Price ₹ 300/- per copy

No. MCS/149/2016-18 / R.N.I. No. MAHENG/2012/47041 - Total Pages: 240

HEAVEN BE OUR GUIDE
Estd. 1926
91st Year
ज्ञानं परमं बलम्

A Monthly Journal of
The Chamber of Tax Consultants

THE CHAMBER'S JOURNAL

Vol. VI | No. 8 May 2018

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

Penalties & Prosecution
Part II

Other Contents

- Direct Taxes
- Other Laws
- Best of the Rest
- Indirect Taxes
- International Taxation
- Corporate Laws
- The Chamber News

Innovate Excel & Lead

Log on to The Chamber's revamped website
www.ctconline.org
Online payment for programmes can be done through website

International Study Tour to Mauritius from 28th April, 2018 to 2nd May, 2018

Group Photo of delegates

The delegates visited Indian High Commission Office at Mauritius

Group Photo of delegates

Delegates with Mr. Dennis Seksum, Chairman and Mr. Patrice Tze, Executive Director, First Island Trust Company, Mauritius

CONTENTS

Vol. VI No. 8 | May – 2018

SPECIAL STORY : PENALTIES AND PROSECUTION : PART II

TECHnovation

DIRECT TAXES

INTERNATIONAL TAXATION

INDIRECT TAXES

CORPORATE LAWS

OTHER LAWS

ACCOUNTING AND AUDITING

THE CHAMBER OF TAX CONSULTANTS
3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai – 400 020
Phone : 2200 1787 / 2209 0423 / 2200 2455
E-Mail: office@ctconline.org • Website : http://www.ctconline.org.

The Chamber's Journal

DISCLAIMER

Opinions, views, statements, results, replies, etc., published in the Journal are of the respective authors/contributors. Neither The Chamber of Tax Consultants nor the authors/contributors are responsible in any way whatsoever for any personal or professional liability arising out of the same.

Non-receipt of the Review must be notified within one month from the date of publication, which is 12th of every month.

***READER'S SUGGESTIONS AND VIEWS**: We invite the suggestions and views from readers for improvement of The Chamber's Journal. Kindly send your suggestions on office@ctconline.org.*

MEMBERSHIP FEES & JOURNAL SUBSCRIPTION FOR THE F.Y. 2017-18 (w.e.f. 1-7-2017)

Sr. No.	Membership Type		Fees	GST 18%	Total
1.	Life Membership (W.e.f. 1-7-2017)	₹	12000	2160	14160
2.	Journal Subscription (Life Members)	₹	1200	0	1200
					₹ 15360
3.	Admission Fees – Ordinary Members	₹	500	90	590
4.	Ordinary Membership Fees	₹	2200	396	2596
					₹ 3186
5.	Admission Fees – Associate Members	₹	1000	180	1180
6.	Associate Membership Fees	₹	5000	900	5900
					₹ 7080
7.	Journal Subscription (Non Members)	₹	2100	0	₹ 2100
8.	Student Membership Fees	₹	700	45	₹ 295
9.	Journal Subscription	₹	700	0	₹ 700

Editorial

We all are living in strange times. The judiciary in India is not under a threat, democracy is not under a threat, but the institutions are not growing and maturing in an organic manner. Ideological dispensation which ruled this country for long had put its shades on all institutions. Shift in the ideological base in governance is causing withdrawal symptoms at all levels. Happenings in the Parliament and in the Apex Court is only a reflection of the changes which are taking place in the socio-political arena of our country. In the international arena, a leader of the mono-polar world shirks its responsibility citing its national interest. Here, I am reminded of a piece written by great Jurist Nani A Palkhivala on 24th June, 1993 in the Times of India *"This year, when the world is celebrating the 2500th anniversary of the birth of democracy, the greatest crisis facing the free world is that there is no real leadership. Men, smaller than life, are strutting and fretting their hour upon the stage in the democratic States of the East and the West. It is difficult to recall a time when so many heads of Government had so little public support and commanded so little public respect. Instead of real leadership, we have just "holes in the air", to use the expressive phrase of George Orwell."*

The Special Story of the present issue of the Chamber's Journal is in continuation of the April issue. In this issue, eminent professionals have written about new provisions which have replaced earlier provisions to levy penalty for concealment and furnishing inaccurate details of income. In this issue, we are covering the provisions pertaining to prosecution under direct taxes as well as indirect taxes. I hope, this issue will be of help to the members when the department is busy in issuing notices to launch prosecution in number of matters left, right and centre.

I thank all the professionals for taking time out of their invaluable vacation time earned by burning their midnight oil.

K. GOPAL
Editor

From the President

Namaskar,

Dear Members & Readers,

Lot of turbulence is going on in Supreme Court, however there is something good to hear at the Bombay High Court. Hon'ble Justice S. J. Kathawalla has been burning the midnight oil since the last week before High Court vacation to reduce pendency and finish hearing matters before the month-long summer break kicks in from May 5. On Friday, 4th May, breaking all the records, the room was packed till 3.30 am with litigants and advocates. He heard more than 135 matters since morning, 70 of which were urgent matters. The rush of matters for interim relief is usually high before the break. His commitment for work has been lauded by many, his justice-oriented mind and that serving the people has been his priority. Justice Kathawalla, 59, was sworn in as an Additional Judge at the HC in 2009 and became permanent judge in July 2011.

I can say that Judge inspires confidence and that justice can be delivered swiftly.

The Supreme Court is mooting formation of a three-member committee to consider issues concerning Tribunals across the country. The order was passed by a Bench of Hon'ble Justices Shri A. K. Goel and Hon'ble Justice Smt. Indu Malhotra after considering the response filed by the Central Government and the suggestions made by *amicus curiae* Shri Arvind Datar in the case of *Rojer Mathew vs. South Indian Bank Limited (SLP (Civil) No. 15804 of 2017; dt. 7-5-2018)* .

When the Court was initially seized of the matter, it was only considering whether the appointment process and functioning of Debt Recovery Tribunals (DRTs) as provided under the Recovery of Debts and Bankruptcy Act, 1993 are taking place as per its previous decisions. It had then appointed Datar as *amicus curiae* to assist the Court. Pursuant to the same, Datar submitted a concept note to the Court as per which he suggested that there was a need for an independent oversight body for Tribunals.

The Court after noting the suggestions made by the *amicus* set out the following issues for consideration:

- Creation of regular cadres laying down eligibility for recruitment for Tribunals
- Setting up of an autonomous oversight body for recruitment and overseeing the performance and discipline of the members so recruited and other issues relating thereto
- Amending the scheme of direct appeals to this Court so that the orders of Tribunals are subject to jurisdiction of the High Courts

- Making Benches of Tribunals accessible to common man at convenient locations instead of having only one location at Delhi or elsewhere. In the alternative, conferring jurisdiction on existing courts as Special Courts or Tribunals.

The Court then held that the above issues may require setting up of a committee preferably of three members. One of the committee members should be a retired judge of the Supreme Court who may have served in a Tribunal.

It is said that it is not easy to escape the long arm of the law, Judge Andrew Henshaw of the UK High Court has upheld a worldwide freeze order against Vijay Mallya and ruled in favour of 13 Indian State-owned banks to recover funds amounting to nearly 1.145 billion pounds in a judgment. It was held that Vijay Mallya, wanted in India to face charges of fraud and money laundering amounting to around ₹ 9,000 crore, can be regarded as a "fugitive from justice". The ruling by the UK Court has been described as "significant" by TLT LLP, the UK law firm which represented the Indian Banks in the case. This is a positive and big step forward. The judgment enables the Indian Banks to proceed with enforcement of the Indian Debt Recovery Tribunal (DRT) ruling, which has now been registered and is immediately enforceable.

The CTC's International Study Tour to Mauritius, organised ably by the Chairman Shri Rajesh Shah of International Tax Committee was a perfect blend of engrossing technical sessions and enjoyable recreational activities. The tour experience was akin to a well-crafted music concert starting with a great beginning and finishing on a high.

The participant met Mr. Denis Seksum, Chairman and Mr. Patrick Tze, Executive Director of the First Island Trust Company Ltd., who gave the members an overview of the tax system in Mauritius and an insight into the thought process of the Government which was in the process of overhauling the same in the short-to-medium term. The members of the CTC also met Mr. Arun Kutowaroo and Mr. Romesh Ramchurn the Office Bearers of the Mauritius Branch of the International Fiscal Association where topics of mutual interest and areas of mutual co-operation were discussed.

The CTC team also met the officials at the Financial Services Commission (FSC) at their office where Ms. Leena Doman-Brette, Head Licencing and Mr. Deerajen Ramaswamy, Head Financial Stability & Statistics, led two interesting technical discussions on the way forward for the company licencing process and the proposed overhaul thereof and the impact of recent fiscal developments on the Foreign Direct Investment (FDI) into Mauritius and the way forward for Mauritius as an investing jurisdiction.

Another very interesting and informative discussion with the officials of the Indian High Commission in Mauritius where the members engaged in a very interesting technical discussion with Mr. Abhay Thakur, the Indian High Commissioner, Mr. K. D. Dewal, the Deputy High Commissioner and the Indian High Commission's team on the cultural connect between India and Mauritius and the investments by India into Mauritius.

The Special Story for the month is on "Penalty & Prosecution – Part- II". I thank all the authors for sparing their valuable time and their contribution to the Chamber's Journal for this month.

AJAY R. SINGH
President

Chairman's Communication

Dear Readers,

While there was a positive outlook for the economic turnaround in the last quarter of the F. Y. 2017-18, despite disruption caused by GST and a perceived cash crunch, and a forecast of GDP growth at 7.5 was considered achievable, a different kind of disruption has slowly set in, in terms of

- Stagnation/negative growth of exports
- Rising fuel prices
- Discouraging results of banking industry and deterioration of Asset quality
- Widening trade deficit
- Risk of inflation

However, crossing collection of GST over ₹ one lakh crore in March 2018 was a positive indicator, promising stabilisation of GST regime in course of time. Quick decisions of GST Council to reduce compliance work, would also speed up the process of normalisation of GST regime.

The Banking Industry continues to pass through difficult phase due to problem of mounting NPAs resulting in many banks declaring loss for March, 2018 . Bankruptcy Code seems to be the long-term solution to this problem. However on the Bankruptcy Code implementation, number of issues have been thrown through various cases dealt with by the appropriate authorities calling for clarity and revisiting some of the provisions of the Code and the concepts.

This issue is in continuation of the April issue on Penalty and Prosecution. We have made an attempt to cover all the important aspects on the subject which I am sure the members would find useful. My sincere appreciation for painstaking efforts of my colleagues Rahul Hakani and Naresh Sheth in structuring the design as well in overall co-ordination.

My gratitude to all the learned authors for sparing their valuable time despite their busy schedule and sharing their knowledge on the subject of Penalty and Prosecution.

VIPUL K. CHOKSI
Chairman – Journal Committee

Keshav Bhujle, *Advocate*

Are Penalty and Prosecution Aides of Compliance?

1. Introduction

No law will be respected or obeyed unless sanction accompanies such law. Tax law is not an exception to this rule. For the effective and satisfactory implementation of a fiscal legislature it is necessary to provide for the consequences of non-compliance of the law. Compliance with the tax laws is enforced by providing three fold liability for non performance of the obligations imposed on an assessee, viz. (i) interest, (ii) penalty and (iii) prosecution. To compensate the loss that the State may suffer on account of the non-compliance by the assessee the fiscal legislature provides for levy of interest which is mainly relating to payment of taxes. It is purely compensatory in nature and is normally mandatory. As against that, penalty is imposed with a view to deter the assessee by threat of punishment compelling him to pay substantial Amount by way of penalty for non-compliance of tax laws. The object of imposing penalty is to make the assessee aware that the non observance of tax laws will lead to serious pecuniary liability. The prosecution provisions are deterrent not only to the assessee himself but also to all the other assessees. Chapter XXI of the Income-tax Act, 1961, deals with penalties imposable for defaults or non compliance of obligations under the said Act. Chapter XXII of the Income-tax Act, 1961, deals with prosecution for offences.

2. Penalty Proceedings

2.1 Penalty proceedings are quasi criminal in nature and accordingly are concerned with the criminal jurisprudence. However, the penalty proceedings are not criminal proceedings in the strict sense of the term. Those are quasi criminal in nature and like the civil proceedings and are based on the principle of preponderance of probabilities. The provisions for presumption, further take them away from criminal jurisprudence. Penalty proceedings are Departmental proceedings and the authority procedure for penalty proceedings is to be found in the Income-tax Act, itself. The Departmental authorities have the power to impose penalty. The Act also provides for remedy by way of appeals etc., against the penalty order.

2.2 Penal provisions are discretionary and not mandatory: Mere technical default is not liable to be punished – *Hindustan Steel Ltd. vs. State of Orissa 83 ITR 26 (SC).* The word concealed in Section 271(1)(c) and the provisions of Section 273B in respect of defaults in other provisions clarify the intention of the legislature in this respect. The judgment of the Supreme Court in

CIT vs. Smt. P. K. Noorjahan 237 ITR 570 (SC), though dealing with Section 69, would support this principle. Even the new provision, Section 270A substituted for Section 271(1)(c) w.e.f. AY 2017-18 also clearly indicates that an addition to income does not automatically result in imposition of penalty. An addition to income is divided into three parts. The first is an addition not amounting to under-reporting of income for which there is no penalty. The second is an addition amounting to under-reporting of income but not as a consequence of misreporting for which penalty provided is 50% of the tax amount. The third is an addition amounting to under-reporting of income as a consequence of misreporting for which penalty provided is 200% of the tax amount. Thus, even today, under Section 270A of the Income-tax Act, 1961 penalty is neither mandatory nor automatic. The Assessing Officer has to determine, on appreciation of the facts, as to which of the above three categories the addition to income would fall and levy penalty accordingly. Further, for such a determination, the Assessing Officer has to give an opportunity to the person concerned. Under Section 270A, the discretion of the Assessing Officer is limited to this extent. The Assessing Officer does not have further discretion to decide the quantum of penalty unlike Section 271(1)(c) wherein the Assessing Officer had the discretion to impose penalty ranging from 100% to 300% of the tax amount.

3. Prosecution Proceedings

The Income-tax Act, 1961, though provides the procedure for the assessment proceedings it does not provide any special procedure for prosecution proceedings. Therefore, once the complaint is filed before a Magistrate the procedure to be followed is the general procedure followed by the Criminal Courts, which is laid down by the Code of Criminal Procedure, 1973. In *State vs. Awtar Krishna (1957) 8 STC 244 (All)* the Allahabad High Court has held that the relevant provisions of the Code of Criminal Procedure are applicable to the trial of an accused for an offence under the Revenue Acts and they have to be given effect to.

Section 292 of the Income-tax Act, 1961, provides that only the Metropolitan (formerly Presidency) Magistrate or a Magistrate of the First Class has jurisdiction to try and convict a person of an offence under the Act. Therefore, the department has to file a complaint before a Metropolitan Magistrate or a Magistrate of the First Class and such court is the first authority to try the offences under the Act.

4. General Principles

4.1 Burden of proof:

4.1.1 It is the cardinal rule of our criminal jurisprudence that the burden of proof would always lie upon the prosecution to prove all the facts constituting the ingredients of offence beyond reasonable doubt. If there is any reasonable doubt, the accused is entitled to the benefit of the reasonable doubt. At no stage of the prosecution case, the burden to disprove the fact would rest on the defense. However, exceptions have been provided in ss. 105 and 106 of the Evidence Act. In a criminal case it would not matter if the accused is not able to establish his plea. The onus is on the prosecution to bring home the guilt of the accused.

4.1.2 Penalty proceedings are quasi criminal in nature and accordingly are concerned with the criminal jurisprudence. Therefore, primarily the burden of proof is on the revenue. However, the penalty proceedings are not criminal proceedings in the strict sense of the term. Those are quasi criminal in nature and like the civil proceedings are based on the principle of preponderance of probabilities. The provisions for presumption, further take them away from criminal jurisprudence. Penalty proceedings being quasi criminal in nature the burden to prove its case is always on the revenue. However, the provisions for presumption assist the revenue to a large extent and substantially shift the onus to the assessee.

4.2 Mens Tea

4.2.1 The conditions of criminal liability are sufficiently indicated by the maxim, *'Actus non facit reum, nisi mens sit rea'* - a man is responsible not for his acts in themselves, but for his acts coupled with the 'mens rea' or 'guilty mind' with which he does them. Before imposing punishment, the law must be satisfied of two things, first, that an act has been done which by reason of its harmful tendencies or results, is fit to be represented by way of penal discipline; and secondly, that the mental attitude of the doer towards his deed was such as to render punishment effective as a deterrent for the future, and, therefore, just.

4.2.2 It is well-settled principle of common law that *'mens rea'* is an essential ingredient of criminal offence. A statute can exclude that element, but it is a sound rule of construction adopted in England and also accepted in India to construe a statutory provision creating an offence in conformity with the common law rather than against it unless the statute expressly or by necessary implication excludes *'mens rea'*. In this respect, the following observations of Justice Subba Rao in the case of *State of Maharashtra vs. Mayer Hans George AIR 1965 SC 722* are relevant:

"It is a well settled principle of common law that *mens rea* is an essential ingredient of a criminal offence. Doubtless a statute can exclude that element, but it is a sound rule of construction adopted in England and also accepted in India to construe a statutory provision creating an offence in conformity with the common law rather than against it unless the statute expressly or by necessary implication excluded *mens rea*. To put it differently, there is a presumption that *mens rea* is an essential ingredient of a statutory offence; but this may be rebutted by the express words of a statute creating the offence or by necessary implication. But the mere fact that the object of a statute is to promote welfare activities or to eradicate grave social evils is in itself not decisive of the question whether the element of guilty mind is excluded from the ingredients of the offence. It is also necessary to enquire whether a statute by putting a person under strict liability helps him to assist the State in the enforcement of the law: Can he do anything to promote the observance of the law? *Mens rea* by necessary implication can be excluded from a statute only where it is absolutely clear that the implementation of the object of a statute would otherwise be defeated and its exclusion enables those put under strict liability by their act or omission to assist the promotion of the law. The nature of *mens rea* that will be implied in a statute creating an offence depends upon the object of the Act and the provisions thereof."

4.2.3 Penalty being quasi criminal in nature the element of '*mens rea*' is normally incorporated in the provisions for penalty in different forms. The present provisions for penalty include '*mens rea*' in terms of 'concealment of income' and 'a default committed with knowledge or without reasonable cause'. In section 270A, *'mens rea'* is provided in terms of 'under-reporting' and 'misrepresentation'.

4.3 Presumption and shift of burden of proof

4.3.1 Penalty proceedings are quasi criminal in nature and as such the principles applicable to penalty proceedings were similar to those applicable to criminal proceedings. The legislature felt that the burden cast on the revenue in such penal proceedings is too heavy and for this reason many defaulters have escaped punishment. Therefore, so as to make the provisions workable, certain provisions providing for presumptions and shift in the burden of proof have been introduced. As for example, Explanation 1 to Section 271(1)(c) provides for presumption of concealment of income in respect of the amount added or disallowed in computing the total income. This *Explanation* shifts the burden on the assessee to show that the addition to the total income does not represent concealed income. Before the introduction of this Explanation the burden was on the revenue to prove that the addition to the total income represents concealed income. However, the burden cast on the assessee is that applicable in civil proceedings i.e., on the basis of preponderance of probabilities. The Explanation requires the assessee to offer an explanation as regards the addition to show that the amount of addition does not represent concealed income. If the Explanation is *bona fide* the presumption of concealment is rebutted. If the Explanation is proved to be false by the Assessing Officer then the presumption of concealment would be applicable. Similar implied presumption and burden of proof on assessee is provided in Section 270A for determining the 'under-reported income' and under-reported income as a consequence of misrepresentation'.

4.3.2 Section 278E provides for presumption of *mens rea* and also provides for shift of burden of proof from revenue to the assessee. According to this new section the accused is required to prove that there is no *"mens rea"* and sub-section (2) therein requires the accused to prove the absence of *'mens rea'* beyond reasonable doubt. The section further provides that the mere proof by a preponderance of probability would not be sufficient. This provision is unreasonable, illogical and too harsh. It requires the assessee to do an impractical and almost impossible thing. It is contrary to the general principles of law and the criminal jurisprudence. The provision of presumption has been introduced for the reason that it is difficult for the revenue to establish the existence of *'mens rea'* which is a positive factor to be established. To prove the absence of *'mens rea'* is still more difficult being a negative factor. As such it is much more difficult to prove the absence of *'mens rea'*. Further, the section requires such a proof to be beyond reasonable doubt. Such a burden on the accused is highly unjust being practically impossible. It is also illogical. The legislature has mechanically introduced this provision without any application of mind. In the case of penalty for concealment under Section 271(1)(c) under-reported income as a consequence of misrepresentation or otherwise under Section 270A, the burden cast on the assessee is reasonable and workable. The proof required therein is by preponderance of probabilities. Similar proof would have been sufficient in respect of the presumption of *"mens rea"* in Section 278E. The provisions of section 278E would lead to unintended and dangerous consequences.

5. Penalty and Prosecution

5.1 It is well-established principle of law that mere addition to the total income does not justify penal interest, penalty and prosecution, It is also well-established that where penal interest is not justified penalty and prosecution cannot be justified and further that where penalty is not justified prosecution cannot be justified. As such where penal interest is deleted and penalty is dropped/cancelled, prosecution for corresponding offences would not be justified.

5.2 The proceedings for penalty are departmental proceedings which are civil in nature. The Income Tax Authorities and the Appellate Authorities under the Act decide the validity of the penalty and the penalty proceedings under the Act. The trial for offences under the Act is conducted by the Criminal Courts as noted above. Under the Income-tax Act, 1961, the proceedings for penalty and prosecution, though arising out of the same default, are not substitutes for each other. The outcome of one proceeding may be relevant for the other proceeding. For example, where penalty is not justified in a case, prosecution would not be justified. Therefore, the question arises as to whether the findings and the conclusion arrived at by the Departmental and Appellate Authorities in penalty proceedings is binding on Courts conducting the trial for offences in respect of the corresponding defaults. Strictly speaking, the finding and the conclusions of the Departmental Authorities are not binding on the Courts. The Courts will have to take an independent decision in the criminal proceedings. If in a Departmental proceeding the assessee is held to have committed a default and is penalised that would not be binding on a Court trying for an offence. The Court will have to make an independent enquiry and arrive at an independent conclusion. The fact that the accused has been penalized in the Departmental proceedings will be one of the relevant evidences.

5.3 On the other hand, where the penalty is held to be not justified in the Departmental proceeding, the situation is different. In a trial before the Court for an offence under the Act, the complainant is the Department. Therefore, where, in a Departmental proceeding the finding and conclusion is that it is not a fit case for penalty, it will have to be accepted by the Criminal Court, since it is contrary to the complaint itself. In such a situation, it is well established principle that the prosecution proceedings/conviction are/is dropped/ cancelled. In *Uttam Chand vs. I.T.O. 133 ITR 909 (SC)* the Hon'ble Supreme Court held that in view of the findings (favourable to the assessee) recorded by the Appellate Tribunal the assessee could not be prosecuted for filing false returns. In *P. Jayappan vs. I.T.O. 149 ITR 696 (SC)* the Hon'ble Supreme Court reiterated the principle and observed.

> "It is true that, as observed by this Court in *Uttam Chand vs. I.T.O. 133 ITR 909* the prosecution once initiated may be quashed in the light of a finding favourable to the assessee recorded by an authority under an Act subsequently in respect of the relevant assessment proceedings."
>
> The Hon'ble Court further observed:—
>
> "The criminal court no doubt has to give due regard to the result of any proceeding under the Act having a bearing on the question in issue and in an appropriate case it may drop the proceedings in the light of an order passed under the Act."

5.4 This principle has been followed by the Hon'ble Supreme Court in *S. P. Sales Corporation vs. S. R. Sikdar (1993) 113 Taxation 203 (SC)* and in *G. L. Didwania vs. I.T.O. (1995 Supp (2) S.C.C. 724); 224 ITR 687 (SC)*. Following this principle the Courts have quashed the prosecution proceedings on the basis of the cancellation of penalty by the Appellate Authority. Few such cases are:—

i) *M/s. Shastri Sales Corporation vs. I.T.O. (1996) Cr.L.J. 449 (Bom.).*

ii) *Shashichand Jain & Ors. vs. Union of India & Ors. (1995) 213 ITR 184 (Bom.).*

iii) *Jamnadas Madhavji & Co. vs. Shri D.C. Sreedhar 1996(1) All MR 444 (Bom.).*

iv) *V. Rajasekharan Nair vs. C.I.T. 204 ITR 783 (Ker.).*

v) *C.I.T. vs. V. Rajasekharan Nair 207 ITR 33 (st) (SC)*

vi) *Premier Breweries Ltd vs. Dy. C.I.T. 207 ITR 871 (Ker.).*

vii) *Madras Spinners Ltd. vs. Dy. C.I.T. 203 ITR 282 (Ker.).*

viii) *Prakash Chand vs. I.T.O. 134 ITR 8 (P&H).*

ix) *Kanshiram Wadhwa vs. I.T.O. 145 ITR 109 (P&H).*

x) *I.T.O. vs. Rulia Ram Dewan Chand Thanesar & Ors. 194 ITR 562 (P & H).*

xi) *Surinder & Co. vs. A. K. Thati 195 ITR 189 (P & H).*

xii) *I.T.O. vs. B. B. Mittal 199 ITR 805 (P&H).*

xiii) *Sequoia Construction Co. Pvt. Ltd. vs. I.T.O. 158 ITR 496 (Del).*

xiv) *Asstt. C.I.T. vs. Belco Engineers (P) Ltd. 87 C.T.R. 1 (Del.).*

xv) *Umayal Ramanathan vs. I.T.O. 194 ITR 462 (Mad.).*

xvi) *Mohammed I. Unjawala vs. Asstt.C.I.T. 213 ITR 190 (Mad.).*

xvii) *Banwarilal Satyanarayan and Ors. vs. Stat of Bihar 179 ITR 387 (Pat.).*

xviii) *Gopalji Shaw vs. I.T.O. 173 ITR 554 (Cal).*

5.5 Recently, this principle has been reiterated by the Hon'ble Supreme Court in *K. C. Builders vs. A.C.I.T. 265 ITR 562 (SC)*, wherein the Hon'ble Supreme Court held as under:

"i) Once penalties imposed on the assessee u/s. 271(1)(c) of the Income-tax Act, 1961, are cancelled on the basis of the conclusive finding of the Appellate Tribunal that there is no concealment of income, prosecution of the assessee for an offence u/s. 276C for wilful evasion of tax cannot be proceeded with thereafter : quashing of the prosecution is automatic.

ii) The finding of the Appellate Tribunal was conclusive and the prosecution could not be sustained since the penalty was cancelled following the Tribunal's order and no offence survived under the Income-tax Act thereafter. Quashing of the prosecution was automatic. Allowing the trial to proceed further would be an idle and empty formality."

5.6 The new section 270A, divides an addition to income into three parts. The first is an addition not amounting to under-reporting of income for which there is no penalty. The second is an addition amounting to under-reporting of income but not as a consequence of misreporting for which penalty provided is 50% of the tax amount. The third is an addition amounting to under-reporting of income as a consequence of misreporting for which penalty provided is 200% of the tax amount. Sections 276C, 276CC and 277 also provide prosecution and rigorous imprisonment for same defaults with higher degree of guilty mind i.e. mens rea. Section 270A of the Act obliges the Assessing Officer to determine, on appreciation of the facts, as to which of the above three categories the addition to income would fall and levy penalty accordingly. Obviously, where the case falls in the first category, i.e, an addition not amounting to under-reporting of income neither the penalty nor prosecution could be justified. In fact, section 270A bars penalty in such a case. Therefore, it should be understood that in such case, prosecution is also not permitted. In the second category, where the addition amounts to under-reporting of income but not as a consequence of misreporting for which penalty provided is 50% of the tax amount. Thus, section 270A prohibits higher punishment in such a case. Therefore, it should be understood that in such case also, prosecution is also not permitted. Therefore, only when a case falls in the third category, i.e., where the addition amounts to under-reporting of income as a consequence of misreporting the sanctioning authority will have to consider as to whether it is a fit case for launching prosecution and filing a complaint against the assessee. Even where the case falls in the third category, the sanctioning authority would not be justified in mechanically granting sanction in all cases. The authority concerned will have to apply his mind to all the relevant facts and circumstances and taking into account the scheme of the Act, as briefly explained above, and decide as to whether the case is fit for filing complaint. Normally, the Assessing Officer/the authority imposing penalty would be the complaint and the complaint would not be justified in filing a complaint in contradiction to his own findings in the penalty order. If a complaint is so filed, then the trial court will have to decide whether it is a fit case for admitting a complaint and if the complain is admitted, then the trial court will proceed with the trial and pass its order.

6. Limitation

6.1 The Income-tax Act, 1961 does not prescribe any period of limitation for initiation of prosecution proceedings. Chapter XXXVI of the Code of Criminal Procedure, 1973 lays down the period of limitation beyond which no court can take cognizance of an offence which is punishable with fine only or with imprisonment not exceeding three years. But the Economic Offences (Inapplicability of Limitation) Act, 1974, provides that nothing in the aforesaid Chapter XXXVI of the Code of Criminal Procedure, 1973 shall apply to any offence punishable under any of the enactments specified in the schedule. The schedule referred to therein contains various enactments, including the Indian Income-tax Act, 1922 and the Income-tax Act, 1961. The Kerala High Court dealing with section 277 of the Act, held that the bar of limitation specified in section 468 of the Code of Criminal Procedure, 1973 would not apply to a prosecution under the Income-tax Act.

6.2 Accordingly, there is no period of limitation for initiation of prosecution proceedings for offences under the Act. Therefore, once the offence is committed under the Act, then the proceedings for that offence may be initiated at any time thereafter. Thus the sword of prosecution can always be hanging over the head of the assessee throughout his life. It may be noted, that this may result in an injustice to the assessee because a person who is in a better position to explain the issue or things in the initial stage, may not be able to do so later if he is confronted with after a lapse of time.

7. Power to grant immunity

7.1 Section 245H – Power of Settlement Commission to grant immunity

Sub-section (1) of section 245H empowers the Settlement Commission, under the specified circumstances, to grant immunity to the assessee from prosecution for any offence under this Act, subject to such conditions as it may think fit to impose. However, sub-section (2) of section 245H also empowers the Settlement Commission to withdraw the immunity so granted if it is satisfied that such person had not complied with the conditions subject to which the immunity was granted or that such person had, in the course of the settlement proceedings, concealed any particulars material to the settlement or had given false evidence.

7.2 Section 270AA – Power of Assessing Officer to grant immunity

Section 270AA of the Income-tax Act, 1961 empowers the Assessing Officer to grant immunity to the assessee from penalty under section 270A and prosecution under sections 276C and 276CC if the assessee pays the tax and interest as per the assessment/reassessment order within the time prescribed in the demand notice and does not file an appeal against such order. Sub-section (3) of section 270AA provides such immunity will not be granted if the Assessing Officer has initiated proceedings for penalty under section 270A concerning under-reporting of income as a consequence of misreporting. This subsection (3) makes the whole power redundant. As seen above in paragraph (5.6), this third category of misreporting is the only category in section 270A where prosecution can be contemplated. Thus, effectively, immunity u/s. 270AA is only in respect of penalty under section 270A second category of under-reporting of income but not as a consequence of misreporting.

7.3 Section 279(1A): Immunity from prosecution under sections 276C and 277 when penalty under section 270A or 271(1)(c) is waived or reduced under section 273A

Sub-section (1A) of section 279 provides that a person shall not be proceeded against for an offence u/s. 276C or 277 in relation to an assessment for an assessment year in respect of which penalty imposed or imposable under section 270A or 271(1)(c) has been reduced or waived under section 273A of the Act. Thus, in such a situation the assessee gets immunity from prosecution.

7.4 Section 291 – Power of Central Government to grant immunity

Sub-section (1) of section 291 confers on the Central Government a power, under specified circumstances, to grant immunity to the assessee from prosecution for any offence under the Act on condition of his making a full and true disclosure of the whole circumstances relating to the concealment of income or evasion of payment of tax on income. However, sub-section (3) of that section empowers the Central Government to withdraw the immunity so granted if such person has not complied with condition on which immunity was granted or is wilfully concealing anything or is giving false evidence.

8. Compounding

Sub-section (2) of section 279 of the Income-tax Act, 1961 empowers the Chief Commissioner/

Director General to compound the offences. Sub-section (2) of section 279 provides that the Chief Commissioner/Director General may, either before or after the institution of prosecution proceedings compound any such offence. Composition means in general an arrangement or settlement of differences between the injured party and the person against whom the complaint is made. In particular, composition is a bilateral act as a result of agreement between the Department and the accused.

Section 279(2) does not say that the offence can be compounded only if it is proved to have been committed. If there is a proceeding or charge for any offence, a composition may well be effected. Where the prosecution proceedings on a charge were compounded and the composition money paid, the assessee thereafter cannot claim a refund of the composition fee on the ground that he had really committed no offence – *Shamrao Bhagwantrao Deshmukh vs. Dominion of India (1955) 27 ITR 30 (S.C.).*

It is not necessary that an actual proceeding against the accused must be going on. All that is necessary is that the person applying for a composition must be alleged to have committed an offence. Even a formal notice of show cause has not been made a condition precedent. On the other hand, even if a prosecution has ended in conviction and the accused has preferred an appeal, there seems to be no bar to effect a composition during the pendency of such appeal and the accused shall not have to undergo the sentence awarded if he pays the composition money.

9. Conclusion

The law expects that prosecution proceedings are not initiated in each and every case of default but should be initiated only in exceptional cases where it is found by the higher authorities (Principal Commissioner etc.) that it is a fit case for initiation of prosecution proceedings. However, many cases are filed mechanically without considering as to whether initiation of prosecution proceedings is justified. Unlike the assessment proceedings and the appellate proceedings before the Tribunal or the higher courts the trial proceedings in the criminal courts take a long time. The accused is required to be present in the Court at each and every date unless he is exempted, irrespective of whether the complainant is present or not. This results in loss of time, energy and business to an assessee. Thus the initiation of criminal proceedings itself amounts to the punishment much more than what the default deserved. Therefore, many a times the assessees preferred to compound the prosecution proceedings by paying reasonable compounding fees, to avoid such consequences of the prosecution proceedings even if no offence is committed by them. The loss of business on account of attending in the prosecution proceedings also compels the assessees to prefer compounding the proceedings by paying reasonable compounding fees. Particularly in the case of technical offences composition is the best solution for the assessees and the revenue. However, the compounding fees fixed by the revenue in such cases are exceptionally high and unreasonable. Further, the compounding applications made by the accused are not disposed of for a long time. There are many such cases pending before the authorities for finalising the compounding applications. If these cases are disposed of it would save the assessees' time wasted in the Court which they would otherwise be using for the growth of their business. There are many cases of technical defaults which have not yet come to the notice of the department. Any compliance by such assessees in any year would result in detection of such default of the earlier years and it would result in harsh punishment of those who wish to comply in the future. Therefore, it is advisable that the Government comes out with an immunity scheme whereby the assessees are allowed to come forward to disclose the defaults committed in the past and pay a reasonable composition fees so that they would feel free to comply with the provisions and there would be no technical defaults in the future.

❍❑❍

CA Jagdish Punjabi

Contours of under-reporting and mis-reporting (Section 270A) and clemency (Section 270AA)

1 Introduction

1.1 Chapter XXI of the Income-tax Act, 1961 ("the Act") contains provisions for levy, imposition and collection of penalty.

Up to assessment year 2016-17, section 271(1)(c) of the Act provided for levy of penalty for concealment of particulars of income or for furnishing inaccurate particulars of income. The provisions of section 271(1)(c) were subject matter of litigation between the department and the assessee. While the judiciary has virtually settled most of the issues arising out of the provisions of section 271(1)(c) of the Act, the Officers implementing the Act initiated proceedings and levied penalty under section 271(1)(c) in every case where a disallowance was made or an addition was made to the total income though there was no *prima facie* case against the assessee. This led to a lot of unwanted litigation. Also, the provisions of section 271(1)(c) provided a discretion to the Officers to levy penalty at a rate varying from 100% of the amount of tax sought to be evaded to 300% of the amount of tax sought to be evaded. The Government was of the view that the provisions of section 271(1)(c) were subjective and provided discretion to the Assessing Officer which led to corruption and/or avoidable litigation.

1.2 With a view to reduce litigation and to reduce the discretion of the tax authority, the Finance Act, 2016, with effect from 1-4-2017, substituted the provisions of section 271(1)(c) dealing with levy of penalty for concealment of income or for furnishing inaccurate particulars of income with the provisions of section 270A of the Act. Section 270A provides for a penalty for "under-reporting of income" and "mis-reporting of income". The Explanatory Memorandum to the provisions of the Finance Bill, 2016 explains the objective of inserting section 270A as to bring in objectivity, certainty and clarity in the penalty provisions.

1.3 The newly inserted section 270A has 12 sub-sections. Hereunder is a brief description of what each of the sub-sections of section 270A deal with –

Sub-section	*Description of what is dealt with*
(1)	Levy of penalty and who can levy penalty
(2)	Provides for seven situations in which a person shall be considered to have "under-reported" his income
(3)	Computation of "under-reported" income
(4) and (5)	Penalty for intangible additions of earlier years if it is claimed that the same constitute source of investment, deposit or receipt in any assessment year
(6)	Exclusions from "under-reported income"
(7) / (10)	Quantum of penalty for under-reporting
(8) / (10)	Quantum of penalty for mis-reporting
(9)	Cases of mis-reporting of income
(11)	No double levy for the same addition or disallowance
(12)	Order to be passed in writing

1.4 **Date of applicability of provisions of section 270A:** The Finance Act, 2016 has introduced provisions of section 270A with effect from 1-4-2017. Therefore, a question arises as to whether the provisions of section 270A are applicable to –

(i) penalty orders passed on or after 1-4-2017; or

(ii) penalty initiated on or after 1-4-2017; or

(iii) return of income filed on or after 1-4-2017 irrespective of the assessment year to which such return pertains; or

(iv) for returns pertaining to assessment year 2017-18.

The Finance Act, 2016 has, with effect from 1-4-2017, introduced sub-section (7) in section 271 which provides that the provisions of section 271 shall not apply to and in relation to assessment for the assessment year commencing on or after 1-4-2017. Therefore, the provisions of section 270A which are to take effect upon provisions of section 271 ceasing to operate will apply to assessments for assessment year 2017-18 and subsequent assessment years.

2. Who can levy penalty and when can a direction be given to pay penalty [Section 270A(1)]

2.1 Sub-section (1) of section 270A provides that the Assessing Officer or Commissioner (Appeals) or Commissioner or Principal Commissioner (these four authorities are hereinafter for brevity sake referred to as "the Specified Authority") are empowered to direct payment of penalty on the "under-reported income". The direction has to be given during the course of `any proceedings' under the Act. It is relevant to mention that the phrase "during the course of any proceedings under the Act" was not there in the provisions of section 270A as were proposed in the Finance Bill, 2016. The absence of this phrase led to questions as to whether the proceedings for penalty could have been initiated even after completion of proceedings or independent of proceedings unlike the provisions of section 271 which provided that the proceedings for penalty will necessarily have to be initiated during the course of proceedings. However, introduction of this phrase, at the time of passage of the Finance Bill, 2016, has settled the position. The direction has to be "during the course of any proceedings under the Act". The term "any proceedings" is wide enough to cover proceedings for assessment, appeal, rectification, revision, passing of an order to give effect to an appellate order, etc.

2.2 **Can direction be given during the course of proceedings for a different assessment year:** Another question which arises is as to whether during the course of proceedings under the Act for a particular assessment year, can direction be given for payment of penalty for a different assessment year. To illustrate, during the course of proceedings for Assessment Year 2020-21, can the authorities mentioned in sub-section (1) give a direction for payment of penalty for assessment year 2018-19? It appears that the direction for payment of penalty has to be for the same assessment year for which the proceedings are going on except in cases of additions covered by sub-sections (4) and (5) which are dealt with subsequently.

2.3 **Is the power to direct payment of penalty under section 270A mandatory or discretionary?** The Specified Authority has the power to direct any person who has under-reported his income to pay a penalty. The power can be exercised when assessee under-reports income. On a reading of the provisions of section 270A, at first blush, it appears that the power to direct payment of penalty under section 270A is mandatory and not discretionary. The objects for which the section has been introduced also suggest that the levy of penalty is mandatory and not discretionary. However, section 270A(1) uses the word 'may' and hence it can be argued that the power to direct payment of penalty under section 270A is discretionary and not mandatory –

It is a settled position that the levy of penalty under section 271 is discretionary and not mandatory. As is evident, the language of the two provisions granting power to direct payment of penalty is similar. Therefore, it may be contended that the ratio of the decisions holding that the levy of penalty under section 271 is discretionary will hold good even for the purposes of section 270A:

(i) The Apex Court has in the case of *Mansukhlal vs. CIT [1969] 73 ITR 546 (SC)* has held that penalty need not be imposed when there is a minor breach of law and having regard to the facts, ends of justice require that the assessee need not be penalized;

(ii) The Apex Court has in the case of *Hindustan Steel Ltd. vs. State of Orissa [1972] 83 ITR 26 (SC),* held that penalty cannot be levied for a mere technical / venial breach.

(iii) Section 274 of the Act requires issue of show cause notice and an opportunity of being heard has been granted to the assessee. Certainly, the requirements of issue of notice and providing an opportunity to show cause cannot be empty formalities.

(iv) Levy of penalty in excess of ₹ 20,000 requires approval of higher authority.

3. Situations in which a person shall be considered to have under-reported his income [Section 270A(2)]

While the penalty under section 270A of the Act is for under-reporting of income, the term `under-reporting' is not defined.

3.1 However, sub-section (2) provides seven situations, in clauses (a) to (g) of sub-section (2), in which a person shall be considered to have under-reported his income. The seven situations mentioned in sub-section (2) are –

(a) **In a case where assessee has furnished his return of income [clause (a) of section 270A(2)] – if assessed income is greater than** income determined on processing of the return of income under section 143(1)(a) (this income is hereinafter for brevity sake referred to as "**processed income**"). To illustrate, if the assessee has filed return of income declaring total income of ₹ 10,00,000 and upon processing the return under section 143(1)(a) the total income is determined at ₹ 12,00,000 and on completion of assessment the total income is assessed at ₹ 15,00,000 then the person shall be considered to have under-reported his income because the assessed income (₹ 15,00,000) is greater than processed income (₹ 12,00,000). However, if the assessed income is also ₹ 12,00,000 then inspite of the fact that assessed income is greater than the returned income, it cannot be said that the person has under-reported his income because what is relevant is that the assessed income should be greater than processed income.

(b) **In a case where assessee has not furnished his return of income [clause (b) of section 270A(2)] – if assessed income is greater than maximum amount not chargeable to tax.** To illustrate, if an individual (who is not a senior citizen) has not filed his return of income for AY 2017-18 and if his income is assessed at ₹ 3,60,000 (which is more than maximum amount not chargeable to tax) such a person will be regarded as having under-reported his income. The fact that the taxes due were duly paid and even the fact that a refund was determined to be payable to the assessee on completion of assessment, is irrelevant.

(c) **In cases of reassessment [clause (c) of section 270A(2)] – if the income reassessed is greater than the income assessed or reassessed immediately before such assessment.** To illustrate, if the total income of XYZ Pvt. Ltd. was assessed at ₹ 15,00,000 and subsequently the total income is reassessed at ₹ 18,00,000, then XYZ Pvt. Ltd. shall, in the course of reassessment proceedings, be considered to have under-reported its income (because reassessed income i.e. ₹ 18,00,000 is greater than income assessed immediately before such assessment). Subsequently, if there is a second reassessment and in the second reassessment the income assessed is say ₹ 20,00,000 then XYZ Pvt. Ltd. shall, in the course of such second reassessment proceedings, once again be regarded to have under-reported its income as reassessed income (₹ 20,00,000) is greater than income assessed as per preceding order (₹ 18,00,000). What is relevant is that the income reassessed is greater than the income assessed in the immediately preceding assessment. Of course, this is subject to the provisions of sub-section (6) which provide for exclusions from under-reported income.

(d) **In a case where return of income is filed and assessed / reassessed book profits (deemed to be total income under section 115JB/115JC) are greater than processed book profits i.e. book profits as per return processed under section 143(1)(a) [clause (d) of section 270A(2)].**

(e) **In a case where return of income is not filed and assessed / reassessed book profits (deemed to be total income under section 115JB/115JC) are greater than the maximum amount not chargeable to tax - [clause (e) of section 270A(2)];**

(f) **Reassessment in cases where book profits are deemed to be total income [clause (f) of section 270A(2)] – if assessed / reassessed deemed total income under section 115JB/115JC is greater than assessed / reassessed deemed total income under section 115JB/115JC as per immediately preceding assessment / reassessment.**

(g) **In case of a loss [clause (g) of section 270A(2)]** – if assessed / reassessed loss is less than the returned / assessed loss. Also, if assessee had returned a loss or previous assessment was at a loss and a positive income is assessed / reassessed.

