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DIRECT TAX REVIEW

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Issue of shares – out of TP rigours – Rules Bombay High Court

Brief of the case

The much-awaited ruling of the Bombay High Court (HC) in the context of the Writ Petition filed by Vodafone India Services Private Limited (VISPL or the taxpayer) has been released. The taxpayer had challenged the following transfer pricing (TP) adjustments made by the Revenue:

- Alleged undervaluation of shares issued by VISPL in favour of its Associated Enterprise (AE); and
- Imputing of notional interest on such alleged undervaluation of shares, by treating the shortfall as loan advanced by VISPL to its AE.

The taxpayer in the first Writ Petition (WP No.1877 of 2013) challenged these adjustments as being patently illegal and without jurisdiction. This was on the ground that the purported undervaluation could never have been brought under the ambit of taxation by taking course to TP, as the same was on capital account. The HC directed the Dispute Resolution Panel (DRP) to decide the taxpayer's preliminary issue of jurisdiction. Consequent to this direction, the taxpayer made it submissions before the DRP. However, the DRP held the alleged undervaluation of shares as 'income' chargeable to tax. Further, it imputed notional interest on such alleged undervaluation by treating it as deemed loan. Against the said order of the DRP, the taxpayer filed a Second Writ Petition before the HC. In this Second Writ proceeding, the Bombay HC categorically held that issue of shares at a premium by the VISPL in favour of its AE did not give rise to any "income" from an International Transaction, and therefore, there was no need to invoke TP provisions.

Case in detail

On August 21, 2008, VISPL issued ₹2,89,224 equity shares of the face value of ₹10 each at a premium, at ₹8,509 per share to its AE. This resulted in VISPL receiving a total consideration of ₹2.46 billion from its AE on issue of shares. The fair market value of the equity shares at ₹8,519 per share was determined by VISPL in accordance with the Capital Issues (Control) Act, 1947. However, according to the Tax Officer (TO) and Transfer Pricing Officer (TPO), VISPL ought to have valued each equity share at ₹53,775, and hence, the shortfall in premium to the extent of ₹45,256 per share resulted into total shortfall of ₹13.09 billion.

Both, the TPO and the TO held, on application of the TP provisions contained in Chapter X of the Act that this amount of ₹13.09 billion was income chargeable to tax in the hands of VISPL. They further held that this amount of ₹13.09 billion was required to be treated as deemed loan given by VISPL to its AE, and periodical interest thereon was to be charged to tax as interest income of ₹883.5 million in the Financial Year 2008-09 i.e. Assessment Year 2009-10.

Issue before the HC

Whether the alleged shortfall in share premium arising out of the transaction of the issue of shares by VISPL to its AE constituted 'income' in the hands of VISPL chargeable to tax under the Act?

Decision of the HC Scope/ objective of Transfer Pricing Provisions

- A plain reading of section 92(1) of the Income-tax Act, 1961 (the Act) very clearly brought out that "income" arising from an International Transaction was a condition precedent for application of Chapter X of the Act.
- Transfer Pricing provisions in Chapter X of the Act were to ensure that in case of International Transaction between AEs, neither the profits were understated, nor losses overstated. They did not replace the concept of Income or Expenditure as normally understood in the Act, for the purposes of Chapter X of the Act.
- The objective of Chapter X of the Act was certainly not to punish Multinational Enterprises and/ or AEs for doing business inter se.
- Arm's length price (ALP) was meant to determine the real value of the transaction entered into between AEs. It was a re-computation exercise to be carried out only when income arose in case of an International transaction between AEs. It did not warrant re-computation of a consideration received/ given on capital account.

Income under section 2(24)-Whether includes capital receipt?

It could not be disputed that income would not in its normal meaning under the Act include capital receipts unless specified. The amount received on issue of shares was admittedly a capital account transaction not separately brought within the definition of Income, except in cases covered section 56(2) (viib) of the Act.

Therefore, absent express legislation, no amount received, accrued, or arising on capital account transaction could be subjected to tax as income. Parliament had consciously not brought to tax amounts received from a non-resident for issue of shares, as it would discourage capital inflow from abroad. Neither the capital receipts received by the tax payer on issue of equity shares to its AE, a non-resident entity, nor the alleged shortfall between the so called fair market price of its equity shares and the issue price of the equity shares, could be considered as "income" within the meaning of the expression as defined under the Act.

