

Notes for DCJP SC Meeting on 20th June, 2015

Hierarchy of laws

Purpose of this discussion

- CA's, by training, focus on the figures and procedural law; Computation of tax, filing of returns, assessment, etc.;
- Seldom question the legality of any action initiated/ taken by the AO, on grounds of jurisdictional facts, such as jurisdiction, limitation, basis of satisfaction regarding income escaping assessment, authority of the AO for seeking for information/ documents, mode of service of notice, add back/ disallowance without confronting the assessee, etc.
- Seldom exercise the available rights, such as to seek "the reasons to believe", cross examination of witnesses, demand a copy of the order sheet, etc.
- Advocates question these parameters and exercise their rights, but may not understand the financial statements and the figures
- Purpose of this discussion, to be followed by more in the later meetings, is to initiate CA's into the basics of law, which was never taught during our student days.

Hierarchy of laws

Professionals deal with variety of laws and official administrative pronouncements, such as:

- **Substantive Laws**
 - Constitution of India
 - Acts of the Parliament and the State Assemblies
- **Law as declared by the Supreme Court (Art. 141 Constitution of India)**
- **Delegated/ Subordinate legislations**
 - Rules
 - Exemption & Abatement Notifications (Indirect Taxes)
 - Notifications prescribing procedures for certain actions, such as seeking refund of tax, etc.
 - Other Notifications: Notifying Rules, Date of commencement of operation of a statute/ amendment, rescinding/ amending Notifications issued earlier, etc.
 - Circulars
 - Instructions
 - Trade Notices (Indirect Taxes)
 - Policies (EXIM Policy, Industrial Policy)
 - Schemes (Sales Tax Deferral Scheme)
 - Advance Ruling/ Determination Order
- **Other sources relating to interpretation of law**
 - Education Guide (ST June, 2012)
 - FAQ's
 - Tax Payer Education Series Booklets

Constitution

- Mother of all Indian Laws
- Indian Constitution modeled on quite a few constitutions such as USA, Ireland, Canada, Australia, etc.
- Constituent Assembly set up in 1946.
- Drafting Committee, of 7 members, chaired by Dr. B R Ambedkar
- Constitution signed by the President of the Constituent Assembly on 26th Nov., 1949 and was adopted on 26th Jan., 1950

- Has more than 450 Articles (Originally 395 Articles), 12 Schedules, 122 amendments in 65 years; GST Bill is the 122nd Amendment.
- Fundamental Rights, Directive Principles of State Policy, Fundamental Duties
- Fundamental Rights justiciable, Directive Principles of State Policy are not
- Fundamental Rights: Art. 14 to 32
- Directive Principles of State Policy: Art. 36 to 51
- Fundamental Duties: Art. 51A

Separation of Powers in the Constitution

- **Legislature** (President, Lok Sabha, Rajya Sabha) (Governor, State Legislative Assembly, State Legislative Council) -- Enact laws
- **Executive** -- Council of Ministers, Government Departments and all organs/ limbs of the Govt. – Implement the laws, Govern
- **Judiciary** – Interpret the laws (Original jurisdiction, Appellate jurisdiction and Advisory Jurisdiction)
- Article 246 r/w Seventh Schedule: Powers of legislation of the Union and the States
 - **List I/ Union List:** Exclusive powers of the Union (Parliament)
 - **List II/ States List:** Exclusive powers of the State Legislatures
 - **List III/ Concurrent List:** Both the Union and the States can make laws
- **Art. 265. Taxes not to be imposed save by authority of law** No tax shall be levied or collected except by authority of law; Hence, any tax levied by the Union or any State has to be within the powers granted in the respective List of the 7th Schedule
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- **Union List:** Income Tax (Entry # 82), Corporation (Income) Tax (#85), Customs Duties including Export Duties (#83), Central Excise (#84), Wealth Tax (#86), Estate Duty (#87), Stamp Duty on Bill of Exchange, Shares, etc. (#90), CST (#92A), Consignment Tax (#92B), Service Tax (#92C, not yet made effective, hence ST being levied under the residuary entry # 97), Residuary Entry (#97)
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- **States List:** Sales Tax/ VAT (Entry #54), Excise Duty on alcoholic liquor for human consumption and Opium (#51), Land Revenue (#45), Tax on Agricultural Income (#46), Profession Tax (#60), , Entertainment Tax (#62), Stamp Duty, other than those contained in the Union List (# 63), etc.
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- All laws made by the Parliament, State & UT Legislatures are subject to the Constitution.
- All delegated/ subordinate legislations also subject to the Constitution.
- Rules & Regulations, Schemes framed by any agency of the Government, including local bodies (MCD, NDMC), corporations created under an enactment of the P/ SL (such as Central & State PSU's), arms of the Executive, such as Boards (Railway Board, CBDT, CBEC, DDA, DJB, etc.), autonomous Govt. funded such as UGC, etc., and Administrative actions by the Govt., also subject to the Constitution
- Vires? Power; Intra Vires: Within powers; Ultra Vires: Beyond the powers
- Vires of any law can be challenged on the grounds of it being in contravention of any of the Articles of the Constitution, including the FR's
- Challenge to Constitutional validity only before the HC's and SC
- Tribunals being creatures of a Statute, cannot adjudicate on the vires of a Statute
- Vires of any delegated legislation can be challenged as being contrary to the enabling Act
- Enactments can also be ultra vires other enactments; Non Obstante clause;