4. Computation of amount of under-reported income [Section 270A(3)]

4.1 The penalty under section 270A is for under-reporting income. Penalty is @ 50% of the amount of tax payable on under-reported income. Therefore, the first step is to ascertain if a person has to be considered as having under-reported his income and if yes, the next step would be to compute the amount of under-reported income.

4.2 Sub-section (3) of section 270A deals with computation of under-reported income. Various situations dealt with by sub-section (3) are –

(i) **in a case where income has been assessed for the first time, -**

(a) **if return has been furnished**, the amount of under-reported income is difference between the income assessed and processed income;

(b) in a case **where no return has been furnished**, -

(A) **in the case of a company, firm or local authority :** income assessed will be regarded as amount of under-reported income; and

(B) **in case of persons other than those covered in (A) above** [i.e., other than company, firm or local authority], the amount of under-reported income is aggregate of difference between assessed income and processed income and maximum amount not chargeable to tax.

(ii) **in any other case** [i.e. cases where income is not assessed for the first time], the amount of under-reported income is difference between the amount of income reassessed or recomputed and the amount of income assessed, reassessed or recomputed in a preceding order.

4.3 In respect of deemed total income assessment, pursuant to section 115JB or section 115JC, in a case where the additions made to the normal total income and deemed total income are different, the aggregate of additions made to the normal total income and deemed total income would be considered as under-reported income. Thus, additions made for different purposes would be considered as under-reported income where the income assessed is as per the deemed total income either under section 115JB or section 115JC.

4.4 It is relevant to note that, in case of first assessment, if assessed income is positive under-reported income is computed with reference to processed income, whereas in case of loss it appears that the language envisages that the under-reported income is to be computed with reference to loss claimed (loss claimed would mean returned loss) and not processed loss e.g. if returned loss is ₹ 10,00,000 and processed loss is ₹ 8,00,000 and assessed loss is ₹ 6,00,000 then going by the language of section 270A(3)(g), under-reported income is ₹ 4,00,000 [i.e. (-) 6,00,000 – (-)10,00,000] i.e. comparison of assessed loss with returned loss whereas in all other clauses what is envisaged is comparison of assessed income with processed income which in this case would lead to under-reported income being ₹ 2,00,000. While the literal interpretation leads to a discrimination in treatment between cases where the income assessed / returned, for the first time, is a loss and cases where income assessed / returned is a positive amount, the illustration given by way of Example 3 in the Explanatory Memorandum to the provisions of the Finance Bill, 2016, under-reported income has been worked out with reference to processed loss and not with reference to returned loss, as is suggested by the language of the provision.

4.5 In case of second and subsequent assessments, under-reported income will be difference in losses as per two assessments.

4.6 The quantification of under-reported income is based on difference between assessed income and processed income and not on the basis of aggregate of various additions which may, possibly, represent under-reported income. If, in an assessment there are additions and also reductions, it is only the net amount which will be regarded as under-reported income exigible to penalty.

Where no return of income is furnished, in case of a company, the income assessed could be regarded as under-reported income. A foreign company, from whose income tax is deducted at source, may not file its return of income as entire tax due from it is paid by way of tax deducted at source. In such a case, if an assessment is made, the entire total income will be regarded as under-reported income exigible to penalty, subject of course to exclusions mentioned in sub-section (6).

5. What shall not constitute under-reporting of income [Section 270A(6)]

5.1 Sub-section (6) provides that under-reported income shall not include certain specified amounts of income under specified circumstances.

5.2 If an item of income / addition to total income falls under any of the five clauses of sub-section (6) then such items shall not be regarded as under-reported income.

Looking at the the language used in section 270A(6) a question which arises for consideration is as to whether the exclusions mentioned in five clauses of sub-section (6) are exhaustive or can an item of income not covered by these five clauses be also not included in under-reported income. Supreme Court in the case of *Narpatchand A. Bhandari vs. Shantilal Moolshankar Jain AIR 1993 SC 1712* was considering the scope of definition of landlord in the Explanation to section 13(1)(g) which stated that Landlord will not include a rent-farmer or rent collector or estate manager. The Apex Court held that a mortgagee with possession would qualify as a landlord as it is not specifically excluded. Thus, items of income which are not covered by specific exclusions mentioned in sub-section (6) shall not be excluded from under-reported income. In other words, based on the ratio of the decision of the Apex Court in *Narpatchand A. Bhandari vs. Shantilal Moolshankar Jain (supra),* it can be concluded that the exclusions mentioned in sub-section (6) are exhaustive.

5.3 The five exclusions which are mentioned in sub-section (6) are –

(a) ***Bona fide* explanation coupled with disclosure of all material facts to substantiate the explanation offered [clause (a) of section 270A(6)]** – The amount of income in respect of which the following conditions are cumulatively satisfied shall be excluded from under-reported income. The conditions required to be cumulatively satisfied are:

(i) the assessee offers an explanation;

(ii) the Specified Authority is satisfied that the explanation is *bona fide*; and

(iii) the assessee has disclosed all material facts to substantiate the explanation.

The term `*bona fide*' has been explained to mean "in good faith", "genuinely" which are suggestive of honesty of purpose. They convey absence of intention to deceive and connote that the transaction in question is a true and genuine transaction and not a colourable and sham one and there are no strings of any kind attached to that transaction and that there is no secret or covert arrangement. *[GTO vs. Gautam Sarabhai [1989] 29 ITD 212 (Ahd.)]*

"*Bona fide*" means good faith implying the absence of fraud, unfair dealing or acting, whether it consists in simulation or dissimulation. *[GTO vs. Rajmata Shantadevi P. Gaekwad [2001] 76 ITD 299 (Ahd.)].*

The term `satisfied' means make up one's mind not troubled by doubt or reach a clear conclusion on the evidence before the authority.

The term "material facts" has been explained by Rajasthan High Court in *Mohammed Yusuf vs. Bhairon Singh Shekhawat AIR 1995 Raj. 239*, for the purpose of the Representation of People Act, 1951, as follows –

> "Following settled position of law emerges from the decisions already referred:
>
> … The material facts mean (a) facts necessary to formulate a complete cause of action, (b) all preliminary facts which must be proved by the party to establish a cause of action, (c) the basic facts which constitute

ingredients of particular corrupt practice, (d) all the facts which are essential to clothe the petitioner with complete cause of action, (e) the facts which if established would give the petitioner the relief asked for, (f) the facts on the basis of which the Court could give a direct verdict in favour of the election petitioner in case the returned candidate did not appear to oppose the petition, (g) facts which if not proved, the petition must fail.

.....There is a difference between `material facts' and `particulars'. The function of particulars is to present as full a picture of cause of action with such information in detail as to make the opposite party understand the case he will have to meet. There may be some overlapping between `material facts' and `particulars', but the two are quite distinct. The distinction is one of degree. The `material facts' are those which the party relies upon and which if it does not prove, he fails."

(b) **Estimation of under-reported income in a case where accounts are correct and complete but the method employed may not enable proper determination of income [clause (b) of section 270A(6)]** – If an item of income satisfies the following conditions cumulatively then such amount will be excluded from under-reported income -

(i) the amount of under-reported income is estimated;

(ii) the accounts are correct and complete to the satisfaction of the Specified Authority;

(iii) method employed may not enable proper determination of income.

It is relevant to note that for the exclusion referred to in clause (b) of sub-section (6) of section 270A it is not necessary that the assessed income should be estimated but the amount of under-reported income should be an estimated. *Prima facie*, it appears that this exclusion will cover additions made on an estimate basis, without rejection of books of accounts. However, in such cases where additions are made on estimated basis, without rejection of books of account, satisfaction of third condition will not be possible because for satisfaction of third condition the method employed by the assessee has to be such as would not enable proper determination of income. Therefore, it appears that examples of what may be covered by the exclusion referred to in section 270A(6)(b) could be additions which arise in a case where an assessee follows project completion method but the AO, without rejecting the books of account, assesses the income on percentage completion method. Another example could possibly be a case where the AO estimates the gross profit without rejecting the books of account. Cases where personal expenditure is estimated and disallowed may not fall in this exclusion.

(c) **Change in estimate of disallowance or reduction of claim [clause (c) of section 270A(6)]** - The third exclusion from under-reported income is an amount which satisfies the following conditions –

(i) an assessee has estimated an amount in respect of claim or disallowance;

(ii) such claim is reduced or disallowance is increased in the assessment;

(iii) the assessee has disclosed all the facts material to the addition or disallowance.

Upon satisfaction of the above-mentioned three conditions, the difference in the amount of estimate shall not be considered as amount of under-reported income. Examples of additions which could be covered by the situation envisaged by this clause could be where assessee has estimated personal expenditure and has disallowed it and in the intimation the disallowance made by the assessee gets accepted but in the assessment the AO increases the amount estimated by the assessee. Of course, the assessee should disclose all the facts material to the disallowance. Another example could be where to claim a deduction under Chapter VI-A, assessee adopts transfer price in respect of a specified domestic transaction and the AO, while assessing the income of the assessee, varies the price adopted by the assessee. Here also, the difference could be excluded from under-reported income provided the assessee has disclosed all facts material to determination of the transfer price.

(d) **Transfer pricing adjustment [clause (d) of section 270A(6)]** – If the following conditions are cumulatively satisfied –

(i) addition is made to the total income returned on account of adjustment in arm's length price determined by the Transfer Pricing Officer;

(ii) the assessee has maintained information and documents prescribed under section 92D of the Act;

(iii) the assessee has declared the international transaction under Chapter X; and

(iv) the assessee has disclosed all the material facts relating to the transaction;

then, the addition will not be regarded as under-reported income.

In a case where an addition is made to the returned income on account of adjustment in arm's length price determined by TPO, the assessee can satisfy the condition about disclosure of all material facts relating to the transaction by making a reference to the disclosures made in the return of income or in the Transfer Pricing report or those made in the course of proceedings before the TPO or the AO. The finding or absence of finding by the TPO / AO would also be a relevant factor for satisfaction of the condition about assessee having made disclosure of all the material facts relating to the transaction. The condition about the declaration of the international transaction under Chapter X can be satisfied either by producing the Transfer Pricing Report furnished by the Auditors' or from the observation made by the AO in the assessment order that all the international transactions have been reported or even by the absence of a finding that the international transaction under consideration was not declared by the assessee. The requirement about maintenance of information and documents prescribed under section 92D can be established to have been satisfied either by positive remarks mentioned in the assessment order or in the absence of any adverse remark in the assessment order about non-maintenance of information and documents prescribed under section 92D, it may be inferred that the assessee has maintained the information and documents prescribed under section 92D.

(e) **Undisclosed income referred to in section 271AAB [clause (e) of section 270A(6)]** – The amount of undisclosed income referred to in section 271AAB needs to be excluded from under-reported income. Section

271AAB levies penalty on undisclosed income. Section 271AAB is applicable only to undisclosed income of a specified previous year. The terms `undisclosed income' and `specified previous year' are defined in section 271AAB. Since undisclosed income of a specified previous year is liable for penalty under section 271AAB, clause (e) of sub-section (6) of section 270A provides that such undisclosed income shall be excluded from under-reported income.

6. Intangible additions or earlier years [Sections 270A(4) and 270A(5)]

6.1 Sub-sections (4) and (5) deal with additions made in earlier years for which no penalty was levied in an earlier year and which addition is now explained to be source of any receipt, deposit or investment.

6.2 Sub-sections (4) and (5) are exception to the rule that the penalty under section 270A can be initiated in the course of any proceedings for the assessment year for which the penalty is to be levied.

6.3 The provisions of sub-section (4) are subject to the provisions of sub-section (6) which means that if any of the clauses of sub-section (6) are applicable then the provisions of sub-section (4) shall not apply.

6.4 Sub-section (4) provides that if in an assessment year the source of any receipt, deposit or investment is claimed to be an amount added to income or deducted while computing loss in any earlier year and no penalty was levied for such earlier year when the addition was made or loss was reduced then, the under-reported income shall include such amount as is sufficient to cover such receipt, deposit or investment.

6.5 Sub-section (5) provides that where addition was made in several earlier years then the amount of under-reported income of the preceding year shall be determined by going backwards. To illustrate, if in the assessment of AY 2021-22 source of receipt of ₹ 20 lakh is explained by the assessee to be additions made in earlier years and in respect of these additions penalty was not levied in earlier years then the additions of earlier years to the extent of ₹ 20 lakh will be deemed to be under-reported income of earlier years. Suppose, if the additions made in earlier years were : AY 2020-21 : ₹ 5 lakh; AY 2019-20 : ₹ 12 lakh and AY 2018-19 : ₹ 20 lakh. To decide as to which years under-reported income it will be one has to go backwards. Therefore, amount deemed to be under-reported income for each of the assessment years is : ₹ 5 lakh for AY 2020-21; ₹ 12 lakh for AY 2019-20 and ₹ 3 lakh for AY 2018-19.

7. Quantum of penalty for under-reporting [Section 270A(7)] and for misreporting [Section 270A(8)]

7.1 Sub-section (7) of section 270A provides that penalty for under-reporting shall be 50% of the amount of tax payable on under-reported income. Therefore, to work out the amount of penalty to be levied under this section, first the amount of under-reported income has to be determined in accordance with provisions of sub-sections (3) and (6) and thereafter tax payable on such under-reported income has to be worked out in accordance with provisions of sub-section (10).

7.2 Sub-section (8) overrides the provisions of sub-sections (6) and (7) and provides that if under-reporting is as a consequence of mis-reporting then penalty for mis-reporting shall be 200% of the amount of tax payable on such under-reported income which is as a consequence of mis-reporting.

7.3 Therefore, exclusions provided in sub-section (6) shall not be applicable if under-reported income is as a consequence of mis-reporting.

7.4 It needs to be noted that the language of the provision is that –

> "where under-reported income is in consequence of any misreporting thereof by any person ….."

Therefore, if there is mis-reporting but there is no under-reported income as a consequence of such misreporting then the assessee will not be liable to pay penalty under this section. It is only when there is under-reported income which is as a consequence of misreporting that sub-section (8) will apply and the assessee will be liable to pay penalty @ 200% of the amount of tax payable on under-reported income.

7.5 While mis-reporting is a sub-set of under-reporting, sub-section (8) provides that mis-reporting attracts penalty @ 200% of tax payable on under-reported income whereas, if under-reported income is not as a result of misreporting, then sub-section (7) provides that under-reporting attracts penalty @ 50% of the amount of tax payable on under-reported income.

7.6 If only a small part of under-reported income is as a result of misreporting, a question arises as to whether only that part which is as a result of misreporting will attract penalty @ 200% and the balance under-reported income will attract penalty @ 50% or will the entire under-reported income attract penalty @ 200% of the amount of tax payable on under-reported income. This doubt arises in view of the language of sub-section (8). Equitably, only that part of under-reported income which is as a result of misreporting should attract penalty @ 200% of the amount of tax payable on under-reported income. However, the matter is not free from doubt and in order to achieve one of the objects for which the section has been introduced viz. certainty and clarity, it is advisable that CBDT issues a circular clarifying this position.

8. Computation of amount of tax payable on under-reported income [sub-section (10)]

8.1 Sub-section (10) provides for manner of computation of amount of tax payable on under-reported income. This sub-section envisages three situations, viz.

(i) a case where return of income is not furnished and assessment is made for the first time;

(ii) a case where total income as per intimation or as assessed or as reassessed or as recomputed is a loss; and

(iii) all other cases.

8.2 As regards situation (i) above, viz. a case where return of income not furnished and assessment is made for the first time, tax payable on under-reported income is amount of tax payable on under-reported income plus maximum amount not chargeable to tax.

8.3 As regards situation (ii) above, viz. a case where total income as per intimation or as assessed or as recomputed is a loss, tax payable on under-reported income will be amount of tax payable on under-reported income as if the under-reported income is a loss.

8.4 As regards situation (iii) above, viz. all other cases i.e. cases not covered by situations (i) and (ii), tax payable on under-reported income is the amount of tax payable on under-reported income plus income under section 143(1)(a) / assessed income / reassessed income / recomputed income (as if it were total income) minus income under section 143(1)(a) / assessed / reassessed / recomputed.

8.5 From the manner of computation of amount of tax payable on under-reported income it can be seen that in cases where the total income is a loss, amount of under-reported income itself is treated as total income and therefore, the tax benefit of maximum amount not chargeable to tax will be available.

8.6 While computing amount of tax payable on under-reported income, credit for prepaid taxes is not available.

9. When is under-reporting in consequence of mis-reporting by a person [Section 270A(9)]

9.1 Sub-section (8), as has been mentioned above, provides for levy of penalty @ 200% of the amount of tax payable on under-reported income if the under-reported income is in consequence of any misreporting thereof by any person. Sub-section (9) enumerates six cases which shall be regarded as misreporting of income referred to in sub-section (8). Six cases enumerated in sub-section (9) are -

(a) Misrepresentation or suppression of facts;

(b) Failure to record investments in the books of account;

(c) Claim of expenditure not substantiated by any evidence;

(d) Recording of any false entry in the books of account;

(e) Failure to record any receipt in books of account having a bearing on total income; and

(f) Failure to report any international transaction or any transaction deemed to be an international transaction or any specified domestic transaction, to which provisions of Chapter X apply.

9.2 The term `mis-reporting' implies wrong reporting Merriam Webster dictionary, explains meaning of `mis-' as follows:

> `mis' is a prefix meaning; `1a: badly: wrongly, misjudge; b: unfavourable <misesteem>; c: in a suspicious manner <misdoubt> 2 Bad: wrong <misdeed>; 3: opposite of lack of <mistrust> 4: not <misknow>

9.3 The above meanings suggest that misreporting implies wrong reporting i.e. it would mean a deliberate action with a view to reduce the total income liable to tax and therefore reduce the liability to pay tax.

9.4 Sub-section (9) does not define the term `misreporting' but only lists down six cases of misreporting for the purposes of sub-section (8). It appears that the list is exhaustive and a case not mentioned in sub-section (9) cannot be said to be a case of misreporting. A perusal of the above six clauses clearly reveals that the six situations mentioned above are those where the assessee has deliberately attempted to reduce the income and consequently the tax either by doing an act e.g. misrepresentation or suppression of facts, or by refraining from doing an act expected by him e.g. failure to record investment in books of account.

9.5 Each of the six cases of misreporting are briefly explained hereunder:

(a) **Misrepresentation or suppression of facts [clause (a) of section 270A(9)]**:

For under-reported income to be as a result of misreporting it should have been on account of misrepresentation or suppression of facts. Madras High Court has in the case of *P. M. Perianna Pillai vs. Commissioner, Board of revenue (Commercial Taxes) 1980 46 STC 94 (Mad.)* has explained the term `misrepresentation' as follows:

> "1. The act of making a false or misleading assertion about something, usually with the intent to deceive. The word denotes not just written or spoken words but also any other conduct that amounts to a false assertion. 2. The assertion so made; an assertion that does not accord with the facts. Also termed false representation."

According to Shorter Oxford Dictionary, the word "suppression" means the action of keeping secret; refusal to disclose or reveal.

Madras High Court in the case of *State of Tamil Nadu vs. Sri Swamy and Company [1977] 39 STC 85 (Mad.)* followed in *State of Tamil Nadu vs. R. R. Ramachari and Sons [1977] 40 STC 542 (Mad.)* held –

> "the use of the word `suppression' shows that what the assessing officer found was willful non-disclosure. If it was not a willful non-disclosure, the assessing officer would have stated it as merely omissions. The use of the

word "suppression" clearly brings out the willful nature of the non-disclosure and, therefore, the tribunal was not right in setting aside the penalty merely on the ground that there was no finding of willful non-disclosure."

To sum up, a willful attempt to represent facts wrongly i.e. to falsify facts or to hide facts i.e. to suppress will lead to under-reported income being held to have been as a result of misreporting.

(b) **Failure to record investments in the books of account [clause (b) of section 270A(9)]**

For applicability of this clause, an assessee should be required to maintain books of accounts and has failed to record investments in the books of account i.e. there is a deliberate attempt on the part of the assessee not to record investments in the books of account.

Section 2(12A) defines books of account inclusively as under:

> "includes ledgers, the books, cash books, account books and other books, whether in the written form or as printouts of data stored in a floppy, disk, tape or any other form of electromagnetic data storage device."

The Bombay High Court has in the case of *Pannalal Nandlal Bhandari vs. CIT [1956] 30 ITR 57 (Bom.)* explained the meaning of the term failure as follows:

> "Failure must connote that there is an obligation which has not been carried out and if there was no obligation upon the assessee to make a return then it would not be a failure on his part to carry out that obligation. But the Legislature has also used the expression "omission", and it is clear that the expression "omission" does not connote any obligation as the expression "failure" does. "Omission" is a colourless word which merely refers to not doing of something, and if the assessee in fact does not make a return, it is an omission on his part, whether the law casts an obligation upon him to make a return or not."

It is relevant to note that if the addition is under section 69 then penalty will be leviable under section 271AAC and not under this section.

(c) **Claim of expenditure not substantiated by any evidence [clause (c) of section 270A(9)]**

It appears that this clause will cover that expenditure in respect of which the assessee has no evidence whatsoever to substantiate the incurrence of expenditure. In other words, it appears that bogus or false expenditure is sought to be covered by this clause. In view of the use of the word `any' before evidence it appears that this clause may not cover expenditure for which there is no direct evidence but circumstantial or indirect evidence of incurrence of expenditure is available.

It is debatable as to whether the expenditure incurred on travelling for which the assessee does not have tickets to substantiate the travel but the expenditure has been incurred by making a payment to the employee concerned and there is enough circumstantial evidence to substantiate that the employee did travel, it appears that such expenditure even if considered as under-reported income would not be as a result of misreporting.

Lahore High Court has in the case of *Paras Dass Munna Lal vs. CIT [1937] 5 ITR 523 (Lah.)* explained the meaning of the word `evidence' as including direct as well as circumstantial evidence –

(d) **Failure to record any receipt in the books of account having a bearing on total income [clause (e) of section 270A(9)] –** This clause envisages that the assessee is maintaining books of account and has failed to record any receipt in the books of account and such receipt which assessee has failed to record has a bearing on total income. To illustrate non-recording of a loan or a gift (which is not taxable) would not have a bearing on total income but non-recording of a receipt of fee by a professional would be one which has a bearing on total income. A question would arise if a receipt is entered in the memorandum books of account but is not entered in the books of account from which financial statements are prepared and computation of income is made, can it be said that it is a case of misreporting. It appears that the answer to this question would depend upon whether the failure is deliberate or not. Only if the failure is deliberate then it would be regarded as misreporting and not otherwise.

(e) **Failure to report an international transaction [clause (f) of section 270A(9)]**

If the under-reported income is on account of

(i) failure to report any international transaction; or

(ii) failure to report any transaction deemed to be an international transaction; or

(iii) failure to report any specified domestic transaction.

The transaction is such to which the provisions of Transfer Pricing contained in Chapter X apply, such under-reported income would be regarded as having arisen on account of misreporting and will be exigible to a larger penalty.

10. No addition or disallowance to form basis of imposition of penalty twice [Section 270A(11)]

If any addition or disallowance has formed basis for imposition of penalty in the case of the person for the same or any other assessment year then such addition or disallowance cannot be the basis for levying penalty under the section. To illustrate, if penalty is levied for under-reporting and in subsequent year such under-reported income is explained to be source of investment then in the subsequent assessment year penalty cannot be levied for having under-reported income.

11. Order to be in writing [Section 270A(12)]

Sub-section (12) mandates that the order levying penalty shall be made in writing.

12. Is the levy of penalty automatic?

12.1 A question arises as to whether levy of penalty under section 270A is automatic or can there be cases where there is under-reporting but penalty may be not levied.

12.2 It is true that sub-section (2) provides cases in which a person shall be considered to have under-reported his income. Sub-section (2) mainly envisages comparison of the assessed income with income determined on processing the return under section 143(1)(a) of the Act. Thus, whether a person shall be considered to have under-reported his income or not will be determined by an arithmetical exercise.

12.3 Section 274 provides that before penalty under section 270A is levied a show cause notice is to be issued and an opportunity of being heard is to be provided to the person who has under-reported his income.

12.4 Sub-section (6) provides that under-reported income shall not include amounts referred to in five clauses of sub-section (6) provided the conditions mentioned therein are satisfied. Therefore, while a comparison of the assessed income with processed income [as required by sub-section (2)] may reveal under-reporting it is quite possible that by virtue of one of the five clauses of sub-section (6) the amount of under-reported income may go down.

12.5 The conditions prescribed in various clauses of sub-section (6) are subjective conditions e.g. clause (a) requires that the Specified Authority is satisfied that the explanation is *bona fide* and that the assessee has disclosed all the material facts to substantiate the explanation offered. Therefore, the assessee will have to prove that all the material facts have been disclosed by him either in the return or in the course of assessment proceedings and that his explanation is *bona fide* and the AO should be satisfied that the explanation is *bona fide.* Therefore, it cannot be said that the levy of penalty is automatic.

12.6 Further, sub-section (9) provides situations in which under-reported income will be regarded as being in consequence of misreporting thereof. It will be for the AO to initially prove that the case of the assessee is covered by one of the six clauses of sub-section (9) and then it will be for the assessee to show cause that his case is not covered by any of the clauses of sub-section (9).

12.7 In the view of the above, it appears that levy of penalty is not automatic. Possibly, whether proceedings for levy of penalty under section 270A are to be initiated or not will be determined by an arithmetical exercise and to that extent the section is objective.

13. Appeal against order levying penalty under section 270A:

Consequent to introduction of section 270A levying penalty, an amendment has been carried out to the provisions of section 253(1)(a) and also to section 253(1)(c) providing for filing an appeal to the Tribunal against an order passed by Commissioner (Appeals)/ Principal Commissioner or Commissioner under section 270A. However, no amendment has been effected to the provisions of section 246A. So, at first blush, it appears that there is no appeal against an order under section 270A to the Commissioner (Appeals). However, clause (q) of section 246A (1) provides for an appeal against an order levying penalty under Chapter XXI. Section 270A is a section in Chapter XXI and therefore, an appeal does lie to the Commissioner (Appeals) against order under section 270A passed by the Assessing Officer.

14. Section 273A, prior to its amendment by the Finance Act, 2016 empowered the Principal Commissioner or Commissioner to use discretion for waiver of penalty imposable on the tax payer under section 271(1)(c). The section did not provide for any time limit for accepting or rejecting the petition for waiver of penalty. Consequent to introduction of section 270A, Finance Act, 2016 has amended the provisions of section 273A to incorporate reference to penalty levied under section 270A. Application for waiver of penalty shall now be disposed within a period of 12 months from the end of the month in which the application was received by the Principal Commissioner or by the Commissioner.

15. Will penalty under section 270A be imposable if the assessee does not report at all i.e. the assessee does not file a return of income.

15.1 The Act does not define the terms 'under-report' and/or 'mis-report'. Section 270A merely states the circumstances in which a person shall be considered to have under-reported his income. Also, sub-section (9) lists down cases in which under-reporting will be regarded to be in consequence of misreporting thereof by any person

15.2 Both the terms under-report and mis-report imply reporting of income by the assessee. Reporting of income by an assessee is in the Form of return of income. A question arises as to whether in a case where assessee has not reported any income (as he has not filed the return of income) can it be said that he has under-reported or misreported his income?

15.3 One view is that non-reporting of income can be equated with reporting nil income. Therefore, the assessee could be said to have under-reported / misreported his income if he has not filed his return of income. Moreover, section 270A specifically provides that in a case where return of income is not filed the assessed income shall be regarded as under-reported income. Manner of computing under-reported income and also the amount of tax payable thereon has also been provided. Therefore, it appears that non-filing of the return of income cannot be a valid defence to contend that since there is no reporting of income by the assessee the question of assessee having under-reported his income does not arise.

15.4 The other view is that not reporting the amount by virtue of non-filing of return of income is not the same as having reported a nil amount and therefore since there is no reporting the question of it being under-reported or misreporting does not arise. However, if this view is accepted then it will render the provisions dealing with computation of under-reported income in a case where assessee has not filed return of income otiose. The courts may not be inclined to uphold an interpretation which makes certain parts of a provision otiose.

16. Burden of proof

16.1 Sub-section (2) of section 270A provides for seven cases / situation in which a person shall be considered to have under-reported his income. By and large, sub-section (2) provides that a person shall be considered to have under-reported his income if assessed income is greater than processed income or income reassessed is greater than income assessed in the immediately preceding order. Therefore, till this stage there is no question of any burden of proof because an arithmetical exercise determines whether the person shall be considered to have under-reported his income or not. In the circumstances, the question of burden of proof does not arise. The initiation appears to be on the basis of an arithmetical exercise.

16.2 Sub-section (6) provides for certain situations / amounts which shall not be included in under-reported income. Therefore, five items / cases covered by five clauses of sub-section (6) are to be excluded from under-reported income. Each of the clauses has certain conditions attached upon satisfaction of which the amount referred to in that clause will not be included in under-reported income. The initial burden will be on the assessee to show that the requisite conditions mentioned in the relevant clause of sub-section (6) are satisfied and therefore the amount which satisfies those conditions is not to be included in under-reported income. Once the assessee has discharged the initial burden, it will be for the AO to demonstrate that the case of the assessee is not covered by any of the clauses of sub-section (6).

16.3 Sub-section (9) provides for situations in which under-reported income will be regarded to be in consequence of misreporting of income. Misreporting of income attracts penalty @ 200% of the amount of tax payable on under-reported income whereas if under-reporting is not as a consequence of misreporting of income then the penalty is 50% of the amount of tax payable on under-reported income. If the Specified Authority alleges that the under-reported income is as a consequence of misreporting then it will be for the Specified Authority to demonstrate that the case of the assessee falls in one of the 6 clauses of sub-section (9).

17. Immunity from imposition of penalty for under-reporting – Section 270AA

17.1 It appears that with a view to reduce litigation and to recover taxes along with interest, legislature has introduced this provision authorising the AO to grant immunity from imposition of penalty under section 270A and initiation of prosecution under section 276C or section 276CC, upon satisfaction of conditions mentioned in the section.

17.2 Section 270AA, as introduced, has 6 sub-sections. The section seeks to impose conditions on satisfaction of which the AO shall grant immunity from imposition of penalty and also from prosecution.

17.3 **Application to whom to be made and for what:**

Sub-section (1) provides that an assessee may take an application –

(i) to the Assessing Officer;

(ii) for grant of immunity from imposition of penalty under section 270A and initiation of proceedings under section 276C or section 276CC.

17.4 **Conditions to be satisfied:** The application may be made only if the assessee satisfies both the following conditions:

(a) the tax and interest payable as per the order of assessment or reassessment under section 143(3) or section 147, as the case may be, has been paid within the period specified in the notice of demand; and

(b) no appeal has been failed against the order under section 143(3) or under section 147.

17.5 **Time within which the application is to be made:** Sub-section (2) of section 270AA provides that the application has to be made within a period of 30 days from the end of the month in which the order under section 143(3) or under section 147, as the case may be, has been received.

17.6 **Form in which the application is to be made and verification of the Form:** Rule 129 has prescribed Form No.68 for this purpose. The Form prescribed does not require any significant details to be filed in. The application form has to be signed by a person who can and may be authorized to verify such application in terms of the provisions of law or other requirements as may be applicable.

17.7 **Duties of the Assessing Officer on receipt of the application:** The Assessing Officer shall, after expiry of the period for filing an appeal to the CIT(A) has expired, grant immunity from imposition of penalty under section 270A and from initiation of proceedings under section 276C or section 276CC provided –

(i) the two conditions mentioned in sub-section (1) are satisfied by the assessee i.e. the assessee has paid tax along with interest within the time specified in the notice of demand and has not filed an appeal against the order under section 143(3) or under section 147, as the case may be; and

(ii) the penalty proceedings under section 270A are not for misreporting of income.

17.8 The order shall be passed by the Assessing Officer within a period of one month from the end of the month in which application is received by the Assessing Officer. The order may accept the application of the assessee or reject such application. However, before passing an order rejecting the application the assesse shall be given an opportunity of being heard [Sub-section (4)].

17.9 The order accepting application or rejecting such application shall be final. In other words no appeal or revision shall lie against such an order even if the order is rejecting the application made by the assessee [Sub-section (5)]

17.10 No appeal to CIT(A) or revision to Commissioner under section 264 shall lie against an order of assessment under section 143(3) or of reassessment under section 147 where an order has made under sub-section (4) of section 270AA accepting the application.

Certain observation / issues

17.11 It appears that immunity will be granted if order of assessment is under section 143(3) or under section 147. A question would arise as to whether an application for grant of immunity can be made if the order of assessment is under section 153A or under section 153C of the Act. It appears that orders for assessment under sections 144, 153A or 153C may not qualify for grant of immunity under section 270AA.

17.12 One of the conditions is that the tax and interest mentioned in the notice of demand has to be paid within the time specified in the notice of demand. Usually, for payment of tax and interest, a time period of 30 days is available. However, in certain cases, the Assessing Officer may stipulate that the amount mentioned in the notice of demand be paid within a period less than 30 days. In such cases, tax and interest will have to be paid within the period stated in the notice of demand.

17.13 It is quite possible that the amount of tax and interest stated in the notice of demand is erroneous for various reasons such as calculation of interest could be wrong or credit for prepaid taxes may not have been correctly granted and the assessee may have upon receipt of such a notice of demand applied for rectification. It appears that in such cases, pending the disposal of the rectification by the Assessing Officer, the assessee will have to pay the amount stated in the notice of demand within the period stated in the notice of demand without waiting for rectification application to be disposed. If the payment is not done, the assesse will not be eligible to apply for grant of immunity from imposition of penalty under section 270A and initiation of proceedings under section 276C or section 276CC.

17.14 While it is a precondition that the tax and interest as per notice of demand must be paid within the time period mentioned in the notice of demand, it is quite possible that the assessee having paid the amount demanded may not get immunity as his application may be rejected and such order rejecting the application is final and not appealable.

17.15 The section confers power of granting immunity only on the Assessing Officer.

Hence, Commissioner (Appeals), Commissioner or Principal Commissioner does not have such a power. Accordingly, when penalty is initiated by Commissioner (Appeals) or Commissioner or Principal Commissioner it appears that an application for immunity cannot be made.

17.16 There is a prohibition on filing an appeal. However, at that stage there is no prohibition on filing a rectification or revision application. Also, there is no prohibition on *suo motu* rectification or revision of the order of assessment or reassessment.

17.17 One the condition is that the assessee must not file an appeal against the order of assessment or reassessment if the assessee is making an application for grant of immunity from imposition of penalty. In an assessment order, there may be several additions/ disallowances to the total income. The difference between assessed income and processed income will represent under-reported income. Now this under-reported income could comprise of different additions and in respect of different additions different situations might arise e.g. some of the additions may be excludible from under-reported income as they might fall under one of the clauses of sub-section (6) of section 270; some of the additions may be regarded as under-reported income and some of the additions may be regarded as misreported income. In such a case, penalty proceedings would be initiated for under-reported income and also for misreported income. In such a situation, it appears that the assessee may not be able to make an application or even if he makes an application, the Assessing Officer may pass an order rejecting the application made by the assessee on the ground that the immunity is only in cases of under-reported income and not in cases where under-reporting is as a consequence of misreporting.

17.18 The time period taken from the date of making an application to the date of order rejecting the application is to be excluded while computing the period of limitation for filing of appeal to CIT(A). However, the time period from the date of receipt of the order till the date of making the application is not to be excluded. The assessee is eligible to make an application for immunity only if he has not preferred an appeal against the order of assessment or re-assessment, as the case may be. The time limit for filing an appeal to CIT(A) is 30 days from the date of receipt of the notice of demand which is generally served along with the order of assessment or re-assessment and the time for making an application for grant of immunity from imposition of penalty under section 270A is 30 days from the end of the month in which the order of assessment or reassessment is received. Therefore, it is quite possible that by the time the assessee makes an application the time period for filing an appeal has already expired and if in such a case the order under section 270AA(4) rejects the application of the assessee, the appeal will be delayed and condonation of delay would have to be sought for filing an appeal. Therefore, it is advisable that the application for immunity should be made before the time period for filing appeal expires so that in the event the application of the assese is rejected, the assessee still has some time to file an appeal.

17.19 It is relevant to note that while the time period from the date of making the application till date of order rejecting the application is to be excluded for computing the period of limitation to file an appeal to CIT(A), similar exclusion is not available for computing the period of limitation to file an appeal to the Tribunal. Therefore, there could be some difficulty in cases where the application is rejected and an appeal is to be preferred directly to the Tribunal e.g. cases where assessment is completed pursuant to the direction of DRP.

17.20 The order rejecting the application is final. Therefore, if the application is rejected on the ground that the under-reporting is in consequence of misreporting it may so happen that the department may, in the course of appellate proceedings, contend that the order under section 270AA(4) being final, the assessee has accepted that there is misreporting of income. It is advisable that upon receiving the order rejecting the application the assessee writes a letter to Assessing Officer saying that he does not accept the findings in the order rejecting the application and that appeal is not being filed because the order is not appealable. Such a letter will demonstrate the case of the assessee that he did not accept the case of the Assessing Officer.

Conclusion

The above analysis attempts to explain the provisions of section 270A and 270AA. There are several issues which due to constraint on the length have not been covered above e.g. in the context of sub-sections (4) and (5) the issue could be where the addition in the earlier year was made it was provisions of section 271(1)(c) which were operative and in the current year where the addition is being explained as source of deposit, receipt or investment section 270A applies. The deeming fiction is that the amount disallowed in earlier year will be deemed to be under-reported income of earlier assessment year in which addition was made and penalty not levied. Can one deem that provisions of section 270A were in operation for assessment years prior to 2017-18? Also, as regards amount of tax on under-reported income, an issue could arise as to whether the amount of under-reported income consists of income chargeable to tax at special rate e.g. long term capital gains, etc then is the normal rate to be applied or is it that the special rate be applied. If one comes to a conclusion that special rate is to be applied how will one apply the special rate when the under-reported income is an aggregate of several additions and net of deductions allowed in assessment which were not there in return of income e.g. upon change in head of income under which a particular income is assessed by the AO the amount of income *qua* that source may be assessed to be a lower amount than the amount returned. It appears that a fresh round of litigation is about to commence and this will be against the interest of the assessee and contrary to the objectives for which the provisions have been introduced.

❍❑❍

Aditya Ajgaonkar, *Advocate*

Principles of Natural Justice during sanction and Procedure of Prosecution

The Principles of natural justice as the the name suggest are those fundamental principles that are innate in nature for 'Justice' to be done. They exist upon a separate pedestal in law and though they overlap the fundamental rights guaranteed by the constitution to its citizen from time to time, they can be said to be a part of something larger, grander and unquantifiable even in the legal sphere, transcending the spheres of legislation and constitutional law being subservient only to universal human rights of which it forms a part of. The importance of the principles of natural justice is further accented by the essential part of the rule of law that states "Justice must not only be done but also seen to be done".

The Hon'ble Justice A Sikhri in the matter of *V. P. Singh & Ors. 82 (1999) DLT 845* held that "Non-observance of Principles of Natural Justice would come under the ground "procedural impropriety". It is well known that the Principles of Natural Justice encompass two Principles, namely: (1) That no man shall be judge in his own cause. (This is derived from the Latin maxim, namely, 'Nemo debet essa judex propria sua causa:) (2) That no man shall be condemned unheard. (This is also derived from a Latin maxim, namely 'Audi alterm Partem)" and a third was also introduced:- (3) That the concerned authority shall pass speaking order giving reasons in support of its order.

The Hon'ble Supreme Court in the case of *State of Punjab vs. K. R. Erry AIR 1973 SC 834* held as follows "The law on the point is not in doubt. Where a body or authority is judicial or where it has to determine a matter involving rights judicially because of express or implied provision, the Principles of natural justice audi alteram partem applies. With the proliferation of administrative decisions in the welfare State it is now further recognised by courts both in England and in this country, especially after the decision of House of Lords in 1964 AC 40 that where a body or authority is characteristically administrative, the Principles of Natural justice is also liable to be invoked if the decision of that body or authority affects individual rights or interests and having regard to the particular situation it would be unfair for the body or authority not to have allowed a reasonable opportunity to be heard. An order by the State to the prejudice of a person in derogation of his vested rights may be made only in accordance with the basic rules of justice and fair play.

The deciding authority, it is true, is not in the position of a Judge called upon to decide an action between contesting parties, and strict compliance with the forms of judicial procedure may not be insisted upon. He is however under a duty to give the person against whom an enquiry is held an opportunity to set up his version or defence and an opportunity to correct or to controvert any evidence in the possession of the authority which is sought to be relied upon to this prejudice. For that purpose the person against whom an enquiry is held must be informed of the case he is called upon to meet, and the evidence in support thereof. The rule that a party to whose prejudice an order is intended to be passed is entitled to a hearing applies alike to judicial tribunals and bodies of persons invested with authority to adjudicate upon matters involving civil consequences. It is one of the fundamental rules of our constitutional set up that every citizen is protected against exercise of arbitrary authority by the State or its officers. Duty to act judicially would therefore arise from the very nature of the function intended to be performed, it need not be shown to be super-added. If there is power to decide and determine to the prejudice of a person, duty to act judicially is implicit in the exercised of such power. If the essentials of justice be ignored and an order to the prejudice of a person is made, the order is a nullity. That is a basic concept of the rule of law and importance thereof transcends the significance of a decision in any particular case."

It is therefore an established principle of constitutional jurisprudence that the Principles of Natural Justice can broadly be classified into three :- Opportunity for an impartial hearing, Opportunity of a fair hearing & a reasoned order. There rights need to have been adhered to when an administrative action is being scrutinised by Judicial review. Prosecutions proceedings themselves as a departure from the proceedings under the Income Tax Act are subject to influence from the Criminal Procedure Code, the Indian Evidence Act and also the Principles of natural justice. However, there are questions asked if whether the principles of natural justice would extend to the grant of sanction for prosecution under the Income Tax Act. The answer to that would of course depend upon if the grant of sanction is considered as an administrative act or a judicial / quasi judicial proceeding.

The Hon'ble Supreme Court in *Assistant Commissioner vs. Velliappa Textiles Ltd. [2003] 263 ITR 550 (SC)* has held that a grant of a sanction is purely and administrative Act and therefore just because no opportunity of being heard to the Accused is contemplated at that stage. The Hon'ble Apex Court relied upon its order in the case of *Superintendent of Police, C.B.I. vs. Deepak Chowdhary [1995] 6 SCC 225* where it was held that ". . . The grant of sanction is only an administrative function, though it is true that the Accused may be saddled with the liability to be prosecuted in a court of law. What is material at that time is that the necessary facts collected during investigation constituting the offence have to be placed before the sanctioning authority and it has to consider the material prima facie, the authority is required to reach the satisfaction that the relevant facts would constitute the offence and then either grant or refuse to grant sanction. The grant of sanction, therefore, being administrative act the need to provide an opportunity of hearing to the Accused before according sanction does not arise. The High Court, therefore, was clearly in error in holding that the order of sanction is vitiated by violation of the principles of natural justice." The Supreme Court has thus established that no opportunity of hearing is required to be given by the Commissioner of Income Tax before the grant of sanction by the by the Commissioner of Income tax. This Judgement of the Hon'ble Supreme Court has overruled the order of the Hon'ble High Court of Karnataka in the case of *P.V. Pai vs. DCIT [1993] 200 ITR 717 (Karnataka)* where the Hon'ble High Court had held the the powers to grant sanction are quasi judicial in nature. Hence, it is now settled law that the act of granting sanction is an administrative act and no opportunity of being heard is needed to be given to the Assessee before the sanction of prosecution is granted.

It is also of note that though there are no specific procedure provided under the Act or the Rules for initiating prosecution proceedings, the Department has framed its own guidelines for initiation the said prosecution proceedings. The manual of the Income Tax Department deals with the various guidelines to be followed before launching prosecution proceedings which also prescribe that the Commissioner issues sow cause notice to the Assessee and if he is not satisfied that the case is fit for prosecution, then he may not grant sanction for prosecution.

It is however important to note that in a majority of cases it is being observed that the department is issuing show cause notices to the Assessee before the prosecutions are sanctioned. It is to be remembered that there is no bar against the department to actually provide an opportunity to be heard to the Accused, just that it is nor mandatory and that the prosecution proceedings shall not stand vitiated for the sole reason that the mandatory sanction was granted without giving a sufficient opportunity to the Assessee. It is also entirely possible that the said show cause notices are being issued in an effort to avoid actual litigation that would cause the Revenue authorities and the judicial system time and money and get the Assessee an opportunity to buy peace via compounding before the lengthy procedure of prosecution is well underway. Assessee are also cautioned about what submissions and information is placed on record in the reply to show cause notice as any semblance of admission / omission or contradiction can be used against them in the court of law during prosecution proceedings.

