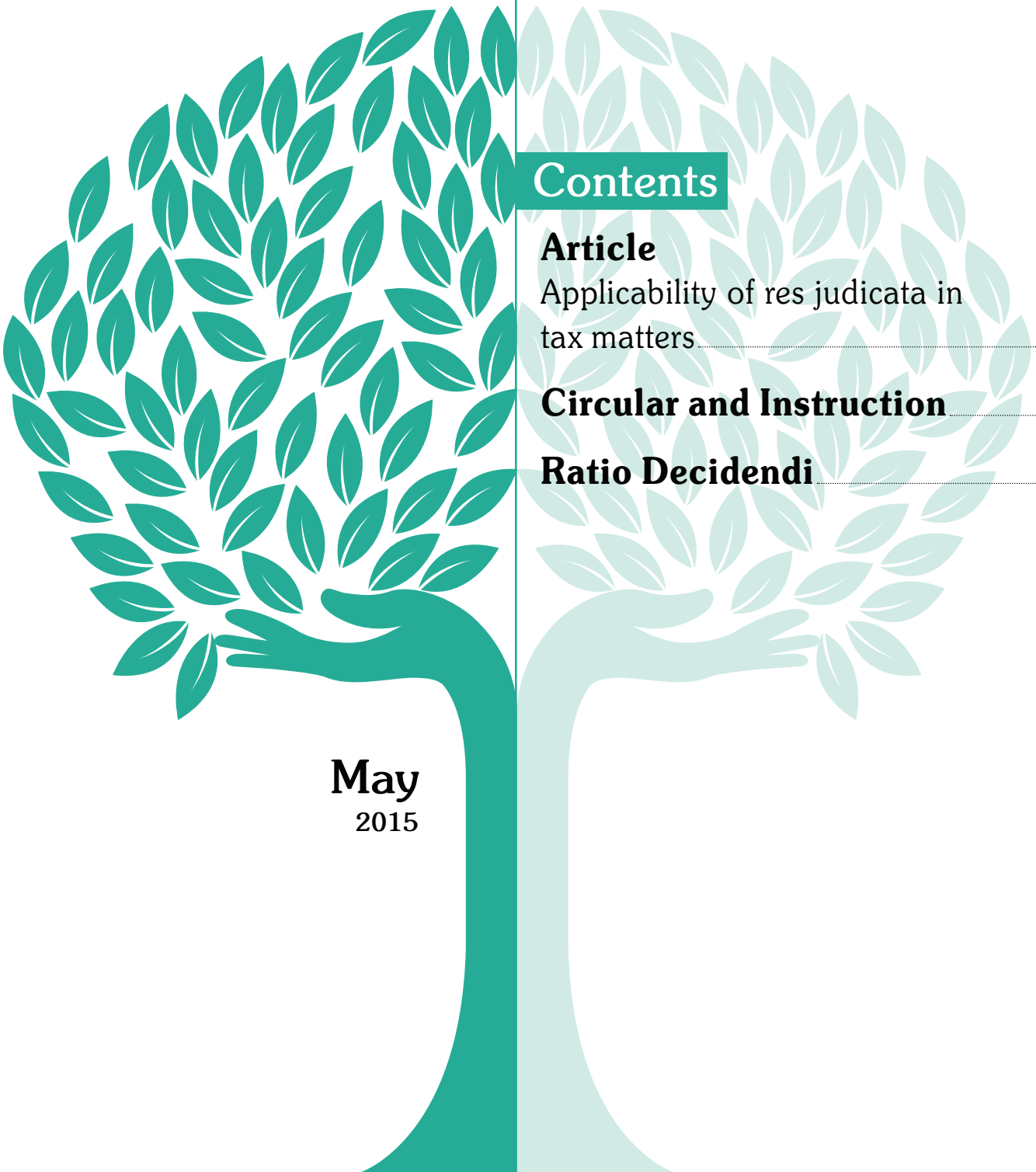
Lakshmikumaran & Sridharan tax

Direct Tax amicus

An e-newsletter from
Lakshmikumaran & Sridharan, New Delhi, India

May 2015 / Issue–10



Contents

May
2015

Article

Applicability of res judicata in tax matters

By **Amar Gahlot**

Introduction

Res Judicata is the Latin term for "a matter (already) judged", or "a thing adjudicated". It means a case or suit already decided. It was recently defined as "a final judgment on the merits by a court having jurisdiction is conclusive between the parties to a suit as to all matters that were litigated or that could have been litigated in that suit" by the Tennessee Court of Appeals[1]. In the Income Tax Act, 1961 ("ITA") the principle is incorporated, though only to a degree, in Section 158A of the ITA. This section provides that the decision of the High Court or the Supreme Court in the case of assessee may be applied by the AO to an identical question arising in the assessee's assessment proceedings in another year, provided the assessee requests for the same. Even so, *res judicata* is a wider concept, certain key issues on which shall be discussed in the subsequent paragraphs.

Inapplicability of res judicata in taxation

The general rule that is being applied over many years is that the doctrine of *res judicata* is not applicable in tax matters as has been already introduced earlier. The principle underlying is that no one should present same set of facts differently so as to reach different conclusions in different financial years. If the same issue is dealt with, in different financial years, differently, this will cause a lot of confusion and harassment. Financial law by its very nature is ever dynamic and changes every year. Consistency in law and its interpretation is hence essentially expected not only from tax authorities but also from the assessees.

Certain decisions of Supreme Court (SC) have held that the principle of *res judicata* is inapplicable in tax matters and the general rule is not to apply this doctrine. In *Instalment Supply (Pvt.) Ltd.*[2] the SC held that in tax matters there is no question of *res judicata* because each year's assessment is final only for that year and does not govern later years.