A transaction on capital account or on account of restructuring would become taxable to the extent it impacts income, i.e., under- reporting of interest received or over-reporting of interest paid or claim of depreciation, etc. It was only that income which had to be adjusted to the ALP.

The issue of shares at a premium was a capital account transaction and not income. Notional income v. Real income Reliance by the Revenue upon the definition of International Taxation in sub clauses (c) and (e) of Explanation (i) to section 92B of the Act to conclude that Income had to be given a broader meaning to include notional income, as otherwise Chapter X of the Act would be rendered otiose/ meaningless, was held to be far- fetched.

Provisions of Chapter X – Whether charging or machinery provisions?

In the absence of a charging Section in Chapter X of the Act, it was not possible to read a charging provision into Chapter X of the Act. Chapter X of the Act was a machinery (computational) provision to arrive at the ALP of a transaction between AEs.

The substantive charging provisions were in sections 4, 5, 15 (Salaries), 22 (Income from house property), 28 (Profits and gains of business), 45 (Capital gain) and 56 (Income from other Sources). Even income arising from International Transactions between AEs had to satisfy the test of Income under the Act and had to find its home in one of the above heads, i.e., charging provisions.

Revenue's reliance on section 92(2) of the Act

Section 92(2) of the Act dealt with a situation where two or more AEs entered into an arrangement whereby, if they were to receive any benefit, service or facility, then the allocation, apportionment or contribution towards the cost or expenditure had to be determined in respect of each AE having regard to the ALP. It would have no application in VISPL's case where there was no occasion to allocate, apportion or contribute any cost and/ or expenses between the tax payer and the AE

Revenue's reliance on section 56 of the Act – Income from other sources

Although section 56(1) of the Act would permit including within its head all income not otherwise excluded, it did not provide for taxing a capital account transaction of issue of shares as was specifically provided for in section 45 or section 56(2)(viib) of the Act and included within the definition of income in section 2(24) of the Act.

Conclusion

Issue of shares at a premium by VISPL to its AE did not give rise to any "income" from an International Transaction. Therefore, there was no need to invoke TP provisions.

Interest payment towards delay in paying sale consideration after slump sale is affected and plant is in operation, is to be treated as revenue in nature

Ahmedabad, October 15, 2014: The issue before the Bench is – "*Whether interest payment towards delay in paying sale consideration after slump sale is effected and plant is in operation, is to be treated as revenue in nature.*" The answer is YES

Facts of the case

The assessee concern is a joint venture company formed by Sandvik AB Sweden and M/s. Chokshi Tubes Company Limited. The company was incorporated on 20th October 1996 with the share holding of 51% by Sandvik AB and 49% by M/s. Chokshi Tubes Company Limited. M/s. Chokshi Tubes Company Limited was previously having EMD undertaking at Rajpur of Mehsana doing extrusion of stainless steel pipes and tubes. The joint venture company acquired the EMD undertaking of M/s. Chokshi Tubes Company Limited, situated at Rajpur, Mehsana as a going concern on "as is where is basis" and an agreement was made on December 4, 1996 between Sanvik Chokshi Limited and M/s. Chokshi Tubes Company Limited for transfer of EMD undertaking as a going concern at a slump price of ₹100 Crores. Such amount was paid for acquisition, which included fixed assets, current assets, raw materials, advances, cash and bank balance, liabilities, etc., without bifurcating specifically in the agreement, any asset, raw materials or advances and no separate value for different assets also were determined. The assessee attributed a sum of ₹89.34 Crores to the various depreciable assets and claimed depreciation accordingly. For the AY 1997-98, in the return of income, the assessee had claimed depreciation. However, AO noted that there was no amount mentioned in the agreement against each of the above items, and therefore, it was not possible to ascertain the value of the items. The AO was of the opinion that the plant and machinery installed could not be included in the actual cost and adopted the actual cost of the various assets as per the WDV shown in the books of account of the CTC Limited and against the depreciation claimed of ₹10.78 crores, an amount of ₹9.82 crores had been disallowed.

