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BHARAT AGARWAL
ON
LANDMARK JUDGMENTS ON
DIRECT TAX

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VASHI STATION COMPLEX,
NAVI MUMBAI – 400703.
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REAL INCOME
VS.
NOTIONAL INCOME



COMMISSIONER OF INCOME-TAX
V.
SHOORJI VALLABHDAS & CO.

SUPREME COURT OF INDIA
[1962] 46 ITR 144 (SC)

FACTS AND ISSUE BEFORE THE COURT

- Assessee firm passed “BOOKS ENTRIES” accruing commission income of ₹.2,56,815 and ₹. 1,71,885 from M Ltd. and N Ltd. respectively as managing agent.
- Subsequently, assessee firm resigned and floated X Ltd. and Y Ltd. as managing agents for M Ltd. and N Ltd. respectively.
- Rate of commission was reduced from 10% to 2.5% for X Ltd. and Y Ltd. assessee firm accepted and entered into revised agreement with both M Ltd. and N Ltd.

FACTS AND ISSUE BEFORE THE COURT

- Assessee firm gave up 75 % of its commission during the year under question to the tune of Rs. 1,36,903/- (M Ltd.) and Rs. 2,00,625 (N Ltd.) and claimed same as expenditure.
- Tax authorities disallowed expenditure claimed and made addition of accrued commission income as per books entries passed by assessee firm.



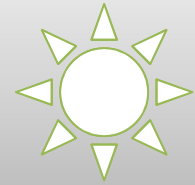
QUESTION OF LAW



- (1) Whether two sums of Rs. 1,36,903 and Rs. 2,00,625 are income of the year under question ?
- (2) If the answer to the first question is in the affirmative, whether same can be allowed as expenditure in computing the assessee firm's income for the year under question?"



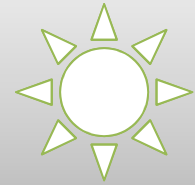
LAW LAID DOWN BY THE SUPREME COURT



- *If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a "hypothetical income".*
- *Where income has, in fact, been received and is subsequently given up it remains the income of the recipient, even though given up, the tax may be payable.*



LAW LAID DOWN BY THE SUPREME COURT



- *Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income.*
- *Even though an entry to above effect might, in certain circumstances, have been made in the books of account.*
- *A mere book-keeping entry cannot be income, unless income has actually resulted*



REAL INCOME
Vs.
UNREAL INCOME



COMMISSIONER OF INCOME-TAX

V.

BOKARO STEEL LTD.

SUPREME COURT OF INDIA
[1999] 236 ITR 315(SC)

FACTS AND ISSUE BEFORE THE COURT

- Assessee follows mercantile method for accounting and had shown in its accounts accrued interest income.
- Assessee company however reversed said interest income in the next year, assessee passed resolution agreement ceased to be operative *ab initio*.
- Tax authorities made addition of accrued interest in that respective AY.
- High Court held that income in question was not exigible to tax as no real income accrued to the assessee.

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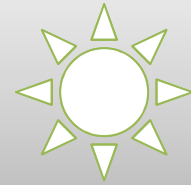
QUESTION OF LAW



- Whether Jurisdictional High Court was justified under law in deciding that real income did not arise even when assessee had itself shown said accrued income in its books of account for relevant AY?



LAW LAID DOWN BY THE SUPREME COURT



- *Method of accounting is irrelevant in connection with the hypothetical income.*
- *Unless there is real income, there cannot be any income-tax.*
- *Assessee may accrue income in its books of account by following mercantile method but tax thereon cannot be levied if said income is not realised in real sense.*



ACCRUAL OF INCOME



E.D. SASSOON & CO. LTD.
V.
COMMISSIONER OF INCOME-TAX

SUPREME COURT OF INDIA
[1954] 26 ITR 27 (SC)

FACTS AND ISSUE BEFORE THE COURT

- S Ltd. was managing agent of particular co. and had right to received commission after completion the definite period.
- S Ltd. transferred it's managing agency to another co. (assignee) through formal assignment deed during 1943.
- ITO of S Ltd. completed assessment proceeding at particular income; excluding commission income earned before the transfer of agency.