In *Radhasoami Satsang Vyas*[3], the Supreme Court observed that each assessment year is a separate unit. Decision in one year may not carry forward and hold for a subsequent year. The court held that in taxation matters, the rule of *res judicata,* as embodied in Section 11 of Civil Procedure Code, 1908 (CPC) has no application. Each year's assessment and decision is hence final to only that financial year and hence so determines the liability of the assessee of that particular financial year or period. It is open to the authorities to consider the issues and position of the assessee

1 J. M. Hanner Construction Company Inc. v. Thomas Brothers Construction Company, Inc, 2012

2 Instalment Supply (Pvt.) Ltd. v. Union of India, AIR 1976 SC 53

3 Radhasoami Satsang Vyas v. CIT, 1991 Indlaw SC 948

in the subsequent years. The decision was affirmed by the Apex Court in the *Municipal Corporation of City of Thane*[4] case.

In India, as early as in 1930, the conflicting views that whether the doctrine is applicable or not, were reconciled by a Full Bench of the Madras High Court in *Sankaralinga*[5], wherein it was held that questions relating to rights of parties and not varying with income of the party, if decided by court should be *res judicata* and the same question should not be argued subsequently. However, questions which do depend on factors determining income or considerations which vary every year forming questions which relate to different years and also vary from year to year cannot be held *res judicata*. These questions need to be argued for every year and need to be settled for each and every year as and when the dispute arises. The principle of *res judicata* hence should be applied only if there is a fundamental issue in question and the facts which change every year cannot utilize this doctrine for defence.

The Allahabad High Court reiterated the same rule regarding the doctrine of *res judicata in Kamlapat*[6], and held that a general and a fundamental question of right or title once decided should be *res judicata* and should govern the question in subsequent years. This should hold even if the question has not been decided expressly and the same result should follow. However, the Bombay High Court in *H.A. Shah*[7] gave a slightly different view. It held that "the principle of estoppel or *res judicata* does not strictly apply to the Income Tax authorities" and declared that,

> "An earlier decision on the same question cannot be reopened if that decision is not arbitrary or perverse, if it had been arrived at after due inquiry, if no fresh facts are placed before the Tribunal giving the later decision and if the Tribunal giving the earlier decision has taken into consideration all material evidence."