It is also to be noted that Under S. 279, the competent authority to grant sanction for prosecution is the Commissioner, Commissioner (Appeals), Chief Commissioner or the Director General. Prosecution, without a requisite sanction shall make the entire proceedings void ab initio. The sanction must be in respect of each of the offences in respect of which the Accused is to be prosecuted. It therefore also follows that if the sanction is granted for a specific offense, the Accused cannot be tried or convicted for an offense for which sanction is not granted as held by the Hon'ble Judicial Commissioner's Court in *Champalal Girdharlal vs. Emperior (1933) 1 ITR 384 (Nag) (HC).* A direct parallel can be drawn between this provision and the provisions for imposition of penalty where if the satisfaction is specific to 'Concealment' of Income, then penalty cannot be levied for furnishing inaccurate particulars of Income and vice-versa.

It is however to be noted that the observations of the Supreme Court are restricted to the issue of a show cause notice before granting of sanction. It was held that the grant of sanction being a purely administrative action, there is no need for the Assessee to be heard. However, once the prosecution itself is initiated, the scenario undergoes a dramatic change and the rights of the Accused get the full protection of the law as granted to him by the criminal procedure code, the constitution of India as well as the un-codified principles of natural justice. At that Juncture when Judicial proceedings are ongoing the Judgement of the *Hon'ble Apex Court in State of Punjab vs. K. R. Erry AIR 1973 SC 834* shall apply and the infraction of any of the principles of natural justice can act as an impediment in the case of the prosecution.

Procedure and Trial after the Sanction of prosecution

Limitation is the provision of law by which certain legal remedies allowed to a certain authority or individual are 'time barred'. The issue of limitation being a jurisdictional issue has to be decided in a technical manner in the first instance before weighing a case on merits. If the period of limitation has elapsed, then no action can be taken against a defaulted and the remedy itself is lost. It is to be noted that there is no specific limitation prescribed against economic offenses under the Criminal Procedure Code. In *Friends Oil Mills & Ors. vs. ITO (1977)*

106 ITR 571 (Ker.) (HC), the Hon'ble Kerala High Court held that the bar of limitation specified in section 468 of the Code of Criminal Procedure, 1973 would not apply to a prosecution, under the Income-tax Act. Therefore a view can be taken that there is no fixed period of limitation for initiation of proceedings under the Act. The effects of this while varied would mean that the Income Tax Department could initiate proceedings against an assessee for an offense committed in the past even after the efflux of a substantial amount of time. In *Gajanand vs. State (1986) 159 ITR 101 (Pat) (HC))*, the Hon'ble High Court held that where the Criminal Proceedings had proceeded for 12 years and the Income tax department failed to produce the evidence, the Hon'ble Patna High Court held that the prosecution was to be quashed. In *State of Maharashtra vs. Natwarlal Damodardas Soni AIR 1980 SC 593, 1980 SCR (2) 340,* the Court held that a long delay along with other circumstances in the favour of the Assessee must be taken in to consideration in the mitigation of the sentence.

Bail, very simply put is the process of procuring the release of an Accused by ensuring his attendance in court. In short, obtaining Bail is the process by which an Accused is released from custody and given his freedom subject to certain conditions felt necessary to ensure his attendance in Court. Offenses fall under two distinct categories – Bailable and Non-Bailable and depending upon whether the Accused is being prosecuted for a bailable offense or a non-bailable offense shall dictate the procedure and the challenges of obtaining bail. Bailable offenses are those offenses were bail is granted as a matter of right. Non-Bailable offenses on the other hand as opposed to the interpretation placed upon the title by laymen refers to offenses where bail is not obtainable as a matter of right but is at the discretion of the Courts.

The right to liberty is an important right that is enshrined in our constitution. The very concept of arresting a person is a direct violation of the said right to liberty and yet it is desirable that anti-social elements and offenders be segregated from the society both for reform and punishment. The loss of liberty is one of the strongest deterrents placed by the criminal justice system in India in an effort to curb crime. However, just as right to liberty is not absolute and is subject to reasonable restrictions that are placed upon it by legislation, the loss of liberty itself also is not automatic and has safeguards woven into the process in order to minimize the abuse of legal provisions. A person cannot be deprived of his liberty without the due process and sanction of the law. Obtaining Bail is the first step in restoring of a person's liberty when he is accused of a crime. The Hon'ble Supreme Court in the case of *Maneka Gandhi vs. UOI in (1978) 1 SCC 248* held that "Bail is the rule and jail is the exception".

Are economic offenses to be judged by a different yardstick as compared to other offenses? The public at large holds economic offenses at a lower standard as compared to offenses to life, limb and property. However, as criminal jurisprudence has grown over time there has been a paradigm shift in the view of both the government as well as the judiciary towards the entire gamut of economic offenses. The government has stepped up its efforts to clamp down on economic offenses and the approach of the Judiciary can be encapsulated by the following extract of the judgment of the Supreme Court as reported in *State of Gujrat vs. Mohanlal Jitamal Porwal & Ors. AIR 1987 SC 1321* "The entire Community is aggrieved if the economic offenders who ruin the economy of the State are not brought to books. A murder may be committed in the heat of moment upon passions being aroused. An economic offence is committed with cool calculation and deliberate design with an eye on personal profit regardless of the consequence to the Community. A disregard for the interest of the Community can be manifested only at the cost of forfeiting the trust and faith of the Community in the system to administer justice in an even handed manner without fear of criticism from the quarters which view white collar crimes with a permissive eye unmindful of the damage done to the National Economy and National Interest". The said quote was reapproved in *Ram Narain Popli vs. CBI 2003 (3) SCC 641* where the Hon'ble Court observed "Unfortunately in the last few years, the country has seen an alarming rise in white-collar crimes which has affected the fiber of the country's economic structure. These cases are nothing but private gain at the cost of the public, and lead to economic disaster." And in the case of *Y.S. Jaganmohan Reddy vs. CBI (2013) 7 SCC 439* "Economic offences constitute a class apart and need to be visited with a different approach in the matter of bail. The economic offence having deep rooted conspiracies and involving huge loss of public funds needs to be viewed seriously and considered as grave offences affecting the economy of the country as a whole and thereby posing serious threat to the financial health of the country." In line with the above observations of the Supreme Court, the jurisprudence for bail in economic offenses has also developed separately from that applicable to traditional offenses.

In bailable offenses, bail is granted as a matter of right. The Accused has to in the case of prosecution under the Income Tax Act in the case a bailable offense, needs to merely present himself in court and make a simplicitor application for bail. Bail shall be granted as a matter of right subject to the conditions the court may deem fit. An important caveat even in bailable offenses is that by being released on bail, the Accused undertakes to produce himself in court as and when required. Any violation of any condition imposed while granting bail, even in case of a bailable offense can cause the bail to be cancelled and the Accused to be taken into custody. The court can can refuse bail even if offense is bailable if conditions imposed while granting bails are violated.

If the Assessee apprehends that he may be made an Accused of committing a non-bailable offense, it is possible for him to seek anticipatory bail. Section 438 of CRPC provides for anticipatory bails as follows :- Where any person has any reason to belive that he may be arrested on accusation of having committed a non-bailable offense, he may apply to the High Court or the Court of Session for a direction under this section that in the event of such arrest he shall be released on bail. The Court may, after taking into consideration, inter alia the following factors, namely:- (i) the nature and gravity of the accusation ; (ii) the antecedants of the applicant … (iii) the possibility of the applicant to flee from justice (iv) where the accusation has been made with the object of injuring or humiliating the applicant by having him so arrested; either reject the application forthwith or issue an interim order for grant of anticipatory bail." It is to be noted that in case the offenses under Income Tax Act are clubbed with other offenses, it is better to avail of anticipatory bail in order to preserve the liberty of the Accused. However, anticipatory bail can also turn into a dual edged sword as ff interim protection is not granted, the concerned officer may arrest the applicant on basis of accusation apprehended in such application. The Anticipatory bail application must ideally be moved before the Court of Session and only in exceptional circumstances can it be moved directly before the High Court. It is recommended that the anticipatory bail application be moved before the sessions court as not only does it give the Assessee an extra protection in the form of the High Court if the said bail is refused but also allows the High Court to have the advantages of the reasoning and observations of the Sessions court.

In the case of a non- bailable offense, as opposed to what the name seems to suggest, it is not that bail cannot be obtained. Rather, the grant of bail is not automatic and a matter of right but rather, Bail must be obtained from the court on merits. At the time of granting bail the Court only looks at the prima facie material and should not go into merits of the case by appreciating evidence. In granting or not granting of bail in a non-bailable offense, the primary consideration is the nature and gravity of the offense. The Hon'ble Court in the case of *State vs. Jaspal Singh Gill 1984 SCC (3) 555* held that At the time of granting bail in cases involving non-bailable offences particularly where the trial has not yet commenced, the court should take into consideration various matters such as the nature and seriousness of the offence, the character of the evidence, circumstances which are peculiar to the Accused, a reasonable possibility of the presence of the Accused not being secured at the trial, reasonable apprehension of witnesses being tampered with, the larger interests of the public or the State and similar other considerations. In case of a non-bailable offense, the Bail application must be made before the Trial Court and it needs to be brought out on the circumstances that the Accused is deserving of bail and needs to be enlarged upon bail. In case bail is refused, the Session Court and later the High Court may be apprcoahed in order to obtain bail.

The Rajasthan High Court in the case of *ITO vs. Gopal Dhamani [1988] 172 ITR 462 (Raj)* laid down the proposition :- "in such cases where tax evasion is prima facie of very high valuation, the question of bail should be considered seriously and it should not be granted as a matter of course. Tax evasion of high value certainly jeopardise the entire economy of the country, and is an economic crime of serious magnitude. Jail and not bail in serious economic, anti-social, white-collar crimes". Armed by the said Judgment , the Department attempted to prevent bails in the case of economic offenses citing the severity and the magnitude. However, Subsequently the Hon'ble Rajsthan High court in *J.P. Singh vs. IACIT [1990] 185 ITR 659 (Rajasthan)* held that "There is no force in the contention of learned counsel for the Department that anticipatory bail cannot be granted in cases involving economic offences" and in *Rajvir Singh vs. State of Rajasthan [1990] 186 ITR 144 (Rajasthan)* the Hon'ble Court held that "a general principle cannot be laid down that in all cases involving commission of economic offences anticipatory bail is to be refused. What is to be seen is whether in the facts and circumstances of the case, anticipatory bail should be granted or not. Bail can be refused even in bailable cases, provided the circumstances for doing so exist. The guiding factor for grant or refusal of bail is not the issue of bailable or non-bailable warrants in the first instance, but would be the facts and circumstances of the case to be considered in the light of sections 437 and 438, Criminal Procedure Code". The Action of the Rajsthan High Court to clarify that the stringent observations in the case of *ITO vs. Gopal Dhamani* are not all encompassing and that every case needs to be scrutinized on merit came as a great relief to tax payers and has contributed in a large fashion to the jurisprudence regarding bails in offenses under the Income Tax Act.

The entire gamut of the jurisprudence regarding bail is much wider than the narrow compass by which it has been viewed. However, it stands to reason that Bail in the case of non-bailable offenses shall be largely influenced by the nature and gravity of the offense, the flight risk posed by the Accused and the chances that he may tamper with evidence. Getting bail in the first instance is critical as multiple applications without change of circumstances are not maintainable and hence the process of obtaining bail attains a special significance where a criminal trial can take multiple years to complete. Equally critical then is to conform to the conditions laid down the the order granting bail, failing which a non-bailable warrant maybe be issued against an Assesse Accused of a bailable offense.

Once the Accused is enlarged on bail, the next step is for the Accused to attempt to obtain an exemption from appearing in Court until required to do so by the requirement of the Court. The laws relating to exemption are governed by Section 205 of the Criminal Procedure Code. It is to be appreciated that it is the sole discretion of the court to grant exemption or not. The grant of exemption has the effect of doing away with the requirement of the accused having to present himself before the court time and again before the time is to start. In a scenario where the commencement of the Criminal Trial itself can take years, getting an exemption from personal appearance can act as a major relief against the harassment that a criminal prosecution may cause to an Assessee. It is also important that the Accused person should have regularly attended trial up to the point when the exemption is sought for. In other words the accused should have not been absconding from trial and should not have been declared a Proclaimed Offender by the Magistrate. The Magistrate while considering such applications thus has to bear in mind the following: (a) The nature of the crime alleged to have been committed. (b) The conduct of the Accused which is of paramount importance. It is also possible for an accused that has even for the first time appeared before the Trial Court through a pleader and not in person to ask for exemption from appearing before the Trial Court. In case the exemption is not granted, the Accused shall have the option of filing a revision petition before the Session Court and an appeal thereon if required to the High Court.

A simple guide to the laws relating to bail in prosecutions under the Income-tax Act

Bail, very simply put is the process of procuring the release of an accused by ensuring his attendance in court. In short, obtaining bail is the process by which an accused is released from custody and given his freedom subject to certain conditions felt necessary to ensure his attendance in Court. Offences fall under two distinct categories – Bailable and non-bailable and depending upon whether the Accused is being prosecuted for a bailable offence or a non-bailable offence shall dictate the procedure and the challenges of obtaining bail. Bailable offences are those offences were bail is granted as a matter of right. Non-bailable offences on the other hand as opposed to the interpretation placed upon the title by laymen refers to offences where bail is not obtainable as a matter of right but is at the discretion of the Courts.

The right to liberty is an important right that is enshrined in our Constitution. The very concept of arresting a person is a direct violation of the said right to liberty and yet it is desirable that anti-social elements and offenders be segregated from the society both for reform and punishment. The loss of liberty is one of the strongest deterrents placed by the criminal justice system in India in an effort to curb crime. However, just as right to liberty is not absolute and is subject to reasonable restrictions that are placed upon it by legislation, the loss of liberty itself also is not automatic and has safeguards woven into the process in order to minimise the abuse of legal provisions. A person cannot be deprived of his liberty without the due process and sanction of the law. Obtaining bail is the first step in restoring of a person's liberty when he is accused of a crime. The Hon'ble Supreme Court in the case of *Maneka Gandhi vs. UOI in (1978) 1 SCC 248* held that "Bail is the rule and jail is the exception".

Are economic offences to be judged by a different yardstick as compared to other offences? The public at large holds economic offences at a lower standard as compared to offences to life, limb and property. However, as criminal jurisprudence has grown over time there has been a paradigm shift in the view of both the Government as well as the judiciary towards the entire gamut of economic offences. The Government has stepped up its efforts to clamp down on economic offences and the approach of the Judiciary can be encapsulated by the following extract of the judgment of the Supreme Court as reported in *State of Gujarat vs. Mohanlal Jitamal Porwal & Ors. AIR 1987 SC 1321* "The entire community is aggrieved if the economic offenders who ruin the economy of the State are not brought to book. A murder may be committed in the heat of moment upon passions being aroused. An economic offence is committed with cool calculation and deliberate design with an eye on personal profit regardless of the consequence to the community. A disregard for the interest of the community can be manifested only at the cost of forfeiting the trust and faith of the community in the system to administer justice in an even handed manner without fear of criticism from the quarters which view white collar crimes with a permissive eye unmindful of the damage done to the national economy and national interest". The said quote was reapproved in *Ram Narain Popli vs. CBI 2003 (3) SCC 641* where the Hon'ble Court observed "Unfortunately in the last few years, the country has seen an alarming rise in white-collar crimes which has affected the fibre of the country's economic structure. These cases are nothing but private gain at the cost of the public, and lead to economic disaster." And in the case of *Y. S. Jaganmohan Reddy vs. CBI (2013) 7 SCC 439* "Economic offences constitute a class apart and need to be visited with a different approach in the matter of bail. The economic offence having deep rooted conspiracies and involving huge loss of public funds needs to be viewed seriously and considered as grave offences affecting the economy of the country as a whole and thereby posing serious threat to the financial health of the country." In line with the above observations of the Supreme Court, the jurisprudence for bail in economic offences has also developed separately from that applicable to traditional offences.

In bailable offences, bail is granted as a matter of right. The accused has to in the case of prosecution under the Income-tax Act in the case a bailable offence, needs to merely present himself in court and make a simplicitor application for bail. Bail shall be granted as a matter of right subject to the conditions the court may deem fit. An important caveat even in bailable offences is that by being released on bail, the Accused undertakes to produce himself in court as and when required. Any violation of any condition imposed while granting bail, even in case of a bailable offence can cause the bail to be cancelled and the Accused to be taken into custody. The court can refuse bail even if offence is bailable if conditions imposed while granting bail are violated.

If the Assessee apprehends that he may be made an Accused of committing a non-bailable offence, it is possible for him to seek anticipatory bail. Section 438 of CRPC provides for anticipatory bail as follows : Where any person has any reason to belive that he may be arrested on accusation of having committed a non-bailable offence, he may apply to the High Court or the Court of Sessions for a direction under this section that in the event of such arrest he shall be released on bail. The Court may, after taking into consideration, *inter alia* the following factors, namely: (i) the nature and gravity of the accusation; (ii) the antecedants of the applicant ... (iii) the possibility of the applicant to flee from justice (iv) where the accusation has been made with the object of injuring or humiliating the applicant by having him so arrested; either reject the application forthwith or issue an interim order for grant of anticipatory bail." It is to be noted that in case the offences under Income-tax Act are clubbed with other offences, it is better to avail of anticipatory bail in order to preserve the liberty of the accused. However, anticipatory bail can also turn into a dual edged sword as if interim protection is not granted, the concerned officer may arrest the applicant on basis of accusation apprehended in such application. The Anticipatory bail application must ideally be moved before the Court of Session and only in exceptional circumstances can it be moved directly before the High Court. It is recommended that the anticipatory bail application be moved before the Sessions court as not only does it give the Assessee an extra protection in the form of the High Court if the said bail is refused but also allows the High Court to have the advantages of the reasoning and observations of the Sessions court.

In the case of a non-bailable offence, as opposed to what the name seems to suggest, it is not that bail cannot be obtained. Rather, the grant of bail is not automatic and a matter of right but rather, Bail must be obtained from the court on merits. At the time of granting bail the Court only looks at the *prima facie* material and should not go into merits of the case by appreciating evidence. In granting or not granting of bail in a non-bailable offence, the primary consideration is the nature and gravity of the offence. The Hon'ble Court in the case of *State vs. Jaspal Singh Gill 1984 SCC (3) 555* held that at the time of granting bail in cases involving non-bailable offences particularly where the trial has not yet commenced, the court should take into consideration various matters such as the nature and seriousness of the offence, the character of the evidence, circumstances which are peculiar to the accused, a reasonable possibility of the presence of the accused not being secured at the trial, reasonable apprehension of witnesses being tampered with, the larger interests of the public or the State and similar other considerations. In case of a non-bailable offence, the bail application must be made before the Trial Court and it needs to be brought out on the circumstances that the accused is deserving of bail and needs to be enlarged upon bail. In case bail is refused, the Sessions Court and later the High Court may be approached in order to obtain bail.

The Rajasthan High Court in the case of *ITO vs. Gopal Dhamani [1988] 172 ITR 462 (Raj)* laid down the proposition :— "In such cases where tax evasion is *prima facie* of very high valuation, the question of bail should be considered seriously and it should not be granted as a matter of course. Tax evasion of high value certainly jeopardise the entire economy of the country, and is an economic crime of serious magnitude. Jail and not bail in serious economic, anti-social, white-collar crimes". Armed by the said Judgment, the Department attempted to prevent bails in the case of economic offences citing the severity and the magnitude. However, Subsequently the Hon'ble Rajasthan High Court in *J.P. Singh vs. IACIT [1990] 185 ITR 659 (Rajasthan)* held that "There is no force in the contention of learned counsel for the Department that anticipatory bail cannot be granted in cases involving economic offences" and in *Rajvir Singh vs. State of Rajasthan [1990] 186 ITR 144 (Rajasthan)* the Hon'ble Court held that "a general principle cannot be laid down that in all cases involving commission of economic offences anticipatory bail is to be refused. What is to be seen is whether in the facts and circumstances of the case, anticipatory bail should be granted or not. Bail can be refused even in bailable cases, provided the circumstances for doing so exist. The guiding factor for grant or refusal of bail is not the issue of bailable or non-bailable warrants in the first instance, but would be the facts and circumstances of the case to be considered in the light of sections 437 and 438, Criminal Procedure Code". The action of the Rajasthan High Court to clarify that the stringent observations in the case of *ITO vs. Gopal Dhamani* are not all encompassing and that every case needs to be scrutinized on merit came as a great relief to taxpayers and has contributed in a large fashion to the jurisprudence regarding bails in offences under the Income-tax Act.

The entire gamut of the jurisprudence regarding bail is much wider than the narrow compass by which it has been viewed. However, it stands to reason that Bail in the case of non-bailable offences shall be largely influenced by the nature and gravity of the offence, the flight risk posed by the accused and the chances that he may tamper with evidence. Getting bail in the first instance is critical as multiple applications without change of circumstances are not maintainable and hence the process of obtaining bail attains a special significance where a criminal trial can take multiple years to complete. Equally critical then is to conform to the conditions laid down the order granting bail, failing which a non-bailable warrant maybe be issued against an assessee accused of a bailable offence.

❍❑❍

Mandar Vaidya, *Advocate*

Prosecution for obstructing Recovery and failure to pay to Government and Abatement

Chapter XII of the Income-tax Act, 1961 (IT Act), which deals with the offences & prosecutions, is always a matter of concern for anyone concerned and related with the IT Act. It is quite perplexing to understand the defences available to anyone prosecuted under the provisions of this chapter of the IT Act.

1. Offences and prosecutions under Income-tax Act, 1961

The sections dealing with offences and prosecution proceedings are included in Chapter XXII of the Income-tax Act, 1961 i.e., Section 275A to Section 280D of the Act (hereinafter referred as "said Act"). Provisions of the Criminal Procedure Code, 1973 are to be followed relating to all offences under the Income-tax Act, unless the contrary is specially provided for by the Act.

The Finance Act, 2012, w.e.f. 1-7-2012 has inserted Sections 280A to 280D, wherein the Central Government has been given the power to constitute Special Courts in consultation with the Chief Justices of the respective jurisdictional High Courts. Normally, the Magistrate Court in whose territorial jurisdiction an offence is committed tries the offence.

2. Presumption of *Mens rea* in case of prosecution (Section 278E)

The concept of mens rea is integral to criminal jurisprudence. An offence cannot be committed unintentionally. Generally a guilty mind is a sine *qua non* for an offence to be committed. The rule in general criminal jurisprudence established over the years has evolved into the concept of 'Innocent until proven guilty' which effectively places the burden of proving the guilt of the accused beyond reasonable doubt squarely on the prosecution.

However, the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986, inserted Section 278E with effect from 10th September, 1986 has carved out an exception to this rule. It is utmost important to note that with respect to all the offences under Chapter XXII of the IT Act, a judicial presumption, under Section 278E of the IT Act, as to the culpable state of mind i.e. *Mens rea*, is raised against all accused in relation to all offences. The said Section places the burden of proving the absence of *mens rea* upon the accused and also provides that such absence needs to be proved not only to the basic threshold of 'preponderance of probability' but 'beyond reasonable doubt'.

Section 278E of the Act, which is analogous to Section 138A of the Customs, Act, 1962, Section 92C of the Central Excise and Salt Act, 1944, Section 98B of the Gold (Control) Act, 1968 and Section 59 of the Foreign Exchange Regulation Act, 1973. Similar provision was introduced under Wealth-tax Act, 1957, i.e. Section 35-0 and Gift–tax Act, Section 35D. Constitutional validity of the said provision was upheld in *Selvi J. Jayalalitha vs. UOI and Ors. (2007) 288 ITR 225 (Mad.) (HC), Selvi J. Jayalalithav. ACIT (2007) 290 ITR 55 (Mad.) (HC)* which was affirmed by Apex Court in *Sasi Enterprises vs. ACIT (2014) 361 ITR 163 (SC).* The Apex Court in the afore mentioned decision observed that where ever specifically provided, in every prosecution case, the Court shall always presume culpable mental state and it is for the accused to prove the contrary beyond reasonable doubt. This is a drastic provision which makes far reaching changes in the concept of mens rea in as much it shifts the burden of proof to show the absence of the necessary ingredients of the intent to commit the crime upon the accused and is radical departure from the concept of traditional criminal jurisprudence. According to this section, wherever mens rea is a necessary ingredient in an offence under the Act, the Court shall presume its existence. No doubt, this presumption is a rebuttable one. The Explanation to the section provides for an inclusive definition of culpable mental state which is broad enough in its field so as to include intention, motive, knowledge of a fact and belief in or a reason to believe a fact. The presumption arising under sub-section (1) may be rebutted by the accused, but the burden that is cast upon the accused to displace the presumption is very heavy. The accused has to prove absence of culpable mental state not by mere preponderance of probability.

In *Prakash Nath Khanna vs. CIT (2004) 266 ITR 1 (SC),* the Court observed that the Court has to presume the existence of culpable mental state, and the absence of such mental state can be pleaded by an accused as a defense in respect of the Act charged as an offence in the prosecution. It is therefore open to the appellants to plead absence of a culpable mental state when the matter is taken up for trial.

Absence of Mens Rea can be taken as a defence and this is one of the strongest defense available for any prosecutions under this Chapter. Going by Section 278E(2) of the IT Act, the presumption against the accused has to be judiciously raised only when the Court believes that there are facts on record to establish guilt of the accused beyond reasonable doubt, and mere existence of a possibility of commission of an offence cannot be a ground for conviction.

While dealing with the aspect of *Mens rea* in relation to Section 276C of the IT Act, the Supreme Court in the case of *Gujarat Travancore Agency vs. CIT AIR 1989SC 1671,* held that:

> "There can be no dispute that having regard to the provisions of Section 276C, which speaks of wilful failure on the part of the defaulter and taking into consideration the nature of the penalty, which is punitive, no sentence can be imposed under that provision unless the element of *mens rea* is established."

The above decision, in a way, is an explanation to Section 278E of the IT Act, wherein it has been held that for offences under Section 276C(1), the prosecution has to establish the element of Mens rea. This is contrary to the plain language of Section 278E of the IT Act.

Applying unequivocally Section 278E of the IT Act, which deals with the presumption as to culpable mental state in a prosecution of offence, for offences committed under Section 276CC of the IT Act, the Supreme Court in *Sasi Enterprises vs. Assistant Commissioner of Income Tax (2014)5 SCC 139: 361 ITR 163 (SC),* held that in case of a prosecution of an offence, the Court has to presume the existence of *mens rea* and it is for the accused to prove the contrary and that too beyond reasonable doubt.

A First Class Magistrate or a Metropolitan Magistrate, should try the prosecution case under the direct taxes. If a Special Economic

Offences Court with specified jurisdiction is notified, the complaint is to be filed before the respective court. Prosecution can continue while assessment proceedings are in progress.

3. Some basic principles of prosecution under Income-tax Act

The assessment proceedings need not be concluded for launching of prosecution – *P. Jayapan 149 ITR 696 (SC).* However, if the assessment is set aside by the Tribunal, the prosecution cannot continue – *Uttam Chand 133 ITR 909 (SC); Sheo Shankar Sah 106 Taxman 536 (Pat.).* Once penalty u/s. 271(1)(c) of the Act is set aside by the Tribunal, prosecution would end automatically. – *K. C. Builders 265 ITR 562 (SC).* Finding given by the Tribunal would be binding on the Criminal Court – *V. Gopal & Co. 279 ITR 510 (SC); Nandlal & Co. 341 ITR 646 (SC).* Where additions are deleted by the Tribunal, prosecution would not survive – *CIT vs. Didwania 224 ITR 687 (SC); Ashok Kumar Jhunjhunwala 310 ITR 160 (Pat.).* Where appellate proceedings are in progress, the criminal court is expected to stay the proceedings – *Bhupen Dalal 248 ITR 830 (SC).*

4. Prosecution u/s. 276 – Removal, concealment, transfer or delivery of property to thwart tax recovery. Section 276 of the Act reads as follows

Section 276. : Removal, concealment, transfer or delivery of property to thwart tax recovery. Whoever fraudulently removes, conceals, transfers or delivers to any person, any property or any interest therein, intending thereby to prevent that property or interest therein from being taken in execution of a certificate under the provisions of the Second Schedule shall be punishable with rigorous imprisonment for a term which may extend to two years and shall also be liable to fine.

This Section creates such an Act as an offence, where the accused has (with an intention to defeat the interests of the revenue), removed and/or concealed/transferred/embezzled any property/interest therein. It needs to be noted that an accused in this section need not be the assessee-in-default viz., the accused need not be the assessee against whom recovery is due; any person who has removed/transferred such property/interest is liable to be proceeded under this section. For e.g., if an assessee-in-default has transferred his/her property to his/her spouse for no or inadequate consideration, then by virtue of Section 222, such property can be included in the certificate u/s. 222 by the TRO. But if, subsequently, the spouse of the assessee-in-default removes/transfers the property with an intention to defeat the recovery certificate, then even the spouse can be proceeded against under this section.

5. Circumstances under which the Commissioner cannot initiate proceedings

Section 279(1A) has provided for the exception to the Power of Commissioner to initiate proceedings. Therefore, if a particular case falls and is established u/s. 276C or 277 of the said Act and if an order u/s. 273A has been passed by the Commissioner, by using the phrase "has been reduced or waived by an order under Section 273A" in Section 279(1A), the legislature has made it clear that the order referred to in Section 279(1A) is the order of the Commissioner waiving or reducing the penalty u/s. 273A and not the order of non imposition of penalty by the ITO or the order of cancellation of penalty for lack of ingredients as required by Section 271 by Appellate Authorities. This is relevant because in the cases where the penalty is waived partly u/s. 273A, the Commissioner is precluded from granting sanction u/s. 279 of the Act.

Therefore, the non-existence of the circumstances enumerated in Section 273A is a precondition for the initiation of proceedings for prosecution u/s. 276C or 277. Accordingly, the CIT should ascertain by himself that the circumstances prescribed in Section 273A do not exist. A complaint filed for prosecution u/s. 276C or 277 would be illegal and invalid if the circumstances as provided in Section 273A exist. It may be noted that, as per the instruction No. 5051 of 1991 dt. 7-2-1991 issued by the Board stated as under:

6. Prosecution need not normally be initiated against a person who has attained the age of 70 years at the time of commission of the offence

In *Pradip Burma vs. ITO (2016) 382 ITR 418 (Delhi) (HC),* the court held that, at the time of commission of offence the petitioner has not reached the age of 70 years, hence the circular was held to be not applicable.

7. S. 136: Proceedings before income-tax authorities to be judicial proceedings

Section 136 provides that any proceedings under the Act shall be deemed to be a judicial proceeding within the meaning of Section 193 and 228 and for the purpose of Section 196 of the Indian Penal Code.

8. Power of Central Government to grant immunity. S. 291

Section 291(1) of the said Act, confers on the Central Government a power, under specified circumstances, to grant immunity to the assessee, from prosecution for any offence under the Direct Taxes, IPC or any other Central Act to a person, with a view to obtain evidence. This is subject to condition of him making a full and true disclosure of the whole circumstances relating to the concealment of income or evasion of payment of tax on income. However, sub-section (3) of this Section, empowers the Central Government to withdraw the immunity so granted, if such person has not complied with the condition on which such immunity was granted or is wilfully concealing anything or is giving false evidence.

9. Limitation for initiation of proceedings

Chapter XXXVI of the Code of Criminal Procedure, 1973 lays down the period of limitation beyond which no Court can take cognisance of an offence which is punishable with fine only or with imprisonment not exceeding three years. But, for economic offences (in respect of applicability of Limitation Act, 1974) it is provided that nothing in the aforesaid chapter XXXVI of the Code of Criminal Procedure, 1973, shall apply to any offence punishable under any of the enactment specified in the Schedule. *The Schedule referred to includes Income tax,* Wealth tax, etc. In *Friends Oil Mills & Ors. vs. ITO (1977) 106 ITR 571 (Ker.) (HC),* dealing with Section 277 of the Act, the Hon'ble Kerala High Court held that the bar of limitation specified in Section 468 of the Code of Criminal Procedure, 1973 would not apply to a prosecution, under the Income-tax Act (also refer *Nirmal Kapur vs. CIT (1980) 122 ITR 473 (P&H) (HC).*

In view of this, as there is no fixed period of limitation for initiation of proceedings under the Act, the sword of prosecution can be said to be perpetually hanging on the head of the assessee for the offences said to have been committed by him. It may be noted that this may result in injustice to the assessee because a person who is in a better position to explain the issue or things in the initial stage, may not be able to do so later, if he is confronted with the act of commission of an offence under a lapse of time. In *Gajanand vs. State (1986) 159 ITR 101 (Pat.) (HC)),* the Hon'ble High Court held that where the Criminal Proceedings had proceeded for 12 years and the Income tax department failed to produce the evidence, the prosecution was to be quashed. In *State of Maharashtra vs. Natwarlal Damodardas Soni AIR 1980 SC 593, 1980 SCR (2) 340,* the Court held that a long delay along with other circumstances be taken into consideration in the mitigation of the sentence.

❍❑❍

Dharan Gandhi, *Advocate*

Prosecution for wilful attempt to evade tax, etc.

Government has, of late started using rampantly, some of the sections of the Income-tax Act, 1961 ('Act') which were scarcely used before. Those sections form part of Chapter XXII of the Act. This Chapter deals with 'Offence and Prosecution'. Due to increasing use of some of the most aggressive measures to ensure proper payment of tax, it would be important for the professionals to understand the prosecution provisions. I would like to appreciate the efforts of The Chamber of Tax Consultants in bringing out a special story on 'Prosecution'. In this article I shall be dealing with the offences punishable u/s. 276C, 276CC, 277, 277A and 278 of the Act.

Section 276C – Wilful attempt to evade tax, etc.

Section 276C(1) states that if a person wilfully attempts in any manner whatsoever to evade any tax, penalty or interest Chargeable or imposable, or under reports his income, under this Act, he shall, without prejudice to any penalty that may be imposable on him under any other provision of this Act, be punishable,—

a. in a case where the amount sought to be evaded or tax on under-reported income exceeds ₹ 25,00,000/-, with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine.

b. in any other case, with rigorous imprisonment for a term which shall not be less than three months but which may extend to two years and with fine.

Whereas sub-section (2) of section 276C states that if a person wilfully attempts in any manner whatsoever to evade the payment of any tax, penalty or interest under this Act, he shall, without prejudice to any penalty that may be imposable on him under any other provision of this Act, be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to two years and shall, in the discretion of the court, also be liable to fine.

Difference between section 276C(1) and 276C(2)

Section 276C prescribes two offences with different punishments. First sub-section punishes any evasion of tax, penalty or interest which is chargeable or imposable and not necessarily charged or imposed. Thus, 276C(1) can penalise even before the tax evasion amount is determined. Whereas, sub-section (2) penalizes evasion of payment of tax, penalty or interest which means that sub-section (2) envisages a situation where a person is liable to make payment and he evades. Accordingly, only when payment of tax, penalty is determined, can sub-section (2) be attracted. The difference between the two sub-sections has been best explained by the Hon'ble Gujarat High Court in case of *Chandulal Shah vs. State of Gujarat & Anr. (213 ITR 307).* The Court held that sub-s. (1) contemplates evasion before charging or imposing tax, penalty, or interest as the section has used the term 'chargeable or imposable' whereas sub-s (2), penalises cases of tax evasion after charging or imposition, that is, evasion after completion of assessment comes within the purview of sub-section (2).

Important elements of section 276C(1)

Section 276C(1) is attracted if following conditions are fulfilled:

a. a person <u>wilfully attempts</u>

b. in <u>any manner</u> whatsoever

c. to <u>evade tax, penalty or interest</u>

d. such tax penalty or interest is <u>chargeable or imposable under the act or</u>

e. <u>under reports</u> his income under the Act.

Mens rea

The section would be attracted only if there is a wilful attempt to evade tax. The term 'wilful' and 'evade' both signify that existence of *'mens rea'* or 'culpable mental state' is sine qua non for section 276C(1) to apply. The Hon'ble Supreme Court has held in case of Dharmendra Textile Processors (295 ITR 244) that *mens rea* is as an essential ingredient in the matter of prosecution under the Income-tax law. Though the same is essential, section 278E has shifted the onus from the Department to the assessee. In other words, though *'mens rea'* is still a prerequisite to charge any person, but the onus to prove the same has been shifted from the Department to the assessee. Therefore, the Department would not be required to prove the culpable mental state of the assessee as it shall be presumed to be present and the assessee would be required to prove the absence of such mental state.

Under reporting

Under reporting of income would attract section 276C(1). Under reporting of income has been defined u/s. 270A(2), whereas section 270A(6) carves out exceptions in respect of cases which shall not constitute under reporting of income. Section 270A(9) prescribes cases which shall constitute misreporting of income in which case a higher penalty is leviable. Section 270AA deals with immunity from prosecution and penalty and such immunity is available only in case of under reporting of income which is not misreporting. These provisions have been discussed in details in other articles and therefore, not discussed here.

Evasion of tax

The section penalises evasion of tax. Evasion of tax in simple terms means non-payment of tax due under the income-tax law. Therefore, even if the income is disclosed and returned, however tax is paid at a lower rate and the AO assesses the income at a higher rate, there is still a case of invoking section 276C(1). Though, in such cases one can argue that the same was not wilful and therefore, should be out of section 276C(1).

Where income has been disclosed, however the source is not disclosed, can prosecution be initiated? When a person fails to explain the source of any income, the income becomes chargeable to tax u/s. 68 and therefore, the tax would be payable @ 60% u/s. 115BBE (w.e.f. 1-4-2017). The person would have offered the said income to tax at highest rate of 30% and non-disclosure of source would lead to taxability @ 60%. This would certainly amount to evasion of tax. However, Hon'ble Patna High Court in case of *Patna Guinea House vs. CIT (243 ITR 274)* has held that failure to disclose the source of income, in contradistinction to the failure or refusal to disclose the corpus/income itself is not punishable under s. 276C(1). This judgment would prove useful in demonetisation cases.

The amount of tax sought to be evaded has not been defined u/s. 276C(1) as defined in Explanation 4 to section 271(1)(c). Explanation 4 to section 271(1)(c) defines the amount of tax sought to be evaded in case where the loss is reduced or loss is converted into income. However, there is no similar definition in context of section 271(1)(c). Therefore, if there is reduction of returned loss as a result of any assessment, will it amount to evasion of tax u/s. 276C(1)? We have already seen above, that evasion of tax can be in any manner whatsoever. If the loss so reduced was set-off in any subsequent year, then technically speaking one may say that there was evasion of tax. However, the Hon'ble Punjab & Haryana High Court in case of *Nuchem Ltd. vs. DCIT (216 ITR 446)* has held that where there is reduction of loss, but the assessee is finally assessed at a loss figure, the motive to avoid tax during the year in question is completely missing and therefore, criminal proceedings u/ss. 276C(1), 277 and 278B would amount to abuse of the process of Court.

Larger question which may come for one's consideration would be the fate of prosecution where an addition to the income is made based on preponderance of probability. In many cases, the Department would not be having the evidences to nail an assessee from all corners. This is because of the fact that the assessee is having knowledge about his affairs and the Department cannot catch hold of all the evidences like the undisclosed cash, cash trail or evidences of cash changing hands etc. In such scenarios to make the game more balanced, the Hon'ble Courts have taken a view that based on preponderance of probabilities and the surrounding circumstances, the Department can make additions. Though, additions can be made based on such principles, however would it be sufficient to prosecute the assessee for wilful evasion of tax? In case of penny stock, bogus purchases, client code modification or undisclosed share capital etc. the additions are made based on the principles of preponderance of probability. Further, section 278E would presume that there was culpable mental state on the part of the assessee and it would further require the assessee to prove absence of *mens rea* and such absence should be proved beyond reasonable doubt and that the same cannot be accepted merely on the basis of preponderance of probability. This, it seems would be unfair for the assessee where though he is taxed on the basis of preponderance of probability, however in prosecution matter he has to prove that there was no *mens rea* and that too not on the basis of preponderance of probability. In my humble view, where addition is made based on surrounding circumstances and based on preponderance of probability, it would be a good case to argue that though on such principles, quantum addition is made, however, merely based on such principles a person should not be penalised especially in a case where he has all the documentary evidence in his possession to demonstrate the genuineness of the transition.

Penalty and prosecution

The Apex Court in *K. C. Builders & Anr. vs. ACIT [(2004) 265 ITR 562 (SC)]* held that levy of penalty under section 271(1)(c) of the Act and prosecution under section 276C of the Act are simultaneous. Once the penalty levied under section 271(1)(c) of the Act has been cancelled / deleted on the ground that there was no concealment of income, the quashing of prosecution was automatic. Similar view is taken in *Detecon Indian Project Office vs. ITO, 210 ITR 260 (Delhi)* and *Harkawat and Co. vs. UOI, 302 ITR 7 (MP).* The above were the cases, where penalty was deleted on merits. If penalty is deleted on technical grounds like non-striking off of irrelevant particular in notice u/s. 274, then the same shall not be a reason to discontinue the prosecution proceedings.

What shall be the position where no penalty proceedings are initiated? Can one argue that prosecution cannot be launched? As per section 271, for initiation of penalty, the AO has to record satisfaction in the assessment order that either there was concealment of income or furnishing of inaccurate particulars of income. Thus, when the AO does not record the same, it may be presumed that the AO was of the view that the case did not warrant levy of penalty leave aside prosecution and in such a situation, no prospection can be initiated. Where, AO records satisfaction and initiates penalty proceedings and drops the penalty proceedings, then one may argue that the AO did not feel fit to levy penalty in the case and therefore, there was no need to initiate prosecution. However, the above are only arguments which may or may not be accepted by the Court particularly because the prosecution proceedings are independent of the penalty proceedings and there is no express bar that prosecution can be launched only in cases where penalty is levied.

Pendency of appeal against penalty proceedings under section 271(1)(c) of the Act was held not to be a bar to launching of prosecution under the Act in case of *C. R. Balasubramaniam vs. CIT [(1999) 235 ITR 35 (Mad.)].*

While arguing penalty matters we generally take arguments like when the issue is debatable, no penalty can be levied or where there is adequate disclosure of particulars of income, mere making of wrong claim would not lead invocation of penalty *[CIT vs. Reliance Petroproducts (P) Ltd. - 322 ITR 158(SC)]* or that the claim made was based on legal advice of counsel and therefore, penalty cannot be levied *[T. Ashok Pai vs. CIT – 292 ITR 11(SC)].* These defences would also apply with equal force while dealing with the prosecution issues as the same would enable the assessee to prove absence of *mens rea.* Also, when such defences lead to deletion of penalty and deletion of penalty puts an end to the prosecution matter, such defences should also exonerate one from prosecution matters.

Pendency of appellate proceedings and finding in such appellate proceedings

The Courts have held that pendency of appellate proceedings is not a relevant factor for not initiating prosecution proceedings. However, it was held that hearing in the prosecution proceedings can be postponed / stayed till the finality of assessment / penalty proceeding - *Gauri Shankar Prasad vs. UOI [(2003) 261 ITR 522 (Pat.)]* and *Prabhava Organics P. Ltd. vs. DCIT [(2008) 297 ITR 392 (AP)].*

The Hon'ble Andhra Pradesh High Court in the case of, *ITO vs. Siddique (K.A.) [(1997) 227 ITR 677 (AP)]* held that a Criminal Court has to give due regard to the result of any proceedings under the Act having a bearing on the question in issue and in suitable cases it may drop the proceedings in the light of an order passed under the Act. Although the criminal court has to judge the case independently on the evidence placed before it, the finding of facts recorded by the ultimate income-tax authority is conclusive and binding on the criminal court. Further the Hon'ble Madras High Court in the case of, *Mohammed I. Unjawala vs. CIT [(1995) 213 ITR 190 (Mad.)]* held that Criminal Court is bound to accept the findings of Tribunal on questions of fact more so when such findings are in favour of assessee.

Whether assessment necessary for initiating penalty?

As already discussed above, such tax etc. should be chargeable or imposable under the Act and need not necessarily be charged or imposed under the Act for section 276C(1) to apply. This may lead to a conclusion that for initiating prosecution under this section, there need not be any assessment. If we compare with the provisions of section 271, for initiating prosecution, there is no requirement to record any satisfaction in the assessment order. The section only requires an allegation or complain of wilful attempt to evade tax and if same can be demonstrated from any other material then one may argue that there is no need for assessment. Let us take two scenarios (i) Where there is no scope of making any assessment or reassessment as the time limit has expired and (ii) Where assessment or reassessment can be made. In first case where there is no scope of making any assessment or reassessment, however, from material available it can be proved that there was wilful evasion of tax, then prosecution can be initiated u/s. 276C(1) even in absence of any assessment order or any concrete order determining the income of the assessee. However, in case (ii), where there is time available to make assessment or reassessment, generally it would be premature for the Department to initiate prosecution when the assessment is under progress, and in such cases a person can approach the High Court to get the notice for prosecution quashed. Similar view was taken in the case of *ITO vs. Abdul Razack and Ors. - 181 ITR 414 (AP).*

276C(2)

Section 276C(2) applies if there is a wilful attempt in any manner to evade payment of tax, penalty or interest. This section can be applied once the amount of tax etc. is determined. Failure to pay advance tax cannot be held to be prosecutable u/s. 276C(2). However, when a person files return of income and he is liable to pay self-assessment tax under such return, then non-payment of such tax may attract provisions of section 276C(2). Once there is an assessment, and a notice of demand has been issued u/s. 156 for payment of demand, non-payment of demand within the time stipulated therein would invite consequences u/s. 276C(2). Wilful transfer of property so as to thwart the recovery of the same would also get covered by section 276C(2). The above, ofcourse, is subject to the fact that the evasion is wilful. Element of *mens rea* must be present for penalizing anyone under this sub-section.

