



Government Law College MOOT COURT ASSOCIATION

'A' Road, Churchgate, Mumbai 400020

Tel: +91-22-2204 1707

E-mail: mcaglc@gmail.com

COMMON ELIMINATION - 2

The MCA is pleased to announce Common Elimination-2, to be held on **Saturday, 27th August** for the:

8th Nani Palkhivala Memorial National Tax Moot Court Competition, 2011 to be held from the **13th – 15th October, 2011**.

All interested students can send an email to mcaglc@gmail.com with their details (name, year & contact number) to register.

The Case Study for the same can be found below

CASE STUDY

CIT v Pot Holes Expert Development Ltd.

1. Pot Holes Expert Development Ltd. (herein after referred to as “Pot Holes”) is a public limited company engaged in the business of development and construction of infrastructure projects in India, including roads, bridges, dams, etc. In the financial year 2001-02, Pot Holes entered into a contract with National Highway Authority of India (“NHAI”) for carrying out the expansion of the two lane Highway into a four lane Highway between Mumbai and Delhi. It was provided in the contract that the consideration of Rs. 50,000 Crores will be payable to Pot Holes after the completion of the contract i.e. after the whole of the work of Pot Holes was complete. It was specifically provided that Pot Holes would not be entitled to any advances or consideration on the basis of proportionate completion of the work. The contract also provided the technical specifications on the basis of which the expansion work was to be performed by Pot Holes.
2. Pot Holes completed the expansion work as per the terms of the contract in the financial year 2003-04 and accordingly received full consideration for the work done. Pot Holes earned a profit of Rs. 20,000 Crores from the aforesaid project. For the assessment year 2004-05, the amount of Rs. 20,000 Crores was shown as income in the gross total income of Pot Holes and claimed as deduction under section 80IA(4) of the Income-tax Act, 1961 (herein after referred to as “the Act”). Vide an assessment order dated 29th December, 2006, under section 143(3) of the Act, the Assessing Officer accepted the claim of deduction under section 80IA(4) of the Act and allowed the deduction to the assessee.
3. A search action was initiated under section 132 of the Act on 1st January, 2007 at the offices and premises of Pot Holes. No undisclosed income or incriminating documents were found at the time of the search. The regular

books of accounts and a few documents were seized but no undisclosed income was determined from the books of accounts.

4. Notice dated 2nd April, 2007 under section 153A was issued to Pot Holes for the assessment years 2001-2002 to 2006-07 asking pot Holes to furnish the return of income for each of the assessment years within 30 days of the receipt of the notice. In reply to the aforesaid notice, Pot Holes challenged the notice on the ground that as no material indicating undisclosed income was found during the course of the search, proceedings under section 153A of the Act cannot be initiated against the assessee. Without prejudice, Pot Holes stated that the returns originally filed should be treated as a return in compliance to the notice under section 153A of the Act.

5. **Assessment Order:**

5.1 The assessment for assessment year 2004-05 was selected for scrutiny and a show cause notice was issued to Pot Holes asking Pot Holes to show cause as to why deduction under section 80IA of the Act should not be disallowed.

5.2 The assessee vide a reply dated 24th February, 2008, argued as follows:

5.2.1 The proceedings under section 153A of the Act are *void-ab-initio* and bad in law, as the proceedings under section 153A cannot be initiated when no undisclosed income or incriminating material has been found during the course of the search.

5.2.2 The Assessing Officer had already allowed the deduction under section 80IA in the regular assessment proceedings and hence, deduction cannot be disallowed in 153A proceedings, unless the disallowance is based on any material found during the course of the search. Even if the deduction was erroneously granted by the Assessing Officer

in the order under section 143(3) of the Act, proceedings cannot be initiated under section 153A of the Act.

5.2.3 The assessee has correctly claimed deduction under section 80IA(4) of the Act as the assessee has developed an infrastructure facility and fulfilled all the conditions as prescribed in clause (4) of section 80IA of the Act.

5.2.4 The Explanation to section 80IA as inserted by the Finance Act, 2007 w.r.e.f. 1st April 2000 is not applicable to the assessee as, firstly, the assessee is a developer and not a works contractor and secondly, the Explanation disallows deduction only in the hands of sub-contractors.

5.3 The Assessing Officer vide an order dated 25th September, 2008 under section 143(3) r.w.s 153A of the Act, disallowed the claim of deduction under section 80IA (4) of the Act for the following reason:

5.3.1 Section 153A provides that the Assessing Officer shall issue notice to the assessee for filing return of income for six assessment years immediately preceding the assessment year relevant to the previous year in which the search is conducted. Therefore, once the search is validly conducted, the Assessing Officer does not have any discretion and is bound to issue notice under section 153A and complete the assessment as per the provision of section 153A of the Act for the six assessment years.

5.3.2 The assessment under section 153A is not required to be based on any material found during the course of the search. Once the assessment is required to be made under section 153A of the Act, then the Assessing Officer can go into all the issues for making the assessment for that year. Therefore, there is no merit in the argument that the

assessment under section 153A ought to be restricted to material found during the course of the search.