Res judicata was hence excluded from tax matters as has already been discussed earlier. This along with other judgments as discussed above rendered the doctrine inapplicable to tax disputes. But, once again, due to judicial wisdom and considerations of public policy, the advantages of the rule continued to remain available. This took a different form. It needs to be mentioned that constructive *res judicata* has lost its role as far as tax matters are concerned. Constructive *res judicata* gets its formulation in explanation IV of Section 11 of CPC. The Supreme Court in *The Workmen of Cochin*[8] explained the meaning of *res judicata* with respect to constructive *res judicata* as:

> "The rule of constructive res-judicata is engrafted in Explanation IV of Section 11 of the Code of Civil Procedure and in many other situations also Principles not only of direct res-

4 Municipal Corporation of City of Thane v. Messrs Vidyut Metallics Limited and another, 2007 INDLAW SC 900
5 T.M.M. Sankaralinga Nadar & Bros. v. CIT, (1929) 4 ITC 226 (MAD.)
6 Kamlapat Motilal v. CIT, (1950) 18 ITR 812 (AHD.)
7 H. A. Shah and Co. v. CIT, (1956) 30 ITR 618 (Bom)
8 The Workmen of Cochin Port Trust v. The Board of Trustees of the Cochin Port Trust and Anr, AIR 1978 SC 1283

judicata but of constructive res-judicata are also applied, if by any judgment or order any matter in issue has been directly and explicitly decided, the decision operates as res-judicata and bars the trial of an identical issue in a subsequent proceedings between the same parties. The Principle of res judicata comes into play when by judgment and order a decision of a particular issue is implicit in it, that is, it must be deemed to have been necessarily decided by implications even then the Principle of res judicata on that issue is directly applicable. When any matter which might and ought to have been made a ground of defence or attack in a former proceeding but was not so made, then such a matter in the eye of law, to avoid multiplicity of litigation and to bring about finality in it, is deemed to have been constructively in issue and, therefore, is taken as decided"

The question had also been earlier addressed by the Apex Court when the matter came up directly for consideration in *Amalgamated Coalfields*[9]. It held that,

> "In considering of this question, it may be necessary to distinguish between decision on questions of law which directly and substantially arise in any dispute about the liability for a particular year, and questions of law which arise incidentally or in a collateral manner ... the effect of legal decisions establishing the law would be a different matter."

The Supreme Court gave a somewhat balanced approach in the understanding and application of this issue. It distinguished between questions which arise incidentally and questions of law which arise directly and substantially in any financial year. The effect of application of the principle and of legal decisions under these different circumstances will be different. An issue which is significant only for a particular year once decided cannot be held *res judicata* for a subsequent year.

Rule of consistency

Though largely, the jurisprudence has been that *res judicata* is inapplicable to tax proceedings, courts at times have preferred the rule of consistency. In the case of *Sunil Kumar Ganeriwal*[10], for example, the Bombay High Court relied on the rule of consistency. In this case, the assessing officer had accepted the transaction of shares as investment and income arising from it under the head short term capital gains in earlier and also in subsequent assessment years. In a particular year, it was held by the assessing officer to be under head profits and gains from business owing to the frequency, scale and period of holding. The ITAT Mumbai held that the rule of consistency demanded that the Assessing Officer can't take a different view in selective assessment year, and ruled in favour of the assessee.

Recently, in the case of *Man Mohan Kedia*[11], the Calcutta High Court, though giving a finding that *res judicata* is inapplicable to tax proceedings, emphasized on the importance

[9] Amalgamated Coalfields v. Janapada Sabha, AIR 1964 SC 1013

[10] Sunil Kumar Ganeriwal v. Deputy Commissioner of Income-tax, Circle 14(2), Mumbai, [2011] 16 taxmann.com 311 (Mum.)