FACTS AND ISSUE BEFORE THE COURT

- ITO of assignee completed assessment thereby made addition of total commission income received for the year under consideration.
- Excess profit officer of S Ltd. opined that amount earned by S Ltd. prior to transfer was not brought into tax.
- Notice for escaped assessment was issued and finally proportionate commission income added in the hand of S Ltd.



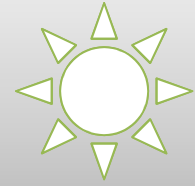
QUESTION OF LAW



- Whether total commission received was liable to be apportioned between the “S Ltd.” and the “assignee” for broken periods?
- If they answer to the above question is in negative; to whom the commission in question accrued?



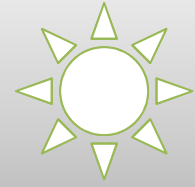
LAW LAID DOWN BY THE SUPREME COURT



- Income cannot be apportioned on basis of broken period between assignor and assignee.
- Income accrues only when enforceable debt is created in favour of assessee; till right to receive does not arise the income does not accrue.
- Right to receive arises as per contract between parties. Service not completed consequent income does not accrue on day to day efforts.



LAW LAID DOWN BY THE SUPREME COURT



- AS per the agreement income accrues and enforceable debt arises only when entire service is completed.
- Section 36 of TOPA will be applicable only in the absence of a agreement. It does not apply between the “*crown*” and its “*subject*”.

*DEBITUM IN PRAESENTI, SOLVENDUM
IN FUTURO*



A debt due at present,
to be paid in future



ACCRUAL OF INCOME



COMMISSIONER OF INCOME-TAX
V.
HARIVALLABHADAS KALIDAS & CO.

SUPREME COURT OF INDIA
[1960] 39 ITR 1 (SC)

FACTS AND ISSUE BEFORE THE COURT

- Agreement - assessee firm were to act as managing agent for M Ltd. for 5% commission on sale of yarn + 10% all other item sold.
- As per the agreement, M Ltd. were to pay commission each year after December 31.
- There was contingencies clause to forgo certain portion of the commission.

FACTS AND ISSUE BEFORE THE COURT

- On 9/12/1950 M Ltd. modified agreement reduced the commission from 5% to 3%.
- Tax authorities linked clauses of agreement with mercantile method of accounting – Held – Commission accrued as and when sales made.
- Addition were made on the basis that assessee firm had “voluntarily relinquished” a sum.



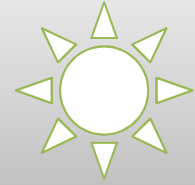
QUESTION OF LAW



- Whether the commission accrued on the proceeds of every single sale made by M Ltd. or only when the assessee firm exercised its right to receive the commission?
- In any case what shall be effected date of modified agreement dated 9/12/1950?



LAW LAID DOWN BY THE SUPREME COURT



As per agreement option of receiving commission is exercisable only after the end of year.

Clause of agreement have to read as an indivisible.



LE CONTRAT FAIT LA LOI.
MEANS



THE CONTRACT MAKES
THE LAW.



BUSINESS EXPENDITURE



COMMISSIONER OF INCOME-TAX
V.
DHANRAJGIRJI RAJA NARASINGIRJI

SUPREME COURT OF INDIA
[1973] 91 ITR 544 (SC)

FACTS AND ISSUE BEFORE THE COURT

- Assessee filed a Civil suit and also lodge complaint with the police against “R” for multiple reasons.
- Government instituted a criminal case against “R” and assessee also appointed its lawyer in this connection.
- The prosecution culminated in the conviction of “R”.

FACTS AND ISSUE BEFORE THE COURT

- Assessee claimed expenses incurred for both civil as well as criminal litigation.
- Tax authorities contended that there was no **“NECESSITY”** for assessee to appoint it’s own lawyer as government was to pursue litigation.
- Tax authorities disallowed expense claimed in connection with criminal proceeding.



