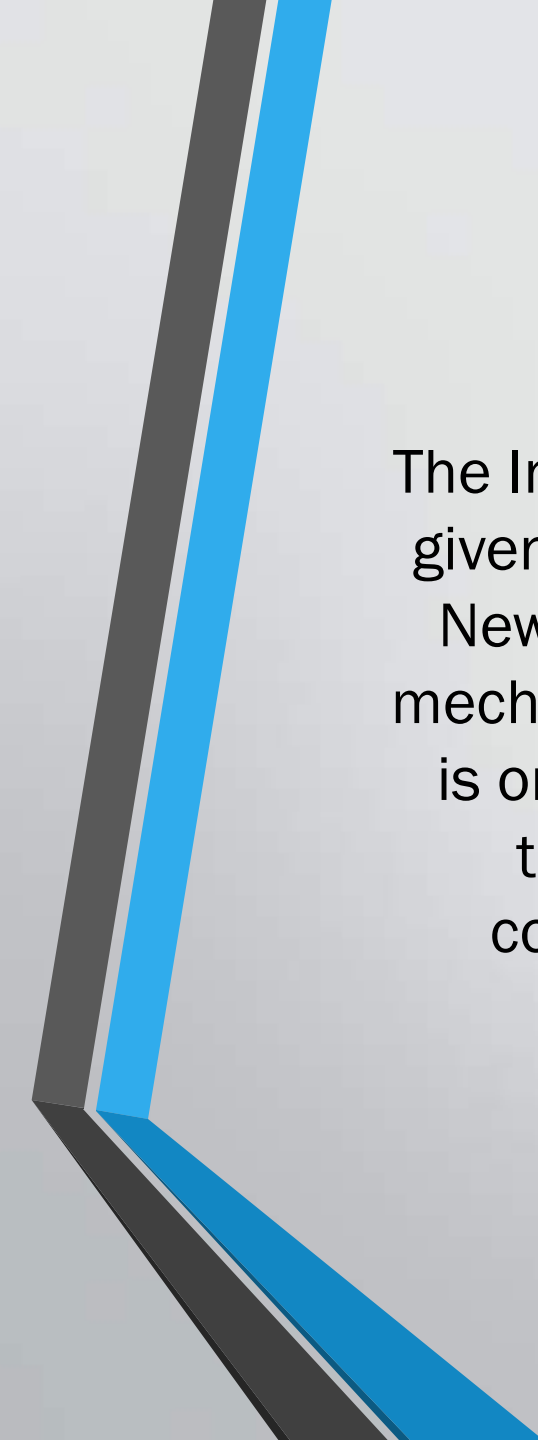




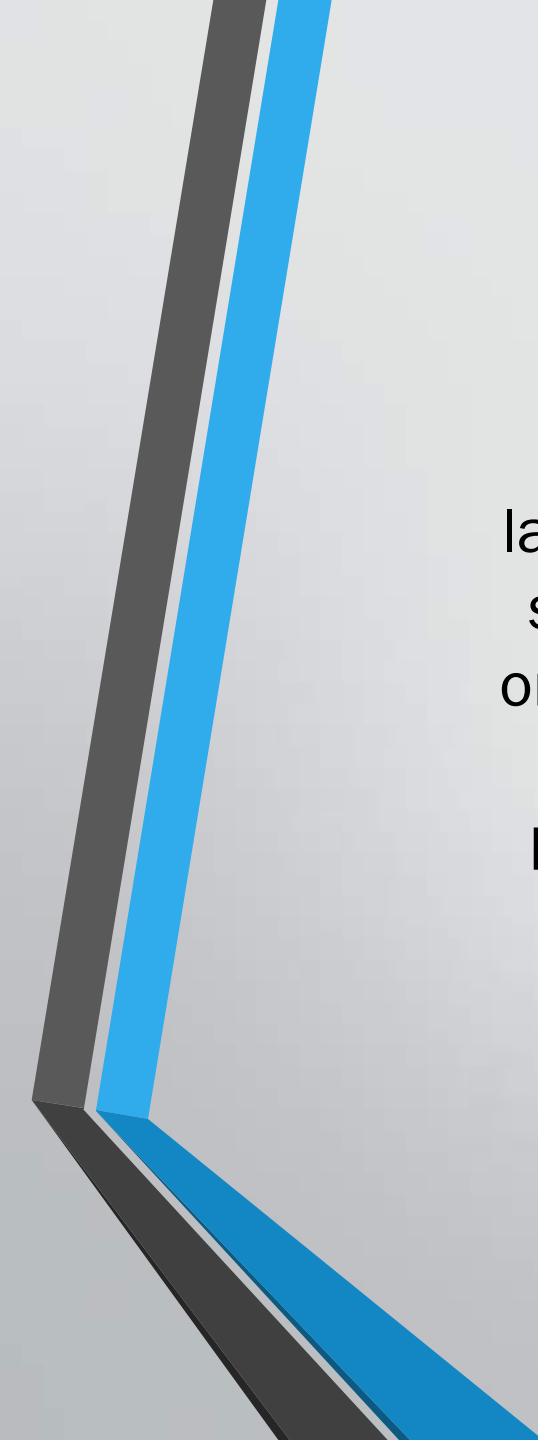
Taxation

Landmark principles of Direct tax laws

Presented by
CA Anil Sathe



The Income Tax Act 1961 “Old Act/ ITA 1961” has been repealed and has given way to the Income Tax Act 2025 “New Act/ ITA 2025” However the New Act does not make any change in the policies, concepts, charging mechanism as enshrined in the Old Act but the purpose of the enactment is only to make the law simpler, lucid, easier to understand. Only when the new law is judicially tested that one will be able to arrive at a conclusion as to whether the noble objectives have been achieved



Since the fundamentals of the Old Act remain unchanged the landmark principles which have developed over the last century or so, continue to hold the field. Some of them have been modified or diluted by way of the amendments to the law which is within the legislative competence of the Parliament. The objective of this presentation is to revisit these landmark principles and examine their relevance in the current scenario



Any law in India has to satisfy the test of constitutionality. The Constitution in terms of article 265 provides is under

