NOTES

Landmark Judgments on Tax Law - Part 2

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Studying landmark judgments on tax law is essential for mastering the core constitutional and statutory frameworks tested in the CLAT PG exam. These judicial precedents clarify the boundaries of legislative competence, resolve ambiguities in fiscal statutes, and establish the evolving legal principles governing both direct and indirect taxation in India.

CLICK HERE TO READ PART 1 ON TAX LAW.

1. GVK Industries Ltd. v. Income Tax Officer, (2011) 4 SCC 36

Facts

GVK Industries Limited, an Indian company, entered into an agreement with ABB Zurich, a Swiss company, for consultancy and technical services connected with setting up a power project in India.

Before remitting payment to ABB Zurich, ***GVK approached the Income Tax Officer seeking a "No Objection Certificate" under Section 195***, arguing that ABB had no business connection in India and had rendered no technical services within India, so neither ***Section 9(1)(i) nor Section 9(1)(vii)(b) of the Income Tax Act applied.***

The Income Tax Officer rejected this application, and after conflicting decisions at the Commissioner and High Court levels, the matter reached the Supreme Court.

Issue

Beyond the specific question of whether the payment attracted tax under Section 9, the case raised a larger constitutional question before a five-judge Constitution Bench:

- Whether *Parliament possesses the power under Article 245 to enact legislation concerning extraterritorial aspects or causes that bear no connection to India*

- Whether such legislation could validly operate if ***it had no real nexus with India's territory or the welfare of its inhabitants.***

Judgment

The Constitution Bench held that **Parliament's power under Article 245 does not extend to enacting laws concerning extraterritorial aspects or causes that have no direct or indirect, tangible or intangible, impact on India or the interests and welfare of its inhabitants.**

The Court clarified that any nexus relied upon to justify such legislation must be real and not illusory, and that legislation lacking this essential connection would exceed Parliament's constitutional authority and risk violating principles of territorial sovereignty recognised in international law.

The Court, however, left the specific question of whether *Section 9(1)(vii) itself satisfied this nexus requirement open, remanding that particular determination*. This ruling remains the leading authority on the territorial nexus doctrine as applied to Parliamentary tax legislation.

2. Commissioner of Customs (Import) v. Dilip Kumar and Company, (2018) 9 SCC 1

Facts

The respondents imported a consignment of Vitamin E-50 powder, feed grade, and claimed the benefit of a customs exemption notification.

The Assistant Commissioner of Customs denied the exemption, but the Commissioner of Customs (Appeals) reversed this decision, relying on the ***Supreme Court's earlier ruling in Sun Export Corporation v. Collector of Customs****, which had held that an ambiguous exemption notification should be construed liberally in favour of the assessee.*

The CESTAT affirmed this view, and the matter eventually reached the Supreme Court, where a Division Bench doubted the correctness of Sun Export's liberal approach and referred the question to a Constitution Bench.

Issue

The five-judge Constitution Bench *had to resolve the conflict between Sun Export Corporation, which favoured liberal interpretation of exemption notifications benefiting the assessee*, and later decisions that favoured strict interpretation, determining which approach should govern where genuine ambiguity exists in an exemption provision.

Judgment

The Constitution Bench **overruled Sun Export Corporation, holding that taxing statutes, including exemption notifications, must be interpreted strictly, and that the burden of proving eligibility for an exemption rests entirely on the assessee claiming its benefit.**

The Court clarified that where genuine ambiguity exists in an exemption notification after exhausting all interpretative tools, that *ambiguity must be resolved in favour of the Revenue rather than the assessee, reversing the presumption Sun Export had established*.

The Court distinguished this principle from the interpretation of a charging provision, where any ambiguity continues to benefit the assessee, since a charging provision and an exemption provision serve fundamentally different purposes within a taxing statute.

3. Engineering Analysis Centre of Excellence Pvt. Ltd. v. CIT, (2022) 3 SCC 321

Facts

Engineering Analysis Centre of Excellence, along with several similarly placed Indian end-users and distributors, imported shrink-wrapped or off-the-shelf computer software directly from foreign suppliers, including from the United States, without deducting tax at source on the payments made.