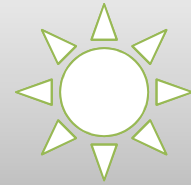
QUESTION OF LAW



- Whether it is open for revenue department to decide what expenditure is “**NECESSARY**” for the assessee’s business?
- Whether revenue department will decide, what expenditure an assessee should incur and in what circumstances he should incur that expenditure?



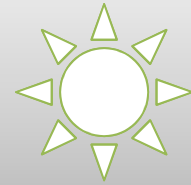
LAW LAID DOWN BY THE SUPREME COURT



- *Tax laws does not make any distinction between civil litigation and criminal litigation.*
- *Every businessman knows his interest best.*
- *One have to see whether the expenditure in question was bona fide incurred wholly and exclusively for the purpose of business.*



LAW LAID DOWN BY THE SUPREME COURT



- *It is not open to the department to prescribe what expenditure an assessee should incur and in what circumstances he should incur that expenditure.*
- *It was the duty of the assessee to see that the prosecution was properly conducted. He was interested in successfully prosecuting the case.*

HERO CYCLES (P) LTD.

VS.

COMMISSIONER OF INCOME TAX (CENTRAL) LUDHIANA

[2015] 281 CTR 481 (SC)

NOVEMBER 5, 2015

Once it is established that there is nexus between the expenditure and the purpose of business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the Board of Directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. It further held that no businessman can be compelled to maximize his profit and that the income tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own view point but that of a prudent businessman.



DEDUCTIONS
WHEN THERE IS NO
PROVISION



BADRIDAS DAGA
V.
COMMISSIONER OF INCOME-TAX

SUPREME COURT OF INDIA
[1958] 34 ITR 10 (SC)

FACTS AND ISSUE BEFORE THE COURT

- Mr. A PoA holder of Mr. B withdrew huge funds from Mr. B's bank account to repay his his personal debts.
- Suit was filed by Mr. B, part sum was recovered and the balance was claimed as Bad debts.
- Tribunal and High court stated that said sum was not trading loss, hence cannot be allowed as deduction from taxable profit.



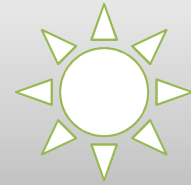
QUESTION OF LAW



- Whether the embezzled funds by Mr. A being assessee's "*munim*" is allowable as a deduction under revenue laws?
- If the answer for the above question is negative; What shall be the treatment for bona fide deductions claimed for which there is no specific provision in revenue laws?



LAW LAID DOWN BY THE SUPREME COURT



- *Loss resulting from embezzlement by an employee or agent is admissible as deduction under Income Tax Act if it arises out of the carrying on the business and is incidental to it.*

WHEN THE CLAIM IS MADE FOR DEDUCTION

NO SPECIFIC PROVISION
IN REVENUE LAW

Admissibility

Non-
Admissibility

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Accepted commercial practice and trading principles.

Loss must springs directly from carrying on business and incidental to it.

Not any loss sustained by the assessee even if it has some connection with business.



ADDITION OF INCOME UNDISCLOSED SOURCE



COMMISSIONER OF INCOME-TAX

V.

U.M. SHAH, PROPRIETOR,

HIGH COURT OF BOMBAY

[1973] 90 ITR 396 (BOM.)

FACTS AND ISSUE BEFORE THE COURT

- Details in connection to the loan received from Hundi brokers through a/c payee cheque were asked by Id ITO from assessee.
- Assessee submitted Name, PAN, GIR no., address, and details of interest paid through a/c payee cheque of all lenders, ITO summoned all parties for cross examination.
- Instead of appearing personally each one of them sent a letter conforming loan advanced by them to assessee.

FACTS AND ISSUE BEFORE THE COURT

- Authorities confessed that complete details have been furnished by the assessee in respect of loans from lenders.
- Held when lenders did not turn up for summon; assessee is obliged to produce parties in person.
- ITO made some enquiries from banker. ITO failed to provide details inspite of assessee having asked adverse details. ITO made addition of total loan amount received.