No tax shall be **levied or collected** except by authority of law.

C.Nanda Kumar Vs Union of India 396 ITR 21(AP)

Facts

Compulsory acquisition of land. Acquisition was covered by Right to fair compensation and transparency in land acquisition, rehabilitation and resettlement Act 2013 { RFCTLARR 2013 } The compensation was exempt in terms of section 96 of the said Act.

Issue

Whether tax could be withheld from such compensation as section 194LA which governs deduction of tax at source from “payment of compensation on acquisition of certain immovable property” uses the words “any sum”. {This was prior to the insertion of the proviso to section 194LA, which clarified that the said section was subject to section 96 of RFCTLARR 2013.}

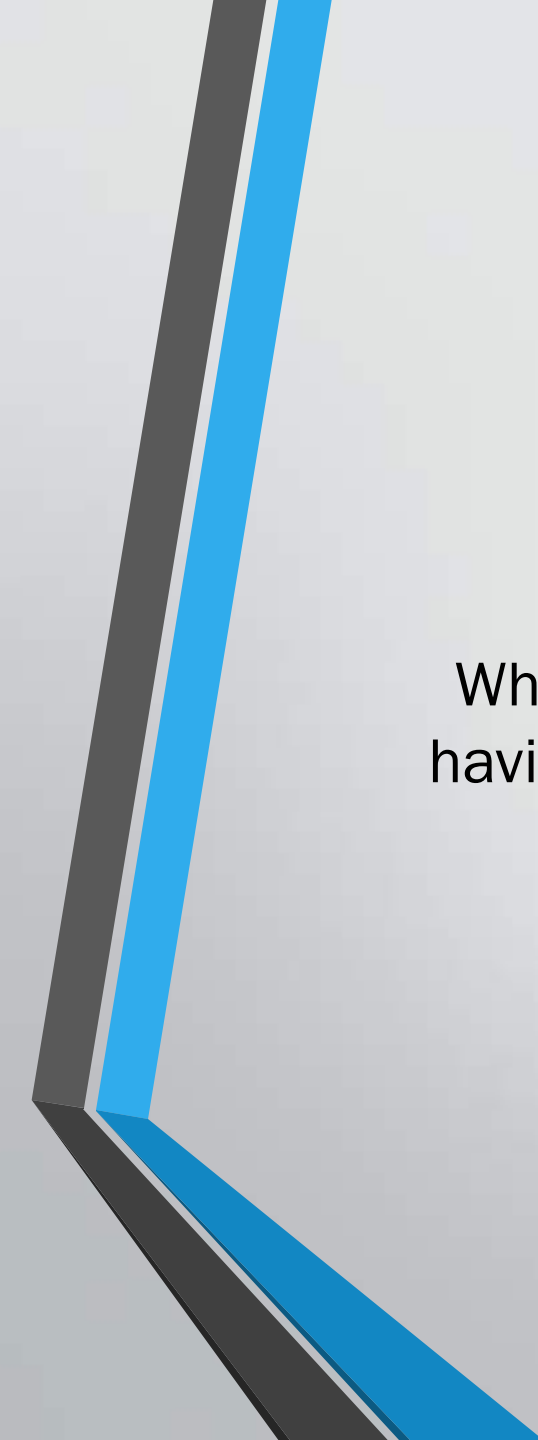
Findings of the High Court

1. The deduction/collection of tax mandated by Chapter XVII of ITA 1961 has to have the **authority of law**
2. In terms of section 96 of RFCTLAR), no income tax shall be levied on any award made under the said Act
3. While section 194LA undoubtedly uses the words “any sum”, the said section is controlled by section 190(1), the avowed purpose of which is to authorise deduction of “tax on income”. When no Income tax can be levied no tax can be deducted.

