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An e-newsletter from **Lakshmikumaran & Sridharan**, India

February 2022 / Issue–89

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**February**
**2022**

# Article

## Dilemma of formation by reconstruction or splitting-up of existing business – A deterrent to income-tax benefits?

By **Prachi Goel and Aastik Ahuja**

### *Introduction*

The legislature has time and again introduced various income-tax benefits and incentives to encourage fresh investments and stimulate the economic growth. These incentives are generally given to new businesses in form of tax holidays, concessional tax rates or additional deductions.

In order to effectively realize said objectives and curb any abuse of the same, certain restrictions on the eligibility to claim such benefits are usually imposed. One such restriction which is provided under various provisions of the Income-tax Act, 1961 ('**IT Act**') is that the new business should 'not be formed by splitting up, or the reconstruction, of a business already in existence'. The intent behind this restriction is to ensure that the businesses are not enabled to avail the tax benefits by mere manipulation of their existing investments without dispensing any actual capital into the economy.

### *Tax Benefits under Sections 80-IAC, 80JJAA and 115BAB*

The allowability of tax benefits under the following provisions is subject to the restriction of the 'businesses not being formed by splitting up or reconstruction of an existing business':

- *Section 80-IAC: Tax holiday to eligible Start-ups*

Section 80-IAC provides for profit-linked tax holidays to eligible startups for a period of any 3 consecutive years within 10 years from the year of their incorporation. The startups are required to be incorporated between 1 April 2016 and 31 March 2022. It is pertinent to note that the sunset date for claiming deduction under this provision has been proposed to be extended to 31 March 2023 by the Finance Bill, 2022.

- *Section 80JJAA: Deduction in respect of employment of new employees*

Section 80JJAA allows businesses to claim an additional deduction of 90% of the additional employee cost incurred on additional employees over a period of 3 years starting from the year in which such employment is provided.

- *Section 115BAB: Lower tax rate for new domestic manufacturing companies*

Section 115BAB provides for a lower tax rate of 15% from AY 2020-21 for new companies which are set-up and registered on or after the 1 October 2019 and commencing manufacturing or production before 31 March 2023. The sunset date for claiming deduction under this provision has also been proposed to be extended to 31 March 2024 by Finance Bill, 2022.

### *Meaning of Reconstruction & Splitting-up*

In order to examine the restriction with respect to formation of a start-up/ business/ company imposed under the abovementioned provisions, it is pertinent to firstly understand the meaning of the terms, 'reconstruction' and 'splitting-up' of a business already in existence. Although, these

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terms have been used extensively under various provisions for tax benefits under the IT Act, but they have not been defined anywhere. However, there are numerous judicial pronouncements in the context of other tax benefit provisions under the IT Act wherein the Courts have interpreted the similar language employed in those provisions to deduce their meaning.

The phrase 'reconstruction of a business already in existence' has been interpreted as continuation of the same business in some altered form by a new entity in such a manner that the identity of the original business is not lost or abandoned.[1] The phrase 'splitting-up of a business already in existence' can be understood as a break-up or division of an integral part of the existing business/its assets between the old and new business.[2]

## *Applicability of restriction on 'Formation' – Contrary Rulings*

As observed above, the position on the interpretation and meaning of the phrase 'reconstruction or splitting-up of a business already in existence', is pretty settled. However, the controversy arises with respect to the applicability of this restriction.

The usage of the term 'formed' raises a question as to whether the applicability of the conditions is restricted only to the year of formation of the start-up/business/company, or would it apply every year for which the tax benefit is being claimed? As per the judicial pronouncements discussed below, the position in this regard is far from settled.

There is no direct ruling on this aspect with respect to Sections 80-IAC, 80JJAA or 115BAB of the IT Act. However, identical conditions under other provisions of the IT Act have been subject to contrary views from various Courts.

Although, a couple of judgments of the Supreme Court ('**SC**') do shed light on the interpretation of this restriction, however, they fail to provide a conclusive answer to settle the controversy. In the case of *Bajaj Tempo Ltd.* v. *CIT*[3], the SC took the view that the term 'formation' has to be understood such that an undertaking could not have come into being without the violation of the restriction. However, the issue of whether this condition would be required to be fulfilled in subsequent years after the initial year of formation was not deliberated upon by the SC. In another judgment[4], the SC pronounced an *obiter dictum* to the effect that these conditions are required to be fulfilled during the initial year of the constitution of the undertaking.