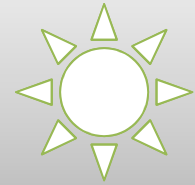
QUESTIONS



- Could assessee be held liable for failure on lenders part to attend ITO in person?
- Was the Id. ITO correct in not providing details received; against the assessee on third party enquiry?
- Can ITO make said addition when ITO himself accepted the plethora of details submitted remain unrebutted?



LAW LAID DOWN BY THE HIGH COURT



*Loan amount lent and repaid
through cross cheques.*

*Interest on loan was paid
through **cross cheques**.*

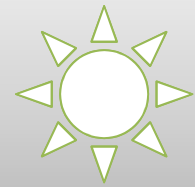
*No doubt about Hundi Loans
can be raised where*

*All lenders and brokers are
Income-tax assesses and even
assessee provided postal
address of all parties.*

*Lenders have confirmed having
lent the amount and all details
remain “untouched” and
“unrebutted”.*



LAW LAID DOWN BY THE HIGH COURT



- *If lenders did not appear before ITO assessee could not be blamed for this at all.*
- *On the contrary the income tax officer had necessary powers to enforce the terms of summons issued.*
- *ITO cannot use any evidence recorded behind the back of assessee. Its violation of principle of natural justice - audi alteram partem.*



PRINCIPLE OF RES-JUDICATA



H.A. SHAH & CO.
V.
COMMISSIONER OF INCOME-TAX

HIGH COURT OF BOMBAY
[1956] 30 ITR 618 (BOM.)

FACTS AND ISSUE BEFORE THE COURT

AY 1941-42

H is not partner but trustee of his Minor son

TRIBUNAL'S ORDER IN PARTNERSHIP OF H

H is Partner in his own right

AY 1942-45



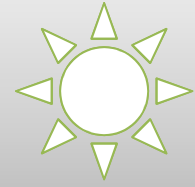
QUESTION OF LAW



- Whether the tribunal's decision for AY 1942-43, 1943-44 and 1944-45 was justified in law in departing from the previous year finding given that Mr. H was not a partner in his own right but was a trustee of the minor Son?



LAW LAID DOWN BY THE HIGH COURT



The previous decision may be arbitrary.

Current year's facts borne from investigation leads to different conclusion.

AO cannot depart from finding/reaching to different conclusion than its predecessor.

Decision of last AY is not arrived at after due enquiry

Decision may be departed in subsequent AYs

Estoppel by record does not apply to the decisions of Income-tax Authorities



PRINCIPLE OF PROMISSORY ESTOPPEL



COMMISSIONER OF INCOME TAX,
(CENTRAL), CALCUTTA

VS.

B.N. BHATTAVHARGEE AND ANOTHER

SUPREME COURT OF INDIA
[1979] 118 ITR 461 (SC)

FACTS AND ISSUE BEFORE THE COURT

- State of UP announced a total exemption from sales tax for three years to all new industrial units in order to enable them to establish themselves firmly.
- Acting on this assurance the assessee sugar mills set up a Vanaspati manufacture plant by raising a huge loan.

FACTS AND ISSUE BEFORE THE COURT

- Subsequently, the UP Government changed its policy and announced that sales tax exemption will be given at varying rates over three years.
- The appellant contended that they set up the plant and raised huge loans only due to the assurance given by the UP Government and they are bound honour the assurance.
- HC rejected this plea.



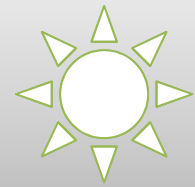
QUESTION OF LAW



- Whether Promisor (including government) possess power to act in a different manner or change the term of its promise made earlier; where Promisee has altered its position by acting upon the agreed terms of promise in good faith?