Dipti Enterprises Vs AFIT CPC 181 taxmann.com 10 (Bom)

Facts

The assessee undertook housing project which was approved prior to 1st April 2013 the profits of which were fully deductible in terms of section 80IB(10). While filing the return of income the system applied section 115JC (AMT), and determined tax which was paid by the assessee. The assessee filed a revision petition under section 264, placing reliance on an earlier ruling of the tribunal on similar facts. The petition was rejected on the ground that the department had not accepted the earlier ruling.



Issue

Whether the assessee having filed a return of income and the same having been accepted as filed was entitled to relief under section 264 of ITA 1961?

Finding of the High Court

The Bombay High Court held relying on its earlier rulings in *Nirmala Mehta Vs A.BalaSubramnaiam* CIT 269 ITR 1, and *BalMukund Acharya Vs DCIT* 310 ITR 310, that the doctrine of estoppel prevents a person from adopting a different stand which is contrary to his earlier stand. However, the same does not act as a bar in taxing statutes, and a person is entitled to take a different/new stand which is in consonance with the Act/law. If the same is not permitted, it will result in violation of Article 265, and in turn, amount to the levy or collection of tax without the authority of law. In taxing statutes, acquiescence cannot take away from a person the relief that he is entitled to. It further held that the approach of the revenue to disregard the judicial precedent on the ground of it being challenged before the Superior Court is unacceptable.

Sneh Lata Jain Vs CIT140 Taxman 156 (J & K)

Facts

The assessee furnished a return submitting to tax capital gains on sale of land. This was accepted under section 143(1). Realising that a claim under section 54F had not been made on account of erroneous advice, she approached the revisionary authority, but her petition was rejected on the ground that the return had no claim and the said return had been accepted. A writ petition was filed before the J & K High Court.

Issue

Could the assessee be aggrieved by the acceptance of her return which she herself had filed ?

Assuming that she could raise a grievance, could a writ court exercise an appellate jurisdiction ?

Held

When a substantive law confers a benefit on the assessee, it cannot be taken away by mere technicalities. It is a settled position of law that no tax can be levied or recovered without authority of law. Article 265 of the Constitution of India imposes an embargo on imposition and collection of tax if the same is without authority of law. The intimation under section 143(1), was not an error of the revenue, it was an error which the assessee had committed but later discovered. Further while it is true that this court is not to act as a court of appeal while exercising writ jurisdiction but when admitted facts disclose the non exercise of jurisdiction by an adjudicating authority and a citizen is subjected to tax which is not payable by him interference is warranted.

Diversion by overriding title
Sitaldas Thiraldas Vs CIT 41 ITR 367 (SC)
CIT Vs Sunil Kinariwala 259 ITR 10 (SC)

Facts

In Sitaldas Thirardas, the assessee was obliged by virtue of a consent decree to make payment of maintenance to his wife and children.

In Sunil Kinariwala, the assessee assigned 50% of his share in a partnership to trust in which his relatives were beneficiaries. In both the assessee claimed that the income could not be charged to tax in his hands.

Issue

Whether an obligation to pay from income creates a diversion by overriding title
?

Findings of the court

The true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, are there in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable.

Destruction of Source

Karamchand Thapar and Bros (P) Ltd Vs CIT 80 ITR 167(SC)