The root of the controversy arises due to the divergent views emanating from the rulings of various High Courts ('**HCs**'). In 1990, the Karnataka HC[5], held that the word 'formed' suggests that the eligibility for exemption must be tested only in the initial/ first AY and once such eligibility is satisfied in the initial year, the benefit could be availed in the succeeding years. An identical view has been subsequently laid down by various other HCs and Tribunals ('**ITAT**')[6].

On the other hand, the Gujarat HC in 1978[7], had taken a diametrically opposite view. It was held that principally such conditions are required

[1] *CIT* v. *Gaekwar Foam and Rubber Co. Ltd.* [1959] 35 ITR 662 (Bombay HC); *Textile Machinery Corporation Ltd.* v. *CIT* [1977] 107 ITR 195 (SC); *CIT* v. *Travancore Rayons Ltd.* [1986] 50 CTR (Kerala HC) 51; *Nagardas Bechardas & Bros. (P.) Ltd.* v. *CIT* [1976] 104 ITR 255 (Gujarat HC); *CIT* v. *Ganga Sugar Corpn. Ltd.* [1973] 92 ITR 173 (Delhi HC).

[2] *Smt. Sangita Agarwal* v. *CIT* [2012] 18 taxmann.com 97 (Calcutta HC); *T. Satish U. Pai* v. *CIT* [1979] 1 Taxman 123 (Karnataka HC).

[3] [1992] 62 Taxman 480 (SC).

[4] DCIT v. ACE Multi Axes Systems Ltd. [2018] 400 ITR 141 (SC).

[5] CIT v. Nippon Electronics [1990] 181 ITR 518 (Karnataka HC).

[6] CIT v. Dandeli Ferro Alloys (P.) Ltd. [1995] 212 ITR 1 (Bombay HC); CIT v. Paul Bros. [1995] 216 ITR 548 (Bombay HC); Jain Udhay Hosiery (P) Ltd. v. ACIT [2004] 1 SOT 193 (Chandigarh Trib.); Aqua Plumbing (P.) Ltd. v. ACIT [2011] 46 SOT 366 (Agra Trib.).

[7] CIT v. Satellite Engineering Ltd. [1978] 113 ITR 208 (Gujarat HC).

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to be fulfilled in each of the subsequent years for which the benefit is being claimed. This judgement has been followed by multiple HCs subsequently[8]. Even the Punjab & Haryana HC in 2016[9], had held in line with the Gujarat HC ruling after an extensive discussion on divergent rulings. These judgments are based on the reasoning that the object behind the insertion of beneficial provisions would be frustrated if it is held that the conditions are not required to be satisfied in subsequent years.

Thus, the dilemma with respect to the year of applicability of the restriction has continued to persist due to the contrary rulings of the HCs.

## Conclusion

Keeping in mind this dichotomy in the interpretation of the condition, the taxpayers must be extremely vigilant while claiming the benefits. This is especially pertinent when the new enterprises are engaged in similar businesses which have been previously undertaken by the already existing enterprises. This is because such cases are highly prone to scrutiny by the Income-tax Department as such cases are more likely to result in reconstruction or splitting up of an existing business. Needless to mention that the fulfilment of this condition must be examined keeping in mind the objects and purposes for which a specific tax benefit provision has been inserted.

In order to avoid any protracted litigation on this front, the new entities, which are likely to be adversely impacted by the divergent views taken by the HC, may consider approaching the CBDT for necessary clarifications in this regard.

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# Notifications and Circulars

### E-Advance Rulings Scheme, 2022 notified

The Central Government has, *vide* Notification No. 7 dated 18 January 2022, notified the E-Advance Rulings Scheme, 2022 (‘**Scheme**’).

The Scheme shall be applicable to:

a) applications of advance rulings made to the Board for Advance Rulings (‘**Board**’) by an applicant (under Section 245Q (1) of the IT Act) or;

b) applications of advance rulings randomly allocated or transferred to the Board (under Section 245Q (4) of the IT Act) through an automated allocation system.

The broad contours of the Scheme are as follows:

- ***Submission of additional facts***: The Board may at its discretion permit or require the applicant to submit additional facts as necessary to pronounce the advance ruling.

[8] CIT v. Suessin Textile Bearing Ltd. [1982] 135 ITR 443 (Gujarat HC); CIT v. Seeyan Plywoods [1991] 190 ITR 564 (Kerala HC).
[9] CIT v. Micro Instruments Co. [2016] 388 ITR 46 (Punjab & Haryana HC).