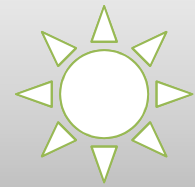
LAW LAID DOWN BY THE SUPREME COURT



- *In this case government is bound to carry out the representation and exempt the assessee from sales tax.*
- *The law may, therefore, now be taken to be settled as a result of this decision, that where the government makes a promise knowing or intending that it would be acted on by the promisee and, in fact, the promisee, acting in reliance on it, alters his position, the Government would be held bound by the promise and the promise would be enforceable against the Government at the instance of the promisee.*



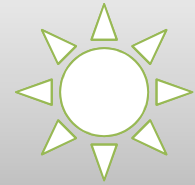
LAW LAID DOWN BY THE SUPREME COURT



- *Thus, if the statute does not contain a provision enabling the Government to grant exemption, it would not be possible to enforce the representation against the Government, because the Government cannot be compelled to act contrary to the statute.*
- *But if the statute confers power on the Government to grant the exemption, the Government can legitimately be held bound by its promise to exempt the promisee from payment of any tax.*



LAW LAID DOWN BY THE SUPREME COURT



- *Since the doctrine of promissory estoppel is an equitable doctrine, it must yield when the equity so requires. But it is only if the court is satisfied, on proper and adequate material placed by the government, that overriding public interest requires that the government should not be held bound by the promise but should be free to act unfettered by it, that the court would refuse to enforce the promise against the government.*
- *No representation can be enforced which is prohibited by law in the sense that the person or the authority making the representation or promise must have the power to carry out the promise. If the power is there, then subject to the preconditions and limitations noted earlier, it must be exercised.*