- SEZ Act, 2005 Sec. 7 exempts all goods & services procured by a SEZ Developer and units in a SEZ from all the Union taxes such as Customs, Excise, Service Tax, CST, etc.
- SEZ Act, 2005 Sec. 51. (1) The provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act.

Type and purpose of enactments

- Enactments of the Parliament/ State Legislatures: Substantive law
- Delegated/ Subordinate Legislations: Procedural law, Machinery provisions; Includes Notifications, Rules, Schemes, Circulars, Instructions, Trade Notices, etc.
- Substantive law prevails over procedural law
- Delegated/ Subordinate Legislations cannot travel beyond the enabling (parent) Act
- Inconsistency between enabling enactment & delegated/ subordinate legislation: Enabling Act shall prevail
- Delegated legislation can be declared ultra vires the enabling Act, or read down to avoid its being declared ultra vires
- Substantive law may be rendered inoperative, in the absence of procedural law.
 - Capital gains on transfer of goodwill cannot be subjected to tax, as computation mechanism is absent. B C Srinivasa Shetty 128 ITR 294 (SC)
 - No tax on capital gains in slump sale PNB Finance Ltd. 175 Taxman 242 (SC)
 - CST Act, 1956 Sec. 2(h) "Sale Price" in the case of transfer of property in goods involved in the execution of a WC, to be determined in the prescribed manner. No method prescribed as yet. Held, State Rules prescribing the method would apply, per Sec. 9(2). Mahim Patram (SC)
 - Anonymous donations u/s 115BBC ITA, 1961: Recipient of contribution to maintain record indicating name, address and such other particulars as may be prescribed. No such particular s prescribed till date. Held, Name and address sufficient. (ITAT Lucknow 2015)

Court made law

Art. 141. Law declared by Supreme Court to be binding on all courts — The law declared by the Supreme Court shall be binding on all courts within the territory of India.

- "Marketability" as an essential ingredient for levy of excise propounded by the SC in DCM (1) ELT (J 177) (SC 5 Mem. Cont. Bench), not found in Sec. 3 of the CEA, 1944
- Determination of taxable turnover in Works Contracts; Gannon Dunkerley (1993) 88 STC 204 (SC)
- Parliament/ State Legislatures often legislate on the basis of judgments of the Supreme Court; Determination of taxable turnover in Works Contracts, as prescribed in Gannon Dunkerley 1993) 88 STC (SC)

Rules

- Rules are framed by the Executive (Ministry of Finance/ CBDT/ CBEC) vide powers granted in the Statute. Power could be to make Rules for carrying out the purposes of the Act, and/ or in respect of specific matters. Usually, Rules are to be laid before the Parliament for 30 days.
 - Sec. 295 ITA, 1961; Rules to made by CBDT, subject to the control of the Central Govt.