On appeal, CIT(A) held that the action of AO in invoking Explanation 3 to sub-section (1) of Section 43 was not justified in as much as the plant and machinery; land and building forming part of the EMD undertaking had been valued by the approved valuer and the same had been duly recorded in the books of account, and therefore, the onus was on the part of the Revenue to prove that the valuation was incorrect by providing another valuation report, which was not done in the instant case. CIT [A] was actuated by the fact that even after allowing the lower rate of depreciation as per the WDV of the assets in the books of M/s. Chokshi Tubes Company Limited, there was no profit in the succeeding years. CIT[A] accordingly directed AO to allow the depreciation at ₹10.79 Crores to the assessee. On further appeal by Revenue, Tribunal noted the fact that after allowing the lower depreciation as per the WDV in the books of account of the transferor company, no profit in the hands of the assessee in the succeeding assessment years could be noticed and on cumulative consideration of the entire materials, it held in favour of the assessee concurring with the findings of the CIT[A].

The second issue concerns disallowance of ₹1.57 crores (rounded off) on account of interest expenditure on unpaid purchase consideration. The Assessing Officer found that the amount of interest claimed by the assessee concern the delay in payment of sale consideration to CCTC and therefore, he concluded that the interest was a part of total consideration paid by the respondent-assessee for acquiring the EMD undertaking. Therefore, such interest amount was to be treated not as revenue expenditure relatable to the cost of acquisition. The assessee had challenged such issue before the CIT [A] and the CIT [A], after considering Explanation 8 to Section 43 of the Act and applying the same to the facts of the case concluded in favour of the assessee and against the Revenue. It can be noticed that a detailed working is made by the CIT [A] while concluding such an issue. Revenue when challenged the issue before the Tribunal, it relied upon discussion made in the order of the CIT [A] to concur with the CIT [A].

It was held that

In the instant case, we notice that the issue with regard to the slump sale and the consideration as a result of the sale for a lump sum consideration of ₹100 crores has not been a matter of dispute. However, against individual asset sale, since there was no bifurcation of the consideration, the Assessing Officer had questioned and doubted the claim made by the assessee for the purpose of depreciation. The Assessing Officer also had made verification from the income tax records of the transferor company and it was noticed that there also there is no bifurcation made of the consideration of ₹100 crores against the individual assets sold by it. This being essentially the question of fact – both the CIT [A] and the Tribunal have extensively dealt with the entire factual matrix and have also applied the relevant provisions of law to these facts to conclude that the assessee arrived at a price of ₹100 crores on slump sale basis for transfer of a running business of EMD undertaking, and therefore, factum of assessee not having paid consideration for acquiring individual assets cannot be construed as illusory or colorable. Explanation-3 can be invoked if the Assessing Officer is satisfied that the main purpose of the transfer of assets, direct or indirectly to the assessee, was the reduction of a liability of income tax by claiming depreciation with reference to an enhanced cost. In such circumstances, the actual cost to the assessee can be determined by the Assessing Officer having regard to all the circumstances of the case, with the previous approval of the Joint Commissioner. It can be noted from the record that at the time of transfer of the assets, the assessee had no income for it to reduce its tax liabilities by way of such transfer, and therefore, both the CIT [A] and the Tribunal had rightly concluded that the Assessing Officer was in error in invoking Explanation 3 to Section 43 for determining actual cost in the said deal. For the reasons mentioned hereinabove, we see no mistake in CIT [A] as well as Tribunal in concluding that Explanation 3 to Section 43 of the Act was not required to be invoked. The first issue need no consideration therefore as no substantial question of law has arisen;

It can be noticed that such explanation is brought on the statute book by the Finance Act, 1986, w.e.f 1st April 1974, which explains that where an amount is paid or is payable as interest in connection with acquisition of asset, so much of such amount which is relatable to any period after such asset is first put to use shall not be included and shall be deemed to have been included in the actual cost of such asset. The Bombay High Court in case of CIT v. Rajaram Bandekar, reported in 202 ITR 514 was considering Explanation 8 to Section 143 (1) wherein, it is held that the said explanation was added with an object of removing doubts with regard to the includibility of interest relatable to any period after the asset has first been put to use, in the computation of its actual cost. By this Explanation, it has been declared by Parliament that, "where any amount is paid or is payable as interest" in connection with the acquisition of an asset, "so much of such amount as is relatable to any period after such asset is first put to use shall not be included, and shall be deemed never to have been included," in the actual cost of such assets. Parliament, in the above Explanation, has taken full care to couch the Explanation in the widest possible terms to avoid any further controversy in regard to the very same issue on the basis of the manner of payment of interest or time of payment thereof. This has been done by the use of expression "where any amount is paid or is payable as interest". In the matter on hand, CIT [A] as well as the Tribunal have noticed that in view of introduction of Explanation 8 to Section 43 (1) which was held retrospective in nature, the interest cannot be capitalized which was paid after the slump sale was effected and the factory was in operation, and therefore, such expenses were revenue in nature. The directions given to the Assessing Officer to allow the amount of interest of ₹1.57 crores is in accordance with the provision of law. No question of law much less substantial question of law arises.