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- ***Questions contained in the application***: The applicant shall not except by leave of the Board be heard in support of any additional question not set forth in the application. The Board shall however consider all aspects of questions set forth as necessary to pronounce a ruling.
- ***Proceedings to be conducted electronically***: Under the Scheme, the applicant shall not be required to appear either personally or through authorised representative in connection with any proceedings before the Board or such other authority. All communications between the Board and the applicant shall be exchanged by electronic mode. Every notice or order or any other electronic communication from the Board shall be delivered to the applicant via e-mail to the registered e-mail address of the applicant/his authorized representative. The applicant may request the Board to provide an opportunity of hearing through video conferencing or video telephony.
- ***Rectification of mistakes***: The Board with a view to rectifying any mistake apparent from record, may amend any order passed by it before such ruling has been given effect to by the assessing officer ('**AO**').

## Securities Transaction Tax Rules amended to include insurance companies

Section 167 of the Finance Act, 2021, provided an amendment to Section 97 of the Finance (No. 2) Act, 2004. By virtue of this amendment the sale or surrender or redemption of a unit of equity-oriented fund to an insurance company on or after 1 February 2021, upon maturity or partial withdrawal of the unit linked insurance policy issued by such insurance company was included under the definition of 'taxable securities transaction'. Accordingly, Securities Transaction Tax ('**STT**') is now applicable on such transactions.

In order to facilitate the levy of the STT on such insurance companies, the Central Government has amended the Securities Transaction Tax Rules, 2004 *vide* Notification No. 9 dated 18 January 2022.

- A new rule *viz.* Rule 5A has been inserted specifying the managing director or whole-time director duly authorised by the Board of Directors of such company to be the person responsible for collection and payment of STT in case of an insurance company.
- Corresponding amendments have been under Rule 6, 7 and 8 providing for abovesaid personnel to pay the STT to the credit of the Central Government, and also to sign, verify and furnish, the return in this regard.
- Form No. 2A has also been notified for the purposes of filing return of taxable securities transactions for insurance companies.

## Exemption on consideration from unit linked insurance policies – Guidelines

Section 10(10D) of the IT Act provides for exemption on sums (including the bonus) received under a life insurance policy. *Vide* Finance Act, 2021 the following amendments were made wherein:

- The exemption shall not be applicable on unit linked insurance policies ('**ULIPs**') issued on or after 1 February 2021, if the premium payable exceeds INR 2.5 lakh ('**High Premium ULIPs**') for any of the previous years during the policy term.
- In case where premium is payable for multiple ULIPs issued on or after said date, the exemption shall be applicable only with respect to those ULIPs having an aggregate amount of premium less than INR 2.5 lakh.

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The CBDT has now *vide* Circular 2 of 2022 dated 19 January 2022 issued certain guidelines for claiming exemption on sums received from ULIPs issued on or after 1 February 2021 ('**Eligible ULIPs**').

Situation 1: No consideration has been received on any Eligible ULIPs during the previous years or it has not been claimed on receipt. The exemption shall be determined as under:

- The consideration received under one Eligible ULIP which is not a High Premium ULIP shall be eligible for exemption under Section 10(10D).
- The entire consideration from multiple Eligible ULIPs, shall be eligible for exemption if the aggregate amount of premium payable on such ULIPs is less than INR 2.5 lakh. However, if such aggregate amount of premium payable for all the Eligible ULIPs is higher than INR 2.5 lakh, then consideration from only such combination of ULIPs shall be eligible for exemption wherein the aggregate amount of premium payable is less than INR 2.5 lakh.

Situation 2: Consideration has been received on one or more Eligible ULIPs and has been claimed to be exempt in any of the previous year. The exemption shall be determined as under:

- Such ULIPs under which the consideration has been received and also claimed, are referred to as '**Old ULIPs**'.
- The consideration received under one Eligible ULIP shall be eligible for exemption if the aggregate amount of premium payable on such Eligible ULIP (during the term of such ULIP) and Old ULIP is less than INR 2.5 lakh.
- The entire consideration from multiple Eligible ULIPs, shall be eligible if the aggregate amount of premium payable on such Eligible ULIPs (during their term) and Old ULIPs is less than INR 2.5 lakh. However, if such aggregate amount of premium payable on multiple Eligible ULIPs (during their term) and Old ULIPs is higher than INR 2.5 lakh, then consideration from only such combination of ULIPs shall be eligible wherein the aggregate amount of premium payable is less than INR 2.5 lakh.

