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THE NEWSLETTER

Cost Sharing Arrangement doesn't constitute Provision of Technical Services

The Hon'ble Supreme Court of India ("**SC**")in the case of ***Director of Income-tax (IT)-I*** v. ***A.P. Moller Maersk A S***, **[[2017] 78 taxmann.com 287 (SC)]** held that amount received by a foreign company from the usage of its common global telecommunication facility by its Indian agents are not taxable in India as fees for technical services because it was merely a cost sharing arrangement between the assessee and its agents to efficiently conduct its shipping business. In the present case, assessee was a foreign company engaged in the shipping business and tax resident of Denmark and was having agents in India which acted as clearing agent for the assessee. In order to help all its agents, across the globe, to carry out its business, the assessee had set up and was maintaining a global telecommunication facility called Maersk Net System which was a vertically integrated communication system. The said system enabled the agents of the assessee to access several information like tracking of cargo of a customer, transportation schedule, customer information, documentation system and several other information. Expenditure which is incurred for running the said system is shared by all the agents and paid to the assessee. The assessing officer was of a view that the above mentioned amount received by the assessee from the agents is fees for technical services rendered by the assesses and thus, passed the order holding that the said amount is taxable in India under Article 13(4) of the Double Taxation Avoidance Agreement. The order of the assessing officer was appealed in ITAT by the assessee and the ITAT revered the said order. In furtherance, the Revenue Department appealed before the Hon'ble High Court of Bombay. The Bombay High Court dismissed the Revenue's appeal holding the observation of ITAT to be correct that the Maersk Net Communication System was an automated software based communication system which did not require the assessee to render any technical services. It was merely a cost sharing arrangement between the assessee and its agents to efficiently conduct its shipping business. Aggrieved by the judgement of Bombay High Court, the Revenue Department filed an appeal before SC. SC while dismissing the appeal filed by the Revenue Department held that the amount received by assessee from its agents was in the nature of reimbursement of cost which the agents paid their proportionate share of the expenses incurred on common global telecommunication facility and therefore, no technical service is rendered by the assessee and the said amount received by the assessee cannot be taxed in India.

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Decree of Injunction can be enforced against the Legal representatives of deceased judgment debtor

The Hon'ble Supreme Court of India ("**Supreme Court**") in the case of ***Prabhakara Aditya*** v. ***Gowri & Ors.*** [**Civil Appeal No. 3007-3008/2017**] held that the decree for injunction can be executed against the legal representatives of the deceased judgment debtor. In the instant case, appellant was in lawful possession of a property and the respondent without any reason tried to dispossess the appellant from his property. Upon scrutiny, the court of civil judge II found out that the property was allotted to the appellant *via* a registered partition deed and accordingly a decree of permanent injunction was issued against the respondent. Thereafter, the respondent died on 10.12.2012 and the heirs of the respondent again tried to dispossess the appellant from his property. Aggrieved by this, the appellant filed an execution petition against the legal heirs of the respondent. The executing court held that the legal heirs of the respondent were bound by the decree of permanent injunction. Against this, the legal heirs of the respondent preferred a writ petition before the Karnataka High Court ("**High Court**"), wherein the High Court ruled that the decree of injunction does not travel with land and thus it cannot be enforced against the legal heirs of the respondent. Aggrieved by the decision of the High Court, the appellant approached the Supreme Court. Supreme Court stated that, Section 50 of Civil Procedure Code, 1908 (**"CPC**") deals with execution of decrees of all kinds including that of permanent injunction. It is apparent from the said section that when judgment debtor dies before the decree has been satisfied, it can be executed against the legal representative of the deceased. The Supreme Court observed that it would be against the public policy to ask the decree holder to litigate over again against the legal representatives of the judgment debtor when the cause and injunction survives and therefore held that it is crystal clear from a perusal of Section 50 of CPC that a decree for permanent injunction can be executed against the judgment debtor or his legal representatives.

Harsh punitive actions to be taken against Shell Companies

The Ministry of Finance in a press release dated 10.02.2017 announced that "Harsh Punitive Actions" ("HPA") will be taken against the shell companies who are involved in money laundering in India such as freezing of bank accounts, striking off the names of dormant companies, invocation of Benami Transactions (Prohibition) Amendment Act, 2016, etc. A task force consist of members from various Ministries and Enforcement Agencies has been set-up under the co-chairmanship of the Revenue Secretary and Corporate Affairs Secretary to monitor the actions taken against deviant shell companies by various agencies.