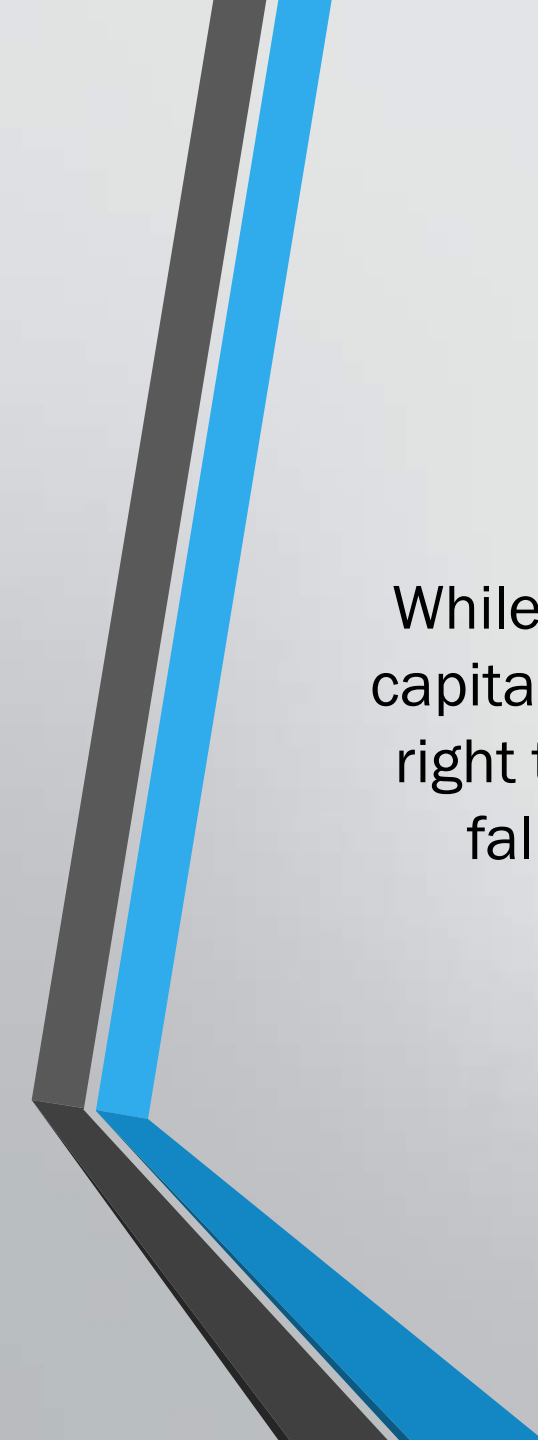
Facts

The assessee company, held managing agencies of various companies. Vide resolution passed in April 1951 these were terminated, and a compensation was to be paid to the company. In the litigation that ensued, the tribunal held that the termination of the managing agencies was destruction of a source of income and therefore a capital receipt. The High Court took a view that the resolutions passed were not genuine. The matter reached the Supreme Court.

Finding of the Supreme Court

The Supreme Court recorded two significant findings. Firstly the court held that the tribunal was the last fact-finding body and the High Court did not have any jurisdiction to find fault with the facts recorded unless a perversity was found. It also held that the compensation was not taxable. In our opinion, it was wholly impermissible for the High Court to disturb the findings of fact reached by the Tribunal. The Tribunal was the final fact-finding authority. The facts found by it could have been challenged only on certain recognised grounds. Neither the High Court nor this court has jurisdiction to reappreciate the material on record to find out whether the facts found by the Tribunal are correct or not. The High Court should not have taken upon itself the responsibility to go into the question whether the findings of fact reached by the Tribunal are correct

Ordinarily compensation for loss of office or agency is regarded as a capital receipt, but this rule is subject to an exception that payment received even for termination of an agency agreement would be revenue and not capital in the case where the agency was one of many which the assessee held and its termination did not impair the profit-making structure of the assessee, but was within the framework of the business, it being a necessary incident of the business that existing agencies may be terminated and fresh agencies may be taken. But it is for the income-tax department to clearly establish that the case fell within the exception to the ordinary rule. In the present case, according to the findings of the Tribunal, the termination of the agency in question had resulted in the destruction of a source of income of the company. Applying tests laid down in On applying these tests to the facts found by the Tribunal in this case, the receipt must be considered as a capital receipt.



While this is indeed a landmark decision in the context of what constitutes a capital receipt or revenue receipt on compensation received for destruction of right to carry on business, the same may no longer be good law , if the case falls within the purview of the insertion of Section 28(ii)(a) , (b) and (c).

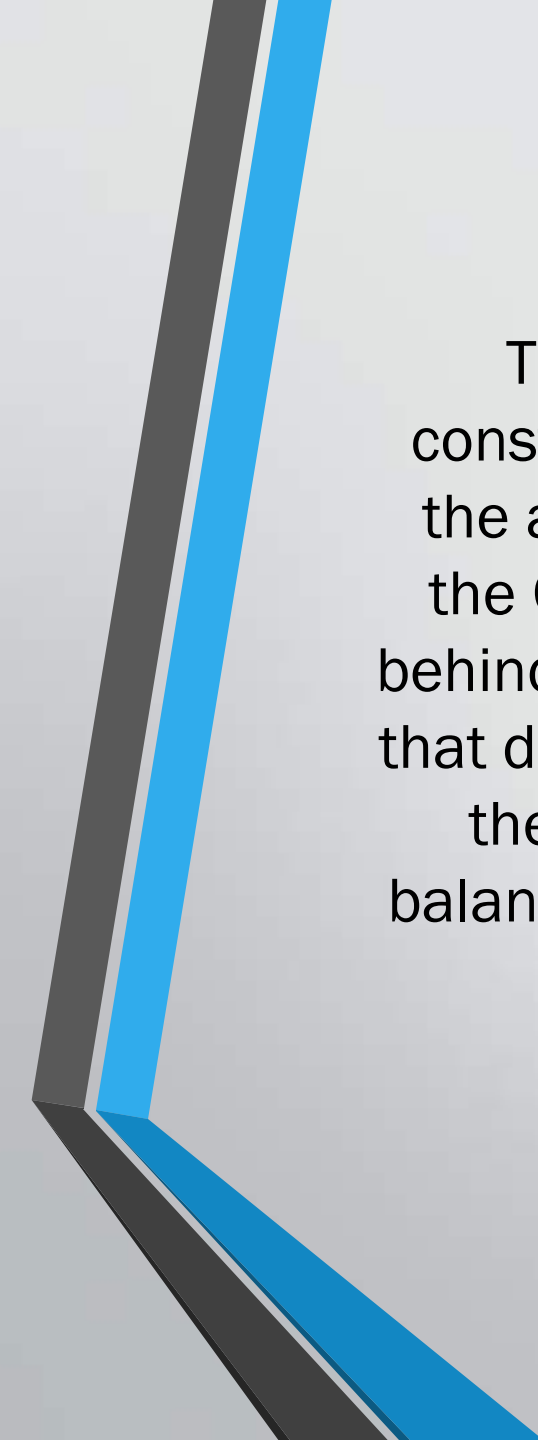
Power of the legislature to expand the definition of income.
Serum Institute of India (P) Ltd Vs Union of India 463 ITR 582 (Bom)