## Computation of capital gains from ULIPs not exempt under Section 10(10D) – New Rule notified

Sub-section (1B) was inserted under Section 45 *vide* the Finance Act, 2021 providing that any profits or gains arising from receipt of sums from ULIPs which are not exempt under Section 10(10D), shall be chargeable to tax under the head 'Capital Gains'. The CBDT has *vide* Notification No. 8 of 2022 dated 18 January 2022, notified Rule 8AD under the Income-tax Rules, 1962 ('**IT Rules**'), prescribing the computation mechanism for such income taxable as capital gains under Section 45(1B).

Rule 8AD(1)(i) provides that the capital gains shall be computed by deducting the aggregate amount of premium paid during the term of the policy until the date of receipt of total amount for the first time under a ULIP, from such total amount so received.

Rule 8AD(1)(ii) covers cases wherein certain amount is received after the receipt of the amount referred to in sub-clause (i) provided above. In such cases, the capital gains shall be computed by reducing from such amount received (excluding amount considered for calculation of taxable amount during earlier previous years), the aggregate premium paid during the term of the policy until the date of such receipt excluding the premium that has

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already been considered for calculation of taxable amount during earlier previous years.

Consequently, the capital gains as computed above, shall be deemed to arise from the transfer of a unit of equity-oriented funds set up under a scheme of an insurance company comprising ULIPs.

## MFN clause on Protocol to India's DTAA clarified

The Protocol to India's DTAAs with certain European countries and OECD members contains a provision known as the Most Favoured Nation ('**MFN**') clause. It provides that if after the signature/entry into force of such DTAAs, India subsequently enters into a DTAA with another OECD member, limiting its source taxation rights to a lower rate or restrictive scope, then such favourable treatment should be conferred upon the former country as well. The controversy has arisen in the backdrop of certain countries namely Slovenia, Columbia and Lithuania ('**States**') with whom India had entered into DTAA providing for lower rate of source taxation w.r.t. certain items of income ('S**econd Treaty**'), becoming OECD members recently. However, these States were not members of the OECD at the time of conclusion of the DTAAs with India and have become OECD members thereafter. Subsequently, France, Netherlands and Switzerland issued unilateral decree/bulletin/publication, declaring that the lower tax rates provided under the Second Treaty, shall be retrospectively applicable to their respective DTAAs from the date on which such States became members of the OECD.

In view of the above, the CBDT, *vide* Circular 3 of 2022, dated 3 February 2022, has issued clarifications on the applicability of the MFN clause. At the outset, it has been clarified that unilateral declarations are devoid of any binding force or effect on tax liability, as they do not represent the shared understanding of both the treaty partners on the applicability of the MFN clause. Further, the MFN Clause clearly provides that the third State must be an OECD member, at the time of conclusion of the treaty with India and also, at the time of applicability of MFN clause. The CBDT has taken a stance that the concessional rates/restricted scope are applicable from the date the DTAA with the third State comes into force and not from the date the third State becomes member of the OECD. Further, the restricted scope/concessional tax rates as provided in the DTAA with the third State cannot be imported to another DTAA in the absence of a notification being issued under Section 90(1) of the IT Act providing for the same. It has also been clarified that countries cannot selectively invoke and apply the MFN clause.

In accordance with these clarifications, the CBDT has laid down the following conditions which must be satisfied for importing lower rate/ restricted scope of source taxation rights provided in India's DTAA with a third State to the first OECD State under an MFN Clause:

i. The subsequent treaty with the third State is entered into after the signature/entry into force of the India's DTAA with the first state.

ii. The third State is an OECD member at the time of signing the subsequent treaty.

iii. India limits its taxing rights in relation to rate or scope of taxation in respect of certain items of income in the subsequent treaty.

iv. A separate notification is issued under Section 90(1) of the IT Act, importing the benefits of the subsequent treaty into the treaty with the first State.

Further, it has been clarified that the aforesaid clarification will not impact the implementation

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of a favourable decision issued to a taxpayer by any Court.