Section 148- Reopening based on re-appreciation of same material on record is not valid

In a case where the proviso to section 147 of the said Act was applicable, it must be clearly indicated that the understatement of income was on account of the failure on the part of the assessee to fully and truly disclose all material facts necessary for the assessment. The purported reasons behind the issuance of the notice under section 148 of the said Act are reproduced below:-

The assessment of M/s Global Signal Cables (India) Pvt. Ltd for the assessment year 2006-07 was completed after scrutiny in September 2008 determining an income of ₹1,06,25,5578 . It is gathered that the assessee debited ₹81, 30,819 to profit and loss account on account of interest and financial charges. In the auditor's report it was stated that interest free loan up to the tune of ₹5,20,57,726 had been given to other companies. Therefore, proportionate amount of expense on account of interest and financial charge should have been disallowed by the assessing officer. The mistake resulted in underassessment of income of ₹56,01,390 involving short levy of tax of ₹24,32,200 including interest. On the basis of the facts as stated above, I have reasons to believe that income chargeable to tax exceeding ₹1 lakh has escaped assessment, as the assessee has not disclosed fully and truly all material facts necessary for his assessment for the relevant assessment year. Hence, a notice u/s 147 read with section 148 for reopening of assessment is required to be issued in this case. It is evident that while the assessing officer mentioned that income had escaped assessment because of the failure on the part of the assessee to fully and truly disclose the material facts for assessment, he has not indicated as to which material fact had not been fully and truly disclosed by the petitioner/assessee. The learned counsel for the petitioner placed reliance on a decision of this Court in the case of Haryana Acrylic Manufacturing Co. vs. Commissioner of Income-Tax and Another: [2009] 308 ITR 38 (Delhi). While considering the provisions of sections 147 and 148 of the said Act, in particular the first proviso thereof, this court observed as under: -

In the reasons supplied to the petitioner, there is no whisper, what to speak of any allegation, that the petitioner had failed to disclose fully and truly all material facts necessary for assessment and that because of this failure there has been an escapement of income chargeable to tax. Merely having a reason to believe that income had escaped assessment is not sufficient to reopen assessments beyond the four year period indicated above. The escapement of income from assessment must also be occasioned by the failure on the part of the assessee to disclose material facts, fully and truly. This is a necessary condition for overcoming the bar set up by the proviso to section 147. If this condition is not satisfied, the bar would operate and no action under section 147 could be taken. We have already mentioned above that the reasons supplied to the petitioner do not contain any such allegation. Consequently, one of the conditions precedent for removing the bar against taking action after the said four year period remains unfulfilled. In our recent decision in Wel Intertrade Private Ltd. [2009] 308 ITR 22 (Delhi) we had agreed with the view taken by the Punjab and Haryana High Court in the case of Duli Chand Singhania [2004] 269 ITR 192 that, in the absence of an allegation in the reasons recorded that the escapement of income had occurred by reason of failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment, any action taken by the Assessing Officer under section 147 beyond the four year period would be wholly without jurisdiction. Reiterating our view-point, we hold that the notice dated March 29, 2004, under section 148 based on the recorded reasons as supplied to the petitioner as well as the consequent order dated March 2, 2005, are without jurisdiction as no action under section 147 could be taken beyond the four year period in the circumstances narrated above. The same principle is reiterated in Rural Electrification Corporation Ltd. vs. Commissioner of Income Tax: [2013] 355 ITR 356. Also in Microsoft Corporation (I) Pvt Ltd vs. Deputy Commissioner of Income Tax & Anr: [WP(C) 284/2013 decided on 23.05.2013] a Division Bench of this Court had observed as under:-