Facts

The insertion of section 2(24)(xviii) which made a large number of subsidies, which were hitherto treated as capital receipt, includible in the definition of income , was challenged as violative of Article 19 and Article 14 of the Constitution. A writ petition was filed before the Bombay High Court.

Findings of the Court

The domain of economic and fiscal policy formulation is primarily vested in the Legislature and the executive. The judiciary's role is limited to ensuring conformity with the Constitution without delving into the policy merits. Furthermore, this presumption ensures stability and predictability in fiscal policies, which are essential for economic growth and development. Overturning fiscal statutes could lead to economic chaos and undermine the authority of the legislative body. Therefore, Courts must balance the necessity to uphold constitutional mandates with the practical implications of interfering with legislative judgments in fiscal matters. In the utilities, tax and economic regulation cases, there are good reasons for judicial self restraint if not judicial deference to legislative judgment. The Legislature after all has the affirmative responsibility. The courts have only the power to destroy, not to reconstruct. When these are added to the complexity of economic regulation, the uncertainty, the liability to error, the bewildering conflict of the experts, and the number of times the judgments have been overruled by events-self-limitation can be seen to be the path to judicial wisdom and institutional prestige and stability.



The only examination of the Court is restricted to the finding of a constitutional infirmity in the provision, as is placed before the Court. In the absence of any finding of any constitutional infirmity in a provision, the Court is not empowered to invalidate a provision. The *raison d'être* behind this self-imposed restriction is because of the fundamental reason that different organs of the State do not scrutinise each other's wisdom in the exercise of their duties. The time-tested principle of checks and balances does not empower the Court to question the motives or wisdom of the Legislature, except in circumstances when the same is demonstrated from the enacted law.

In light of the above, the amendment to section 2(24) by the insertion of sub-cause (xviii) of the Finance Act, 2015, is a perfect example of a legislative endeavour to align the definition of 'income' with the evolving economic landscapes and judicial precedent of it being an inclusive and elastic term. The submissions of petitioner though appear to be of fiscal concern were, more an argument of diminished profits and a narrow interpretation of income which the Apex Court has time and again expanded. The submissions of petitioner fall short of appreciating the overarching legislative intent to foster a comprehensive and equitable taxation regime. The amendment to section 2(24) by insertion of the impugned sub-clause that includes various subsidies and concessions only indicates the well established jurisprudential path ensuring that the income tax laws remain attuned to the economic realities and continue to serve as a vital cog in the nation's fiscal machinery.

CIT Vs Parle Soft Drinks (Bangalore) Pvt Ltd 400 ITR 108 (Bom)

Facts

The assessee, a part of the Parle Group of Companies, was engaged in the business of manufacturing, bottling and distribution of soft drinks and beverages under several popular brands. In terms of master agreement between Coca-Cola and the Parle Group, a subsidiary was to be formed for bottling soft drinks for Coca-Cola. In the said agreement itself, a draft of right of first refusal regarding bottling rights was also elaborated. Later Coca-Cola took a strategic decision to set up its own plant. This led to a breach of the obligation of the Coca-Cola group in respect of the 'right of first refusal given to Parle Group', The breach led to a dispute which was settled by payment of a compensation of 16.06 crores to the assessee. This was claimed by the assessee to be a capital receipt. This was disputed by the revenue authorities which dispute finally reached the High Court. An SLP against the decision of the High Court was dismissed

The High Court Held as under

The right of first refusal itself constituted a substantial right and foundation on which the assessee could have built its bottling business. If such right would have been assigned to the assessee, it would have been the source of assessee's income and profit making apparatus. The assessee has also submitted its business plans and various modes for carrying out the bottling business to the Coca Cola Company. There is no dispute that the Coca Cola Company had breached the agreement and particularly the right of first refusal by not assigning the rights. It was on account of breach of this agreement that the compensation amount was settled between the parties. That source of income, by way of setting up of a bottling plant at Pune territory was lost forever. The compensation was therefore a capital receipt. All the tests that were evolved by the Supreme Court in various decisions, have been applied to arrive at the correct conclusion.

