section 279(2) enables the Chief Commissioner or the Director General or the Principal Chief Commissioner or the Principal Director General to compound any offence under Chapter XXII of the Act either before or after institution of proceedings. The wording of the section indicates that only offences under Chapter XXII of the IT Act could be compounded. Hence, apparently the benefit of compounding is not available in respect of offences committed and charged under the IPC *[T.S. Balaiah vs. T.S.Rangachari, ITO 72 ITR 787 (SC)]*

Compounding of offence is however, not a right bestowed on the assessee, on the contrary, the same is in the nature of discretionary power granted to the Chief Commissioner or Director General or Principal Chief Commissioner or Principal Director General *[Paneerdas & Co P. Ltd. vs. ACIT – 267 ITR 383 (Mad.)]*.

Further, the section explicitly provides that compounding can be done either before or after the institution of the proceedings. Thus, even when the proceedings are pending in the criminal court, Commissioner can exercise his power to compound the offence *[Laxmandas Pranchand vs. UOI–234 ITR 261 (MP)]*. Compounding offence is also plausible during the pendency of appeal against conviction *[Chairman, CBDT vs. Smt. Umayal Ramanathan 313 ITR 59 (Mad.)]*.

Further, opportunity of hearing need not be given before compounding of offence *[UOI vs. Banwari Lal Agarwal – 238 ITR 461 (SC)]*

CBDT issued instructions and guidelines to its officers, to be followed before compounding any offence. Instruction F.No. 4/7/69-IT (Inv) dt. 21st March, 1969, provided some guidelines which had to be followed before compounding any offence. The said Instruction provided that previous approval of the Board should always be obtained before compounding an offence. Similarly, Board's Instruction No. 1317 dt. 11th March, 1980, laid down guidelines regarding cases which should not be compounded and cases which may be compounded.

However, there was a lot of debate over the Board's powers to fetter the discretion of the tax authorities by issuing instructions or directions, particularly in the wake of Delhi High Court's judgment in the case of *M.P. Tiwari vs. Y. P. Chawla ITO [187 ITR 506 (Del.)]*, wherein it was held that instructions issued are invalid and *ultra vires*. This led to a retrospective insertion of Explanation to section 279, which provided that Board always had the power to issue instructions or directions to the Authorities in relation to composition of offences. Consequently, Hon'ble Supreme Court reversed the Delhi High Court's decision. The Supreme Court's decision is reported in 195 ITR 607 (SC). Subsequently, in September 1994, the CBDT, after reviewing the earlier guidelines, issued revised guidelines. These guidelines have also been amended *vide* CBDT Instruction [F No. 265/26/2002 IT(INV)] dated 29-7-2003. The salient features of these guidelines are as under:

a. Guidelines have reintroduced the concept of distinction between technical and non-technical offences. Offences u/ss. 276B, 276BB, and 276E are regarded as technical ones. All other offences are regarded non-technical.

b. The technical offences can be compounded even before filing complaint and all types of technical offences can be compounded by CCIT/DGIT. However, a non-technical offence can be compounded only with the approval of the Board subject to satisfaction of the few conditions.

c. The revised guidelines have been made applicable to all pending applications also.

d. Further, following conditions should be satisfied for compounding an offence.

- There should be a written request from the assessee.
- The amount of undisputed tax, interest and penalties relating to the default should have been paid.
- The assessee should express his willingness to pay both the prescribed compounding fees as well as establishment expenses.

e. The composition fees for compounding of various offences are also prescribed.

Section 279(3) of the Act, debars a person from contending that all the statements made or accounts or documents produced were under the belief that the same would be used for waiver or reduction of penalty u/s 273A or for compounding of prosecution u/s 279(2) and now, the same cannot be used as an evidence against the assessee in a prosecution proceedings.

6. Certain offences to be non-cognisable – Section 279A

Generally, cognisable offence means an offence for which a police officer has the authority to make an arrest without a warrant. Police is also allowed to start an investigation with or without the permission of a court. By contrast, in the case of a non-cognisable offence, a police officer does not have the authority to make an arrest without a warrant and an investigation cannot be initiated without a court order. The police can file a First Information Report (FIR) only in cases of cognisable offences. Normally, serious offences are defined as cognisable; these usually carry a sentence of 3 years or more. In India, crimes like rape, murder, theft etc. are considered cognisable, and crimes like public nuisance, simple hurt, mischief etc. are considered as non-cognisable.

Section 279A of the Act, deems offences punishable under sections 276B, 276C, 276CC, 277 or 278 to be non-cognisable within the meaning of Criminal Procedure Code, 1973. Thus, when a complaint has been filed by the Authorised Officer after obtaining sanction of the sanctioning authorities u/s 279 in respect of the aforementioned sections, then, Police cannot arrest such person against whom complaint has been filed without any warrant or cannot investigate into any matter without the permission of the Court.

Complain must necessarily be in accordance with the provisions of section 279, as explained above. It was held by Hon'ble Karnataka High Court that offences u/ss. 276C and 277 of the Act are non-cognisable and a complaint as to these offences can only be at the instance of the *CIT. [Balaji Oil Traders & Ors. vs. ITO - 150 ITR 128 (Kar)].*

New offences have been brought under the statute after insertion of section 279A; however, these new sections have not been updated in the list of non-cognisable offences, so probably such offences will be treated as cognisable offences, though unintentionally.

7. Proof of entries in records or documents – Section 279B

Section 279B of the Act provides that the entries appearing in the records or other documents in the custody of the Tax Department can be admitted as an evidence in any prosecution proceedings under Chapter XXII of the Act. Further, it also provides that such entries may be proved either by producing the original records or documents in the court or by producing the certified true copy of such documents or records in the court.

This section was inserted w.e.f. 1-4-1989 and the rationale behind introduction was to remove practical difficulties faced in production of original records and documents every time for the prosecution proceedings before the courts

which also had the risk of original documents and records getting lost or of it being taken away unlawfully. Therefore, section 279B was inserted which provided that even certified true copy of the records and the documents would suffice for proving any entry in such records or documents.

8. Disclosure of particulars by Public Servant – Section 280

Section 138 of the Act deals with the furnishing or non-furnishing of information obtained under the provisions of the Act to others. Section 138(1) permits the Board or any other Income Tax Authorities to divulge certain information for certain purposes. Whereas, section 138(2) provides that, Central Government may by notification in Official Gazette, prohibit furnishing of information or production of documents by public servant in certain scenarios as may be specified in the notification.

Section 280 of the Act, specifically deals with the violation of the provisions of sub-section (2) of section 138 of the Act, by a Public Servant. Thus, when a public servant furnishes any information or produces documents in contravention of the provision of section 138(2), he shall be punishable with imprisonment which may extend to 6 months and shall also be liable for a fine. However, no prosecution can be instituted under this section without the prior sanction of the Central Government.

9. Provisions relating to Special Court (Section 280A to Section 280D)

Vide Finance Act, 2012, section 280A to section 280D were introduced in order to strengthen the prosecution mechanism under the Act. These sections were also introduced to provide administrative convenience to Income-tax Authorities who were facing difficulties during trial of the offence. These sections mainly provides for –

a. Constitution of Special Courts, by Central Government, by notification in Official Gazette, for trial of offences under the Act (sections 280A and 280B).

b. Application of summons trial for certain offences under the Act to expedite prosecution proceedings (section 280C) and

c. Providing for appointment of public prosecutors (Section 280D).

However, no such Special Courts have been designated by the Central Government till date.

10. Conclusion

With so many serious and stringent provisions around for tackling tax evasion, hopefully the real purpose behind the same is achieved i.e. prevention of commission of tax offence so that the Government earns its rightful share of taxes. It is rightly said by Vittorio Alfieri that 'disgrace does not consist in the punishment, but in the crime'. However, at the same time, chances of misuse of such provisions cannot be ignored. Few safeguards already exist in form of section 279 or 279AA. However, need exists for additional safeguards, including provision for prosecution of the Tax Officers for wrongful prosecution of the innocent, before the Department starts harping on these dangerous provisions in a wrongful manner like what P. J. O'Rourke said, 'Let's reintroduce corporal punishment in the schools – and use it on the teachers'.

"Each patient carries his own doctor inside him."

— Norman Cousins

Vijay Garg, *Advocate*

Procedure & Trial after sanction of prosecution

Earning revenue is one of the essential requirements for the Government to run the nation. Levy of taxes therefore becomes indispensable. Taxes levied on income are governed by the Income-tax Act, 1961 (hereinafter referred to as the "IT Act"). For ensuring the effective implementation of the IT Act, penalty proceedings alone are not sufficient. In order to deter the evasion of taxes, prosecution of the evaders becomes necessary. Chapter XXII of the IT Act deals with various offences committed under the IT Act and prescribes punishment for the same.

The offences under the IT Act can be tried only by a Court of Magistrate as provided under Sections 292 and 280A(1) of the IT Act. Therefore, after obtaining the requisite sanction, a complaint can only be filed before the Court of Magistrate. It should be noted that the IT Act itself does not lay down any procedure to be followed by the Court of Magistrate for the conduct of criminal proceedings. Section 280D(1) of the IT Act however, states that for any prosecution under the IT Act, the Court of Magistrate will be required to follow the Code of Criminal Procedure, 1973 (hereinafter referred to as the "Code") subject to the exception where the provisions of the Code are repugnant to the provisions of the IT Act. For instance, Section 360 of the Code shall not apply in view of Section 292A of the IT Act except where the person convicted is under eighteen years of age.

Some of the important aspects involved in prosecution of offences under the IT Act are discussed hereinbelow.

Cognisance

The Magistrate is required to take cognisance of the offence upon filing of the complaint. The word cognisance has not been defined in the Code. It can be construed to mean the process whereby the Magistrate peruses the complaint with a view to ascertain whether any offence has been committed or not. As the prosecution under the IT Act is by way of a complaint, the cognisance of the same can be taken under Section 190 (a) of the Code.

It has been observed by the Apex Court[1] that taking cognizance does not involve any formal action but occurs as soon as the Magistrate applies his mind to the suspected commission of the offence from the contents of the complaint. Cognisance therefore takes place when the Magistrate first takes judicial notice of an offence. This application of mind must be done with a view to proceed under Section 200 of the Code and the sections following it.

While taking cognisance, if the Magistrate comes to a conclusion that no offence has been made out then he can dismiss the complaint under Section 203 of the Code. In case if he decides that an offence has been committed then he can issue process against the accused under Section 204 by way of a summons or a warrant, as the case

1. *Smt. Mona Panwar vs. Hon'ble High Court Judicature at Allahabad through its Registrar and Others, [(2011) Cri.L.J. 1619]*

may be. Normally summons are issued, both for a summons-case and a warrant-case unless the Magistrate considers it necessary to issue a warrant in a warrant-case.

The summons/warrants issued as process under Section 204 of the Code are served in the manner provided under Chapter VI of the Code. After the service of the summons or execution of the warrants, as the case may be, the accused has to appear or be produced before the Court of Magistrate on the returnable date.

The complaint should contain all the necessary details which constitute the offence(s) alleged to have been committed. The details therein should be sufficient enough to make out a *prima facie* case. The complaint should give necessary details about the role played by each of the accused persons.

A complaint must contain material so as to enable the Magistrate to make up his mind for issuing process. Section 204 of the Code begins with the words "if in the opinion of the Magistrate taking cognisance of an offence there is sufficient ground for proceeding...." The words "sufficient ground for proceeding" suggest that ground should be made out in the complaint for proceeding against the accused. It is a settled law that at the time of issuing of the process the Magistrate is required to consider only the allegations in the complaint and where allegations in the complaint do not constitute an offence against a person, the complaint is liable to be dismissed.

When the offence relates to a juristic person, it is not sufficient to reproduce the language of Sections 278B and 278C of the IT Act in order to make out a case against directors and/or other officials of a company, partners of a firm and a member of HUF by way of vicarious liability. Specific allegations need to be averred in the complaint against each accused. There were conflicting views of various courts with respect to prosecution of a juristic person when a mandatory imprisonment is prescribed under law. The law is now well settled and accordingly a juristic person can be prosecuted even where a mandatory imprisonment is prescribed. It has been held by the Constitutional bench of the Hon'ble Supreme Court that "there is no immunity to the companies from prosecution merely because the prosecution is in respect of offences for which the punishment prescribed is mandatory imprisonment…".[2] Since the juristic person cannot be sent to jail, it can only be punished with imposition of fine. It has been further held by the Apex Court[3] that "A company / corporation cannot escape liability for a criminal offence, merely because the punishment prescribed is that of imprisonment and fine…"

Limitation

Section 268 under Chapter XXXVI of the Code prescribes the period of limitation for offences having different terms of punishment. However, the period of limitation does not apply to prosecutions under the IT Act in view of Section 2 and Schedule of the Economic Offences (Inapplicability of Limitation) Act, 1974.

Complaint for offences under IT Act and Indian Penal Code, 1860 (hereinafter referred to as the "IPC")

Apart from the prosecution under the provisions of the IT Act, the accused persons can also be tried for offences under IPC in the same trial. There is no bar under the IT Act for such a situation. If it is made out that the accused has also committed an offence under IPC, he can be tried for the same along with the offences under the IT Act. In this regard, Section 280A(2) of the IT Act is relevant. Some of the offences under IPC for which the accused may be tried along with the offences under IT Act can be cheating, forgery and offences under Sections 193 and 228.

Bail

After the accused appears before the Magistrate, he must seek bail under Section 436 or 437 of the Code, as the case may be. Normally, the Court of Magistrate grants bail as the prosecution is launched

2. *Standard Chartered Bank & Ors. vs. Directorate of Enforcement & Ors. [(2005) 4 SCC 530]*
3. *Iridium India Telecom Ltd. vs. Motorola Incorporated & Ors. [(2011) 1 SCC 74]*

only upon collection of the necessary evidence, both documentary and oral. The various factors which may weigh upon the Court while refusing bail or fixing the quantum of bail amount inter alia are the antecedents of the accused, nature of the crime, availability of the accused to face trial/ jumping off the bail and the likelihood of tampering with the evidence. As the evidence collected by the IT department is by and large, documentary in nature, it is very unlikely that the accused would be in a position to tamper with any such evidence. Besides it is a settled position in law that an accused should not be kept in custody by way of punishment.

In a recent case while dealing with a case under Section 498 of IPC and Dowry Prohibition Act, 1961, the Hon'ble Supreme Court[4] issued certain directions to ensure that the accused is not unnecessarily arrested by the police and the Magistrate should not authorise detention casually and mechanically. It has been further held that these directions shall be applicable to all such cases where offence is punishable with imprisonment for a term which may be less than seven years or which may extend to seven years; whether with or without fine.

In the event of the accused getting convicted in the criminal prosecution, he can seek bail under Section 389 of the Code if he wishes to go in appeal against the order of conviction.

Exemption from personal appearance during the proceedings

The accused can seek exemption from personal appearance before the Court either on the respective dates of the hearing or till further orders from the Court (sometimes also termed as permanent exemption) under Section 205 and/or Section 317 of the Code. An accused cannot seek such exemption as a matter of right and it is the judicial discretion of the Court which depends upon facts and circumstances of each case. If the Court feels that personal attendance of the accused is not essential, the Court can dispense with the same. Exemptions are normally granted depending upon the.15 at any stage of the proceedings notwithstanding the grant of such exemption earlier.

Non-cognisable and cognisable offences

Section 2(c) of the Code defines cognizable offence as one where a police officer may, in accordance with the First Schedule of the Code or under any other law for the time being in force, arrest without warrant. Section 2(l) of the Code defines a non-cognisable offence as one where a police officer has no authority to arrest without a warrant. Under Part II of First Schedule of the Code under the caption – 'Classification of offences against other laws', an offence punishable with an imprisonment for less than three years or with fine only is non-cognisable. An offence punishable with an imprisonment for three years and upwards but not more than seven years is cognizable.

From perusal of the various provisions of the IT Act regarding offences and prosecutions, it is seen that the offences under Sections 276B, 276BB, 276C, 276CC, 277 and 278 are punishable with imprisonment which may extend to seven years and with fine. Offence under Section 276CCC is punishable with imprisonment which may extend to three years and fine. In view of Part II of First Schedule of the Code, offences under the aforementioned sections therefore become cognisable. It should however be noted that Section 279A of the IT Act carves out an exception and provides that notwithstanding anything contained in the Code, offences punishable under Sections 276B, 276C, 276CC or 277 or 278 shall be deemed to be non-cognisable within the meaning of the Code. It is pertinent to note that Section 279A does not cover Section 276BB and Section 276CCC under its purview. Consequently offences under Section 276BB nd Section 276CCC can be said be to be cognisable.

It can be seen that prosecution for certain offences under the IT Act require prior sanction. Section 279 of the IT Act requires prior sanction of the Commissioner for prosecution of offences under various sections including Section 276BB. It does not however include Section 276CCC. Section 279A was inserted in the IT Act with effect from October 1, 1975. Section 276BB and Section 276CCC

4. *Arnesh Kumar vs. State of Bihar & Anr. [2014 (3) JBCJ 352 (SC)]*

were inserted in the IT Act with effect from June 1, 1988 and January 1, 1997 respectively. Looking at the scheme of the IT Act, offences punishable with imprisonment even up to seven years are deemed to be non-cognisable under Section 279A. It can therefore be assumed that Section 276BB and Section 276CCC should also be deemed to be non-cognisable. This is further supported by the fact that police has not been given any powers to investigate any offence under IT Act. Further Section 280B of the IT Act provides that a complaint before the Special Court can be made by an authority authorised in that behalf. There is no provision in the IT Act which authorises any IT officer to arrest any person in relation to assessment proceedings or for prosecution of offences unlike the Customs Act, 1962.

The aforesaid provisions of the IT Act when read along with the provisions of the Code raise a serious issue for consideration whether offences under Section 276BB and Section 276CCC of the IT Act are cognisable or not.

Procedure for trial of summons-case and warrant-case

After issuance of the process and service thereof, the accused is required to enter his appearance before the Court and seek bail as mentioned hereinabove. The procedure for trial of the offence shall depend upon the punishment prescribed for the offences alleged in the complaint.

Section 2(x) of the Code defines warrant-case as a case relating to an offence punishable with death, imprisonment for life or imprisonment for a term exceeding two years. Section 2(w) defines a summons-case as a case relating to an offence not being a warrant-case. The IT Act *vide* Section 280C states that offences under Chapter XXII punishable with imprisonment not exceeding two years or with fine or both shall be tried as a summons-case by the Court notwithstanding anything contained in the Code.

Chapter XX of the Code lays down the procedure for trial of summons-case. In a summons-case, upon appearance of the accused, the particulars of offence are stated to the accused and he is called upon by the Court to state whether he pleads guilty or wishes to defend himself. There is no necessity for the Magistrate to frame a formal charge. In case the accused pleads guilty, the Magistrate may record his plea and may in his discretion convict the accused. In the event of the accused not being convicted, the Magistrate shall take all such evidence as the prosecution may produce in its support. The accused shall have the right to cross examine the witnesses produced by the prosecution. The prosecution may conduct re-examination of any witness if necessary. The accused may also enter upon his defence and produce evidence, if he so chooses. Upon consideration of the evidence, the Magistrate will either convict the accused or order an acquittal. The Magistrate can in a summons-case relating to an offence punishable with imprisonment exceeding six months, in the interests of justice, convert the summons-case into a warrant-case and adopt the procedure laid down for a warrant-case and proceed to re-hear the case and may recall any witness who may have been examined.

Chapter XIX of the Code lays down the procedure for trial of warrant-case. The complaints under the IT Act have to be dealt in accordance with the provisions for cases instituted otherwise than on police report beginning with Section 244 of the Code. In a warrant-case, the Court shall proceed to hear the prosecution and take all such evidence as may be produced by it in its support. Upon taking all such evidence, if the Court comes to a conclusion that no case has been made out against the accused, which, if unrebutted would warrant his conviction, the Court shall discharge him. The accused has a right to cross examine the witnesses produced for evidence under Section 244 of the Code. In the event of the accused not being discharged upon the evidence recorded and the Magistrate is of the opinion that the accused has committed an offence, then he shall frame the charge in writing against the accused. Thereupon, the charge shall be explained and read out to the accused and would be asked whether he pleads guilty or wants to be tried. If the accused pleads guilty, the Magistrate may record the plea and may convict him thereon. If the accused wants to be tried or he is not convicted even upon his pleading guilty, he would be given an opportunity to cross examine all or any of

the witnesses who have been earlier examined by the prosecution. In case the accused wishes to cross examine any such witness, they would be called and offered for cross examination and re-examination, if necessary, by the prosecution. Thereafter, the evidence of the remaining witnesses of the prosecution shall be taken. After the evidence of prosecution witnesses is completed, the accused shall enter upon his defence and produce his evidence, if he so chooses. Upon consideration of the evidence, the Magistrate will either convict the accused or order an acquittal.

The major difference between the summons-case and a warrant-case is that the trial under a summons-case is quicker than a warrant-case. Further, it should be noted that framing of a formal charge is mandatory in a warrant-case unlike in a summons-case. In a warrant-case, the accused gets a second opportunity to cross examine the prosecution witnesses, however, in a summons-case the accused gets only one chance to cross examine the prosecution witnesses. The Magistrate can convert a summons-case into a warrant-case in the interests of justice but not vice versa.

In the event of there being more than one offence alleged in the complaint and one of them being triable as a warrant-case, then the trial shall be conducted in accordance with the procedure as applicable to a warrant-case.

It is pertinent to note that during the pendency of criminal proceedings, if the accused is exonerated in the penalty proceedings, then the criminal prosecution based upon the same set of facts is not tenable in law.[5]

Concept of *mens rea*

It is a general principle of criminal jurisprudence that the prosecuting agency has to prove its case. The onus to prove the case lies squarely upon the prosecuting agency. The burden of proof keeps shifting as and when each party to the proceedings discharges its burden pertaining to the evidence. However the statute can create exceptions by virtue of certain presumptions and the burden to prove innocence lies upon the accused. Sections 278D and 278E of the IT Act lay down such presumptions. But these are rebuttable presumptions.

The IT Act by virtue of Section 278E shifts the burden of proof on the accused, contrary to the generally accepted principles of criminal jurisprudence. The Supreme Court followed this principle in *Prakash Nath Khanna & Anr. vs. Commissioner of Income Tax & Anr.*[6] observing that the Court has to presume the existence of culpable mental state and absence of such mental state can be pleaded by an accused as a defence in respect to the act charged as an offence in the prosecution.

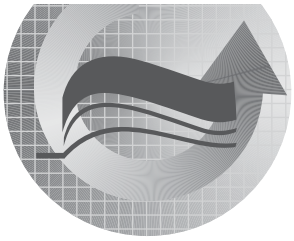
The Supreme Court while interpreting application of provisions of Section 138-A of the Customs Act, 1962 akin to section 278E of IT Act, which deals with presumption of culpable mental state has ruled that Section 138-A is an exception to the general criminal jurisprudence that onus never shifts on the accused[7]. The Hon'ble Supreme Court[8] while interpreting the application of provisions of Section 138-A of the Customs Act, 1962 ruled that the burden of proof lies on the accused to displace the presumption of culpable mental state.

The Apex Court has in *Sasi Enterprises vs. Assistant Commissioner of Income Tax*[9], while dealing with Section 278E with respect to presumption as to culpable mental state held that the "court in prosecution of an offence like Section 276CC has to presume the existence of mens rea and it is for the accused to prove the contrary and that too beyond reasonable doubt".

Conclusion

Criminal prosecution under the IT Act can act as a deterrence in real terms only when the cases are decided expeditiously.

5. *Radheshyam Kejriwal vs. State of West Bengal & Anr., (2011) 3 SCC 581*
6. *(2004) 9 SCC 686*
7. *Bhanabhai Khalpabhai vs. Collector of Customs and Anr., 1994 Supp (2) SCC 143*
8. *Devchand Kalyan Tandel vs. State of Gujarat and Anr., (1996) 6 SCC 255*
9. *(2014) 5 SCC 139*



Case Laws Index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Expenditure incurred for earning exempt income : Guide to law on Section 14A

1. Introduction – Legislative history of section 14A

Section 14A of the Income-tax Act, 1961 (the "Act") was Legislature's response to a host of judicial decisions which did not differentiate between expenditure incurred for earning taxable income and for earning exempt income for the purpose of allowability of expenditure as deduction. To overcome the Supreme Court decision in the case of *Rajasthan State Warehousing Corporation v. CIT [2000] 242 ITR 450 (SC)* wherein it was held that in case of an indivisible business, some income wherefrom is taxable while some exempt, entire expenditure would be permissible deduction and the principle of apportionment would apply only for an indivisible business.

As a result of these decisions, section 14A was enacted vide Finance Act, 2001 w.r.e.f. 1-4-1962, so that net taxable income is actually taxed and no deduction is allowed against taxable income for expenditure incurred in earning exempt income. As per the Memorandum Explaining Provisions of Finance Bill, 2001[1], "expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income."

Sub-sections (2) and (3) of this section were introduced later which along with Rule 8D of the Income-tax Rules, 1962 (the "Rules"), prescribe a method of determining expenditure incurred for earning exempt income.

The constitutional validity of the provisions and that of Rule 8D has been upheld by the Bombay High Court in the case of *Godrej & Boyce Mfg. Co. Limited v. CIT [2010] 328 ITR 81 (Bom.) (HC)* observing that Rule 8D is applicable w.e.f. Assessment Year (AY) 2008-09 and subsequent years.

2. Basic issues and controversies

In practice, it would not be uncommon to see a situation arise where no incremental expenditure has been incurred for earning exempt income or where the amount of expenditure that is actually incurred would not have been any lesser than is even in absence of exempt income. In such a situation, the application of rigours of section 14A may seem harsh and unjustified.

While on one hand, the kind of controversies and problems arising out of section 14A seem to have become more complex, on the other, even the most basic issues keep coming up time and again. The following are some of such basic controversies:

1 [2001] 248 ITR (St.) 162, 196

2.1 Non-recording of satisfaction of the Assessing Officer – Mechanical application of Rule 8D

A plain reading of the provisions of section 14A(2)/ (3)suggests that the disallowance can be made only if the Assessing Officer is satisfied that the amount claimed by the assessees incurred for earning exempt income is not correct. Furthermore, such satisfaction is to be arrived at from the accounts of the assessee. This position is also clear from the Memorandum explaining provisions of Finance Bill, 2006[2].

The following are some important decisions wherein the above proposition was laid down:

- *Maxopp Investment Ltd. & Ors. v. CIT [2011] 347 ITR 272 (Del.) (HC)* – The requirement of the AO embarking upon a determination of the amount of expenditure incurred in relation to exempt income would be triggered only if AO returns a finding that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure [AYs. 1998-99 to 2005-06].