From the above, it is evident that merely having a reason to believe that income had escaped assessment is not sufficient for reopening the assessment beyond the four year period referred to above. It is essential that the escapement of income from assessment must be occasioned by the failure on the part of the assessee to, inter alia, disclose material facts, fully and truly. If this condition is not satisfied, there would be a bar to taking any action under Section 147 of the said Act. The facts of the present case are squarely covered by the decision of a Division Bench of this Court in M/s Swarovski India Pvt. Ltd. vs. Deputy Commissioner of Income Tax: W.P.(C) 1909/2013 decided on 08.08.2014 wherein the notice under section 148 of the said Act was quashed for being issued after the expiry of 4 years from the relevant assessment year wherein there was no specific mention of which material facts were not disclosed by the assessee in the course of its original assessment proceedings under section 143(3) of the said Act. The relevant paragraph is reproduced herein below:-

It is clear that the escapement of income by itself is not sufficient for reopening the assessment in a case covered by the first proviso to Section 147 of the said Act unless and until there is failure on the part of the assessee to disclose fully and truly all the material facts necessary for assessment. In the present case, it has not been specifically indicated as to which material fact or facts was/were not disclosed by the petitioner in the course of its original assessment under Section 143(3) of the said Act. In the present case also, there exist no grounds for re opening the assessment after the expiry of 4 years from the relevant assessment year. The notice under section 148 of the said Act is based on re-appreciation of the same material on record. The respondent has not specifically indicated as to which material facts were not disclosed by the petitioner/ assessee in the course of the assessment proceedings under the said Act. In view of the aforesaid discussion, the notice dated 28.03.2013 issued by the respondent under section 148 of the said Act is liable to be quashed. It is ordered accordingly. All proceedings pursuant to the notice dated 28.03.2013 also stands quashed.

(Ref: Global Signal Cables (India) Pvt. Ltd. Vs. DCIT (Delhi High Court), W.P](C) 747/2014, dated: 17.10.2014)

Section 80IC-Assembling of Tools & Machinery for final product is equal to manufacturing process

The case is as under:

The respondent-assessee was engaged in the business of manufacture of health care and surgical items and in the returns filed for Assessment Years 2006-07, 2008-09 and 2009-10 had declared taxable income of ₹26,25,230, ₹94,90,363 and ₹32,18,350 respectively. The deduction claimed under Section 80-IC of the Act was to the tune of ₹42,90,162, ₹35,69,594 and ₹2,46,13,965 respectively. The respondent-assessee had set up a manufacturing unit for manufacture of air purifier or air purification systems. The Assessing Officer held that the aforesaid activities would not qualify as manufacturing activity as the respondent-assessee was a mere assembler and did not have requisite tools or machinery.

The finding of the appellate authorities, including the Tribunal is that the product produced and sold by the respondent-assessee was air purification system. For manufacturing the said product, the assessee had purchased parts like base motors, filters, UV lights etc. but the final product produced was entirely different from its constituents or parts. The product manufactured or produced, i.e. the air purifier or air purification system was completely a new and an entirely different commodity having distinct name, character and use. The respondent-assessee had even filed photographs before the Assessing Officer to support his contentions on the manufacturing activities undertaken. The respondent-assessee had filed a flow chart of the manufacturing process. The manufacturing unit stood registered with District Industries Centre, Roorkee, Pollution Control Department, Commercial Tax Department, Uttaranchal, etc.

The Assessing Officer did not dispute or question the purchases of the parts used for manufacturing as well as the sale consideration received by the respondent-assessee from sale of the air purifiers but did doubt the purchases of the tools and implements required to undertake the manufacturing activities. It is not the case of the Revenue that the air purifiers were not actually manufactured or sold to third parties and there was bogus purchase of parts or transactions for sale of the manufactured The stand of the respondent-assessee was that they had used simple tools and testing equipments like frequency tester, multi meter, VV intensity meter, wires, CFM flow meter, ozone intensity monitor, nuts and bolts, hand drill, screw driver set, plier cutting set, etc. to carry out assembling and manufacturing of the air purifiers.

In view of the aforesaid factual findings, the appeal of revenue is dismissed.