Powers of ITAT to rectify or amend its own order is subjective

In case of ***Jayant D. Singhvi* v. *The Income Tax Appellate Tribunal and two Ors.* [WP No. 2966 of 2016],** the issue of powers of the Appellate Tribunal to rectify or amend its own order as per the provisions of Section 254(2) of the Income Tax Act, 1961 ("**Act**") was under consideration before the Hon'ble Bombay High Court. In this case, the appeal filed by the assessee before the ITAT was dismissed as withdrawn by the ITAT on his specific request seeking unconditional leave. Thereafter, an application was filed by the assessee before ITAT to recall the withdrawn appeal by giving a specific reason that the appeal was withdrawn in view of the advice given by the advocate of the assessee. The said application was dismissed by ITAT by recording the following facts: (i) The appeal was withdrawn only on the specific request of the assessee wherein there was no reference to the fact that the appeal is being withdrawn because of the advice of the advocate and (ii) there is no error or mistake apparent from record to exercise jurisdiction under Section 254(2) of the Act. Thereafter, the assessee filed a petition before the Hon'ble High Court ("**Court**") to direct the ITAT to recall its order. In this regard, the Court in view of the above facts and circumstances held that as there was nothing on record in the form of advocates letter, etc. to indicate that the petitioner acted upon his legal advice to withdraw the appeal, the said application falls out of the scope of Section 254(2) of the Act and thus, cannot be entertained. In view of the same, the petition filed by the assessee was dismissed.

Difference Between Gross Negligence and Mere Negligence under Advocates Act, 1961

In the case of ***TA Kathiru Kunju* v. *Jacob Mathai & Anr,*** the Hon'ble Supreme Court of India ("**Court**") set aside the order of the Disciplinary Committee of the Bar Council of India ("**Committee**") by distinguishing between '*mere negligence*' and '*gross negligence*' under Section 38 of the Advocates Act, 1961 ("**Act**"). The Committee held appellant guilty of gross negligence in discharge of his professional service to the client and imposed the punishment of reprimand with a penalty of sum of Rs.5,000/- to the Bar Council of India. The facts of the case are such that the respondent engaged the appellant to file a complaint under Section 138 of the Negotiable Instruments Act, 1881 ("**NI Act**") as a cheque issued by Mr.X in favour of the respondent was dishonored. However, the appellant chose to file a complaint before the Magistrate under Section 420 of the Indian Penal Code. Further, the respondent filed a complaint before the Bar Council of India alleging that the cheque that was handed over to the appellant to initiate criminal action against Mr. X under Section 138 of the NI Act was not returned to him. The appellant contended that he was entrusted with the original cheque along with the photocopy of the said cheque and the original cheque was handed over to the investigating agency. It was observed by the

Committee that the appellant was guilty of gross negligence as he failed to obtain the acknowledgment of the cheque from the respondent. The Court finally observed that it was required to be seen whether it was a mere negligence (error of judgment) or gross negligence to decide whether the Appellant can be punished under Section 35 of the Act for professional misconduct. It was finally held that the act of the Appellant of not getting the acknowledgement cannot be treated in the realm of gross negligence but it only qualifies as mere negligence and hence, he could not be punished.

Settlement amount paid to ex-employees is not profit in lieu of salary under Section 17(3)(i) of the Income Tax Act, 1961

Section 192 of the Income Tax Act, 1961 (**"Act"**) deals with applicability of tax deducted at source ("**TDS**") on salary and states that employer is required to deduct TDS from the salary which is paid to the employees and deposit the same to the government. Further, Section 15, Section 16 and Section 17 of the Act provides as to what constitutes as income from salary of an employee. On 15.02.2017, Hon'ble ITAT – Mumbai in the case of ***Income Tax Officer (TDS), Mumbai*** **v.** ***Kuwait Airways Corporation*** **[[2017] 78 taxmann.com 187]**, held that compensation paid to the ex-employees under settlement shall not be considered as "profit in lieu of salary" as per Section 17(3)(i) of the Act and therefore, TDS shall not be deducted from the said compensation. In the present case, Ld. A.O. treated the assessee as assessee in default under Section 201(1) and Section 201(1A) of the Act for non deduction of TDS from the amount of compensation paid to the employees. Hon'ble ITAT observed that the word "compensation" has not been defined under the Act and therefore, meaning of the same shall be understood in common parlance. Compensation paid to anyone should be in the nature of something awarded to compensate for loss, suffering or injury. In the context of employment, compensation would mean to pay an amount to an employee in return for some services rendered by him and therefore, on such compensation tax shall be deducted. But, in the instant case, the amount received by the ex-employees from the assessee (employer) is as per the order passed by the Regional Labour Commissioner under Section 33C(1) of the Industrial Dispute Act, 1947 and thus the said amount cannot be considered as a compensation under Section 17(3)(i) of the Act because there is no vested right of the ex-employees to get amount of any compensation from the assessee at or in connection with the termination of their employment or the modification of the terms and conditions of the employment in the present case. Thus, after considering the facts and circumstances of the present case and relying on the judgment passed by Hon'ble High Court of Gujarat in