Interesting issue would be whether failure by a debtor to pay under garnishee proceedings would attract section 276C(2)? One can argue that section 276C(2) applies only if a person evades payment of tax etc., levied under the Act on such person. Recovery of the amount under garnishee proceedings is not in the nature of tax, interest or penalty levied under this Act in so far as the debtor is concerned. Such tax is of some other person and on his failure to pay, the debtor is made liable to pay to the department.

Explanation to section 276C

Apart from the above, Explanation to section 276C deems certain situation to be in the nature of wilful attempt to evade any tax, penalty or interest chargeable or imposable under this Act or the payment thereof. Such situations are given hereunder:

a. if a person has in his possession or control any books of account or other documents (being books of account or other documents relevant to any proceeding under this Act) containing a false entry or statement; or

b. if a person makes or causes to be made any false entry or statement in such books of account or other documents; or

c. wilfully omits or causes to be omitted any relevant entry or statement in such books of account or other documents; or

d. if a person causes any other circumstance to exist which will have the effect of enabling such person to evade any tax, penalty or interest chargeable or imposable under this Act or the payment thereof.

The cases as given in the explanation merely deems certain scenarios to be in the nature of wilful attempt and therefore, they cannot be construed to be exhaustive.

Mere possession or control of any books of account and other documents containing a false entry or statement is not punishable. It is only where a person in possession or control of such books of account or other documents has knowledge of the false entry or statement, he renders himself punishable *[See Thakasi Satyanarayana vs. State of Andhra Pradesh - 153 ITR 818 (AP)].* Books must be relevant to any proceedings under the Act. Thus, if the books relate to the period for which no action can possibly be taken under the Act for the reason of expiry of limitation, there will be no offence. Though the provision does not say that the books should belong to the person in whose possession or control they are found, it implies that he should be the owner thereof or they should relate to him. This inference is drawn from the language of sub-section (1) which refers to the tax, penalty or interest imposable upon him and not on any other person. Incomplete books not containing all the transactions entered into by the assessee during the relevant period would be sufficient to prima facie establish the guilt. Thus, if on comparison with the accounts of the other party it is found that certain transactions have been omitted, the offence is committed. Last clause is of the widest import. Thus, doing business or entering into the transaction in benami name may fall under this clause. It is to be noted that *Explanation 1* can be invoked only if the situations lead to evasion of tax etc.

Section 276CC – failure to furnish returns of income

Section 276CC states that if a person wilfully fails to furnish in due time the return of income which he is required to furnish u/s. 139(1) or by notice given u/s. 142(1)(i) or section 148 or section 153A, he shall be punishable,—

a. in a case where the amount of tax, which would have been evaded if the failure had not been discovered, exceeds ₹ 25,00,000/-, with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine

b. in any other case, with imprisonment for a term which shall not be less than three months but which may extend to two years and with fine:

Provided that a person shall not be proceeded against under this section for failure to furnish in due time the return of income u/s. 139(1) if

a. the return is furnished by him before the expiry of the assessment year or

b. the tax payable by such person, not being a company, on the total income determined on regular assessment, as reduced by the advance tax, if any, paid, and any tax deducted at source, does not exceed three thousand rupees.

Thus, non-failure to file return of income is punishable u/s 276CC. Such non-filing of return must be wilful. For the section to attract, there should be evasion of tax. If there is no evasion of tax, then there would not be any prosecution. This becomes certain from two things viz. (a) clause (i) uses the term *'amount of tax, which would have been evaded if the failure had not been discovered'* and (b) proviso states that if the tax payable by such person after deduction of advance tax and TDS does not exceed ₹ 3,000/-, then a person would not be prosecuted under this section. The above two provisions can be used to interpret that if there is no tax evasion, then section 276CC would not apply. A person may be charged for offences as envisaged u/s. 276C and 276CC simultaneously. There may be overlapping.

The quantum of punishment is dependent upon the amount of tax evaded. As discussed in context of section 276C, there is no formula given for calculating the said amount. Therefore, the amount of tax sought to be evaded can be calculated in the manner provided in sub-clause (b) of clause (ii) of the proviso to section 276CC i.e. it can be calculated by computing the tax on the assessed income as reduced by the amount of self-assessment tax, TDS, advance tax. Even the formula to calculate the compounding fees are on same lines.

Proviso to section 276CC provides exception to prosecution under the said section. Proviso applies only in case of failure u/s 139(1) and not in case of s.142, 148, 153A. Further, in two cases, prosecution would not be launched viz.

(i) either the return of income is filed up to the end of the assessment year i.e. where belated return is filed u/s 139(4), or

(ii) the tax payable by such person, not being a company, on the total income determined on regular assessment, as reduced by the advance tax, if any, paid, and any tax deducted at source, does not exceed three thousand rupees.

Filing of return up to the end of assessment year would take the case out of section 276CC, however, what would happen in a case where there is no absolute non-filer but where the return is filed after the end of the assessment year after obtaining the condonation of delay from CBDT or where the return is filed belated in response to notice u/s. 142(1) or 148 or 153A etc.? In such cases one case use the judgment of the Hon'ble Andhra Pradesh High Court in case of *ITO vs. Autofil & Ors. (184 ITR 47)*, wherein the Court held that late filing of return itself would show that there was no mens rea and therefore, no prosecution should be launched in such cases.

The second exception clause does not apply to company. Earlier it used to apply, however, *vide* Finance Act, 2018 this door was closed for the company so as to not provide any leeway for shell companies or companies holding Benami properties.

Section 277 – False statement in verification, etc.

Section 277 states that if a person makes a statement in any verification under this Act or under any rule made thereunder, or delivers an account or statement which is false, and which he either knows or believes to be false, or does not believe to be true, he shall be punishable,—

a. in a case where the amount of tax, which would have been evaded if the statement or account had been accepted as true, exceeds ₹ 25,00,000/-, with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine.

b. in any other case, with rigorous imprisonment for a term which shall not be less than three months but which may extend to two years and with fine.

Under the Income-tax Act and the rules thereunder, a person is required to give verifications on number of occasions. If such verifications are false, and which the person either knows or believes to be false, or does not believe to be true, then he shall be punishable u/s. 277. Further, where a person delivers an account or statement under the Act or Rules thereunder, he shall be punishable u/s. 277. However, such false statement must lead to evasion of tax. If there is no evasion of tax, then there cannot be any prosecution u/s. 277. This view is also taken by the Hon'ble Andhra Pradesh High Court in case of *ITO vs. Gadamsetty Nagamaiah Chetty & Ors. (219 ITR 263).*

Section 277A – Falsification of books of account or documents

If any person wilfully and with intent to enable any other person to evade any tax or interest or penalty chargeable and imposable under this Act, makes or causes to be made any entry or statement which is false and which the first person either knows to be false or does not believe to be true, in any books of account or other document relevant to or useful in any proceedings against the first person or the second person, under this Act, the first person shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to two years and with fine.

The explanation to section states that for the purposes of establishing the charge under this section, it shall not be necessary to prove that the second person has actually evaded any tax, penalty or interest chargeable or imposable under this Act.

This section applies to someone like an accommodation entry provider. The intention of such person, is to enable any other person (beneficiary) to evade any tax or interest or penalty chargeable or imposable under the Act. For such intention, the entry provider makes a false entry or statement in the books of account and also falsifies other documents. In such a scenario, section 277A would apply to entry provider. The explanation to the section expands the scope of section 277A. As per the explanation, evasion of tax etc. is not necessary to establish charge under this section. Therefore, where the action of any person is to enable other person to evade tax etc., irrespective of actual evasion, the first mentioned person would be punishable u/s. 277A.

Section 278 – Abatement of false return etc.

If a person abets or induces in any manner another person to make and deliver an account or a statement or declaration relating to any income chargeable to tax which is false and which he either knows to be false or does not believe to be true or to commit an offence under sub-section (1) of section 276C, he shall be punishable,—

a. in a case where the amount of tax, penalty or interest which would have been evaded, if the declaration, account or statement had been accepted as true, or which is wilfully attempted to be evaded, exceeds ₹ 25,00,000/-, with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine;

b. in any other case, with rigorous imprisonment for a term which shall not be less than three months but which may extend to two years and with fine.

A tax advisor or an auditor, if punishable, would be so under this section. However, merely, preparing returns on the basis of the accounts placed before him and having the same typed in his letter-head and delivering it to the client for signature, will not make an auditor liable, even if the returns are subsequently found to be false, on the basis of some new material gathered by the Department. In the said case before the Hon'ble Madras High Court it was held that there was no allegation in the complaint that documents unearthed subsequently were placed before auditor while preparing returns for assessee (Mad.) *Navarathna & Co. vs. State by ITO (168 ITR 788).*

Common issues for the prosecution sections

Limitation

There is no provision in the Act which prescribes any limitation for initiation of prosecution under any of the aforementioned sections. However, there are Court judgments dealing with the limitation issue. The Hon'ble Bombay High Court in the case of *K.M.A. Ltd. vs. ITO [(1996) Tax LR 248]* held that complaint filed after 13 to 14 years after the date of alleged offence was liable to be quashed on the ground of inordinate and unreasonable delay. The Hon'ble Patna High Court in the case of

Gajanand vs. State [159 ITR 101] set aside the prosecution under section 276C of the Act holding that if the department lets proceedings drag for years without making any serious efforts to proceed with it, the same is liable to be quashed. The Hon'ble Apex Court in the case of State of *Maharashtra vs. Natwarlal Damodardas Soni [AIR 1980 SC 593]* held that a long delay in prosecution is a factor which should along with the other circumstance, be taken into consideration in mitigation of the sentence. The Hon'ble Bombay High Court in the case of *Vishnoo Kamat vs. First ITO [(1994) 207 ITR 1040 (Bom.)]* quashed the criminal proceedings initiated before the Magistrate on the facts that penalty was already imposed on the accused and the criminal proceedings were instituted after a long delay of about ten years reckoned from due date of return.

Initiation of prosecution during the pendency of assessment or appellate proceedings

There is no condition prescribed under the Act to the effect that no prosecution can be launched during the pendency of assessment proceedings or penalty proceedings or appellate proceedings. In so far as launching of prosecution during the pendency of assessment proceedings are concerned, it would be very prudent that the prosecutions are not launched prior to completion of assessment. Assessment order is the first step either for levy of penalty or launching prosecution. Further, as discussed before, there is no time limit prescribed in launching of prosecution. Therefore, one may knock the doors of the court in case where prosecution proceedings are launched during the pendency of assessment proceedings. It would amount to unnecessary harassment. There is one more reason to it; it may happen that the AO does not make any addition in the assessment proceedings, it may also happen that the AO does not levy any penalty in respect of such assessments. Both the scenarios would mitigate the need to launch a prosecution proceeding.

Next we take a scenario where the assessment is completed and an appeal is filed however, penalty is not yet levied i.e. the same is kept in abeyance till the disposal of first appeal. In such a scenario, nothing stops the Department from launching prosecution under any of afore dealt sections, however where the penalty proceedings have been stayed, it would be prudent to stay the prosecution proceedings especially in light of the judgment of the Apex Court in case of *K.C. Builders (supra).*

In so far as the issue of launching prosecution proceedings during the pendency of appellate proceedings is concerned, the Hon'ble Supreme Court in case of *Sasi Enterprises vs. ACIT – 361 ITR 163(SC)* has held that pendency of the appellate proceedings is not a relevant factor for not initiating prosecution proceedings under Section 276CC of the Act. Also, many other Courts have taken a view that pendency of appellate proceedings would not act as a bar for launching of prosecution proceedings u/ss. 276C, 277, 277A and 278.

Prosecution as a measure to recover tax has been taken very seriously by the Tax Department. It results into unnecessary harassment considering the fact that the procedure is cumbersome. Few years back, such measure was seen as unnecessary. However, in recent years the menace of black money has come to light, in wake of which the prosecution measures appear to be apt. However, mechanical application of such prosecution proceedings to all the cases would not restore faith on the efforts of the Government in bringing the unaccounted cash into the mainstream. Rather the same is seen as an avoidable exercise which leads to wastage of taxpayers money. Selective prosecution should be the ideal way of tackling such menace.

❍❑❍

Rahul Hakani & Niyati Mankad, *Advocates*

Offence by Companies etc. and Prosecution against Person-in-Charge or Responsible for conduct of the business

Introduction

Numerous occasions arise when it is alleged that an offence under any Act is committed by a company and prosecution is invariably sought to be launched against the company, its directors and some of its executives. As "Company" is an artificial person created by law, and is capable of acting only through human agency occupying the position of directors and executives, it is but natural that all such persons are charged for the offence.

The provisions regarding the liability of the directors and other persons for offences committed by the company are enumerated under various Acts such as Industries (Development and Regulation) Act; Foreign Exchange Regulation Act; MRTP Act; Securities Contracts (Regulations) Act; Essential Commodities Act; Employees' Provident Funds and Misc. Provisions Act; Workmen's Compensation Act; Payment of Bonus Act; Payment of Wages Act; The Environment (Protection) Act; Water (Prevention and Control of Pollution) Act; Minimum Wages Act; Payment of Gratuity Act; Apprentices Act; Central Excise and Salt Act, Customs Act, 1961. Negotiable instruments Act etc. etc. and the provisions are somewhat identical in nature. Hence, when the provisions *qua* the directors' liability are considered under the Income Tax Act, 1961, it is also pertinent to note the law as laid down under other Acts by the Courts.

Provisions of Section 278B

As per sub-Section (1) of Section 278B, where an offence under this Act has been committed by a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. The proviso to sub-Section (1) provides that nothing contained in this sub-Section shall render any such person liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

Sub-Section (2) provides that notwithstanding anything contained in sub-section (1), Where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

As per sub-section (3) where an offence under this Act has been committed by a person, being a company, and the punishment for such offence is imprisonment and fine, then, without prejudice to the provisions contained in sub-section (1) or sub-section (2), such company shall be punished with fine and every person, referred to in sub-section (1), or the director, manager, secretary or other officer of the company referred to in subSection (2), shall be liable to be proceeded against and punished in accordance with the provisions of this Act. The Explanation to Section 278B provides that for the purposes of Section 278B — (a) "company" means a body corporate, and includes— (i) a firm; and (ii) an association of persons or a body of individuals whether incorporated or not; and (b) "director", in relation to— (i) a firm, means a partner in the firm; (ii) any association of persons or a body of individuals, means any member controlling the affairs thereof.

Legislative History and Analysis of the Section

Section 278B was inserted by the Taxation Laws (Amendment) Act, 1975 reported in (1975) 100 ITR 33 (ST) w.e.f. 1-10-1975. The object and scope of this Section was explained by the Board in its Circular No. 179 dated 30-9-1975 reported in (1976) 102 ITR 26 (ST).

Under sub-section (1), the essential ingredient for implicating a person is his being "in charge of" and "responsible to" the company for the conduct of the business of the company. The term responsible is defined in Blacks Law dictionary to mean accountable. Hence, the initial burden is on the prosecution to prove that the accused persons at the time when the offence was committed were "in charge of" and "was responsible" to the company for its business and only when the same is proved that the accused persons are required to prove that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

Both the ingredients "in charge of" and "was responsible to" have to be satisfied as the word used is "and" *[Subramanyam vs. ITO (1993) 199 ITR 723 (Mad.)]*. Under sub-Section (2) emphasis is on the holding of an officer and consent, connivance or negligence of such officer irrespective of his being or not being actually in charge of and responsible to the company in the conduct of the business. Also, while all the persons under sub-Section (1) and sub-Section (2) are liable to be proceeded against it is only persons covered under sub-Section (1) who by virtue of the proviso escape punishment if he proves that the offence was committed without his knowledge or despite his due-diligence. From the language of both the sub-Sections it is also clear that the complaint must allege that the accused persons were responsible to the firm/company for the conduct of its business at the time of the alleged commission of the business to sustain their prosecution. *[Jai Gopal Mehra vs. ITO (1986) 161 ITR 453 (P&H)].*

Insertion of sub-Section (3) by the Finance (No.) Act, 2004 w.e.f. 1-10-2004 was explained by Circular No. 5 dated 15th July 2005 reported in (2005) 276 ITR 151 (ST). The said amendment was brought to resolve a judicial controversy as to whether a company, being a juristic person, can be punished with imprisonment where the statute refers to punishment of imprisonment and fine. The Apex Court in *Javali (M.V.) vs. Mahajan Borewell and Co. (1998) 230 ITR 1* held that a company which cannot be punished with imprisonment can be punished with fine only. However, in a subsequent decision by majority in the case of *ACIT vs. Veliappa Textiles Ltd. (2003) 263 ITR 550 (SC)* it was held that where punishment is by way of imprisonment then prosecution against the company would fail. In order to plug loopholes pointed by the apex court in *Veliappa Textiles (supra)* sub-Section (3) was introduced whereby company would be punished with fine and other person in charge of or conniving officers of the company would be punished with imprisonment and fine. It is also to be noted that the legal position laid down in the case of *Veliappa Textiles (supra)* was overruled by the Apex Court decision rendered in *Standard Chartered Bank vs. Directorate of Enforcement (2005) 275 ITR 81 (SC).*

Nature of liability

The principal liability under Section 278B is that of the company. The other persons mentioned in sub-Section(1) and sub-Section (2) are vicariously liable i.e., they could be held liable only if it is proved that the company is guilty of the offence alleged.

The Apex Court in *Sheoratan Agarwal vs. State of Madhya Pradesh AIR 1984 S.C. 1824* while dealing with the provisions of Section 10 of the Essential Commodities Act which are similar to Section 278B has held that the company alone may be prosecuted. The person-in-charge only may be prosecuted. The conniving officer may individually be prosecuted.

The Apex Court in *Anil Hada vs. Indian Acrylic Ltd. A.I.R 2000 S.C. 145* while dealing with Section 141 of the Negotiable Instruments Act held that where Company is not prosecuted but only persons incharge or conniving officer are prosecuted then such prosecution is valid provided the prosecution proves that the company was guilty of the offence.

Strict Construction

The Supreme Court in the case of *Girdharilal Gupta vs. D. N. Mehta, AIR 1971 S.C. 2162,* has held that since the provision makes a person who was in charge of and responsible to the company for the conduct of its business vicariously liable for an offence committed by the company. The provision should be strictly construed.

Mens Rea

Section 278B is a deeming provision and hence it does not require the prosecution to establish *mens rea* on the part of the accused. In *B. Mohan Krishna vs. UOI 1996 Cri. L. J. 638 AP* it is held that exclusion of *mens rea* as a necessary ingredient of an offence is not violative of Article 14 of the Constitution of India.

Proprietary Concern

In *S. K. Real Estates (2002) Cr. L. J. 1689 (Mad.)* it was held that prosecution against a proprietary concern is not maintainable as it is not a legal entity or juridical person.

Society

In *Dharma Pratisthan vs. Mandal (1988) 173 ITR 487 (Del.)* it is held that a Society being an AOP and its members can be prosecuted.

Liability of Directors, Managing Directors, Manager, Partners, etc.

From the analysis of the provisions of Section 278B, it could be seen that the scope and the exact connotation of the expression "every person who at the time the offence was committed was in-charge of, and was responsible to, the company for the conduct of business of the company" assume a very important role. If a person i.e. the director or an executive of the company falls within the purview of this expression, he would be liable for the offence of the company, and may be punished there for. If, on the other hand, the person charged with an offence is not the one who falls within the ambit of that expression, the court will relieve him of the accusation. Therefore, the essential question that arises is as to who are the persons in charge of, and responsible to, the company of the conduct of the business of the company. It should be noted that the onus of proving that the person accused was in charge of the conduct of the business of the company at the time the contravention took place lies on the prosecution.

In *Girdhari Lai Gupta's case (Supra)*, the Supreme Court construed the expression, 'person in charge and responsible for the conduct of the business of the company' as meaning the person in overall control of the day-to-day business of the company. In arriving at this inference the Supreme Court took into consideration the wordings pertaining to sub-Section (2) and observed:

"It mentions director, who may be a party to the policy being followed, by a company and yet not be in charge of the business of the company.

Further, it mentions manager who usually is in charge of the business but not in overall-charge. Similarly the other officers may be in charge of only some part of business".

Firm and partners

The Apex Court in *State of Karnataka vs. Pratap Chand & Ors. (1981) 2 SCC 335* has while dealing with prosecution of partners of a Firm held that 'person in charge' would mean a person in overall control of day-to-day business. A person who is not in overall control of such business cannot be held liable and convicted for the act of firm. In *Monaben Ketanbhai Shah & Anr. vs. State of Gujarat & Ors. (2004) 7 SCC 15 (SC)* the Apex Court while dealing with the provisions of Sentions 138 and 141 of the Negotiable Instruments Act, 1881, it was observed that when a complaint is filed against a firm, it must be alleged in the complaint that the partners were in active business. Filing of the partnership deed would be of no consequence for determining the question. Criminal liability can be fastened only on those who at the time of commission of offence were in charge of and responsible for the conduct of business of the firm. The Court proceeded to observe that it was because of the fact that there may be sleeping partners who were not required to take any part in the business of the firm; there may be ladies and others who may not be knowing anything about such business. The primary responsibility is on the complainant to make necessary averments in the complaint so as to make the accused vicariously liable. In *Krishna Pipe and Tubes vs. UOI (1998) 99 Taxman 568 (All.)* it was held that sleeping partners cannot be held liable for offence.

Manager

In *Municipal Corporation of Delhi vs. Ram Kishan Rohtagi & Ors. AIR 1983 SC 67*, the accused invoked the jurisdiction of the High Court under Section 482 of the Code praying for quashing of criminal proceedings initiated against them under the Prevention of Food Adulteration Act, 1947. Whereas accused No. 1 was manager of the company, accused Nos. 2-5 were directors. A complaint was filed by the Food Inspector of the Municipal Corporation, *inter alia*, alleging that 'Morton Toffees' sold by the accused did not conform to the standards prescribed for the commodity. The Metropolitan Magistrate issued summons to all the accused for violating the provisions of the Act. It was contended on behalf of the accused that proceedings were liable to be quashed as it was not shown that accused persons were incharge of and responsible for the conduct of business. The High Court allowed the petition and quashed the proceedings. Aggrieved Municipal Corporation challenged the decision. The Apex Court held that so far as the manager is concerned, we are satisfied that from the very nature of his duties it can be safely inferred that he would undoubtedly be vicariously liable for the offence, vicarious liability being an incident of an offence under the Act.

Company and Directors etc.

In *Jamshedpur Engineering & Machine Manufacturing Co. Ltd. & Ors. vs. Union of India & Ors. (1995) 214 ITR 556 (Pat.)*, the High Court of Patna (Ranchi Bench) held that no vicarious liability can be fastened on all directors of a company. If there are no averments in the complaint that any director was 'in charge of' or 'responsible for' conduct of business, prosecution against those directors cannot be sustained.

In *R. K. Khandelwal vs. State [(1965) 2 Cri. L.J. 439 (AH)]* while dealing with liability of non-working directors it has been very succinctly stated by Mathur J. as under:

> "In companies there can be directors who are not in charge of, and responsible to the company for the conduct of the business of the company. There can be directors who merely lay down the policy and are not concerned with the day-to-day working of the company. Consequently, the mere fact that the accused person is a director of the company, shall not make him criminally liable for the offences committed by the company unless the other ingredients are

established which make him criminally liable. To put it differently, no director of a company can be convicted of the offence under section 27 of the Act [The Drugs Act, 1940] unless it is proved that the sub-standard drug was sold with his consent or connivance or was attributable to any neglect on his part, or it is proved that he was a person in charge of, and responsible to the company for the conduct of the business of the company."

In *Homi Phiroze Ranina vs. State of Maharashtra [2003] 263 ITR 636(Bom.)(HC)* while dealing with liability of non-working directors the Bombay High Court held as follows

"11. Unless the complaint disclosed a *prima facie* case against the applicants/accused of their liability and obligation as Principal Officers in the day-to-day affairs of the Company as Directors of the Company under Section 278B, the applicants cannot be prosecuted for the offences committed by the Company. In the absence of any material in the complaint itself *prima facie* disclosing responsibility of the accused for the running of the day-to-day affairs of the Company process could not have been issued against them. The applicants cannot be made to undergo the ordeal of a trial unless it could be *prima facie* showed that they are legally liable for the failure of the Company in paying the amount deducted to the credit of the Company. Otherwise, it would be a travesty of justice to prosecute them and ask them to prove that the offence is committed without their knowledge. The Supreme Court in the case of *Sham Sundar vs. State of Haryana AIR 1989 SC 1982* held as follows

"... It would be a travesty of justice to prosecute all partners and ask them to prove under the proviso to sub-Section (1) that the offence was committed without their knowledge. It is significant to note that the obligation for the accused to prove under the proviso that the offence took place without his knowledge or that he exercised all due diligence to prevent such offence arises only when the prosecution establishes that the requisite condition mentioned in sub-Section (1) is established. The requisite condition is that the partner was responsible for carrying on the business and was during the relevant time in charge of the business. In the absence of any such proof, no partner could be convicted...." (p. 1984)."

Recently Madras High court in *Kalaninthi Maran vs. UOI [2018] 92 taxmann.com 308 (Mad.)(HC)* dealt with liability of Non-Executive Chairman of Board of Directors of Company for offence of non-deposit of TDS. The assessee was a Non-Executive Chairman of the Board of Directors of Company Spice Jet Limited based in Delhi/NCR region. The company was engaged in the business of operation of scheduled low cost air transport services under the brand name 'Spice Jet'. The assessee was residing and carrying on business at Chennai and was not receiving any remuneration whatsoever from the company. The assessee was full time Executive Chairman of Sun TV Network Ltd., which is a public limited company, from which he drew remuneration as per the provisions of the Companies Act. There was failure on part of Spice Jet Limited to deposit tax deducted at source from amounts paid/payable to third parties for financial years 2013-14 to 2014-15. The Assessing Officer passed an order dated 3-11-2014 under Section 2(35) with respect to TDS default of Spice Jet to the tune of ₹ 90 crores treating the assessee as the Principal Officer of the Company within the meaning of Section 2(35). By the impugned order, while naming the assessee as the Principal Officer, the Assessing Officer also held that the assessee was liable for prosecution under Section 276B for the Tax Deducted at Source default committed by the Company. The High Court while setting aside the order held as under

"8.7: Under Section 2(35)(b) of the Income-tax Act, the Assessing Officer can serve notice only to Persons who are connected with the management or administration of the company to treat them as Principal Officer.

8.8: Section 278B of the Income-tax Act clearly states that it shall not render any such person liable to any punishment, if he proves that offence was committed without his knowledge.

8.9: In the case on hand, the petitioner has stated that he was not involved in the day-to-day affairs of the company and that he is only a Non-Executive Chairman and not involved in the management and administration of the company. Whereas, the Managing Director, viz., Mr. K. Natrajhen himself has specifically stated that he is the person in charge of the day-to-day affairs of the company.

8.10: The 2nd respondent, while passing the impugned order naming the petitioner as the Principal Officer, has not given any reason for rejecting the contention of the Managing Director. When the Managing Director himself has stated that he is the person who is in charge of the day-to-day affairs of the management and administration of the company and that the petitioner is not so, the 2nd respondent without any reason has named the petitioner as the Principal Officer. Merely because the petitioner is the Non-Executive Chairman, it cannot be stated that he is in charge of the day-to-day affairs, management and administration of the company. The 2nd respondent should have given the reasons for not accepting the case of the Managing Director as well as the petitioner in their respective reply.

8.11: The conclusion of the 2nd respondent that the petitioner being a Chairman and major decisions are taken in the company under his administration is not supported by any material evidence or any legally sustainable reasons.

9.1: It is pertinent to note that the 2nd respondent has not produced any material to establish that the petitioner was responsible for the day-to-day affairs of the company. In the absence of any material, the 2nd respondent should not have come to the conclusion that the petitioner is the Principal Officer. The reasoning given by the 2nd respondent is without any material to substantiate the same. Unless the 2nd respondent make out a *prima facie* case against the petitioner of his liability and obligation as Principal Officer in the day-to-day affairs of the company as Chairman-cum-Director of the company, under Section 278B of the Income-tax Act, the petitioner could not be prosecuted for the offence committed by the company. In the absence of any material, the show cause notice itself, prima facie disclosing the responsibility of the petitioner for the running of the day-to-day affairs of the company process, could not have been issued against him. The petitioner cannot be made to undergo the ordeal of a trial unless it could be *prima facie* disputed that he was legally liable for the failure of the company in paying the amount deducted to the credit of the company. Otherwise, it would be a travesty of justice to prosecute the petitioner and ask him to prove that the offence is committed without his knowledge. A mere allegation that the petitioner is incharge of the conduct of the company is not sufficient to hold that the petitioner is the Principal Officer. There should be credible material to show his active involvement in the conduct and management and business of the Company."

In *Mahalderam Team Estate Pvt. Ltd. vs. D. N. Pradhan [(1979) 49 Comp. Cas. 529 (Cal.)]*, a case under the Employees' Provident Fund, Act, 1952, of which Section 14A is *parimateria*, all the directors of a company were prosecuted for the offence of non-payment of provident fund contributions of the company's employees, the Calcutta High Court held that under the said Section a company is made primarily liable for an offence committed under the Act. The liability may be extended to other persons vicariously only under the conditions laid down in the' Section. A director of a company may be concerned only with the policy to be followed and might not have any hand in the management of its day-to-day affairs. Such person must necessarily be immune from such prosecutions. Thus, it has to be established by placing before the Court necessary and sufficient material from which the Court can satisfy itself, that the accused directors took some part in the running of the business of the company and a mere bald statement that the accused persons are directors of the company and hence responsible for the conduct of the business and management of the company will not do.

In the case of *Om Prakash vs. Shree Keshariya Investments Ltd. [(1978) 48 Comp. Cas. 85 (Delhi)]*, had held that a distinction has to be made between directors who are on the board purely by virtue of their technical skill or because they represented certain special interests and those who are in effective control of the management and affairs and it would be unreasonable to fasten liability on independent directors for defaults and breaches of the company where such directors were appointed by virtue of their special skill or expertise but did not participate in the management. This view has been followed by the Division Bench of the Bombay High Court in the case of *Tri-Sure India Ltd. [(1983) 54 Comp. Cas. 197 (Bom.)]*.

In *S.M.S. Pharmaceuticals Ltd. vs. Neeta Bhalla & Anr. [2005] 148 Taxman 128 (SC)* wherein this Court while dealing provisions of Section 141 of the Negotiable Instruments Act which is similar to Section 278B laid down following important law relating to liability of Directors

(a) It is necessary to specifically aver in a complaint under Section 141 that at the time the offence was committed, the person accused was in charge of, and responsible for the conduct of business of the company. This averment is an essential requirement of Section 141 and has to be made in a complaint. Without this averment being made in a complaint, the requirements of Section 141 cannot be said to be satisfied.

(b) Merely being a director of a Company is not sufficient to make the person liable under Section 141 of the Act. A director in a company cannot be deemed to be in charge of and responsible to the Company for conduct of its business. The requirement of Section 141 is that the person sought to be made liable should be in charge of and responsible for the conduct of the business of the company at the relevant time. This has to be averred as a fact as there is no deemed liability of a director in such cases.

(c) The Managing Director or Joint Managing Director would be admittedly in charge of the company and responsible to the company for conduct of its business. When that is so, holders of such positions in a company become liable under Section 141 of the Act. By virtue of the office they hold as Managing Director or Joint Managing Director, these persons are in charge of and responsible for the conduct of business of the company. Therefore, they get covered under Section 141.

In *Madhumilan Syntex Ltd. vs. UOI (2007) 290 ITR 199 (SC)* assessee had deducted TDS but credited the same to the account of the Central Government after the expiry of the prescribed time limit thereby constituting an offence under Section 276B r.w.s. 278B. A show cause notice was issued against the company as well as its four Directors as "principal officers". The accused pleaded that the ground of "Reasonable cause". However sanction for prosecution was granted a complaint was filed against the appellants on 26th Feb., 1992 in the Court of the Addl. Chief Judicial Magistrate (Economic Crime), Indore. The accused filed applications under section 245 of the Cr. PC, 1973 (hereinafter referred to as 'the Code') for discharge from the case contending that they had not committed any offence and the provisions of the Act had no application to the case. It was alleged that proceedings were initiated *mala fide*. In several other similar cases, no prosecution was ordered and the action was arbitrary as also discriminatory. Moreover, there was 'reasonable cause' for delay in making payment and the case was covered by Section 278AA of the Act. The directors further stated that they could not be treated as 'principal officers' under Section 2(35) of the Act and it was not shown that they were 'incharge' of and were 'responsible for' the conduct of business of the company. No material was placed by the complainant as to how the directors participated in the conduct of business of the company and for that reason also, they should be discharged. However the prayers of the accused were rejected. Against this rejection a revision petition was filed which was also rejected. Against the same criminal petition was filed before the High Court which was also dismissed. Hence the accused approached the Supreme Court. Following were the important points of law laid down by the Apex Court

1. Wherever a company is required to deduct tax at source and to pay it to the account of the Central Government, failure on the part of the company in deducting or in paying such amount is an offence under the Act and has been made punishable.

2. From the statutory provisions, it is clear that to hold a person responsible under the Act, it must be shown that he/she is a 'principal officer' under section 2(35) of the Act or is 'in charge of' and 'responsible for' the business of the company or firm. Where necessary averments have been made in the complaint, initiation of criminal proceedings, issuance of summons or framing of charge, cannot be held illegal and the Court would not inquire into or decide correctness or otherwise of the allegations levelled or averments made by the complainant. It is a matter of evidence and an appropriate order can be passed at the trial.

3. No independent and separate notice that the directors were to be treated as principal officers under the Act is necessary and when in the show cause notice it was stated that the directors were to be considered as principal officers under the Act and a complaint was filed, such complaint is entertainable by a Court provided it is otherwise maintainable.

4. Once a statute requires to pay tax and stipulates period within which such payment is to be made, the payment must be made within that period. If the payment is not made within that period, there is default and an appropriate action can be taken under the Act.

5. It is true that the Act provides for imposition of penalty for non-payment of tax. That, however, does not take away the power to prosecute accused persons if an offence has been committed by them.

Though the Apex Court did not go into the merits of the case and decided the issue in respect of maintainability of criminal complaint, the decision has given a clear warning to the corporates and their principal officers, the need for strict adherence to time schedules in the matter of payment of taxes, especially TDS. It is time that the taxpayers also realise they have to be extra careful when it comes to remittance of the TDS, as it is money due to the Government, which they have withheld from paying to a third party. However it is important that the Revenue do not take shelter of this decision and launch criminal prosecution even in case of few months of delayed remittance of Tax Deducted at Source.

Accountant

In *Dev vs. State of A.P. 2002 Cri.L.J 4770 (Andhra Pradesh)* it was held that an Accountant is in charge of and was responsible to the company for the conduct of its business.

❍❑❍

Sashank Dundu, *Advocate*

Procedure before Sanction of Prosecution and Compounding

Prosecution is nothing but the institution and conducting of legal proceedings against someone in respect of a criminal charge.

Under income-tax law, evasion is treated as a crime, and the persons committing such crimes would be prosecuted. Punishment is not for revenge, but to lessen crime and reform the criminal. Main purpose behind prosecution provisions under the Income-tax Act, 1961 ('Act') is a lesson for tax evaders and reduction of tax evasion.

The Wanchoo Committee was appointed to examine and suggest legal and administrative measures for countering evasion and avoidance of direct taxes. In their report with regard to the prosecution policy recommended and insisted on having stringent prosecution provisions in order to prevent and discourage the people from engaging in tax offences. It mentions that in a fight against tax evasion, monetary penalties are not enough. It mentions that if the only risk to which he is exposed is monetary penalty in the year in which he happens to be caught. The public in general also tends to lose faith and confidence in the tax administration once it knows that even when a tax evader is caught, the administration lets him get away lightly after paying only monetary penalty – when money is no longer a major consideration with the tax evader if it serves his business interest

Rampant issuance of prosecution notices, in recent times, has made this subject an important aspect for consideration by all. We would be dealing with the provisions of Sections 278A, 278E, 279, 279A, 279B, 280 and Sections 280A to 280B of the Act in this article.

Section 278E – Presumption as to culpable mental state

It mentions that in any offence, there should be existence of culpable mental state on the part of the accused. *Mens rea* is a Latin word for "guilty mind". In criminal law, it is viewed as one of the necessary elements for any act to be considered as a crime. The Latin phrase, *'actus non facit reum nisi mens sit rea'* gives us a clearer picture which states that any act is not culpable unless the mind is guilty. As a general rule, criminal liability does not get attracted to a person who merely acted without application of mind. Thus, onus is always on the prosecution to prove *mens rea* on the part of the accused to charge him with any offence. Even, under the Income-tax Act, 1961, as held by Hon'ble Supreme Court in case of Dharmendra Textile Processors (295 ITR 244), *mens rea* is held as an essential ingredient in the matter of prosecution.

Section 278E of the Act was inserted w.e.f. 10th September 1986. It provides for statutory presumption of existence of culpable mental state on the part of the accused. However, such presumption is not absolute and irrebuttable; accused can prove the fact that there was no such mental state with respect to the act charged in such prosecution.

Further, Section 278E(2) provides that accused, in order to discharge its burden, must prove beyond reasonable doubt, based on valid factual evidences, the non-existence of culpable mental state; merely establishing non-existence of *mens rea* based on preponderance of probability won't suffice to get one outside the clutches of Chapter XXII of the Act.

Constitutionality of the said Section was challenged before the Hon'ble Madras High Court in case of *Selvi J. Jayalaitha vs. Union of India (169 Taxman 408) / [[2007] 288 ITR 225 (Madras)]*. Hon'ble Court, upholding the Constitutionality of the said Section, held that introduction of Section 278E, which gives rise to a presumption as to culpable mental state of accused, entire basis of accusatorial jurisprudence has been shifted; that while having to defend wholly baseless and vexatious criminal proceedings, they were also expected to discharge burden of not possessing criminal intent and proving it beyond a reasonable doubt; and that, thus, impugned provision violates Articles 20(3) and 21 of Constitution. Merely because Act requires assessee to prove that there were circumstances which prevented him from filing return, it would not amount to violation of Article 20(3) of Constitution.

Mens rea is sine qua non i.e., absolutely essential for prosecution; only the burden of proof of culpable mental state has been shifted to accused from Department. On appeal, Hon'ble Apex Court held that Section 278E deals with the presumption as to culpable mental state, which was inserted by the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986. The question was on whom the burden lies, either on the prosecution or the assessee, under Section 278E to prove whether the assessee has or has not committed wilful default in filing the returns. Court in a prosecution of offence, like Section 276CC has to presume the existence of *mens rea* and it is for the accused to prove the contrary and that too beyond reasonable doubt. Resultantly, the appellants have to prove the circumstances which prevented them from filing the returns as per Section 139(1) or in response to notices under Sections 142 and 148 of the Act. *[Sasi Enterprises vs. ACIT, 361 ITR 163 (SC)].*

In so far as prosecution is concerned, requirement of *mens rea* is indispensable. It was held by the Hon'ble Supreme Court that where an order of assessment or reassessment on basis of which penalty has been levied on assessee has itself been finally set aside or cancelled by Tribunal or otherwise, penalty cannot stand by itself and same is liable to be cancelled *[K.C. Builders vs. ACIT [2004] 265 ITR 562 (SC)].*

However, a contrary view has been taken by Hon'ble Delhi High Court in case of *Bandhu Machinery Pvt. Ltd. vs. Addl. Chief Metropolitan Magistrate [259 ITR 703 (Del.)]* wherein it was held that adjudication in penalty proceedings by Tribunal cannot be binding on Criminal Court and, therefore, it must arrive at its own decision on an independent evaluation of evidence adduced before it.

Section 279(1) – Sanction before prosecution

Section 279(1) of the Act lays down that a person shall not be proceeded against for the offences enumerated in the Sections under the Income-tax Act, 1961, except with the previous sanction of the Commissioner or Commissioner (Appeals) or the appropriate authority (hereinafter referred to as 'Commissioner'). Thus, grant of sanction by Commissioner is *sine qua non* for launching any prosecution under the Act.

The intention of the legislature is to protect persons from unnecessary prosecutions and resultant harassment. Therefore, the sanction to prosecute is very important and it constitutes a condition precedent to the institution of the prosecution. For a valid sanction, it must be proved that a valid sanction exists in respect of the facts constituting the offence charged and must be offence specific.

The authority giving the sanction may *prima facie* consider all the evidence and other circumstantial evidence before coming to a conclusion with respect to whether such sanction can be given or not. Thus, the sanctioning authority needs to apply his mind to the facts of the case and then has to accord sanction for prosecution. Since the process of granting sanction is an administrative one, there is no need to provide an opportunity of hearing to the accused before according sanction, because an order of sanction does not have the effect of conviction or imposing any penalty causing any injury of any kind on the accused and the accused will get full opportunity to defend himself in the trial. Therefore, the order of sanction will not get vitiated by violation of the principles of natural justice. *[ACIT vs. Velliappa Textiles Ltd. [2003] 263 ITR 550 (SC)].*

The Section mentions that prosecution should be launched at the instance of the Commissioner. However, nowhere it is specified that the complaint should be filed by the Commissioner himself. Prosecution launched by any officer with the sanction of the Commissioner would suffice. In the case of *Veerakistiah vs. ITO 139 ITR 113 (AP)*, it was held that complaint at instance of Commissioner by third person is permissible.

Commissioner can *suo motu* launch prosecution proceedings and there is no need for any proposal to be submitted by the Officer for launch of prosecution. In the case of *Gopal vs. ACIT [1994] 207 ITR 971 (Madras)* it was held that it does not appear that such sanction can be given only on initiation of proposal by some other agency. The clear language of the Section would show that the submission that only on a proposal submitted to him in this behalf, sanction can be accorded by the Commissioner or Commissioner (Appeals) or appropriate authority, is not warranted.

Compounding of offences – Section 279(2)

As per Black's Law Dictionary, 'Compound' means 'to settle a matter by a money payment, in lieu of other liability'. Compounding of an offence is nothing but a way of settlement, by which, one is given an option to pay money and settle the issue in lieu of his prosecution, thereby avoiding a prolonged litigation.

Section 279(2) empowers the Chief Commissioner or Director General to compound an offence under the Act, either before or after the initiation of proceedings. The Department has issued new set of guidelines for compounding of offences under direct taxes *vide* notification F.No. 185/35/2013 IT (Inv.V)/108 dated December 23, 2014 (2015) 371 ITR 7 (St) (www.itatonline.org).

These guidelines replace the existing guidelines issued *vide* F. No 285/90/2008, dated May 10 2008 with effect from January 1, 2015.

Under Section 279(2), an offence can be compounded at any stage and not only when the offence is proved to have been committed. Once compounding is effected, the assessee cannot claim a refund of the composition amount paid on the ground that he had not committed any of said offences *(Shamrao Bhagwantrao Deshmukh vs. The Dominion of India (1995) 27 ITR 30 (SC)).* The requirement under Section 279(2) is that the person applying for a composition must have allegedly committed an offence. The compounding charges might be paid even before a formal show cause notice has been issued. On the other hand, even if the accused is convicted of an offence and an appeal has been preferred against the same, there seems to be no particular bar to give effect to a compounding during the pendency of such appeal and the accused shall not have to undergo the sentence awarded if he pays the money to be paid for compounding. Prosecution initiated under Indian Penal Code, if any, cannot be compounded under the provisions of the Income-tax Act. However, Section 321 of the Criminal Procedure Code, 1973, provides for withdrawal of such offences.

Notwithstanding anything contained in the guidelines, the Finance Minister may relax restrictions for compounding of an offence in a deserving case on consideration of a report from the board on the petition of an appellant.

It must also be noted here that only the aggrieved party or the victim has the right to compound an offence and nobody else, not even the public prosecutor has the power to compound an offence. Under the Act, the aggrieved party is the Government or the Tax Department and therefore, Section 279(2) enables the Chief Commissioner or the Director General or the Principal Chief Commissioner or the Principal Director General to compound any offence under Chapter XXII of the Act either before or after institution of proceedings. The wording of the Section indicates that only offences under Chapter XXII of the IT Act could be compounded.

Section 279 confers a discretionary power upon Chief Commissioner or Director General to compound an offence under Act and Chief Commissioner has to necessarily appraise circumstances of matter and compound same, if facts warrants so. *[Paneerdas & Co. P. Ltd. vs. ACIT [2004] 267 ITR 383 (Madras)].*

Where against conviction and sentence passed by trial court, on compliant preferred by appellants, respondent had filed an appeal and same was pending, said appeal was a 'proceeding' as contemplated under Section 279(2) and pending appeal, appellants could very well compound offence *[Chairman, CBDT vs. Smt. Umayal Ramanathan [2009] 313 ITR 59 (Madras)].*

Section 279(2) cannot give right to party to insist on Chief Commissioner or Director General to make an offer of compounding before prosecution is launched and said sub-Section cannot be interpreted to mean that before any prosecution is launched, either a show cause notice should be given or an opportunity be afforded to assessee to compound matter *[UOI vs. Banwari Lal Agarwal [1999] 238 ITR 461 (SC)].*

Section 279(3) of the Act, debars a person from contending that all the statements made or accounts or documents produced were under the belief that the same would be used for waiver or reduction of penalty u/s. 273A or for compounding of prosecution u/s. 279(2) and now, the same cannot be used as an evidence against the assessee in a prosecution proceedings.