A similar view was also taken in the following cases by the Income-tax Appellate Tribunal (the "Tribunal"/ ITAT):

- *Kodak India Pvt. Ltd. v. ACIT [2013] 155 TTJ 697 (Mum.)(Trib.) [AY 2008-09];*
- *JK Investors (Bombay) Limited (Mum.) (Trib.) (www.itatonline.org) [AY 2008-09];*
- *Auchtel Products Limited v. ACIT [2012] 52 SOT 39 (Mum.) (Trib.) [AY 2003-04, 2007-08, 2008-09];*
- *Priya Exhibitors Pvt. Ltd. v. ACIT [2012] 54 SOT 356 (Del.) (Trib.) [AY 2008-09];*
- *DCIT v. REI Agro Ltd. (Kol.) (Trib.) (www.itatonline.org) [AY 2009-10].* This decision has been upheld by the Calcutta High Court in GA 3022 of 2013 dated 23/12/2013 (www.itatonline.org);
- *ACIT v. Iqbal M. Chagla (Mum.) (Trib.) (www.itatonline.org) [AY 2009-10].*

2.2 Assessing Officer to show how Assessee's computation is incorrect

In many cases, assessees offer a suo motu sum as disallowance under section 14A. The principles of natural justice require that the Assessing Officer to first show how such computation is incorrect before proceeding tore-compute the disallowance. Such a view has been taken in the following cases:

- *Kalyani Steels Ltd. v. Addtl. CIT (Pune) (Trib.) (www.itatonline.org) [AY 2008-09];*
- *Priya Exhibitors Pvt. Ltd v. ACIT [2012] 54 SOT 356 (Del.) (Trib.) [AY 2008-09].*

Therefore, it becomes imperative on the Assessing Officer to first show how the suo motu disallowance, if any, offered or the claim that no expenditure is incurred for earning exempt income is incorrect and to record satisfaction as regards incorrectness of the claim of the assessee. If the same is not done, assessees would be well advised to mention this in the Statement of Facts and take specific grounds in the Grounds of Appeal to be filed before the First Appellate Authority, if they prefer an appeal.

2.3 Expenditure must be claimed as deduction

Section 14A is a "disallowance" provision and not an "addition" provision. This means before invoking it, the impugned expenditure must be claimed as deduction in the first place. This is based on the simple proposition that what has not been claimed as deduction cannot be disallowed. A similar view was taken in the following case:

2 [2006] 281 ITR (St.) 178, 190

– *CIT v. Hero Cycles Ltd. [2010] 323 ITR 518 (P&H) (HC)* – Where it is found that for earning exempted income no expenditure has been incurred, disallowance under section 14A cannot stand [AY 2004-05];

– *Modern Info Technology P. Ltd. v. ITO (Del.) (Trib.) (www.itatonline.org) [AY 2009-10];*

– *Relaxo Footwears Ltd. v. ACIT [2012] 50 SOT 102 (Del.) (Trib.) [AY 2008-09].*

As a corollary to this proposition, the disallowance computed in accordance with Rule 8D cannot also exceed the total expenditure claimed as deduction, as was held in the case of:

– Iqbal M. Chagla (supra) – Disallowance of ` 16.35 lakhs as against expenditure of ` 13 lakhs claimed by the assessee in P&L account is not justified.

2.4 Nexus of expenditure with exempt income

In the following decisions, it was held that there should be a proximate relationship between the expenditure and exempt income:

– *CIT v. Hero Cycles Ltd. (supra)* – In the absence of nexus of expenditure incurred and the income generated, disallowance cannot be made [AY 2004-05];

– *Justice Sam P. Bharucha v. Addl. CIT [2012] 53 SOT 192 (Mum.) (Trib.) (URO) [AY 2008-09];*

– *DCIT v. M/s Allied Investments Housing P Ltd. (Chennai) (Trib.) (www.itatonline.org) [AY 2009-10]*

3. Recent issues and controversies in section 14A

The law on section 14A has evolved over the last 14 years and complex issues have arisen out of its application. Following are some of the recent issues that have arisen in this provision:

3.1 Disallowance in absence of exempt income

The intention of section 14A is to disallow expenditure incurred in relation to income which does not form part of total income (i.e., exempt income). Therefore, it seems only logical that unless there is exempt income in a particular year, section 14A should not trigger for that year. However, the Delhi Special Bench of the Tribunal, in *Cheminvest Ltd. v. ITO [2009] 121 ITD 318 (Del.) (Trib.) (SB)*, took a view that when the expenditure is incurred in relation to exempt income, it has to suffer disallowance irrespective of the fact whether any exempt income is earned by the assessee or not. This also prompted the Board to issue a Circular No. 5/2014 dated 11-2-2014 reiterating the view of the Special Bench.

However, subsequently, in the following cases, various High Courts have taken a view that unless there is exempt income in a year, no disallowance under section 14A can be made for that year:

– *CIT v. Lakhani Marketing, ITA No. 970/2008 (www.itatonline.org) (P&H) (HC);*

– *CIT v. Shivam Motors (P) Ltd., ITA No. 88/2014 (www.itatonline.org) (All.) (HC)*

– *CIT v. Cortech Energy Pvt. Ltd., TA No. 239 of 2014 (www.itatonline.org) (Guj.) (HC)*

– *CIT v. Delite Enterprises, ITA No. 110/2009 (www.itatonline.org) (Bom.) (HC)*

Following the above High Court decisions, the Chennai bench of the Tribunal in *ACIT v. M. Baskaran (Chennai) (Trib.) (www.itatonline.org)* held that the Delhi Special Bench decision of Cheminvest Ltd. (supra) and Circular No. 5/2014 dated 11-2-2014 (supra) are no more good law.

Thus, the current legal position is that no disallowance under section 14A should be made for a year in the absence of exempt income.

3.2 Applicability to income for which deductions available under Chapter VI-A/ profit-linked exemption provisions

Allowability of expenditure incurred for earning income for which deductions are available under Chapter VI-A by virtue of which no tax is payable (either in whole or in part) on them is discussed, among others, in the following cases:

– *Punjab State Co-operative Milk Producer Federation Ltd. v. ITO [2007] 104 ITD 408 (Chd.) (Trib.)* – Section 14A is applicable even in respect of the incomes which are excluded from total income by virtue of deductions under Chapter VI-A [AY 2002-03].

Contrary view

– *Infosys Technologies Ltd. v. JCIT [2007] 109 TTJ 631 (Bang.) (Trib.)* – Section 14A would not be applicable to a deduction under section 80G as it is limited in its operation to Chapter IV only whereas deduction under section 80G falls under Chapter VI-A and donation made does not constitute expenditure [AY 1998-99];

– *ACIT v. Tamil Nadu Silk Producers Federation Ltd. [2007] 105 ITD 623 (Chennai) (Trib.) [AY 1996-97, 1997-98 and 1999-2000].*

In our opinion, the decision of Bangalore Tribunal and Chennai Tribunal is better view because albeit in both situations (i.e. exempt income and income deductible under Chapter VI-A), the assessee would not have to pay tax, one of the fundamental differences between exempt income and income for which deduction is available under Chapter VI-A is that while the former type of income does not even enter the computation, the latter income enters the computation but is deductible under special provisions and section 14A deals only with the former type of income. Such a view is supported by the following decisions:

– *CIT v. King Exports [2009] 319 ITR 100 (P&H) (HC);*

– *CIT v. KRIBHCO [2012] 349 ITR 618 (Del.) (HC)*

3.3 Applicability to shares held as stock-in-trade

Shares in a company can be held either as capital assets (i.e., as investment) or as stock-in-trade. If the same are held as stock-in-trade, their sale is not exempt from tax. The only exempt income from such shares can be in the form of dividend.

In the latest case of *D. H. Securities Pvt. Ltd. v. DCIT [2014] 146 ITD 1 (Mum.) (TM)*, the Third Member bench of the Tribunal held that section 14A r.w. Rule 8D disallowance can be made in respect of tax-free securities held as stock-in-trade. This view was taken following the decisions in *ITO v. Daga Capital Management (P) Ltd. [2009] 117 ITD 169 (Mum.) (SB).* The Bombay High Court has admitted an appeal against the Special Bench decision in case of *Daga Capital Management (P) Ltd. (supra)* vide order dated 1-7-2009 in Income Tax Appeal No. 989 of 2009 while the appeal against the decision in D. H. Securities Pvt. Ltd. (supra) is pending admission before the Bombay High Court in ITXA/1233/2014.

However, in the case of *DCIT v. Damani Estates & Finance Pvt. Ltd. [2014] 41 taxmann.com 462 (Mum.) (Trib.)*, since share trading was found to be the dominant objective of the assessee and shares were held as stock-in-trade, disallowance of interest was restricted to 20% of the amount computed u/r. 8D(2)(ii).

3.3.1 Authors' views

The Tribunal, in D. H. Securities Pvt. Ltd. (supra) followed the jurisdictional High Court in the case of Godrej & Boyce Mfg. Co. Limited (supra) while coming to the conclusion that section 14A is applicable to shares held as stock-in-trade as well. However, this was not the issue before the jurisdictional High Court. A judgment ought to be read as a whole and the observations from the judgment have to be considered in the light of the questions which were before the Court[3].

3 CIT v. Engineering Works (P) Ltd. [1992] 198 ITR 297 (SC)

In view of the decisions of non-jurisdictional High Courts *{CCI Ltd. v. JCIT [2012] 206 Taxman 563 (Kar.) (HC) & CIT v. Smt. Leena Ramachandran [2011] 339 ITR 293 (Ker.) (HC)}* on the issue, the same ought to have been followed[4] as was done in the following cases:

– *DCIT v. M/s India Advantage Securities Ltd. (Mum.) (Trib.) (www.itatonline.org) [AY 2008-09];*

– *Vivek Mehrotra v. ACIT (Mum.) (Trib.) (www.itatonline.org) [AY 2008-09].*

Considering that this issue is affecting a large number of assessees, it is desirable that the Bombay High Court decides the appeal in case of Daga Capital Management (P) Ltd. (supra) at the earliest to bring some certainty on the issue.

3.4 Investment in shares of foreign companies

Dividend received on shares held in foreign companies is not exempt from tax in India as such companies are not required to pay dividend distribution tax in accordance with section 115-O. Also, the profit/gain on their sale is also not exempt from tax under section 10. Thus, such shares (whether held as investment or stock-in-trade) neither earn nor are capable of earning exempt income for the holder. Therefore, section 14A should not apply in such cases as was held in the following cases:

– *CIT v. Suzlon Energy Ltd. [2013] 354 ITR 630 (Guj.) (HC)*

– *Birla Group Holdings Ltd. v. DCIT [2007] 13 SOT 642 (Mum.) (Trib.)*

– *ITO v. Strides Acrolab Ltd. [2012] 138 ITD 323 (Mum.) (Trib.)*

Similarly, dividend on preference shares is also taxable. Hence, interest incurred for making investment in preference shares is also allowable – *ACIT v. Tellicherry Co-op Hospital Society Ltd., ITA No. 404/Coch/2013, dated 4-4-2014 (Coch.) ITAT) [AY 2008-09].*

3.5 Investment in mutual funds or in short term investments

Sundaram Asset Management Co. Ltd. v. DCIT [2013] 145 ITD 17 (Chennai) (Trib.) – Held, some of the investments made by the assessee are short-term. Since assessee was paying capital gains tax on short term investments, Rule 8D will not apply on them and the AO was directed to recompute disallowance u/s 14A read with Rule 8D after excluding short-term investments [AY 2008-09].

As regards units in a mutual fund, they are normally held as investment and not stock-in-trade. Whether the provisions of section 14A can be applied in such cases would depend on the nature of mutual fund units. In case of investment in liquid fund or debt fund mutual funds, since both the gains from sale and dividend are taxable, section 14A should not be applicable.

3.6 Considering only those investments which derive exempt income

Sarabhai Holdings Pvt. Ltd. v. ACIT, ITA No. 2328/Ahd/2012, dated 11-4-2014 (Ahm.) (Trib.) – Only average of value of investment from which exempt income has been earned is to be considered and not total investment at beginning of year and at end of year in disallowing administrative expenses [AY 2009-10].

3.7 Investment due to commercial expediency – whether a relevant factor

EIH Associated Hotels Ltd. v. DCIT (Chennai) (Trib.) (www.itatonline.org) – Investments made by the assessee in the subsidiary company were not on account of investment for earning capital gains or dividend income. Such investments had been made by the assessee to promote subsidiary company into the hotel industry and were on account of business expediency and dividend therefrom is purely incidental. Therefore, the investment made by the assessee in its subsidiary are not to be reckoned for disallowance u/s 14A r.w.r. 8D [AY 2008-09].

4 Nanubhai D. Desai v. ACIT [2014] 104 DTR 1 (Ahm.) (Trib.) (SB)

Other decisions on the issue: *CIT v. Oriental Structural Engineers Pvt. Ltd. (Del.) (HC) (www.itatonline.org), JM Financial Ltd. v. ACIT (Mum.) (Trib.) (www.itatonline.org) [AY 2009-10].*

3.8 Investment in subsidiary and for acquiring controlling interest/ strategic investment

Interglobe Enterprises Ltd. v. DCIT (Del.) (Trib.) (www.itatonline.org) [AY 2008-09 & 2009-10] - Assessee had utilised interest free funds for making fresh investments and that too into its subsidiaries which were not for the purpose of earning exempt income but for strategic purposes only. No disallowance of interest is required to be made under rules 8D(i) & 8D(ii) as no direct or indirect interest expenditure has incurred for making investments. Strategic investment has to be excluded for the purpose of arriving at disallowance under Rule 8D(iii).

Other favourable decisions on the issue: *Garware Wall Ropes Ltd. v. ACIT (Mum.) (Trib.) (www.itatonline.org) [AY 2009-10].*

3.9 Applicability to profit share from partnership firm

Share in partnership firm is exempt from tax under section 10(2A). Therefore, expenditure incurred for earning such exempt income may be disallowed as deduction. In the following decision, among others, this view was taken:

– *Vishnu Anant Mahajan v. ACIT [2012] 137 ITD 189 (Ahd.) (SB)* – Any expenditure incurred in earning the share income will have to be disallowed [AY 2006-07].

The contrary decisions on the issue viz. Shri Sudhir Kapadia v. ITO and Hitesh D. Gajaria v. ACIT are no more good law on this issue.

3.10 Whether net interest can be considered for computing disallowance under Rule 8D(2)(ii)

ITO v. Karnavati Petrochem Pvt. Ltd. (Ahm.) (Trib.) (www.itatonline.org) - As the interest income was more than interest expense and the assessee was having net positive interest income, the interest expenditure cannot be considered for disallowance u/s 14A and Rule 8D [AY 2008-09].

Sitsons India (P) Ltd. v. ACIT [2014] 63 SOT 37 (Mum.) (Trib.) (URO) – On facts, the interest income was held to be received from bank deposit, while interest payment is made to directors and not against any bank loan. Hence, in the absence of any nexus, the contention of netting off interest was rejected [AY 2008-09].

4. Other complex issues

4.1 Section 14A and presumptive taxation

4.1.1 Tonnage tax scheme

Varun Shipping Company Ltd. v. ACIT [2012] 134 ITD 339 (Mum.) (Trib.) – When income of the assessee from the business of operating ships is computed as per the special provisions of Chapter XII-G, any expenditure other than the expenditure incurred for the purpose of the said business cannot be said to have been allowed and consequently no addition to income so computed can be made by way of disallowance under section 14A on account of expenditure incurred by the assessee in relation to earning of exempt dividend income. If at all the assessee has claimed any such expenditure in computation of profits of business of shipping, the same are to be taken as disallowed when the income of the said business is finally computed in accordance with the provisions of Chapter XII-G and no separate disallowance on account of such expenditure under section 14A can be made [AY 2008-09].

4.1.2 Insurance business

Oriental Insurance Co. Ltd. v. ACIT [2010] 130 TTJ 388 (Del.) (Trib.) – In case of an insurance company, it is not permissible to the AO to travel beyond section 44 and Schedule I and make disallowance by applying section 14A.

4.1.3 Authors' views

In our view, this analogy can also be applied when an assessee offers income under sections 44AD, 44AE and 44AF.

4.2 Interest capitalised and not claimed as deduction

When interest cost is capitalised and not claimed as deduction, same cannot be considered for disallowance under section 14A – *ITO v. M/s Arihant Advertising Pvt Ltd, ITA No. 2750/Del/2011, dated 21-9-2012 (Del.) (Trib.) [AY 2007-08].*

4.3 Power of enhancement when the matter is set aside by the Tribunal to the file of the Assessing Officer

While the First Appellate Authority has the power of enhancement, the Tribunal does not have such powers[5]. Therefore, once a matter has been set aside by the Tribunal to the Assessing Officer, the assessee cannot be put in a worse off situation than he was earlier[6].

Thus, once a matter is set aside by the tribunal to the file of the Assessing Officer for redetermination of the amount of disallowance under section 14A, the Assessing Officer has no power of enhancement.

4.4 Can a method other than the one prescribed under Rule 8D be adopted if the same results in better estimation of expenditure incurred for earning exempt income

The objective of section 14A and Rule 8D are that net income is actually taxed. In our view, this objective should always be kept in mind while computing the disallowance. A reasonable disallowance, if results in more accurate estimation of such expenditure should be adopted. Similarly, if computation in accordance with Rule 8D results in manifestly unreasonable disallowance, the same should, in our view, be eschewed. In the case of *Ramkumar Venugopal Investments Pvt. Ltd. v. ACIT (Mum.) (Trib.) (www.itatonline.org) [AY 2009-10]*, the Tribunal restricted the disallowance as computed by the lower authorities under Rules 8D(2)(ii) and (iii) to 5% and 10% of the amounts respectively as the same resulted in a better and fair estimation of the expenditure to be disallowed under section 14A. The decision in the case of Damani Estates & Finance Pvt. Ltd. (supra) also merits consideration in this regard.

However, in the case of *Joint Investment Pvt. Ltd. v. ACIT, ITA No. 785/Del/2013 dated 6-6-2014 (Del.) (Trib.) [AY 2009-10]*, the Tribunal held that the word "shall" in section 14A(2) makes it mandatory for the Assessing Officer to determine the amount of expenditure incurred in relation to exempt income as per the prescribed method i.e. Rule 8D.

5. Interplay between section 14A and other provisions

5.1 Revision of assessment under section 263

Decisions in favour of the assessee

CIT v. Galileo India (P) Ltd. [2014] 220 Taxman 115 (Mag.) (Del.) (HC) – The CIT passed order u/s 263 and recorded that the AO should have conducted further inquiries and correct disallowance should have been made under Section 14A read with Rule 8D. Held, an order is not erroneous, unless the CIT holds and records reasons why it is erroneous [AY 2006-07].

DLF Ltd. v. CIT [2009] 27 SOT 22 (Del.) (Trib.) – There being no specific finding by CIT to the effect that any particular expenditure was incurred for earning dividend income exempt under s. 10(33), he was not justified in his revisional jurisdiction under s. 263 in asking the AO to make enquiry and find out of common expenses, which could be disallowed under s. 14A on proportionate basis [AY 2002-03]. This

5 Mcorp Global (P) Ltd. v. CIT [2009] 309 ITR 434 (SC)

6 Kellogg India Pvt. Ltd. v. ACIT (Mum.) (Trib.) (www.itatonline.org)

decision is upheld in *CIT v. DLF Ltd. [2013] 350 ITR 555 (Del.) (HC).*

Similar view was taken in *CIT v. Land T Infrastructure Development Projects Ltd. [2013] 357 ITR 763 (Mad.) (HC).*

Decisions in favour of the Revenue

CIT v. RKBK Fiscal Services P Ltd. [2013] 358 ITR 228 (Cal.) (HC) – Revision of order u/s 263 on account of no disallowance being made by AO u/s 14A was valid.

CIT v. Goetze (India) Ltd. [2014] 361 ITR 505 (Del.) (HC) – Revision order u/s 263 was held justified as the AO made error in computing income u/s.115JA and also failed to apply s.14A [AY 2000-01 to 2001-02].

Jammu & Kashmir Bank Ltd. v. ACIT [2009] 118 ITD 146 (Amr.)(Trib.) – AO having allowed exemption under ss. 10(15), 10(23G) and 10(33) without even considering the applicability of s. 14A, his order was erroneous as also prejudicial to interests of Revenue, hence rightly set aside by CIT in exercise of revisional jurisdiction. The total investment for earning such income must be more than 300 crores. An enquiry and examination was required to be made by the AO at the time of completing the assessment as regards disallowance under s. 14A [AY 2002-03].

5.2 Reassessment under section 148

CIT v. P.G. Foils Ltd. [2013] 356 ITR 594 (Guj.) (HC) – The AO reopened assessment by issuing notice u/s 148 recording three reasons. Two of such reasons pertained to extent of earnings exempt from Income-tax, which Revenue contended should have been disallowed u/s 14A. The CIT(A) as well as the Tribunal held that both issues were examined by AO in original assessment. Held, CIT(A) noted that AO had raised several queries with respect to those issues. Thus, Tribunal correctly held that any attempt on part of AO to re-examine such issues would only amount to change of opinion [AY 2008-09].

CIT v. Dhanalakshmi Bank Ltd. [2013] 357 ITR 448 (Ker.) (HC) – By virtue of proviso to s. 14A, there is no justification to make reassessment u/s 147 for any AY prior to AY 2001-02.

Reckitt Benckiser Healthcare India Ltd. v. ACIT [2013] 216 Taxman 209 (Guj.)(HC) – Since the entire issue pertaining to disallowance of expenditure under s. 14A was scrutinised by Assessing Officer during original assessment proceedings, reopening of assessment to make disallowance of such expenditure on basis of formula provided in rule 8D would amount to change of opinion, and hence, bad in law [AY 2007-08].

Similar issue was decided in favour of the assessee in *ACIT v. Sterling Infotech Ltd. [2013] 59 SOT 19 (Chennai) (Trib.) (URO)* [reopening beyond four years].

5.3 Computation of book profits under section 115JB

Time Technoplast Ltd v. Addl. CIT, ITA No. 8126, 7576/M/2011, dated 2-1-2014 (ITAT Mumbai), Godrej Consumer Products Limited v. Addtl.CIT [2014] 159 TTJ 21 (Mum.)(Trib.), ITO v. RBK Share Broking (P) Ltd. [2013] 60 SOT 61 (Mum.)(Trib.) (URO), Dabur India Ltd. v. ACIT [2013] 145 ITD 175 (Mum.) (Trib.) etc. – Amount of expenditure disallowable under section 14A was to be added back while computing book profit under clause (f) of Explanation (1) to section 115JB.

5.4 Section 14A and section 10B

Sandoz P. Ltd. v. DCIT [2013] 145 ITD 551 (Mum.) (Trib.) - Provisions of section 14A are not attracted in the case of the unit suffering losses eligible for deduction under section 10B and further the assessee is entitled to set off of loss of STP unit under section 10B against other business income [AY 2008-09].

5.5 Penalty under section 271(1)(c)

Sunash Investment Co. Ltd. v. ACIT [2007] 14 SOT 80 (Mum.) (Trib.) – When assessee claimed deduction of interest on borrowed funds which

were invested in the financing business as well as purchase of shares of group companies under bona fide belief that such interest was deductible in entirety in view of some judicial pronouncements, it cannot be said that the assessee is guilty of concealment or furnishing of inaccurate particulars of income. Held, penalty under s. 271(1)(c) was not leviable [AY 1998-99].

CIT v. Liquid Investment and Trading Co. [ITA 240/2009 dated 5-10-2010 – Delhi HC] – Disallowance u/s 14A of the Act was a debatable issue. Also, High Court had admitted the appeal of the assessee on quantum. Hence, penalty was not leviable.

Skill Infrastructure Ltd. v. ACIT [2013] 157 TTJ 565 (Mum.)(Trib.) – Disallowance u/s 14A does not call for penalty.

6. Relevant factors to be pointed out by assessee against invocation of section 14A and Rule 8D

In the case of *AFL Private Limited [2013] 60 SOT 63 (Mum.) (Trib.)*, it was held that onus to prove that expenditure has been incurred for the purpose of earning taxable income is on the assessee. A similar view was taken in the case of *CIT v. Deepak Mittal [2014] 361 ITR 131 (P&H) (HC)*.

In any case, the onus to substantiate claims made in the return of income is always on the assessee.

The fact whether a particular expenditure is incurred in relation to exempt income or in relation to taxable income is essentially a question of fact. Therefore, the submission against disallowance under these provisions should be on facts. The following factors may be pointed out by the assessee before the Assessing Officer against the disallowance:

– Establishing nexus of loans with taxable income/ business can help minimise disallowance under clause (ii) of Rule 8D(2) – *CIT v. Ms. Sushma Kapoor [2009] 319 ITR 299 (Del.) (HC), ITO v. Narain Prasad Dalamia [2014] 30 ITR (T) 619 (Kol.) (Trib.), ACIT vs. Best & Crompton Engineering Ltd. [2013] 60 SOT 53 (Chennai) (Trib.) (URO) etc.*

- In case of secured loans from banks, this can be done with the help of "purpose of loan clause" in loan agreements. *Interglobe Enterprises Ltd. v. DCIT (supra)* – One of the factors that found favour with the Tribunal was that most of the interest bearing loans were vehicle loans and not for making tax-free investment.
- In case of unsecured loans from non-institutional lenders, it is advisable that the assessee enters into a loan agreement and mentions the purpose of taking loan in the agreement and utilises the loan for that purpose;
- Apart from the above, sufficiency of own funds for the purpose of making investments would be an important factor – *CIT v. HDFC Bank Ltd. [2014] 366 ITR 505 (Bom.) (HC)*

  – Other decisions on sufficiency of own funds/interest-free funds:

    CIT v. Torrent Power Ltd. [2014] 363 ITR 474 (Guj.) (HC), DIT v. BNP Paribas SA [2013] 214Taxman 548 (Bom.) (HC), CIT v. UTI Bank Ltd. [2013] 215 Taxman 8 (Mag.) (Guj.) (HC),CIT v. Reliance Utilities & Power Ltd. [2009] 313 ITR 340 (Mum.)(Trib.), Sharekhan Financial Services (P) Ltd. v. ACIT, ITA No. 5861/M/2011, dated 20-8-2014 [AY 2008-09] etc.

- If some portion of interest is already disallowed under some

other provisions of the Act such as section 36(1)(iii) or section 40(a)(ia), the assessee may request for exclusion of the such interest from computation of disallowance under Rule 8D(2)(ii).

- Against the disallowance of administrative expenditure under Rule 8D(2)(iii), the assessee must give submissions in respect of each item of expenditure and establish how it was incurred for the purpose of taxable income/ business only.
- Reasonable bifurcation of expenditure such as electricity expenses, salary, etc. as incurred towards exempt income and taxable income (depending on facts of each case) can be given.
- An individual-assessee may establish nexus of expenditure incurred for earning exempt income with drawings to show that such expenditure has not been claimed as expenditure.
- Separation of accounts for taxable business and other business.

In the case of Iqbal M. Chagla (supra), it was held that since the assessee had not claimed any expenditure in its P&L account as incurred for earning exempt income, the onus was on the Assessing Officer to prove that the expenditure incurred under various heads were related to earning of exempt income. This decision of the Tribunal is contrary to that in the case of AFL Private Limited (supra). However, after discharging the initial onus in the manner stated above, the burden of proof may shift on to the Assessing Officer and the decision in the case of Iqbal M. Chagla (supra) should come to the aid of the assessee.

7. Authors' views

In recent times, it is seen that injudicious invocation of these provisions has become a cause of serious harassment for tax payers resulting in increased litigation.

While the purpose of introducing the provisions of section 14A was to ensure that net income is actually taxed and no expenditure incurred for earning exempt income is claimed as deduction from business income, the blanket application of this section read with Rule 8D often results in a situation wherein even expenditure incurred for earning taxable income is disallowed. It is not uncommon to see a notional/estimated disallowance computed by the Assessing Officer exceeding the amount of exempt income by multifold times or the disallowance so computed exceeding the total expenditure of the assessee.

The purpose of introduction of sections 10(34), 10(35) and 10(38) was to promote investment into Indian companies (directly or via mutual funds) by exempting dividends and capital gains upon their sale in certain circumstances, However, considering the amount of disallowance under section 14A that can follow the receipt of such exempt income, an assessee would only be constrained to observe that the Assessing Officer takes by one hand what the Legislature has given by the other.