(Ref: CIT Vs. M/s. Faith Biotech Pvt. Ltd. (Delhi High Court), Income Tax Appeal Nos. 509/2014, 510/2014 & 515/2014, Date of Order: 12.09.2014)

Penalty u/s 271(1)(c) should not be levied on the amount which was voluntarily surrendered by the assessee during survey

The facts in brief borne out from the record are that the assessee is a partnership firm engaged in the business of manufacturing and trading of bristles and brushes. Return of income was filed on 31.10.2006 showing nil income and the same was processed under section 143(1) of the Act. A survey was conducted on 23.10.2007 at the premises of the assessee where from books of account and loose papers were impounded. During the course of survey, it was found that assessee has a large list of creditors, from whom purchase of raw bristles were made. During the course of survey, statement of Shri. Pawan Sood, partner of the assessee firm was recorded wherein he surrendered certain amounts which included the amounts standing as credits in three sundry creditors. Thereafter assessee filed a revised return on 19.12.2007 including the amount of ₹45,75,945 surrendered in respect of sundry creditors as part of total income and paid tax thereon. Thereafter assessment was completed under section 143(3) of the Act. The Assessing Officer initiated penalty on the surrendered amount in respect of sundry creditors. In response to show cause, it was contended before the Assessing Officer that the assessee has made a voluntary surrender during the course of survey proceedings in order to buy peace and filed the return accordingly and paid tax. Therefore, there is no positive detection by the Department either before or at the time of surrender or subsequently. Therefore, penalty under section 271(1)(c) of the Act should not be levied on the surrendered amount. The Assessing Officer was not convinced with the explanations of the assessee and he levied the penalty having observed that the assessee has filed appeal against the additions made by the Assessing Officer in the assessment proceedings, therefore, it punctured the theory of agreed surrender. Held by ITAT- It is evident from the record that surrender was made during the course of survey by the assessee and furnished the return of income declaring additional income and paid the tax thereon. Nothing has been brought out on record by the Assessing Officer that the surrender was made when the assessee was cornered by the Assessing Officer. Though the Assessing Officer has mentioned in the order that the additions, on which penalty was levied, were challenged before the ld. CIT(A), but the facts are otherwise. The assessee has made voluntary surrender on account of sundry creditors and returned the additional income in the return of income filed and paid tax thereon. We have also carefully examined the judgment referred to by the parties and we find that it is a case of voluntary surrender by the assessee during the course of survey. Therefore, penalty under section 271(1)(c) of the Act cannot be levied. We have carefully perused the order of the ld. CIT(A) and we find that the ld. CIT(A) has adjudicated the issue judiciously in the light of various judicial pronouncements referred to before him. Since no infirmity has been pointed out in the order of the ld. CIT(A), we confirm the same.

(Ref: ITO Vs. M/s Indian & Overseas Trading Co.(ITAT Lucknow), ITA No.195/LKW/2011 – Assessment Year: 2006-07, Date of pronouncement: 25.08.2014)

Assessee is not eligible for deduction u/s 54EC, even if investment made in relevant AY was not within six months from handing over of possession to developer by virtue of JDA

Bangalore, October 10, 2014: The issue before the Bench is – *"Whether assessee is eligible for deduction u/s 54EC, even if investment made in the relavant AY was not within six months from handing over of the possession to the developer by virtue of joint development agreement."* The answer is NO.

Facts of the case

The assessee is an HUF consisting of Mr. S.R. Madhavan, as kartha of the joint family. The assessee had entered into a joint development agreement (JDA) with M/s Sumanth & Co. Chennai for jointly developing the said property by demolishing the existing building and structure. As per the joint development agreement, the consideration for the owners was entitlement of 7763 ft of the super built up area. The estimated cost of the construction was ₹70.00 lakhs. As per this agreement, the property was redeveloped and each stakeholder in the joint development agreement got their shares. It had declared a total income of ₹2,317 and long term capital gain (LTCG) of ₹38,33,570 on sale of house property in the alleged JDA. Subsequently, in assessment year 2006-07, the assessee had declared a total income of ₹1,626. It had further claimed exemption u/s 54 and 54EC of ₹28,41,770 and ₹27.00 lakhs respectively. However, during assessment, the AO took only ₹70.00 lakhs as sales consideration received instead of ₹97,37,800, as taken by the assessee and computed the taxable LTCG at ₹6,35,030. Whereas, for the AY 2006-07, the AO concluded a STCG of ₹9,10,249.