Procedure for compounding

The accused has to approach the Commissioner with a proposal for compounding. A hearing has to be given to the assessee by the Commissioner on the proposal for compounding made by him and thereafter the compounding fees are finally determined. The ultimate decision as to the acceptance or refusal of the compounding proposal lies with the Commissioner. If the Commissioner accepts the proposal for compounding, the same would have to be recommended by him to the Central Board of Direct Taxes. It may be noted that offences under Indian Penal Code cannot be compounded by the competent authority under the Income-tax Act. However, generally when the alleged offences under direct tax laws are compounded, the prosecution launched for the corresponding alleged offences under IPC are also withdrawn. In *V. A. Haseeb and Co. (Firm) vs. CCIT (2017) 152 DTR 306 (Mad.) (HC)/ [2017] 245 Taxman 139 (Madras),* the Court held that, against conviction and sentence passed by Trial Court assessee had filed an appeal and same was pending, said appeal was also a 'proceeding' as contemplated under Section 279(2); Revenue Authority, thus, for pending appeal, could compound offence.

Certain offences to be non-cognisable – Section 279A

Generally, cognisable offence means an offence for which a police officer has the authority to make an arrest without a warrant and to start an investigation with or without the permission of a court. In contrast to the above, in the case of a non-cognisable offence, a police officer does not have the authority to make an arrest without a warrant and an investigation cannot be initiated without a court order. The police can file a First Information Report (FIR) only in cases of cognisable offences. Normally, serious offences which may usually carry a sentence of 3 years or more, are defined as cognisable. In India, crimes like rape, murder, theft etc., are considered cognisable, and crimes like public nuisance, simple hurt, mischief etc., are considered as non-cognisable.

Section 279A of the Act, deems offences punishable under Sections 276B, 276C, 276CC, 277 or 278 to be non-cognisable within the meaning of Criminal Procedure Code, 1973. Thus, when a complaint has been filed by the Authorised Officer after obtaining sanction of the sanctioning authorities u/s. 279 in respect of the aforementioned Sections, then, police cannot arrest such person against whom complaint has been filed without any warrant or cannot investigate into any matter without the permission of the Court.

Complain must necessarily be in accordance with the provisions of Section 279, as explained above. It was held by Hon'ble Karnataka High Court that unless the Income-tax authorities in the process of assessing the assessee for a particular year come to the conclusion that he, the assessee, in the matter of his returns, had committed violations, they cannot initiate any prosecution in the matter under these provisions—Sections 276C and 277. *[Balaji Oil Traders & Ors. vs. ITO [1984] 150 ITR 128 (Karnataka)].*

Punishment for second and subsequent offences – Section 278A

Second 278A deals with second and subsequent offences. If any person is convicted of an offence for second time or for every subsequent offence under any of the Sections mentioned therein of the Act, he shall be punishable with the corresponding minimum and maximum penalties given therein.

Section 278A provides that once a person is convicted of any offence under any of the Sections mentioned in the table, gets convicted again, for any of the offences mentioned under any of the same Sections, then for every second and subsequent offence he shall be liable for a more serious punishment u/s. 278A. Here, it is not necessary to commit offence under the same Section again for triggering the provisions of Section 278A of the Act. So if a person is convicted of an offence u/s. 276B and then at a later point of time he gets convicted of offence, not under the same Section but, under any other Section, then in such case, provisions of Section 278A shall get attracted and he shall be made punishable thereunder.

In case of *K. V. Narsimhan vs. ITO [209 ITR 797 (Mad)]*, the Hon'ble Court held that when it was in evidence that the accused had already been once before convicted under Section 278 and as per Section 278A for a subsequent offence the punishment should not be less than six months, the reduction of sentence by the Sessions Judge was against law and could not be sustained.

Proof of entries in records or documents – Section 279B

Section 279B provides that entries in the records or other documents in the custody of an income- tax authority shall be admitted in evidence in any proceedings for the prosecution of any person for an offence under this Chapter, and all such entries may be proved either by the production of the records or other documents in the custody of the income-tax authority containing such entries, or by the production of a copy of the entries certified by the income-tax authority having custody of the records or other documents under its signature and stating that it is a true copy of the original entries and that such original entries are contained in the records or other documents in its custody. This Section was inserted w.e.f. 1-4-1989 and the rationale behind introduction was to remove practical difficulties faced in production of original records and documents every time for the prosecution proceedings before the Courts which also had the risk of original documents and records getting lost or of it being taken away unlawfully. Therefore, Section 279B was inserted which provided that even certified true copy of the records and the documents would suffice for proving any entry in such records or documents.

Disclosure of particulars by Public Servant – Section 280

If a public servant [furnishes any information or produces any document in contravention of the provisions of sub-Section (2) of Section 138], he shall be punishable with imprisonment which may extend to six months, and shall also be liable to fine.

Section 138 of the Act deals with the furnishing or non-furnishing of information obtained under the provisions of the Act to others. Section 138(1) permits the Board or any other Income-tax Authorities to divulge certain information for certain purposes.

Section 280 of the Act specifically deals with the violation of the provisions of sub-Section (2) of Section 138 of the Act, by a public servant. Thus, when a public servant furnishes any information or produces documents in contravention of the provision of Section 138(2), he shall be punishable with imprisonment which may extend to 6 months and shall also be liable for a fine. However, no prosecution can be instituted under this Section without the prior sanction of the Central Government.

❍❑❍

Sashank Dundu, *Advocate*

Liability of Tax Professionals

The recent outburst on the assessees and professionals alike has caught every person in the grip of fear since, even if there is an act due to a mistake or under some *bona fide* belief of it being right, the Act does not carve out an exception for those. To understand how a tax professional or a Chartered Accountant or an Advocate, etc., would be liable, not only one has to look at the provisions of the Income-tax Act but also the Criminal Procedure Code read with the Indian Penal Code.

In a recent headline, it was seen that the Central Bureau of Investigation (CBI) has issued a press release dated 12th April 2018 stating that in a case of bribe, two tax professionals, i.e. one Advocate and one Chartered Accountant, were arrested where a demand of ₹ 50,00,000/- was asked as a bribe by an IRS, who was also arrested.

The basic section which would get attracted is Section 278 of the Income-tax Act wherein it is stated that if a person abets or induces in any manner another person to make and deliver an account or a statement or declaration relating to any income [or any fringe benefits] chargeable to tax which is false and which he either knows to be false or does not believe to be true, he shall be punishable with rigorous imprisonment having a term of a minimum of 6 months and could extend uptil a maximum of 7 years, along with fine.

Section 278 was first introduced in the year 1961 with the heading, "Abetment of False Return". Currently the section stands amended 4 times during its tenure and existence in the Income-tax Act. This section introduces a principle of criminal jurisprudence which makes liable any person who aids, abets, counsels or procures the commission of an offence. It makes the abetment of inducement, in any manner, in making and delivery of a false account, statement or declaration relating to any taxable income an offence.

Section 278 of the said Act, imposes a criminal liability on the abettor for abetment of false return etc. Circular No. 179 dated 30/1975 (1975) 102 ITR 9 (St.)(25) also explains the provision. Under this section, if a person abets or induces in any manner, another person to make or deliver an account, statement, declaration which is false and which he either knows to be false or does not believe to be true, he shall be punishable with rigorous imprisonment of not less than three months.

In the past, a few instances have taken place where professionals along with the tax evaders have been caught in the net and sentences have been awarded.

In press release issued by the Ministry of Finance posted on 12/1/2018, by PIB Delhi, it gave instances where criminal proceedings had been initiated.

One such instance was, *"the Court of CJM, Jalandhar convicted a cloth trader with 2 years rigorous imprisonment for trying to cheat the Department by fabricating affidavits and gift deeds, in connivance with his advocate and witness, with the motive of evading tax. The Court, while awarding the sentence* *to the trader, also simultaneously awarded one year's imprisonment to the advocate notarising the forged affidavit and also to the witness for aiding and abetting the serious offence".*

Another instance which was reported in the newspapers on 28-4-2018 was that, *"The Enforcement Directorate Friday said it has arrested a Mumbai-based Chartered Accountant on money laundering charges for illegally routing an estimated ₹ 834 crore."*

"Probe revealed that the Chartered Accountant hatched a criminal conspiracy to defraud the shareholders as well as overseas investors by creating a web of shell companies in various countries through fictitious dealings in order to receive wrongful gains."

Liability of Professionals

The section is constructed in a very wide and comprehensive language. Due to this reason, if a professional is engaged in advising or counselling any person in income tax matters, abets or induces any person to make or deliver a false return, such person would be liable to be prosecuted under this section.

In the case of *ITO vs. City Dry Fish Co. [1991] 188 ITR 177 (Andhra Pradesh) (HC)* a survey had taken place in the premises of the firm and the residence of its managing partner and its accountant. Discrepancies were found between the income originally submitted by the firm on the basis of which the assessment order was passed and the secret account books found during the survey. Secret account books along with regular account books were seized from the house of the accountant.

The income-tax practitioner at Vijayawada deposed that he was the consultant for firm from 1975 onwards, that the accountant was instructing him in the preparation of the returns and that the managing partner was signing and sending the filed returns. He specifically stated that the managing partner signed and filed the returns.

The accountant of the firm was convicted for the offences under Sections 276C and 277 and was sentenced to pay a fine of ₹ 1,000 under each count and also imprisonment till the rising of the Court; in default of fine, simple imprisonment for a term of six months.

In another case of *P. D. Patel vs. Emperor, (1933) 1 ITR 363 (Rangoon)(HC)*, a warning has been given of which every legal practitioner has to take a serious notice. In this case, an advocate deliberately omitted in a return submitted by him a certain amount of money and persisted in taking up false defences. The Government lost a huge amount because of the exclusion of the said amount in the return filed by the advocate on behalf of his client. A fine for the said offence was levied by the Trial Court on an appeal, the High Court took a serious view of the offence and held that in a case like this, the punishment should be deterrent and exemplary and the assessee was ordered to be kept in simple imprisonment for one month.

Also, in the case of *Navrathna & Co. vs. State (1987) 168 ITR 788 (Mad.)(HC)(790)*. The Court held that, merely preparing returns and statement on the basis of the accounts placed before the Chartered Accountant, the question of abetment or conspiracy cannot arise.

The Supreme Court in the case of *Jamuna Singh vs. State of Bihar, AIR 1967 SC 553 (Supra)*, has held that a person can be convicted of abetting an offence even when the person alleged to have committed that offence in consequence of abetment has been acquitted.

The section casts an onerous duty on the advocates, Chartered Accountants and Income Tax Practitioners to be cautious and careful. The legal profession is a noble one and legal practitioners owe not only a duty towards his client but also towards the court. It would be highly unprofessional if a legal practitioner is to encourage dishonesty or to file such returns knowing or having reason to believe that the returns or declarations so made are false.

However, we may not be able to gauge or predict whether, with every prosecution notice and its approval by the appropriate authority, whether a criminal complaint would be filed only on the assessee or also the tax professional who was consulted. Only time would be able to give everyone better clarity with respect to this.

❍❑❍

SS-VIII-64

Bharat Raichandani, *Advocate*

Penalty and Prosecution – An Intrinsic Hypothesis

Barry Goldwater says "Income Tax has created more criminals than any other Act of the Government". Where there is tax, there would be avoidance. *Ergo,* need to curb. "Penalty" is a punishment inflicted for breaking law, rule, or contract. In this opening piece, we would have an overview of some of the general facets of penalties under tax laws and the "new law" GST.

Interestingly, there was a presumption, in ancient days, that person in breach of the duty could be made liable for the offence of contempt of the statute even if the statute has laid a mandatory duty but provided no mode of enforcing it. This rule of construction was, however, struck down as obsolete in *R vs. Horseferry Road Magistrate's Court*[1] stating that the same has no Application to modern statutes. It is now a well entrenched principle of law that in order to create an Act, a crime/offence with consequential punishment, statute must state in clear language[2]. There can be no analogy to cover acts not within the words of the statute on any doctrine of substance of the matter[3]. It is permissible to evade an Act of Parliament in the sense that a person may not do that which the Act prohibits but he is free to do anything which though equally advantageous to him, as that which is prohibited, nevertheless, outside the prohibition, penalty or burden imposed by the act[4]. Simply put, if a statute prohibits doing of A, the courts are powerless to extend the prohibition to cover B when the legal significance of A & B are different and distinct even if A and B in substance produce similar results.

It is also an intended measure for tax compliance. The Legislature resorts to charging of interest and imposition of penalty against tax delinquents. While charging of interest is compensatory in character, imposition of penalty and institution of prosecution act as deterrents against potential tax delinquents.

Proportionality

A cardinal rule is that penalty imposed has to be commensurate with the gravity of the offence. This doctrine is, popularly, known as "Doctrine of Proportionality". This rule of law also mirrors

1 (1986) 2 All ER 666 P. 674

2 *Kartar Singh vs. State of Punjab JT* 1994 (2) SCC 432

3 *IRC vs. Duke of Westminster* (1936) AC 1 pp. 19, 24 (HL)

4 *Yokshire Railway Wagon Company vs. Maclure* 1882 21 Ch D 309

right to equality enshrined under Article 14 of the Constitution. In *Coimbatore District Central Cooperative Bank*[5], the Apex Court opined that 'Proportionality' is a principle where the Court is concerned with the process, method or manner in which the decision-maker has ordered his priorities, reached a conclusion or arrived at a decision. The very essence of decision-making consists in the attribution of relative importance to the factors and considerations in the case. The doctrine of proportionality, thus, steps in focus true nature of exercise the elaboration of a rule of permissible priorities. *De Smith*[6] states that 'proportionality' involves 'balancing test' and 'necessity test'. Whereas the former ('balancing test') permits scrutiny of excessive onerous penalties or infringement of rights or interests and a manifest imbalance of relevant considerations, the latter ('necessity test') requires infringement of human rights to the least restrictive alternative.

Mens Rea

"Mens Rea" means, literally, a guilty mind. It is a cardinal principle of English Common Law that a person cannot be convicted and punished in a proceeding of a criminal nature unless it can shown that he had a guilty mind. This principle is self explanatory. A person should be punished for deliberate defiance of law, rather than something which he did not intentionally or something which happened accidently. Nevertheless, this principle is most misconceived. In certain offences, called "statutory offences", it is argued that *mens rea* is not required. Taxation offences are statutory offences. Natural corollary should follow. In *Gujarat Travancore*[7], the Supreme Court held that '*mens rea*' is not an essential ingredient for imposing a penalty unless statute specifically prescribes so. What is pertinent to note here is that penalty provision in a taxing statute cannot be equated to a criminal statute, which, impliedly, requires presence of guilty mind. Under taxing statutes, unless there is something in the language of the Act indicating the need to establish *mens rea*, it is generally sufficient to prove that a default in complying with the provisions of the Act has occurred, for which penalty is provided.

Technical Breaches

Penalty for non compliance of provisions like registration, issuance of deficient invoice, delayed filing of returns etc., will attract penalty even though the supplier was unaware of such compliance or has simply failed to abide thereof. However, penalty will not be imposed merely because it is lawful to do so. In *Hindustan Steel Limited*[8], the Supreme Court held that penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially and on consideration of all the relevant circumstances. Even if a minimum penalty is prescribed, the authority competent to impose penalty will be justified in refusing to impose penalty, where there is a technical or venial breach of the provisions of the Act or where the breach flows from *bona fide* belief that the offender is not liable to act in the manner prescribed in the statute. Thus, discretion is hallmark of provisions relating to penalty. No such discretion vests with the tax or interest thereof.

Ignorance of Law is no excuse

One of the guiding principles behind imposition of penalty is that a person is presumed to know the law. It is, hence, that its ignorance does not normally afford any defense[9]. It flows from

5 Coimbatore District Central Co-operative Bank vs. Coimbatore District Central Co-operative Bank Employees Association & Anr. (2007) 4 SCC 669

6 Judicial Review of Administrative Action'; (1995) pp. 601-605 para 13.085

7 *Gujarat Travancore Agency Cochin vs. CIT, Kerala* AIR 1989 SC 1671

8 *Hindustan Steel Ltd. vs. The State of Orissa* - 1969 (2) SCC 627

9 *Assistant Collector of Central Excise, Madras vs. Nagappa Chettiar* 1979 (4) ELT J 179 (Mad.)

Latin maxim *Ignorantia juris non excusat*. No one is permitted to plead ignorance as a defense to escape the rigours of law. If it is so, it is very easy for any person to put it forward as a defence even though he may be aware of the law and its consequences. However, in cases involving interpretation of law, no penalty can visit.

Penal provisions under GST

Legacy continues. The existing provisions from the Central and the State Acts have found way into the "new" "Good and Simple Tax". *Winston Churchill* said: "There is no such thing as a good tax". The dogs have donned new attire.

Chapter XIX contains provisions in relation to offences and penalties. Section 122(1) enlists offences committed by a taxable person which shall be subject to penalty of rupees ten thousand or the amount of tax evaded, whichever is higher. Peculiar here is sub-clause (iv) which provides that if the tax collected is not deposited within three months, the same would visit penalty. Delay in payment of tax would attract interest, but penalty? That too, equivalent to the tax amount. Tool for oppression? Sub-section (2) provides for penalties in relation to supplies of any goods or services or both on which any tax has not been paid or short-paid or erroneously refunded, or where the input tax credit has been wrongly availed or utilised. Sub-section 3 provides for penalties on supporting star cast i.e., any person other than taxable person, who is involved in aiding or abetting the commission of the offence the committing offence.

Section 123 provides for penalty for failure to furnish information/return. Section 124 levies fine for failure to furnish information or return required under Section 151 of the Act. Section 125 is a general provision which provides for penalty for any offence for which no penalty is separately provided. Section 126 provides for general principles relating to imposition of penalty. Discretionary powers to officers to choose not to impose any penalty for "minor breaches" of tax regulations or procedural requirements and in particular, any omission or mistake in documentation which is easily rectifiable and made without fraudulent intent or gross negligence. *"minor breaches"* means a breach involving the tax amount of rupees five thousand or less. Laughable or not. I, certainly, think it is. Taken, before even being born. Section 127 provides for imposition of penalty which is not covered by provisions of sections 62, 63, 64, 73, 74, 129 or 130. Provision or not, penalty is certain.

Section 129 provides for detention and seizure of goods and conveyance in transit and release thereof. Adding to the said cause, Section 130 lays down penalties in case confiscation of goods and penalties. This gives a heads up in this piece and sets the tone for detailed examination by following authors.

Prosecution

Prosecution is conducting of legal proceedings against someone in respect of a criminal charge. Unlike penalty, which flows from a breach of statute, *mens rea* is a pre-requisite to initiate prosecution. In order to establish a criminal charge, two elements are must: (i) there must be compelling words to treat the act as an offence and (ii) the accused must have a culpable mental state. "Culpable mental state" includes intention, motive, knowledge of a fact, and belief in, or reason to believe, a fact. However, as held by the Madras High Court in *Paulsamy's*[10] case, the same can be proved by preponderance of probabilities and not beyond reasonable doubt.

The bottom line, as appears to me, is necessity of existence of a culpable mind has to be seen in light of the most cardinal rule of interpretation of

10 *R. Paulsamy vs. Supdt., Narcotics Control Bureau, Chennai* 2003 (162) E.L.T. 39 (Mad.)

taxing statute – strict construction. The Golden Rule of interpretation. It is well settled that the intention of the legislature has to be gathered from the language of the statute. The legislature says what it means and means what it says. There is no intendment or logic or equity in matters of taxation. In *Gwalior Rayons Silk Mfg. (Wvg.) Co. Ltd.*[11] It was held that in seeking legislative intention judges not only listen to the voice of the legislature but also listen attentively to what the legislature does not say.

Section 132(6) mandates obtaining prior sanction of the Commissioner of GST before launching of prosecution. The purpose of requirement of sanction, as explained by Supreme court in *Velliappa Textiles Ltd.*[12] is to prevent malicious and unnecessary prosecutions leading to harassment. It is condition precedent to launch of prosecution. It must be proved that it was given with respect to facts constituting the offence. Narration of facts on its face is desirable, but not essential. If there is no such narration, prosecution must, in course of trial, by extraneous evidence prove that those facts were before sanctioning authority who applied its mind to them before grant of sanction. However, opportunity of hearing is not necessary to be given before grant of sanction of prosecution, and it cannot be justified on the ground that it would give opportunity to a person to offer composition to avoid disgrace and ignominy of prosecution.

Section 132 enlists the offences which are subject to trial. Section 135 provides for presumption as to culpable mental state. Hence, the onus to prove otherwise lies upon the accused. The accused is required to prove beyond reasonable doubt that he did not possess the requisite mental state. In Inder Sain[13], the appellant got a parcel of apples released from the railway. While he was carrying the parcel, he was intercepted by the police and the parcel was found to contain opium. He was convicted under Section 9. The only question was whether the appellant was in possession of opium. It was held by that if possession is an offence then there must be proof that the accused was knowingly in possession of the article. That knowledge involved in possession of the unauthorised article had to be proved. It was further held that the word "possession", in such cases, connotes possession with knowledge. The Apex Court, therein, has drawn a dichotomy between the law pertaining to presumptions and the law relating to the burden of proof. It was held that though knowledge is an essential ingredient of the offence of possession, it is a different thing to say that the prosecution should prove that the accused was knowingly in possession. It was held that by virtue of Section 10, similar to Section 135 of GST Act, the onus of proof was placed on the accused to prove that he did not knowingly possess the article.

Adjudication (leading to imposition of penalties) and Prosecution are, however, independent and parallel proceedings. In *Maniklal Pokhraj*[14], it was held that findings in one proceeding cannot be relied upon in the other.

In parting, I am reminded of words of H. L. Mencken that penalty for laughing in court room is six months in jail. If it were not for this penalty, the jury would never hear the evidence.

❍❑❍

11 *Gwalior Rayons Silk Mfg. (Wvg.) Co. Ltd. vs. Custodian of Vested Forests, Palghat & Another* 1990 (Supp) SCC 785

12 *Asst. Commr., Assessment-II, Bangalore vs. Velliapa Textiles Ltd.* 2003 (157) E.L.T. 369 (S.C.)

13 *Inder Sain vs. State of Punjab* [(1973) 2 SCC 372]

14 *Maniklal Pokhraj Jain vs. Collector of Customs (Preventive), Bombay & Others* [1986 (26) E.L.T. 689 (Bom.)

Harsh Shah, *Advocate* & CA Ruchita Shah

Penalty for non-payment/short payment of tax or wrong availment or utilisation of input tax credit u/s. 122(2) of CGST Act

A tax statute typically puts various compliance requirements on the taxpayers. With the compliances come the consequences of non-compliances, which are in the form of various penal provisions. Various penalty and prosecution provisions are included in tax legislations to act as deterrent for non-compliance, safeguard the Government's right of due revenue collection and compensate for the deliberate or non-deliberate non-compliances of the taxpayers.

The Indirect tax legislations in India have had penal provisions of varied degrees for several non-compliances identified therein. These provisions under the Central and State level Indirect tax laws have historically been a subject matter of considerable litigation, based on which various principles for operation of such penal provisions have also evolved.

The Goods and Services Tax ('GST') law being a radical Indirect tax reform in India has given birth to a new set of penal provisions, interpretation and applicability of which would however be influenced by the shadows of the corresponding provisions under the erstwhile Indirect tax laws.

The penal provisions under the Central GST Act, 2017 ('CGST Act') identify various non-compliances and prescribe applicable penalty for the same. Of the same, Section 122(2) of the CGST Act deals with penal implications arising out of non-compliance in the form of non-payment or short-payment of tax (including wrong availment or utilisation of credit). The said Section 122(2) of the CGST Act is reproduced below:

"(2) Any registered person who supplies any goods or services or both on which any tax has not been paid or short-paid or erroneously refunded, or where the input tax credit has been wrongly availed or utilised, —

(a) for any reason, other than the reason of fraud or any wilful misstatement or suppression of facts to evade tax, shall be liable to a penalty of ten thousand rupees or ten per cent of the tax due from such person, whichever is higher;

(b) for reason of fraud or any wilful misstatement or suppression of facts to evade tax, shall be liable to a penalty equal to ten thousand rupees or the tax due from such person, whichever is higher."

It may be observed that the above quoted provision is dividing the non-payment, short-payment, etc. into two categories and prescribed penalty for each of such category, is explained in the table below:

Reason for non-payment, short-payment, wrong availment or utilisation of credit, etc.	Whether chargeable to penalty	Quantum of penalty
Any reason other than fraud or any wilful misstatement or suppression of facts to evade tax	Yes	₹ 10,000 or 10% of the tax due – whichever is higher
Fraud or any wilful misstatement or suppression of facts to evade tax	Yes	₹ 10,000 or the tax due – whichever is higher

The above quoted penalty provisions of Section 122(2) of the CGST Act look largely rooted in Section 11AC of the Central Excise Act, 1944 ('CE Act') and Section 78 of the Finance Act, 1994 ('Finance Act'). However, the mechanism to levy fixed minimum penalty looks guided from erstwhile State Value Added Tax ('VAT') legislations. A brief comparison of the non-payment, short-payment related penal provisions of the CGST Act and the erstwhile Indirect tax laws identifying the key differences is presented below:

1. Section 122(2) of the CGST Act vs. Section 11AC of the CE Act (or Section 78 of the Finance Act)

- The underlying reasons based on which penalty may be imposed in cases involving *mala fide* intent have been rationalised under the CGST Act, as can be observed from the comparison below:

Elements of *mala fide* intent / conduct to justify levy of penalty	
Section 11AC(1)(c) of the CE Act	**Section 122(2)(b) of the CGST Act**
Fraud	Fraud
Any wilful mis-statement	Any wilful misstatement
Suppression of facts	Suppression of facts to evade tax
Collusion	
Contravention of any of the provisions of this Act or of the rules made thereunder with intent to evade payment of duty	

- In respect of cases not involving any *mala fide* intent, Section 122(2) of the CGST Act still prescribes a fixed penalty of 10% of the tax due. As against this, Section 11AC(1)(a) of the CE Act included a discretion to levy penalty 'not exceeding 10% of the duty so determined'.

- The provisions for imposing reduced penalty where tax, interest and penalty are paid within specified time from issuance of show cause notice or order have undergone change as explained in the table below:

Provisions for reduced penalty				
Payment made	**CE Act (Section 11AC)**		**CGST Act (Section 73 / 74)**	
	Penalty in cases involving fraud, etc.	**Penalty in other cases**	**Penalty in cases involving fraud, etc.**	**Penalty in other cases**
Before issuance of show cause notice	No provision	Nil	15% of the tax	Nil
Within 30 days from issuance of show cause notice	15% of the duty demanded	Nil	25% of the tax	Nil
Within 30 days from communication of order	25% of the duty demanded	25% of penalty imposed	50% of the tax	No provision

2. Section 122(2) of the CGST Act vs. penal provisions of the VAT laws

- As stated above, the penal provisions under Section 122(2) of the CGST Act are rooted in the corresponding penalty provisions of the CE Act and the Finance, Act, which have been structurally quite different than penalty provisions of the State VAT legislations. Further, even from State to State, the penalty provisions pertaining to non-payment of tax under the VAT legislation had sharp differences.
- At a broad level, the following fundamental elements of non-payment of tax related penalty provisions under various State VAT laws do not seem to find any place in Section 122(2) of the CGST Act:
  - o Multiple descriptions of situations (such as concealment of particulars, fraud, furnishing inaccurate particulars, knowingly misclassifying goods, claiming excess set-off, etc.) leading to levy of penalty equal to tax demanded or more than the tax demanded;
  - o Imposition of penalty of more than 100% of tax demand;
  - o Separate penalty provisions concerning wrongdoings for end-use based exemptions;
  - o Imposition of significant penalty or penalty equal to demand of tax even in situations not involving explicit *mala fide* intent / conduct;
  - o Imposition of automatic penalty of fixed / discretionary amount in situations where the difference between tax paid and assessed exceeds the specified percentage;
  - o Very broad description of situations treated to be involving *mala fide* intent / conduct;
  - o Levy of simultaneous penalty under various penalty provisions / clauses for the same non-payment or short-payment of tax, etc.

Having discussed the basic scheme of levy of penalty under Section 122(2) of the CGST Act and its comparison with corresponding penalty provisions of the CE Act and VAT laws, we would now analyse some key aspects of Section 122(2) of the CGST Act.

1. Levy of penalty on unregistered person

Interestingly, the opening para of Section 122(2) of the CGST Act seems to be limiting its applicability only to a "registered person". In this context, it would be important to refer the following definitions under the CGST Act.

- Registered person [Section 2(94)]

  "Registered person means a person who is registered under section 25 but does not include a person having a Unique Identity Number."

- Taxable person [Section 2()]

  "Taxable person means a person who is registered or liable to be registered under section 22 or section 24."

  Accordingly, it appears that a person liable to registration, but who has not obtained registration may not be covered within the ambit of 'registered person', although such person may be treated as taxable person. While Section 122(1) lays down penalty for failure to obtain registration, suppression of turnover leading to evasion of tax, etc., there seems a possible window for arguing levy of penalty under provisions of Section 122(2) of the CGST Act for non-payment or short-payment of tax by such an unregistered person.

  In this context, it is also pertinent to note that while Section 25(8) of the CGST Act empowers the proper officer to register a person who has failed to obtain registration, Rule 16(2) of the Central Goods and Services Tax Rules, 2017 provides that such *suo motu* registration would take effect from the date of order granting registration. Accordingly, it would be interesting to observe how levy of penalty under Section 122(2) of the CGST Act unfolds in respect of assessment of unregistered person/persons who have failed to obtain registration for the period under dispute.

2. Provisions of Section 126 of the CGST Act

Section 126 of the CGST Act lays down general disciplines for imposition of penalty under the CGST Act and *inter alia* provides the situations in which penalty should not be levied. With the provisions of Section 126, the disciplines to be followed for imposition of penalty have been for the first time included in the law itself.

In the context of discussion on Section 122(2) of the CGST Act, it would be pertinent to note the following provisions of Section 126(1) of the CGST Act.

"(1) No officer under this Act shall impose any penalty for minor breaches of tax regulations or procedural requirements and in particular, any omission or mistake in documentation which is easily rectifiable and made without fraudulent intent or gross negligence.

Explanation. — For the purpose of this sub-section,—

(a) a breach shall be considered a 'minor breach' if the amount of tax involved is less than five thousand rupees;

(b) an omission or mistake in documentation shall be considered to be easily rectifiable if the same is an error apparent on the face of record… …

(6) The provisions of this section shall not apply in such cases where the penalty specified under this Act is either a fixed sum or expressed as a fixed percentage."

In view of the above, it seems that minor breaches, easily rectifiable omission or mistake in documentation, etc. are not intended to be penalized. However, Section 126(6) specifically restricts applicability of this provisions in cases where penalty has been prescribed as a fixed sum or expressed as a fixed percentage. It would therefore appear that considering the fixed penalty prescribed under Section 122(2) of the CGST Act, even a minor breach in respect of payment of tax may be liable to penalty (even if resulting out of a mistake).

At this stage, it would also be important to notice that the provisions of Section 126(1) providing guidance for non-imposition of any penalty in certain situations do not start with a non-obstante clause, and hence no overriding effect to the same has been provided in the law. In such a situation, applicability thereof in the context of various penal provisions would be interesting to analyse.

3. No discretion on levy or amount of penalty

The penalty prescribed under Section 122(2) of the CGST Act is in the nature of a mandatory penalty and no discretion has been left for the authorities as regards:

- Whether to levy such penalty in case of a non-payment, short-payment, etc.;
- Quantum of the penalty (once it is decided whether the issue involves fraud, etc. or not).

Accordingly, the only discretion available to the authorities for levy of penalty under Section 122(2) is to determine whether the matter involves any fraud, willful misstatement, suppression to evade tax or not. Once the authority decides on this issue, there is no discretion provided as regards the levy or quantum of such penalty.

4. No *mens rea* prescribed for imposition of 10% penalty

Even in cases where non-payment, short-payment of tax is purely unintentional and is attributable to reasons other than fraud or any wilful misstatement or suppression of facts to evade tax (i.e. not attributable to any wrongdoing or intention on part of the taxpayer), a minimum penalty prescribed under Section 122(2)(a) is leviable.

<u>The doctrine of *mens rea* and applicability thereof in taxation statutes</u>

Generally, *mens rea* (guilty mind) is considered as a key element to constitute an offence or crime. The maxim *"Actus non facit reum, nisi mens sit rea"* (the intent and act must both concur to constitute the crime) suggests that there must be mind at fault before there can be a crime.

While this concept of *mens rea* is often discussed in the context of levy of penalty under tax statutes, the Hon'ble Supreme Court in the case of *Union of India vs. Ganesh Das Bhojraj*[1] has recognised the following exceptions to the doctrine of *mens rea*:

"The doctrine that mens rea is an essential ingredient in every offence has three recognised exceptions:

(i) cases not criminal in any real sense but which in the public interest are prohibited under a penalty;

(ii) public nuisance; and

(iii) cases criminal in form but which are really only a summary mode of enforcing a civil right."

However, the Supreme Court in the case of *Commissioner of Sales Tax vs. Sanjiv Fabrics*[2] emphasised on the importance of mens rea even for levy of penalty under the taxation statute and observed that:

"there is a rebuttable presumption that mens rea is essential ingredient in every offence. For examining whether mens rea is essential for an offence created under a tax Statute, three factors require particular attention, (i) the object and scheme of the Statute; (ii) the language of the section; and (iii) the nature of penalty."

In this context, it would be important to refer to the following jurisprudence on levy of minimum penalty or mandatory penalty even in the absence of *mens rea*:

a. The Larger Bench of the Supreme Court in the case of *Hindustan Steel Limited vs. State*

1. 2000 (116) ELT 431 (SC)
2. 2010 (258) ELT 465 (SC)

of Orissa[3] held the following in the context of penalty for failure to obtain registration under Sales Tax Law:

"Whether penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially and on a consideration of all the relevant circumstances. Even if a minimum penalty is prescribed, the authority competent to impose the penalty will be justified in refusing to impose penalty, when there is a technical or venial breach of the provisions of the Act or where the breach flows from a bona fide belief that the offender is not liable to act in the manner prescribed by the statute."

b. However, the Supreme Court in the case of *SEBI vs. Shriram Mutual Fund and Another*[4] held that unless the language of the statute so provides, the need to examine *mens rea* is unnecessary in the context of breach of a civil obligation.

c. Similar view (i.e. there is no need to examine *men rea* for breach of a civil obligation) has also been adopted by the Larger Bench of the Supreme Court in the case of *Union of India vs. Dharmendra Textile Processors*[5] in the context of Section 11AC of the CE Act.

In light of the conflicting decisions cited above, if and how the debate on applicability of the doctrine of *mens rea* unfolds in the context of levy of penalty under Section 122(2)(a) of the CGST Act would be interesting to observe.

5. Elements of *mens rea* for imposition of penalty under Section 122(2)(b)

As stated above, compared to the penalty provisions of the CE Act and the Finance Act, the elements of *mens rea* for imposition of penalty under Section 122(2)(b) have been rationalised. The three elements (fraud, any wilful misstatement, suppression of facts to evade tax) covered in Section 122(2)(b) have been well-recognised legal concepts under the jurisprudence developed under the provisions of the CE Act and the Finance Act.

Considering a huge 90% variance in the penalty depending on whether a case falls within ambit of these three elements or not, the jurisprudence to establish presence or absence of these elements would continue to be of utmost importance even under the GST regime. While each case would have to be determined on its own peculiar facts, the jurisprudence on the subject would definitely be a guiding force in analysis of case specific facts in this context.

We would now analyse some of the judicial precedents on interpretation of these terms and burden to establish existence or absence thereof:

a. The Supreme Court in the case of *Tamil Nadu Housing Board vs. Collector of Central Excise*[6] held that the initial burden is on the Department to establish that such situations existed. However, once the Department is able to bring on record material to show that the appellant was guilty of any of such situations, the burden shifts and then applicability of the provision has to be construed liberally.

b. The difference between a mere failure to pay tax / duty and evasion thereof is also well recognized by the Supreme Court in the case of *Tamil Nadu Housing Board vs. Collector of Central Excise (supra)* wherein it was held that:

"When the law requires an intention to evade payment of duty then it is not mere failure to

3. 1978 (2) ELT (J 159) (SC)
4. Judgement dated 23-5-2016 in Civil Appeal 9523-9524
5. 2008 (231) ELT 3 (SC)
6. 1994 (74) ELT 9 (SC)

pay duty. It must be something more. That is, the assessee must be aware that the duty was leviable and it must deliberately avoid paying it. The word `evade' in the context means defeating the provision of law of paying duty. It is made more stringent by use of the word `intent'. In other words the assessee must deliberately avoid payment of duty which is payable in accordance with law."

c. The Supreme Court in the case of *Pushpam Pharmaceutical Company vs. Collector of C. Ex., Bombay*[7] has observed the following while construing meaning of the term 'suppression of facts':

"It does not mean any omission. The act must be deliberate. In taxation, it can have only one meaning that the correct information was not disclosed deliberately to escape from payment of duty. Where facts are known to both the parties the omission by one to do what he might have done and not that he must have done, does not render it suppression."

Similarly, in *CC vs. Tin Plate Co. of India Ltd.*[8], it was held that suppression envisages a deliberate and conscious omission to state a fact with the intention of deriving wrongful gain. More recently, the Hon'ble Supreme Court has in *CCE vs. Pioneer Scientific Glass Works*[9] and *CCE vs. Bajaj Auto Ltd.*[10] re-affirmed the positions stated in the Pushpam (supra) and Tin Plate (supra).

d. The Supreme Court in the case of *Cosmic Dye Chemical vs. Collector of Central Excise*[11] held that the "intent to evade duty / tax" is inbuilt in the expression 'Fraud'.

In light of the aforesaid analysis, the penal provisions of Section 122(2) of the CGST Act appear to be old wine in a new bottle. These penalty provisions dealing with non-payment / short-payment of tax in fact come with a background of significant jurisprudence as regards their interpretation and validity. Despite this, it would be interesting to observe development of new concepts or modification of old concepts on levy of such penalty under the GST regime. Further, the extent of 'genuine' compliance of the disciplines for imposition of penalty laid down in Section 126 of the CGST Act would also be tested in the days to come.

At this stage, we may hope that while the penalty provisions under the CGST Act come with the baggage of past (in term of their similarity to provisions of the CE Act and the Finance Act), the baggage of past practices of alleging *mala fide* intent / conduct as a mechanical exercise would be left behind. Since with great power comes great responsibility!

DISCLAIMER: The authors can be reached at harshshah@elp-in.com or ruchitashah@elp-in.com for any comment or query. The information provided in the article is intended for informational purposes only and does not constitute legal opinion or advice. Readers are requested to seek formal legal advice prior to acting upon any of the information provided herein.

❍❑❍

7. 1995 (78) ELT 401 (SC)
8. 1996 (87) E.L.T. 589 (S.C.)
9. 2006 (197) E.L.T. 308 (S.C.)
10. 2010 (260) E.L.T. 17 (S.C.)
11. 1995 (75) ELT 721 (SC)

CA Sumit Jhujhunwala & CA Hemang Shah

Penalty for offences u/s. 122(1)(i) and (ii) of the CGST Act

Major offences under GST law are obviously

- Non-payment or short payment of taxes, or
- Improper availment or utilisation of input tax credit, or
- Erroneous refund

Penal provisions in taxation laws are often formulated to achieve following objectives

- To curb tax evasion itself
- To curb malpractices which aid or abet such tax evasion
- To ensure timely payment of tax
- To ensure timely compliance of law
- To deter any acts of taxpayer which result in loss to exchequer

We shall be discussing the first two points i.e. penal provisions pertaining to attempts to evade payment of tax and malpractices which aid or abet such tax evasion in form of

- Non issuance of invoice, Issuance of incorrect/false invoice
- Issuance of invoice without supply taking place
- Taking Input Tax credit without receiving the goods or services

GST law provides for minimum penalty of ₹ 10,000 and maximum penalty equivalent to tax amount evaded when a taxpayer who does any of the above acts.

Although such penalty is rightly imposable on wilful tax evaders, but a levy of harsh penalty on taxpayer who has infringed the provisions of law by mistake wouldn't be justified.

Penalty for non-issuance of invoice, issuance of incorrect/false invoice

Non-issuance of invoice, issuance of incorrect/false invoice generally takes place with the intent to neither collect nor pay tax to Government or to collect tax from recipient but to pocket the same rather than to pay the same to Government.

In cases where any person makes a taxable supply but does not issue proper invoice with the possible intent to evade payment of tax would be required to pay penalty under the law. Such stringent penal provisions are highly welcome in view of the frequent cases of tax evasion coming to light.

Examples: Refusal of issue invoice for a taxable supply, non-issuance of invoice in connivance with the recipient, etc.

However in case of sale of goods on approval, the supplier is obligated to issue invoice on the date of approval of the goods or at the end of 6 months of the date of removal of goods. However, it is quite possible that in situations where the goods remain unapproved by the recipient, the supplier may miss out on issuance of invoice at the end of 6 months due to passage of time and may be subject to harsh penalties although the entire transaction is recorded in books of account and there may not be any intent to evade payment of tax.

Similarly, a taxpayer who fails to record correct details of recipient on the invoice and issues invoice with incorrect particulars may be deemed to be in default of provisions of law and may be subject to penalty.

Examples: Non-recording of registration No. details of recipient, incorrect classification (HSN) of supply, etc.

There have also been cases wherein the recipient has been issued an invoice but the invoice turns out to be fake. Such cases while they affect the rights of recipient as a consumer are also affecting the revenue of the Government as well.

Examples: Issuance of same invoice to two recipients, etc.

Penalty for issuance of invoice without actual supply taking place

Issuance of invoice without actual supply generally takes place with the intent to 'accommodate' the recipient in order to aid / abet to reduce the tax liability of such recipient. In such situations it is not necessary that the Government receives the taxes.

Suppose Mr. X has excess ITC lying with him for which he may be in position to claim refund and Mr. Y has some tax payable for which he may be any ITC to utilise. In such situation, Mr. X in connivance with Mr. Y raises an invoice on the latter (without actual supply) thereby the credit of Mr. X is utilised to pay the fictitious liability and Mr. Y gets ITC to utilise against his actual liability.

Penalty for availing or utilising input tax credit without actual receipt of goods or service or both

A registerd person as per sections 16(1) & 16(2) of CGST Act, is eligible to claim credit of Input Tax subject to following conditions:

a) ....

b) he has received the goods or services or both,

c) ....

d) ....

The said condition are inserted to cover situations where, with the intent to reduce the liability, registered person in connivance, accepts invoice from other registered person without actually receiving goods or service or both, wherein contravaning provisions for claiming Input Tax credit under CGST Act.

However, in case of goods which are received in lot or installments, registered person will be eligible for claiming credit of input tax on receipt of last lot or installment.

Penalty is not only for utilising but also for availing credit of inputs without actual receipt of goods or service or both.

Thus the penalty is not only for utilising wrong Input Tax credit, but also for wrong availment of Input Tax credit, where due to genuine reasons goods are not received but invoice is issued & are getting reflected in your eletronic credit ledger may be considered as input availed by departmental officer & may lead to trouble.

There may also be scenarios wherein such penal provisions can be misinterpreted and misused by the enforcers of law, since penalty is not only for utilising wrong Input Tax credit, but also for wrong availment of Input Tax credit, where due to gunuine reasons goods are not received but invoice's are issued in advance & are getting refelected in your eletronic credit ledger, which otherwise as per section 31 of CGST Act, a taxpayer is required to issue invoice 'before' or 'at the time of removal' of goods and invoice for services 'before' or after provision of service, may be considered as input available by departmental officer & may lead to trouble. The crux in the present scenario is that whilst the law itself provides that an invoice can be issued before the supply, but in cases wherein there is a time gap between issuance of invoice and actual supply and the records of taxpayer is scrutinised in this time gap itself, in such situations apprehensions may arise in the minds of tax officer concerning possibility of tax evasion. A tax officer who may not appreciate facts of particular case, may impose such harsh penalties on innocent taxpayers for an alleged infringement which may never be intended.

We have also seen that though the law provides for a formal adjudication process to be followed before any penalty is levied on taxpayer, however the adjudication procedure invariably turns out to be farce for the simple reason that the adjudication is carried out by the very same officer who levies the charges on taxpayer.