It is the need of the hour for the Legislature to step in and carry out necessary amendments to prevent misuse of the provisions of section 14A of the Act. While in cases where the Assessing Officer is able to demonstrate nexus of expenditure with non-taxable business of the assessee, the actual amount of such expenditure (irrespective of the amount) should be disallowed under section 14A, in cases where Rule 8D is applied by the Assessing Officer for want of satisfaction with the correctness of the claim of the assessee as regards such expenditure, the introduction of the following proviso in Rule 8D may curtail litigation in this regard:

"Provided that where such expenditure determined in accordance with sub-rule (2) exceeds the amount of income which does not form part of the total income under the Act, then, such excess shall be ignored."

Kshitij Sharma

The Democratic Project of India !!

I. Introduction

It is an election year in India and election fervor is already high among us: the argumentative Indians! The parodies are being made; leaders of parties are busy in sending diatribes, some of which in imagination even exceed those which were used by Shishupala in reference to the Krishna. It is a common feature nowadays in Indian T.V. shows to see leaders of various political parties engaging in calling one another as authoritarian, dictators and the list goes on. This makes me wonder, what is so inherently wrong with the dictatorship, monarchies and how come, and democracy has become the talk of the town which everyone wants to claim? Why is an authoritarian tendency bad? What is so good about democracy?

In fact, if we look at authoritarian governments, they tend, many a times to have a better economic performance than their democratic counterparts,[1] and they often have ensured better living standards for their people[2], then why is this clamour for the democracy which cannot even raise the basic standards of living for people. In fact, in short run, it has been shown to have lowered the living standards of the people.[3]

It raises a very important question: Why should we have democracy after all? In fact most of the people just accept it as a self evident truth that democracy is the best form of the Government but never ask why. This is the aim of the present essay to look into the conjuncture that the democracy is the best possible form of the Government for India and I would be supporting the conjuncture that the democracy is indeed the best form of the Government for the India.

II. The structure of the essay

In the present essay, I will first venture to define what democracy is and then proceed towards a claim that democracy is indeed the best form of Government for India. I would start by listing various reasons why democracy has been

1 Take the comparison between the economic performance of democratic India and authoritarian China. See: Amartya Sen, 'Why India Trails China', New York Times, June 19, 2013.

2 Contrast the standards of the water available between India and China. In fact, many authoritarian governments such as that of South Korea (in its initial years) and Singapore have succeeded in ensuring the better standards for their people through authoritarianism. See Economic Development and Authoritarianism: A case study, Ann Sasa List Jensen, DIIPER Research Series, Working Paper No. 5, ISSN: 1902-8679

3 It is due to the fact that as new democracies tend to pass legislations favouring poor, they impose various restrictions on rich people such as higher taxes of their property may be confiscated (such as various Land Acts and Tenancy Acts in India). This leads to the flight of the capital from the countries which have newly turned democratic.

effective for India and serves its idea more than anything else. After listing the various reasons and looking at the situations which would have been there in the absence of the democracy, I would conclude my essay on how to improve the democracy of India so that we can utilise the potential of the country to an even bigger extent. I will also simultaneously draw comparisons with other forms of the Government such as monarchy, dictatorship, authoritarian, theocracy etc. During the course of the essay, it would be my attempt to establish that India would not have been what it is at present if the democracy would not have been there; rather it would have been much worse off!!

III. The idea of India: An essentially democratic one!!

What does India stand for? What is that which characterise India and imparts it a distinct personality in whole of the nations? In short, I want to ask an important question: what is the idea of India and what does it stand for?

If we go back in the past, we observed that India existed as a British colony which was encompassing within it, far more territorial units what it is having now. It consisted of parts of Afghanistan, Burma, and Sri Lanka etc. But in the course of times, these all parts got separated and took their separate identities. Pakistan was supposed to be for the Muslims[4], Sri Lanka for the Sinhalese people, Burma was for some other community, but what was India for? Here is what I believe: India was for those people who believed that the magic of democracy can unite them and that they can live together even when they have their differences in terms of religion, languages and castes. For India to survive a power sharing arrangement was of utmost necessity and there was no better contender than democracy. The phenomenon of granting universal franchise to everyone from the first elections itself had been termed as ***'one of the biggest gambles[5]'*** but in reality, there was no other choice India had to be democratic as that is what it stood for, that is why India resisted the British rule at the first place, as the British had not wrested the final decision making powers in the hands of the Indians. India was meant to be a place *where an argumentative Indian can finally settle in peace*, *a place where synthesis of many cultures can take place in peace with one another without endangering one another and where the people will write by themselves on the slate of future.*

That's way what I conjecture is that there is no India without the democracy. India was there 2000 years ago, it was there 500 years ago and was there 100 years ago also but it was not what the modern India is: it was not democratic!! Maybe it was rich, but for whom? Nawab of Hyderabad was considered to be the richest man of the world[6] but what about the general public of the Hyderabad? What about the general public residing in the regions being governed by the Mughal Mansabdars, who are said to be the highest salaried persons of that time.[7] Was that India? Yes in the sense that the territory being governed was to quite a large extent the same only, but what differentiated it from the modern India is **that it did not have the voice of the poor as the voice which will decide who the ruler would be?** People in those times did not have independence and freedom to criticise their rulers, they did not have freedom to criticise the existing policies of the Government and in those periods, and they had no recourse to the legal systems which treats everyone with equality regardless of their castes, religions or region.

4 Although later on that proved to be a farce as Bangladesh separated from it leaving Pakistanis to grapple till this date: What is their identity?

5 The Biggest Gamble in History, India After Gandhi, Ramchandra Guha, Page 147, Picador India, New Delhi, 2011

6 Mirror News, 'The Last Nizam of Hyderabad was so rich that he had a 50 million $ Paperweight!', April 15, 2008. Available at < http://www.mirror.co.uk/news/uk-news/exclusive-the-last-nizam-of-hyderabad-was-so- rich-302814>

7 Abraham Eraly, 'The Mughal World: Life in India's last golden age', Chapter 3: Living and Partly Living; Penguin Books, New Delhi, 2007

Thus in my view, the idea of India is itself a democratic one. India was conceived as a great democratic project by our constitutional forefathers where people having divergent views can reside with one another to create a great egalitarian society. Its distinctness lies in it being a democratic one, it identity is a democratic identity and it will 'shatter away like a glass does on falling if it is made devoid of 'democracy'. It won't be able to survive on its own and will certainly crumble like a three legged stool does when one of its legs breaks apart.

As it has been stated by Abraham Lincoln that: *"As I would not be a slave, so I would not be a master. This expresses my idea of democracy."*

The democracy by its very definition is democratic in nature. It enables people from very diverse backgrounds and different set of opinions to arrive at a compromise for the betterment of their interest which ultimately results in the betterment of the nation as a collective whole.

IV. Democracy promotes the Unity of India: Enabling different voices to come and decide for themselves!!

A good way to start analysing the correlation between the democracy and the presence of a united strong India is to consider the hypothesis that what would have happened if there would have been no democracy in India. Would India been a more strong nation or would it have withered away, unable to bear the burden of its large size, the diversities which is presented by its sheer mass of people!!

If India would not have been a democracy, it could have been a monarchy or a dictatorship or a one party ruled state authoritarian state or something else. Whatever scenario we may take, the history tells us that these monarchs, dictators or the leaders of one party would have been dominated by the leaders from one or few geographical regions or communities. It is quite certain that they would not have been presenting the diversity which Indian democratic elected representatives present. It is certain that they could not have been speaking a majority of Indian languages, they would not have been practicing a majority of religion as a dictator or monarch can only follow a specific religion, and can come from a specific region only. Thus these dictators/monarchs would have been biased towards their own region, language and religion. They would not have aware about the problems which a common man of India has to face in its daily life. Thus, democracy allows people to voice their concerns to someone who is one of them and lives nearby to them.

It may look like that I'm mixing the democracy with the decentralisation. Although I'm not but even if I'm, the assumption that democracy encourages decentralisation is not an unrealistic one. Democracy and decentralisation may be sounds like two terms but in reality they are two side of a same coin. If one is there, other has to be there by a necessary implication for the survival of another, otherwise the coin will be like that badly minted coin which no one would like to take. Thus democracy and decentralisation go hand in hand and promote survival of one another.[8]

Thus if democracy would not have been there, there would have been some Central Government (assuming that India is still united!!). What disastrous conclusions it would have entailed for the people of India are unimaginable to portray. The people would have been living under the tyranny of the Central Government rule which would have been imposing its dictates over the people of India. In such a satiation, it is certainly possible that people would have had their grievances but no channel to resolve them. This would have made them revolt against the Government which

8 Local democracy, Democratic Decentralization & Rural developments: theories, Challenges and options for policy, Craig Johnson, Development Policy Review, 2001.
Available at < http://r4d.dfid.gov.uk/pdf/outputs/livelihoodsresearch/cjdecentralisation.pdf>

would have endangered the unity of India. Thus the unity of India itself depends on the reason that there is democracy is India which promotes local self governance which does not let people think that they are being governed by some outside power.

India is a country of great diversity having many different cultures synthesised with one another. In fact as a proverb puts this diversity very succinctly, ***"Every two miles the water changes, every four miles the speech".*** These diverse set of people have had a very rich history of their own rulers, their own customs. Thus these people who come from a very rich and diverse linguistic diversity group would not have taken it kindly if some other person who does not speak their language and does not live in their region is governing them and is imposing its own will over them. Needless to say in such a scenario, India would have fragmented in many pieces beyond any recognition such as that what happened in the Balkan region.[9]

In fact these people from very diverse set of background came together only because of the inherent democratic nature of the Indian freedom movement which promised them the local self governance. Thus it is imperative for the unity of India that India remains a democracy. Therefore, it can be said with ease that the India is 'India' only till the time that India is a democracy!!

V. Democracy promotes the rule of law!!

Democracy is a synonym of rule of law. Yes, it may not be a good synonym but what I claim is that it is a much better synonym than any other form of governance possible.[10] The monarchy for example does not recognise the concept of rule of law. For instance, it does not recognise the concept that criminal rules must not be retrospectively applied. In a monarchy whatever the word of the King is, it becomes the law of the land. There cannot be any voice raised against it, nobody has a right to challenge the word of the King. Similar is the example of one party rule such as that of China where there is a co-operative judiciary which violates the basic tenets of the rule of law.[11]

Rules of law empowers powerless people

It is rule of law which provides a tool in the hands of the powerless people to defend themselves and protect their rights. It is the rule of law which ensures that powerful cannot trample over the rights of the powerless. It is in fact the rule of law only which is the best possible guarantee that there would be a more egalitarian society, a less unequal world.[12] Thus, if we our aim is to maximise the happiness of the most of the people of any country, then the easiest way to do so is to ensure the rule of law in a country. Socialistic communist countries in their endeavours to decrease the inequality followed an authoritarian path and there is no need to bring into this essay what was their fate. Thus it is rule of law which ensures that a person can have a redressed of its grievances if they are trampled; it is it which truly empowers people.

Thus, the rule of law and democracy are inextricably interlinked. They go hand in hand to improve the lives of the common ordinary folks which are being discriminated. The

9 Balkan as metaphor: Between Globalization and Fragmentation, D.I. Bjelic & Obrad Savic, MIT Press, 2005

10 Democracy as rule of law, Thompson ayodele, Institute of Public Policy, Lagos. Available at <http://www.ippanigeria.org/2004/2004-7.html>

11 Judicial independence in China, Lessons for Global rule of law promotion, Randall Peerenboom, New York, Cambridge University press, 2010

12 Administrative law, Chapter 2: 'Conceptual Objections against the Growth of administrative law', I.P. Massey, ed. VII, Eastern Book Co., Lucknow, 2008

democracy by ensuring the rule of law ensures the enhancement and enrichment in the quality of the life of people and thus, the democracy is the best possible form of government for India where there are so many poor people and high income inequality.

VI. Democracy ensures the protection of the human rights of all citizens!!

It is a misconception that democracy consists of only the rule by the people, for the people and of the people. It is indeed true that it consists of all these three elements but it cannot be limited to these three basic elements. Rather the democracy contains as a necessary constituent in it, the guarantee that the human rights of all citizens shall be protected and that there shall be a minimum standard of these human rights. American democracy which has the privilege of being the oldest democracy had included this concept of guaranteeing the basic rights of the citizen, after a lot of criticism of the Constitution by the anti-federalists in the form of the Bill of rights.[13] **Thus, there cannot be a democracy which does not believe in the human rights of all the citizens.[14]**

The protection of human rights enables one to live their lives with dignity which is becoming of a human being and thus ensures that the society benefits from the contribution of all its members. It ensures that everyone can participate freely and fully in the growth of the society and the community in which they are living so that it can attain new heights. It gives meaning to one's life as without it, there would be no meaning to life.

Thus it is quite necessary that India should have had a democracy otherwise it would not have taken much time in a highly unequal country like India for few to trample over the human rights of others. Without democracy, there would have been genocides of the population as the Indian subcontinent has a rich diversity of people like no other place. It would not have taken much time in the absence of such a guarantee of the protection of the human rights for such people's lives and other various rights to have got endangered. The democracy by ensuring the human rights of the people is naturally the best possible choice of the Government for India.

VII. Democracy is inherently peaceful in nature: democratic India is desirous of peace

Democracy in India has ushered in an era of peace. Democratic nations in general are more peaceful than compared to the aristocratic ones or other types such as dictatorship etc. It is due to the reason that in a democracy, it is people whose lives are affected by the horrors of wars; it is people whose lives are disrupted.[15] Since in a democracy, people will never want their lives to be disrupted, the leaders in a democratic nation like India will never go on a war of their own. This desire of peace is not limited to the wars which may be externally imposed but manifests it in the internal matters also; for example India deals with insurgencies in a much more peaceful way than compared to any nations practicing other forms of government. The recent example of Syria and Libya are in front of us where the Government unleashed a cycle of terror to suppress the dissent which plunged their nations into a cycle of chaos.[16]

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13 Bill of Rights of the United States of America, Available at < http://billofrightsinstitute.org/founding- documents/bill-of-rights/ >

14 Article 21(3) of the Universal Declaration of the Human Rights. It goes *"The will of the people shall be the basis of the authority of government; this will shall be expressed in periodic and genuine elections which shall be by universal and equal suffrage and shall be held by secret vote or by equivalent free voting procedures."*

15 Alexis de Tocqueville, Democracy in America, Section 3.
Available at < http://xroads.virginia.edu/~Hyper/DETOC/ch3_22.htm >

16 'In Chaos of Syria Conflicts, Kurd's autonomy rests on shaky grounds', M.M. Gunter, World Politics Review, Feb. 3, 2014, Available at < http://www.worldpoliticsreview.com/articles/13541/in-chaos-of-syria- conflict-kurds-autonomy-rests-on-shaky-ground>

Contrast this with that of India. My guess is that no nation had ever to face so many insurgencies in such a short period of time as India had to face. But India has always looked for peaceful means to settle the disputes: whether it is in North East or in Punjab, India has always primarily tried to settle the disputes through conciliation and when they have failed, it has applied the minimum possible force necessary to contain it. Gradually, the insurgents have comes to accept the fault in their reasoning and have often come to talks, the recent example of many Naxalites and insurgents in North East being one.[17]

It is true that India had been engaged in many wars and a menace of terrorism for which it had to deploy a sizeable standing army which it initially was not in favour of.[18] But on a whole, India had always been desirous of peace and this reflects in the actions of India and various schemes which had been proposed by it. The India has never gone on to a war with any nation due to the fact that people of India will never forgive a war mongering Parliament and Prime Minister who disrupted their lives due to their thirst of blood. Moreover, in a democracy like India, leaders are not hereditary (they can be dynastic but they all have to face the elections!!) and this ensures that leaders of India do not plunge their nation into war just for the sake of revenge. History is full of examples where one King plunged his nation into war so as to revenge the defeat of his ancestors by some other Kings of other territory.[19]

Since in India, leaders have to bow down to the public pressure, it ensures that India does not remain a mere slave to the whims and caprice of these leaders. They have to constantly think about their elections as a peaceful prosperous state of affairs ensures re-election. Thus, democracy by ensuring peace in a nation like India is the best possible form of government.

VIII.Poor and their upliftment in a democracy: Raising the standards of living through passing laws!!

It can be asserted quite easily that rise of wages in a democracy is a law. It is due to the reason that in a democracy, leaders owe their existence on how well they improve the lives of the poor and middle classes which are always going to outnumber the number of rich people. Since, they owe their existence to the will of these people; it is only but natural that the leaders in a democracy will try to improve the lives of the poor people to as much an extent as possible.[20]

Leaders in a democracy have to ensure the minimum wages for the workers which will increase the general prevailing wages in the market. They will introduce many schemes for the poor such as Compulsory employment schemes like MNREGA in India which play a pivotal role in improving the general welfare of the poor people. It ensures that poor can no longer be exploited as these poor always have an option to go to the Government for the minimum allowance which it is giving. Thus in a democracy, it always happens that wages rise and with it, the general living conditions of the poor.

In other forms such as aristocracy, since only few vested interest control whole of the decision making, they do not let the laws such as those which promises a minimum wages as it is contrary to their interest. In such forms of

17 'Bodo Group ready to talk to New Delhi', The Economics Times, Apr. 2, 2002. Available at < http://articles.economictimes.indiatimes.com/2002-04-02/news/27353655_1_ndfb-nabla-peace-talks>

18 Chapter 15:'The Experience of defeat', India After Gandhi, Ramchandra Guha, Picador India, New Delhi, 2011

19 Many of the wars in history have been fought for the sake of exacting revenge (or at least had a twinge of revenge as a reason for them) starting from the war of Troy (if we consider it to be a real one!!)

20 Alexis de Tocqueville, Democracy in America, Section 3, Influence of democracy on wages. Available at < http://xroads.virginia.edu/~Hyper/DETOC/ch3_07.htm>

government, poor owe their whole existence in the hands of these few rich businessmen who can control them like puppets in a theatre. He can ask them to work for long hours without even ensuring the basic wages to maintain their existence as he always knows that there are more people in the industry who are ready to take the jobs of these people. Thus, he oppresses them more and more and these people find them in a vicious cycle as more they are oppressed, poorer they become, and poorer they become, more easily can they be oppressed.[21]

Thus what Aristotle stated was not wrong: *"Democracy is when the indigent, and not the men of property, are the rulers."*

Democracy ensures the upliftment of every participant in it. It is true that in a democracy, it is the rule of majority, but in a diverse country like India, the majority itself is often fractured and divided. For example, if we take Hindus to be consisting of the majority in India, it is only rare that all Hindus vote in a particular pattern. Rather there are caste coalitions which many a times depend upon the support of minorities such as Muslims, Sikhs to come to the power. Thus it is but natural that in such a situation, those who are coming into the power will be bound to take care of the interests of every community as their sole existence depends on them.

In India, it manifests itself in caste coalitions, regional coalitions which many a times spans across many castes and religions. Thus, these groups, which would have been living on fringes had there been a dictator or an aristocrat belonging to particular community; they in a vibrant democratic nation like India by participating in elections can ensure that laws and policies which are favourable to them are enacted.[22] *Various laws have been enacted in India such the abolition of untocuhability*[23], Prevention of Atrocities Against Act, 1989, reservation policy of the Government are some of the manifestation of this power politics in a democracy in which everyone can participate and feel empowered. This participatory democracy ensures the respect of the human rights of everyone in the nation.

Therefore, the democracy is the best possible form of government as it ensures the basic human rights to people and empowers them to claim their rights.

IX. Democracy raises public spirit in people and makes them patriotic: Loving the nation because you are a part of it!!

People are patriotic towards their birthplace due to many factors. They are fond of the revered traditions of their birthplace, its customs which may have endured for centuries unchanged and unchallenged and these traditions and customs are cherished by them. People feel a certain kind of reverence and fondness towards these customs which make them patriotic towards their birthplace. They do not weigh these customs in the golden scale of rationality but they cling to these customs and traditions just like a vine to a support. They won't like any change in their custom as doing so means changing the lifestyle which they adapted to over many years of their life. They resist any change and see any attempts to criticise them on the scales of rationality as heretic.[24]

These customs can be through many different reasons and may manifest themselves in many forms. For example, the customs can be social

21 Ibid

22' India should stop the forced eviction of Muzaffarnagar victims', Muslim Mirror, Jan. 18, 2014. Available at < http://muslimmirror.com/eng/india-should-stop-forced-evictions-of-muzaffarnagar-riot-victims-hrw/>

23 Article 17 of the Constitution of India

24 Alexis de Tocqueville, Democracy in America, Chapter 14: 'What are the advantages which American society derives from a democratic government'. Available at < http://xroads.virginia.edu/~Hyper/DETOC/1_ch14.htm>

sanctioned by religious practices such as that of untouchability, the differences can be due to the religious, linguistic and regionalistic diversity and these can give rise to narrow feelings of parochialism and provincialism which takes not much time to push a nation into chaos and anarchy.

In a democratic country like India, this patriotism towards one's motherland can be dangerous. Since, India consists of many diverse people; the very idea of 'India' can be threatened by this love narrow 'patriotism'[25] which should be rather characterised as provincialism. For example, if India would have been a dictatorship with say a Hindu being the ruler, would the Muslims or Sikhs have allowed any changes to their customs? In fact, the democracy in India has helped in diffusing this tension through the percolation of democracy at the very foundational level as it has ensured that people accept the changes in their practices and customs as it is their people only who will be bringing these changes.

Since, in a democratic India, anyone can only come to power only by sharing it with many diverse sets of people (i.e. by taking all communities together), it is possible for the country to get the laws passed which may interfere with the existing lifestyle of the people by outlawing their customs, but still no one stands in revolt against them. For example, many customs such as practice of child marriage, untouchability etc. have effectively been banned[26] but since every stakeholder had been consulted prior to taking such decisions, these decisions could be implemented. Contrast this to the 1857 revolt[27] which many attribute to the changes in social practices which were affected by the British government. The British government failed to take into account the religious sentiments of the Indian people which caused the revolt to take place.

The democracy in India thus helps in peaceful means of taking any action and then adopting it. It is true that it more often than not slows down the decision making process, as the consultation process after taking into account divergent and maybe conflictual and irreconcilable vies is time consuming but on the profits side, it ensures that people understand why a certain decision has been taken and why is it good for them. For example, the Hindu Code Bill initially could not be passed in one single Act by B.R. Ambedkar due to the continued opposition to it. But it did indeed get passed, albeit in somewhat modified form. But it resulted in the peaceful adoption of the Bill by all the stakeholders as their concerns have been taken care of.[28]

People in a democracy understand that they have to accept the decision even if it is not to their liking even when it is exactly not to their liking, as their views have been considered. Generally due to such a consultation process, actions are more often than not modified. For example, in India, Hindi was indeed made a national language but English continued to be used in the official processes. It is not very hard to imagine the ramifications which would have ensued if the leaders in Delhi would not have consulted their brethren from the southern India.[29]

This democracy in turn leads to the broadening of the feeling of the patriotism as now people start feeling patriotic for whole of their nation rather than just for their small region in which

25 Here I mean feelings of parochialism and provincialism by the ter 'Patriotism'. Thus I'm using therm 'Patriotism' in a narrow sense here.

26 The word 'effectively banned' has been used instead of 'banned' as many of these practices such as 'sati' had already been banned during the British times also but these bans were not effective.

27 Or the 'First fight for freedom'.

28 Chapter VIII: 'Home and the world', India After Gandhi, Ramchandra Guha, Picador India, New Delhi, 2011

29 Chapter IX: 'Redrawing the map', India After Gandhi, Ramchandra Guha, Picador India, New Delhi, 2011

they have been born. Thus in India, a Tamil does not only feel patriotism on him being a Tamilian but also on him being and Indian. The democracy also helps in ensuring that these two forms of patriotism do not come in conflict with one another. This is through the consultation process due to which generally the decision are changed which helps in awakening the feelings of public spirit in a person who always thinks that since the government is listening to his views, he must be loyal to that Government. This lack of feeling of patriotism is what characterise the other forms of Governments and differentiates them from the democratic ones. For example, in China, since the Tibetan people are not a part of the decision making process, they resent Han Chinese being settled in the Tibetan region of China.[30]

In contrast, in India, since people are free to settle anywhere, people of one state do not resent it. Even when they do so, they do not engage in mass rioting but express their dissent through peaceful political means and channel their anger through legitimate means. Moreover, their resentment is less as they have been consulted prior to taking the decision. Thus, democracy is the best possible form of government for India as it invokes the feeling of patriotism (love towards one's nation) and feelings of public spirit in them.

X. The discipline in army due to the democracy: Democracy helps winning wars!!

The armies of a democratic nation like India are comparatively more disciplined than that of any other nation due to a simple reason that in a democracy, since all are equals, only equals are admitted in the army. It is true that upon entering the army, distinction is created among them but still, they are freer to express their dissent than compared to say, an aristocratic army. In an aristocratic army, there are few officers and all others are soldiers who their very existence on the well wishes of the officers. This makes them obedient to the multitude of the wishes of these officers, howsoever unreasonable they may be as they have to just show their unquestionable loyalty to their superior officer and not towards their nation.

This in turn ensures that democratic armies are more capable of accomplishing wonders than compared to an aristocratic army. This stems from the fact that when a democratic army goes to a war, soldiers are united in their love towards their nation, they fight to protect the dignity, gaining honours of their motherland. But in an aristocratic army, this bond of patriotism is often loose and discipline of soldiers often breaks as their discipline and obedience has been conditioned for the times of peace and not for the times of the wars.[31]

In an aristocracy, rather military discipline is nothing but an enhancement of social servitude and hence, the armies are like the private vassals of the aristocrats, without any feelings of martyrdom and public spirit in them. History also tells us that it is the democratic armies which consisted of freemen and citizens which took on bigger armies than them, the battle of Thermopolis being an example of it.

XI. Authority of law and Democracy: respecting laws which we ourselves create!!!

Most of the nations which became independent after 1950s soon became autocratic, dictatorship or theocracy. Those which did not, revolts broke out in them. In fact, it has been shown that level of poverty is correlated with that of the tendency

30 Tibetans have been resisting the imposition of the mainland Chinese culture on themselves. See: <http://www.tibetanuprising.org/>

31 Alexis de Tocqueville, Democracy in America, Chapter XXII:' Why democratic nations are generally desirous of peace…', Available at < http://xroads.virginia.edu/~Hyper/DETOC/ch3_22.htm >

of people in a country to revolt.[32] Going by this, majority of the people of India should have revolted by now as they are living under so impoverished conditions. But the fact that they have not goes on to prove that democracy helps in preventing the revolts from ever occurring.

In a democracy, participants feel that they have a legitimate way to get their problems addressed by those who are in power. Thus the people of democratic India even when marred by so high levels of poverty do not rise up to revolt against the Government as they always feel that they have certain legitimate means to get their problems addressed. They can approach their elected leaders, howsoever corrupt they may be, they will ultimately have to bend to people's wishes as it is they only who will cast their votes for them, based upon their performance.

In addition, there is a less tendency of certain powerful vested interests to create revolts as in a democracy like India; democracy leads to the creation of many powerful vested groups which counter one another when it comes to the occurrence of revolts. For example, if one community in the army does revolt, the others will be there to stop them. It is not possible if there is no democracy as it is being seen in the Syria where the army primarily consists of Shia community who in turn are helping their ruler Bashar Al Assad to commit all the atrocities.[33]

Another reason why people in a democracy have more respect for laws and do not participate in a revolt is that as people feel that they are themselves part of the law making process, they cannot just overthrow, the reason being that parties in a India feel that they are in a contractual relationship with the Government regarding the laws. They have only one way of changing the laws which are against their interests: to make themselves the majority and then to influence the decision making regarding the laws.[34]

If India would not have been a democracy, poor of India would have always been suspicious of the motives of the Government and would not have allowed it to function properly. They would have always thought that whatever is being done by the Government, it is against their interests and that they must oppose it. Thus, India by being a democracy reduces all these sectarian conflicts and therefore making the democracy the best possible choice for India.