The Revenue argued that these ***payments constituted "royalty" under Section 9(1)(vi) of the Income Tax Act***, and separately under the royalty definition in the applicable Double Taxation Avoidance Agreements, thereby triggering a TDS obligation under **Section 195 that the assessees had failed to discharge.**

Issue

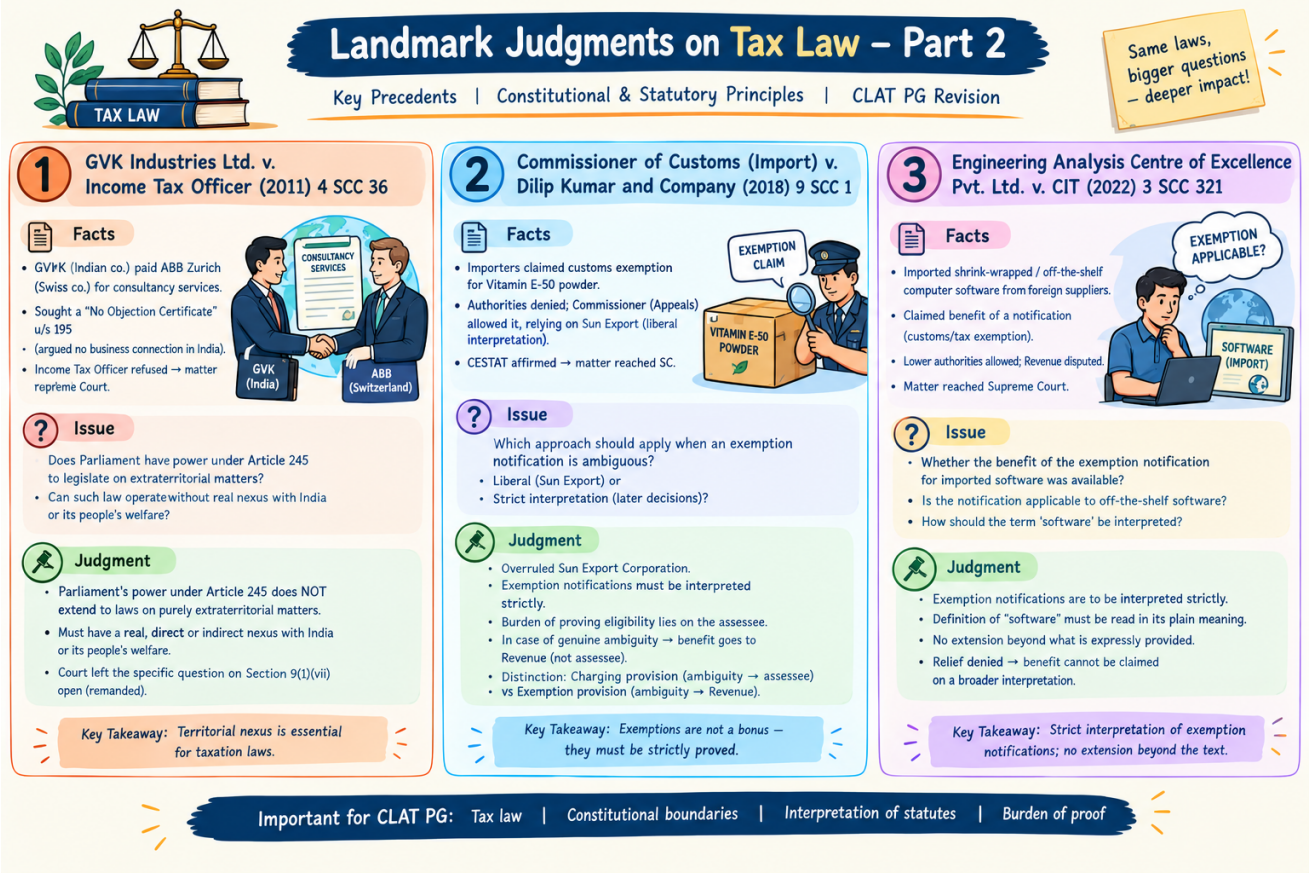
Whether payments made by Indian resident end-users or distributors to foreign software suppliers, for the resale or use of computer software through End-User Licence Agreements or distribution agreements, constituted "royalty" for the use of copyright in the software, thereby attracting tax liability and a TDS obligation in India.