5.3.3 The assessee is not a developer and merely a contractor who is executing a works contract, and hence, the assessee is not developing an infrastructure facility. A developer is one who conceives of the idea and not one who merely executes a contract on the basis of the specifications provided by the government. Therefore, the assessee is not entitled to deduction under section 80IA(4) of the Act.

5.3.4 The assessee is also not entitled to deduction as assessee is clearly covered by the Explanation to section 80IA(13) of the Act.

5.4 The assessee filed an appeal before the Commissioner of Income-tax (Appeals) against the order of the Assessing Officer.

6 Commissioner (Appeals) Order:

6.1 The Commissioner (Appeals) vide an order dated 15th January, 2009, rejected the jurisdictional ground of the assessee and confirmed the finding of the Assessing Officer that the provisions of section 153A are applicable even if no material indicating undisclosed income is found during the course of search and that in 153A proceedings need not be restricted to material found during the course of search and additions can be made on issues on which no material was found during the course of the search. However on the merits of the case, the CIT(A) allowed the appeal of the assessee holding that the assessee is a developer and not a contractor. The CIT(A) held that even though the work is to be completed as per the specification given by the Government, the assessee is using its expertise to complete the work. Further, the assessee has to invest his own funds till the time of completion of the work. Therefore, the assessee is a developer who is

carrying on the business of development of an infrastructure facility as contemplated in section 80IA (4) of the Act. The CIT(A) further held that the Explanation to section 80IA inserted by the Finance Act 2007 is also not applicable to the assessee as the explanation is applicable only to sub contractors and that the assessee is not a sub-contractor. Therefore, the assessee is entitled to deduction under section 80IA (4) of the Act.

6.2 The Department filed an appeal to the Income-tax Appellate Tribunal against the order of the CIT(A).

7 Income-tax Appellate Tribunal's ("Tribunal") Order:

7.1 Although the assessee had not filed an appeal or a cross objection to the appeal of the Department, the assessee argued the appeal not only on the merits of the case but on the jurisdictional issue which was decided against the assessee by the CIT(A). The assessee further argued that if the interpretation sought to be placed by the department to section 153A is to be accepted, then the provision of section 153A would be rendered unconstitutional as it would mean that the department can merely initiate a search action on a person and then reopen the assessment of that person for 6 years even though no material indicating undisclosed income has been found at the time of the search. This clearly cannot be the intention of the Legislature. Therefore, the provision of section 153A needs to be interpreted to mean that it would be restricted only to issues for which material is found at the time of search and if no material is found then no proceedings can be initiated under section 153A of the Act.

7.2 In the mean time, by the Finance (No 2) Act, 2009, the Explanation to section 80IA, which was inserted by the Finance Act 2007, was substituted with retrospective effect from 1st April, 2000. The assessee inter alia argued that the substituted

Explanation is not applicable to the assessee as the assessee is a developer and not a works contractor. The assessee further argued that if at all, the explanation ought to be applied prospectively from assessment year 2009-10 onwards and not before that. The Department inter alia argued that the assessee is covered by the Explanation and hence, not entitled to deduction under section 80IA(4) of the Act. The Tribunal allowed the Appeal of the revenue holding as follows:

7.2.1 The Tribunal confirmed the order of the CIT(A) on the issue of the jurisdiction of the Assessing Officer under section 153A to issue the notice and to disallow the deduction even though no material resulting in undisclosed income has been found during the course of the search proceedings.

7.2.2 The Tribunal held that the assessee is not a developer but merely a contractor who is engaged in the construction of the road as per the specification given by the NHAI for a fixed consideration.

7.2.3 The Tribunal further held that the assessee is directly covered by the Explanation to section 80IA inserted by the Finance (No. 2) Act of 2009 and hence not entitled to deduction under section 80IA(4) of the Act. The Tribunal further held that the Explanation would be applicable from A.Y. 2000-01 and not from A.Y. 2009-10.

8 Against the order of the Tribunal, the assessee filed an Appeal in to the High Court at Bombay. The High Court admitted the appeal of the assessee on the following questions -

8.1 Whether on the facts and in the circumstances of the case and in law the Tribunal was right in law in holding that even though no material resulting in undisclosed income was found at the time

of the search, proceedings under section 153A of the Act can be initiated against the assessee?

8.2 Whether on the facts and in the circumstances of the case and in law the Tribunal was right in holding that the additions / disallowance under the 153A proceedings need not be restricted to material found during the course of the search.

8.3 Whether on the facts and in the circumstances of the case and in law the Tribunal was right in holding that the assessee is not a developer and merely a contractor and therefore, not entitled to deduction under section 80IA (4) of the Act?

8.4 Whether on the facts and in the circumstances of the case and in law the Tribunal was right in holding that the assessee is not entitled to deduction under section 80IA (4) as the assessee is covered by the Explanation to section 80IA, which was inserted by the Finance (No. 2) Act, 2009?

8.5 Whether on the facts and in the circumstances of the case and in law, the Tribunal was right in holding that the Explanation to section 80IA inserted by the Finance (No. 2) Act, 2009 would apply from A.Y. 2000-01 and not from A.Y. 2009-10?

9 The Appeal is now fixed for final hearing and disposal by the Hon'ble Bombay High Court.