XII. The effect of democratic India on the flourishing of the arts: Respecting the diversity!!

If one goes to any music store in India, one would find a huge variety of music there comprising many regional forms, spiritual ones, classical ones, western ones etc. What I believe is that choice which people are getting to choose from is a by product of democracy only. It by allowing people to make their choices themselves, allows many different forms of arts and music to flourish as people are of many divergent tastes.

Suppose what would have been a situation if India would not have been democratic: what would have happened to the diverse forms of arts which are practiced in India. There would have been certain aristocrats or dictators who would have promoted maybe science or some forms of arts which would have pleased their aesthetic and most probably, their puritanical senses. They would have certainly not promoted any other forms to flourish and may have passed laws outlawing them.[35] For example they may

32 Income and democracy, Daren Acemoglu et all., American Economic Review, 2008. Available at < http://www0.gsb.columbia.edu/faculty/pyared/papers/democracy.pdf >

33 Syrian army consists of manly minority Shia forces. See Syria's sectarian war goes international as foreign fighters and arms pour into country", Sengupta, The Independent (Antakya), 20th February, 2012.

34 Supra 31

35 Alexis de Tocqueville, Democracy in America, Chapter XI: 'In what spirit, the Americans cultivate the Arts', Available at < http://xroads.virginia.edu/~Hyper/DETOC/ch1_11.htm'.

have liked the classical Indian music of any specific region and may have promoted it only, letting others rot in the sidelines and fringes. Whole of the resources of the state would have been spent of the promotion of this music, arts only and people of India would have been forced to train in this form of arts only.[36]

This would not have given the people the pleasure of listening to other forms of music such as the famed Bollywood Hindi cinema music as that would not have suited the puritanical tastes of the people. People would have had fewer choices to choose from and they would have had to accept whatever government must have been providing to them. Democracies inherently let market forces to dominate in certain fields which ensure that people live a life with more choices and can enjoy their life much more. Therefore, the democracy helps in the flourishing and thriving of the various diverse arts forms which are otherwise impossible in other forms of the Government.

XIII. Conclusion : Improving the democracy to make it the not only the best possible but the best ever!!!

It is indeed true that democracy like any other government is marred with corrupt practices where crony capitalism takes place, leaders enter into backroom deals and corruption is often rampant. Democracies are often slow in decision making and sometime delay them beyond any imagination.[37] But still, democracy reflects the qualities, and the ambitions of the general populace. They can be as good only as the people residing in them are. Thus, they have a potential to self correct them which is missed by dictatorships. In fact, democracies which have regular elections have a tremendous possibility to improve the general welfare of people as leaders in these democracies will have to attend to the people's needs and aspirations. Thereof, all the features discussed above make the democracy the best possible choice of the Government for a country like India which has got a multilingual, multi-religious people residing in them. As it has been stated by Winston Churchill:

"Democracy is the worst form of the Government except all those which have ever been tried."

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Alexis de Tocqueville, Democracy in America, Section 3.

36 The analogy is true in the sphere of the languages also. A democracy like India makes sure that every language gets its due which is not possible in other forms of governments such as in the authoritarian China.

37 It took India about 8 long years to clear the POSCO steel plant project. See: 'India Removes Hurdle for Posco Project Before Park Visit', The Bloom Berg, Jan. 10, 2014. Available at http://www.bloomberg.com/news/2014-01-09/india-clears-hurdle-for-8-billion-posco-plant-before-park- visit.html

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DIRECT TAXES
Supreme Court

Proviso inserted to section 113 by Finance Act, 2002 w.e.f. 1-6-2002 to impose surcharge in search assessments is not clarificatory or retrospective. *CIT vs. Suresh N. Gupta [297 ITR 322 (SC)]* is overruled.

CIT vs. Vatika Township Pvt. Ltd.

Civil Appeal No. 8750 of 2014 dated 15th September, 2014.

A search and seizure operation u/s 132 was conducted on 10-2-2000 pursuant to which an assessment order for the block period from 1-4-1989 to 10-2-2000 was passed on 28-2-2002 at a total undisclosed income of ` 85 lakhs. Tax was charged at the rate prescribed in s. 113. Subsequently, a Proviso was inserted to s. 113 by the Finance Act, 2002 w.e.f. 1-6-2002 to provide for the levy of surcharge at 10%. The AO took the view that the said amendment was clarificatory in nature and he levied surcharge by passing an order u/s 154. However, the Tribunal and High Court upheld the assessee's claim that the said amendment was prospective in nature and did not apply to block periods falling before 1-6-2002. When the present case reached the Supreme Court, the Division Bench was of the view that the issue ought to be referred to a larger Bench of five judges as the plea of the assessee was rejected by the Supreme Court in the case of *CIT vs. Suresh N. Gupta [297 ITR 322 (SC)]* wherein it was held that the said proviso is clarificatory in nature and applied to earlier block periods.

The Larger Bench of five judges dismissing the appeal of the Revenue held as under:

(i) Chapter XIV-B comprehensively takes care of all the aspects relating to the block assessment relating to undisclosed income, which includes sec. 158BA(2) as the charging section and even the rate at which such income is to be taxed is mentioned in sec. 113 of the Act. Though sec. 4 is also a charging provision, it does not apply to Chapter XIV-B.

(ii) On the application of general principles concerning retrospectivity, the proviso to sec. 113 cannot be treated as clarificatory in nature, thereby having retrospective effect. The rule against retrospective operation is a fundamental rule of law that no statute shall be construed to have a retrospective operation unless such a construction appears very clearly in the terms of the Act, or arises by necessary and distinct implication.

(iii) An assessment creates a vested right and an assessee cannot be subjected to reassessment unless a provision to that effect inserted by amendment is either expressly or by necessary implication retrospective.

(iv) There cannot be imposition of any tax without the authority of law. Such a law has to be unambiguous and should prescribe

the liability to pay taxes in clear terms. If the concerned provision of the taxing statute is ambiguous and vague and is susceptible to two interpretations, the interpretation which favours the subjects, as against there the revenue, has to be preferred. This very principle is based on the "fairness" doctrine as it lays down that if it is not very clear from the provisions of the Act as to whether the particular tax is to be levied to a particular class of persons or not, the subject should not be fastened with any liability to pay tax.

(v) Though the Chief Commissioners in their Conference suggested that there should be a retrospective amendment to sec. 113, the legislature chose not to do so even though other amendments were made with retrospective effect. The CBDT circular No.8 of 2002 dated 27-8-2002 also makes it clear that the amendment to sec. 113 is prospective;

(vi) Consequently, the conclusion in *CIT vs. Suresh N. Gupta* treating the proviso to sec. 113 as clarificatory and giving it retrospective effect is not correct and is overruled.

Manufacture – Cut and polished diamonds – Gem India Mfg. Co. not followed

Heaven Diamonds Pvt. Ltd. vs. CIT

Civil Appeal No. 9936 of 2011 dated 18th November, 2011.

In A.Y. 2000-01 the assessee company was engaged in the business of cutting and polishing rough diamonds. The A.O. disallowed deduction u/s. 80IB of the Act on the ground that cutting and polishing of rough diamonds for making polished diamonds does not amount to manufacture for which he relied on the decision of the Supreme Court in *CIT vs. Gem India Mfg. Co. Ltd. (249 ITR 307).* The CIT(A) upheld the action of the A.O. The Appellate Tribunal dismissed the assessee's appeal relying on the decision in the case of *CIT vs. Gem India Mfg. Co.* (Supra).

The Bombay High Court dismissed the appeal of the assessee u/s. 260A of the Act observing as under:

"The findings recorded by the Tribunal relying on the judgment of the Apex Court in the case of the *CIT vs. Gems India Mfg. Co. [(2001) 249 ITR 307]*, cannot be faulted. In this view of the matter, appeal stands dismissed for want of substantial question of law with no order as to cost."

Aggrieved by the order of the Bombay High Court the assessee filed an SLP in the Supreme Court. Admitting the SLP and allowing the Civil Appeal the Supreme Court held as under:

"We find from the impugned order of the Income Tax Appellate Tribunal ['Tribunal', for short) that there is no discussion on the process undertaken by the assessee, who claims benefit of section 80IB of the Income-tax Act, 1961 ['Act', for short]. The assessee imports raw diamonds and applies thereon the process of Sawing, Turning, Profiling, Cutting, Drilling, Polishing, etc., by the use of sophisticated machineries resulting in production of a superior marketable commodity. Detailed procedure has been set out in the paper book. The Tribunal ought to have examined the process as to whether such process would constitute 'manufacture' under Section 80IB of the Act. That exercise has not been undertaken. The reliance on the judgment of this Court in the case of *Commissioner of Income Tax vs. Gem India Manufacturing Company*, reported in [2001] 249 I.T.R. 307, may not be correct for the simple reason that, in that case, the Revenue succeeded as Gem India Manufacturing Company was not able to demonstrate the process undertaken by it to convert raw diamonds into a superior commodity. Moreover, the High Court has also not gone into that aspect. The High Court should have remitted the case to the Tribunal to consider whether the process undertaken by the assessee constituted "manufacture". Under the above circumstances, the impugned orders of the High Court and the Tribunal are set aside and the matter is remitted to the Tribunal for *de novo* consideration in the light of what we have stated hereinabove.

"The civil appeal filed by the assessee is, accordingly, allowed with no order as to costs."


Jitendra Singh & Sameer Dalal
Advocates

DIRECT TAXES
Tribunal

REPORTED

1. Search and seizure – Section 153A of the Income-tax Act, 1961 – Material seized during the search operation and return filed by the assessee depicted that the additional income declared by the assessee was only unaccounted money received by the assessee from the customers on account of sale of flats in the housing project, eligible for deduction under section 80-IB(10) of the Act – Assessee's claim for deduction under section 80-IB(10) of the Act with regard to the enhanced income held to be within the scope of the assessment under section 153A(1)(b) of the Act and the Assessing Officer should consider the same. A.Y.: 2008-09 to 2010-11

Malpani Estates vs. Asstt. CIT - (2014) 108 DTR 255 (Pune) (Trib.)

For assessment years, assessee had originally filed a return of income, including profits from execution of a housing project which was claimed as exempt under section 80-IB(10) of the Act. Thereafter, a search operation under section 132(1) of the Act was carried out in the case of the assessee and the partner of the assessee firm in his statement recorded under section 132(4A) of the Act declared additional income on account of on-money received by the firm from the firms customers on sale of flats in the housing project. In response to a notice issued under section 153A(1) (a) of the Act, assessee furnished a return of income after claiming deduction under section 80-IB(10) of the Act on the additional income declared. The assessee contented that the enhanced claim of deduction under section 80-IB(10) of the Act was on account of an additional income declared by the assessee in the return filed in response to notice issued under section 153A(1)(a) of the Act. The said additional income was declared on account of on-money received by it from its customers on sale of flats. The claim of the assessee was that the additional consideration received from the customers which was not declared in the regular books of account but declared in the statement during the course of search, was nothing but an income in respect of the project, which was eligible for deduction under section 80-IB(10) of the Act.

The Assessing Officer, disallowed the claim of the assessee for deduction under section 80-IB(10) of the Act with respect of the on-money on sale of flats received by the assessee, though he accepted the additional income as a part of total income but, did not treat it as 'business income' of the assessee and therefore he did not allow deduction under section 80-IB(10) of the Act with respect to such additional income declared.

On appeal the Tribunal held that where in response to notice issued under section 153A(1)(a) after search, assessee declared certain additional income pertaining to a housing project undertaken by it,

nature of income has to be treated as 'business income' though the same was not accounted for in books of account. Further, benefits of Chapter VI-A of the Act, which inter alia includes section 80-IB(10) are applicable to an assessment made under sections 153A to 153C of the Act also. Thus, the assessee firm was eligible for deduction under section 80-IB(10) of the Act in relation to additional income pertaining to a housing project which was offered by its partner in a statement recorded under section 132(4) of the Act in course of a search and subsequently declared in return filed in response to notice under section 153A(1)(a) of the Act.

Note: Punjab and Haryana High Court in the case of, *Tudor Knitting Works P. Ltd. vs. CIT – [(2014) 108 DTR (P&H) 180]* – Held that where the assessee was not able to demonstrate that the income surrendered by the assessee during the survey was derived from the industrial undertaking, then deduction under section 80 IB was not admissible to the assessee on such surrendered income.

2. Interest income – Section 10A of the Income-tax Act, 1961 – Interest income which falls under the Chapter IV–D of the Act that is 'Profits and Gains of Business or Profession' – Eligible for exemption under section 10AA of the Act. A.Y.: 2009-10

Mercer Consulting (India) P. Ltd. vs. Dy. CIT - (2014) 108 DTR 348 (Del.) (Trib.)

While computing exemption under section 10AA of the Act the assessee had included the interest income in its net profit and claimed exemption on the said interest income. The Assessing Officer ('A.O.') held that interest income could not be construed as profits derived from business of the undertaking and he accordingly reduced the interest income from the net profit while computing exemption under section 10AA of the Act.

On appeal the Tribunal held as the term 'profits of the business' is not defined in section 10AA of the Act, therefore, it has to be understood in common parlance, that is, profits of any nature related to business. Thus, even if the relation between the income and business is indirect, it would qualify as business profit which falls under Chapter IV–D of the Act and therefore eligible for exemption under section 10AA of the Act.

Note: Apex Court decision in case of, *Pandian Chemicals vs. CIT – [(2003) 262 ITR 278 (SC)]* is discussed and distinguished in this decision.

3. Anonymous donations – Section 115BBC of the Income-tax Act, 1961 – Assessee trust was established as wholly and exclusively for religious purpose – Anonymous donations cannot be taxed under section 115BBC. A.Y.: 2009-10

Bhagwan Shree Laxmi Narain vs. Income-tax Officer (E) - [2014] 50 taxmann.com 23 (Delhi - Trib.)

The assessee before the Hon'ble Appellate Tribunal was a trust. The assessee was granted registration under section 12A of the Act. During the year, the assessee was mainly involved in imparting of spiritual education through the lectures/samagam delivered by Brahamrishi Shree Kumar Swami Ji and in distribution of medicines and cloths to the needy and destitute. Thus, the assessee was falling within the scope of "general public utility." The assessee during the relevant period received donations amounting to ` 27,25,306/-. As the assessee was unable to provide the details of the same, the A.O. has made the addition of said amount invoking the provisions of section 115BBC of the Act. On appeal the first Appellate Authority upheld the action of the A.O.

The assessee being aggrieved by the order passed by the Learned CIT(A) preferred an appeal before the Hon'ble Delhi Appellate Tribunal. The Appellate Tribunal allowed the appeal of the assessee and deleted the addition made by the A.O. by observing that on considering the objects of the trust, in the facts of the instant case the tax authorities have proceeded on a very narrow and incorrect understanding in holding that the assessee trust was engaged in spreading spirituality and since section 115BBC only exempts religious trust, a trust allegedly imparting spiritual knowledge was consequently not contemplated as an exception by the Legislature as much as it consequently is

barred to claim exemption vis-à-vis the anonymous donation.

UNREPORTED

1. Deemed dividend – Section 2(22)(e) of the Income-tax Act, 1961 – Amount received by the assessee in pursuant to family settlement from a company in which he had substantial interest – Not deemed dividend. A.Y.: 2008-09

SKM Shree Shivkumar vs. Asstt. CIT – [I.T.A. Nos. 1965 / Mad / 2011 & 2278 / Mad / 2012 ; Order dated: 17-7-2014; Chennai Tribunal]

The assessee was director of two companies. During year, assessee received certain amount and assets from one of the companies. As the amount and assets were received under family settlement pursuant to arbitration award the same was not offered for taxation by the assessee. The Assessing Officer ('A.O.') treated the amount received from the company in which the assessee was having a substantial share holder as deemed dividend under the provisions of section 2(22)(e) of the Act. The order of the A.O. was confirmed by the Appellate Commissioner.

On further appeal to the Tribunal, the Tribunal held that if the family settlement had not taken place there was a peril for the dissolution of the family owned companies for the sake of partition. In order to prevent such a precarious situation the assets of the family owned companies had to be realigned. Thus, there was a commercial exigency for the family owned companies to transfer some of its assets and liquid assets in order to avoid extinction. Thus, as the transactions were between the family members and their wholly owned companies due to the family settlement the provisions of section 2(22)(e) of the Act were not applicable in the case.

2. Commencement of business – Section 4 of the Income-tax Act, 1961 – In pursuance of a contract awarded to the assessee for installation of bus queue shelters, assessee entered into agreement with third party and also made advance payment to them – The business of the assessee ought to have commenced during the relevant year and not in the subsequent year when shelters would be ready for providing space to assessee for advertisement. A.Y.: 2007-08

Jcdecaux Advertising India (P.) Ltd. vs. Dy. CIT - [I.T.A. No. 964 / Del / 2011; Order dated 8-9-2014; Delhi Tribunal]

The assessee was awarded its first contract by a local authority for construction of Bus Queue Shelters ('Shelters') on Build-Operate-Transfer (BOT) basis. As per the contract, the assessee was required to undertake preliminary investigations, study, design, finance, construct, operate and maintain shelters at its own cost. In consideration, the assessee was allowed to commercially exploit the space allotted in these shelters by means of display of advertisement, etc. for a certain period. During the year under consideration, the assessee claimed deduction for a sum of Rs. 18.36 crores incurred in discharge of its obligations under the contract. However as the expenditure was of capital nature the Assessing Officer ('A.O.') disallowed the same which was also accepted by the assessee. Further, the assessee also claimed expenditure amounting to ` 3.17 crores as deductible. The AO accepted such expenditure to be of revenue in nature but refused to allow deduction on the ground that the business of the assessee had not commenced. The A.O. justified his action as according to him the assessee had not commence its business. According to the AO the business of the assessee would commence only when the shelters would be ready for providing space for advertisement.

On appeal the Tribunal reversing the order of the A.O. held that, in pursuance of contract awarded for construction of shelters, assessee had entered into agreement with third party for manufacture and installation of shelters and also paid advances. Thus, according to the Tribunal the assessee's business had commenced in relevant year and, therefore, the A.O. was not justified in rejecting assessee's claim for deduction of expenses taking a view that said expenses were in nature of pre-operative expenses as business was set up in a subsequent year when shelters would be ready for providing space to assessee for advertisement.


CA Tarunkumar Singhal & CA Sunil Moti Lala

INTERNATIONAL TAXATION
Case Law Update

A] HIGH COURT JUDGMENTS

I. Assessee undertaking trading intermediary activities *(Sogo Shosha)* to be characterised as 'trader' & not 'service' provider – Where assessee entered into transaction of sales and purchase of goods on principal to principal basis, for the purpose of transfer pricing, the activities could not be compared to a commission agent or broker and were akin to trading activities

Mitsubishi Corporation India (P) Limited vs. Addl. CIT [2014] 48 taxmann.com 45 (Del) – Assessment Year 2006-2007

Facts

1. The assessee is a wholly owned subsidiary of Mitsubishi Corporation – a company incorporated under the laws of Japan.

2. For the year under consideration, it had reported four international Transactions namely services, commission, cost-to-cost reimbursement as well as sale of products imported from the Associated Enterprise ('AE'). During the assessment, the Assessing Officer ('AO') made a reference to the Transfer Pricing Officer ('TPO') under section 92CA of the Income-tax Act, 1961 ('Act') in respect of the international transactions between the assessee and its AE.

3. The TPO rejected the Profit Level Indicator ('PLI') used by the assessee to benchmark its international transactions which was a ratio of net revenue to operating expenses. The sales and cost of sale had been excluded by the assessee. The TPO computed the Arm's Length Price ('ALP') by assuming a margin of 19.6% (by comparing the assessee to a trader) and accordingly, enhanced the income of the assessee.

4. The draft assessment order was passed in accordance with the TPO's order. The assessee filed objections before the Hon'ble Dispute Resolution Penal ('DRP') under section 144C of the Act, who rejected the objections of the assessee.

5. Aggrieved, the assessee preferred an appeal before the Hon'ble Income-tax Appellate Tribunal ('ITAT') contesting the addition made on account of transactions of sale and purchase of goods.

6. It was submitted before the Hon'ble ITAT, that its functional profile was not that of a trader but that of a service provider. The assessee places orders for purchase with its parent company on the basis of confirmed orders from its customers and thus, it was not exposed to the risk of carrying any inventory and / or deploying any significant working capital. Accordingly, it was claimed that the cost of goods sold should not be taken into consideration while computing the profit margins, which should be calculated on the operating costs and appropriate ratio to be considered for

comparing with other entities would be the ratio of net revenue to operating costs. Alternatively, if the transactions of buying and selling were considered to be trading then, the ALP should be determined in comparison with companies which were similarly situated.

7. The Hon'ble ITAT observed that the nature of assessee's business was to undertake (*sogo shosha*) the role of a trade intermediary. The assessee recorded the purchase and sales in its books of account and the title of the goods were held by it during such intermediary period. Therefore, the transaction entered into by the assessee were on principal to principal basis. Though it was claimed that it performed intermediary activities, the same could not be classified as activities of a commission agent or a broker. Thus the activity in question is akin to trading activities.

8. Aggrieved, the assessee preferred an appeal before the Hon'ble Delhi High Court. The contentions raised before the Hon'ble ITAT were reiterated by the assessee.

Judgment

1. The Hon'ble High Court held that it was not disputed that the transactions of purchase and sale between the assessee and its AE were done on a principal to principal basis and therefore, the reasoning of the Hon'ble ITAT that such transactions were akin to trading and could not be considered as activities of a commission agent or a broker was upheld.

2. Further, the Hon'ble High Court also rejected assessee's alternate plea (to consider comparables which were similarly situated) on the ground that the Hon'ble ITAT made it clear that appropriate comparables would have to be considered for determination of the ALP. This would imply that entities which were similarly placed as the assessee, including in respect of their functional and risk profile as well as working capital exposure, would be chosen as comparables.

II. CIT has no revisionary powers under section 263 of the Act once the Arm's Length Price is accepted by the Assessing Authorities

CIT vs. SAP Labs Private Limited [2014] ITA No. 842 of 2008 & ITA No. 339 of 2010 (Kar.) – Assessment Year 2002-03

Facts

1. The assessee's return of income for Assessment Year 2002-03 was processed under section 143(1) of the Income-tax Act, 1961 ('Act'). Subsequently, the AO issued a notice under section 148 for re-opening the assessment and referred the case to the TPO, who sought details regarding the international transactions entered into by the assessee with its group companies.

2. During the reassessment proceedings, the assessee contended that at the time of referring the matter to the TPO, no valid return was pending on the basis of which notice under section 92CA of the Act could have been issued, since no notice under Section 143(2) of the Act was issued pursuant to filing of the original return. The assessment was deemed to have become final. However, the TPO passed an order under section 92CA of the Act accepting the Arm's Length Price ('ALP') as determined by the AO.

3. The Commissioner of Income-tax ('CIT') invoked powers vested in him by section 263 of the Act and initiated proceedings and set aside the order of the AO/TPO on the ground that it was erroneous and prejudicial to the interest of the revenue.

4. The assessee preferred an appeal before the Hon'ble ITAT against the revision order passed under section 263 of the Act. The Hon'ble ITAT, in its order held that when two views were possible and when the TPO had accepted ALP as determined by the AO, the CIT had no jurisdiction to interfere with the assessment order. Further, it also held that on the day the reference was made by the AO, there was no return pending for consideration and therefore, the Hon'ble ITAT set aside the order of the CIT.

5. Aggrieved, the revenue preferred an appeal before the Hon'ble Karnataka High Court.

Judgment

1. The Hon'ble High Court confirmed the order of the Hon'ble ITAT. It *inter-alia* held that:

a. The reference made by the AO to the TPO was bad in law, as on the day of the reference, there was no return pending for consideration by him.

b. Even otherwise, the TPO did not find fault with the adjudication of determining the ALP of the AO.

2. Accordingly, dismissing the Revenue's appeal, it held that the CIT had committed an error and he had no jurisdiction to interfere with the assessment order.

III. Capital gains on sale of Indian Government Securities by individual residents of UAE not subject to capital gains tax in India under India-UAE DTAA – DTAA benefits available despite no tax on individuals in UAE

DIT(IT) vs. ICICI Bank [2014] 49 taxmann.com 1 (Mum) – Assessment Year 2005-06

Facts:

1. The assessee made remittance without deduction of tax at source to various individual clients, resident in UAE, who transacted in Government of India's 364 days Treasury Bills ('T-Bills') through the assessee. The clients had NRE account with the assessee through which purchase and sale of T-Bills was effected.

2. The clients transferred T-Bills before maturity and earned capital gains on such transfer. The assessee claimed that the clients were resident of UAE and were not subject to capital gains tax in India as per India-UAE Double Taxation Avoidance Agreement ('the DTAA'). Accordingly, there was no obligation to deduct tax at source.

3. The Assessing Officer ('AO') observed that UAE did not levy tax on individuals and thus the clients were not entitled to treaty benefit since they were not 'resident' of UAE in terms of Article 4 of the DTAA, as they were not liable to tax in UAE. Accordingly, the AO held the assessee to be "assessee in default' under section 201.

4. On appeal, the CIT(A) relying on the decision of the Hon'ble Supreme Court in the case of *Union of India vs. Azadi Bachao Andolan (263 ITR 706)* and the Hon'ble ITAT's decision of *ACIT vs. Green Emirates Shipping & Travels (100 ITD 203)* held that there was no tax liability on the capital gains on the constituents / account holders who were residents of UAE.

5. On further appeal, the Hon'ble ITAT held that the capital gains were not taxable in India in view of the provisions of India-UAE DTAA. It observed that T-Bills were 'movable property' and capital gains was taxable only in the country of residence under Article 13(3) of the DTAA. It further observed that even if the DTAA was not applicable to individuals of UAE, a person would not be resident of India as well as UAE, and hence, capital gains would not be taxable under the DTAA. While dismissing the appeal, the Hon'ble ITAT relied on the decision in the case of Green Emirates shipping and Travel (supra).

6. Aggrieved, the Revenue preferred an appeal before the Hon'ble Bombay High Court.

Judgment

1. The Hon'ble High Court dismissed the appeal of the Revenue held that the Hon'ble ITAT and the CIT(A) have not committed any perversity in taking the view that the assessee was not obliged to deduct the tax at source.

IV. Exemption under Explanation 1(b) to section 9(1)(i) of the Act available for 'sourcing' services provided by Indian branch and actual purchases and export by the Indian branch not necessary

DIT vs. Mondial Orient Limited [2014] 48 taxmann.com 263 (Kar.) – Assessment Years 2003-04 to 2005-06

Facts

1. The assessee, a Hong Kong based company, had established a branch office in India. For the year under consideration, the assessee filed return disclosing 'nil' income.

2. The Indian branch identified suppliers, communicated with overseas buyers for pricing & orders, ensured quality control and co-ordinated for delivery. The Indian branch thus rendered services to foreign buyer and Indian suppliers, which, in view of the assessee resulted in export of goods out of India. Accordingly, it claimed exemption under Explanation 1(b) to section 9(1)(i) of the Act on ground that it carried out its operations in India which were confined to purchase of goods in India for purpose of exports and, therefore, no income was deemed to have accrued or arisen in India.