### Computation mechanism for specified funds attributable to investment division of an offshore banking unit

Section 10(4D) of the IT Act provides exemption for income accrued or arisen to or received by the investment division of an offshore banking unit. The CBDT *vide* Notification No. 6/2022 dated 14 January 2022 has notified:

- Rule 21AJA to the IT Rules, prescribing the mechanism for computing the exempt income in the case of investment division of offshore banking unit under Section 10(4D) of the IT Act.
- Rule 21AJAA to the IT Rules, prescribing the mechanism for determination of income of specified fund attributable to investment division of an offshore banking unit under Section 115AD(1B) of the IT Act.

## Ratio Decidendi

### Sale of self-generated technical know-how is not taxable under Section 45 as cost of acquisition is indeterminable

In the year under consideration i.e., AY 1997-98, the assessee received a certain sum for transfer of its transportation business undertaking on a slump sale basis. Further, the assessee also received non-compete fee. The AO held that the consideration allocated by the purchaser of undertaking towards technical know-how was taxable as capital gains under Section 45 of the IT Act. The AO treated non-competition fee as revenue receipt.

The Commissioner of Income-tax (Appeals) ('**CIT(A)**') dismissed the appeal filed by the assessee. The ITAT relying upon the judgement of the Apex Court in the case of *CIT* v. *B.C. Srinivasa Shetty*[8], held that the profit on sale of technical know-how cannot be brought to tax as 'capital gains' under Section 45 of the IT Act in the absence of cost of acquisition. With respect to additions on account of non-competition fee, the same was set aside by the ITAT.

The High Court upheld the decision of ITAT. The HC discussed the legislative history related to taxation of goodwill *vis-à-vis* the decision of Apex Court in the case of *B.C. Srinivasa Shetty (supra).* The HC held that it cannot be denied that the assets, in the present case, were self-generated and the cost of acquisition of the said assets was indeterminable and therefore, the same cannot be taxed under Section 45 of the IT Act.

With respect to the non-competition fee, the HC relied on *Mahindra & Mahindra Ltd.* v. *CIT*[9], which states that Section 28 does not apply to

[8] (1981) 128 ITR 294 (SC).

[9] 261 ITR 501 (Bombay HC).

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benefits in cash or money. Further, the HC also held that the fee was in fact a payment for sharing customer database and sharing of trained employee. The receipt towards the said transfer is not attributable to transfer of any assets or right and the mere fact that the receipt is not attributable to non-compete covenant, it cannot be automatically concluded that the receipt was either from business or income of an activity recurring in nature. [*Commissioner of Income-tax* v. *ABB Limited* – ITA No. 568 of 2015, Order dated 4 October 2021, Karnataka High Court]

## Collection charges retained from passenger service fee by airline operators is commission liable to TDS under Section 194H

The Assessee (Delhi International Airport) received Passenger Service Fee ('**PSF**') from the airline operators for security and facilitation services. The airline operators retained a collection charge from the PSF. The AO disallowed the claim of the Assessee under Section 40(a)(ia) of the IT Act as no TDS was deducted by the Assessee on the collection charges being retained by the Airlines operator. The AO treated the collection charges to be in the nature of commission and held the Assessee to be liable to deduct TDS under Section 194H.

The CIT(A) dismissed the appeal filed by the assessee. The ITAT restored the matter to the AO by directing that if the recipient of the collection charges has paid the tax and filed the return thereon, the Assessee should not be held in default. Being aggrieved, the Assessee preferred an appeal before the HC.

Relying on *Director, Prasar Bharati* v. *CIT*,[10] the Karnataka High Court held that the collection charges retained by the Airlines operator are in the nature of payment made by way of commission. Accordingly, the HC held that the Assessee was under a statutory obligation to deduct the income tax on collection charges notwithstanding that there was no agreement between the appellant and the Airlines Operators. The HC however held that no denial of allowance claimed under Section 40(a)(ia) of the IT Act could be made by the Department, in the event the Airlines Operators have offered the said commission, to tax. Accordingly, the HC upheld the decision of ITAT to restore the matter to verify whether the Airlines Operator has offered the collection charges to income tax. [*Delhi International Airport Ltd.* v. *PCIT* – ITA Nos. 513, 514 ,515 ,701, 702, 703 of 2018, Order dated 14 December 2021, Karnataka High Court]

## Judicial and quasi-judicial proceedings – Period between 15 March 2020 to 28 February 2022 to be excluded for calculating limitation

In March 2020, the SC took *suo motu* cognizance of the difficulties faced by the litigants in filing petitions/ applications/ suits/ appeals/ all other quasi proceedings within the period of limitation prescribed under the general and special laws due to the outbreak of COVID-19 pandemic. *Vide* order dated 23 March 2020 and 8 March 2021, the SC excluded the period falling between 15 March 2020 to 14 March 2021 from being considered for calculating the period of limitation in all proceedings before all Courts/Tribunals. In its order, the SC made it clear that the period of limitation would start from 15 March 2021. During the second wave of COVID-19, the SC *vide* Order dated 23 September 2021, extended the period of limitation in all proceedings before all the Courts/Tribunals w.e.f. 15 March 2020 till 2 October 2021.