Judgment

The Supreme Court held that such ***payments did not constitute royalty***, since the EULAs and distribution agreements in question granted only a licence to use the copyrighted software product itself, without transferring any part of the underlying copyright, such as the right to reproduce, adapt, or commercially exploit the software's source code.

The Court held that **where the provisions of the applicable DTAA are more beneficial to the assessee than the domestic law definition of royalty under Section 9(1)(vi), the treaty provisions must prevail,** and since the DTAAs here defined royalty narrowly to require an actual transfer of copyright, mere sale of a copyrighted article fell outside that definition.

Consequently, the Court held there existed no obligation to deduct tax at source on these payments, resolving years of conflicting interpretations across different High Courts on the taxability of cross-border software payments.



4. *CIT v. Walfort Share and Stock Brokers Pvt. Ltd., (2010) 326 ITR 1 (SC)*

Facts

Walfort Share and Stock Brokers purchased units of a mutual fund shortly before the fund declared a dividend, received the dividend, *which was exempt from tax under Section 10(33) of the Income Tax Act*, and then sold the units shortly afterward at a reduced price reflecting the payout, thereby incurring a loss.

The assessee claimed this loss as a deduction against its other taxable income, while **continuing to treat the dividend itself as tax-exempt, a practice commonly known as "dividend stripping."**

The Revenue disallowed the claimed loss, treating the entire transaction as a device designed to artificially generate a tax-deductible loss while sheltering genuinely exempt dividend income.

Issue

- Whether the loss arising from the sale of mutual fund units, following receipt of tax-exempt dividend income, could be legitimately claimed as a deductible loss, or
- Whether such a transaction amounted to an impermissible tax avoidance device that the Revenue could disregard despite the apparent legality of each individual step.

Judgment

The **Supreme Court dismissed the Revenue's appeals and ruled in favor of the assessee**. The Court held that the loss arising from the dividend stripping transaction prior to April 1, 2002, **was fully deductible and could be set off** against other taxable income.

- **Section 14A Limitation:** The difference between the purchase and sale price of units is a capital/business loss, not an "expenditure incurred" to earn exempt income, meaning Section 14A could not be invoked to disallow it.
- **Prospective Application of Section 94(7):** Parliament introduced Section 94(7) specifically to plug this loophole from April 1, 2002. Before this specific anti-avoidance provision was enacted, courts could not judicially rewrite the statute to disallow genuine economic losses, even if the primary motive was tax planning.
- **Tax Planning vs. Sham:** Because an actual sale and purchase of units took place at prevailing NAV prices, the transaction could not be branded as a "sham" or a colorable device under the *McDowell* doctrine.

5. *Mathuram Agrawal v. State of Madhya Pradesh, (1999) 8 SCC 667*

Facts

The Madhya Pradesh Municipalities Act empowered municipal authorities to levy a property tax, but the specific provision under which the tax was imposed on the appellant's property *did not clearly specify the basis or criteria for determining the annual letting value used to compute the tax.*

The appellant challenged the levy, arguing that the absence of clear statutory criteria for determining the taxable value rendered the imposition invalid, regardless of whether the municipality had followed some internally consistent valuation practice.