3. The A.O., formed an opinion that the branch office was not involved in any purchase activity in India. Further, based on a survey under section 133A, it was observed that the branch office was actually engaged in business of supply chain management for garments which included services like product design and development, sourcing, merchandising follow up, quality control, factory evaluation and shipping co-ordination. He held that the work of branch office fell within nature of business activity under the guise of liaison office, thereby resulting in income that accrued or arose or deemed to have accrued or arisen in India and accordingly, denied the benefit of Explanation 1(b) to section 9(1)(i) of the Act.

4. On appeal, the CIT(A) upheld the A.O.'s Order.

5. On further appeal, the Hon'ble ITAT held that purchase *per se* for the purpose of export was not the requirement of the Section 9(1)(i) of the Act and that nothing in the section suggests that the assessee cannot purchase on behalf of any other person and accordingly allowed the appeal of the assessee.

6. Aggrieved, the revenue preferred an appeal before the Hon'ble Karnataka High Court.

Judgment

1. The Hon'ble High Court observed that the assessee was not placing any orders with the manufacturers. The assessee was not purchasing the merchandise and was not exporting the merchandise but the fact remains that the entire effort put forth by the assessee results in a valid buyer placing orders with an Indian manufacturer and after the goods are manufactured according to the specifications, they are exported out of the country.

2. The Hon'ble High Court rejected the contention of the Revenue that Explanation 1(b) to section 9(1)(i) exemption was not available to assessee since it did not place order on Indian manufacturers. A wider interpretation to the expression "any income accruing or arising in India to him through or from operations which are confined to purchase of goods in India for the purpose of export" was given in allowing the exemption.

3. It further held that the said section nowhere specified that assessee should purchase goods and then export out of India. On the contrary it is expressly mentioned any income accruing or arising in India to him through or from operations which are confined to purchase of goods in India for the purpose of export alone is exempt from payment of tax. Thus, if an assessee carries on operations which results in purchase of goods in India for the purpose of export, the income so accrued or arising out of such transactions are exempted from payment of income tax. The whole object of this provision is to encourage export of merchandise from India. An incentive is given to a non-resident to carry on business in India. Accordingly, the appeal of the revenue was dismissed.

V. Services rendered by non-resident for arranging export sales and realising payments were not in the nature of 'Fees for Technical Services' within the meaning of section 9(1)(vii) of the Act

DIT (Intl. Tax) – II vs. Panalfa Autoelektrik Limited [2014] ITA No. 292/2014 (Del.) – Assessment Year 2010-11

Facts

1. The assessee made an application under section 195(2) before the Assessing Officer for authorisation to remit certain amount to a non-resident company, registered in Liechtenstein, as commission for arranging export sales and realising payments. There was no DTAA between India and Liechtenstein.

2. The AO held that the commission payment to the non-resident company on procuring orders was taxable as "Fee for Technical Services" under sub-clause (b) to Section 9(1)(vii) of the Act. He relied on the decision of the Hon'ble Authority for Advance Rulings in In Re: *M/s. Wallace Pharmaceuticals P. Ltd. [2005] 278 ITR 97 (AAR).*

3. The CIT(A), after going through the factual matrix, including the agreement between the assessee and the non-resident, reversed the finding of the A.O. and held that the commission was not in the nature of 'fees for technical services". On appeal, the Hon'ble ITAT affirmed the finding of the CIT(A).

4. Aggrieved, the Revenue preferred an appeal to the Hon'ble Delhi High Court.

Judgment

The Hon'ble High Court dismissing the appeal of the Revenue held as under:

1. The subject services that is procurement of export orders, etc. could not be treated as 'management services' since the non-resident was not acting as a manager or dealing with administration nor was it controlling the policies or scrutinising the effectiveness of the policies. Neither did it perform as a primary executor, any supervisory function. The non-resident was acting as an agent for procuring orders and not rendering managerial advice or management services.

2. It also held that the assessee was legally bound with the non-residents representations and acts, only when there was a written and signed authorisation issued by the respondent assessee in favour of the non-resident. Thus, the assessee dictated and directed the non-resident.

3. Further, the procurement services rendered by the non-resident could not be considered as "technical services" since to fall within its ambit, special skills or knowledge relating to a technical field were required. Technical field would mean applied sciences or craftsmanship involving special skills or knowledge but not fields such as arts or human sciences.

4. The Hon'ble High Court also held that commission paid for arranging of export sales and recovery of payments cannot be regarded as consultancy service rendered by the non-resident. For consultation service to fall under Explanation 2, there should be a provision of service by the non-resident, who undertakes to perform it, which the acquirer may use. The service must be rendered in the form of an advice or consultation given by the non-resident to the resident Indian payer. The Hon'ble High Court noted that the non-resident had not rendered any consultation or advice to the assessee.

5. It further observed that the non-resident acquired skill and expertise in the field of marketing and sale of automobile products, but it did not act as a consultant, who advised or rendered any counselling services. It also stated that "the skill, business acumen and knowledge acquired by the non-resident were for his own benefit and use. The non-resident procured orders on the basis of the said knowledge, information and expertise to secure "their" commission."

6. For interpreting the terms "managerial", "technical" and "consultancy" services, the Hon'ble High Court referred to the Organisation of Economic Co-operation and Development ('OECD') Report on e-commerce titled, Tax Treaty Characterisation Issues arising from e-commerce: Report to Working Party No.1 of the OECD Committee on Fiscal Affairs dated 1st February 2001.

VI. Amounts paid for use of intranet facility belonging to a Canadian group company constitutes 'royalty' and merely because the agreement is styled as cost

sharing agreement does not take away the character of 'royalty' from the said payment

CIT vs. CGI Information Systems & Management Consultants (P) Limited [2014] 48 taxmann.com 264 (Karnataka High Court)

Facts

1. The assessee, an Indian company, was engaged in the business of design, development, implementation and support systems for the Information Technology (IT) Sector. It entered into a 'Cost Sharing Agreement' ('agreement') with CGI Group Inc., a company incorporated in Canada ('Canadian company'), for sharing costs of the internal telecommunication and communication tool facility, called as CGI Information Technology Infrastructure ('intranet facility'), developed by said company.

2. Under the agreement, the Canadian company allowed the assessee to use the intranet facility and the assessee would reimburse the cost allocated to it without any mark-up.

3. The assessee, while making the payments under the agreement, deducted tax @ 20% under section 195 of the Income-tax Act, 1961 ('the Act'). However, it challenged the same under section 248 of the Act before the Commissioner of Income Tax (Appeals) ['CIT(A)'], on the grounds that the payments were in the nature of reimbursement and no income element was embedded in the same and therefore, no tax was liable to be deducted at source.

4. The CIT(A) held that the payments made by the assessee company to the Canadian company were not in the nature of 'royalty', however, the same were in the nature of 'Technical or consultancy services' and, therefore, assessee company was liable to deduct tax at source.

5. On appeal, the Hon'ble ITAT held that payments were in the nature of reimbursement of expenses and no income element was embedded in the same. Further, it held that payments could not be treated as 'royalty'. Accordingly, the assessee was not required to deduct tax at source.

6. Aggrieved, the Revenue filed an appeal before the Hon'ble Karnataka High Court.

Judgment

1. The Hon'ble High Court ('HC') allowed the appeal of the Revenue and held that the amounts paid to the Canadian Company were in the nature of 'royalty'.

2. The Hon'ble HC on perusal of the agreement, held that the Canadian Company was the absolute owner of the Intranet facility and held the IPR in its name. Further, one of the clauses in the said agreement stated that the assessee company shall not, in any manner, transfer the right assigned therein to other parties. Relying upon the said clause, it held that some rights in the intranet facility were assigned to the assessee company under the said agreement.

3. Referring to the decision of *CIT vs. Synopsis International Old Ltd. [ITA Nos. 11 to 15/2008 & 17/2008 (Karnataka High Court)]*, the Hon'ble HC, concluded that the rights assigned to the assessee company was nothing but a licence to use the intranet facility. It observed that without entering into an agreement, the assessee was not permitted or allowed to use the facility which exclusively belongs to the Canadian Company. The cost is paid for use of the said facility. By use of such facility, a right is conferred on the assessee.

4. The Hon'ble HC held that mere styling the agreement as cost sharing agreement, did not make any difference in the eyes of the law. The agreement clearly stated that the Canadian Company was the absolute owner of the intranet facility and had there been the intention to share the cost of developing the facility, the assessee also, would have been one of the co-owners, which is not so in the present case.

5. The Hon'ble HC observed that the facility provided by the Canadian company was the intranet facility. An intranet is a computer network

that uses Internet Protocol Technology to share information, operational systems, or computing services within an organisation. Referring to Explanation 4 to section 9(1)(vi) inserted with retrospective effect, it concluded that the payments made by the assessee company to the Canadian Company represented 'royalty' payable for the licence granted to use the said facility.

6. Accordingly, it concluded that this Cost Sharing Agreement is only a device to avoid payment of tax as contemplated under the aforesaid provision and thus was nothing but a royalty.

7. In so far as the argument of the assessee company that, payments made were reimbursement of cost of development of the intranet facility was concerned, same was rejected by the HC on the ground that in the agreement there is no whisper about reimbursement of the cost and on the contrary the agreement speaks about sharing of the cost.

VII. Profit attribution to India PE of Dutch company engaged in Computerised Reservation System business upheld at 15% – Since AO failed to bring out new facts / data on record, co-ordinate bench rulings in assessee's own case for earlier years followed

M/s Galileo Nederland BV vs. ADIT [ITA No. 654, 656, 659, 661 of 2012 (Delhi High Court) Order dated 25 August 2014]

Facts

1. The assessee, a company incorporated in Netherlands, was engaged in the business of providing electronic distribution services to travel industry through Computerised Reservation System ('CRS').

2. The appellant had maintained computer facility at Denver, Colorado in USA, which stored the data which was fed on real time basis on availability of airlines seats, hotel rooms, car hires, fares etc. The aforesaid CRS enabled travel agents and others to make bookings by communicating their requirements online.

3. The assessee appointed an exclusive distributor in India, M/s. Galileo India Private Limited who negotiated and entered into contracts with various travel agents in India who wished to be connected to the assessee's CRS and provided connectivity to them.

4. In order to enable the travel agents in India to connect to the CRS, the assessee entered into an agreement with Societe Internationale de Telecommunications Aeronautiques ('SITA'), an independent and separate entity to provide nodes in India which SITA owned and, the travel agents, through these nodes remained connected and established communication link with CRS.

5. The assessee had received Euro 3 for each completed booking from the airline, hotels etc. outside India and paid Euro 1 for each completed booking to their distributor in India.

6. During assessment proceedings, the A.O. held that the assessee has a Permanent Establishment and business connection in India. He held that 75% of the profits generated from the operations in India was attributable to the PE in India as major part of business activity of the assessee was carried out in India.

7. On appeal, CIT(A) held that issue was covered by the decision of Hon'ble ITAT in assessee's own case for the A.Ys. 1995-96 to 1998-99 wherein after undertaking Functions, Assets and Risk ('FAR') analysis, it was concluded that 15% of the revenue arising out of operations in India were attributable to PE in India. Further, deduction of Euro 1 being amount paid to Indian Distributor was to be allowed, which ultimately, resulted in net loss attributable to the Indian operations of the assessee.

8. On further appeal, Hon'ble ITAT distinguished the order of Hon'ble ITAT and Hon'ble Delhi High Court in assessee's own case for earlier years by relying upon the order of

Hon'ble ITAT in case of one Amadius IT Group which held that in view of increase in globalisation and increase in Indian passengers originating from India, old ratio/ formula cannot be applied following the principles of consistency. Further, the said order of Hon'ble ITAT in case of Amadius IT Group was not disturbed by the Hon'ble Delhi High Court. Ultimately, it remitted the matter back to the A.O. for fresh determination of the profit attributable to Indian operations.

9. Aggrieved, assessee filed an appeal before the Hon'ble Delhi High Court.

Held

1. The Hon'ble High Court held that Hon'ble ITAT misread the order of the same court in case of Amadius IT Group and erred in concluding that the Court had refused to interfere with the order of the Hon'ble ITAT in case of Amadius IT Group. On the contrary, the Hon'ble High Court had overturned the order of the Hon'ble ITAT in case of Amadius IT Group by relying upon the order of the same court in case of the assessee for earlier years.

2. Further, Hon'ble High Court also held that it had upheld the same ratio in case of assessee for subsequent years and also in case of Sabre Inc., USA, involved in similar business. Consequently, it concluded that Division Benches of the Delhi High Court have specifically rejected the plea and submission that globalisation by itself mandates and requires change in 15% formula for attribution profits to Indian PE.

3. The Hon'ble Delhi High Court also held that principles of consistency needs to be followed in case of absence of change in facts, as held by Hon'ble Supreme Court in case of *Radhasoami Satsang vs. CIT [1992] 193 ITR 321 (SC)*, and in the current case no attempt was made by the A.O. to cull out new data or facts.

4. The Hon'ble High Court referring to the order of the Hon'ble ITAT in case of assessee for earlier years concluded that 15% of the revenue earned from Indian operations were attributable to PE in India and held that the conclusions of the Hon'ble ITAT were sound and reasoned ones since, the same were based upon the analysis of the functions performed in India and that outside India.

B) Tribunal Decisions

I) India – France DTAA – Whether Copyright subsists in the news reports and photographs supplied by a French news agency, therefore, payments for the use of same is taxable as 'royalty' – Held: Yes

Agence France Presse vs. ADIT 2014-TII-137-ITAT-DEL-INTL – Assessment Years: 2002-03 to 2005-06 and 2008-09

Facts

1. The taxpayer is an International News Agency having its headquarters at France. The taxpayer is owned by Government of France. There exists a mandatory stipulation under the 1956 Cabinet Resolution inasmuch as foreign news agencies are required to distribute news in text form and photos within India through any of the Indian news agencies such as Press Trust of India (PTI), UNI, IANS India Pvt. Ltd. (IANS), etc.

2. Keeping in view the 1956 Cabinet Resolution, the taxpayer has been distributing its text news and photos connected with news in India through various Indian news agencies viz. PTI and IANS. The news on the web can directly be provided to the subscribers in India on their web sites by the taxpayer.

3. There were two categories of payments received by the taxpayer from India, one for transmission of news and the other for transmission of news photos. It provides daily reports of international events of interest which occur in the various fields such as politics, sports, economic, etc. The agreements with subscribers invariably speak of provision of 'Information'. Prompt knowledge and publication of worldwide news, textual as well as visual are essential for the conduct of an international News Agency for wide circulation of news.

4. According to the taxpayer, news *per-se* are not property hence, are not copyrightable. Therefore, as per terms of agreements between the taxpayer and IANS & PTI, the predominant or primary intention between the contracting parties involves consideration for transmission of photos, reporting of current events etc. and does not secure any copyright in the expression of such news reports. Accordingly, the payments made under the above said agreements did not partake the nature of 'royalty' in the context of the meaning of the term 'royalty' in common parlance as well as the definition contained in Explanation 2 of Section 9 (1)(vi) of the Act or Article 13(3) of the tax treaty. The taxpayer had filed a NIL return for Assessment Year (A.Y.) 2006-07.

5. The Assessing Officer (AO) as well as the Commissioner of Income Tax (Appeals) [CIT(A)] were of the view that various terms under the agreement entered into between taxpayer and Indian news agencies inasmuch as IANS & PTI clearly pointed out that copyright subsisted in newspapers as well as photographs distributed / circulated by the taxpayer in terms of Copyright Act, 1957 and hence, the payments as received by the taxpayer qualify as 'royalties' in terms of definition contained in Explanation 2 of section 9(1) (vi) of the Act or Article 13(3)of the tax treaty.

Decision:

1. The Tribunal held in favour of the revenue as under: With regards to allowability of fresh/ additional evidence, the case-papers pertaining to taxpayer's dispute with Google Inc. is of crucial importance in determination of the central issue at hand i.e. whether copyright subsisted in the newspaper reports, photographs distributed/ circulated by the taxpayer in India. The additional evidence as adduced by the tax department, particularly the case-papers relating to taxpayer's case against Google Inc. before US District Court, Colombia had always remained within the exclusive knowledge and possession of the taxpayer and not produced before the AO as well as the CIT(A) despite insistence by the respective authorities for reasons best known only to the taxpayer. Further, the copy of complaint which could not be considered at any prior stage of proceedings in the instant case and could only be brought to light from the internet domain before the Tribunal hence, the same needs to be considered. It would be prudent that in absence of any direct evidence to the contrary with respect to case-details/complaint by the taxpayer, the Tribunal considered the next best evidence, which in the instant case happens to be case-details as obtained from the internet. Further, admission of the same shall cause no prejudice to the taxpayer as the same pertains to taxpayer's own case and even none of its contents have been controverted by the taxpayer. The Tribunal thus allowed the application for additional evidence

2. With regards to the main issue at hand, on a perusal of Article 13 of the tax treaty, the Tribunal observed that 'royalties' covers within its fold payments pertaining to copyright of literary, artistic work etc. and since, the above terms i.e. copyright of literary, artistic work etc. has neither been defined or illustrated under the Act nor under the tax treaty, there was a need to place reliance from relevant provisions of Indian Copyright Act, 1957 in order to understand the true meaning and context for usage of the expression copyright of literary, artistic work etc.

3. In this regard, the Tribunal referred to the decision of Gracemac Corporation, wherein it has been observed by the Tribunal that, in absence of meaning of 'copyright' under the Act or the tax treaty reliance needs to be placed upon the Indian Copyright Act, 1957 for the limited purpose of finding out the true meaning and context for usage of expression 'copyright'. Further the Delhi High Court in the case of *Super Cassettes Industries Limited vs. Mr. Chintamani Rao and Ors.*, *2012 (49) PTC 1 (Del)* had held that, copyright is a statutory right, and no person is entitled to claim copyright or any similar right in any work, otherwise than in terms of section 16 of the Copyright Act, 1957. Hence, whatever rights are claimed by the parties, must spring from the Act and there are no equitable rights which either party can claim under the law of copyright.

4. Therefore, in light of the above observations, the taxpayer's contention that, the meaning in respect to the words 'copyright of literary, artistic work' should be given the ordinary literal meaning instead of lending it from the Copyright Act cannot be accepted and we need to look into Copyright Act for the limited purpose of finding out the true meaning and context of the words 'copyright of literary, artistic work'.

5. In terms of the emerging principles from various judicial precedents/jurisprudence given below, the Tribunal observed that it is a settled legal proposition that in order to determine copyrightable works or original literary, dramatic, musical and artistic works etc. (as in the instant case) the key test to be adopted is that such works should have a 'modicum of creativity' involving considerable skill, labour, capital as held in *MacMillan & Co. vs. K&J. Cooper.*

- *TV Independent News Service Pvt. Ltd. & Ors vs. Yashraj Films reported in 192 (2012) DLT 502; Salmond's jurisprudence, 11th edition, p. 462;*
- *Savitri Devi vs. Dwaraka Prasad, AIR 1939 All 305;*
- *R.C. Cooper vs. Union of India, 1970 3 SCR 530;*
- *MacMillan & Co. vs. K&J. Cooper AIR 1924 PC 75;*
- *Halsbury's Laws of England by Lord Hailsham Fourth Edition; Copinger in his book on Copyright 11th Edition;*
- *Eastern Book Company vs. D.S. Modak [(2008) 1 SCC 1]*

6. On a reading of relevant clauses of various distribution agreements, the Tribunal observed that the taxpayer exercises a great degree of control and strictly regulates its news-content supplied by it to Indian news agencies and most of its information is proprietary-in-nature and copyrighted inasmuch as access to archived data, distribution rights, commercial rights, credit to the taxpayer along with copyright symbol 'AFP©' or without copyright symbol 'AFP' (as may be determined by the taxpayer in terms of its internal policy), which can be used except as per terms of the taxpayer.

7. The Tribunal also observed that the news that is distributed by the taxpayer to various news agencies is obtained from different sources including the taxpayer's own personnel, domestic as well as international news correspondents, and other agencies etc. that have a good amount of experience in news reporting. Such news stories as obtained by the taxpayer is further evaluated and processed by its editorial team which comprises a network of senior journalists who are the best journalistic minds in news business possessing specialised skills and are capable of coming out with news-stories having a distinct feature and innate quality. It is for this very distinct feature and innate quality that the taxpayer's news is preferred and is revered to as one of the most reliable news agencies in the world since its year of inception i.e. 1835.

8. In view of the discussion, the Tribunal observed that the instant case satisfies the elements of labour, skill and capital.

9. With regards to the question of news and photographs being the subject matter of copyright, the Tribunal observed that the entire gamut of news services provided by the taxpayer could be split into the following three categories for the sake of brevity.

a. First category 'News': Concerning news *per se*, the same constitutes reporting of mere facts current events etc. and thus cannot be copyrighted as it does not fulfill the requirements enlisted under section 13(1)(a) of the Indian copyright Act 1957. Further, also taking notice of the fact that the parties have adopted the same stand on copyrightablity of news *per se*, there is no hesitation in holding that news *per se* is not copyrightable.

b. Second category-News story including archived news: Since it is established above that news *per se* cannot be copyrighted it

could be stated that, there is no copyright over the news. However, there is copyright over the way in which a news item is reported." to appreciate the distinction between mere reporting of facts from news stories which constitutes a form of expression.

Taking cues from the observation by the jurisdictional High Court in the case of *India TV Independent News Service Pvt. Ltd. & Ors. vs. Yashraj Films*, it is noted that a news item or news story as distributed by the taxpayer to Indian News agencies would, if looked in contrast to the first category discussed above is greater in content as well as original literary expression and even posses independent commercial value vi-a-vis subscription agreements and hence, most definitely does not constitute trifle details or news as covered under the first category.

Thus, such news-reports as well as archived data being in the nature of 'original literary works' does not fall foul to the doctrine of de minimi and meets statutory requirements for copyright outlined under section 13(1)(a) of the Indian Copyright Act, 1957. Hence, in light of foregoing facts and circumstances involved in the instant case it could be concluded that copyright subsists in such news item/ news story under consideration.

c. Third category – photographs: In the present case the photographs as distributed by the taxpayer is taken by a professional photographer of high levels of competence. Thus, on a reading of the subscription agreement, it emerges that the images or photographs as uploaded in the taxpayer's website cannot be altered with except minor fading effect and resizing. The credit line for taxpayer's photographs is required to display a specific credit line i.e. AFP. On a reading of section 2(C)(i) of the Indian Copyright Act 1957 which deems 'photographs' as 'artistic works' keeping in view of the terms of use of such photographs vis-à-vis subscription agreement as discussed above as well as separate commercial value being ascribed to such photographs the same very clearly fits into the sweep of section 13(1)(a) of the Indian Copyright Act, 1957. Hence it could be concluded that copyright subsists in such photographs/image under consideration.

10. Keeping in mind that the taxpayer in the instant case is providing a gamut of service covering all three categories without any split, all of the three categories in the case of the taxpayer is interlinked hence, should be construed as composite service possessing the 'modicum of creativity' under second and third category and that copyright subsists in the news reports and photographs supplied by the taxpayer, the same rightfully possesses the minimum 'modicum of creativity'.

II) India-Thailand DTAA – Services which do not impart technical know-how or transfer any knowledge, experience, or skills, can be taxed as royalty – Held : No

GECF Asia Limited vs. DIT 2014-TII-114-ITAT-MUM-INTL – Assessment Year: 2007-08

Facts

1. The taxpayer is a non–resident company incorporated in Thailand, engaged in the business of providing services to meet the needs of various GE Group companies.

2. The taxpayer entered into a Master Service Agreement (MSA), 2005 with the GE Countrywide Consumer Financial Services Ltd. (GEMFSL), in terms of which the taxpayer is required to provide accounting and finance support services, human resources services, legal and compliance services, risk management services, quality consultation and training, sales and marketing, information technology and system support, and strategic management assistance.

3. The taxpayer has received payment from GEMFSL for providing the aforesaid services.

Subsequently, the taxpayer also filed nil return of income claiming that income earned by it was in the nature of business income, and it cannot be taxed under Article 7 of the tax treaty in the absence of a Permanent Establishment (PE) as defined in Article 5 of the tax treaty.

4. The AO held that the payment received by the taxpayer was on account of business connection in India and, hence, taxable under the Income-tax Act, 1961 (the Act). He also held that services rendered by the taxpayer would also fall within the definition of Fees for Technical Services (FTS) under section 9(1)(vii) of the Act. Alternatively, such services would also fall within the definition of 'royalty' under the Article 12(3) of the tax treaty and, hence, would be taxable in India.

5. The Dispute Resolution Panel (DRP) held that the payments received by the taxpayer are for providing industrial, commercial, or scientific experience and, hence, the receipts are taxable as 'royalty' defined under Article 12(3) of the tax treaty.

Decision

The Tribunal held in favor of the assessee as follows:

1. The OECD commentary on Article 12, has explained the term 'industrial, commercial, or scientific' experience. On a perusal of the same, it indicates that the royalty payment received as consideration for information concerning industrial, commercial, scientific experience alludes to the concept of know-how. There is an element of imparting know-how to the other, so that the other person can use or has the right to use such know-how.

2. In the case of industrial, commercial, and scientific experience, if services are being rendered simply as an advisory or consultancy, then it cannot be termed as 'royalty', because the advisor or consultant is not imparting his skill or experience to the other, but rendering services from his own know-how and experience. All that he imparts is a conclusion or solution that draws from his own experience. Further, the difference between royalty and rendering services has been reiterated by the eminent author Klaus Vogel.

3. The thin line of distinction which needs to be considered while rendering the services on account of information concerning industrial, commercial, and scientific experience is, whether there is any imparting of know-how or not. If there is no 'alienation' or the 'use of' or the 'right to use of' any know-how i.e., there is no imparting or transfer of any knowledge, experience or skill or know-how, then it cannot be termed as 'royalty.

4. The services may have been rendered by a person from their own knowledge and experience but such a knowledge and experience had not been imparted to the other person as the person retains the experience and knowledge or know-how which was required to perform the services to clients. Hence, in such a case, it cannot be held that such services are in the nature of 'royalty'.

5. Thus, if the services have been rendered *de hors* the imparting of know-how or transfer of any knowledge, experience or skill, then such services will not fall within the ambit of Article 12 of the tax treaty.

6. Since the lower authorities have not examined the nature of service rendered by the taxpayer, the matter was remitted back to the AO to examine the nature of services in line with the principles discussed above. If such services do not involve imparting of know-how or transfer of any knowledge, experience or skill, then it cannot be held to be taxable as 'royalty'.

7. Since the issue of FTS was not the subject matter of dispute after the direction of the DRP, hence, the Tribunal did not express any opinion on FTS.

(Note: India-Thailand DTAA does not contain FTS Clause)

III) Whether taxpayer is eligible for lower rate of tax under section 115A of the Act on payment of royalty since the new agreements entered into by the taxpayer were not an extension of old agreements – Held : Yes

GKN Holdings Plc vs. DDIT 2014-TII-139-ITAT-PUNE-INTL – Assessment Year: 2009-10

Facts

1. The taxpayer is a U.K. based company. It has two associate companies in India, namely GKN Sinter Metals Ltd. and GKN Driveline (India) Ltd.

2. The taxpayer is a proprietor of certain trademarks and entered into agreements in the year 2004 with GKN Sinter Metals Limited and GKN Driveline (India) Limited permitting them to use its trademarks in respect of various products and services.

3. In the year 2007, new licence agreements were entered into by the taxpayer with its associates as per which royalty was charged based on sales at the rates dependent on the reported operating profit by each foreign entity.

4. During the Assessment Year 2008-09, the taxpayer received payment of royalty from GKN Driveline (India) Ltd. and from GKN Sinter Metals Ltd., and it was offered to tax at 10.56% as per section 115A of the Act.