Principle of Mutuality
Bankipur Club 92 Taxman 278 (SC)
Chelmsford Club 243 ITR 89 (SC)
Bangalore Club Vs CIT 350 ITR 509 9SC)
CBDT Circular no. 11 of 2008

Issues

The claim of mutuality is a contentious matter. The following issues arise

- a. what are the streams of income that would enjoy an exemption based on the principle of maturity
- b. what is the precise impact of section 28(iii)
- c. what is the concept of complete identity between contributors and beneficiaries

Ratio of decisions

In Bankipur Club the Supreme Court held as under

It should be noticed that in the case of 'mutual society or concern' (including a 'Members' club'), there must be complete identity between the class of contributors and the class of participators. The particular label or form by which the mutual association is known, is of no consequence. The court held that once the transactions with members were not tainted by commerciality, there was no profit earning motive, the surplus arising to the entity on account of the excess of revenue expenditure was not in the nature of income chargeable to tax. So a club offering food refreshments or an occasional use of premises to its members would not attract the provisions of section 28(iii), and the surplus would not be chargeable to tax. However in terms of section 28 (iii), if the association was a trade, professional or similar association offering specific services to members the same would be chargeable to tax. For example if a trade association provided, a certificate to a member for the purposes of the goods that he exported that would be a service chargeable to tax.



In Chelmsford Club, the assessing officer sought to tax the deemed annual value of the premises which were used by members in terms of section 22. The court held that once the contributors and beneficiaries were identical there could be no deemed income

Bangalore Club laid down three important principles of Mutuality

- a. There must be complete identity between contributors and participants
- b. The actions of the contributors and participants must be in furtherance of the mandate of the Association
- c. There must be no scope of profiteering by the contributors from a fund made by them which could only be expended or returned to themselves.

The Court held that none of three conditions were satisfied in the case of Bangalore club and consequently the income was taxable.

The CBDT circular no.11 of 2008 has created a fair amount of confusion.
The circular was issued in the context of the proviso to section 2(15).
Paragraph 3.1 of the circular read as under

There are industry and trade associations who claim exemption from tax under section 11 on the ground that their objects are for charitable purpose as these are covered under 'any other object of general public utility'. Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax.

In such cases, there must be complete identity between the contributors and the participants. Therefore, *where industry or trade associations claim both to be charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) owing to the principle of mutuality.* However, if such organizations have dealings with non-members, their claim to be charitable organizations would now be governed by the additional conditions stipulated in the proviso to section 2(15).

It needs to be understood that mutuality and the claim of exemption cannot go together. They can be alternate claims

Receipts during capital asset creation **CIT Vs Bokaro Steel Ltd 256 ITR 315(SC)**

Facts

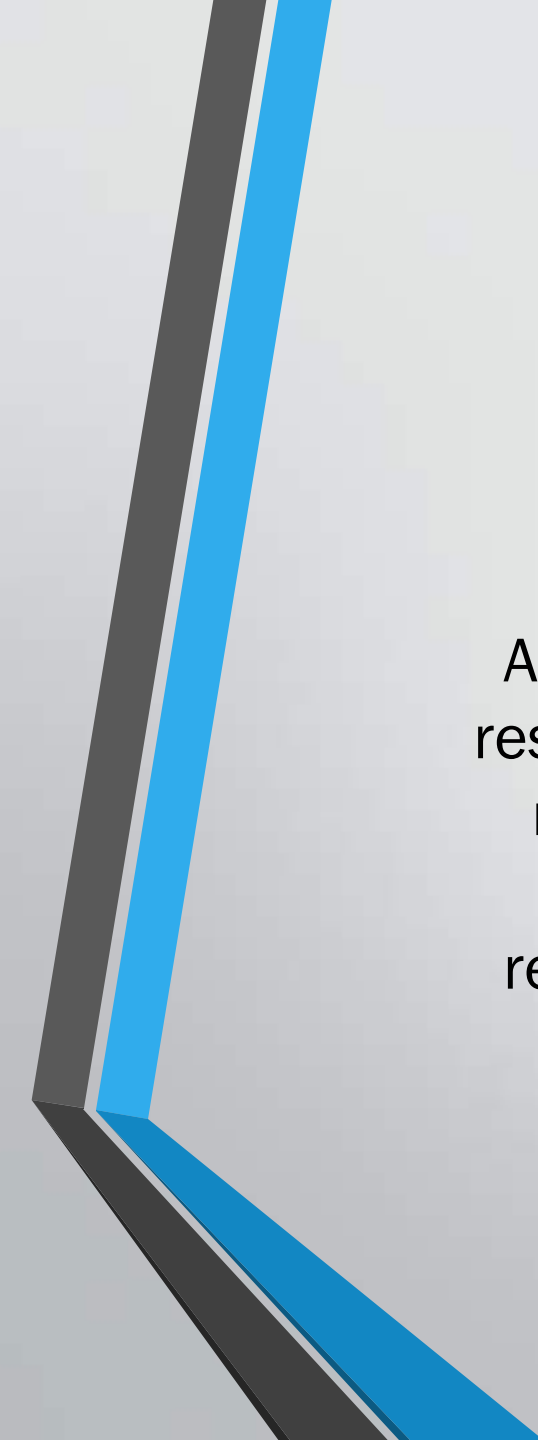
The assessee was in the process of constructing a steel plant. During that period the assessee received revenue from rent recovered for housing contractor's workers, hire charges for plant and machinery used for constructing the plant and royalty for excavation and use of stones lying on assessee's land used for construction . The department sought to tax the said income . The litigation reached the Supreme Court