Issue

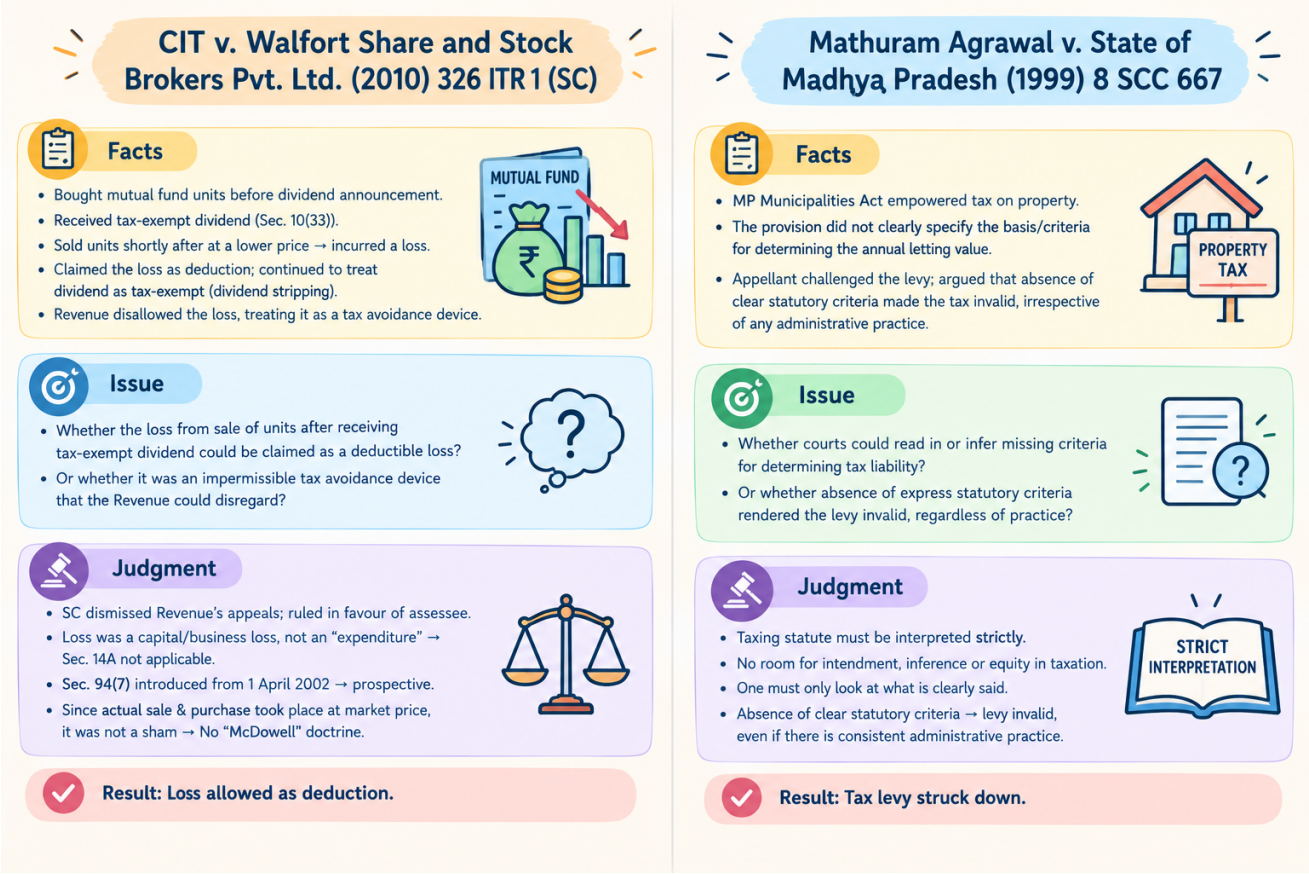
- Whether courts could read in or infer missing criteria for determining tax liability where the statute itself remained silent or unclear, or
- Whether the absence of express statutory criteria rendered the levy itself invalid regardless of administrative practice.

Judgment

The Supreme Court held that a **taxing statute must be interpreted strictly, and that there exists no room for intendment or inference while construing such statutes, since a taxpayer cannot be taxed unless the statutory language unambiguously brings the taxpayer's case within its terms.**

The Court articulated the now-frequently cited principle that in a taxing statute, one must **simply look at what is clearly said, since there is no room for any intendment, no equity about a tax, and nothing is to be read in or implied, but one must only look fairly at the language actually used.**

Applying this principle, the Court held that the absence of clear statutory criteria for determining the basis of the levy rendered the tax imposition itself invalid, reinforcing that administrative practice or convenience *cannot substitute for the legislative clarity a taxing statute demands.*



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