On appeal, the Tribunal held that

The working made by the first appellate authority is scientific and based on logic. The rate adopted is the rate accrued between the builder and the assessee for surrender of the constructed area. Therefore, the assessee cannot dispute that he has not received the amount as worked out by the CIT (A). The only dispute in assessment year 2006-07 is that the CIT (A) has erred in computing the STCG of ₹9,10,249. In our opinion, in view of the above discussion, there is no error in the order of the CIT(A) in computing the STCG. Therefore, we do not find any merit in Ground of the assessee's appeal for assessment year 2006-07.

As far as assessment year 2005-06 is concerned, the grievance of the assessee is that the Assessing Officer has erred in working out the LTCG of ₹6,35,030. It is submitted that the transactions for sale of land as well as the sale of super built up area is to be considered as one transaction. The assessee had made investment eligible for deduction u/s 54EC. This investment was made, though in a period related to assessment year 2006-07 and not within six months from the handing over of the possession to the developer by virtue of joint development agreement. But if it is considered a single transaction, then the assessee had made investment on 27.7.2005 in REC Board and it is entitled for the deduction. We have duly considered the rival contentions and perused the record carefully. As observed earlier, the transactions for sale of land was completed in the accounting year relevant to assessment year 2005-06. The assessee has handed over the possession to the builder on 15.06.2004. The assessee itself has disclosed the LTCG in assessment year 2005-06. The investment in REC Board was not made in six months. It was made only on 27.7.2005 i.e. beyond the period of six months. Therefore, the CIT(A) has rightly observed that the assessee is not eligible for deduction u/s 54EC.

For the purpose of claiming Sec 10B benefits, it is necessary to obtain approval of STPI authority

Chennai, October 7, 2014: The issue before the Bench is- "*Whether, for the purpose of claiming Sec 10B benefits, it is necessary to obtain approval of the STPI authority.*" The answer goes against the assessee.

Facts of the case

The assessee company, incorporated in 2003, was engaged in software development. It had started business operations from January, 2004. The assessee prepared accounts for the period 19.12.2003 to 31.3.2005. For the first time, in AY 2005-06, the assessee claimed deduction u/s 10B and filed return of income declaring total income of ₹38,430 The said return was processed u/s 143(1) and subsequently, the case was taken up for scrutiny. The AO while dealing with the claim of deduction u/s 10B it found that the assessee had applied for registration as 100% EOU to Software Technology Parks of India (STPI) and obtained approval only in May, 2005; hence, as per Circular No.1 of 2005 dated 06.01.2005 of the CBDT, the assessee was not eligible for the benefit u/s 10B. Accordingly, AO disallowed the entire claim of deduction u/s 10B on the ground that the assessee had obtained approval from STPI only in May, 2005, which was after the end of the previous year relevant to the A.Y. 2005-06. On appeal, CIT(A) had partly allowed the appeal holding that it was settled proposition of law that an exemption had to be granted as and from the AY in which the conditions prescribed in the section had been satisfied until the end of the holiday period. (C.I.T. Vs. Gopal plastics Ltd., 215 ITR 136 Mad). This view was also supported by the decision of SC in the case of Textile Corporation Ltd. Vs. C.I.T. 107 ITR 195. In the case of assessee, it was found that the assessee was engaged in the manufacturing and export of computer software and had commenced hundred percent export of computer software during the A.Y. 2005-06. CIT(A) held that the assessee had fulfilled all the conditions specified u/s 10B and had correctly claimed deduction under that section. The AO, therefore was not justified in denying the claim of deduction, consequently, he was directed to allow the same as per the claim made by the assessee in the return of income. On further appeal, Tribunal held that if the assessee satisfies the three conditions as stipulate, it would be granted the benefit u/s 10B. It had also held that there was no pre-condition that the assessee company had to obtain registration from STPI before making a claim u/s 10B; the Circular of the CBDT could not override the plain provisions of the Act and the circulars of the CBDT were either in the nature of clarification or rather explanatory in nature. The Tribunal further held that the STPI agreement/certificate nowhere mentioned that it was for claiming deduction u/s 10B. The Tribunal also held "a claim which is allowed by the plain provisions of the Act cannot be restricted by imposing conditions which cannot be carried out". The Tribunal also held that beneficial, promotional and incentive provisions like the provisions of Section 10B, which was aimed at promoting software industry in India, should be liberally construed and should not be defeated on technical grounds.