[11] Man Mohan Kedia v. Income Tax Officer, Kolkata, [2015] 370 ITR 649 (Calcutta)

of maintaining consistency in tax proceedings. It was held by the High Court that in taxation cases the Revenue Department is taken as one party for all assessment years and the assessees together taken as the other party. That which is decided between the Revenue and one assessee in an assessment year, having permanent effects should not be decided otherwise or treated in any other way by the revenue with regard to any other assessee, so as to maintain consistency and fairness in government action.

Conclusion

As a general rule, the principle of *res judicata* is not applicable to tax related proceedings. An assessment of particular year is final, complete and binding in relation to the assessment year in which the decision is given. In income-tax proceedings, though the principle of *res judicata* does not apply, rule of consistency which in itself emanates from the doctrine of *res judicata* does apply, i.e., if no fresh facts come to light on investigation, the assessing officer is not entitled to reopen the same question on mere ground of suspicion or change of opinion. This view of courts is also based on principle of natural justice. This principle broadly safeguards the interests of the assessees against arbitrary actions arising out of prerogative interpretations and biased actions of the departmental authorities.

[The author is a Principal Associate, Direct Tax Practice, Lakshmikumaran & Sridharan, Mumbai]

Circular and Instruction

Interest for default in filing wealth tax return not to be levied on self-assessment tax paid: A default in filing return of net wealth by the assessee results in the levy of interest under Section 17B of the Wealth Tax Act. This section is similar to Section 234A of the Income Tax Act, which provides for the levy of interest in case of a default in filing income tax return. In cases where the self-assessment tax was paid by the assessee but the return was not filed, the Supreme Court in the case of Prannoy Roy[12] held that interest u/s 234A shall be paid only on the amount of tax that has not been deposited before the due date of filing of the income tax return. The decision had already been given effect in income tax, vide Circular No. 2/2015 dated 10-2-2015. In line with the same, Circular No. 5/2015 dated 9-4-2015 has been issued for wealth tax, mandating that no interest u/s 17B of the Wealth Tax Act be levied on the amount of self-assessment tax paid before the due date of filing the return of net wealth.

Collection of taxes to be suspended during Mutual Agreement Procedure pursuant to India-UK DTAC: In pursuance to the provisions of Article 27 of the India-UK DTAC, the Competent Authorities of India and the UK had entered into an MoU for the implementation of MAP, which suspended the collection of taxes during the pendency of MAP. Accordingly, Instruction No. 3/2004 dated 19.03.2004 stated that the collection of outstanding taxes in case

[12] *CIT* v. *Prannoy Roy* [2009] 309 ITR 231 (SC)

of a UK resident taxpayer, whose request under MAP is pending, shall be kept under abeyance subject to a bank guarantee. As the number of transfer pricing disputes has grown, Instruction No. 3/2015 has been recently issued, modifying the abovementioned instruction, and clarifying that the provisions of the MoU are equally applicable to Indian resident taxpayers in cases involving transfer pricing disputes where MAP has been invoked by the UK resident.

Ratio decidendi

ITAT empowered to extend stay beyond 365 days when delay in disposal not attributable to assessee: When the delay in disposing of the appeal is not attributable to the assessee, the Tribunal has the power to grant extension of stay beyond 365 days in deserving cases. Examining the constitutional validity of third proviso to Section 254(2A) of the Income Tax Act, 1961 (the Act) the Delhi High Court agreed with the petitioner's contention that amendment by addition of the words 'even if the delay in disposing of the appeal is not attributable to the assessee', unequal persons have been treated equally and the provision violated Article 14 of the Constitution. It opined that while the condition that the stay order could be extended beyond a period of 180 days only if the delay in disposing of the appeal was not attributable to the assessee was a reasonable restriction on the power of the Tribunal, it cannot be argued that even when the delay is not caused by the assessee, the Tribunal would have no power to extend stay. [*Pepsi Foods Pvt. Ltd* v. *ACIT*, Order dated 19-5-2015 in WP (C) No. 1334/2015, Delhi High Court]