- Sec. 94 FA, 1994: Central Govt. empowered to make Rules.
- Sec. 37 CEA, 1944: Central Govt. empowered to make Rules.
- Sec. 156 CA, 1962: Central Govt. empowered to make Rules.
- Rules are issued by way of Notifications in the Official Gazette
- Rules are made for procedural matters such as payment of taxes, filing of returns, various forms, appeals, recovery of tax, etc.
- Rules could also be for valuation, computation, alternate tax schemes such as composition, etc.
- Direct Taxes have relatively lesser no. of Rules;
 - Income Tax: ITR, 1962; Certificate Proceedings, 1962; ITAT Rules, 1963; Settlement Commission Rules, 1997; BCTT Rules, 2005; AAR (Procedure) Rules, 1996; etc.
- Indirect Taxes tend to have quite a few Rules;
 - Service Tax: STR, 1994, POTR, 2011, ST (Valuation Rules, 2006; PPSR, 2012; Regn. of Spl. Category of Persons, 2005; CENVAT Credit Rules, 2004; etc.
- Rules cannot be inconsistent with or repugnant to the enabling Act;
- Rules cannot travel beyond the scope of the enabling provision of the enactment.
- Rules cannot impose a restriction, condition, rigor not sanctioned by the enabling Act
- Rules could be mandatory or directory; Courts interpret Rules with a certain degree of leniency
 - IT Form 10 for accumulation of income u/s 11(2) ITA, 1961, to be filed on/ before the due date for filing the ITR; Form 10 filed after filing the ITR, before the completion of assessment; Nagpur Hotel Owners Association (2001) 247 ITR 201 (SC)
- Rules to be interpreted in a manner conducive to the achievement of the purposes of the enactment.

Case study 1: Rule struck down

- **Valuation of taxable services**
 - Sec. 67 of the FA, 1994 that provides for the valuation of taxable services, reads as under:
 - For the purposes of this Chapter, the value of any taxable service shall be the gross amount charged by the service provider for such provided or to be provided by him.
 - Rule 5(1) ST (Valuation) Rules, 2006 reads as under:
 - **RULE 5 Inclusion in or exclusion from value of certain expenditure or costs**
 - (1) Where any expenditure or costs are incurred by the service provider in the course of providing taxable service, all such expenditure or costs shall be treated as consideration for the taxable service provided or to be provided and shall be included in the value for the purpose of charging service tax on the said service.
 - Rule 5(1) struck down by the Delhi HC in **Intercontinental Consultants [2012] 28 taxmann.com 213 (Delhi)** – Travels beyond the scope of Sec. 67

Case study 2: Rule read down

- **Haryana VAT on Builders & Developers**
 - SC in K. Raheja Developers (2005) 5 SCC 162 (SC 2 Mem.) reviewed by a large bench and upheld as correct in L & T (2013) 46 PHT 269 (SC-LB)
 - Rule 25(2) Haryana VAT Rules, 2003 prescribed method of computation of taxable turnover in case of a contractor, following the method prescribed by the SC in Gannon Dunkerley Vs. State of Rajasthan (1993)
 - Method of computation in Rule 25(2) did not provide for deducting the value of land from the consideration for sale of flat.

- Haryana Govt. issued a series of circulars, in 2013 and 2014, directing completion of assessments of builders/ developers.
- Circular dt. 10-02-2014 explicitly stated that a builder/ developer opting for Composition Scheme u/s 9 r/w Rule 49 and paying VAT @ 4% would not be entitled to any deduction from the gross contract consideration, including the value of land.
- Rule 25(2) and the Circulars were challenged in a bunch of Writs before the P & H High Court, challenging levy of tax on the value of land, and the value of goods used in the construction before entering into the agreement to sell (the flat)
- P&H HC read down Rule 25(2), to bring it conformity with the SC ruling in L & T (supra)

Circulars/ TRU Letters issued post Finance Bill and Finance Act/ Instructions

- Issued by CBDT/ CBEC/ Finance Ministry, etc.
- Contemporanea Expositio: That the meaning of words in a document are to be understood in the sense which they bore at the time of the document.
- Though the law was made by the Parliament/ State Legislature, it is Executive, which drafted the Act/ Rules. Hence, the Executive is supposedly an authority on the intent behind the law. Hence, the relevance of Circulars.
- Enabling Act provides for issue of Circulars
 - Sec. 119 ITA, 1961 (Authority to CBDT to issue instructions, etc.)
 - Sec. 37B CEA, 1944 (Authority to CBEC to issue instructions, etc.)
- Circulars could be used to reduce the rigor of the law
- Circulars are binding only on the Revenue
- Revenue cannot chose not to follow the circulars
- Benevolent circulars are binding on the Revenue even if they deviate from the legal position
- Circulars not binding on assessee's, quasi judicial authorities (Appellate Officers), Tribunals or Courts
- Policy matters, by way of Instructions, binding on Revenue: Appeals not to be filed if disputed taxes below certain threshold
- Circulars ultra vires the enabling Act?
 - Sec. 9(1) DVAT Act 2004 regarding availment of ITC in proportion o goods sold, kept in abeyance by Commissioner (VAT) by issue of circulars? Sec. 70 empowers the Commissioner to issue notifications regarding forms, other matters.