***Arun Bhai R. Naik* v. *Income Tax Officer* (379 ITR 511)**, the Hon'ble ITAT decided the matter in favour of the assessee and the dismissed the appeal filed by the department.

Guidelines for the Principal Employer Engaging Employees through a Contractor

According to paragraph 30(3) of the Employees' Provident Funds Scheme, 1952 ("Scheme"), the principal employer is responsible to pay all contribution towards the social security and administrative charges in the Act, for the employees directly engaged by himself and employees employed by or through a contractor. In order to bring more clarity in connection to the said responsibility of the principal employer, the Employees' Provident Fund Organization, Ministry of Labour, Government of India ("EPFO") vide circular dated 02.02.2017 ("Circular") issued following guidelines which are to be compulsorily followed by principal employer:

(a) Before awarding any contract to a contractor, the principal employer should ensure that the said contractor is registered with the EPFO.

(b) After awarding of the contract to the contractor, the principal employer shall enter the details of the contractor on the EPFO web portal.

(c) The principal employer shall make payments due to the contractor only after all statutory provident funds payments have been made by the contractor to the EPFO.

(d) The payment of all statutory provident funds to the EPFO by the contractor, can be verified either directly from the EPFO web portal or by obtaining the payment receipts received by the contractor from the EPFO web portal while making the payment.

(e) Even if the contractor has separate provident funds code number, the overall/sole responsibility for ensuring the compliance under the Act for the employees working through the contractor for deposit of dues with the EPFO regularly, rests with the principal employer.

(f) The principal employer shall be entitled to deduct employees' provident funds dues from the contractor bills and deposit the same either against the contractor code number or their own code number.

Director not Entitled to Compounding of Offence When Offence is Committed with Mala Fide Intent

The applicant in this case is an erstwhile Managing Director ("**MD**") of the Company. The Company in question in the present is in default under various sections under the Companies Act, 1956 ("**Act**") and the applicant being the MD of the Company in the present case was also charged for prosecution in the light of the defaults committed by the Company and in the instant case, ROC initiated prosecution against the applicant for offences pertaining to various section under the Act. The Serious Fraud Investigation Officer ("**SFIO**") carried out the investigation and established that sale of Company's were grossly inflated by the applicant by raising fictitious invoices etc. and manipulating other documents and further, it was established that these activities were done with criminal intention and in conspiracy. In the present case, it was revealed that there was deliberate falsification of books of account and financial statements of the Company and moreover, there was violation of the provisions relating to acceptance of deposits under the Act. The applicant in the present case filed a compounding application for compounding of the offences alleged against the applicant and the Company. The SFIO also initiated prosecution under IPC and submitted charge sheet, it was further found that the said defaults were no done due to any *bona fide* omission rather the same were committed with *mala fide* intention. The National Company Law Tribunal, New Delhi Bench ("**Tribunal**") in the present case contended that discretion to compound an offence under the Companies Act is with the Tribunal and should primarily be exercised in cases of inadvertent technical aberrations. The provisions for compounding primarily exist to impose fines for such inadvertent defaults with a gateway to escape the trauma of a protracted trial for a *bona fide* mistake. The Tribunal further stated that the non-adherence to the statutory compliances and requirements under the Act were intentional and compounding of offences committed in the present case would demolish and prejudice the penal provisions also. Hence, compounding in the present petition cannot be permitted on account of the reason that compounding of such offences committed with *mala fide intent* would hamper the criminal prosecution.