Lease income is business income if business of the company was to acquire properties and lease them: The Supreme Court has held that when the main object of the company, as per its Memorandum of Association, was to acquire properties and earn income by letting out the same, income was to be brought to tax as business income and not as income from house property. Overruling the High Court, the Apex Court relied on its decision in *Karanpura Development Co. Ltd*[13] and held in the instant case that the assessee rightly disclosed its receipts from leasing of property as business income since leasing of properties was the business of the assessee, established also by the fact that its only income was from leasing. This judgement has, in a subtle manner, brought out that the ownership of a property and leasing it out may be done as a part of business or it may be done as a land owner. The foremost step in income tax computation is to assign incomes to a certain head of income. The mere fact there is a specific head for taxing income from house property should not preclude one from analyzing the true nature of income received from leasing of property – it may well be business income. [*Chennai Properties & Investments Ltd* v. *CIT*, [2015] 56 taxmann.com 456 (SC)]

No deduction under Section 80HHC to be allowed where assessee had a loss in export business: The question whether a deduction under Section 80HHC would be allowed in a case where there is a loss in the export business

[13] *Karanpura Development Co. Ltd.* v. *Commissioner of Income Tax, West Bengal*, 44 ITR 362 (SC)

and profit in other business carried out in India, was answered against the assessee by the Supreme Court. The Apex Court followed its decisions in the cases of *IPCA Laboratory Ltd.* and *A. M. Moosa*, and held that in these cases the Court was concerned only about the net profit from different export businesses. In a situation as posed by the present case where there are losses in the export business, but profits of indigenous business outweigh those losses and net result is that there is a profit of the business, the argument of the assessee that deduction u/s 80HHC would be available, was not acceptable. [*Jeyar Consultant & Investment (P) Ltd* v. *CIT*, [2015] 373 ITR 87 (SC)

Profits earned are eligible for 80-IA deduction where losses have already been set off against other income: The assessee, a company engaged in windmill power generation, had claimed the benefit under Section 80-IA for the assessment year in question and also for subsequent years. The Madras High Court held that since losses incurred by the assessee had already been set off against other incomes, profit earned would be eligible for deduction. The instant case wherein the assessee has exercised its option for the benefit and its losses having already been set off against other income of the business enterprise, was identical in facts in *Velayudhaswamy Spg. Mills*[2] case and the court followed it's decision in *Velayudhaswamy Spg. Mills*. [*CIT* v. *Mallow International*, [2015] 57 taxmann.com 160 (Madras)]

Comparable entity not to be excluded merely because it has high profitability: The question, whether entities can be excluded from the list of comparables for determining the ALP merely because they make extremely high profits, has been answered in the negative recently by the Delhi High Court. The Court has held that Rule 10B does not provide for an exclusion solely on the basis of high profitability, and unless material differences cannot be eliminated as provided for under Rule 10B(3), the entity making such high profits would be considered as a comparable. The High Court also held that the reliance on earlier year's data by the assessee was incorrect. It was only under exceptional circumstances that such a resort should be taken and such reliance on multiple year data was not warranted in the present case. The Court also examined the OECD transfer pricing guidelines on the issue of extreme results and on multiple year data, and its relevance to the case. The matter was remanded back to the DRP for reconsideration on the basis of principles laid down by the High Court. [*Chryscapital Investment Advisors (India) Pvt. Ltd.* v. DCIT [2015] 56 taxmann.com 417 (Delhi)]

No Agency-PE in India for telecasting business having advertising income through agents: The Bombay High Court enquired into the existence of an agency PE of the assessee company in India. It was held that since the agent in India does not have the power to conclude contracts, it was not a dependent agent. The High Court rejected the Revenue's contention that the principle laid

