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## Direct Tax Newsletter

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- Net Direct Tax Collections Exceed 9.57 Lakh Crore, Marking a 21.82% Increase Compared to the Previous Year | CBDT
- Form 60 Can't be Submitted by a Co. or Firm that is Involved in a Transaction Specified Under Rule 114B | CBDT

### 1. Excess Stock Can't be Treated as Undisclosed Income if Assessee Identified Diff. Much Prior to Commencement of Search

In the instant case<sup>1</sup>, a search was conducted on the premises of the assessee's group companies. Assessing Officer (AO), while completing the assessment for the relevant assessment year, issued a show cause notice to the assessee, calling upon it to explain the under-valuation of physical stock.

In response, the assessee stated that the excess stock of leather found during the physical verification of inventory from January to February 2014 had been properly accounted for in the books for the financial year 2014-15, and the same had also been disclosed.

Rejecting the explanation offered, AO treated under-valued stock as undisclosed income.

On appeal, the CIT(A) deleted the additions made by AO. Aggrieved-AO filed an appeal to Calcutta High Court.

The High Court held that no material had been brought on record by the AO to show that during the search, the authorized officer had conducted a physical inspection of the stock, because of which excess quantities of raw leather were detected. Consequently, additions were made towards undisclosed stock.

It was found that well before the search, the assessee had internally conducted a stock-taking exercise and detected the discrepancy in stock, and the same was reported. Before the commencement of the search, the managing director had instructed the respective unit heads to reconcile the stocks and

records and incorporate differences in the books for the said financial year.

Further, the assessee is a corporate body that is required to maintain and prepare its accounts in conformity with the provisions of the Companies Act. The accounts must be audited, and the auditor must furnish his report in the manner prescribed. After taking note of the auditor's report as well as the stock inspection report, it was found that such an inspection report was prepared at the instance of the assessee as a matter of internal control, and the same was drawn up much before the date of search.

Therefore, the difference in stocks had been identified by the internal team of the assessee itself much prior to the commencement of the search. Accordingly, the action taken by AO wasn't correct.

### 2. CIT(E) Can't Reject Trust Application Merely Due to Inadvertent Error of Mismatch in Name as Appearing on PAN

In the instant case<sup>2</sup>, the assessee applied for registration under section 12AB in Form No. 10AB in accordance with rule 17A. The assessee furnished the necessary details when applying electronically, including a copy of the original registration, trust deed, PAN and the activities with the audited financial statements for the last two financial years.

On perusal of details of the assessee in different documents, the Commissioner (Exemption) found that the assessee's name differed from the name mentioned in the certificate of registration and financial statements.

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<sup>1</sup> **PCIT vs. Industrial Safety Products (P.) Ltd. - [2023] (High Court of Calcutta)**

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<sup>2</sup> **Shri Balkrishna Shudhhdwait Sthanik Mahasabha vs. CIT (Exemptions) - [2023] (Surat-Trib.)**

The Commissioner (Exemption) believed that the assessee had not furnished the required details and decided to dispose of the application based on material available on record. The matter reached the Surat Tribunal.

The Tribunal held that the basic ground of rejection of the application under section 12AB was a mismatch in the name of the assessee vis-à-vis name shown in PAN. Such mistake may be unintentional as the registration number, PAN, and the assessee's object are not in dispute.

The application of the assessee was rejected in a mechanical way. Assessee had duly filed copy of the PAN, registration certificate granted under the provisions of the Bombay Public Trust Act . The audited financial statement also mentioned the registration number and the name of the assessee trust and PAN. The trust deed also clearly mentioned the name of the assessee-trust.

The assessee was not given an opportunity either to explain the mismatch or to get such a mismatch corrected. Thus, the assessee deserved one more opportunity to correct its name wherever required. Accordingly, the issue was restored to reconsider the registration of the assessee under section 12AB afresh and pass the order in accordance with the law.

### **3. Mutuality Doesn't Exempt Interest Income of Clubs Even If Banks are Corporate Members**

In the instant case<sup>3</sup>, the assessee-club was a mutual association of persons existing solely for the benefit of its members. The main object of the club was to promote social activities, including sports and recreation, amongst its members and various services can be availed by its members.

The surplus income generated by the club consists of payments made by the members deposited in as fixed deposits, post office deposits, national savings certificates etc.

The issue before the Supreme Court was:

*“Whether the deposit of surplus funds by Clubs by way of bank deposits in various banks wouldn't be subject to tax in the hands of the Clubs considering the principle of mutuality?”*

The Supreme Court held that the principle of mutuality is rooted in common sense. This implies that a person cannot earn profit from an association that he shares a common identity with. The essence of the principle lies in the commonality of the contributors and the participants who are also beneficiaries. There has to be a complete identity between the contributors and the participants. Therefore, it follows that any surplus in the common fund shall not constitute income but will only be an increase in the common fund meant to meet sudden eventualities.

The principle of mutuality would not apply to interest income earned on fixed deposits made by the Clubs in the banks, irrespective of whether the banks are corporate members of the club or not.

If there is an entry of a third party or non-member to utilize the funds of the club and return the same

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<sup>3</sup> **Secundrabad Club etc. vs. CIT - [2023] (Supreme Court of India)**

with interest, then the parties' relationship is not on the basis of privity of mutuality. The essential condition of mutuality, i.e., identity between the contributors and participators, would end. The relationship would then be like any other commercial relationship, such as that between a customer and a bank where the customer makes a fixed deposit to earn an interest income.

If the principle of mutuality is to apply, where many people who contribute to a fund are ultimately paid the surplus from the fund. In that case, it is a mere repayment of the contributors' own money. However, if the very same surplus fund is not applied for the common purpose of the club or towards the benefit of the members of the club directly but is invested with a third party who has the right to utilize the said funds, subject to payment of interest on it and repayment of the principal when desired by the club, then, in such an event, the club loses its control over the said funds.

When surplus funds of a club are invested as fixed deposits in a bank, and the bank has a right to utilize the said fixed deposit amounts for its banking business subject to repayment of the principal along with interest, the identity is lost.

Thus, the interest income earned on fixed deposits made in the banks by the Clubs has to be treated like any other income from other sources.

#### **4. AO Can't Reference Only One of Two Available Guideline Values for the Value Property**

In the instant case<sup>4</sup>, the Assessing Officer (AO) reopened the assessment of the assessee under section 147 on the ground that he had not disclosed the value of the property and passed the assessment order under section 144B(1) in a faceless manner.

Assessee filed writ petition before the Madras High Court contending that the assessment had taken only the guideline of the Gandhi Nagar alone. In contrast, there were two guideline values available to value property. Thus, directions should be issued to AO to redo the assessment.

The Madras High Court held that AO had taken a wrong valuation for the property. In the assessment order, there was no discussion of the two guideline values (one for Canal Street and another for Gandhi Nagar). The assessment has taken only the guideline value of Gandhi Nagar alone. Therefore, the assessee should be granted one more opportunity.

Accordingly, the impugned assessment order was quashed, and the AO was directed to grant the personal hearing. At his liberty, the assessee can produce records, especially the guideline value provided by the concerned authorities. AO was directed to pass the assessment order on merits by taking appropriate facts.

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<sup>4</sup> **R. Rajasekaran v. ACIT - [2023] (High Court of Madras)**