Issue

Whether receipts received during construction period which were inextricably linked to the creation of a capital asset could be charged to tax ?

Finding of the court

The Supreme court held that, as per generally accepted accounting principles (GAAP) all costs linked to the creation of a capital asset incurred prior to it reaching a stage of completion or the asset capable of being put to use , had to be capitalized. Similarly revenue which was inextricably linked to the creation of the asset would have to be reduced from the cost, and could not constitute a source of income



Accrual of Income

Babulal Narottamdas Vs CIT 187 ITR 473 (SC)

Facts

A company, of which the assessee was a managing agent passed a resolution for payment of special additional remuneration to him. The resolution was passed in 1949. The shareholders challenged the same before the Bombay High Court. The court held that the resolution was validly passed and the remuneration was payable to the managing agent.



Issue

Whether if a debt accrued and arising to the assessee is challenged in a judicial forum does the accrual of income be deferred ?

Finding

The right to receive the extra remuneration flowed from the resolution. The income accrued or arose at the end of each accounting year irrespective of the fact whether the amount was actually paid by the company to Narottamdas or not. Though the payment was deferred on account of the pending litigation, it cannot be said that accrual of income was postponed simply because a suit was filed by the shareholders challenging the validity of the resolution passed by the company. Income can be held to accrue when the assessee acquires a right to receive that income. In *E.D. Sassoon & Co. Ltd. v. CIT* [1954] 26 ITR 27 (SC), the principle that income must be held to accrue on the date when a debt becomes due has been affirmed.

Place of Accrual / Receipt **KanchanGanga Sea Foods Ltd Vs CIT 325 ITR 540 (SC)**

Facts

The assessee company, was engaged in the export of seafood. It obtained permission to fish in the exclusive economic zone but outside Indian territorial waters. For that purpose it chartered vessels from a non-resident company. Its charter fee was payable in terms of 85% of the catch of fish. The trawlers embarked from Chennai conducted fishing operations in the exclusive economic zone outside Indian territorial waters. The trawlers returned to Chennai with the fish which were valued 85% earmarked and thereafter the trawlers left to deliver the catch outside India to the designated customer. The issue was of place of accrual and receipt of income for the non-resident.

Issue

Whether the income accrued to or was received by the non-resident company in India though the sale proceeds of the fish were paid subsequent to the delivery of the catch outside India to the designated customer ?

Findings

It is after the non-resident company was given share of its 85 per cent of the catch it did come within its control. It is trite to say that to constitute income the recipient must have control over it. Thus the non-resident company effectively received the charter-fee in India. Therefore, in our opinion, the receipt of 85 per cent of the catch was in India and this being the first receipt in the eye of law and being in India would be chargeable to tax.

In our opinion, the non-resident company having received the charter-fee in the shape of 85 per cent of fish catch in India, sale of fish and realization of sale consideration of fish by it outside India shall not mean that there was no receipt in India. When 85 per cent of the catch is received after valuation by the non-resident company in India, in sum and substance, it amounts to receipt of value of money. Had it not been so, the value of the catch ought to have been the price for which non-resident company sold at the destination chosen by it. In the light of what we have observed above there is no escape from the conclusion that income earned by the non-resident company was chargeable to tax under section 5(2) of the Income-tax Act. Consequently the assessee was liable to deduct tax under section 195.

Time of receipt
Toshoku Ltd Vs CIT 125 ITR 525 (SC)

Facts

An Indian exporter sold tobacco non-resident sales agent. The exporter credited the amount to the non-resident sales agent. On that basis the Indian tax authorities treated the amount credited to the non-resident, as income received in India. The litigation travelled to the Supreme Court



Issue

Whether credit of income in the books of the Indian exporter, amounted to receipt by the non-resident sales agent ?