[14] *Velayudhaswamy Spg. Mills (P.) Ltd.* v. *Asstt. CIT* [2012] 340 ITR 477 (Madras)

down in *Morgan Stanley*[15] shall not be applicable to the present case. The Court further held that even if the Indian entity constitutes a PE for the assessee, the remuneration has already been paid at arm's length. For such determination, the Court has accepted that 15% is the norm for advertising agency as determined by Circular No. 742 of 1996. Thus it was held that no further profits should be taxed in the hands of the assessee. [*DIT(IT) v. B4U International Holdings Ltd.*, [2015] 57 taxmann.com 146 (Bombay)]

Reopening of assessment valid if assessee did not disclose the existence of PE of its parent company in India: The Allahabad High Court held that if there has been a non-disclosure by the assessee of the existence of a PE of its parent company in India, validity of reassessment proceedings after the expiry of four years from the end of the relevant year was to be upheld. The Assessing Officer had initiated reassessment proceedings in case of assessee on ground that it had made payments to its parent company located in Korea without deducting tax at source and, thus said payments were to be disallowed. In this regard, the Court rejected the contention of the assessee that there being no failure on its part to disclose complete and full facts, the reassessment was bad. [*Principal Officer, L. G. Electronics (P) Ltd. v. ACIT*, [2015] 57 taxmann.com 178 (Allahabad)]

[15] *Director of Income Tax (International Taxation) v. Morgan Stanley & Company Inc.*, [2007] 292 ITR 416

NEW DELHI
5 Link Road,
Jangpura Extension,
Opp. Jangpura Metro Station,
New Delhi 110014

B-6/10, Safdarjung Enclave
New Delhi - 110 029
Phone : +91-11-4129 9811
E-mail : lsdel@lakshmisri.com

MUMBAI
2nd floor, B&C Wing,
Cnergy IT Park,
Appa Saheb Marathe Marg,
(Near Century Bazar)Prabhadevi,
Mumbai - 400025.
Phone : +91-22-24392500
E-mail : lsbom@lakshmisri.com

CHENNAI
2, Wallace Garden,
2nd Street
Chennai - 600 006
Phone : +91-44-2833 4700
E-mail : lsmds@lakshmisri.com

BENGALURU
4th floor, World Trade Center
Brigade Gateway Campus
26/1, Dr. Rajkumar Road,
Malleswaram West, Bangalore-560 055.
Ph: +91(80) 49331800
Fax:+91(80) 49331899
E-mail : lsblr@lakshmisri.com

HYDERABAD
'Hastigiri', 5-9-163, Chapel Road
Opp. Methodist Church, Nampally
Hyderabad - 500 001
Phone : +91-40-2323 4924
E-mail : lshyd@lakshmisri.com

AHMEDABAD
B-334, SAKAR-VII,
Nehru Bridge Corner, Ashram Road,
Ahmedabad - 380 009
Phone : +91-79-4001 4500
E-mail : lsahd@lakshmisri.com

PUNE
607-609, Nucleus, 1 Church Road,
Camp, Pune – 411 001. Maharashtra
E-mail : lspune@lakshmisri.com

KOLKATA
2ND Floor, Kanak Building
41, Chowringhee Road, Kolkatta-700071
Phone : +91-33-40051 5570
E-mail : lskolkata@lakshmisri.com

CHANDIGARH
1st Floor, SCO No. 59, Sector 26,
Chandigarh - 160026
Phone : +91-172-4921700
E-mail : lschd@lakshmisri.com

GURGAON
OS2 & OS3, 5th floor,
Corporate Office Tower,
AMBIENCE Island, Sector 25-A,
Gurgaon- 122001
Phone: +91- 0124 – 477 1300
Email: lsgurgaon@Lakshmisri.com

EUROPE
Lakshmikumaran & Sridharan SARL
35-37, Avenue Giuseppe Motta, 1202 Geneva
Phone : +41-22-919-04-30
Fax: +41-22-919-04-31
E-mail : lsgeneva@lakshmisri.com