As there was a fresh surge of Covid-19 cases due to the Omicron variant, the SC has further extended the period of limitation with the following guidelines:

[10] (2018) 92 taxmann.com 11(SC).

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i. the period from 15 March 2020 till 28 February 2022 shall stand excluded for the purposes of limitation under any general or special laws in respect of all judicial or quasi-judicial proceedings.

ii. the balance period of limitation remaining as on 3 October 2021, if any, shall become available with effect from 1 March 2022.

In cases where the limitation would have expired during the period between 15 March 2020 till 28 February 2022, notwithstanding the actual balance period of limitation remaining, all persons shall have a limitation period of 90 days from 1 March 2022. In the event, the actual balance period of limitation remaining, with effect from 1 March 2022 is greater than 90 days, that longer period shall apply. [In Re: *Cognizance for Extension of Limitation* – Suo Motu WP (C) No. 3 of 2020, Order dated 10 January 2022, Supreme Court]

## Notices issued after 1 April 2021 for re-opening of assessment, pursuant to relaxed limitation period, quashed

*Via* this decision, the High Court of Calcutta settled the legality of the notices issued under Section 148 of the Income Tax Act without observing the statutory formalities under Section 148A of the Act as introduced by the Finance Act, 2021. The HC held that Explanation A(a)(ii) in the Notification No. 20 dated 31 March 2021 and Explanation A(b) in Notification No. 38 dated 27 April 2021, extending the applicability of the pre-amendment reassessment provisions to the period beyond 31 March 2021 is *ultra vires* the parent legislation, *viz.*, The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 ('**Enabling Act**'). Accordingly, the HC quashed the impugned notices issued under the erstwhile provisions with the liberty to the AO to initiate re-assessment proceedings in accordance with the amended provisions. For making the aforesaid judgement, the HC heavily relied on the decision of Allahabad HC in the case of *Ashok Kumar Agarwal* v. *Union of India*[11]. Reference was also made to the decisions of Rajasthan HC in the case of *Bpip Infra Private Limited* v. *Income Tax Officer*,[12] and Delhi HC in the case of *Man Mohan Kohli* v. *Assistant Commissioner of Income Tax & Anr*[13]. [*Manoj Jain* v. *Union of India* – WPA No.11950 of 2021, Order dated 17 January 2022, Calcutta High Court]

## AO is bound by the decision of ITAT passed in case of assessee for earlier years and the Supreme Court

AO disallowed the claim of the assessee regarding the depreciation on goodwill. The assessee challenged the order by way of a writ on the ground that the AO in making such addition has overlooked the decision in the assessee's own case passed by the ITAT. Further, that the subject matter of disallowance is duly covered by the decision of the Supreme Court in *CIT* v. *Smifs Securities Limited*[14] in the favour of the assessee.

The High Court, without going into the merits, held that unless there is a stay on the order of Jurisdictional ITAT, the said order is binding on all income tax authorities within its jurisdiction.[15] Further, it held that all authorities whether administrative or quasi-judicial or judicial are to follow the law declared by the Supreme Court,

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[11] Writ Tax No. 54/2021.
[12] S.B. Civil Writ Petition No. 13297/2021.
[13] W.P. (C) 6176 of 2021.
[14] (2012) 348 IT 302 (SC).
[15] Reference was made to the decision of the Apex Court in *Union of India* v. *Kamlakshi Finance Corporation Ltd.* 1992 Supp (1) SCC 443 and *Collector of Customs* v. *Krishna Sales (P.) Ltd.* 1994 Supp (3) SCC 73, *Ganesh Benzoplast Limited* v. *Union of India* 2020 (374) ELT 552 and the decision of Bombay HC in *Himgiri Buildcon & Industries Limited* v. *Union of India*.