Section 132 of the CGST Act also provides for prosecution for offences of above nature and such offences carry imprisonment up to 5 years and fine depending upon the quantum of tax evasion. Interestingly if the prosecution procedure requires proving culpable state of mind of accused to the Court, the Government has washed off their hands from their duty to prove such culpable state of mind by incorporating Section 135 of CGST Act which stipulates that the Court shall presume the existence of such mental state but it shall be a defence for the accused to prove the fact that he had no such mental state with respect to the act charged as an offence in that prosecution.

Although Hon'ble Supreme Court has stated in case of *Hindustan Steel Ltd. v. State of Orissa AIR 1970 SC 253*, that the discretion to impose penalty must be exercised judicially. A penalty will ordinarily be imposed in case where the party acts deliberately in defiance of law, but not in cases where there is a technical or venial breach of the provisions of the Act or where the breach flows from a *bona fide* belief that the offender is not liable under the Act.

But with provisions like these actually required to be framed in law for wilful, chronic tax offenders, even the honest tax payer needs to be wary about his activities and ensure that he does not infringe the provisions of law even inadvertently.

❍❑❍

Be not afraid. Think not how many times you fail. Never mind. Time is infinite. Go forward; assert yourself again and again, and light must come.

— *Swami Vivekananda*

CA Naresh K. Sheth & CA Shraddha Mehta

Penalty under sections 122(1)(iii) and (iv) of Central Goods and Services Tax Act, 2017

I. Preamble

Fiscal statutes, in addition to tax, provide for imposition of interest, penalties, late fees, compounding charges etc. Tax is compulsory exaction of money by Government for public purpose. Penalty is imposed on rash and errant assessee for deliberate defiance of law or wilful evasion of tax. Fiscal statutes also contain prosecution provisions to deal with hard core tax defaulters.

Section 122 of Central Goods and Services Tax Act, 2017 (hereinafter referred to as 'CGST Act') provides for penalty for various offences listed in sub-sections (1), (2) and (3) of section 122. Section 126 of CGST Act further provides for general discipline to be maintained by GST Officer and also guidelines to be followed by him while imposing the penalty on tax payer.

II. Scope of Article

The Chamber has divided topic of penalty into various sub-topics and allotted specific offence and relevant provision dealing with it to different learned authors. The topic allotted to us is offences listed in sections 122(1)(iii) and (iv) of CGST Act. We will restrict this article to allotted topic only. The readers are requested to read this article in conjunction with article dealing with section 126 of CGST Act.

III. Relevant legal provisions under CGST Act

Relevant extract of sections 122(1)(iii) and (iv) of CGST Act is reproduced hereunder:

"(1) Where a taxable person who––

(i) ……………………………………;

(ii) ……………………………………;

(iii) *Collects any amount as tax but fails to pay the same to the Government beyond a period of three months from the date on which such payment becomes due;*

(iv) *Collects any tax in contravention of the provisions of this Act but fails to pay the same to the Government beyond a period of three months from the date on which such payment becomes due;*

(v) ……………………………………………;

……………………………………………;

(vi) ……………………………………………;

he shall be liable to pay a penalty of ten thousand rupees or an amount equivalent to the tax .... collected but not paid to the Government ...., whichever is higher"

IV. Analysis, Interpretation and Views

1. On bare perusal of aforesaid provision, it appears that sections 122(iii) and (iv) applies in the cases where an amount representing as 'tax' is collected or 'tax' is collected in contravention of the provisions of CGST Act and the same is not deposited with the Government.

   In simple words, this penalty is leviable when the person after collecting following amount from other person does not deposit it with Government within prescribed limit:

   - Amount ostensibly or wrongly collected as tax even when same was not collectible as "tax"; or
   - Tax is collected in contravention of provisions of CGST Act.

   In this context, it becomes important to refer section 76 of CGST Act which provides for tax collected but not paid to Government. Relevant extract is reproduced as under:

   ***76.** (1) ...., every person who has collected from any other person any amount as representing the tax under this Act, and has not paid the said amount to the Government, shall forthwith pay the said amount to the Government, irrespective of whether the supplies in respect of which such amount was collected are taxable or not.*

   *(2) Where any amount is required to be paid to the Government under sub-section (1), and which has not been so paid, the proper officer may serve on the person liable to pay such amount a notice requiring him to show cause as to why the said amount as specified in the notice, should not be paid by him to the Government and **why a penalty equivalent to the amount specified in the notice should not be imposed on him under the provisions of this Act.***

   Section 76 of CGST Act gives power to GST Officer to recover from any person any amount which is collected as tax or tax collected in contravention of the provisions of CGST Act along with interest and penalty thereon where such tax or amount is not deposited with Government within prescribed time. GST Officer is empowered u/ss. 122(1)(iii) and (iv) of CGST Act to impose penalty for this offence.

2. Following are pre-requisites for imposing penalty u/s 122(1)(iii) and (iv):

   - Person committing the said offence is a 'taxable person'; **and**
   - Such person collects any amount as 'tax' or collects 'tax' in contravention of the provisions of CGST Act; **and**
   - Fails to deposit it to the Government within three months from the due date of payment of such tax i.e. 20th of subsequent month.

3. If a taxable person commits aforesaid offence, he is liable to be penalty which is **higher of**:

   - ₹ 10,000; or
   - Amount collected as tax or tax collected in contravention provisions of CGST Act.

Penalty u/ss. 122(1)(iii) and (iv) is applicable to taxable person only

4. Section 122(1) of the CGST Act applies to offences committed by a 'taxable person'. Any person other than taxable person will not be liable to penalty u/s 122(1) of the CGST Act. Term 'taxable person' is defined u/s. 2(107) of CGST Act to mean a person who is registered or liable to be registered u/s. 22 or 24 of CGST Act.

Meaning of term 'tax'

5. Penalty u/ss. 122(1)(iii) and (iv) of the CGST Act triggers only when a taxable person either collects amount as 'tax' or collects 'tax' in contravention of the provisions of CGST Act. Hence, it becomes important to understand meaning of term 'tax'.

6. Term 'tax' *per se* is not defined in the CGST Act. However, terms 'Central Tax', 'Integrated Tax', 'State Tax', 'Union territory tax' are defined under sections 2(21), 2(58), 2(104) and 2(115) of the CGST Act to mean said taxes leviable under respective legislations.

7. Question arises whether above referred penal provisions apply to similar defaults or offences committed in respect of 'compensation cess'?

   Section 11 of the Goods and Services Tax (Compensation to States) Act, 2017 provides that provisions of CGST Act and the rules made thereunder including those relating to offences and penalties shall *mutatis mutandis* apply in relation to levy an collection of cess.

   Hence, section 122(iii) and (iv) will *mutatis mutandis* apply to similar defaults or offences committed in respect of 'compensation cess'.

Penalty arises on failure to pay amount collected as tax or tax collected wrongly

8. Penalty is leviable only when taxable person fails to deposit the amount so collected within 3 months from the due date of payment of tax.

   Penalty is not leviable where such amount is paid along with interest thereon within 3 months from the due date for payment of such tax.

Probable situations triggering penalty u/ss. 122(iii) and (iv) of the CGST Act

9. Following are probable situations in which GST Officer can invoke penalty u/ss. 122(iii) and (iv) of CGST Act:

   - A composition dealer collects GST from customers and fails to pay to Government within 3 months from the due date of payment of tax;
   - Supplier (registered or liable to be registered) collects GST on exempted goods or services and fails to pay to Government within 3 months from the due date of payment of tax;
   - A taxable person collects excess tax from its customer and does not deposit such excess tax and fails to pay to Government within 3 months from the due date of payment of tax.

Relevant Judicial Precedents

10. Sections 76, 122(1)(iii) and 122(1)(iv) of CGST Act are analogous to section 11D of Central Excise Act, 1944, section 73A of Finance Act, 1994, Rule 27 of Central Excise Rules, 2002 and section 89 of Finance Act, 1994. All these provisions under earlier law were providing for recovery of any amount collected as duty or tax and not deposited with

Government and penalty thereon. Hence, judicial pronouncement under earlier tax regime will be relevant in GST regime also.

11. The Courts in following cases have held that contractual obligation to reimburse the tax paid by a person designed to do so by law cannot be said to be tax collected in any manner warranting recourse to section 73A of Finance Act, 1994 / section 11D of Central Excise Act, 1944:

    - *Mafatlal Industries Ltd. vs. UOI [1997 (89) ELT 247 (SC)]*
    - *Unison Metals Ltd. vs. CCE [2006 (4) STR 491 (Tri-LB)]*
    - *HDFC Standard Life Insurance Co. Ltd. vs. CCE [2017 (49) STR 301 (Tri-Mumbai)]*

12. Honourable Courts held in the following cases that demand u/s. 11D of Central Excise Act or section 73A of Finance Act is not barred by limitation period:

    - *CCE, Jaipur vs. Raghuvar (India) Ltd. – 2000 (118) E.L.T. 311 (SC)*
    - *Katralia Products Pvt. Ltd. vs. CCE, Coimbatore – 2008 (227) E.L.T. 553*
    - *Vimal Moulders (I) Ltd. vs. CCE, New Delhi - 2004 (164) E.L.T. 302*
    - *Mohinder Steels Ltd. vs. CCE, Chandigarh - 2002 (145) E.L.T. 290 (Tri. - LB)*

13. In the case of *CCE vs. Mahavishnu Cylinders [2015 (322) E.L.T. 234 (Mad.)]* it was held that provisions of section 11D cannot be invoked where invoices show duty amount erroneously on account of clerical or software error.

Prosecution for offence

14. Section 132 of CGST Act provides for prosecution for various offences under the Act. There is a separate Chapter in this issue of Journal dealing with the prosecution. Readers are requested to read this article in conjunction with said Chapter.

V. Conclusion

Power to levy penalty is an effective weapon in the armory of tax administrators to deal appropriately with tax evaders and defaulters. Judiciaries have approved such powers of tax administrators. Power of penalty is a sharp edged weapon in the hands of tax administrators. It is, therefore, incumbent for tax administrators to use it judicially.

❑❍❍

> We must point out not the mistakes that people are making in their thoughts and actions, but the way in which they will gradually be able to do these things better.
>
> — *Swami Vivekananda*

CA Manish R. Gadia

Penalties under Sections 122(v) and 122(vi) of Central GST Act, 2017

With the introduction of GST w.e.f. 1st July, 2017, the concept of Tax Deduction at Source (TDS) and Tax Collection at Source (TCS) has been introduced on certain supplies of goods and services as well. The TDS and TCS under GST are in addition to the existing Income Tax TDS and TCS.

Although the TDS and TCS provisions are introduced in GST, they have not been made applicable yet and shall remain suspended till 30th June, 2018 as per decision taken in 26th GST Council Meeting held on 10th March 2018.

The government has also put in force the penalty provisions in case of non-deduction, short deduction or non-payment of TDS and corresponding penalty provisions in case of non-collection, short collection or non-payment of TCS in accordance with the provisions of law. However before understanding the penalty provisions, the applicability of TDS and TCS under GST is briefly explained below;

Tax Deduction at Source under Section 51

TDS is liable to be deducted by:

- Department or establishment of Central Government or State Government
- Local Authority
- Governmental Agencies
- An authority or a board or any other body, -
  - (i) set up by an Act of Parliament or a State Legislature; or
  - (ii) established by any Government,

  with 51% or more participation by way of equity or control, to carry out any function
- Society established by the Central Government or the State Government or a Local Authority under the Societies Registration Act, 1860
- Public sector undertakings

Rate of TDS

- Intra State Supply – 1% under Central GST and 1% under State GST
- Inter State Supply – 2% under Integrated GST

TDS Deduction From

- Payment made or credited to the supplier

Value for Supply for applicability of TDS

- Supply made under a contract the amount for which excess ₹ 2.50 Lakhs (excluding CGST, SGST, UTGST, IGST and Cess as indicated in invoice)

No TDS for following cases

- Value of supply under a contract is equal to or less than ₹ 2.50 lakh.
- Goods or services supplied are not taxable under GST.

- Location of Supplier and Place of Supply, both are different from the State or UT where recipient is registered.
- Unlike MVAT TDS, which was applicable on payment made or credited for above certain monetary limits for all Works contracts, GST TDS is only applicable for above mentioned class of receiver of taxable goods or services.

Tax Collection at Source under Section 52

TCS is liable to be collected by

- Electronic Commerce Operator (not being an agent)

Rate of TCS

- Intra State Supply – Not exceeding 1% under Central GST and 1% under State GST (as may be notified)
- Inter State Supply – Not exceeding 2% under Integrated GST (as may be notified)

TCS Collection From

- Amount Payable by Electronic Commerce Operator to the Supplier

Value for Collection of TCS

- Net value of taxable supplies of goods or services or both made during any month by all registered persons through the operator reduced by the aggregate value of taxable supplies returned to the suppliers during the said month

No TCS for following cases

- Value of supplies collected directly by the supplier from the recipient
- Supplies of services by way of transportation of passengers by a radio-taxi, etc providing accommodation in hotels, inns, guest houses, etc and house-keeping, such as plumbing, carpentering etc., <u>where Electronic Commerce Operator is liable to pay the entire GST</u>.

In connection with the above principles of TDS and TCS, the Government has prescribed penal provisions for non-deduction, short deduction or non-payment of TDS and for non-collection, short collection or non-payment of TCS.

A penalty equivalent to or ₹ 10,000/- or amount of Tax not deducted, short deducted or deducted but not paid, whichever is higher has been prescribed under the law.

Similarly penalty equivalent to or ₹ 10,000/- or amount of Tax not collected, short collected or collected but not paid whichever is higher has been prescribed under the law.

Illustrations below show the situation in which penalty provisions may apply for cases involving TDS;

Receiver	Supplier	POS	Value of Supply	TDS required to be deducted	TDS Actually Deducted	TDS Paid	Penalty (min. ₹ 10,000)
MH	MH	MH	3,00,000	6,000	0	0	10,000
MH	MH	GJ	5,50,000	11,000	0	0	11,000
MH	GJ	MH	5,50,000	11,000	10,000	10,000	10,000
MH	MH	MH	9,00,000	18,000	18,000	1,800	16,200
MH	MH	MH	2,00,000	0	0	0	–
MH	GJ	GJ	5,00,000	0	0	0	–

MH = Maharashtra, GJ = Gujarat

Common Situations where Tax Payer may default on TDS provisions thereby attracting Penalty

- <u>Advance Payment</u>: Since TDS is liable to be deducted from the payment made or credited to the supplier, even in case of an advance payment, where it is estimated that the value of supply to be made under the contract would exceed ₹ 2.50 Lakhs, TDS should be deducted from such advance payment and the net amount should be remitted.

SS-VIII-84

- Grossing-up of TDS: In cases where the deductor has to make payment to supplier a fixed sum (net of all deductions), in such cases deductor should ensure that TDS amount is grossed up before making the deduction.

  For Eg: If a PSU has to make a fixed payment of ₹ 10 Lakhs to a supplier, payment of 2% TDS i.e. ₹ 20,000/- will not be appropriate. Instead the PSU shall have to gross-up the 2% TDS in base amount and make TDS payment of ₹ 20408/- on a fixed payment of ₹ 10 lakhs.

- TDS Rate: Since TDS @ 1% is prescribed under Central GST Act and 1% under respective State GST Act and 2% under Integrated GST Act, Deductor may make the error to deduct TDS of only 1% on Inter State Supplies instead of 2%

Illustrations below show the situation in which penalty provisions may apply for cases involving TCS

Value of Supply Collected by	Value of Taxable Outward Supply	Value of taxable Supply returned	TCS required to be Collected	TCS Actually Collected	TCS Paid	Penalty (min. Rs.10,000)
ECO	50,000	0	1,000	0	0	10,000
ECO	50,000	10,000	800	1,000	1,000	-
SUP	1,00,000	0	0	0	0	-
ECO	8,00,000	40,000	15,200	15,200	0	15,200

ECO = Electronic Commerce Operator, SUP = Supplier of taxable goods or services

Common Situations where Tax Payer may default on TCS provisions thereby attracting Penalty

- Payment by E-wallet/loyalty points: A lot of E-Commerce Operators introduce the concept of E-wallet wherein buyers can deposit money in the online portal in advance or where buyers get loyalty points redeemable against next purchases. There might be situations in which the buyer of the goods or services may instead of making payment by Debit/Credit Card or Internet Banking, make payment by the E-wallet/loyalty points. In such situations, the E-Commerce Operators has to ensure that TCS is collected from the Supplier even when the payment is collected by E-Commerce Operators by virtue of E-wallet/loyalty points.

- Payment on Delivery: Situations may arise wherein the customer may choose to make payment for the goods or services bought upon receiving the delivery. Where a Debit/Credit Card is swiped on the delivery, it would be prudent for E-Commerce Operators to collect TCS since the money from the POS machine would be normally remitted to the bank account of E-Commerce Operator. However, where the customer makes payment in Cash to the Delivery personnel, a question may arise as to whether the payment is collected by E-Commerce Operators or the Supplier and accordingly whether E-Commerce Operator is required to collect TCS or not. In such cases, it is assumed that the Delivery personnel is a representative of the E-Commerce Operator and accordingly, it is deemed that the payment for supply is collected by the E-Commerce Operator and as such E-Commerce Operator should collect TCS in such cases.

- TCS on Delivery charges, etc.: In many instances, the E-Commerce Operator levies charges in the nomenclature of normal delivery, priority/urgent delivery, gift wrapping charges, etc. In such cases where the charges are retained by the E-Commerce Operator towards the service provided by it and the same is not payable to the Supplier, the E-Commerce Operator may not collect TCS on such charges on the pretext that the charges do not represent the value of goods or services supplied through the E-Commerce Operator.

❍❑❍

CA Rajiv Luthia & CA Jinal Maru

Section 122(1)(viii) of CGST Act – Penalty for Fraudulently Obtaining Refund

Preliminary Introduction

For effective implementation of taxation laws and to simmer down tax evasion, there entails norms according to which people shall be punished if they indulge in avoidance of tax payments owing to fraudulent means. Charging of interest, imposition of penalty, invoking prosecution against the tax delinquents, are the means to ensure tax compliance in the fiscal legislation. While charging of interest is compensatory in character, the imposition of penalty and institution of prosecution proceedings act as strong deterrents against potential tax delinquents.

Chapter XIX of the CGST Act, 2017 regulates the provisions relating to penalties & prosecutions proceedings for the offences committed under GST law. Further, by virtue of section 20 of the IGST Act, 2017 the provisions relating to "Offences & penalties" shall *mutatis mutandis* apply to integrated tax as well. Section 122(1) of the CGST Act lists down varied kinds of offences & prescribes penalty for such offences.

In this article we have analysed the penalty provisions for "fraudulently obtaining refund". The penalty provisions for other offences listed u/s 122(1) of the CGST Act have been discussed by other authors. The term "the Act" herein refers to "the CGST Act, 2017" & the term "the Rules" herein refers to "the CGST Rules, 2017"

Relevant Provision

The relevant excerpt of section 122(1)(viii) of the Act is as under:

"Where a taxable person who—

(i)

(ii) ....

(viii) Fraudulently obtains refund of tax under this Act.

....

(xxi) ....

Shall be liable to pay a penalty of ₹10,000/- or amount equivalent to the tax evaded...................... or the refund claimed fraudulently; whichever is higher".

Analysis & Perspective

On reading of the above provision, one finds that following ingredients to be present for attracting penal action under this sub-section:

- Person committing offence should be "taxable person"
- He should have obtained refund of tax under this Act
- There should be existence of "Fraud" while committing this offence

The term "taxable person" is defined u/s. 2(107) of the Act to mean that a person who is registered or liable to be registered u/s. 22 or 24 of the Act. Accordingly, it is pertinent here to note that person who is not registered under the Act, but is liable to get himself registered under section 22 or any of the sub-clauses of section 24 and applies for refund of tax, incidence of which is borne by him, owing to illegal means then he shall be liable to pay penalty as prescribed under section 122(1). To put it differently, a person who is not liable to be registered under the above provisions of the Act, shall not be attracted to the said penal provisions. For instance an individual customer, who has borne the incidence of tax and applied for refund of the same in view of section 54 of the Act, shall not be liable to penalty u/s. 122(1). However, such persons may be liable to penal provisions under the general section of penalty i.e. u/s. 125 of the Act.

Let us now have brief idea of types of refund available under GST legislation and certain key provisions relating to refund. Chapter XI of the Act governs the provisions relating to Refund of tax under this Act. Section 54 under the said chapter provides that refund of tax can be claimed under following circumstances:

- Refund of tax on zero rated supplies of goods or services or both or on inputs or input services used in making such zero rated supplies;
- Refund of unutilised input tax credit;
- Refund of tax paid on supply which is not provided either wholly or partially;
- Refund of tax paid in pursuance of section 77 i.e. tax wrongfully paid as Central Tax & State Tax instead of Integrate Tax or vice versa;
- Refund of any balance amount in electronic cash ledger
- Refund of tax or interest borne by such other class of applicants as notified by the Central Government.

Element of "Fraud" has to be demonstrated while invoking penal provisions under this sub-section 122(1) of the Act. This means penalty shall be attracted only if there is wilful or criminal deception with an intention of personal or financial gain in obtaining refund which is illegitimate. It is on the assessee to prove otherwise an absence of culprit mind.

Probable instances where "fraud" can be committed while applying for refund could be in case where:

- Refund is hit by doctrine of unjust enrichment i.e. the person has actually passed on the burden of tax to his customers though fraudulently applies for refund of tax paid under the Act,
- Jugglery with the quantification of refund amount,
- Forgery of documents,
- Availment of CENVAT credit on the basis of fraudulent documents of bogus firms,
- Amount of tax paid for goods/services provided fully or partially but claimed as refund exhibiting the transaction as non-provision of goods/services

wholly or partially by wrongfully issuing credit notes to cover the non-receipt of consideration from the customers; etc.

While applying test of "fraudulent intent", mistakes or breach related to procedural compliances which is rectifiable or mistakes committed without intent of fraud or gross negligence cannot stimulate penalty under this sub-section of the Act. In fact, section 126 of the Act comes to rescue of the assessee whereby general disciplines have to be observed by the officer while imposing penalty under the Act.

In cases of erroneous refund obtained by the registered person; in absentia of fraud, wilful misstatement or suppression of facts to evade tax then penalty payable as per provisions u/s. 122(2) (a), shall be higher of

a) ₹ 10,000/- or;

b) 10% of the erroneous refund granted.

Relevant judical precedents

The penalty provisions for fraudulently obtaining refund under the Act corresponds to similar penalty provisions under the erstwhile section 11AC(c) of Central Excise Act,1944 and section 78 of the Finance Act, 1994, which provides penalty in case of non-levy/non-payment or short-levy/short-payment of tax/duty or erroneous refund of tax/duty by reason of fraud, collusion, wilful misstatement or suppression of facts with an intent to evade payment of tax/duty. Hence, principles & ratios laid down by the various judicial forums to determine culpable act with the intention to defraud revenue shall be useful to the taxpayer under the GST legislation.

Hon'ble Courts have addressed the principles, what construes as Act of committing fraud, wilful suppression with malicious intention to evade tax. To list a few:

- **Hon'ble Supreme Court in case of *Uniworth Textiles Ltd. vs. CCE, Raipur* (2013) TIOL 13** → It was observed that every failure of non-payment of tax cannot be construed or made equivalent to collusion or wilful misstatement or suppression of facts. If that were to be true, the Court failed to understand which form of non-payment would amount to ordinary default? The main body of the Section 28 of The Customs Act, 1962, contemplates situation that of. Inadvertent non-payment of duties and leaves cases of collusion or wilful misstatement or suppression of facts, to a smaller, specific and more serious niche, to the proviso of the said section.
- **Hon'ble Supreme court in case of *Cosmic Dye Chemical vs. CCE* (2002) TIOL 236** → The court here held that failure to include the quantity of Rapidogens (exempt goods) manufactured during the relevant period in the statement furnished along with the classification list as well as the declaration appended thereto, while claiming benefit under another exemption notification for another product on account of *bona fide* reasons is not false declaration.. Suppression or misstatement of fact, which is not wilful and yet constitutes a permissible ground for the purpose of the proviso to Section 11A, is not correct proposition of law. Misstatement or suppression of fact must be wilful.
- **Hon'ble Supreme Court in case of *T. N. Dadha Pharmaceuticals vs. CCE* (2003) 152 ELT 251 (SC)** → In this case it was observed that it was the duty of the concerned authorities, particularly, the CCE, Madras to have pursued the matter diligently and placed the record before us to support the allegation in

the show cause notice that there has been suppression of the fact and that dextrose was not mentioned in the classification list 7/82. To make out a case under the proviso of section 73(1), all the three essentials must exist i.e. short/non-payment of tax, reason of fraud, collusion or wilful misstatement or suppression of facts or contravention of any provisions & intention to evade payment of tax/duty. These requirements are cumulative and not alternative. Burden is on the Department to prove presence of all three cumulative criteria and the Revenue shall peruse the matter diligently.

- **Hon'ble Karnataka High Court in case of *CST, Bangalore & Others vs. Motor World & Others* (2012) TIOL 418** → The court held that penalty u/ss. 76, 77 & 78 of the Finance Act, 1994 is not automatic. The essential conditions for the authority to impose penalty are Existence of ingredients mentioned in sections 76, 77 and 78, Failure on the part of the assessee to comply with the requirements of the said provisions; Absence of "reasonable cause" for the failure to comply with the requirement of law.

- **Hon'ble Madras High Court in case of CCE, Tiruchirapalli vs. Shri Suthan Promoters (2010) TIOL 623** → In the absence of any specific finding relating to such instances, viz., fraud or collusion or wilful misstatement or suppression of facts or contravention of any of the provisions of Chapter V, with particular reference to the intention of the assessee to evade payment of service tax, it will have to be held that the approach of the Tribunal in finding fault with the order of the Commissioner that there was no allegation of either fraud or collusion or wilful mis-statement or suppression of facts, merit acceptance.

Concluding Remarks

Penalty proceedings are quasi-judicial and should be imposed by analysing the facts and circumstance of case. With the implementation of GST, it's the aim of Government to reduce the litigations and make society tax compliant. In this scenario, it is utmost important that tax administrators uses "penalty as a weapon" diligently to monitor & control tax evasion, rather using this as tool to generate revenue.

❍❑❍

> Isn't it man that makes money? Where did you ever hear of money making man? If you can make your thoughts and words perfectly at one, if you can, I say, make yourself one in speech and action, money will pour in at your feet of itself, like water.
>
> — *Swami Vivekananda*

CA Mandar Telang

Penalty u/s. 122(1)(ix) of CGST Act and Improper Distribution of Input Tax Credit

1. Where a taxable person takes or distributes input tax credit in contravention of Section 20, or the rules made thereunder, Section 122(1)(ix) provides for a penalty of ten thousand rupees or an amount equivalent to input tax credit availed of or passed on or distributed irregularly, whichever is higher.

2. The general principles for penalty are contained in Section 126. Section 126(2) provides that the penalty imposed under this Act shall depend on the facts and circumstances of each case and shall be commensurate with the degree and severity of the breach. Section 126(2), therefore speaks of discretion to the authority in matter of fixation of quantum of penalty. Further, Section 126(3) provides that no penalty shall be imposed on any person without giving him an opportunity of being heard. However, as per Section 126(6), such discretion shall not be available in cases where the penalty specified under this Act is either a fixed sum or expressed as a fixed percentage. The question may thereof arise, as to in matters relating to Section 122(1)(ix) where there is a fixed sum payable as penalty, whether the levy of penalty is automatic and whether there is no discretion to reduce the quantum of penalty payable?

In this regard, provisions of Section 127 are of some assistance to us. It provides that where the proper officer is of the view that a person is liable to a penalty and the same is not covered under any proceedings under Section 62 or Section 63 or Section 64 or Section 73 or Section 74 or Section 129 or Section 130, he ***may issue*** an order levying such penalty ***after giving a reasonable opportunity of being heard to such person.***

In this context, attention is invited to decision of Gujarat High Court in the case of *CCEx vs. Port Officer 2010 (257) ELT 37 (Guj).* In this case, the issue before the Court was whether Section 76 read with Section 80 of the Finance Act, permits the adjudicating authority to reduce the quantum of penalty below the minimum penalty which is provided in Section 76. The Court held that, the quantum of penalty has been specified in the provision of Section 76 by laying down the minimum and the maximum limits with a further cap in so far as the maximum limit is concerned. The discretion vested in the authority is to levy minimum penalty commencing from one hundred rupees per day on default, which is extendable to two hundred rupees per day, subject to a cap of not exceeding the amount of service tax payable. From this discretion, it is not possible to read a further discretion being vested in the authority so as to entitle the authority to levy a penalty below the stipulated limit of one hundred rupees per day. The moment one reads such further discretion in the provision it would amount to rewriting the provision which, as per settled canon of interpretation, is not permissible. **Hence, Section 76 of the Act as it stands does not give any discretion to the authority to reduce the penalty below the minimum prescribed. As regards Section 80, the Court held that once the parameters laid down in Section 80 are satisfied, no penalty shall be leviable. In other words, even Section 80 does not provide for reduced penalty.**

Attention is also invited to decision of Hon'ble Bombay High Court in the case of M/s Ankit International [2011] 46 VST 1. In this case, the issue before the Court was Does Section 61(2) of the MVAT Act, confers a discretion on whether or not to levy penalty should be imposed as well as quantum of penalty i.e. in the event authority holds that penalty u/s. 61(2) is imposable, can he impose the penalty which is lesser than the fixed penalty which is prescribed in Section 61(2). The Court held that since the Section uses the word "may" and also requires providing to the dealer reasonable opportunity of being heard before penalty is imposed, the penalty u/s 61(2) is not mandatory but discretionary in nature. As regards the quantum of penalty, the court held that, once the Section contemplates discretion as to the levy of penalty, the same can also be extended for the purpose of deciding the extent of penalty. **However, it's significant to note that the Court also expressed a view that where the legislature makes its intention clear through the use of word "shall", the provision would be mandatory with regard to the quantum of penalty imposable.**

In this context decision of Hon'ble Supreme Court in the case of *UOI vs. Rajasthan Spinning & Weaving Mills 2009 (238) ELT 3 (SC)* is worth noting. Clarifying the ratio of Hon'ble Supreme Court in the case of Dharamendra Textiles, the Court held that **imposition of penalty under the law would depend upon the existence or otherwise of the conditions expressly stated in the said Section, but once the Section is applicable, the concerned authority would have no discretion in quantifying the amount and penalty must be imposed equal to the fixed sum mentioned in the said Section.**

The aforesaid judicial precedents clearly suggest that, since Section 127 provides for providing to the assessee opportunity of being heard, the adjudicating authority may have discretion in deciding whether provisions of Section 122(1)(ix) are applicable in a particular case or not, however once, he finds that the Section becomes applicable, there appears to be no further discretion to reduce the quantum of penalty from that provided in the law.

3. Section 20 of the CGST Act, deals with Manner of distribution of credit by Input Service Distributor.

"Input Service Distributor" i.e. ISD is defined in Section 2(61) of the CGST Act as under:

"Input Service Distributor" means an office of the supplier of goods or services or both which receives tax invoices issued under Section 31 towards the receipt of input services and issues a prescribed document for the purposes of distributing the credit of Central tax, State tax, Integrated tax or Union territory tax paid on the said services to a supplier of taxable goods or services or both having the same Permanent Account Number as that of the said office".

ISD is therefore a Registered Taxable Person, that avails the Input Tax Credit (ITC) based on the invoices issued to it by various suppliers and passes on or distributes the said ITC to other units belonging to the same company, on the basis of a prescribed document i.e., Input Service distributor Invoice or as the case may be credit note or debit note. The provisions relating to ISD invoice or credit note are contained in Rule 54(1) of the CGST Rules.

4. Section 20 provides that an ISD shall distribute the credit of Central tax as Central tax or Integrated tax and Integrated tax as Integrated tax or Central tax, by way of issue of a document

containing the amount of input tax credit being distributed in such manner as may be prescribed. The relevant rules are contained in Rule 39 of the CGST Rules. The broad conditions prescribed for the purpose of distribution in Section 20 read with Rule 39 are given below:

(a) The ITC available for distribution in a month shall be distributed in the same month and the amount distributed shall not exceed the ITC availed by ISD.

(b) The credit of tax paid on <u>input services attributable to a specific recipient</u> of credit shall be distributed only to that recipient.

(c) The credit of tax paid on <u>input services attributable to more than one recipient</u> of credit shall be distributed amongst such recipients to whom the input service is attributable and such distribution shall be *pro rata* on the basis of the turnover in a State or turnover in a Union territory of such recipient, *during* the relevant period, to the aggregate of the turnover of all such recipients to whom such input service is attributable and which are operational in the current year, during the said relevant period.

(d) The credit of tax paid on <u>input services attributable to all recipients of credit</u> (i.e. common credit) shall be distributed amongst such recipients and such distribution shall be *pro rata* on the basis of the turnover in a State or turnover in a Union Territory of such recipient, during the relevant period, to the aggregate of the turnover of all recipients and which are operational in the current year, during the said relevant period

(e) The Input Service Distributor shall, separately distribute the amount of ineligible input tax credit (ineligible under the provisions of sub-Section (5) of Section 17 or otherwise) and the amount of eligible input tax credit.

(f) The provisions of Rule 39 also require that the input tax credit on account of Central tax, State Tax, Union Territory tax and Integrated tax shall be distributed separately. In this regard, it may be noted that, although Section 20(1) of the CGST Act provides that, credit of IGST may be distributed as IGST or CGST, the provisions of Rule 39(1)(e) mandates that the input tax credit on account of Integrated tax shall be distributed as input tax credit of integrated tax to every recipient. Thus, the rule does not provide for distributing the same as CGST. In other words, the credit of IGST shall be distributed to recipient located in the same State as that of ISD also as IGST and not as CGST. **It's observed that presently in GSTR-6 portal no exception has been made for such type of transactions, hence, assessee is not in a position to distribute the ITC of IGST as IGST to the unit having same State Code. Many ISD returns therefore could not be filed in time.**

(g) The ISD shall issue an ISD invoice, as prescribed in sub-rule (1) of Rule 54, clearly indicating in such invoice that it is issued only for distribution of input tax credit.

(h) Issuance of Credit Note/Debit Note: If the supplier of service who has issued invoice in the name of ISD issues any credit note/ debit note, then the ISD is also required to issue corresponding credit note/ debit note on all the recipient notes for the purpose of reducing the excess credit distributed to such recipient units (in case of credit note) or as the case may be distributing the additional ITC (in case of debit notes). Any input tax credit required to be reduced on account of issuance of a credit note shall be apportioned to each recipient in the same ratio in which the input tax credit contained in the original invoice was distributed.

5. Another question that may come into mind, is whether penalty prescribed in Section 122(1)(ix), is imposable for availment or distribution of ITC if such credit is subsequently reversed by the recipient of such credit?

In this regard, Rule 39(2) would be of assistance to us. It provides that if any ITC is wrongly distributed to recipient A instead of recipient B, then ISD shall issue a credit note to recipient A and an ISD invoice for recipient B. The said ISD credit note and the ISD invoice shall be disclosed in the return in FORM GSTR-6 for the month in which such credit note and invoice was issued. Similarly, Rule 39(1)(h) provides that the ISD shall issue an Input Service Distributor credit note, as prescribed in sub-rule (1) of Rule 54, for reduction of credit in case the input tax credit already distributed gets reduced for any reason. Therefore, so long as the excess credit availed and distributed to any registered recipient is rectified by issuance of credit notes, the author is of the view that its earlier wrong distribution shall not be a ground for imposing penalty u/s. 122(1)(ix).

6. As regards availment of ITC by ISD, the provisions of Rule 54(1A) are also important to note. The said provisions permit issue of invoice by any registered office of an entity having same PAN and same State Code as that of ISD to transfer credit of common input services to the Input Service Distributor, by issue of invoice, debit note or as the case may be credit note. The particulars to be mentioned on the invoice are contained in Rule 54(1A). Such invoice shall *inter alia*, contain, Goods and Services Tax Identification Number of supplier of common service and original invoice number whose credit is sought to be transferred to the ISD, taxable value, rate and amount of the credit to be transferred. It's also provided that the taxable value in the invoice issued under clause (a) shall be the same as the value of the common services. At the beginning of GST implementation, many organisations could not take the ISD registration. Besides they also receive all the invoices (including invoices in respect of common services) on their regular registration number. In order to permit them to rectify the situation, this provision has been enacted. **In the opinion of author, Rule 54(1A) does not permit transfer of CGST credit as IGST or as the case may be IGST credit as CGST. In other words, the credit of which is transferred to ISD should be the same as is availed by the regular unit. Therefore, in this case, since IGST credit is required to be transferred as IGST credit and GSTR-1 does not permit a local invoice with IGST tax amount, the disclosure of such invoices in GSTR-1 and availment thereof in GSTR-6A is giving problem**.

7. <u>Interpretation of the Term "Ineligible ITC"</u>

As mentioned above, ISD is required to distribute credit of tax as eligible credit and ineligible credit. The term "ineligible ITC" would mean tax paid on input service which is not eligible in the hands of recipient due to provisions of Section 17(5) or due to any other provision.

Ex.1: The credit of tax paid may not be admissible since the prescribed documents issued by the vendors are defective or are misplaced.

Ex.2: Another example could be that credit of CGST+SGST in respect of tax paid on hotel accommodation service taken in Delhi and attributable to a unit located in the State of Maharashtra may not be eligible to the recipient in the State of Maharashtra, unless the entity has a registration in that State also. Thus, if the entity does not have registration in Delhi, ISD would be required to distribute the said ITC to the state of Maharashtra as ineligible ITC.

There is also another angle to the example 2. If the entity has the registration in Delhi, then ITC attributable to Maharashtra will become the ITC attributable to Delhi and Delhi would in turn be required to issue a cross charge invoice on Maharashtra. This is a necessary consequence of the concept of "distinct persons" contained in Sections 25(4) and 25(5) of the Act, and entry 2 of Schedule I, which treats supply of services between the "distinct persons" without consideration as deemed form of supply. The interplay of the conditions which requires the credit to be distributed to the recipient to which such credit is attributable and the condition which requires distribution of ITC as eligible and ineligible credit is therefore required to be construed in the light of provisions of Section 25 and Schedule 1 of the Act.

Interesting although, the law does not envisage a separate State Specific ISD registration, the interpretation of GSTN as regards the same appear to be different. **At present the GSTN system (GSTR-6) does not permit an ISD registered in Maharashtra to avail and distribute the tax paid on services where place of supply is other than Maharashtra. In other words, as regards transaction mentioned in Example 2, if the supplier in Delhi raises an invoice on ISD registered in Maharashtra levying CGST+SGST and showing place of supply as Delhi, the Maharashtra ISD would not be entitled to avail the ITC of the said invoice in his GSTR-6. This practical difficulty is leading to lot of problem.** It appears that, the system has been designed contemplating that under ISD model, the ISD registration is required to be taken in every State, if such distribution also contains the passing of the local credits i.e., CGST+SGST. With due respect, the author is of the view that such interpretation is erroneous. In the opinion of author, only one ISD registration should be sufficient across India and consequently, an ISD registered in Maharashtra should be capable of distributing the local credit of Delhi (i.e. CGST+SGST of Delhi) to a unit in Delhi through ISD mechanism.

There is also another important aspect which needs to be considered in Example 2. If the entity does not have a regular registration in Delhi, then merely taking an ISD registration in Delhi would not permit the said Delhi ISD to take ITC of CGST+SGST of Delhi and then transfer the said ITC to Maharashtra recipient. The author is of the view that ISD is only an enabling provision and hence it cannot substitute a regular registration under GST.

Needless to mention the credit in respect of tax paid on services mentioned in Section 17(5) would be treated in the hands of ISD as ineligible ITC and shall be required to be distributed to respective units as ineligible ITC.

8. Another question may arise as to what would happen, if the company did not avail the ITC of ineligible input services u/s. 17(5) in the ISD. Can such non-availment be regarded as contravention of provision of Section 20 and rule 39(1)(b) so as to attract the penal provisions u/s 122(1)(ix). In the opinion of the author, the provision of distributing ineligible ITC as ineligible ITC is only to ensure that, the recipient unit does not avail the said ITC as eligible ITC. Therefore, the requirement of distributing ineligible ITC as ineligible ITC would come to play only when such ineligible ITC is availed by ISD. If there is no availment of ineligible ITC in ISD, the question of distributing the same as ineligible ITC would not arise. Therefore, author is of the view that not availing ineligible ITC in ISD would not result in contravention of provisions of Rule 39(1)(b).

9. Provisions of Section 21 provides that where the ISD distributes the credit in contravention of the provisions contained in Section 20 resulting in excess distribution of credit to one or more recipients of credit, the excess credit so distributed shall be recovered from such recipients along with interest, and the provisions of Section 73 or Section 74, as the case may be, shall, *mutatis mutandis*, apply for determination of amount to be recovered. **It is important to note that, recovery provisions under Sections 73/74 are applicable in the hands of recipient units and not in the hands of ISD. However, penal proceedings u/s. 122(1)(ix) are imposable on ISD and can be in addition to penalty imposable u/s. 73/74 of the Act for wrong availment or utilisation of ITC by the said registered units.**

❍❑❍

Suyog Naval, *Advocate*

Penalty under Goods and Services Tax Law

Suppression of Turnover leading to evasion of tax under Section 122(1)(xv) of CGST Act, 2017

'Penalty' as an imposition or levy has its roots in the historic formation of and evaluation of legal framework. More prominently, from Kautilya's Arthashastra 'punishment' was deliberately made part of the governance of the kingdom. It is stated in Kautilya's Arthashastra, in English version by R. Shamasastry as under –

> *"That sceptre on which the well-being and progress of the sciences of Anvikshak, the triple Vedas, and Varta depend is known as Danda (punishment). That which treats of Danda is the law of punishment or science of government (dandaniti)."*

So, the law of punishment was based on the principles of deterrence which was for both types of defaults; viz., (a) substantive law & (b) procedural law. 'Deterrence', as the name suggest is more focused towards creating consciousness, awareness and fear in the minds of the wrong doers, defaulters, etc. Deterrence, in the normal parlance is explained as under -

> ***Deterrence*** *is the use of punishment as a threat which is considered as a means to prevent people from offending or to reduce the probability and/or level of offending.*
>
> *The concept of deterrence has two key assumptions: the first is that specific punishments imposed on offenders could prevent the offender from committing further crimes; the second is that fear of punishment could prevent others from committing similar crimes.[1]*
>
> *Deterrence is often contrasted with retributivism, which holds that punishment is a necessary consequence of a crime which the offender deserves and its severity should be calculated based on the gravity of the wrong done. Rehabilitation is another different approach which attempts to reform the offender rather than using punishment.*
>
> *– Source: Wikipedia*

Deterrence was also intended to strike a balance between law abiding citizens versus the defaulters. It was more towards delivering justice and ensuring good governance in pursuit of effective implementation of law.

On an inside-out view point, principle of deterrence i.e., punishment could be awarded only if the deliberate intent to make the default is proved beyond doubt.

As a cardinal principle of jurisprudence penalties and/or prosecution can be invoked under civil and criminal laws only if the intent of default or evasion is established beyond doubt; which is also called as *'mens rea'* i.e. guilty mind. If guilty mind is established, then the penalty or prosecution can be invoked.

In *Union of India vs. Dharamendra Textile Processors*, a question was raised before Hon'ble Supreme Court of India about necessity to establish *"mens rea"* in taxation in offences. The matter was transferred to Larger Bench for judgment. The relevant excerpts of the observations made by Hon'ble Larger Bench is as under –

> *"Penalty under Section 271(1)(c) ibid is a civil liability, enacted to provide remedy for revenue loss."*
>
> *"Wilful concealment not an essential ingredient for attracting civil liability as is the case of prosecution under Section 276C ibid."*
>
> *"Absence of specific reference to* mens rea *in Section 11AC of Central Excise Act, 1944 whether* casus omissus *- Phrases used in relevant provision clear that no discretion to adjudicating authority - Section 11AC ibid."*
>
> *"Interpretation of statutes - Principles therefor - Court cannot read anything into a statutory provision or a stipulated condition which is plain and unambiguous - A statute is an edict of the legislature - Language employed in statute is determinative factor of legislative intent."*

Mens Rea literally means a guilty mind. The cardinal principle of English Common Law is that a person cannot be convicted and punished in a proceeding of a criminal nature unless it can establish that he had a guilty mind. A person should be punished for deliberate breach of law, rather than an inadvertent or accidental happenings, etc.

> *In Allard vs. Selfridge [(1925) 1 K.B. at 137 (Shearman J.)], it was held,*
>
> *"The true translation of mens rea is an intention to do an act which is made penal by statute or by common law."*

In certain offences, called statutory offences, it is argued that *mens rea* is not required. It is also argued that taxation offences are statutory offences, and hence *mens rea* is not required. Supreme Court, High Courts and Tribunals have consistently held that mens rea is not an essential ingredient for imposing a penalty unless statute specifically prescribes so. In economic offences and departmental penalties, *mens rea* is not essential for imposing penalty.

> *In Corpus Juris Secundum, Vol. 85, at p. 580, para 1023, it is stated thus:*
>
> *'A penalty imposed for a tax delinquency is a civil obligation, remedial and coercive in its nature, and is far different from the penalty for a crime or a fine or forfeiture provided as punishment for the violation of criminal or penal laws.'*

The current discussion is around **the levy of penalty in case of suppression of turnover leading to evasion of tax** under GST law.