Before HC, the Revenue's counsel had submitted that Explanation 2 (iv) of Section 10B defines 100% EOU as one approved by the Board. The ten year period commences from the date of such approval. It was further submitted that when the STPI registration itself was beyond the financial year, the assessee was not entitled to the benefit of exemption prior to the date of approval and the assessee was entitled to the benefit of exemption from the next assessment year only. Also the circular of the CBDT was not contrary to the statute but it has only clarified the position. Hence, the order of the Tribunal was liable to be set aside and the appeal may be allowed. On the other hand, the assessee's counsel had submitted that the assesseehad fulfilled the conditions prescribed u/s 10B and hence eligible for exemption. The provision does not make it mandatory that STPI registration should be obtained before making a claim u/s 10-B. Hence, the Tribunal was correct in granting benefit of exemption u/s 10-B to the assessee.

Held that

It is seen that the assessee, which is a company engaged in software development, has applied for registration as 100% Export Oriented Unit on 24.3.2005 before the competent authority and got the approval in May, 2005. The assessee claimed benefit of exemption under Section 10-B of the Act, which falls under Chapter IV, for the assessment year 2005-06. What is relevant for seeking benefit under Section 10-B is deduction of profits or gains as are derived by a hundred per cent export-oriented undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee. A reading of the above provision makes it clear that a 100% EOU as provided under Section 10B(1) will be one that is approved by the Board appointed in this behalf by the Central Government in exercise of the powers conferred by Section 14 of the Industries (Development and Regulation) Act, 1951 (65 of 1951), and the Rules made under that Act. Admittedly, in this case, such approval was granted during May, 2005 only and therefore, prior to that date or the assessment year, relevant to the date of registration, the benefit of Section 10-B would not be available as the requirement of approval by the competent authority is not available as on the date, from which the assessee claimed exemption. Hence, we have no hesitation to hold that Section 10B is very clear and unambiguous that approval by the competent authority is pre-requisite for grant of benefit under Section 10-B. Hence, it will not be appropriate for the Tribunal to hold that there is no pre-condition that the assessee should have obtain STPI registration before making the claim under Section 10-B of the Income Tax Act. That finding of the Tribunal is totally wrong and contrary to the provisions of the Act;

The provisions of Section 10-B of the Income Tax Act make it clear that the benefit will flow if there is a certificate of approval issued by the Board appointed in this behalf, namely, STPI. Hence, we find that the Tribunal is not justified to hold that the claim allowed by the provision of Section 10B cannot be restricted by imposing certain conditions. We hold that this finding of the Tribunal is totally contrary to Clause (iv) to Explanation (2) of Section 10B of the Income Tax Act. The Department, no doubt, clearly states that for the next assessment year the benefit would automatically flow. We do not find any justification to be swayed by the view of the Tribunal that the promotion of software industry should not be scuttled by technicalities. We are also aware of the fact that the benefit granted under Section 10B is more in the nature of exemption, for which certain pre-requisite conditions, namely, approval by the appropriate Board, have to be complied with in the manner prescribed. Unless and until the assessee gets an approval in the manner prescribed under Section 10-B, the question of granting the benefit does not arise. The Tribunal's opinion that if there are two views, then the view in favour of the assessee should be accepted is fully inadmissible on the facts of the present case. We hold that the Circular is nothing but clarification of what the Section 10B really provides for. It is of no avail either to the assessee or to the Department when the provisions of Section 10-B is clear.

It is to be noted that there is no second opinion on the facts of the ratio decided by this Court in the case of C.I.T. Vs. Gopal plastics Ltd., reported in 215 ITR 136 (Mad) that exemption will be available from the inception if the conditions are fully satisfied, which fact is not available to the facts of the present case. We hold that the assessee in this case will be entitled to the benefit of Section 10-B only on complying with the conditions contained prescribed in Section 10-B of the Income Tax Act, and it does not ensure to the benefit for the assessment year in question, namely, 2005-06. The decisions relied on by the Tribunal have no relevance to the facts of the present case. We, therefore, hold that the question of law raised by the Revenue is answered in favour of the Revenue and against the assessee. Accordingly, the order of the Tribunal stands set aside and the Tax Case (Appeal) stands allowed. Counsel appearing for the assessee submits that if there is any material to show that the assessee has got the approval earlier, the assessee may be given liberty to produce the same before the Assessing Officer for availing the benefit. It is open to the assessee to submit the certificate of approval, if any, to show that on earlier date, it has obtained approval and seek rectification in accordance with law.

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