Non Application of mind by the AO – Knocking off the Penalty Order

- By CA Shrayansh Jain, Associate

Introduction

Provision of section 271(1)(c) of the Income Tax Act, 1961 ("**Act**") provides power to assessing officer for imposition of penalty on concealment of particulars of income or furnishing of inaccurate particulars of income. For this purpose, the assessing officer is required to initiate the penalty proceeding and record specifically the kind of offense for which penalty proceeding has been initiated. Section 271(1)(c) of the Act covers following kinds of offenses:

- Concealment of particulars of income, or
- Furnishing of inaccurate particulars of income, or
- Both of the above

'Concealment of income' and 'furnishing of inaccurate particulars of income' carry different connotations. One thing is certain that these two circumstances are not identical in detail although they may lead to the same effect, namely, keeping off a certain portion of income. The former is direct and the latter may be indirect in its execution. Therefore, it is required to analyze first the meaning of 'concealment of particulars of income' and 'furnishing of inaccurate particulars of income'.

Concealment of particulars of income

Conceal signifies a deliberate act of omission on the part of the assessee. The word 'conceal' means to hide, to keep secret. The phrase 'conceal the particulars of his income' would include false deduction or exemptions claimed by the assessee in his return. The word 'conceal' involves knowledge on the part of the assessee of the real income when giving the particulars. The offence of concealment is thus a direct attempt to hide an item of income or a portion thereof from the knowledge of the income-tax authorities. Concealment of income may arise in various ways. It may take various forms of manipulation of entries in accounts, non-disclosure of items of source that existed and income that has clearly been earned by the assessee in the previous year, claim of false deductions or losses, suppression of sales, camouflage of income as loans taken from third parties and claim of interest thereon as deduction, giving a colour of agricultural income to the otherwise taxable income, and unexplained investments that can be clearly attributed to concealed income. However, mere addition or estimates made on mere suspicion that there is something wrong with the book entries or their incompleteness, inadvertent omissions, debatable additions or disallowances, cash credits or investments not accepted as genuine, and rejection of a claim of expenses may not be themselves justify a penalty.

1 T. Ashok Pai v. CIT [2007] 292 ITR 11 (SC)
2 CIT v. Indian Metals & Ferro Alloys Ltd. [1995] 211 ITR 35 (Ori.)
3 Supra Note 1
4 CIT v. Manjunatha Cotton & Ginning Factory [2013] 359 ITR 565 (Kar)
5 Supra Note 2

Furnishing of inaccurate particulars of income

In furnishing its return of income, an assessee is required to furnish particulars and accounts on which such return income has been arrived at. These may be particulars as per its books of account, if it has maintained them, or any other basis upon which it had arrived at the returned figure of income. Any inaccuracy made in such books of account or otherwise which resulted in keeping off or hiding a portion of its income is punishable as furnishing inaccurate particulars of its income.

Ground of initiation of penalty proceeding and ground on which penalty will be levied should be same

From above analysis, it is clear that concealment of particulars of income and furnishing of inaccurate particulars of income carry different meaning. Therefore at the time of initiation of penalty proceedings, Assessing Officer should be clear in his mind for what type of offense penalty is to be levied. Notice issued u/s 274 of the Act should specifically state the grounds mentioned in Section 271(l)(c), i.e., whether it is for concealment of income or for furnishing of incorrect particulars of income. Sending printed form of notice issued u/s 274 of the Act wherein all the grounds mentioned in section 271 of the Act are mentioned, would not satisfy the requirement of law for levy of penalty and principle of natural justice will be offended. That will tantamount to non application of mind of assessing authority. However, Hon'ble Bombay High Court has put an additional requirement that entire factual background would fall for consideration in the matter and no one aspect would be decisive. The issuance of notice is an administrative device for informing the assessee about proposal to levy penalty in order to enable him to explain as to why it should not be done. Mere mistake in the language used or mere non-striking off of inaccurate portion cannot by itself invalidate the notice. Contradictory view was taken by Hon'ble Gujarat High Court that penalty proceeding will not be void if all the grounds mentioned in notice as to penalty order instead of specifying specific ground.

Further, once the proceedings are initiated on one ground, the penalty should also be imposed on the same ground. Where the basis of the initiation of penalty proceedings is not identical with the ground on which the penalty was imposed, the imposition of penalty is not valid. For example, penalty proceeding initiated on ground of 'concealment of particulars of income, however penalty levied on ground of 'furnishing of inaccurate particulars of income' will lead to an interference as to non application of mind of the assessing authority and will be bad in law.

Conclusion

In view of the above analysis, one can lead to inference that if the assessing authority has initiated penalty on one ground and the penalty order was passed on another ground, penalty order may be quashed by the higher appellate authorities on ground of non application of mind by the assessing authority.

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