At the outset, Section 122 of CGST Act, 2017, lists the offences that would attract penalty as a consequence; apart from the requirement to pay the tax and applicable interest. Some of the offences listed under this Section may also attract prosecution under Section 132 but that would depend on the gravity of the offence defined in that section.

The provision is reproduced verbatim –

> *Section 122(1) : Where a taxable person who-*
>
> *(xv) suppresses his turnover leading to evasion of tax under this Act, …*
>
> *… … he shall be liable to pay a penalty of ten thousand rupees or an amount equivalent to the tax evaded, whichever is higher.*

The essential ingredients of the clause (xv) as stated above is -

i. Person is a taxable person;

ii. There is suppression;

iii. Suppression is of turnover;

iv. Suppression of turnover is leading to tax evasion.

This indicates that penalty is invocable when all the above conditions are fulfilled. In other words, any taxable person who suppresses the turnover which ultimately leads to evasion of tax, then such taxable person shall be liable to penalty.

Amount of Penalty

The amount of penalty will be higher of the following two amounts:

– ₹ 10,000/-, or

– Amount of tax evaded.

(A) It is important to note that the penalty is levied on TAXABLE PERSON.

Taxable person as defined under Section 2(107) of CGST Act, 2017 means "a person who is registered or liable to be registered under Section 22 or Section 24. The term person is defined under Section 2(84) to include as under:

i. An individual;

ii. A Hindu Undivided Family;

iii. A company;

iv. A firm;

v. A Limited Liability Partnership;

vi. An association of persons or a body of individuals, whether incorporated or not, in India or outside India;

vii. Any corporation established by or under any Central Act, State Act or Provincial Act or a Government company as defined in clause (45) of Section 2 of the Companies Act, 2013;

viii. Any body corporate incorporated by or under the laws of a country outside India;

ix. A co-operative society registered under any law relating to co-operative societies;

x. A local authority;

xi. Central Government or a State Government;

xii. Society as defined under the Societies Registration Act, 1860;

xiii. Trust; and

xiv. Every artificial juridical person, not falling within any of the above;

In other words, any person who is registered under GST regulations is termed as a taxable person. Also any person who is not registered under GST regulations but is required to get himself registered, then such a person shall also be termed as a taxable person even though he may not be registered under GST.

The person who is not registered but would still be termed as taxable person are as under:

– Person whose turnover is above ₹ 20 lakhs;

– Persons making inter-state supply (other than specifically exempted);

– Person who occasionally undertakes supply of goods/ services in the course or furtherance of business (Casual taxable person);

– Any agent undertaking taxable supply of goods or services or both on behalf of principal;

– Input service distributor (ISD);

– Person supplying goods/services/ both through e-commerce operator who is required to collect tax at source;

– E-commerce operator;

– Person supplying OIDAR services;

– Other notified persons.

(B) The second important point to note is that there is suppression of turnover. TURNOVER as defined under Section 2(112) of CGST Act, 2017 is as under:

"Turnover in State" or "Turnover in Union territory" means the aggregate value of all taxable supplies (excluding the value of inward supplies on which tax is payable by a person on reverse charge basis) and exempt supplies made within a state or union territory by a taxable person, export of goods or services or both and inter-State supplies of goods or services or both made from the state or union territory by the said taxable person but excludes central tax, state tax, union territory tax, integrated tax and cess.

From the above definition, taxable turnover includes aggregate value of:

– All taxable supplies made within a State or union territory;

– Exempt supplies made within a State or Union Territory;

– Export of goods or services and/or both; and

– Inter-state supply of goods and/or services.

However, the taxable turnover excludes the following:

– Inward supplies on which tax is payable under reverse charge mechanism; and

– Central tax, State tax, Union Territory tax and cess.

(C) The third important factor to levy penalty under this Section is SUPPRESSION of turnover

'Suppression' is one of the most essential ingredient for levy of penalty under Section 122(1)(xv) of CGST Act. The term 'suppression' is not defined under the GST law. However, various courts have discussed the term 'suppression' and ratio of the judgments have been laid down to emphasise on the element of intent present in the act of default or breach of law. This, in a way, defines the terms suppression to understand that without deliberate intent one cannot establish suppression.

From the above discussion wherein, Hon'ble Supreme Court has held in Dharamendra Textile's case that *mens rea* is not essential to attract penalty under taxation laws unless specifically intended therein. For Section 122, under the entire scheme of provision, it appears as if the levy of penalty is not consequent to establishing of *mens rea*. However, for sub-Section (1) clause (xv) it is specifically stated that if suppression is established which is leading to evasion of tax then the penalty shall be leviable.

Let's take a dip into the practical scenarios where a penalty under Section 122(1)(xv) might be levied. The following instances/activities can be termed as "suppression of turnover"—

i. Outward supplies shown in the books of account is more than the outward supplies disclosed in GST returns

This is a typical situation wherein the sales figures as shown in the Profit & Loss Account is more than the outward supplies disclosed in GST returns. The reasons for the variances can be:

a. Invoices received after the filing of GST returns and have been inadvertently entered in the same month whose return is filed. Example, Invoice dated 25th February 2018 is received on 23rd March 2018 (i.e. after filing of GSTR 3B for the month of February) and such invoice is mistakenly entered in the month of February. In the given situation, the sales of February will be inflated by the amount of invoice received after filing of GSTR 3B for February.

b. Invoice may have been missed to be reported in GST return due to human or technical error. In today's digital world, books of account or accounting is automated i.e., maintained in specialized accounting software in electronic form and the data is exported to another software such as excel for preparation of statutory returns. Given the vide variety of transactions undertaken by the businesses today, there are chances that a particular transaction may get missed out when exported from the accounting software. This miss can be due to human error as well. Example, while exporting sales from the accounting software, the effect of credit notes may have been missed which can be due to non-linking of such credit note with the sales entry in the accounting software. As a result, the effect of sales plus debit notes can be seen in Profit and Loss Account but the same may not be seen when exported for filing statutory returns due to linkage issue. The same is enumerated with the below example:

Particulars	**Amount (in ₹)**
Sales as per sales register	5,00,000/-
Add: Debit Note	50,000/-
Total Sales as per Profit & Loss Account	5,50,000/-

In the above example, sales as disclosed in Profit & Loss A/c is ₹ 5,50,000/-. However, the sales reported in GST return were ₹ 5,00,000/- since the debit note entries were absent in the data exported for preparation of GST return.

c. The reduced turnover amount is incorrectly reported in GST returns. This can be due to the fact that the less amount is inadvertently reported in GST returns. Example, the invoice value of ₹ 33,333/- is mistakenly reported as ₹ 3,333/- in GST returns leading to reduction in reporting of turnover in GST returns to the tune of ₹ 30,000/- (₹ 33,333 – ₹ 3,333). The said mistake can be due to human error or negligence, i.e., while printing the sales register from the software, the last digit might not have beer printed.

d. The invoice might have been cancelled at the time of filing of GST returns but the effect of the same was pending in the books. There can be situation wherein the sales invoice is cancelled since the physical copy of the invoice has got damaged. The new invoice is issued for the subsequent month in line with the invoicing series. However, the entry for the damaged invoice is not reversed in the books of account thereby inflating the sales in the books of account. Example, invoice number 155 dated 15 January 2018 for ₹ 45,000/- got damaged and therefore, new invoice with invoice number 254 is issued. Now the invoice series for January was from 001 to 200 and the invoice series for February started from 201. Therefore, the new invoice (with number 254) is issued bearing date of February and therefore is not considered in GST return for January. However, the invoice number 155 is not cancelled in the books thereby leading to increase in sale value by ₹ 45,000/- in the month of January.

e. Debit or Credit notes issued and accounted in the books but not reported in GST returns. There are certain transactions where the sale price is not fixed at the time of sale but some later point of time on account of happening of an event. Example, in cases, where the Government determines the minimum prices at which food grains are to be sold. In such a situation, as a matter of business practice the parties under the terms of contract determine a provisional price for supply of goods. Such provisional prices are later changed retrospectively once the final price is fixed. The difference in price is settled through debit/credit note, as the case may be. There can be chances that debit notes or credit notes are issued and accounted in the books of accounts but are not considered in GST returns since the same pertains to only price difference and not actual supply.

ii. Mismatch in taxable turnover reported in GSTR 3B *vis-à-vis* GSTR-1

There can be a situation wherein the amount reported in GSTR 3B is less than the amount reported in GSTR 1. The turnover in GSTR 1 may be reduced due to subsequent changes such as under:

a. Human/ technical error discovered that lead to reduction in turnover in GSTR 3B – this can be due to the fact that the incorrect sales figures were involuntarily reported in GSTR 3B. This can be enumerated in the below illustrations:

   – Invoice of ₹ 56,856/-(as per GSTR-1) reported as ₹ 56,586/- in GSTR-3B leading to reduction in outward supplies to the tune of ₹ 270/- (₹ 56,856 – ₹ 56,586)

   – Invoice of ₹ 45,454/- (as per GSTR-1) reported as ₹ 4,545/- in GSTR-3B which reduced the outward supplies by ₹ 40,909/- (₹ 45,454 – ₹ 4,545/-)

b. Taxable turnover wrongly reported as exempt or nil rated turnover in GSTR-3B now rectified in GSTR-1. There can be instances wherein the taxable turnover is inadvertently reported as exempt or nil rated or non-GST supplies. This can be due to the genuine belief on part of the registered person that a particular supply is not taxable. However, post filing of GSTR-3B, any ruling is passed which leads to the transaction in question to be considered as taxable. In the instant case, the registered person, owing to the judgment, treats the transaction as taxable leading to increase in taxable turnover as per GSTR-1 when compared with GSTR-3B filed for the same month.

There can also be a situation wherein a particular transaction is treated as exempt in GSTR-3B, however, the same is treated as taxable owing to any clarification issued by the department.

iii. Outward supplies not reported in books of account as well as in GST returns but goods delivered through delivery challan or e-Way bill

There can be instances wherein the goods are supplied under the cover of a delivery challan in accordance with Rule 55 of Central Goods and Services Tax Rules (CGST Rules) 2017 as amended from time-to-time. However, the invoice for such supply is not issued later on. This negligence of non-issue of invoice led to non-recording of such sale transaction in the books. The non-recording of sales transaction in the books ultimately led to non-reporting of the said transaction in GST returns.

iv. Cross-charge entries not passed in case where there is supply of goods and/ or services between distinct person

As per Section 7 of CGST Act, 2017 read with Schedule I of CGST Act, any supply of goods or services or both between related/distinct person would termed as supply and shall be liable to GST. The given Section infers that any transaction between the branches such as stock transfer, transfer of assets, supply of services and such other transfers even without any consideration shall be liable to GST. Further, any transactions between the employer and employee (other than employment service) such as supply interest free loans to employees, sale of company car or other fixed assets to employees are liable to GST. Such transactions are required to be reported in GST returns and any non-disclosure of such transactions in the GST returns may be termed as "suppression of turnover".

v. Outward supplies not disclosed by supplier in its GST return but input tax credit claimed by the buyer in its GST return

There can be instances wherein the supplier have not disclosed the outward supplies in his GST return due to human/technical/ any other error. However, the buyer has claimed input tax credit on such supply. Another example wherein the supplier has reported less sales and applicable taxes in its GST return whereas the buyer has reported more sales and input tax credit in his GST return. Then the same may be termed as "suppression of turnover" on part of the supplier where it is established that the supplier has reported less sales in GST return *vis-à-vis* invoice issued.

vi. Turnover mis-match as per GST return *vis-a-vis* Income Tax Returns or Audit Report

Any mis-match in turnover reported in GST returns and that reported in the Income Tax Returns or Audit Report may be termed as "suppression of turnover". Examples of such instances are sales to related person shown in Income Tax Returns or Audit Report may be Arm's Length Price (as per Transfer Pricing regulations) as against the fair market value as per GST regulations. The same is explained by an example wherein the person supplies goods to a related person at invoice value of ₹ 25,000/- which happens to be the fair market value as per GST regulations. However, the same transaction is reported in Income Tax Return or Audit Report at ₹ 35,000/- being Arm's Length Price as per transfer pricing regulations. Therefore, there shall be difference of ₹ 10,000/- is sales reported in GST return and that reported in Income Tax Return or Audit Report. In such a case, a reconciliation statement explaining the reasons for variance may be helpful.

vii. Loss while selling the goods i.e. turnover of sales is less than the cost of goods/ services

It is pertinent to note that supply of goods/ services/ both at a price below the cost may be termed as "suppression of turnover". This issue is dealt in detail in a landmark case of *CCE, Mumbai vs. M/s. Fiat India Pvt. Limited [2012 (283) E.L.T. 161 (S.C.)]*. The Hon'ble Supreme Court observed that –

– Where products are sold at a price lower than the cost of production for an unduly long period of time with a view to penetrate the market, such transaction value was held to be not accepted as assessable value for the purpose of levy of excise duty;

– Merely because the assessee had not sold the products to the related person and the element of flow back directly from the buyer to the seller was not the allegation in the show cause notices issued, the price at which the assessee had sold its products to the whole-sale trader cannot be accepted as 'normal price' for the sale of such products.

It is however pertinent to note that the aforesaid judgment was based on the peculiar facts involved in the said case

– Long duration of 5 years for which products were sold below the cost of production and

– The reasoning of the assessee for such business strategy i.e., market penetration.

Therefore, the commercial rationale and reasoning of the business to sell the goods below cost price weighed in the minds of the Hon'ble Supreme Court while determining the 'normal price' even though the parties in the said case were not related.

viii. Goods destroyed/ lost in fire/ theft/ distributed as free samples not accounted in GST returns but can be evident from insurance claims, books of account, etc.

The meaning of supply as per Section 7 of Central Goods and Service Tax Act, 2017 also refers to disposal of goods as supply. Therefore, goods destroyed or lost in fire or theft or even if distributed as free samples would be termed as supply. Therefore, such transactions are required to be reported in GST returns. there can be instances wherein the good gets damaged or lost in fire and the same are not reported in GST returns being an abnormal transaction. However, insurance is claimed in respect of goods lost in fire and the amount received from insurance claim is disclosed in financial statements. This may be termed as suppression of turnover since the transaction is reported in financial statements but not reported in GST returns. Further Section 17(5) of CGST Act, 2017 specifically disallows input tax credit in relation to such transactions where the goods are destroyed in fire or lost in theft or distributed as free samples.

(D) The fourth important point is evasion of tax i.e., Penalty under this clause can be levied only in case where suppression of turnover has led to EVASION OF TAX

Penalty can be levied when there is mens rea is established beyond doubt. Therefore, as stated in para *supra*, element of guilty mind or deliberate default becomes necessary to invoke penalty on the basis of suppression of turnover leading to evasion of tax. This means, presence of *mens rea* for levying penalty under the Section 122(1)(xv) of CGST Act is a must.

The penalty under the instant clause cannot be levied in cases of minor breaches of tax regulations, procedural requirements and any omission or mistake in documentation which is easily rectifiable and made without fraudulent intent or gross negligence.

Further, 'minor breach' means a breach where the amount of tax involved is less than ₹ 5,000/-. Also, the omission or mistake in documentation shall be considered to be easily rectifiable if the same is an error apparent on the face of record.

(E) Cases where penalty cannot be imposed under Section 126(1)(xv) of CGST Act

The following would not be liable to penalty under the instant clause —

i. Suppression of turnover by a non-taxable person;

ii. Suppression of turnover by a taxable person not leading to evasion of tax;

iii. When there is minor breach as per Section 126 of CGST Act, 2017; and

iv. When suppression is due to any omission or mistake in documentation which is easily rectifiable and made without fraudulent intent or gross negligence as per Section 126 of CGST Act, 2017.

From the above discussion, it stands absolutely clear that if the law wants to levy a penalty which is based on the element of guilty mind and if it is specifically provided therein then the penalty is invokable, if guilty mind is established beyond doubt. On the contrary, levy of penalty is not consequent of establishing presence of guilty mind, like 'suppression of turnover leading to evasion of tax', then the same can be lawfully invoked upon mere occurrence of the default.

Again, whether levy of penalty for offenses which are occurred inadvertently are warranted or shall be termed as harsh is a question which is been debated since ancient times. In each era, the law maker has attempted to strike a balance, but where there are few minds making the law and numerous who are supposed to follow it, an imbalance is not unexpected.

Kautilya in "The Arthashastra" (by R. Shamasastry) has stated -

… … for whoever imposes severe punishment becomes repulsive to the people; while he who awards mild punishment becomes contemptible. But whoever imposes punishment as deserved becomes respectable.

❍❑❍

Vinay Jain, *Advocate*

Analysis of Section 122(1)(x) of the CGST Act, 2017

Introduction

The provisions of section 122(1)(x) of the CGST Act, 2017 (hereinafter referred to as "Act") deal with penalty in cases of falsifying or substituting financial records; or producing fake accounts, providing false information or returns etc. The present section is mainly inspired by the Sales Tax laws. The relevant provision of section 122(1)(x) of the act is reproduced as under:—

> "122(1) Where a taxable person who —
>
> ……
>
> (x) Falsifies or substitutes financial records or produces fake accounts or documents or furnishes any false information or return with an intention to evade payment of tax due under this Act;
>
> ……
>
> he shall be liable to pay a penalty of ten thousand rupees or an amount equivalent to the tax evaded or the tax not deducted under section 51 or short deducted or deducted but not paid to the Government or tax not collected under section 52 or short collected or collected but not paid to the Government or input tax credit availed of or passed on or distributed irregularly, or the refund claimed fraudulently, whichever is higher."

The aforesaid section can be deciphered in the following manner:—

Where a taxable person who —

(i) Falsifies financial records;

(ii) Substitutes financial records;

(iii) Produces fake accounts;

(iv) Produces fake documents;

(v) Furnishes any false information;

(vi) Furnishes any false return

(hereinafter collectively referred to as "specified Act(s)") with an intent to evade payment of tax due under this Act, he shall be liable to pay penalty as under: -

(i) Ten thousand rupees; or

(ii) An amount equivalent to the tax evaded; or

(iii) The tax not deducted under section 51 or short deducted or deducted but not paid to the Government; or

(iv) Tax not collected under section 52 or short collected or collected but not paid to the Government; or

(v) Input tax credit availed of or passed on or distributed irregularly; or

(vi) The refund claimed fraudulently,

whichever is higher.

The central theme of the section revolves around the word "false" and "fake" and therefore it is necessary to analyse these key terms used in the section.

Dictionary meanings of the word "false" and "fake" to the extent relevant for present purpose is reproduced as under:—

False
Black's Law Dictionary tenth edition, page 718

1) Untrue
2) Deceitful
3) What is false can be so by
4) Wrong, erroneous

Cambridge International dictionary of English, LP edition, page 499

1) Not natural: Not real or natural, artificial.
2) Not real: Made to look real, or made to seem true in order to deceive, including false identity, false information, false name, false pretence, false account, falsify would mean to change a document to deceive.
3) Not Correct: in case of information or idea. Not correct or true.

Comments: The natural meaning of the term "false" may include all types of incorrect information however, while interpreting the meaning of the word "false" due regard is to be given in the context in which it is used. If it is used for a criminal offence, it is necessary that there should be an intent to do an act or use words which will deceive a person. If an act is not done with an intention to deceive, or words spoken are done in true belief for them to be true and honest, but are actually incorrect, would not be considered as "false". Thus, the word "false" means more than incorrect or erroneous. It implies wrong or culpable negligence, and signifies knowingly or negligently untrue.

Fake
Black's Law Dictionary tenth edition, page 717

1) Something that is not what it purports to be
2) To make or construct falsely

Cambridge International dictionary of English, LP edition, page 496

Fake (object) – An object made to look real or valuable in order to deceive the public.

Comments: The definition of the word "fake" would include all acts which are done in order to make a thing look alike a real one but in reality, it is not so. The intention to deceive the other party is inherent in it. Hence, the person who is producing fake accounts/fake documents knows that what he is producing is not true or not even believes it to be true.

From the plain perusal of the aforesaid section following observation can be made:—

(i) It will apply to taxable person only.

(ii) It will apply to the certain specified acts done by the taxable person.

(iii) The active involvement in the specified act is necessary.

(iv) The said specified act must have been done with an intent to evade payment of tax due under this act. In other words, *mens rea* is required to be proved.

(v) Minimum penalty prescribed is ten thousand rupees.

(vi) Maximum penalty can be equal to tax evaded/credit wrongly taken/refund fraudulently obtained.

(vii) The section does not specify the proceedings in which such specified act is to be done i.e. during audit/ summon/, assessment etc. Thus, it will apply to specified act in any of the proceedings.

Some issues which can arise in the interpretation of this section with judicially decided cases wherever applicable

Issue 1

Whether the penalty is automatic, the moment the specific act is identified? Whether penalty can be imposed in cases wherein the specified act is merely a technical or venial breach or where the specified act is done on account of a bona fide belief.

It may so happen that the taxable person does any of the specified acts, but such act is on account of *bona fide* belief of the taxable person that what he is doing is correct. In such a case the observations of the Hon'ble Apex Court in the case of *Hindustan Steel Ltd. vs. The State of Orissa, AIR 1970 SC 253,* in context of imposition of penalty, are pertinent:

> *"But the liability to pay penalty does not arise merely upon proof of default in registering as a dealer. An Order imposing penalty for failure to carry out a statutory obligation is the result of quasi-criminal proceedings, and the penalty will not ordinarily be imposed unless the party obliged either acted deliberately in defiance of law or was guilty of conduct contumacious or dishonest, or acted in conscious disregard of its obligation.* ***Penalty will not also be imposed merely because it is lawful to do so.*** *Where penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially and on a consideration of all the relevant circumstances.* ***Even if a minimum penalty is prescribed, the authority competent to impose the penalty will be justified in refusing to impose penalty, when there is a technical or venial breach of the provisions of the Act or where the breach flows from a bona fide belief that the offender is not liable to act in the manner prescribed by the Statute."***

... Emphasis Supplied

Hence, merely because some act of the taxable person results into breach of provisions of Section 122(1)(x) of the act, does not automatically trigger the imposition of penalty. Where the taxable person proves his *bona fide* intention, no penalty is imposable.

Issue 2

Whether the return filed by the assessee *inter alia* claiming exemption can be said to be 'false return' where the exemption is found not available to the assessee

It may so happen that while filing return, the taxable person claims the benefit of some exemption notification. However, during the assessment proceedings or any other proceedings it is found that the taxable person was not entitled for such exemption notification. In such cases whether the return can be treated as 'false return' as the taxable person was *ab initio* not entitled for benefit of exemption notification. The answer to this question can be found in the decision of the Supreme Court in the case of *Cement Marketing Co. of India Ltd. vs. Assistant Commissioner of Sales Tax, 1980 (6) ELT 295 (SC).*

In Cement Marketing Co. case cited supra the question before the court was that whether the Assistant Commissioner of Sales Tax was right in imposing penalty on the assessee for not showing the amount of freight as forming part of the taxable turnover in its returns. The penalty was imposed under Section 43 of the Madhya Pradesh General Sales Tax Act, 1958 and Section 9, sub-section (2) of the Central Sales Tax Act, 1956 on the ground that the assessee had furnished "false returns" by not including the amount of freight in the taxable turnover disclosed in the return. The contention of the assessee throughout was that on a proper construction of the definition of `sale price' in Section 2(o) of the Madhya Pradesh General

Sales Tax Act, 1958 and Section 2(h) of the Central Sales Tax Act, 1956, the amount of freight will not fall within the definition and was not liable to be included in the taxable turnover. The court ultimately held that penalty cannot be imposed in this case as the assessee was under *bona fide* belief and return cannot be stated to be a "false return". Relevant portion of the decision is reproduced as under:—

> *"It is elementary that Section 43 of the Madhya Pradesh General Sales Tax Act, 1958 providing for* ***imposition of penalty is penal in character and unless the filing of an inaccurate return in accompanied by a guilty mind, the section cannot be invoked for imposing penalty.*** *If the view conversed on behalf of the Revenue were accepted, the result would be that even if the assessee raises a* bona fide *contention that a particular item is not liable to be included in the taxable turnover, he would have to show it as forming part of the taxable turnover in his return and pay tax upon it on pain of being held liable for penalty in case his contention is ultimately found by the Court to be not acceptable. That surely could never have been intended by the Legislature.*
>
> …. Emphasis Supplied

Hence, it is not the case that every false information/return will trigger the rigorous of penalty under section 122(1)(x) of the Act. The Specified act should be undertaken in a deliberate and dishonest manner to defraud revenue.

Issue 3

Whether penalty can be imposed in cases wherein the assessee claimed exemption in its return and later produced false document to substantiate the claim. Whether the return can be treated as 'false return'.

This preposition was analysed by the Hon'ble Supreme Court in the case of *State of Kerala vs. Surface Coats 1998 (9) SCC 356.*

In the Surface coats case cited supra, the assessee filed sales tax returns for three assessment years, namely 1983-84, 1984-85 and 1985-86. In these returns, the respondent disclosed certain turnover, but claimed that the entire turnover was exempt from tax on the ground that the products were of an industry which were exempted from sales tax by a Government order. In support of the said returns, the assessee produced a certificate issued by the District Industries center, Kottayam, dated 27-10-1986 granting sales tax exemption for the said three years. On the basis of the said certificate, the Sales Tax Officer granted exemption to the extent of ninety per cent of the turnover. Subsequently, it came to the knowledge of authorities that the said certificate dated 27-10-1986 was a false and forged one. Accordingly, proceedings were taken under Section 45-A(1)(d) of the Act, against the assessee. After hearing the assessee, penalties were levied. When the matter came to the High Court, the High Court allowed the appeal of the assessee on the ground that the charge against the assessee was one of filing "untrue or incorrect return" within the meaning of Section 45-A(1)(d) of the Act and not that he tried to substantiate his returns by producing a false certificate; the said false certificate was not filed along with the return but much later, i.e., about a year later, and that, therefore, the levy of penalty under Section 45-A(1)(d) is unsustainable in law. Department filed an appeal before the Supreme Court and, the Supreme Court overturned the decision of the High Court and held that the fact that the certificate in support of the said plea was filed later does in no way detract from the fact that the returns filed were untrue and incorrect. Relevant portion of the decision of the Supreme Court is reproduced as under: -

> *"We find it difficult to agree with it. In the returns filed by the respondent, it claimed a total exemption of its turnover from the levy of sales tax on the ground that the same is exempted by virtue of a Government order. It is only in support of the said plea that it purported to obtain and file a certificate which was found*

to be forged. ***In the circumstances, it must necessarily follow that the returns filed were indeed untrue and incorrect.*** *The claim for exemption was undoubtedly a false one, i.e., an untrue and incorrect one.* ***The fact that the certificate in support of the said plea was filed later does in no way detract from the fact that the returns filed were untrue and incorrect.*** *In any event, it makes no difference whether the forged certificate was filed along with the returns or at a later point of time."*

…. Emphasis Supplied

Hence, it is held that even if a document submitted by a party is a forged one and filed much later, still the return can be treated as a "false return" and penalty can be levied. The Hon'ble Supreme Court did not agree with the reasoning advanced by the Hon'ble High Court that only the documents produced were false and not the return. This proposition is just to highlight the difference between the act of filing "false return" and "forging documents to support the return filed earlier". In the present context, the said distinction will not be relevant as even if return is not held to be false, still it will be covered by other specified acts of section 122(1)(x) of the Act namely "producing fake documents" and hence will be liable to penalty.

Issue 4

Whether penalty can be imposed in cases wherein information provided is false, but the tax implication is nil

Suppose a taxable person misdeclares the classification of a product in the return, but as per the correct classification also tax implication is nil. In such a case penalty in terms of section 122(1)(x) of the Act cannot be levied. The section does not contemplate levying of penalty wherein tax implication is nil. The section itself provides that the specified acts should be done with an intent to evade payment of tax. In such cases general penalty as provided under section 125 of the act can be imposed. The same is reproduced as under:—

> **"125. General penalty. —** Any person, who contravenes any of the provisions of this Act or any rules made thereunder for which no penalty is separately provided for in this Act, shall be liable to a penalty which may extend to twenty-five thousand rupees."

Hence, penalty under section 122(1)(x) of the Act cannot be imposed in cases wherein the tax implication is nil.

Issue 5

Whether actual evasion of tax is necessary to levy penalty under this section?

Actual evasion of tax is not necessary for the purpose of this section. Merely doing any of the specified acts with intent to evade payment of tax is enough. Actual evasion of the tax need not be proved by the department.

Issue 6

Burden of proof on whom?

The burden of proving *mala fide* conduct is very heavy and is required to be discharged by a party in a straight manner. The burden to prove any of the aforesaid contravention will be certainly on the person who alleges it. The Hon'ble Supreme Court in *Union of India vs. Ashok Kumar and Others, 2005 (8) SCC 760*, held as under:

> *"It cannot be overlooked that burden of establishing* mala fides *is very heavy on the person who alleges it. The allegations of* mala fides *are often more easily made than proved, and the very seriousness of such allegations demand proof of a high order of credibility."*

The Hon'ble Supreme Court in the case of *Uniworth Textiles Ltd. vs. CCE – 2013 (288) ELT 161 (SC)* also held that burden to prove suppression is on the one who makes the said allegation. The relevant para of the said judgment is extracted below:—

> **"24.** Further, we are not convinced with the finding of the Tribunal which placed

> the onus of providing evidence in support of *bona fide* conduct, by observing that "the appellants had not brought anything on record" to prove their claim of *bona fide* conduct, on the appellant. **It is a cardinal postulate of law that the burden of proving any form of *mala fide* lies on the shoulders of the one alleging it.**
>
> **26.** Hence, on account of the fact that the **burden of proof of proving *mala fide* conduct under the proviso to Section 28 of the Act lies with the Revenue."**
>
> …. Emphasis Supplied

However, the department need not have to prove their case with mathematical precision. What is required is the establishment of such a degree of probability that a prudent man may on the basis of such believe in the existence of the facts. The court has to arrive at a conclusion based on the sufficiency and weight of the evidence produced by the department. The aforesaid principle has been enunciated by the Supreme Court in the case of *Collector of Customs, Madras and Others vs. D. Bhoormull reported at 1989 (13) ELT 1546 (SC).* The relevant extract of the decision is reproduced as under:—

> **30.** It cannot be disputed that in proceedings for imposing penalties under clause (8) of Section 167, to which Section 178A does not apply, the burden of proving that the goods are smuggled goods, is on the Department. This is a fundamental rule relating to proof in all criminal or quasi-criminal proceedings, where there is no statutory provision to the contrary. But in appreciating its scope and the nature of the onus cast by it, we must pay due regard to other kindred principles, no less fundamental, or universal application. One of them is that the **prosecution or the Department is not required to prove its case with mathematical precision to a demonstrable degree**. The law does not require the prosecution to prove the impossible. All that it requires is the establishment of such a degree of probability that a prudent man may, on its basis, believe in the existence of the fact in issue. Thus legal proof is not necessarily perfect proof often it is nothing more than a prudent man's estimate as to the probabilities of the case.
>
> **31.** The other cardinal principle having an important bearing on the incidence of burden of proof is that sufficiency and weight of the evidence is to be considered to use the words of Lord Mansfield in *Blatch vs. Archar (1774) 1 Cowp. 63 at p. 65* "According to the Proof which it was in the power of one side to prove and in the power of the other to have contradicted". Since it is exceedingly difficult, if not absolutely impossible for the prosecution to prove facts which are especially within the knowledge of the opponent or the accused, it is not obliged to prove them as part of its primary burden.
>
> …. Emphasis Supplied

Hence, the burden to prove the contravention of any of the provisions of the aforesaid act is on the department and the same needs to be discharged with sufficient, cogent documentary evidence, rather than merely alleging the contraventions of the Act.

Conclusion

The issues discussed above are only illustrative. There will be umpteen number of issues will come up when this section will face the judicial scrutiny. In all the human affairs absolute certainty is not possible and as Prof. Brett puts it "All exactness is fake". In such a case, the assessee should be cautious enough while providing data/ details to the department. Wherever, there is ambiguity in law or interpretation is involved the assessee should disclose all the facts to the department to avoid rigours/unintended imposition of penalty under this section.

❍❑❍

CA Abhay Desai

Penalties Relating to Registration

1. Section 122 of the Central Goods & Services Tax ("CGST") Act, 2017 contains provisions related to penalty. For the purpose of the present article we are concerned with penalties relating to registration. Before making the analysis it is worthwhile to reproduce relevant provisions as under:

"CHAPTER XIX

OFFENCES AND PENALTIES

122. Penalty for certain offences. — (1) Where a taxable person who —

(xi) Is liable to be registered under this Act but fails to obtain registration;

(xii) Furnishes any false information with regard to registration particulars, either at the time of applying for registration, or subsequently;

he shall be liable to pay a penalty of ten thousand rupees or an amount equivalent to the tax evaded or the tax not deducted under Section 51 or short deducted or deducted but not paid to the Government or tax not collected under Section 52 or short collected or collected but not paid to the Government or input tax credit availed of or passed on or distributed irregularly, or the refund claimed fraudulently, whichever is higher."

2. Following questions will arise in the mind of the reader on plain reading of the above provisions:

a. Whether *"mens rea"* is necessary before imposing penalty in the given scenarios related to registration? and

b. What shall be the quantum of penalty, if leviable?

3. Let us analyse both the questions at length.

Mens Rea

4. The term "penalty" connotes any sum imposed by way of a punishment for any wrongdoing. Hence it is generally believed that penalty can be imposed only if the act was done with a guilty mind. This is essentially *"mens rea"*. Whether the authorities have to prove that the person acted with a guilty mind before imposing penalty is a very important question.

5. *Wright, J., in Sherras vs. De Rutzen [1895] 1 QB 918* has observed as follows:

"There is a presumption that mens rea, *an evil intention, or a knowledge of the wrongfulness of the act, is an essential ingredient in every offence;*

but that presumption is liable to be displaced either by the words of the statute creating the offence or by the subject-matter with which it deals, and both must be considered.

.. In order to find out whether mens rea*, i.e., a guilty mind is an ingredient or not, reference has to be made to the language of the enactment, the object and subject-matter of the statute and the nature and character of the act sought to be punished."*

6. The Supreme Court in *R. S. Joshi, Sales Tax Officer vs. Ajit Mills Ltd. [1977] 40 STC 497 (SC)* observed as under:

"The classical view that 'no mens rea *no crime' has long ago been eroded and several laws in India and abroad, especially regarding economic crimes and departmental penalties, have created severe punishments even where the offences have been defined to exclude* mens rea.*"*

7. In the case of *Additional Commissioner of Income-tax vs. Durga Pandarinath Tuljayya & Co. [1977] Tax LIR 258 (FB)*, a Full Bench of the Andhra Pradesh High Court has observed:

"The doctrine of mens rea is of common law origin developed by judge-made law. It has no place in the legislator's law where offences are defined with sufficient accuracy."

8. In para 11 of the said judgment, the High Court has further observed as under:

"Mens rea is an essential ingredient of an offence. However, it is a rule of construction. If there is a conflict between the common law and the statute law, it has always been held that it is a sound rule to construe a statute in conformity with the common law. But it cannot be postulated that a statute cannot alter the course of the common law. The Parliament, in exercise of its Constitutional powers makes statutes and in exercise of that power it can affirm, alter or take away the common law altogether. Therefore, if it is plain from the statute that it intends to alter the course of the common law, then the plain meaning should be accepted. The existence of mens rea as an essential ingredient of an offence has to be made out by the construction of the statute".

9. Similarly Apex Court held in the case of *Tamil Nadu Housing Board vs. Collector of Central Excise (1994) 74 ELT 9 (SC)* that when the law requires an intention to evade, mere failure cannot be the ground to invoke penalty. Relevant portion of the judgment is reproduced below:

"When the law requires an intention to evade payment of duty then it is not mere failure to pay duty, it must be something more. That is, the assessee must be aware that the duty was leviable and it must deliberately avoid paying it. The word 'evade' in the context means defeating the provision of law of paying duty. It is made more stringent by use of the word 'intent'. In other words the assessee must deliberately avoid payment of duty which is payable in accordance with law."

10. From the above rulings we can conclude that in a statute law, which CGST Act, 2017 is, mens rea will be essential only if the words or the context expressly provides. In absence of same, mens rea is not necessary for imposing any penalty.

11. With this background let us now analyse the penalty provisions relating to registrations.

12. Section 122(1)(xi) of the CGST Act, 2017 provides that penalty will be imposed on "failure" to obtain registration when one is legally required to register. Section 22 of the CGST Act, 2017 provides for obtaining registration by a person in the State from where such person makes a taxable supply if his aggregate turnover in a financial year exceeds twenty lakh rupees (ten lakh rupees for special category States). Section 24 of the CGST Act, 2017 on the other hand provides for compulsory registration in following cases:

a) Persons making any inter-State taxable supply;

b) Casual taxable persons making taxable supply;

c) Persons who are required to pay tax under reverse charge;

d) Persons who are required to pay tax under sub-section (5) of section 9;

e) Non-resident taxable persons making taxable supply;

f) Persons who are required to deduct tax under section 51, whether or not separately registered under this Act;

g) Persons who make taxable supply of goods or services or both on behalf of other taxable persons whether as an agent or otherwise;

h) Input Service Distributor, whether or not separately registered under this Act;

i) Persons who supply goods or services or both, other than supplies specified under sub-section (5)of section 9, through such electronic commerce operator who is required to collect tax at source under section 52;

j) Every electronic commerce operator;

k) Every person supplying online information and data base access or retrieval services from a place outside India to a person in India, other than a registered person; and

l) Such other person or class of persons as may be notified by the Government on the recommendations of the Council.

13. Section 23 of the said Act however grants exemption from registration in certain cases. We shall presume that the taxable person in question was liable for registration under any of the referred provisions but failed to obtain the same. This is because if such person is contesting the registration requirement and succeeds subsequently, there will be no question of any penalty. Issue before us therefore is whether such person who was legally liable to obtain registration can avoid the penalty u/s. 122(1)(xi) on the ground that such failure was due to a *bona fide* belief and was not with an intention to evade the tax?

14. Plain reading of the provision suggests that penalty is attracted on failure to register. It does not say that such failure needs to be deliberate. As discussed earlier, when the language of the provision does not require the presence of *"mens rea"*, it cannot be implied. Hence we are of the view that penalty will be attracted on failure to register irrespective of the cause for such failure.

15. One can also refer to the Division Bench decision of Hon. Allahabad High Court in the case of *Kishori Lal Rakesh Kumar vs. Commissioner of Sales Tax [1985] 59 STC 323 (All).*

16. In this case assessee's Munim had failed to get the registration done though he had been so instructed. Sec. 15(1)(g) imposed penalty for not obtaining the registration. Said provision is reproduced below:

"(g) Being liable for registration under this Act, carries on or continues to carry on business without obtaining registration or without furnishing the security demanded under section 8-C."

17. Issue before the Court was whether *"mens rea"* is essential before imposing penalty for failure to obtain the registration.

18. Before the Division Bench there were conflicting views on the issue. In the case of *Ram Lakhan Ved Prakash [1982] 51 STC 347 (App)* it was held that *mens rea* was excluded from clause (g). On the other hand, in the case of *Sadhu Singh 1981 UPTC 887 and Goyal*

Bandhu 1982 UPTC 596 it was held that *mens rea* was necessary for levying the penalty under clause (g). Hence the matter was referred to the Division Bench. The Bench held as under:

"We see no possible reason as to what inhibited the Legislature from using the words "knowingly", "deliberately", "intentionally" or the like, in clause (g), if the intention was to import mens rea in clause (g), except the one that the Legislature did not intend to make mens rea as ingredient of the default contemplated by clause (g). Clear omission of an appropriate word giving a clue of mens rea in clause (g) has constrained us to hold that mens rea is not necessary for making default envisaged by clause (g) punishable. Taking the semantic view of clause (g) we unhesitatingly find that mens rea is not necessary for imposing a penalty for the default, covered by clause (g)."

19. It was also contended before the Court that Hon. Supreme Court in the case of *Hindustan Steel Ltd. [1970] 25 STC 211 (SC)* has held that *"mens rea"* is necessary before imposing penalty. Division Bench went through the referred judgment and held as under:

"From the observations of the Supreme Court, as reproduced above, it is manifest that they relate to Section 25(1)(a), read with Section 9(1), which creates an offence governed by the Criminal Procedure Code, to be tried by a Magistrate of the First Class within the meaning of sub-section (2) of Section 25.

The observations of the Supreme Court made in regard to an offence cannot be applied to a default envisaged by clause (g) of Section 15-A(l), which is not an offence and which is punishable by the assessing authority."

Applying the above rulings we are of the view that penalty u/s. 122(1)(xi) will be imposed on failure to obtain registration irrespective of whether such failure was intentional or otherwise.

20. Section 122(1)(xii) on the other hand provides that penalty will be imposed if a taxable person furnishes any "false" information with regard to registration particulars either at the time of applying for registration or subsequently. The word "false" signifies *mens rea*. This is because furnishing false information means that the person furnishing such information knows that the same is not true. Apex Court had an occasion to interpret the word "false" in the case of *Cement Marketing Co. of India Ltd. vs. Assistant Commissioner of Sales Tax 1980 (6) E.L.T. 295 (SC).*

21. In this case assessee had not shown the freight amount as part of taxable turnover in the returns. Penalty was imposed u/s. 43 of the Madhya Pradesh General Sales Tax Act, 1958 and Section 9(2) of the Central Sales Tax Act, 1956 on the ground that the assessee had furnished false returns by not including the amount of freight in the taxable turnover disclosed in the returns. Apex Court held as under:

"Now it is difficult to see how the assessee could be said to have filed `false' returns, when what the assessee did, namely, not including the amount of freight in the taxable turnover was under a bona fide belief that the amount of freight did not form part of the sale price and was not includible in the taxable turnover. The contention of the assessee throughout was that on a proper construction of the definition of 'sale price' in Section 2(o) of the Madhya Pradesh General Sales Tax Act, 1958 and Section 2(h) of the Central Sales Tax Act, 1956, the amount of freight did not fall within the definition and was not liable to be included in the taxable turnover. This was the reason why the assessee did not include the amount of freight in the taxable turnover in the returns filed by it. Now, it cannot be said that this was a frivolous contention taken up merely for the purpose of avoiding liability to pay tax. It was a highly arguable contention which required serious consideration by the Court and the belief

entertained by the assessee that it was not liable to include the amount of freight in the taxable turnover could not be said to be mala fide or unreasonable. What Section 43 of the Madhya Pradesh General Sales Tax Act, 1958 requires is that the assessee should have filed a 'false' return and a return cannot be said to be 'false' unless there is an element of deliberateness in it. It is possible that even where the incorrectness of the return is claimed to be due to want of care on the part of the assessee and there is no reasonable explanation forthcoming from the assessee for such want of care, the Court may, in a given case, infer deliberations and the return may be liable to be branded as a false return. But where the assessee does not include a particular item in the taxable turnover under a bona fide belief that he is not liable so to include it, it would not be right to condemn the return as a 'false' return inviting imposition of penalty."

22. Drawing support from the above decision we are of the view that penalty u/s. 122(1)(xii) of the CGST Act, 2017 can be imposed only if incorrect information is furnished deliberately. Mens rea will be an essential ingredient before penalty is imposed under the said provision.

Quantum of Penalty

23. Now we shall examine the issue related to the quantum of penalty. Section 122(1) provides that a taxable person committing any of the listed offence shall be liable to pay a penalty of ten thousand rupees or an amount equivalent to the tax evaded, whichever is higher.

24. Apex Court in the case of *Commissioner vs. Illpea Paramount Pvt. Ltd. (2006) 202 ELT 744 (SC)* has held in the context of Section 11AC of the Central Excise Act, 1944 that once the levy of penalty is found to be warranted having regard to the requirements of Statute, the quantum of penalty is not at the discretion of authority.

25. Similarly Apex Court clarified in the case of *Union of India vs. Rajasthan Spinning and Weaving Mills (2009) 238 ELT 3 (SC)* that Dharmendra Textiles Case (2008) 231 ELT 3 (SC) did not stipulate that penalty is an automatic consequence of any demand raised. However once the conditions of Section 11AC are proven, it does not provide for any discretion in quantifying the penalty and the same must be imposed equal to the amount of duty demanded.

26. Plain reading of Section 122(1) of the CGST Act, 2017 stipulates that no discretion is left to the officer in quantifying the penalty by using the phrase "shall be liable to pay a penalty of". This is similar to Section 11AC which provides that in cases involving fraud or collusion or any wilful misstatement or suppression of facts, or contravention of any of the provisions with intent to evade payment of duty person shall be liable to penalty equal to the duty determined. Hence the ratio of above referred decisions shall be squarely applicable and once it is proved that circumstances exist to invoke Section 122(xi)/(xii) of the said Act penalty of ten thousand rupees shall be imposed. It may be noted that penalty for non-payment or short payment of tax on account of not obtaining the registration shall be imposed u/s. 122(2) of the said Act.