5. The Assessing Officer (AO) held that since the new agreement entered in the year 2007 was nothing but extension of the existing agreement, the taxpayer will not get the benefit of lower rate of tax under section 115A(1)(b)(AA) of the Act. Accordingly, the AO rejected the contention of the taxpayer and assessed the royalty income at 15 % under Article 13 of the India-U.K. tax treaty (tax treaty). The Dispute Resolution Panel (DRP) upheld the order of the AO.

Decision

The Tribunal held in favour of the assessee as follows:

1. As per the provisions of section 115A(1)(b)(AA) of the Act, the tax will be levied on royalty income at 10% on the strength of the agreement. It was an undisputable fact that the taxpayer had an earlier agreement in 2004 with GKN Sinter Metals Ltd. and the same was renewed in 2007.

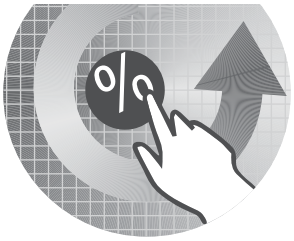
2. The provisions of section 115A(1)(b)(AA) of the Act does not debar the taxpayer from entering into new agreements after change of situation in the provisions of the said section as far as the reduced rate of royalty is concerned.

3. New agreements entered into in 2007 between the taxpayer and GKN Sinter Metals Ltd., and in the same year with GKN Driveline (India) Ltd. are independent agreements.

4. The taxpayer can manage its affairs within the framework of the statute. The tax department cannot sit into the business decisions of the taxpayer. By no stretch of imagination, the new agreement entered into in 2007 can be said to be the extension of old agreements entered into between the parties.

5. Even if the taxpayer has managed its affairs as far as the renewal of agreement is concerned, the tax department should not interfere with the same, unless it is proved beyond doubt that it is nothing but a colourable device. Even if the taxpayer had entered into new licence agreements with GKN Sinter Metals Ltd. and GKN Driveline (India) Ltd. to take advantage of the lower rate of tax of 10 %, the same cannot be denied to the taxpayer on the grounds that the same is nothing but an extension of the old agreement. The new licence fee agreement entered into by the taxpayer with GKN Sinter Metals Ltd. and in the same year with GKN Driveline (India) Ltd. is nothing but a new and separate agreement. Accordingly, the licence fee income should be taxed at 10%.

CA Janak Vaghani



INDIRECT TAXES
VAT Update

1) Amendment to MVAT Rules, 2005.

Notification No. VAT.1514 /CR- 62/Taxation-1, dated 13-8-2014
The Maharashtra Value Added Tax (Fourth Amendment) Rules, 2014
The Maharashtra Government, to give effect to announcement made in State Budget-2014, has made amendment to certain rules by above notification.

2) Notification under Schedule Entries

i) Notification No. VAT 1514/CR-59/ Taxation-1, dated 21-8-2014
Spare Parts of Aircrafts – Entry 2A of Schedule A
The Government of Maharashtra has issued above notification in exercise of power under entry 2A of Schedule A from 21-8-2014 to notify Spare Parts of Aircrafts for the purpose of said entry on sale of which no tax is payable.

ii) Notification No. VAT-1514/CR-69/ Taxation-1, dated 22-8-2014
Capital Goods Parts and Component – Sub Entry (2A)of Entry 107 of Schedule C
The Government of Maharashtra has issued above notification in exercise of power under sub-entry (2A) of entry 107 of Schedule C, from 1-9-2014 to specify list of Capital Goods and Parts and Component thereof for the purpose of said sub-entry liable to tax @ 5%.

3) Notification under Sections of MVAT Act

i) Notification No. VAT 1514/CR-68/ Taxation-1, dated 21-8-2014
Notified Authority responsible to Collect Tax at Source (TCS) – Section 31(1) and (2)
The Government of Maharashtra has issued above notification in exercise of power under entry sections 31(1) and (2) of the Act from 1-10-2014 to notify following authority to collect tax at source from the dealer to whom quarrying lease or, as the case may be, permit for quarrying is granted in respect of minor minerals as defined in section 3 (e) of the Mines and Minerals (Development and Regulation) Act, 1967, excluding sand @ 10% of amount of royalty payable to it; –

a) District Collector, or

b) Cantonment Board, or

c) Any Authority of State Government or Central Government

ii) Notification No. VAT 1514/CR-54/ Taxation-1, dated 21-8-2014

New Composition Scheme for Retail Dealers – Section 42 of the Act

The Government of Maharashtra has issued above notification in exercise of power under entry section 42 of the act from 1-10-2014 to substitute Notification No. VAT 1505/CR 105/ Taxation-1, dated 1-6-2005 providing for new composition scheme applicable to those retailers whose total sales has not exceeded ` 50 lakhs in previous year whereby rate of composition @ 1.5% is provided on total taxable turnover of sales (excluding tax free) or 1% on total turnover of sales including tax free sales subject to conditions mentioned therein. The existing composition dealer has to mandatorily apply online in Form 4A on or before 31st October 2014 to continue the benefit of new composition scheme. Other retail dealers who are liable to file half yearly returns can opt for composition from 1-10-2014 by applying online in Form 4A on or before 31-10-2014.

4) Trade Circulars

i) No. 16 T of 2014, dated 17-9-2014

Providing e-payment facility for Profession Tax, Luxury Tax and Sugarcane Purchase Tax through GRAS

The Commissioner of Sales tax, Maharashtra State has issued above trade circular to inform the trade and industry about e-payment facility of collection of receipts by various Government departments through GRAS (Government Receipts Accounting System). The Sales Tax Department has also decided to accept the payment under Profession Tax, Luxury Tax and Sugarcane Purchase Tax Acts through GRAS from 18-9-2014. It is also clarified that this facility of payment through GRAS is optional at present and soon it will be made mandatory. In the said circular procedure for payment under GRAS is explained.

ii) No. 17 T of 2014, dated 20-9-2014

Composition Scheme for Retailers under Section 42 of the MVAT Act

The Commissioner of Sales Tax, Maharashtra State has issued above trade circular to explain the trade and industry the new composition scheme notified under Notification No. VAT 1514/CR-54/Taxation-1, dated 21-8-2014 for Retailers applicable from 1-10-2014.

iii) No. 18 T of 2014, dated 26-9-2014

Third and Fourth Amendments to MVAT Rules

The Commissioner of Sales Tax, Maharashtra State has issued above trade circular to explain the trade and industry, the Third and Fourth Amendments to MVAT Rules made by Notification Nos. VAT.1514 /CR-29/Taxation-1, dated 23-7-2014 and VAT.1514/CR-62/ Taxation-1, dated 13-8-2014 respectively.

5) Web Site Update

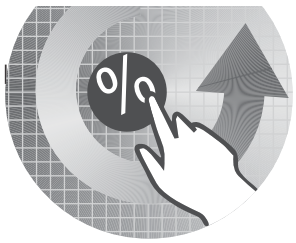
CDA Compliance for 2011-12

The Sales Tax Department has informed on the site that notices for verification are being issued to those dealers who have not submitted CDA web compliances for the period 2011-12 and such dealers may upload CDA web compliance till the receipt of notice from the department.

The greatest religion is to be true to your own nature. Have faith in yourselves! If you do not exist, how can God exist, or anybody else?

— Swami Vivekananda


CA Rajkamal Shah & CA Naresh Sheth



INDIRECT TAXES
Service Tax – Statute Update

1. Service tax implications of Joint Ventures (JV)

CBDT has come out with clarifications on levy of service tax involving transactions between the JV and its members or *inter se* between the members of a JV.

Gist of the clarification is as under:

- JV and its members are treated as distinct persons as provided by explanation 3(a) of Section 65B (44) of the Act.

  Taxable services provided for consideration by JV to its members or vice versa and between the members of the JV are taxable.

- Taxability of Capital contributions (cash calls) made by the members to the JV needs to be examined in the context of terms of joint venture agreement.

  If cash calls are merely a transaction in money, they are excluded from the definition of service provided in section 65B (44) of the Finance Act, 1994 and are not liable to service tax.

  If such cash calls are in nature of advance payment made by the members towards taxable services received or receivable from JV, such transactions would be liable to service tax.

  JV agreeing to do something of direct benefit either to a member or on behest of a member to a third party such as granting of right, reserving production capacity or providing an option on future supplies is a taxable service liable to service tax.

- Any payment made by JV to members or third party towards receipt of taxable service from its members or third party attracts service tax.

  Usually responsibility of managing the cash calls of the JV is assigned to one or some of the members of the JV, by way of a contractual agreement, for which he/they may receive a consideration either in cash or kind. Such consideration is liable to service tax.

  A member may provide support services like administrative service in the form of setting up/management of a project office/site office to the JV for a consideration is liable to service tax.

- Field formation officers are advised to carefully examine leviability of service tax with reference to specific terms and clauses of JV agreement.

(Circular No. 179/5/2014–Service tax dated 24th September, 2014)

2. Mandatory pre-deposit of tax for filing of appeal with Commissioner of Appeals [CCE (A)] or in Customs, Excise and Service Tax Appellate Tribunal (CESTAT)

Section 35F of the Central Excise Act, 1944 is amended w.e.f 6-8-2014 to provide for mandatory pre-deposit as a percentage of the duty demanded where duty demanded is in dispute or where duty demanded and penalty levied are in dispute. Where penalty alone is in dispute, the pre-deposit shall be calculated on the penalty imposed.

CBEC has come out with clarifications on doubts raised by Trade bodies, Industry associations and field formations. The gist of clarifications is as under:

Applicability

- Mandatory pre- deposit provisions shall apply to appeals filed after 6-8-2014.
- All pending appeals/stay applications filed till 5-8-2014 (enactment of the Finance Bill) shall be governed by the erstwhile provisions.

Quantum of pre-deposit

- In the event of appeal against the order of Commissioner (Appeals) before the Tribunal, 10% is to be paid on the amount of duty demanded or penalty imposed by the Commissioner (Appeals). This need not be the same as the amount of duty demanded or penalty imposed in the Order-in-Original in the said case.
- In a case, where penalty alone is in dispute and penalties have been imposed under different provisions of the Act, the pre-deposit would be calculated based on the aggregate of all penalties imposed in the order against which appeal is proposed to be filed.
- In case of any short payment or non-payment of mandatory pre-deposit, the appeal filed is liable for rejection.

Payment made during investigations:

- Payment made during the course of investigation or audit, prior to the date on which appeal is filed (to the extent of 7.5% or 10%, subject to the limit of ` 10 crores) can be considered to be deposit made towards fulfilment of stipulation.
- Any shortfall from the amount stipulated as mandatory pre-deposit shall have to be paid before filing of appeal before the appellate authority.
- Amount paid over and above the mandatory pre-deposit shall not be treated as deposit.
- Since the amount paid during investigation/ audit takes the colour of deposit only when the appeal is filed, the date of filing of appeal shall be deemed to be the date of deposit.

Recovery of the Amount during the Pendency of Appeal

- No coercive measures for the recovery of balance amount i.e., the amount in excess of mandatory pre- deposit shall be taken during the pendency of appeal where the assessee shows to the jurisdictional authorities:
  - proof of payment of stipulated amount as pre-deposit of 7.5%/10%, subject to a limit of ` 10 crores, as the case may be; and
  - The copy of appeal memo filed with the appellate authority.
- Recovery action, if any, can be initiated only after the disposal of the case by the CCE(A)/ CESTAT in favour of the Department.

If the Tribunal decides a case in favour of the Department, recovery action for the amount over and above the mandatory pre-deposit may be initiated unless the order of the Tribunal is stayed by the High Court/Supreme Court. The recovery, in such cases, would include the interest, at the specified rate, from the date duty became payable, till the date of payment.

Refund of pre-deposit

- Notification No. 24/2014-CE (NT) dated 12-8-2014 has been issued specifying six per cent as rate of interest on refunds of mandatory pre-deposit from the date of such payment till the date of refund.
- Where the appeal is decided in favour of the assessee, he shall be entitled to refund of the amount deposited along with the interest at the prescribed rate from the date of making the mandatory pre-deposit to the date of refund.

- Pre-deposit for filing appeal is not payment of duty. Hence, refund of pre-deposit need not be subjected to the process of refund of duty under Section 11B of the Central Excise Act, 1944.
- In all cases where the appellate authority has decided the matter in favour of the appellant, refund with interest should be paid to the appellant within 15 days of the receipt of the letter of the appellant seeking refund, irrespective of whether order of the appellate authority is proposed to be challenged by the Department or not.
- If the Department contemplates appeal against the order of the CCE(A) or the order of CESTAT, which is in favour of the appellant, refund along with interest would still be payable unless such order is stayed by a competent Appellate Authority.
- In the event of a remand, refund of the pre-deposit shall be payable along with interest.

  In case of partial remand where a portion of the duty is confirmed, it may be ensured that the duty due to the Government on the portion of order in favour of the revenue is collected by adjusting the deposited amount along with interest.
- The refund of pre-deposit made should not be withheld on the ground that Department is proposing to file an appeal or has filed an appeal against the order granting relief to the party. Jurisdictional Commissioner should ensure that refund of deposit made for hearing the appeal should be paid within the stipulated time of 15 days.

Procedure for refund

- A simple letter from the person who has made such deposit, requesting for return of the said amount, along with a self-attested xerox copy of the order in appeal or the CESTAT order consequent to which the deposit becomes returnable and attested xerox copy of the document evidencing payment of such deposit, addressed to Jurisdictional Assistant/Deputy Commissioner of Central Excise and Service Tax or the Assistant/ Deputy Commissioner of Customs, as the case may be, would suffice for refund of the amount deposited along with interest at the rate specified.
- Record of pre-deposits should be maintained by the Commissionerate so as to facilitate seamless verification of the deposits at the time of processing the refund claims made in case of favourable order from the Appellate Authority.

Procedure and Manner of making the pre-deposits

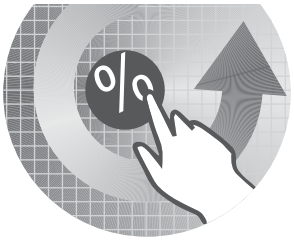
- E-payment facility can be made use of by the appellants, wherever possible.
- A self-attested copy of the document showing satisfactory proof of payment shall be submitted before the appellate authority as proof of payment of mandatory pre-deposit.
- The appeals before CCE(A) and CESTAT are filed in appeal memo in prescribed format. The said appeal forms seek information of payment of duty, fine, penalty, interest along with proof of payment (challan). These columns may, therefore, be used for the purpose of indicating the amount of deposit made, which shall be verified by the Appellate Authority before registering the appeal.
- A copy of the appeal memo along with proof of deposit made shall be filed with the jurisdictional officers.

Amendment to Preamble of Orders

In order to make the new provisions known to the assessee/trade, adjudicating officer or CCE (A) is directed to incorporate an appropriate note in preamble of their order informing that further appeal can be done only on mandatory pre-deposit as prescribed in the Act.

(Circular No. 984/08/2014–CX dated 16th September, 2014)

CA Bharat Shemlani



INDIRECT TAXES
Service Tax – Case Law Update

1. Services

Renting of Immovable Property Service

1.1 Airport Retail Pvt. Ltd. vs. UOI 2014 (35) STR 659 (Del.)

The appellant in this case engaged in activity of granting licence to set up and operate duty-free shops within Airport premises, with stipulation of fixed monthly licence fees and share of gross revenue generated by product sold. Original agreements were entered on 9-11-2006, but appellant closed their operation w.e.f. 30-6-2010. The department sought to tax them under Airport Service. The High Court held that, such activity is liable under Renting of Immovable Property Service w.e.f. 1-6-2007 and prior to that it is not liable to service tax. It is also held that, split of consideration by itself cannot lead to conclusion that, licence fee was not a consideration for use of premises and it is possible that lease rentals or fees for use of space may be based on revenue that may be generated from use of premises, in course of business. This could not alter nature of transaction or interest in immovable property created in favour of lessee/licencee.

Commercial Training or Coaching Service

1.2 CCE, Meerut-I vs. Doon Institute of Information & Techno P. Ltd. 2014 (35) STR 711 (Uttarakhand)

The High Court in this case held that, in absence of statutory definition of Vocational training institute in Notification No. 24/2004-ST dated 10-9-2004, the Court have to proceed on the basis of ordinary meaning of word 'Vocational', which means 'relating to an occupation or employment, directed at particular occupation and its skills. Since nothing has been mentioned in Notification No. 24/2004-ST as regards computer training institutes, notification does not make any distinction between a vocational training institute and computer training institute. Therefore assessee was a vocational training institute in terms of Notification No. 24/2004-ST until 16-6-2005 i.e. when the concept of computer training institute was introduced in Notification No. 24/2004-ST.

Business Auxiliary Services

1.3 CCE, Chandigarh vs. Ashu Forex Pvt. Ltd. 2014 (35) STR 776 (Tri.-Del.)

The assessee in this case was working as sub-agent of AFL Ltd. which was working as principal representative of Western Union, Ireland. The department contended that, activity is not limited to delivery of money to ultimate beneficiary but extended to advertise and promote money transfer. The Tribunal held that, primary function is delivery of money to ultimate beneficiary for commission and following Tribunal decision in *Paul Merchants Ltd. 2013 (29) STR 257 (Tribunal)* activity to be treated as export of service not liable to service tax.

Market Research Agency Service

1.4 J. J. Foam Pvt. Ltd. vs. CCE, Ghaziabad 2014 (35) STR 792 (Tri.-Del.)

The appellant in this case executed agreement which appointed them as Sales Promotion Agent and they were responsible for procurement, supervision and promotion of sale of products and received commission at specified percentage. The Tribunal held that, activity is in the nature of promotion of sale of goods and therefore not classifiable as Market Research Agency Service.

Cargo Handling Services and GTA Service

1.5 Balmer Lawrie & Co. Ltd. vs. CCE, Raigad 2014 (35) STR 800 (Tri.-Mumbai.)

The appellant in this case discharged service tax liability on Cargo Handling Service and GTA Service separately. The department contended payment of Service Tax on whole amount. The Tribunal held that, CBEC Circular No. B-11/1/2002-TRU, dated 1-8-2002 *inter alia* clarified that, where cargo handling charges and transportation charges are shown separately in bills raised, assessee is liable to discharge tax liability only on Cargo Handling Service. Since service tax liability on both services discharged, question of leviability of service tax on whole amount is unsustainable.

Tour Operator Service

1.6 Cox & Kings India P. Ltd. vs. CST, New Delhi 2014 (35) STR 817 (Tri.-Del.)

The Tribunal in this case held as under:

- The definition of Tour Operator is in two facets i.e. generic and specific. The contours of expression in generic facet clearly limited to business of planning, scheduling, organising or arranging tours excluding operation of tours. Operation of tours in tourist vehicle covered by permit granted under Motor Vehicles Act, 1988 or rules thereunder is distinct facet of definition. The activity of the appellant in the nature of operation of tours and planning etc. of tours by mode of transport other than by tourist vehicle is outside the locus of Tour Operators definition.
- The taxable event is provision of taxable service and not pursuit of profession of taxable service provider.
- The activity of planning and scheduling and organising and arranging is not a distinct and separate taxable service and it is incidental to operating and conducting tours therefore, services provided to self not to constitute taxable service.
- Circumstances establishing substantial normative basis for *bona fides* of no liability to tax on outbound tours, therefore invocation of extended period of limitation is unjustified and unwarranted.

Broadcasting Service

1.7 ESPN Software India (P) Ltd. vs. CST, New Delhi 2014 (35) STR 927 (Tri.-Del.)

The appellant is a company based in India, and having head office outside India. They

have provided services of selling time slots, obtaining sponsorship, collecting subscription charges and permitting right to receive communication signals by MSO/DTH. The department sought to assess them under Broadcasting Service as recipient of service. The Tribunal held that, neither foreign broadcaster was service provider nor assessee was recipient of any broadcasting service and distribution rights given by foreign broadcaster to assessee were not liable to service tax.

The consideration received for earning commission as Advertising Sale Representative of foreign company is covered under export of service rules, hence demand is not sustainable.

Reimbursable charges for taxable services cannot form part of gross amount charged towards taxable service hence they cannot be taxed under BAS.

Cartoon Characters and Elements are artistic work as defined in section 2(c) of Copyright Act, 1957 and hence licensing of them is excluded from the definition of IPR service.

The activity of creating, producing and developing concept/format creation/ acquisition and providing pre-production, product and post-production services to create programme content intended for broadcasting on foreign companies international channel network is liable under Programme Producer Service.

2. Interest/Penalties/Others

2.1 Travelite (India) vs. UOI 2014 (35) STR 653 (Del.)

The High Court in this case held that Finance Act, 1994 contemplates only special audit of type stipulated in Section 72A and prescription of circumstances under which it can be carried out compels necessary interference that, Parliament did not intend to provide for general audit that 'every assessee' may be subjected to 'on demand'. To include provision of such general audit through Rule 5A(2) of STR, 1994 is *ultra vires* rule making power conferred under section 94(1).

2.2 Ramilaben Bharatbhai Patel vs. UOI 2014 (35) STR 695 (Guj.)

The appellant in this case applied for STVCES, 2013 scheme, however due to *bona fide* calculation error deposited short amount of service tax than 50% of tax dues by 31-12-2013 and requested for payment of shortfall with interest. The High Court held that, scheme makes no distinction between tax dues which is short paid due to *bona fide* error and short payment which flows from deliberate action and there is no power for waiving or relaxing the condition of depositing 50% of tax dues flowing from section 107. Hence, petitioners request for payment of shortfall amount with interest is not acceptable.

2.3 Centre for Dev. of Imaging Technology vs. CST Thiruvananthapuram 2014 (35) STR 723 (Ker.)

The High Court in this case held that, section 73(1) of FA, 1994 clearly indicates the circumstances under which limitation period of one year and when period of five years has to be read instead of one year. If once the Tribunal decides the limitation issue, even if the demand is in order, the Department may not be entitled to collect the amount of service tax and then impose penalty.

2.4 CST, Delhi vs. EPIC India Pvt. Ltd. 2014 (35) STR 948 (Tri.-Del.)

The assessee in this case rendered BAS prior to increase in rate of service tax from 8% to 12% w.e.f. 10-9-2004. The department alleged that, rate in force at the time of service tax

becomes chargeable to be rate applicable to taxable transaction. The Tribunal after relying on High Court's decision in *Vistar Constructions Pvt. Ltd. 2013 (31) STR 129 (Del)* and *Consulting Engineering Services (I) Pvt. Ltd. 2013 (30) STR 586 (Del.)* held that date of rendition of taxable service is relevant date for purpose of applying rate of tax.

2.5 Arkay Glenrock (P) Ltd. Unit-II vs. CCE, Madurai 2014 (35) STR 953 (Tri.-Chennai)

The department in this case rejected refund claim filed by 100% EOU for clearance made to 100% EOU. The Tribunal held that, it is Government's policy to grant benefit in case of rebate and refund on exports when goods supplied to SEZ and same logic is applicable for supply to EOU also. Further, Gujarat High Court's decision in *Essar Steel Ltd. 2010 (249) ELT 3 (Guj.)* to prevail over Tribunal's decision in *Tiger Steel Engineering (I) Pvt. Ltd. 2010 (259) ELT 375 (Tribunal).*

3. CENVAT Credit

3.1 Ultratech Cements Ltd. vs. CCE, Raipur 2014 (35) STR 641 (Chhattisgarh)

The High Court in this case held that, place of removal is to be decided on facts and circumstances of the each case as to what is place of removal. There is no provision in the Central Excise Act or Rules or Circular to hold that, in case the duty is charged on specified rate, then the place of removal will be factory gate. If legislature or Central Government or CBEC wanted 'place of removal' to be factory gate, they could so define it in Central Excise Act or Rules or Circulars. The presumption by Tribunal that, place of removal is factory gate of manufacturer in case the Excise duty is charged on specified rate is incorrect.

3.2 Lafarge India Ltd. vs. CCE, Raipur 2014 (35) STR 645 (Chattisgarh)

The High Court in present case held that, in case of sale at the place of destination an assessee is only entitled to claim CENVAT credit on Service Tax paid for the GTA Service, provided amount paid was integral part of price of goods. The appellant in this case, has neither treated the GTA service of transporting goods to destination as part of input service nor included the amount paid for the GTA service in price of goods. Therefore, the appellant is not entitled to claim CENVAT credit for the same.

It is further held that, if under terms of contract, the sale takes place at destination then that place may be place of removal and service tax paid on GTA service for transporting goods up to destination might be available for taking credit. In case the sale takes place at the destination, then CBEC Circular No. 97/8/2007-ST dated 23-8-2007 envisages three conditions to be satisfied before CENVAT credit to be claimed. Also in case of transportation of goods on FOR basis is concerned, the ownership of goods continues up to place of destination and this would be treated as input service.

3.3 Commissioner vs. Dynamic Industries Ltd. 2014 (35) STR 674 (Guj.)

The High Court in this case held that, Custom House Agent, Shipping Agent and Container Services used for export of finished goods by manufacturer are input services as exports are on FOB basis and place of removal is port and not factory gate. The disputed services were utilised for purpose of export of final products and exporters could not do business without them. It is further held that, commission paid to overseas agents for export of finished goods is not input service and therefore credit is inadmissible. It is also held that, since credit availment shown

in ER-1 returns and no allegations made of suppression or misrepresentation in respect of availment of CENVAT credit, invocation of extended period and imposition of penalty set aside.

3.4 F.M. Steel Alloys (P) Ltd. vs. CCE, Chandigarh-I 2014 (35) STR 767 (Tri.-Del.)

The department in this case contended that, input service received from registered dealer who allegedly taken the premises on rent on the basis of fake and bogus rent deed. The Tribunal observed that, dealer was registered with Department only after physically visiting the premises and appellant proved transportation of goods, service tax paid on GTA service and the department has not established any alternative source of procurement of inputs. It is held that, appellant procured inputs from registered dealer, reflected the same in RG-23A Part-I, utilized the same in manufacture of final product cleared on payment of duty hence entitled for benefit of CENVAT credit.

3.5 Friends & Friends Shipping Pvt. Ltd. vs. CCE&ST, Rajkot 2014 (35) STR 811 (Tri.-Ahmd.)

The appellant in this case claimed CENVAT credit on the basis of debit notes issued by CHA for service tax paid on services received from Kandla Port Trust and Kandla Dock Labour Board. The Tribunal held that, services provided by CHA has not been mentioned in Debit Notes and appellant has not availed service directly. In absence of evidence of showing CHA acting as agent of assessee, the assessee is ineligible to claim CENVAT credit. It is further held that, rules 5(3) and 9 of CCR, 2004 are very clear and ought to be interpreted as per words contained therein.

3.6 Bharti Airtel Ltd. vs. CCE, Pune-III 2014 (35) STR 865 (Bom.)

The appellant in the present case availed CENVAT credit on Tower/prefabricated buildings (PFB) with antenna, Base Trans-receiver Station (BTS) and parts thereof used for providing cell phone service. The High Court held that, such towers are fastened/fixed to earth and after erection they become immovable hence, they cannot be said to be goods. They are immovable structures, non-marketable and non-excisable. They could not be treated as capital goods, as they were neither components, spares and accessories of capital goods as defined in rule 2(a) of CCR, 2004. Hence, CENVAT credit on such towers/PFB is not allowed.

3.7 L & T Sargent & Lundy Ltd. vs. CCE, Vadodara 2014 (35) STR 945 (Tri.-Ahmd.)

The Tribunal in this case after relying on CBEC Circular No. 868/6/2008-CX dated 9-5-2008 held that, export of service not to be treated as exempted service and CENVAT credit used therein cannot be denied. It is further held that, beneficial circular to be applied retrospectively and when circular is against the assessee, they have right to claim enforcement prospectively.