Findings

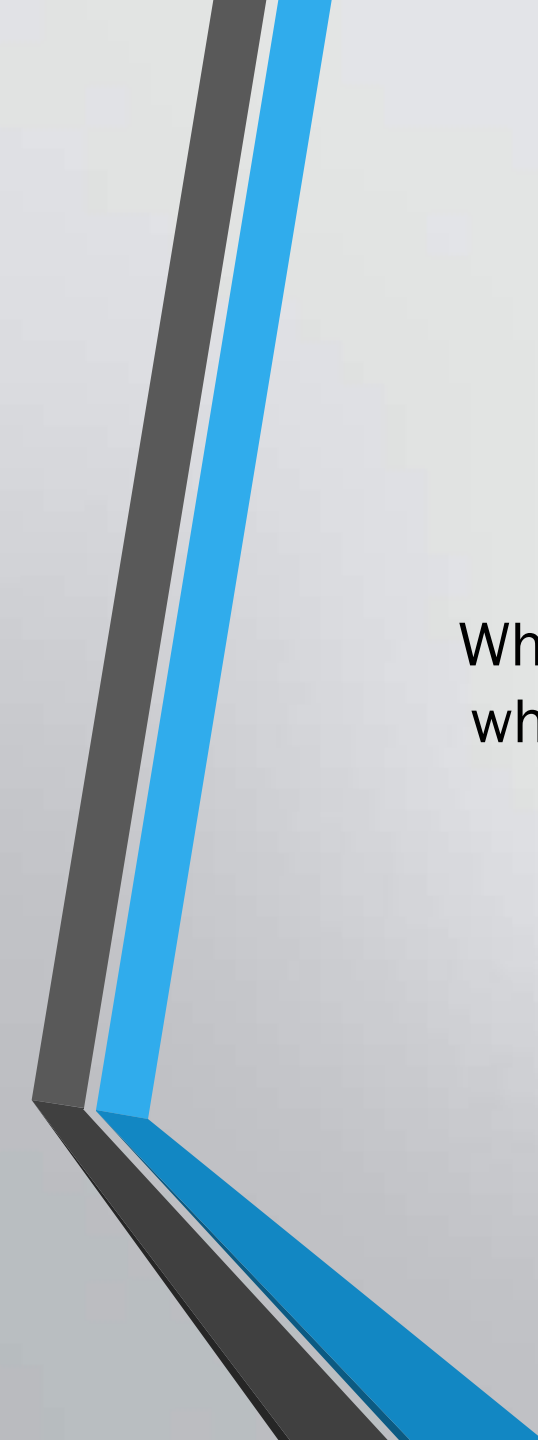
It cannot be said that the making of the book entries in the books of the statutory agent (the company) amounted to receipt by the assesseees who were non-residents as the amounts so credited in their favour were not at their disposal or control. It is not possible to hold that the non-resident assesseees in this case either received or can be deemed to have received the sums in question when their accounts with the statutory agent were credited, **since a credit balance, without more, only represents a debt and a mere book entry in the debtor's own books does not constitute payment which will secure discharge from the debt.** They cannot, therefore, be charged to tax on the basis of receipt of income actual or constructive in the taxable territories during the relevant accounting period.

Real Income

Godhra Electricity Company Ltd Vs CIT 225 ITR 746 (SC)

Facts

The assessee company was a licensee to generate and supply electricity, enhanced its charges. These were disputed by consumers and the dispute was finally decreed in favour of the company by the Supreme Court. The government of Gujarat advised the company to maintain status quo and not recover the enhanced charges. The company was taken over by the government and the undertaking ultimately transferred to the Electricity Board. Based on entries in the books of account, coupled with the company following a mercantile method of accounting, the assessing officer held that income had accrued to the company. The matter finally travelled to the Supreme Court.



Issue

Whether entries in books of account of the assessee, recording income, which the assessee in light of the circumstances could not recover was income which had accrued or was merely hypothetical income

Finding

After the decision was taken by the assessee-company to enhance the charges it was not able to realise the enhanced charges on account of pendency of the earlier representative suits of the consumers followed by the letter of the Under Secretary to the Government of Gujarat. During the pendency of the subsequent suit the management of the undertaking of the assessee-company was taken over by the Government of Gujarat under the Defence of India Rules, and the undertaking was subsequently transferred to the Gujarat State Electricity Board. The question whether there was real accrual of income to the assessee- company in respect of the enhanced charges for supply of electricity has to be considered by taking the probability or improbability of realisation in a realistic manner.

The letter addressed by the Under Secretary to the Government of Gujarat to the assessee-company had no legally binding effect but one has to look at things from practical point of view. The assessee-company, being a licensee, could not ignore the direction of the State Government which was couched in the form of an advice.

The Tribunal had rightly held that the claim at the increased rates as made by the assessee- company on the basis of which necessary entries were made represented only hypothetical income and the impugned amounts as brought to tax by the ITO did not represent the income which had really accrued to the assessee-company during the relevant previous years.

A blue ballpoint pen is shown in the process of writing the words "Thank you!" in a cursive script on a white background. The pen is positioned at the end of the word "you!", with its tip touching the paper. The text is written in a dark blue or black ink.

Thank you!