SCHEDULER FORM OF TAXATION



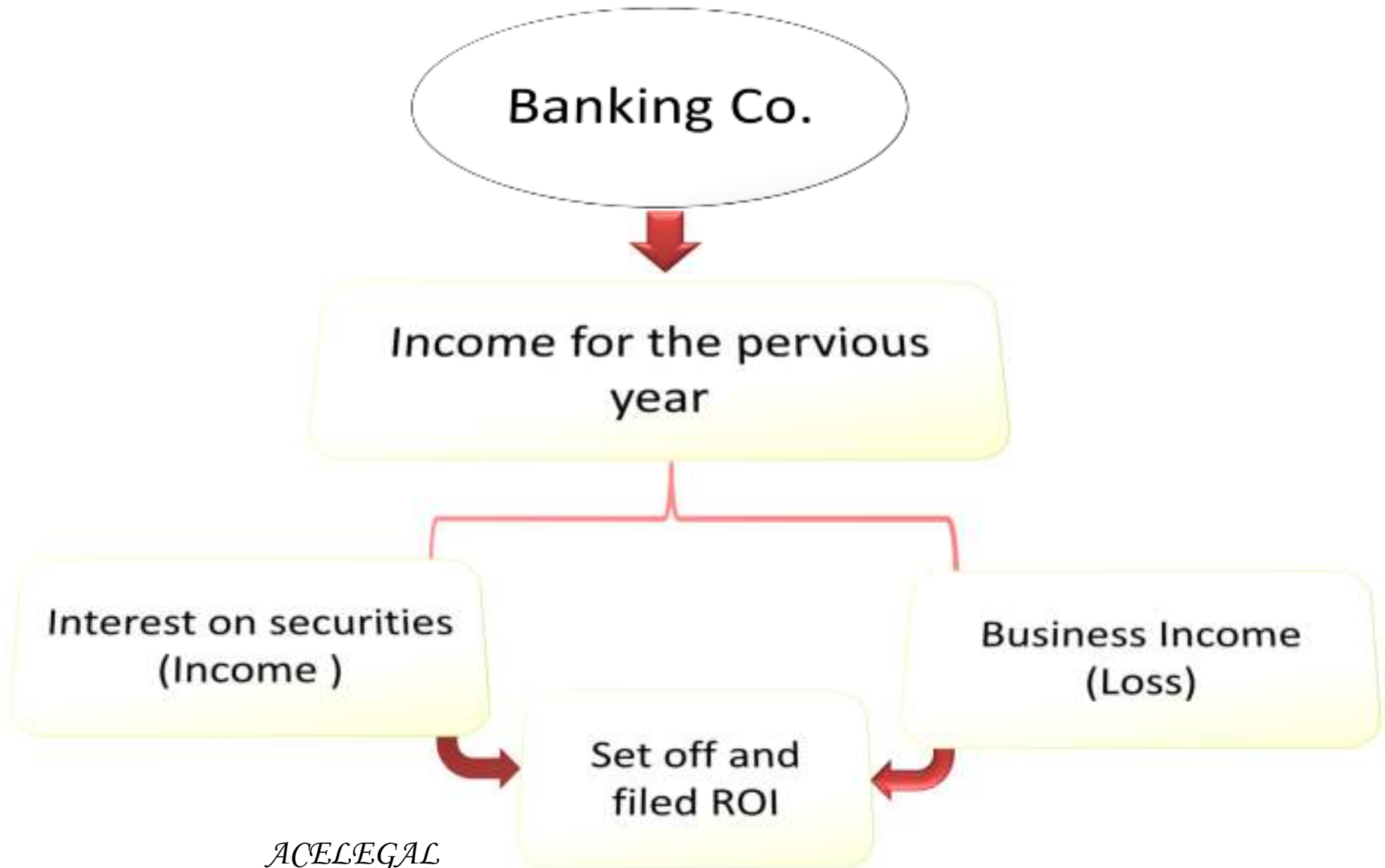
UNITED COMMERCIAL BANK LIMITED

VS.

COMMISSIONER OF INCOME TAX

SUPREME COURT OF INDIA
[1957] 32 ITR 688 (SC)

FACTS AND ISSUE BEFORE THE COURT



FACTS AND ISSUE BEFORE THE COURT

- Assessee claims there is no distinction between both incomes as far as set off is concern.
- ITO, CIT(A), Tribunal, High Court rejected the claim of assessee.



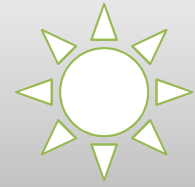
QUESTION OF LAW



- Whether interest on securities was a part of bank's income from business carried on by it?
- Whether the assessee was entitled to set off the carried over loss of the previous year against income during the assessment year?



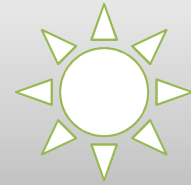
LAW LAID DOWN BY THE SUPREME COURT



- *This interpretation follows from the words used in sections 6, 8 and 10 which must be read so as to give effect to the contrast between "income, profits and gains" chargeable under the head "interest on securities" and "income, profits and gains" chargeable under the head "business".*



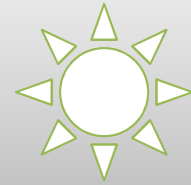
LAW LAID DOWN BY THE SUPREME COURT



- *Section 7 to 12 are modes in which the statutes directs that income-tax is to be levied and these sections are mutually exclusive.*
- *The head of income of which the source is “interest on securities” has its characteristics for income-tax purposes and falls under the specific head covered by section 8 of the Act, and where an item falls specifically under one head it has to be charged under that head and no other.*



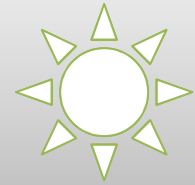
LAW LAID DOWN BY THE SUPREME COURT



- *Thus on this construction the various heads of "income, profits and gains" must be held to be mutually exclusive, each head being specific to cover the item arising from a particular source.*
- *It cannot, therefore, be said that qua the assessee in the present case and for the purpose of securities held by it, section 8 is more specific and section 10 general or vice versa, and therefore no question of the applicability of the principle *generalia specialibus non derogant* arises.*



LAW LAID DOWN BY THE SUPREME COURT



- *Thus both on precedent and on a proper construction, the source of income "interest on securities" would fall under section 8 and not under section 10 as it is specifically made chargeable under the distinct head "interest on securities" falling under section 8 of the Act and cannot be brought under a different head even though the securities are held as a trading asset in the course of its business by a banker.*