3.8 Birla Corporation Ltd. vs. CCE, Lucknow 2014 (35) STR 977 (Tri.-Del.)

The Tribunal in this case allowed CENVAT credit of service tax paid on commission agent's service for procuring sales orders as the same is covered by term advertisement or sales promotion under definition of input service.

CA Mayur Nayak, CA Natwar Thakrar &
CA Pankaj Bhuta

OTHER LAWS
FEMA Update

In this article, we have discussed recent amendments to FEMA through Circulars issued by RBI:

1. Three divisions of Foreign Exchange Department shifted to FED CO Cell at New Delhi

According to Press Release dated June 17, 2014, three divisions of Foreign Investment Division (FID) viz. Liaison/Branch/Project Office (LO/BO/PO) Division, Non-Resident Foreign Account Division (NRFAD) and Immovable Property (IP) Division have been shifted to New Delhi with effect from July 15, 2014. The address for correspondence for the three divisions is FED, CO Cell, Foreign Exchange Department, Reserve Bank of India, New Delhi Regional Office, 6, Parliament Street, New Delhi – 110 001, India.

Vide A.P (DIR Series) Circular No. 106 dated February 18, 2014, AD – Category-I banks were required to furnish on a monthly basis, a statement on the number of applicants and the total amount remitted from NRO account, as per proforma annexed with the circular, to the Chief General Manager-in-Charge, Foreign Exchange Department, Foreign Investments Division (NRFAD), Reserve Bank of India, Central Office, Mumbai – 400 001 within 7 days of the end of the reporting month.

Also, *vide* Para 5(ii) and Para 5(iii) of A.P (DIR Series) Circular No. 24 dated December 30, 2009, AD – Category–I banks were required to report (i) the extension of validity of the Liaison Offices to the Regional Office concerned as well as to the Central Office, and (ii) closure of the Liaison Offices to the concerned Regional Office and closure of the Branch Offices to the Central Office.

The RBI has specified that all cases pertaining to these three divisions and the monthly statements as per circulars ibid/reporting for extension or closure of LOs/BOs shall be sent to the FED CO Cell at New Delhi at the address mentioned above and that the reporting, by e-mail, for NRFAD shall continue at the same e-mail address.

(A.P. (DIR Series) Circular No. 23 dated 2nd September, 2014)

2. Exim Bank's Line of Credit of USD 89.90 million to the Government of the Republic of Congo

The Credit Agreement under the LOC is effective from August 8, 2014 and the date of execution of Agreement is March 9, 2014.

(A.P. (DIR Series) Circular No. 24 dated 2nd September, 2014)

3. External Commercial Borrowings (ECB) in Indian rupees

Under Regulation 6 of Notification No. FEMA.3/2000-RB dated May 3, 2000, persons

resident in India are allowed to raise foreign currency loans from non-residents in accordance with the provisions contained in the Notification.

Vide Paragraph 2(ii)(a) of A.P. (DIR Series) Circular No. 27 dated September 23, 2011, all eligible borrowers are allowed to raise ECB in Indian rupees from foreign equity holders as per the extant ECB guidelines.

In order to provide greater flexibility for structuring of ECB arrangements, the RBI has decided that recognised non-resident ECB lenders may extend loans in Indian rupees subject to the following conditions:

i. The lender should mobilise Indian rupees through swaps undertaken with an Authorised Dealer Category-I bank in India.

ii. The ECB contract should comply with all other conditions applicable to the automatic and approval routes as the case may be.

iii. The all-in-cost of such ECBs should be commensurate with prevailing market conditions.

For the purpose of executing swaps for ECBs denominated in Indian rupees, the recognised ECB lender, if it desires, may set up a representative office in India in accordance with the prescribed process laid down.

The hedging arrangement for ECBs denominated in Indian rupees extended by non-resident equity-holders shall continue to be governed by the provisions of AP (DIR Series) Circular No. 63 dated December 29, 2011.

(A.P. (DIR Series) Circular No. 25 dated 3rd September, 2014)

(Through this relaxation, RBI has allowed all categories of eligible lenders to provide ECB in rupees provided the currency swaps are undertaken with AD Bank in India. While this is a good move, current high forward rates may act as deterrent for increase in inflows. Also while relaxing all-in-cost ceiling for rupee lending to prevailing market condition, RBI has not specified the meaning 'prevailing market condition')

4. Exim Bank's Line of Credit of USD 26.50 million to the Government of the Republic of Honduras

The Credit Agreement under the LOC is effective from August 13, 2014 and the date of execution of Agreement is January 15, 2014.

(A.P. (DIR Series) Circular No. 26 dated 5th September, 2014)

5. Exim Bank's Line of Credit of USD 18 million to the Government of the Republic of Mauritius

The Credit Agreement under the LOC is effective from July 28, 2014 and the date of execution of Agreement is May 5, 2014.

(A.P. (DIR Series) Circular No. 27 dated 5th September, 2014)

6. Risk Management and Inter Bank Dealings: Hedging Facilities for Foreign Portfolio Investors (FPIs)

Under the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 dated May 3, 2000 (Notification No. FEMA.25/ RB-2000 dated May 3, 2000) as amended from time to time and A.P. (DIR Series) Circular No. 32 dated December 28, 2010, Foreign Portfolio Investors (FPIs) are allowed to approach any AD Category-I bank for hedging their currency risk on market value of the entire investment in equity and/or debt in India as on a particular date subject to certain conditions laid down in the above mentioned Circular No. 32 as amended from time to time.

In order to enhance hedging facilities for the FPIs holding securities under the Portfolio Investment Scheme (PIS) in terms of schedules 2, 2A, 5, and 8 of the Foreign Exchange Management (Transfer or issue of Security by a Person Resident Outside India) Regulations, 2000 (Notification No. FEMA 20 /2000-RB dated 3rd May, 2000) as amended from time to time, as announced in the Monetary Policy Statement of April 1, 2014, the RBI has decided to

permit FPIs to hedge the coupon receipts arising out of their investments in debt securities in India falling due during the following twelve months subject to the condition that the hedge contracts shall not be eligible for rebooking on cancellation. The contracts can however be rolled over on maturity provided the relative coupon amount is yet to be received.

All other regulations and guidelines issued under FEMA, 1999 relating to investment in debt securities and hedging facilities for non-resident investors including FPIs shall remain unchanged.

(A.P. (DIR Series) Circular No. 28 dated 8th September, 2014)

(This is a welcome move by RBI allowing FPIs to hedge currency risk on market value of their coupon receipts in addition to the hedging of principal investments allowed earlier. This may make investments more attractive for those FPIs who were unwilling to invest on account of uncovered currency risk on the coupons.)

7. Deferred Payment Protocols dated April 30, 1981 and December 23, 1985 between Government of India and erstwhile USSR

In terms of A.P. (DIR Series) Circular No. 20 dated August 12, 2014, the Rupee value of the Special Currency Basket was indicated as ` 83.137417 effective from August 12, 2014.

A further revision has taken place on September 4, 2014 and accordingly, the Rupee value of the Special Currency Basket has been fixed at ` 80.580297 with effect from September 9, 2014.

(A.P. (DIR Series) Circular No. 29 dated 12th September, 2014)

8. Data on Import of Gold Statement – Submission under XBRL

According to A.P. (DIR Series) Circular No. 103 dated April 3, 2012, AD Category–I banks are required to submit a statement on import of gold, to Reserve Bank of India, in the prescribed format, on a monthly as well as half yearly basis.

The RBI has, now, decided to move from manual reporting of the above-mentioned statements to eXtensible Business Reporting Language (XBRL) system from half year ended September, 2014. The details may be accessed at https://secweb.rbi.org.in/orfsxbrl/. For User name and password, AD banks are advised to submit the fill-in form (format annexed along with the circular) through e-mail on or before September 26, 2014.

AD banks are also advised to submit the statement in soft copy (through XBRL) as well as manual statement (MS-Excel file through e-mail) only for the month/half year ending September, 2014. The submission of manual statements (monthly as well as half yearly) from the month of October, 2014 onwards, would be dispensed with. All other instructions remain unchanged.

(A.P. (DIR Series) Circular No. 30 dated 15th September, 2014)

9. Foreign Direct Investment (FDI) in India – Issue of equity shares under the FDI Scheme against legitimate dues

In terms of paragraph 2(4) of the Schedule 1 of the Notification No. FEMA 20/2000-RB dated May 3, 2000, as amended from time to time, A.P. (DIR Series) Circular No. 15 dated October 1, 2004, and Notification No. FEMA 242/2012- RB dated October 19, 2012, an Indian company under the automatic route may issue shares/convertible debentures to a person resident outside India against lump sum technical know-how fee, royalty External Commercial Borrowings (ECBs) (other than import dues deemed as ECB or Trade Credit as per RBI guidelines) and import payables of capital goods by units in Special Economic Zones subject to certain conditions like entry route, sectoral cap, pricing guidelines and compliance with the applicable tax laws.

The extant guidelines for issue of shares/convertible debentures under the automatic route have been reviewed in consultation with the Government of India and, accordingly, the

RBI has decided to permit issue of equity shares against any other funds payable by the investee company, remittance of which does not require prior permission of the Government of India or Reserve Bank of India under FEMA, 1999 or any rules/regulations framed or directions issued thereunder, provided that:

i. The equity shares shall be issued in accordance with the extant FDI guidelines on sectoral caps, pricing guidelines etc. as amended by Reserve bank of India, from time to time;

   Issue of shares/convertible debentures that require Government approval in terms of paragraph 3 of Schedule 1 of FEMA 20 or import dues deemed as ECB or trade credit or payable against import of second hand machinery shall continue to be dealt in accordance with extant guidelines;

ii. The issue of equity shares under this provision shall be subject to tax laws as applicable to the funds payable and the conversion to equity should be net of applicable taxes.

All the other conditions for issuance of equity shares under the automatic route and Government approval route shall remain unchanged.

(A.P. (DIR Series) Circular No. 31 dated 17th September, 2014)

(This is a welcome relaxation by RBI allowing companies to issue equity shares against legitimate outstanding dues on account of goods and services of the investee companies under automatic route subject to fulfilment of specified conditions / tax withholdings.)

10. Exim Bank's Line of Credit of USD 30 million to the Government of the Republic of Togo

The Credit Agreement under the LOC is effective from August 21, 2014 and the date of execution of Agreement is June 20, 2014.

(A.P. (DIR Series) Circular No. 32 dated 24th September, 2014)

11. Exim Bank's Line of Credit of USD 52 million to the Government of the Republic of Togo

The Credit Agreement under the LOC is effective from September 16, 2014 and the date of execution of Agreement is June 20, 2014

(A.P. (DIR Series) Circular No. 33 dated 25th September, 2014)

12. Risk Management and Inter Bank Dealings : Hedging under Past Performance Route

As per the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 dated May 3, 2000 (Notification No. FEMA/25/RB-2000 dated May 3, 2000) as amended from time to time and A.P. (DIR Series) circular no. 58 dated December 15, 2011, as amended from time to time, and A.P. (DIR Series) circular no. 135 dated May 27, 2014, resident importers are allowed to book contracts up to 50 per cent of the eligible limit. The eligible limit is computed as the average of the previous three financial years' import turnover or the previous year's actual import turnover, whichever is higher.

In light of the evolving market conditions and with a view to bring both exporters and importers at par for hedging of currency risk of probable exposures based on past performance, the RBI has decided to allow importers to book forward contracts, under the past performance route, up to 100 per cent of the eligible limit. Importers who have already booked contracts up to previous limit of 50 per cent in the current financial year, shall be eligible for difference arising out of the enhanced limits.

All the other operational guidelines, terms and conditions shall apply *mutatis mutandis.*

(A.P. (DIR Series) Circular No. 34 dated 30th September, 2014)

(This is a welcome relaxation by RBI in light of stable currency outlook.)


Ajay Singh & Suchitra Kamble, *Advocates*

BEST OF THE REST

1. Appellate Tribunal – Responsibility of Tribunal Members – Different opinion on mixed and purely factual matters – High Courts displeasure in relation to reference to Third Member – No litigant should thrive on uncertainty and unpredictability CESTAT

The appellant before us, made an application before Tribunal styled as 'Miscellaneous Application on 29-9-2012. The appellant contended that there was a difference of opinion and matter was referred to third member. The appellant, however, further submitted that while delivering the original order, the Member (Judicial) has not considered all the propositions. Further, the facts of the appellant's case and those of one M/s. Datamani Technologies India Ltd., appear to be different. They are not at par with the present appellant. Therefore, referring the question to a Third Member, firstly on the issue not dealt with by the learned Member (Judicial) would not be proper. This was an apparent mistake and can be corrected. Secondly, the order deserves to be rectified so as to refer to the facts of the present appellant. The Tribunal in dealing with the application for rectification of mistake filed by the present appellant had held that now, the Third Member is required to express an opinion on factual and other issue or question and this cannot be said to be a mistake apparent in the Tribunal's original order. In these circumstances, the Tribunal proceeded to dismiss the application. The said order is challenged before the Court.

The Hon'ble Court observed that no substantial question of law arises in the appeal, the power of rectification of mistake is not akin to review of the original order. This is not a Review Jurisdiction. This is a power to correct an obvious or apparent mistake on face of the record. No detailed scrutiny or examination of the record again can be permitted. This power, as has been held by the Hon'ble Supreme Court, is extremely limited and restricted in nature. It enables the Tribunal to clear any ambiguity and apparent error in the original order so as not to cause inconvenience or cause prejudice to the parties in any manner. It cannot be equated or termed as substantive proceedings. In the garb of invoking this power the aggrieved party like the appellant cannot seek review of the original order and by calling upon the Tribunal to go behind it in some manner. In the present case, if the appellant is aggrieved by the fact that the original order refers to the case of M/s. Datamani Technologies (India) Ltd. alone and not that of the appellant, then, nothing prevents the appellant from raising this grievance at an appropriate stage and before the appropriate authority and in appropriate proceeding. The matter is still at large before the Third Member on the point/question formulated and noted above. It would be open for the appellant to raise a grievance that the facts pertaining to it should be noted while rendering any opinion and the Third Member should not merely go by the facts noted in the original order. Meaning thereby, the matter need not be decided or opinion need not be rendered

only with reference to the facts of M/s. Datamani Technologies (India) Ltd., but also by taking into consideration the appellant's case. In the event, the Third Member does not agree with the appellant, then, the appellant is not remedy less. The opinion which would be given by the majority would then be the final order of the Tribunal and if it is adverse to the appellant, then, while challenging it the appellant can raise all contentions including the manner in which the appeal is decided originally and by the Third Member. The appellant can point out the errors committed in the course adopted by the Third Member while rendering his opinion or answering the question formulated above.

The court observed that even when seized of an appeal against the order passed by the appellate authority or an original order, this principle has to be borne in mind. The appellate power has to be exercised so as to correct such errors as are referred by the Hon'ble Supreme Court. Equally, due regard and respect must be given to the opinion of the original Authority/Appellate Authority. If the view taken is possible, plausible and probable, then, merely because another opinion can also be rendered on the same facts, every order under appeal need not be interfered with. If this salutary principle and extended by this Court to judicial discipline is borne in mind, there would be few occasions for the Tribunal Members to differ on factual matters and an overall perspective is the requirement in such matters. A broad attitude accompanied by robust common sense is what is expected from the members of the Tribunal. If they bear in mind the parameters and limitation of appellate power, there would not be a friction and conflict in the Tribunal. It does not augur well when there is tension in judicial proceedings. The word 'adjudication' ordinarily means to act and decide judicially. The word 'acting judicially' is not performing some rituals or completing somehow the assigned work, but is a serious business. It requires continued application of mind and alertness. It should not be undertaken casually. No one can approach judicial proceedings in a light-hearted manner. If differing opinions are rendered frequently, then, that creates an imbalance. Certainty and consistency are necessary as that alone instils confidence in the Institution of Judiciary and enables it to earn respect and regard for it. The trust and faith in it is then reaffirmed. Its efficacy is maintained. Then, Rule of Law prevails. The administration of justice and conferment of judicial power is intended to reach this goal. No litigant should thrive on uncertainty and unpredictability. If this basic rules of judicial discipline are not abided by and followed meticulously, there will be several complications and which would, then, require not just judicial intervention by the Higher Court but equally by the Parliament. The members of Tribunal should bear in mind that the Legislature expects them to give finality to certain matters. They are not expected to be left open endlessly. It is often said that lesser the Number of Appeals or interference by the Higher Courts the better it will be for the system. Justice delivery should be expedient and efficient. Ultimately, the adjudication cannot go on and on. It must end at some stage and at least on factual issues. The issues and matters with regard to levy of tax including customs duty in this case ought to attain finality so as to sub serve larger interest of justice. It does not augur well for the economic and the business world and equally for judicial fraternity that matter lingers on and issues are left open giving unending scope for differing opinions and views. That enables the litigants to take chances and resort to even forum shopping. This needs to be avoided at all costs. No member, judicial or technical, is above the law. The Supreme Court's decisions and particularly cautioning the Appellate Tribunal /Court /Authority should, therefore, guide the Tribunals in exercise of their appellate power.

Zenith Computers Ltd vs. Commissioner of Central Excise, 2014 (303) ELT 336 (Bom.)

2. Scope of Arbitration – It was not open to the Arbitrator to decide the issues which were not arbitrable: Arbitration and Conciliation Act, 1996

The Union of India had entered into a contract for construction of a road bridge at a level crossing and in the said contract there was a clause with regard to arbitration. The issue in the instant case is "When in a contract of arbitration, certain disputes are

expressly "excepted", whether the Arbitrator can arbitrate on such excepted issues and what are the consequences if the Arbitrator decides such issues?"

In the contract as per clause 39 it was explained that in the event of extra or additional work entrusted to the contractor, if rates at which the said work was to be done was not specified in the contract, the amount payable for the additional work done was to be discussed by the contractor with the concerned Engineer and ultimately the rate was to be decided by the Engineer. If the rate fixed by the Engineer was not acceptable to the contractor, the contractor had to file an appeal to the Chief Engineer within 30 days of getting the decision of the Engineer and the Chief Engineer's decision about the amount payable was to be final.

It is not in dispute that some work, which was not covered under the contract had been entrusted to the contractor and for determining the amount payable for the said work, certain meetings had been held by the contractor and the concerned Engineer but they could not agree to any rate. Ultimately, some amount was paid in respect of the additional work done, which was not acceptable to the contractor but the contractor accepted the same under protest. In addition to the aforesaid dispute with regard to determination of the rate at which the contractor was to be paid for the extra work done by it, there were some other disputes also and in order to resolve all those disputes the same was referred to the appointed Arbitrator.

The Arbitrator decided all the disputes under his award though the contractor had objected to arbitrability of the disputes which were not referable to the Arbitrator as per Clause 39 of the Contract. Being aggrieved by the award, Union of India had preferred appeal before the City Civil Court under Section 34 of the Arbitration and Conciliation Act, 1996 and the said appeal was allowed whereby the award was set aside. The contractor filed the appeal before the High Court and High Court dismissed the said appeal and the contractor preferred appeal before the Supreme Court.

The Hon'ble Court observed that there was no finality so far as the amount payable to the contractor in relation to the extra work done by it is concerned, because the said dispute was never decided by the Chief Engineer. In the aforestated circumstances, when the disputes had been referred to the Arbitrator, the disputes which had been among "excepted matters" had also been referred to the Arbitrator.

Arbitration arises from a contract and unless there is a specific written contract, a contract with regard to arbitration cannot be presumed. Section 7(3) of the Act clearly specifies that the contract with regard to arbitration must be in writing. Thus so far as the disputes which have been referred to in Clause 39 of the contract are concerned, it was not open to the Arbitrator to arbitrate upon the said disputes as there was a specific clause whereby the said disputes had been "excepted". Moreover, when the law specifically makes a provision with regard to formation of a contract in a particular manner, there cannot be any presumption with regard to a contract if the contract is not entered into by the mode prescribed under the Act.

If a non-arbitrable dispute is referred to an Arbitrator and even if an issue is framed by the Arbitrator in relation to such a dispute, in our opinion, there cannot be a presumption or a conclusion to the effect that the parties had agreed to refer the issue to the Arbitrator. In the instant case, the respondent authorities had raised an objection relating to the arbitrability of the aforesaid issue before the Arbitrator and yet the Arbitrator had rendered his decision on the said "excepted" dispute. In the opinion of the Supreme Court, the Arbitrator could not have decided the said "excepted" dispute.

Thus the Supreme Court held that it was not open to the Arbitrator to decide the issues which were not arbitrable and the award, so far as it relates to disputes regarding non-arbitrable disputes is concerned is bad in law and is quashed. The Appeal was partly allowed.

M/s. Harsha Constructions vs. Union of India & Ors. (Civil Appeal No. 534 of 2007) decided on 5th September, 2014 Supreme Court.

3. Allotment of the institutional plot – Cancelled as it did not confirm to the constitutional philosophy enshrined in Article 14 of the Constitution of India – Effect of separate order passed in a concurring decision

The appellant-Institute of law was allotted the land by the administration of Union Territory of Chandigarh. The rate was fixed by the Chandigarh Administration *vide* its Notification issued under the Punjab Development Regulation Act, 1952 fixing the land rates for allotment to educational institutions in the Union Territory of Chandigarh. The allotment of land was made in favour of appellant-institute for 99 years on leasehold basis with the condition that the initial lease period will be 33 years and renewable for two like periods only if the lessee continues to fulfil all the conditions of allotment.

The Respondent filed a writ petition before the High Court questioning the legality and validity of the allotment of land involved in this case urging various grounds. The Division Bench consisting of the then Chief Justice and a puisne Judge, by two separate but concurring orders disposed of the writ petition cancelling the allotment of land and directing the Union Territory of Chandigarh to take necessary corrective steps in the matter in consonance with the constitutional philosophy of Article 14 of the Constitution of India and further directed the Union Territory of Chandigarh to take policy decision for allotment of educational institutional sites in favour of eligible persons so as to ensure that the allotments are made objectively and in a transparent manner. After delivering the separate concurring orders, however, the puisne judge on the post judgment script specified that there was no agreement on certain paragraphs of the order passed by the then Chief Justice. Aggrieved by the orders, the appellants filed the application under Rule 31 of Chapter 4(F) of the High Court Rules and Orders read with Clause 26 of the Letters Patent, urging that the matter be referred to another Bench or the full Bench for adjudication on the points of difference. The nominated judge of the High Court disposed of the Civil applications holding that there was no point of difference between the Judges of the Division Bench on the question of maintainability of the writ petition. It was held that both the orders reveal a common object i.e. the cancellation of the allotment of land made in favour of the appellant-institute.

The correctness of both the separate orders by Division Bench and the order of the nominated Judge was under challenge in the appeal before the Supreme Court field by the appellant-institute.

The Supreme Court held that the order passed by the then Chief Justice cannot be said to have rendered a different opinion so as to attract the applicability of Rule 31 of Chapter 4 , para F of the High Court Rules and Orders, read with clause 26 of the Letters Patent.

A perusal of the directions contained in the orders of the High Court reveals a common effect, i.e. the allotment of the institutional plot made in favour of the appellant-Institute stands cancelled as it did not conform to the constitutional philosophy enshrined in Article 14 of the Constitution of India. This was also conceded by the nominated Judge of the High Court. Thus there appears to be absolutely no point of difference or divergence between the then Chief Justice and the companion puisne judge, who have issued directions to the Administration of the Union Territory of Chandigarh. It has rightly been pointed out by the nominated Judge that there may apparently seem to be a difference in the thought process and also the relative rigour of the expressions used by both the Judges, yet, it has not been possible to conclude that there was any divergence in the directions recorded in their separate views. Thus the Supreme Court held that the impugned order passed by the puisne Judge which was concurred by the then Chief Justice by his separate order and the order of the third nominated Judge holding that there is no difference of opinion in the orders of the Division Bench are legal and valid and do not require interference, hence the appeal was dismissed.

Institute of Law & Ors. vs. Neeraj Sharma & Ors. Decided on 19th September, 2014 Supreme Court.

4. National Tax Tribunal – The basic structure of the Constitution will stand violated, if while enacting legislation pertaining to transfer of judicial power, Parliament does not ensure, that the newly created Court/Tribunal conforms with the salient characteristics and standards, of the Court sought to be substituted – Constitution of India

Deciding the fate of the National Tax Tribunal, the Constitutional Bench held that Sections 5, 6, 7, 8 and 13 of the National Tax Tribunal Act, 2005 to be unconstitutional. It was held that since these provisions constitute the edifice of the NTT Act, the other provisions will automatically be rendered ineffective and inconsequential, hence, the entire legislation was declared to be unconstitutional.

The petitioner contended that the NTT Act which led to the constitution of the National Tax Tribunal, a quasi-judicial Appellate Tribunal empowered to adjudicate the appeals arising from the Appellate Tribunals constituted under the Income-tax Act, the Customs Act, 1962, and the Central Excise Act, 1962 and the Central Excise Act, 1944, undermined the process of independence and fairness as it intends to substitute High Court's power of judicial review by the extra-judicial body.

The Court while writing down an elaborate judgment, held that Parliament has the power to enact legislation and to vest adjudicatory functions, earlier vested in the High Court, with an alternative court/tribunal and that the exercise of such power by Parliament would not *per se* violate the basic structure of the Constitution. However, the basic structure of the Constitution will stand violated, if while enacting legislation pertaining to transfer of judicial power, Parliament does not ensure, that the newly created Court/Tribunal conforms with the salient characteristics and standards, of the Court sought to be substituted. R. F. Nariman, writing his concurrent opinion, said that a jurisdiction to decide substantial questions of law vests under only with the High Courts and the Supreme Court, and cannot be vested in any other body as a core constitutional value would be impaired thereby. It was concluded that the National Tax Tribunals Act was unconstitutional, being the ultimate encroachment on the exclusive domain of the superior Courts of Record in India.

Madras Bar Association vs. Union of India Transferred Case (C) No. 150 of 2006 decided on 25-9-2014 Supreme Court

5. Month – Month does not mean 30 days – Computation of six months period, Negotiable Instruments Act, 1881, Sec. 138

While hearing on SLP against an order passed by the High Court in context of a complaint filed u/s. 138 of the Negotiable Instrument Act, 1881 the Court was required to consider the meaning of term 'months'.

Proviso (a) to S. 138 provides that the cheque should be presented within six months from the date on which it is drawn. Word 'month' has been defined under S. 3(35) of General Clauses Act to mean a month reckoned as per British calendar. Period of six months cannot therefore be calculated on 30 days basis.

As regards computation of six months period S.9 of General Clauses Act has to be pressed in service proviso (a) to sec. 138 of the Act uses the expression "Six months from the date on which it is drawn". Once the word "from" is used for the purpose of commencement of time, in view of sec. 9 of the General Clauses Act, the day on which the cheque is drawn has to be excluded and the last day within which such act needs to be done is to be included. In other words, six months period stipulated in section 138 would expire on day prior to the date in the corresponding month and in case no such day falls, the last day of the immediate previous month. For calculating period of six months for cheque drawn on 31-12-2005 the first day i.e. 31-12-2005 has to be excluded and the period of six months will be reckoned from the next day i.e. from 1-1-2006; meaning thereby that according to the British calendar, the period of six months will expire at the end of the 30th day of June 2006.