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therefore, it is not open to AO to try to evade from the binding effect of a SC decision by trying to find 'distinguishing features'. [*Mylan Laboratories Ltd.* v. *NFAC* – WP No. 26279 of 2021, Order dated 4 January 2022, Andhra Pradesh High Court]

## Additions made on account of alleged excess share capital/ share premium, alleged bogus purchases and alleged funds deposited with banker during demonetization deleted

Following the search and seizure on the assessee, additions on various issues were made to be taxable income for AY 2012-13 to AY 2017-18. The findings/decision of the ITAT and the Delhi High Court on these issues are given below:

*Issue 1: Additions under Section 68 of the Act due to share capital/share premium received by Assessee for AY 2012-13 to AY 2017-18*

For AY 2012-13 to AY 2014-15 for which assessments stood concluded at the time of search, question arose whether any incriminating material was recovered during the search. ITAT held that the following two sets of material cannot be considered as 'incriminating material':

a) Arpesh Garg's (Managing Director of Assessee-company) statement and subsequent retraction – there was no confession or disclosure that unaccounted income was recorded in Assessee's books of accounts as share capital/premium.

b) Photocopies of certain blank documents (e.g., share transfer forms, signed receipts, signed power of attorney) necessary for share-transfer – these photocopies related to only 12 out of the total 36 shareholders. As per the ITAT's own previous decisions, original share transfer documents too, do not constitute 'incriminating material'. Photocopies, not being primary evidence, cannot be considered as secondary evidence in absence of any other material.

Referring to its decision in *CIT* v. *Kabul Chawla,* [2016] 380 ITR 573 (Delhi), the HC upheld the ITAT's decision for AY 2012-13 to AY 2014-15.

On merits, ITAT deleted this addition because the Assessee had produced sufficient documentary evidence to prove that the money paid by Assessee to its investors was routed back to it as share capital/premium. The AO did not further scrutinize this evidence and didn't verify the trail of source of these funds received by Assessee. No cash was reported to have been deposited in the accounts of Assessee, its investors and other related parties. The Assessee had proved the investors' identity, genuineness and creditworthiness. The HC upheld the ITAT's decision on merits by observing that first proviso to Section 68, which relates to share capital/premium, is silent about motivation of an assessee in routing back its own money as its share capital/premium. If an assessee otherwise escapes Section 68, then motivation alone can't be the basis to re-capture the assessee under that Section.

*Issue 2: Additions of 25% of alleged bogus purchases, in value for AY 2012-13 to AY 2017-18*

The ITAT noted that these additions were made only to protect the interest of the Department. Entire purchases and sales were duly recorded in books of accounts of all concerned parties, were substantiated by quantitative details and were made through normal banking channels, evidenced by bank statements produced before the AO. For AYs 2012-13 to 2014-15, these additions were deleted because these transactions were verified, books of accounts were duly audited, no defects were found with respect to these books by the Department,

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assessments were concluded, and no incriminating material was found during search.

For the rest 3 abated AYs too, these additions were deleted. It was noted that the Assessee had purchased goods at a value lesser than the one at which they were sold. If purchases were bogus, then it was unlikely that the Assessee would have recorded a profit against these purchases in its books. The Department cannot claim the purchases to be bogus, while simultaneously treating the corresponding sales to be genuine. The AO had not produced any material to justify this addition without making any inquiry/investigation. The HC upheld ITAT's decision, noting that ITAT's observations, being pure findings of fact, cannot be interdicted by HC in appeal.

*Issue 3: Addition under Section 68 of the Act due to monies deposited by Assessee with its banker during demonetization - AY 2017-18*

The ITAT deleted this addition because as per the material on record and on analysis of data relating to cash sales and cash deposits made in FY 2016-17 as against FY 2014-15 and FY 2015-16, it was found that total cash deposits mostly corresponded with cash sales in these years. In FY 2016-17, when demonetization happened, the increase in sales was lesser than in the earlier year. Thus, the Assessee had not recorded non-existent sales in its books after demonetization. Further, the Department did not allege that the Assessee had backdated its entries to inflate its cash sales figures. The HC upheld the ITAT decision by noting that there is no material/evidence on record which shows that the Assessee had earned unaccounted income and made cash deposits which were not represented by cash sales. [*PCIT* v. *Agson Global (P.) Ltd.* – ITA Nos. 68 to 73 of 2021, Order dated 19 January 2022, Delhi High Court]

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