Rameshchandra Ambalal Joshi vs. State of Gujarat & Anr. AIR 2014 SCC 1554

CA Rajaram Ajgaonkar

ECONOMY AND FINANCE

RE-EMERGENCE OF RISK

The month of September proved volatile for the global economies. Though the news from the US was encouraging as the economy clocked higher rate of GDP and the confidence about its future increased, the overall month depicted a risk to the global recovery. Suddenly, the European economy has started showing signals of not being able to sustain the expectations and some of its key indicators are getting into negative territory. The economies of Germany and France, which matter the most in the region, displayed signs of uncertainty and slowdown. Chinese economy has again started showing signs of cooling and the uncertainties have emerged again. The pro-democracy agitation in Hong Kong is destabilising the major trade centre of Asia Pacific and the risks emerge more so because of Chinese control over the territory. Japan remains subdued and it is not able to overcome its stagnation. Its strengthening currency is making the economy more vulnerable. The geo-political issues in Ukraine are not settling down and they keep on erupting intermittently, causing tension in the region. Northern Iraq remains under the siege of Muslim fundamentalists. They have also spread their wings in Syria, which makes this oil-rich region disturbed and volatile. The steps taken by the US and some of the European countries to fight terrorism in the region have not yielded the required result, inspite of sustained efforts over a long period. The global terrorism is not receding but it is gradually engulfing more regions. It keeps on raising its ugly head time and again. The possibility of war or a war like situation erupting in the Middle East region cannot be ruled out. The method of retaliation by the terrorists is unpredictable and it can cause destabilisation in any part of the world. Terrorists are indulging in such activities, which can grab the attention of the world; so that their importance is not lost. These developments have increased the risk to recovery of the global economy in the near future. The sentiment which was running high during the earlier months and was getting further positive traction, has suddenly dipped and worries of more uncertainties are emerging. The developed economies are more worried about the emerging trend in Europe, as the region as such contributes a significant part of the GDP of the world. The uncertain sentiments have affected the commodities as well as stock markets across the globe and there are no visible chances of it abating. Under the circumstances, the investors need to re-align their strategies but the task is not easy.

A better growth in the US has put its economy in good spirits. The discovery of abundant shale gas in the country has given a feeling of security to the nation and it has emboldened the

administration to a certain extent. The economic stimulus in the form of Quantitative Easing has been gradually withdrawn and soon it is likely to become history. In the month of September, the risk of withdrawal of stimulus has weighed heavily on the minds of the global economies and it is causing anxieties in the emerging markets. The possibility of increase in interest rates in the US in the near future has increased and that is worrying these markets as a rise in interest rates in the US can result in the increase of outflow of cheap money parked in these economies. If such monies start returning back to the US, it can damage the economic health of the country due to reduction in availability of funds for development. It can negatively affect the currency of the country as the high dollar demand can weaken that currency. If the US becomes aggressive in its efforts on eradicating terrorism, the emerging economies can suffer as a fall out of the same. All in all, the risks and uncertainties have increased and that is harmful for the positive trend which had globally garnered momentum over the last few months.

The new Government coming in power has changed the sentiment and India has become upbeat about its future. The Prime Minister is taking all the pains not only to increase the economic activities in the country but he is also making efforts to market India to the global businesses. It appears that he wants to improve the productivity and change the habits of the people of the country. He not only wants to clean the rivers of the country but to clean the nation as well. The thought process is positive and efforts are being made towards the same. Only time will tell how successful he can be in his endeavours but as of now, hopes are high and there is a belief that change is likely to happen. The first 100 days have passed and there are lots of claims of achievements. However, some corners do feel that the ground realities have not changed as they have been hyped. Every which way, it will take some time for the results of the efforts to surface. It may take some time for India to change its gears. Indians will also need some time to change their habits. The success of the Prime Minister will be measured by the time he takes to bring about the change to a visible level. Though the hopes are high, the risks also are not as low as they appear. The change which has been undertaken is Herculean and the selflessness by which the efforts are to be executed may not be easily forthcoming from all quarters. No doubt that India will improve but how fast and how effectively remains a million dollar question.

Amongst the hype of a better future, the investors cannot forget certain factors which may have negative impact on the Indian economy as well as investor sentiment over the short-run. To remain correct in law, the Supreme Court has ended up declaring the process of allocation of more than 200 licences granted to a large number of companies as arbitrary and illegal. These licences were granted over a period of more than a decade and nobody had thought that there was something amiss in the process of allocation. On the strength of these licences, companies had made investments of more than rupees 2 lakh crores. The judgment will not only have substantial negative impact on the companies, whose licenses are cancelled but it can have huge repercussions on the Indian banking sector and specially public sector banks. These banks have lent large sums of money for the projects. Their Non-Performing Assets (NPAs) may go up substantially which can affect their bottom-line in the immediate future and also deteriorate their quality of assets. 2G scam in the country had adversely impacted investment sentiments then and the results of the court cases have still not come out even from the trial court yet. The coal scam has added fuel to the fire. There being no estoppel against the Government, the situation can be grave for many allottees, who have already made huge investments. Both the issues started by allotments made by respective Government departments but for which the Government has not been held accountable and all the blame has been put on the private

sector, making them suffer tremendously. The emergence of these scams has given wrong signals to the investors and especially foreign investors. These uncertainties may haunt the foreign investors when they will come to invest in India on the strength of the assurances given by the Government. The Finance Minister had specified in the budget speech that every country has the right to make retrospective changes in law and it is correct beyond doubt, so long as the parliament passes the law within the framework of the Constitution. Though these powers exist, stating the same may create anxieties in the minds of the investors, who want stability and clarity in the regime. In the effort to collect more taxes, the various tax arms of the Government can also create situations which are legally correct but economically disastrous. This can make investors more jittery and unwilling to take risks. The expected liberalisation and reforms in India are probably yet to materialise and even after their implementation, they will take their own time to show an impact. In the meanwhile, the sentiments and expectations which have already soared may cause a risk for investors and especially foreign investors. The strengthening of the US dollar against major currencies of the world during the last few weeks have made the global investment strategies more complex by adding one more variable in the already complicated equation. If the strength of the dollar continues and if the Quantitative Easing ends sooner, there can be heavy movement of capital across the various countries, which can have heavy repulse in the global currency markets. Some will gain but many are likely to lose in the process. The investors need to be very cautious about the emerging scenario and they should not assume a secular bull run in the global markets. India is better positioned than many of the other economies in the world but the upward journey may not be as smooth as people perceive. There will be ups and downs. Though the long term outlook is positive, the economy may face bumps from time-to-time. Investors should be mentally prepared to survive through those bad patches, without getting disturbed and get driven to wrong decision making.

Though the Indian stock markets have declined in the month of September, the current slowdown seems to be a temporary phase which may get reversed in the month of October on the back of corporate results or it may bounce back after a lull of a few months. Equity markets in India continue to look good on a medium to long term basis and equities are likely to outperform most of the other asset classes over the next couple of years. As of now, shares of many Blue Chip companies have retreated by about 10% from their peak levels and many of them are quoting at attractive valuations, considering their expected profits in the future. Investors may take a plunge within their asset allocation limit in equity without much of a hesitation as the current phase may herald a good opportunity to increase equity exposure in the rising markets at a reasonable price.

The RBI policy declared at the end of September was lacklustre and did not make much changes. Considering the current tone of the RBI Governor, rate cut does not seem to be imminent, at least before the end of this calendar year. Though there can be marginal reduction of interest rates offered by banks on deposits, major drop is not expected soon. Investors can continue to renew their deposits for a medium term horizon.

Though the month of September was not as good as expected, especially considering the global events; the direction in India has probably not changed much. India is expected to continue to remain on a steady course and investors need not develop any apprehensions. They can remain put on their investments and can reap the fruits of the improving economy by pursuing their investment strategies on a long term basis.

Writ Petition on revised Tax Audit Report before Bombay High Court

Central Board of Direct Taxes has amended the Tax Audit report on 25 July, 2014, *vide* Notification No. 33/2014 effective from the financial year beginning from 1-4-2013. Post amending Tax Audit Report, Revenues utility for submission of Tax Audit report was issued end of August 2014.

Considering the hardship faced by the members. The Chamber of Tax Consultants, through its president Shri Paras Savla has filed a Writ Petition before Bombay High Court challenging the aforesaid notification and subsequent order amending the Tax Audit Report after closure of Financial Year. Other joint petitioners were M/s. KPD & Associates and CA Bharat Gala. The Petition challenges the action of the CBDT in introducing the new TAR without deliberation or inviting any views from the stakeholders and not extending due date of filing return of income even if due date of filing of Tax Audit Report has been extended. The Petition points out that CBDT extended the due date for filing the new Tax Audit Report upto 30/11/2014, however, the date of filing of return has not been extended. This writ came for the hearing before the Bombay High Court on 24th and 25th September 2014. The revenue opposed the grant of any relief by this Court and also filed affidavit of Principal CCIT Mumbai.

The Division Bench of the Hon'ble Bombay High Court consisting of Shri Justice M. S. Sanklecha and Hon'ble Shri Justice N. M. Jamdarvide order dt. 25/9/2014 observed that there will be substantial hardship caused to the assessees, if the date of filing Return is not suitably extended as that of filing of Tax Audit Report. They further expressed that we hope and trust that CBDT will look into all these practical difficulties enumerated in the petition and take a just and proper decision on the matter, before 30 September 2014. The Department counsel further submitted that whenever any major decision, such as the one in question is taken, it does consult all stakeholders.

The Hon. Court further made it clear that in case the Petitioners are entitled any further relief in view of the orders passed in various petitions filed in other High Courts, this order would not preclude the Petitioners from claiming the same.

Pursuant to the decision of the Bombay High Court and other High Courts the CBDT has issued circular F.No.153/53/2014-TPL (Pt.I) dt. 26-9-2014 extending the 'due-date' for furnishing return of income from 30th September, 2014 to 30th November, 2014 for the Assessment Year 2014-15 for all purposes of the Act in the case of an assessee, who is required to file his return of income by 30th September, 2014, and is also required to get his accounts audited under section 44AB of the Act or is a working partner of a firm whose accounts are required to be audited under section 44AB of the Act.

The matter was argued by Dr. K. Shivaram Sr. Advocate (Past President of CTC), Shri Ajay Singh, Advocate, Rahul Sarda, Advocate and KSA Legal team.

IN THE HIGH COURT OF JUDICATURE AT BOMBAY ORDINARY ORIGINAL CIVIL JURISDICTION

WRIT PETITION Lodging No. 2492 of 2014

The Chamber of Tax Consultants
Through its President
Shri Paras Savla & others .. Petitioners

vs.

Union of India
through its Secretary,
Ministry of Finance & others. .. Respondents

Dr. K. Shivaram, Senior Advocate a/w Mr. Ajay Singh a/w Mr. Rahul Sarda a/w Mr. Rahul Hakani a/w Ms. Neelam Jadhav, for Petitioners.

Mr. Arvind Pinto, for Respondents.

CORAM: M.S.SANKLECHA, J.
N.M .JAMDAR, J.
Thursday 25 September, 2014

P.C.:

Rule. Rule made returnable forthwith. Respondents waive service. Taken up for disposal by consent.

2 This petition under Article 226 of the Constitution of India:

(a) Challenges Notification dated 25 July 2014 passed by the Government of India in exercise of powers under Section 295 read with Section 44 AB of the Income-tax Act 1961 (the Act) introducing a new format for Tax Audit Reports;

(b) Seek a direction to the Central Board of Direct Taxes (CBDT) to extend the time for filing Income Tax Returns from 30 September 2014 to 30 November 2014. This is on the basis the time to furnish the Audit Report under Section 44 AB of the Act has been extended from 30 September 2014 to 30 November 2014. This petition relates to Assessment Year (AY) 2014-15.

3 Dr. Shivaram, learned senior Advocate for the Petitioners has placed on record the order passed by the learned Single Judge of Madras High Court dated 24 September 2014 in Writ Petition Nos. 25443 & 26306 to 26310 of 2014. He submitted that the Gujarat High Court has also issued directions permitting the assessees to file Return of Income till 30 November 2014, on payment of interest. He submitted that the copy of the order passed by the Gujarat High Court is not yet available.

4 Dr. Shivaram, after arguing the matter for some time, submitted that in view of the orders passed by the Madras High Court and the Gujarat High Court, Petitioner's grievance will be satisfied if CBDT is directed to consider the representation of the Petitioners. Dr. Shivaram submitted that if the date of filing of Return of Income is not extended to coincide with the date of filing of Tax Audit Report, which is already extended to 30 November 2014, serious practical difficulties will follow. He submitted that the members of the Petitioners' Associations as well as the assessees in general will be put to great inconvenience. Mr. Arvind Pinto learned counsel for the Revenue, opposed the grant of any relief by this Court but is not averse to the matter being considered by CBDT on its own merits.

5 The Petitioners have listed the prejudice that would be caused by non-extension of date of filing of Return of Income to 30 November 2014 as under:

a) The new proforma of Tax Audit under Section 44 AB requires the tax auditor to examine and report on 27 additional aspects of assessees accounts for the purpose of tax Audit. This examination would require time and the Audit would not normally be complete before the date of filing Return on 30 September 2014. This it is submitted would result in the Petitioners declaring an income which may consequent to the Audit be inaccurate / incorrect. The present practice of filing Income Tax Return along with the Audit Report or post the Audit Report ensures that the income offered to tax had been scrutinised and it has been properly declared.

b) The consequence of the Tax Audit not being performed prior to filing Return of Income would result in the Petitioners declaration of Income being erroneous requiring the assessee to file a Revised Return of Income. This Revised Return of Income would entail the Petitioners as mentioned in the petition being deprived as under -

   i Shall deprive the assessee from claiming a set-off of loss carry forward, if any, in the A.Y. 2013-14

   ii Shall deprive the assessee from claiming the benefits available under Section 43B of the Act;

   iii Shall deprive the assessee from claiming the deductions under Chapter VIA of the Act in view of section 80AC of the Act.

   iv Shall lead to the imposition of interest upon the assessee under Section 234A, 234B and 234C of the Act.

c) It was further submitted that computation of the actual tax liability of an assessee can take place and an Income Tax Return can be filed only after obtaining of Tax Audit Report. The entire scheme of the Act (Section 139 read with Section 44 AB of the Act) is weaved based on the aforesaid 'fundamental principle'.

d) It was further submitted that it is settled law that consistency in tax laws is the need of the hour, and such complications (which are a sheer creation of inefficient decision

making) especially *qua* compliances, only adds to the woes of a person and acts as a barrier to the promotion of efficient tax compliances.

e) Keeping the aforesaid time frames in mind, the Chartered Accountants schedule their audits for the assessees, in a manner to meet with the aforesaid timelines, and such audits therefore effectively begin with the finalisation of the books of account of an assessee, as on 31-3-2014.

f) The new proforma of Tax Audit Report cast an additional compliance burden without providing adequate / reasonable time without appreciating that audit is not merely a formality but a statutory duty, non-compliance of which leads to attraction of penal provisions under the Act.

6 In view of the fact that the Hon'ble Madras High Court has already directed the CBDT to examine the representation of the assessees in general, before 30 September 2014, we feel it appropriate that the above representation of the Petitioners is also considered by CBDT. Though we do not wish to express any view of the legalities of various issues involved, it does appear to us, from the arguments advanced, that there will be substantial hardship caused to the assessees, if the date of filing Return is not suitably extended. We hope and trust that CBDT will look into all these practical difficulties enumerated above and take a just and proper decision on the matter, before 30 September 2014, as already directed by the Madras High Court.

7 Dr. Shivaram, also contended that the CBDT should be directed to frame guidelines which will require CBDT to consult all stake-holders like the Petitioners, before taking any major decision, such as the one in question. Mr. Pinto learned counsel for the Respondents, submitted that no such direction is warranted, as whenever the CBDT finds it necessary, it does consult all stake-holders. We leave the issue at that.

8 We are informed at the bar that various High Courts have passed orders on issues identical to the issues raised in this petition. However the orders passed by these High Courts (except one by Madras High Court) are not available for our perusal. It is made clear that in case the Petitioners are entitled any further relief in view of the orders passed in various petitions filed in other High Courts, this order would not preclude the Petitioners from claiming the same.

9 The Petition is disposed of in the above terms. No costs.

N. M. JAMDAR J. M. S. SANKLECHA, J.


CA Hinesh R. Doshi, Ajay Singh, *Advocate*
Hon. Jt. Secretaries

The Chamber News

Important events and happenings that took place between 8th September, 2014 and 8th October, 2014 are being reported as under.

I. ADMISSION OF NEW MEMBERS

1) The following new members were admitted in the Managing Council Meeting held on 12th September, 2014.

Life Membership

1	Mrs. Mehta Roopande Devendra	CS	Mumbai
2	Mr. Goel Chetan Brijendra	CA	Uttar Pradesh
3	Mr. Zaveri Nilesh Jagjivandas	CA	Mumbai
4	Miss Shingala Parnasi Nitin	Advocate	Mumbai
5	Mr. Thakrar Ujwal Natwar	CA	Mumbai
6	Mr. Wala Haresh Kantilal	ITP	Mumbai
7	Mr. Lohia Sulabh Shyam (Tr. From Ord To Life)	CA	New Delhi
8	Mr. Sabherwal Rohit J.	CA	New Delhi
9	Mr. Gupta Praveen Kumar	CA	Noida
10	Mr. Bahra Vikram R.	CA	Chennai
11	Mr. Shah Mayur Haresh	CA	Mumbai

Ordinary Membership

1	Mr. Joshi Vikram Vijaykumar	CA	Mumbai
2	Mr. Thakker Nayak Jayesh	CA	Mumbai
3	Mr. Chande Hiten Kishor	CA	Mumbai
4	Mr. Kothari Harsh Rajesh	Advocate	Mumbai
5	Mr. Goradia Deepak Bhupatrai	CA	Mumbai
6	Mr. Kharawala Mohib Saifuddin	ITP	Mumbai
7	Mr. Gurav Manoj Mukund	CA	Mumbai
8	Mr. Purandare Jairaj Manohar	CA	Mumbai

Student Membership

1	Ms. Chheda Khushbu Haresh	CA Final
2	Mr. Butt Irfan Mohammed Rafik	CA Student
3	Ms. Wadia Sheetal Jitendra	Std. XII Student
4	Mr. Pursnani Varun Gul	CA Student
5	Ms. Lakhani Manali P.	IPCC Student
6	Ms. Mehta Grishma P.	IPCC Student

II. PAST PROGRAMMES

Sr. No.	*Programme Name/ Committee/Venue*	*Date/Subjects*	*Chairman/Speakers*
1.	**Indirect Taxes Committee**		
A.	**Indirect Tax Study Circle Meeting** Venue : Babubhai Chinai Committee Room, IMC	10th September, 2014 / Recent Judgments under Service Tax	Chairman : Mr. M. H. Patil, Advocate Speaker : Mr. L. Badri Narayanan, Advocate
		8th October, 2014 / Issues in CENVAT Credit under Service Tax	Chairman : Mr. Prasad Paranjpe, Advocate Speaker : CA Uma Iyer
2.	**International Taxation Committee**		
A. i)	**FEMA Study Circle Meeting** Venue : CTC Conference Room	9th September, 2014 / Introductory and Hand Shake meeting	—
ii)	**FEMA Study Circle Meeting** Venue : CTC Conference Room	8th October, 2014 / Introduction to FEMA	CA Rashmin Sanghvi
B.	**Intensive Study Group on International Taxation** Venue : CTC Conference Room	13th September, 2014 / i) Taxation of Intangibles ii) OECD Developments iii) Qualification of Taxable Entities	 i) CA Ganesh Rajgopalan ii) CA Harshal Bhuta iii) CA Rutvik Sanghvi & CA Ganesh Rajgopalan
3.	**Study Circle & Study Group Committee**		
A.	**Study Group Meeting** Venue : Babubhai Chinai Committee Room, IMC	11th September, 2014 / Recent Judgments under Direct Taxes	CA Sanjay Parikh

Sr. No.	*Programme Name/ Committee/Venue*	*Date/Subjects*	*Chairman/Speakers*
B.	**Study Circle Meetings** Venue : Babubhai Chinai Committee Room, IMC	18th September, 2014 / Newly inserted Clauses in Tax Audit Report with reference to Guidance note of ICAI & other important issues	CA Nihar Jambusaria
		6th October, 2014 / Issues in Domestic Transfer Pricing Including Various Methods for determining ALP	CA Rakesh Alshi

III. FUTURE PROGRAMMES

Sr. No.	*Programme Name/Committee/Venue*	*Day & Date*
1.	**Allied Laws Committee**	
A.	1st RRC on the Companies Act, 2013 with the flavour of LLP Act, 2008 (Jointly with Corporate Members Committee) Venue : Ras Resort, Silvassa	Friday, 12th December, 2014 to Sunday, 14th December, 2014
B.	**Study Circle Meeting** (Only for Allied Laws SC Members) Subject : Provisions relating to The Indian Partnership Act, 1932 – An Overview. (**Part – II**) Venue : Babubhai Chinai Committee Room, Churchgate	Thursday, 9th October, 2014
2.	**Corporate Members Committee**	
A.	**Half Day Workshop on SEBI / Securities Laws for Chartered Accountants** (Jointly with Corporate and Securities Laws Committee of BCAS) Subject : Introduction to Basic Concepts, Important Regulations, Penalties / Settlement and Clause 49 Venue : 2nd Floor, Babubhai Chinai Hall, Indian Merchants Chamber, Churchgate, Mumbai	Friday, 17th October, 2014
3.	**Direct Taxes Committee**	
A.	**Intensive Study Group on Direct Taxes** (Only for ISG Members) Subject : Recent Important Decisions under Direct Tax 74 Venue : CTC Conference Room	Tuesday, 14th October, 2014

Sr. No.	*Programme Name/Committee/Venue*	*Day & Date*
B.	**Full Day Seminar on Assessment, Reassessment and Settlement Commission** Subject : i) Current common issues faced during assessment and reassessment proceedings ii) Do's and Don'ts during the assessment proceedings and reassessment proceedings with practical examples iii) Law of Evidence and importance of evidence in assessment and reassessment proceedings iv) Settlement Commission Scope, Advantages, Limitations and Procedures. Venue : M. C. Ghia Hall, Rampart Row, Kalaghoda, Fort, Mumbai – 400 001	Saturday, 8th November, 2014
4.	**Indirect Taxes Committee**	
A.	**Panel Discussion on Multi Dimensional Tax Issues** jointly with International Taxation Committee (Direct and Indirect Taxes) In Respect of Certain Transactions (In Tangibles, EPC Contracts, etc.) Venue : M. C. Ghia Hall, Fort, Mumbai – 400 001.	Saturday, 1st November, 2014
B.	**Study Circle Meeting** (Only for IDT SC Members) Subject : Recent Updates & Issues in MVAT Audit Venue : Conference Hall, 2nd Floor, All India Local Self Government, Sthanikraj Bhavan, C. D. Barfiwala Marg, Juhu Lane, Andheri (W), Mumbai – 400 058	Tuesday, 2nd December, 2014
C.	**3rd Residential Refresher Course on Service Tax** At Fountainhead Leadership Centre, Bamansure, Post Kihim, Alibag, Maharashtra – 402 201 Subject : Paper – II - Case studies in Place of Provision and Point of Taxation Rules under Service Tax Paper – I - Case Studies ib Indirect Tax Issues in Real Estate Industry Paper – III- Assorted Case Studies under Service Tax (other than above) Presentation – I - Settlement Commission, Compounding offences and Advance Ruling under Service Tax	23rd January, 2015 to 25th January, 2015

Sr. No.	*Programme Name/Committee/Venue*	*Day & Date*
5.	**International Taxation Committee**	
A.	**Joint meeting of Intensive Study Group on International Tax & Study Circle on International Taxation** (Only for Intensive SG on Int. Taxation and SC on Int. Taxation, Transfer Pricing SC, FEMA SC and Direct Tax SC members only) Subject : Spain as a gateway to Europe, Latam and North Africa – as compared to the traditional intermediate jurisdictions (including basics about EU Directives and their benefits) Venue : Babubhai Chinai Committee Room, 2nd Floor, IMC	Friday, 10th October, 2014
B.	**Seminar on Current Issues in International Taxation** (Jointly with Bombay Chartered Accountants Society) Subject : i) The impact of BEPS on tax treaties ii) Current International Tax Venue : Senator Hall, Status Restaurant, Nariman Point, Mumbai – 400 021	Thursday, 16th October, 2014
C.	*Publication :* **Transfer Pricing** An Industry & Technical Perspective	Special price for Members only ` **1,250/-**
6.	**Residential Refresher Course & Public Relations Committee**	
A.	**38th Residential Refresher Course** Subject : Paper I - Deeming Provisions under the Income-tax Act Paper II - Issues in Corporate Taxation including LLP Paper III - Case Studies on Direct Tax Paper for Presentation : Domestic Transfer Pricing Brain Trust – Direct Tax Venue : At Toshali Sands Resort, Puri, Odisha	Thursday, 19th February, 2015 to Sunday, 22nd February, 2015
7.	**Study Circle & Study Group Committee**	
A.	**Study Circle on International Taxation Meetings** (Only for SC on Int. Taxation Members)	
	Subject : Issues in Taxation of Permanent Establishment Venue : Kilachand Hall, 2nd Floor, IMC	Thursday, 30th October, 2014
B.	**Study Group Meetings** (Only for Study Group Members)	
	Subject : Recent Judgments under Direct Taxes Venue : Babubhai Chinai Committee Room, 2nd Floor, IMC.	Friday, 31st October, 2014

For further details of the Future Events. kindly visit our website www.ctconline.org.

INTERNATIONAL TAXATION COMMITTEE

Transfer Pricing Study Circle Meeting held on 5th September, 2014 on the subject "Transfer Pricing Methods – TNMM" at Kilachand Hall, IMC.

CA Akshay Shah addressing the members

CA Umesh Agarwal addressing the members.

FEMA Study Circle Meeting held on 9th September, 2014 on the subject "Introductory and Hand Shake meeting" at CTC Conference Room.

CA Paras K. Savla, President addressing the members. Also seen CA Naresh Ajwani, Chairman and CA Shreyas Shah

Intensive Study Group on International Taxation held on 13th September, 2014 on the subject "i) Taxation of Intangibles, ii) OECD Developments & iii) Qualification of Taxable Entities" at CTC Conference Room.

CA Ganesh Rajgopalan addressing the members.

CA Harshal Bhuta addressing the members.

STUDENTS COMMITTEE

Student Study Circle Meeting held on 4th September, 2014 on the subject "E-Filing of Income Tax and Wealth Tax Return" at CTC Conference Room.

CA Avinash Rawane addressing the students.

INDIRECT TAXES COMMITTEE

Indirect Tax Study Circle Meeting held on 10th September, 2014 on the subject "Recent Judgments under Service Tax" at 2nd Floor, Babubhai Chinai Committee Room, IMC.

Mr. M. H. Patil, Advocate chairing the session.

Mr. L. Badri Narayanan, Advocate addressing the members. Seen from L to R : CA Akhil Kedia, Convenor, CA Aalok Mehta, Vice Chairman, CA Avinash Lalwani, Vice President, Mr. M. H. Patil, Advocate, Chairman of the Session, CA Pranav Kapadia, Chairman and CA Narendra Soni, Convenor.

STUDY CIRCLE & STUDY GROUP COMMITTEE

Study Group Meeting held on 11th September, 2014 on the subject "Recent Judgments under Direct Taxes" at 2nd Floor, Babubhai Chinai Committee Room, IMC.

CA Sanjay Parikh addressing the members. Seen from L to R : CA Dilip Sanghvi, Vice Chairman, Mr. Rahul Hakani, Member, CA Ashok Sharma, Chairman and CA Dinesh R. Shah, Convenor.

Study Circle Meeting held on 18th September, 2014 on the subject "Newly inserted Clauses in Tax Audit Report with reference to Guidance note of ICAI & other important issues" at 2nd Floor, Babubhai Chinai Committee Room, IMC.

CA Nihar Jambusaria addressing the members.

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