27. From the above analysis we suggest that one needs to be very careful with regard to registration requirements and must obtain the same wherever legally required to avoid penalty in future.

❍❑❍

CA Ashit Shah

Certain specified penalties under GST Law

In this article an attempt has been made to discuss about some specific defaults which taxpayers knowingly or unknowingly commit and would be penalised under Goods and Services Tax Act (hereinafter referred to as "GST") for such default.

(i) Obstructs or prevents any officer in discharge of his duties under this Act. [S. 122(1)(xviii)

It is evident that many a times, taxpayers deliberately create obstruction or prevent any officer or public servants in due discharge of his duties. To prevent such growing tendency of the taxpayers causing obstruction to a public servant in due discharge of their duties, it has become essential for the authorities responsible for administering fiscal laws to deal with the cases of this type severely.

The obstruction or prevention maybe in various modes, it could not only be in physical obstruction or prevention. The provision has to be interpreted in the context of a fiscal statute. The Surveying Officers are to be co-operated by the assessee. The act of non-co-operation under the Act, may amount to obstruction or prevention when deliberately done. In *Commr. of Sales Tax, U. P. vs. M/s. R. P. Gupta and Company, 1982 UPTC 661.* it was held that where Surveying Officer asked the dealer to hand over the books which were found at the time of survey and had been signed by the Survey Officer, instead of signing and returning the books, the dealer handed over books to munim and asked him to run away with them and munim did so. This act amounted to obstruction within the meaning of Section 15-A (1)(j) of the Act.

In the matter of *M/s. Mohammad Ismail Khan vs. Commissioner of Sales Tax, 1985 UPTC 945,* wherein the Court took the view that some obstruction should not be caused in performing the function to the Authority under the Act. The words 'obstruct or prevent' stipulates that some physical force has to be used for obstruction and prevention in the functioning of the authority as contemplated by the legislature.

(ii) Transports any taxable goods without the cover of documents as may be specified in this behalf [Section 122(1)(xiv)]

When tax payer wants to transport goods from his premises to his customer or any other person, through any conveyances, the person in charge of the conveyance shall carry a (i) copy of tax invoice or the bill of supply or delivery challan; and (ii) copy of e-way bill in physical form or the e-way bill number in electronic form or mapped to a Radio Frequency Identification Device (RFID) embedded on to the conveyance. However, if transport mode is by way of rail or vessel or air, documents envisaged at (ii) would not be applicable [Section 68 & Rule 138A].

Certain commonly observed deficiencies are –

- Vehicles carry goods without documents;
- Vehicles carry documents without proper TIN Nos. in the invoice;
- Improper/incorrect entries in the sale invoice;

SS-VIII-114

- Vehicles plying on a deviant route than the commonly used route for movement from place of origin, as mentioned in GR, to destination;
- Vehicles carry different quantities/types of goods than those mentioned in the documents;
- The documents point to undervaluation of the goods than prevailing value of the goods.

(iii) Fails to keep, maintain or retain books of account and other documents in accordance with the provisions of this Act or the rules made thereunder [S. 122(1)(xvi)].

Every registered person has to keep and maintain at his principal place of business, as mentioned in the certificate of registration, a true and correct account of –

(a) production or manufacture of goods;

(b) inward and outward supply of goods or services or both;

(c) stock of goods;

(d) input tax credit availed;

(e) output tax payable and paid; and

(f) such other particulars as may be prescribed:

Moreover, every owner or operator of warehouse or godown or any other place used for storage of goods and every transporter, irrespective of whether he is a registered person or not, shall maintain records of the consignor, consignee and other relevant details of the goods and submit electronically in FORM GST ENR-01 on common portal. [Section 35 & Rule 56 to 58]

These accounts and records have to be kept and retained until the expiry of 72 months from the due date of furnishing of annual return for the year pertaining to such accounts and records [Section 36].

(iv) Fails to furnish information or documents called for by an officer in accordance with the provisions of this Act or the rules made thereunder or furnishes false information or documents during any proceedings under this Act [Section 122(1)(xvii)].

To attract penalty for failure to furnish information or documents, revenue must have to ensure that (i) specific documents were demanded; (ii) non-production of details or documents were relevant non submission will have revenue implication; and (iii) taxpayer had failed to furnish the same.

In the matter of *Shree Dhar Industries – (2013) 32 taxmann.com* it was held that penalty cannot be invoked if there was doubt about service of letters seeking information from taxpayer for furnishing the letters belatedly.

While proposing penalty, show cause notice must specify why penalty should not be imposed under specified sections. In absence of such specific reasoning in show cause notice, penalty cannot be levied as upheld by *Ahmedabad Tribunal in the matter of GoI Golden Organizer (P) Ltd. – (2013) 33 taxmann.com 323* by relying on the Mumbai Tribunal pronouncement in the matter of *Sai Shradha Exim (P) Ltd. – (2015) ELT 121.*

(v) Supplies, transports or stores any goods which he has reasons to believe are liable to confiscation under this Act [Section 122(1)(xviii)].

(vi) Issues any invoice or document by using the registration number of another registered person [Section 122(1)(xix)].

(vii) Tampers with, or destroys any material evidence or document [Section 122(1)(xx)].

(viii) Disposes off or tampers with any goods that have been detained, seized, or attached under this Act [Section 122(1)(xxi)].

Quantum of Penalty

Taxpayers would be liable for penalty of ₹ 10,000 or an amount equivalent to tax evaded, whichever is higher.

Conclusion

Taxpayers have to really beware all the time as now there are so many procedural compliances need to be adhered to and slightest lapse in compliance may attract the penal provisions.

CA Aditya Surte

Other penalties u/ss. 123 to 125 of the CGST Act and Penalty u/s. 47(2) of the CGST Act for failure to furnish Audit Report

Mens Rea – Primary Ingredient

Mens rea or culpable mental state is the primary ingredient that must be present for an action or inaction to be made liable to levy of penalty under the law. As per explanation to section 74 of the Maharashtra Value Added Tax Act, 2002, culpable mental state includes intention, motive, or knowledge of a fact or belief in or reason to believe, a fact and a fact is said to be proved only when the court believes it to exist beyond reasonable doubt and not merely when its existence is established by a preponderance of probability.

As expressed by the Hon'ble Supreme Court in *Commissioner of Sales Tax, Uttar Pradesh vs. Sanjiv Fabrics (35 VST 1)* the use of expression "falsely represents" in the legislature indicates that the offence comes into existence only when a dealer acts deliberately in defiance of law or is guilty of contumacious or dishonest conduct. Therefore, in proceedings of penalty, the burden would be on the Revenue to prove the existence of circumstances constituting an offence.

Penalty proceedings – quasi-criminal in nature

The nature of penalty proceedings can be best described by the following paragraphs from the judiciary –

"Levy of penalty is in the nature of a quasi-criminal proceeding and the power to levy penalty should be exercised only if the party concerned is proved to have acted in total disregard of the law. When there is no finding that the party defaulted deliberately and the circumstances disclose that the assessee acted to the best of his capacity to comply with the provisions of the law, penalty shall not be levied. [Farm House Biscuit Co. P. Ltd. vs. Commissioner of CT 92 STC 161 (Kar.)]

An order imposing penalty for failure to carry out a statutory obligation is the result of a quasi-judicial proceeding, and penalty will not ordinarily be imposed unless the party obliged either acted deliberately in defiance of law or was guilty of conduct contumacious or dishonest, or acted in conscious disregard of its obligation. Penalty will not be imposed merely because it is lawful to do so. Whether penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially and on a consideration of all the relevant circumstances. Even if minimum penalty is prescribed, the authority competent to impose the penalty will be justified in refusing to impose penalty, when there is a technical or venial breach of the provisions of the Act or where the breach flows from a bona fide belief that the offender is not liable to act in the manner prescribed by the statute. [Hindustan Steel Ltd. vs. State of Orissa 25 STC 211 (SC)]".

That being said, it has been noticed that taxation statutes are increasingly focused on envisaging and providing for specific cases of contravention or evasion of tax. Provisions for levy and collection of penalties for contravention of legal requirements have become an integral part of the enactments. As observed by the Madras High Court in *Hindustan Import Export Corporation vs. State of TN* (69 STC 195),

"The doctrine of mens rea has receded to the background, and its scope and ambit reduced, in view of special enactments regarding various offences. Imposing penalty cannot be construed as a punishment as contemplated by the criminal law. In fiscal laws, it is an eye-opener for the assessee concerned, as well as others to see that they comply with the provisions of the relevant enactments strictly in their dealings."

Penalty for failure to furnish information return (section 123)

Section 123 of the Central Goods and Services Tax Act, 2017 (hereinafter referred to as "CGST Act" or "the Act") provides for a penalty in case of failure to furnish information return. We must first understand what the information return is and what it entails.

The Government has prescribed certain compliances to be made by specific persons for ease of gathering information. The information return specified u/s. 150 of the CGST Act is more from an administrative point of view of the Government, to be used for exchange of information. It requires certain categories of taxable persons, authorities, banking companies, stock exchanges, depositories, GST Network and other prescribed persons who are responsible for maintaining record relating to registration, returns, payment of taxes, banking transactions, transactions relating to purchase or sale of goods or provision of services, transactions relating to consumption of electricity or transactions relating to sale of property or a right in property to furnish an information return for such period, within such time, in such form and manner and to such authority, as may be prescribed. It may be noted that this return is not a tax return. It is rather a tax document which is used to report certain business transactions.

Where a person who is required to furnish an information return fails to do so within the specified time, he may be served a notice requiring him to furnish such return within a period not exceeding 90 days from the date of service of the notice.

Where the person on whom a notice as stated above is served and who still fails to furnish the return within the period specified in the notice, the proper officer may direct that the person shall be liable to pay a penalty of ₹ 100 for each day of the period during which the failure to file the return continues. The penalty has been capped at ₹ 5,000. It may be noted that this penalty is under the Central GST Act. A similar provision exists in the State GST Act of each State. Therefore, a separate penalty under the State Act shall also be levied at ₹ 100 per day, restricted to ₹ 5,000.

Fine for failure to furnish statistics (section 124)

Section 151 of the CGST Act grants the Commissioner the power to collect statistics relating to any matter dealt with by or in connection with the Act. The Commissioner may exercise this power by issuing a notification and calling for information from the concerned persons.

Section 124 of the Act states that if any person who is required to furnish any information or return under section 151 of the Act fails to furnish such information or return without reasonable cause or the said person wilfully furnishes or causes to furnish any information or return which he knows to be false, then he shall be punishable with a fine that may extend to ₹ 10,000. Additional fine of ₹100 per day shall be levied in case the offence is of continuing nature. The total fine including the additional daily fine has been capped at ₹ 25,000.

It is worth noting that mere failure to furnish information or merely furnishing incorrect information cannot give rise to a fine under section 124. In order to attract the fine, the failure must be without reasonable cause or the incorrect information must be furnished wilfuly with the knowledge that the same is false.

General Penalty (section 125)

This is a residual provision. Where any of the provisions of the Act or the rules are contravened for which no penalty is separately provided for in the Act, this provision can be resorted to by the proper officer. The general penalty under this section may extend to ₹ 25,000. It may be noted that this provision applies to "any person", whether or not he is registered under the Act.

The general disciplines related to penalty specified in section 126 of the Act state that no penalty shall be imposed for minor breaches of regulations and procedural requirements particularly on account of *bona fide* omission or mistake in documentation which is easily rectifiable. The disciplines are akin to the principles of natural justice, whereby framing of charge, opportunity of hearing, benefit of voluntary disclosure should be followed by the officer imposing the penalty. However, sub-section (6) of Section 126 states that the general disciplines shall not apply in cases where the penalty specified is either a fixed sum or expressed as a fixed percentage. On a plain reading of the provision it appears that while the general penalty under section 125 requires the officer to follow the principles of natural justice, penalty under section 123 does not require the same since the penalty is a fixed sum of ₹ 100 per day.

Late fee for failure to furnish audit report (section 47(2))

Every registered person whose turnover during a financial year exceeds Rs. 2 crores shall get his accounts audited by a chartered accountant or a cost accountant and shall submit a copy of the audited annual accounts along with the reconciliation statement and other documents in FORM GSTR-9C. (Sec. 35(5) of the CGST Act r/w. Rule 80(3) of the CGST Rules)

Every registered person who is required to get his accounts audited in accordance with the provisions of section 35(5) is also required to furnish an annual return along with a copy of the audited annual accounts and a reconciliation statement by 31st December following the end of financial year. (Section 44(2) of the CGST Act).

Where a registered person fails to furnish the annual return required under section 44(2) by the due date, he shall be liable to pay a late fee of ₹ 100 for every day during which such failure continues, subject to a maximum of 0.25% of his turnover in the State. (Section 47(2) of the CGST Act).

It is worth mentioning here that what is prescribed for the delay in filing the annual return along with audited accounts is a late fee and not a penalty. As discussed above, levy of penalty requires framing of charge and other principles of natural justice to be followed. In case of a late fee, it is automatic and it appears that the annual return along with the audited accounts cannot be filed unless the late fees are first paid.

Observations

A question arises whether penalty can be levied in a case where late fee has been levied. It appears that there is no bar to the levy of penalty. Merely because late fee is paid, it would not mean that penalty cannot be levied.

This takes us to another question – whether an appeal lies against the payment of fines and late fees? In this connection a useful reference may be made to the provisions of section 121 of the Act which speaks of non-appealable decisions and orders. Under the Act, no appeal lies against the transfer proceedings, seizure or retention of books of account, grant of sanction for prosecution and against an order granting instalments for payment of tax. Barring the aforesaid four topics, all orders pertaining to assessment, levy of penalty and fine are appealable. Since late fee is being levied automatically without any order being passed for the same, it cannot be appealed against.

❍❑❍

Ishaan Patkar, *Advocate*

Prosecution under GST law

The GST statute has created certain offences which are punishable by imprisonment. These are enumerated in Section 132 of the GST Act. A lot can be written about the process and procedure of prosecution and the technicalities attendant thereto. But there are a few points I wish to discuss in depth, for I feel very passionately about these issues. This article is therefore being confined to those points apart from a general discussion on the offences themselves. This article will not go into the other aspects of the procedural part of the prosection process as such.

Mens Rea – reverse burden of proof

Glanville Williams in his legendary *"Text Book of Criminal Law"* says

> "It has become almost a matter of routine for Parliament, in respect of the most trivial offences as well as some serious ones, to enact that the onus of proving a particular fact shall rest on the defendant, so that he can be convicted 'unless he proves' it."

Common law makes it incumbent upon the Crown to prove the facts underlying the commission of an offence as well as the mental element pervading the offence. The factum of commission of the offence is known as *actus reus* and the mental element supporting the *actus reus* is known as *mens rea*. This concept of *mens rea* is commonly known as "blameworthiness" and consists of knowledge, intention or recklessness.

In a criminal trial at common law, both these elements must be proved beyond reasonable doubt or the charge must fail. This is known as the presumption of innocence. *Mens rea* must be proved for each element of the offence as well as for the overall end-result.

The presumption of innocence became firmly entrenched in English and American common law when the horrors of the witch hunts and the Catholic Inquisitions became all too apparent. The Salem Witch Trials is one such example, which began in a small village called Salem in the then colonial America. A group of young girls accused a host of people of practicing witch-craft and the girls were motivated by nothing but fun, fame and attention. Others followed, and everyone from revenge-seekers to property-grabbers started making accusations of witch-craft against innocent victims.

The legal system of that time presumed anyone who was accused as guilty and put the onus of disproving guilt on the accused himself. Predictably, many people were not able to prove their innocence and were executed. It was only when the truth of the matter was exposed and after 20 people had already been executed, that judges and jurists in England and in America realised the horrors of presuming an accused guilty and became firmly committed to protect the rights of the innocent. Europe had already witnessed the scourge of witch hunts for almost 300 years till then and was well acquainted with the problems of presumption of guilt. It was around this time that Blackstone wrote this famous line in his *Commentaries on the Laws of England*

> "The law holds that it is better that ten guilty persons escape than that one innocent suffer."

I am aware that this article is to be published in a tax journal and that too much wrangling about in legal history may not be the best possible way of serving the readers' interests. But history is being recounted because history is repeating itself. Section 135 contains a presumption of guilt which puts the onus on the accused to prove his innocence: a provision which is strikingly similar to the one which was denounced by the wise men who wanted to put the witch-hunts behind.

> "**135**. In any prosecution for an offence under this Act which requires a culpable mental state on the part of the accused, the court shall presume the existence of such mental state but it shall be a defence for the accused to prove the fact that he had no such mental state with respect to the act charged as an offence in that prosecution.
>
> *Explanation*.— For the purposes of this section,—
>
> (i) The expression "culpable mental state" includes intention, motive, knowledge of a fact, and belief in, or reason to believe, a fact;
>
> (ii) A fact is said to be proved only when the court believes it to exist beyond reasonable doubt and not merely when its existence is established by a preponderance of probability.

The GST statute is not the first to incorporate such a provision. Many other statutes have done so. The customs law, sales tax laws of various states and many other Acts of Parliament and the State Legislature contain similar provisions.

In a series of over a dozen judgments, Justice S. B. Sinha in the Supreme Court continuously denied the presumption of innocence as a fundamental right under the Constitution. In *Seema Silk Fabricators vs. Directorate of Enforcement [(2008) 5 SCC 580]*, Justice Sinha held that a provision casting reverse burden of proof did not violate Article 14. Then in *Noor Aga vs. State of Punjab [(2008) 16 SCC 417]*, Justice Sinha refused to hold that the presumption of innocence is a fundamental right under Article 21 and merely accorded it a status of human right. However, he did concede that the presumption of innocence was a very important human right and whether or not a particular provision in a particular statute casting reverse burden of proof is reasonable and proportional to the object sought to be achieved has to be seen in facts and circumstances of each case. *Noor Aga* (*supra*) also held that where the burden of proof of mental element was reversed, the prosecution was still obliged to prove the foundational facts beyond reasonable doubt. Thus, the prosecution must first prove that an offence has in fact been committed and must do so beyond reasonable doubt. It is only after this stage is crossed, that the burden shifts to the accused to prove his innocence.

It was only after Justice S. B. Sinha retired that the law moved forward. In *Babu vs. State of Kerala [(2010) 9 SCC 189]*, Justice Dr. B. S. Chauhan interpreted *Noor Aga* (*supra*) itself as laying down that a provision which puts the onus of proving innocence on the accused must be tested on the anvil of reasonableness and liberty enshrined in Article 14. Readers must note that though *Seema Silk Fabricators* (*supra*) had dealt with Article 14, the same was only a challenge on discriminatory treatment and the grounds of manifest arbitrariness and reasonableness were never put before the Court, these three being distinct aspects of Article 14 in law.

In *Ajay Kumar Choudhary vs. Union of India [(2015) 7 SCC 291]*, Justice Vikramjit Sen said forcefully that the argument that the Constitution does not explicitly guarantee a right to be presumed innocent is a sophisticated argument which ignores that this presumption is a legal ground norm, inextricable from the Common law jurisprudence and emanates from the first Constitutional document, the Magna Carta, which promises that justice is not denied to anyone.

The opening left in *Noor Aga* (*supra*) on the tests of reasonableness and proportionality were successfully used by the Bombay High Court to strike down reverse onus clauses introduced by the 1995 amendments to the Maharashtra Animal Preservation Act, 1976. This judgment is reported as *Haresh M. Jagtiani vs. State of Maharashtra [(2017) 2 AIR Bom R 140].* Four tests were culled out from a large number of international judgments to decide whether a reverse burden of proof provision is reasonable, fair and proportional to the object sought to be achieved:

(i) Is the State required to prove enough basic or essential facts constituting a crime so as to raise a presumption of balance facts (considering the probative connection between these basic facts and the presumed facts) to bring home the guilt of the accused, and to disprove which the burden is cast on the accused?

(ii) Does the proof of these balance facts involve a burden to prove a negative fact?

(iii) Are these balance facts within the special knowledge of the accused?

(iv) Does this burden, considering the aspect of relative ease for the accused to discharge it or the State to prove otherwise, subject the accused to any hardship or oppression?

Point No. (i) needs some comment. Reversing the burden of proof of mental element on the accused has been held to be Constitutionally permissible by the Bombay High Court only when the foundational facts required to be proved by the State are such that, when proved, are capable of raising a high degree of probability of guilt of accused. For example, where the offense is of smuggling of goods, once the factum of smuggling is proved, it is highly probable that the element of *mens rea* is present looking at the nature of the offence. However, in case of offences like "evasion of tax" in Section 132(1)(e), the foundational facts required to be proved are only non-payment of tax. But merely because tax was not paid, it cannot be said that it is highly probable that tax was not paid due to intention to evade the tax. In such a case, the presumption of guilt is inherently unconstitutional. If this is not so, every non-payment of tax will automatically become "evasion of tax" for the guilt will be presumed.

The Bombay High Court has discussed in detail how these tests are to be applied and the holdings of the Court on this aspect repays study. Section 5C of the Maharashtra Animal Preservation Act, 1976 made the possession of flesh of cow, bull or bullock slaughtered in the State of Maharashtra an offence and Section 9B put the onus of proving that there is no *mens rea* on the accused. The Court held that in such a case the prosecution will prove the factum of possession and then the initial burden to prove that the possession was not with the knowledge that the flesh was of cow, bull or bullock and that the animal was not slaughtered in Maharashtra will shift to the accused. Commenting on the Constitutional impermissibility of such a procedure, the Court held:

> "That means a burden to prove a negative fact. **It is unthinkable how, even by the test of preponderance of probabilities, the accused can reasonably or fairly be expected to discharge this burden beyond possibly his own statement in the witness box that he did not know that it was bovine flesh.** Greater difficulty would be faced if on the basis of possession of such flesh, the State were to prosecute him for an offence under Section 5C, that is to say, for possession of the flesh of a cow, bull

or bullock slaughtered in contravention to the Act, i.e., in Maharashtra. Pray how is the accused to discharge the onus of proving that he did know that the animal was slaughtered in contravention of the Act? Not only does the burden placed on him offend the rule against burden to prove a negative fact, it also subjects the accused to a great hardship and oppression, which is not commensurate with the balance of difficulty faced respectively by the prosecution and the accused in establishing the ingredients of the offence or the lack thereof. It is relatively easy for the prosecution to bear the burden of establishing that the slaughter was in contravention of the Act than for the accused to bear the burden of showing otherwise. Besides, the essence of the offence under Section 5C consists of possession of bovine flesh which is produced out of contravention of the Act, i.e., by slaughter within the State. How can this essential fact be left to the accused to controvert? The basis of any presumption in law in a criminal trial, as we have seen above, is the substantial causal or probative connection between the facts found proved and the facts presumed. That connection is absent in this case. **Merely because a person is found in possession of bovine flesh does not make his knowledge of slaughter within the State in any way probable**. There are many countries where slaughter of a cow, bull or bullock is not illegal. Even within India, there are States where such slaughter is perfectly legal. In fact, the only slaughter which is in contravention of the Act is the slaughter within Maharashtra. Now if a person were to obtain beef from these other countries or States in India, can it be said that his mere possession must lead to a presumption of the place of slaughter being within Maharashtra? Or for that matter, to a presumption of his knowledge of such slaughter within Maharashtra? If bovine flesh from different sources, i.e. from slaughters outside the State as well as within the State, is available in the market, there is practically no way of distinguishing one flesh from the other. There is absolutely no question of fastening any presumed knowledge of slaughter within the State on the accused.

.... as even **the only other ingredient of 'knowledge' also cannot be a matter of presumption**. All cases, where knowledge or, in other words, *mens rea*, imputed to the accused is accepted as Constitutionally valid, are cases where the substances themselves are so obnoxious or harmful that mere possession leads to the presumption of a harmful purpose and knowledge of such harmful purpose. For example, these presumptions are applied to possession of deadly firearms, narcotic or psychotropic substances. That is not the case with beef. No one has told us at the Bar, in the first place, of there being any way of distinguishing the flesh of cow, bull or bullock from the flesh of other bovine species, e.g. buffalo. It is inconceivable that an ordinary consumer would know the difference. On top of it, the State would have the Court presume not just the knowledge of the accused of the nature of the flesh, namely, of an animal protected under the Act, but even the manner of its production, namely, by slaughter in contravention of the Act, and cast the burden of showing otherwise, a pure negative fact, on the accused. This is clearly impermissible."

.... [Emphasis supplied]

Under the GST statute, Section 132 also makes an "attempt" and "abetment" an offence. The problem with reverse onus clauses in such a case will be much graver. *Mens rea* is intricately tied into the very offence of "attempt" and "abetment" and cannot be separated. Transport of goods liable to confiscation under the Act is an offence under Section 132(1)(h). A transporter who does not know anything about the goods and has no means of detecting any contravention will automatically become an offender under the abetment clause.

The Constitutionality of Section 135 must also be reviewed particularly in light of Explanation Clause (ii) which requires the accused to disprove the fact of *mens rea* "beyond reasonable doubt" and not merely on preponderance of probabilities. Thus a probable explanation will not suffice, an unimpeachable explanation is required. This kind of evidentiary burden is difficult to overcome for an accused and is entirely unnecessary to the policy objectives of the statute. It is difficult to understand why the Legislature would want the taxpayer to prove beyond reasonable doubt that he had no *mens rea* in issuing a defective invoice by way of an inadvertent mistake. Explanation to Section 135 Clause (ii) is nothing but manifestly arbitrary and unreasonable.

It is also pertinent to note that in the *Noor Aga* case, the Supreme Court while upholding the Constitutionality of provisions in the Narcotics Act imposing burden on accused to prove his innocence, has noted that the standard of proof required is not "beyond reasonable doubt" but only preponderance of probabilities. Therefore, unless the Explanation Clause (ii) is severed from the Section 135, the entire provision will fail.

Offences which attract prosecution under the Act

Having gone through the entire theory of *mens rea*, we must now turn to the offences themselves. While looking at individual offences, and apart from discussing the other elements of these offences, I will try to show how the draconian nature of the presumption of guilt in Section 135 creates various scenarios where innocents will suffer:

Invoice related offences

Section 132(1)(a) makes the supply of goods or services without the issue of invoice, in violation of the provisions of the GST Act and rules, an offence if the intention is to evade the tax. Quite obviously, the provision should not apply to those cases where the accused believed that the particular transaction is not covered by the Act. But Section 135 will create a presumption that the intention was to evade the tax and the accused will have to prove *beyond reasonable* doubt that he believed that the transaction was not taxable.

Now, where there are two views regarding the taxability of a transaction, the view which favours the assessee is to be taken. Also, the burden of proving that a particular transaction is taxable is itself on the Revenue and not on the assessee. Section 135 is in conflict with these principles.

Section 132(1)(b) makes the issuance of any bill or invoice without the supply of goods or services in violation of the provisions of the Act or the rules, an offence if it leads to wrongful availment or utilization of input tax credit or refund of tax. The conditions precedent for invoking this section are:—

(i) Invoices or bills of supply have been issued; and

(ii) There is no supply which has actually taken place; and

(iii) Such issuance of invoices or bill of supply has led to wrongful availment or utilization of input tax credit or wrongful refund of tax.

If an invoice is issued and there is no supply, but the recipient has not taken or utilized the input tax credit, Section 132(1)(b) will not come into play. Where the recipient reverses the credit, the law will assume that credit was never availed and in such situations Section 132(1)(b) cannot be invoked.

What happens where the invoice is issued and the credit is taken by the purchaser and the supply does not take place for genuine reasons? Will the offence under Section 132(1)(b) still be made out if the purchaser refuses to reverse the credit for whatsoever reason? The word "wrongful" is of importance here. When the credit was taken or even utilized, it was not wrongful since the supply was imminent. Therefore, this particular situation will not come within Section 132(1)(b). What is covered by Section 132(1)(b) are pure hawala transactions and not anything else.

Section 132(1)(c) is a companion offence of the offence under Section 132(1)(b). Whenever the recipient wrongfully avails input tax credit on the basis of an invoice issued without there being an actual supply, the recipient offends Section 132(1)(b).

Though the word "wrongful" introduces the element of *mens rea*, Section 132(1)(b) and (c) are the kind of provisions where rebuttable presumption of guilt under Section 135 would seem reasonable except in peculiar cases like the one mentioned above. In such cases, it can be argued that though the provision is reasonable, its invocation in certain cases may be unreasonable. It is well-settled that though a provision is constitutionally valid, action taken under it may not be valid *[Government of AP vs. Laxmi Devi (2008) 4 SCC 720].*

Unjust enrichment

Where a person collects tax and does not pay over that the tax to the Government within a period of 3 months from the date within which the payment becomes due, he commits an offence under Section 132(1)(d). Historically such offences have never required *mens rea* at all.

Evasion of tax

Where tax is evaded, input tax credit is fraudulently availed or a refund is fraudulently obtained, the same becomes an offence under Section 132(1)(e), if it has already not been covered by clauses (a) to (d) of Section 132(1). The effect of Section 135 on this kind of offence has already been discussed hereinabove.

Falsification of records

Where any person falsifies or substitutes financial records or produces fake accounts or documents or furnishes any false information with an intention to evade payment of tax due under the Act, an offence is committed under Section 132(1)(f). Again the intention to evade tax will be presumed under Section 135 once the foundational facts of falsification is proved. In fact, the word "falsification" also requires *mens rea* and this element will also stand automatically presumed under Section 135. Every wrong book entry will thus be elevated to falsification and the onus will be on the accused to prove that there is neither an intention to falsify nor an intention to evade tax.

Obstruction of officer

Where any person obstructs or prevents any officer in the discharge of his duties under the Act, an offence under Section 132(1)(g) is committed. This obstruction can be during departmental audit, raids, searches and seizures or even in e-way bill processes.

Goods related offences

Where a person acquires possession of, or in any way concerns himself in transporting, removing, depositing, keeping, concealing, supplying, or purchasing or in any other manner deals with, any goods which he knows or has reasons to believe are liable to confiscation under the Act or the rules made thereunder, he commits an offence under Section 132(1)(h). The effect of Section 135 on this kind of offence has already been discussed hereinabove.

Provides or receives supply in contravention of the Act

Where a person receives or is in any way concerned with the supply of, or in any other manner deals with any supply of services which he knows or has reasons to believe are in contravention of any provisions of the Act or the rules made thereunder, an offence under Section 132(1)(i) is made out. It is difficult to understand which kind of supply of services are in contravention of the Act and rules. There is no particular prohibition anywhere on making or receiving supplies. Even otherwise, this provisions is unconstitutionally vague and very, very wide. In the hands of a bad officer, it would surely be a weapon of tyranny.

Tampering with evidence

Section 132(1)(j) declares the tampering with or destruction of any material evidence or documents as an offence. The provision only applies to "material" evidence and it is dependent on the facts and circumstances of each case whether a particular piece of evidence is material or not.

Failure to supply information

Section 132(1)(k) states that failure to supply any information which is required to be supplied under the Act or the rules made thereunder or supplying false information (unless with a reasonable belief that the information supplied by him is true) is an offence. The burden of proving that there was reasonable belief that the information is true is on the accused and this must be proved beyond reasonable doubt under Section 135.

Punishment for offences

Punishment for offences under Section 135 is

(i) In cases where the amount of tax evaded or the amount of input tax credit wrongly availed or utilised or the amount of refund wrongly taken exceeds five hundred lakh rupees, with imprisonment for a term which may extend to five years and with fine.

(ii) In cases where the amount of tax evaded or the amount of input tax credit wrongly availed or utilised or the amount of refund wrongly taken exceeds two hundred lakh rupees but does not exceed five hundred lakh rupees, with imprisonment for a term which may extend to three years and with fine.

(iii) In the case of any other offence where the amount of tax evaded or the amount of input tax credit wrongly availed or utilised or the amount of refund wrongly taken exceeds one hundred lakh rupees but does not exceed two hundred lakh rupees, with imprisonment for a term which may extend to one year and with fine.

(iv) In cases where he commits or abets the commission of an offence specified in clause (f) or clause (g) or clause (j) of Section 132(1), he shall be punishable with imprisonment for a term which may extend to six months or with fine or with both.

The imprisonment under categories (i) to (iii) will be for a minimum period of 6 months, unless the sentencing Court records special and adequate reasons for lesser time. In cases where offence was committed due to technicality, the Court may be able to award a much lesser sentence than 6 months.

In case of a second conviction, the punishment for the second and every subsequent offence is imprisonment upto 5 years and fine.

Closing remarks

The discussion on the various offences under Section 132 and the severity of punishment should bring home the necessity for deleting the presumption of guilt under Section 135, or at least excising the Explanation Clause (ii). The Legislature must have a relook at these provisions and amend them to bring them in line with modern constitutional values. The current provisions are so pro-Government that an officer must only accuse and the Court would hand the conviction on a platter to the Government. This cannot be tolerated in Free India.

❍❑❍

Case Laws Index

❍❑❍

SS-VIII-130

CA Dinesh Tejwani

TECHnovation

Data Privacy and Security

Recently you would have noticed a pop-up about "Prepare for General Data Protection Regulation" GDPR, while opening your Facebook, Twitter or Google Suite?

GDPR is the first comprehensive regulation on data protection coming into force from 25th May, 2018. It is applicable to companies that are based in the European Union or global companies that store and process data about individuals in the EU. In India, also Govt. is working on data privacy and security laws.

Few recent incidents have brought to the fore, risks involved in data breach.

FaceBook Cambridge Analytica (CA) data scandal: It has been the most high profile case of data breach in news recently. CA collected personal information about approx. 87 million Facebook users. It is alleged that these data were used to influence voters opinion on behalf of politicians. Cambridge Analytica collected data by their personality quiz app called 'This is Your Digital Life'.

Aadhaar data leak: In April 2018, Aadhaar number and bank account details of about 1.34 million users of Andhra Pradesh Housing Corporation website. The sensitive information leaked contained Aadhaar Number, Bank Account No, Caste, Religion and geo location. There have been several reports of Aadhaar data leaking from various sources over the past few months.

Debit Card Data Breach: In October 2016, over 3.2 million debit card were compromised in India and several of them were hacked to make unauthorised transactions.

Do these incidents make you sit up and take note? Have you ever considered safety and privacy of your data?

Data Collection by Websites and Apps

Most of the website that we visit, or Apps that we install on our mobiles collect our data and use them. Have you ever given attention to permissions that an App that you are installing?

Most users believe that if they do not give permissions, they will not be able to use the App and without thinking twice, give all permissions.

Given below is a chart that gives "dangerous" App permissions:

Sr. No.	Permission for	Why Dangerous
1	Calendar	Your daily schedule is exposed. It can be shared with criminals or wiped out
2	Camera	Your photo or video can be secretly taken
3	Contacts	Your contact data can be used for spam and frauds
4	Location	Your location is known at all times, exposing you risks. Example: burglars
5	Microphone	App can record all your conversations
6	Phone	App knows all your call history and can even make a call
7	Body Sensors	App has access to all your health data
8	SMS	App can read all your SMS & OTPs and can even send SMS
9	Storage	App can read or delete any file on your phone

Source : https://me-en.kaspersky.com/blog/android-permissions-guide/5907/

What Google and FaceBook know about you

I am giving specific example of these two apps that almost all of us use. These apps are free and but we must remember that *If you're not paying for it; you are the product'*.

Both Google and FaceBook earn by using your profile to given targeted advertisements. To create your detailed Advertisement Profile, they collect whole lot of data.

Google knows

- Where you have been. All your locations everytime you switch on phone. Try searching yours at https://www.google.com/maps/timeline
- What you have ever searched: even if you have deleted search history
- What apps you use: how often you use them
- What YouTube videos you have seen

You can view all that Google Knows about you by going to:

https://myactivity.google.com/myactivity

Facebook knows

- Where and what time you logged into Facebook
- What Apps you connected using Facebook Login
- All your facebook friends and non-facebook contacts including their mobile number
- All calls that you received and made

You can actually download all that facebook knows about you. For this

- Open your Facebook Profile
- Click on Settings
- Click on Ads
- Click Download a copy of your Facebook data

GDPR

As mentioned above, GDPR is the first comprehensive legislation to cover data security. The legislation covers almost all aspects of data security and user will have to be specifically asked for consent for every action. It will be much more that simple "Click to Accept"

What is more important is stringent penalties for non-compliances. The maximum fine stands at 4% of global turnover or $ 20 million, whichever is larger.

Legislation in India

Like other nations, India is also working on regulations on data security and privacy.

Government has appointed B. N. Srikrishna committee in Aug 2017 to suggest a framework and law for protecting data.

It released a white paper in November, 2017 for sought public feedback. The final report by the committee is expected soon.

The committee suggested a framework based on seven principles

1. Flexible law which adapts to changing technologies
2. Law to be applicable to both Government and private entities
3. Genuine, informed and meaningful consent by the user
4. Minimal use of data only for the purpose for which it is sought
5. Entities controlling data to be responsible for data
6. High powered statutory authority for enforcement
7. Adequate penalties to discourage wrongful acts

Actions that you can take

Few essential tips

1. Be mindful of permissions you give while installing Apps. Now you are aware of the dangerous permission, think twice before giving consent.
2. Check and control privacy setting of your browser. You can use Chrome Incognito mode to browse with complete privacy.
3. For Google accounts , you can verify and control your privacy settings by visiting https://privacy.google.com/take-control.html
4. For Facebook account, you can verify and control your privacy settings by visiting https://www.facebook.com/settings and then on "Privacy" link
5. Change your passwords frequently. Keep strong passwords and different passwords for each account. You can check if your password has been previously leaked online by going to: https://haveibeenpwned.com/Passwords or https://haveibeenpwned.com/
6. Turn on two factor authentication wherever available

Finally Educate yourself about data privacy:

Re-visit privacy policies of apps you have installed. Understanding how your data is used can be eye-opening experience.

❍❑❍

> It is not self-sacrifice, then, a virtue? Is it not the most virtuous deed to sacrifice the happiness of one, the welfare of one, for the sake of the many.
>
> — *Swami Vivekananda*

B. V. Jhaveri, *Advocate*

DIRECT TAXES

Supreme Court

Payment made by the Prasar Bharati Doordarshan Kendra to various accredited advertising agencies to secure more business was in the nature of commission liable to TDS under section 194H and therefore, it was held that the assessing authority was correct in invoking the provisions of section 201.

Director, Prasar Bharati vs. CIT

Civil Appeal Nos. 3496-3497 of 2018 dated 3rd April, 2018.

(2018) 92 taxmann.com 11 (SC)

1. The brief facts in the case are that the appellant, 'Prasar Bharati Doordarshan Kendra', was functioning under the Ministry of Information and Broadcasting of Government of India. In the course of business activities which included running of TV channels, the appellant had been regularly telecasting advertisements of several advertising agencies.

With a view to have better regulation of the practice of advertising, the appellant entered into an agreement with various advertising agencies. As per the agreement, in order to receive the status of 'accredited' agencies, the said agencies had to make an application to the appellant and in return they were allowed to telecast advertisement of several consumer products manufactured by several companies on the appellant's TV channel. One of the stipulations in the said agreement was that the appellant would pay commission of 15% to the agency which the agency was allowed to retain from the revenue generated from the telecasting of advertisements.

2. The AO held that since the payments made by the appellant to the agencies were in the nature of commission, the provisions of section 194H, which came into force from 1-6-2001, were attracted and the appellant defaulted in not deducting the TDS on such payments. The CIT(A) dismissed the appeal.

3. The Appellate Tribunal held in favour of the assessee by following its earlier year order and set aside the orders passed by the AO and CIT(A).

4. The High Court held in favour of the Revenue by setting aside the order of the ITAT. The High Court held that the provisions of section 194H were applicable to the payments and the appellant assessee defaulted in not deducting the TDS.

5. On further appeal before the Supreme Court, it was argued by the appellant that the relationship between appellant and the accredited agencies was not that of principal and agent and it was rather in the nature of principal-to-principal. It was further argued that in terms of agreement, the agencies purchased the air time from the appellant and sold it in the market to their customers after retaining 15% commission given to them by the appellant and therefore, the transaction cannot be regarded as being in between principal and agent.

6. The Supreme Court considered the agreements entered into by the appellant with the accredited agencies and discussed the provisions of section 194H of the Act and held as under:

"28. The Explanation appended to Section 194H defines the expression "commission or brokerage". It is an inclusive definition and includes therein any payment received or receivable, directly or indirectly by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to assets, valuable article or thing not being securities. Clause (ii) defines professional services; clause (iii) defines securities; and clause (iv) provides a deeming fiction for treating any income so as to attract the Rigor of the Section for ensuring its compliance."

"29. Keeping in mind the requirements of Section 194H when we examine the transaction in question, we are of the considered view that the reasoning and the conclusion arrived at by the AO, CIT (Appeals) and the High Court appears to be just and proper and does not call for any interference."

"30. In other words, in our considered view, the High Court was right in holding that the provisions of Section 194H are applicable to the appellant because the payments made by the appellant pursuant to the agreement in question were in the nature of payment made by way of "commission" and, therefore, the appellant was under statutory obligation to deduct the income tax at the time of credit or/and payment to the payee."

"31. The aforementioned conclusion of the High Court is clear from the undisputed facts emerging from the record of the case because we notice that the agreement itself has used the expression "commission" in all relevant clauses; Second, there is no ambiguity in any clause and no complaint was made to this effect by the appellant; Third, the terms of the agreement indicate that both the parties intended that the amount paid by the appellant to the agencies should be paid by way of "commission" and it was for this reason, the parties used the expression "commission" in the agreement; Fourth, keeping in view the tenure and the nature of transaction, it is clear that the appellant was paying 15% to the agencies by way of "commission" but not under any other head; Fifth, the transaction in question did not show that the relationship between the appellant and the accredited agencies was principal to principal rather it was principal and Agent; Sixth, it was also clear that payment of 15% was being made by the appellant to the agencies after collecting money from them and it was for securing more advertisements for them and to earn more business from the advertisement agencies; Seventh, there was a clause in the agreement that the tax shall be deducted at source on payment of trade discount; and lastly, the definition of expression "commission" in the Explanation appended to Section 194H being an inclusive definition giving wide meaning to the expression "commission", the transaction in question did fall under the definition of expression "commission" for the purpose of attracting rigor of Section 194H of the Act."

"32. For all these reasons, we find no difficulty in holding that the payment in question was in the nature of "commission" paid by the appellant to the advertisement agencies to secure more business for the appellant."

"33. Once it is held that the provisions of Section 194H apply to the transactions in question, it is obligatory upon the appellant to have deducted

the income tax while making payment to the advertisement agencies. The non-compliance of Section 194H by the assessee attracts the rigor of Section 201 which provides for consequences of failure to deduct or pay the tax as provided under Section 194H of the Act."

"34. In our view, the provisions of Section 201 were, therefore, rightly invoked in this case against the appellant by the assessing authority once having held that the appellant failed to comply with the provisions of Section 194H of the Act."

7. The appellant had relied on the decision of the Allahabad High Court in the case of *Jagran Prakashan Ltd. vs. DCIT (TDS) (2012) 345 ITR 288,* which was distinguished by the Apex Court on the fact that in the case of Jagran Prakasan Ltd. the parties did not have any agreement like the one in the present case. Accordingly, the appellant's case was dismissed.

Interest on share application money kept with the Bank is inextricably linked with the requirement to raise share capital and is thus adjustable towards the expenditures incurred for the share issue.

CIT vs. Shree Rama Multi Tech Ltd.

Civil Appeal No. 6391 of 2013 dated 24th April, 2018.

1. The facts in this case were that the respondent assessee had come out with initial public issue during the year under consideration and the amount of share application money received was deposited with the banks on which certain interest was earned which was shown in the return of income originally filed as Income from other sources. The same was also referred in the Tax Audit report filed under Section 44AB of the IT Act.

2. In the reassessment proceedings u/s. 147 the income was assessed at higher amount than declared by the assessee by not allowing set off of the interest income against the public issue expenses.

3. The CIT(A) partly allowed the assessee's appeal while affirming the findings of the AO in not allowing set off of interest income from share application money.

4. Being aggrieved by the order of the CIT(A), both the parties filed cross-appeals before the ITAT. The ITAT in its order held in favour of the assessee on the issue of set off of interest income while on other issues remanded the matter back to the file of AO.

5. On appeal by the Revenue before the High Court, the appeal was dismissed on the point of taxability of interest income.

6. Aggrieved Revenue filed further appeal before the Supreme Court. The Apex Court held as under:

"9) Coming back to the facts of the case, we may reiterate that the Respondent was statutorily required to keep share application money in the separate account till the allotment of shares was completed. Interest earned on such separately kept amount was to be adjusted towards expenditure for raising share capital. We are, therefore, of the opinion that interest earned was inextricably linked with requirement of company to raise share capital and was thus adjustable towards the expenditures involved for the share issue. Though learned counsel for the Appellant contended that part of the share application money would normally have to be returned to unsuccessful applicants, and therefore, the entire share application money would not ultimately be appropriated by the Company, insofar as present case is concerned, we do not see how this factor would make any significant difference. Interest earned from share application money statutorily required to be kept in separate account was being adjusted towards the cost of raising share capital. In that view of the matter, we are of the opinion that the High Court was right in allowing such deduction."

"10) In light of the above developments in the case, the question of law has been decided by this Court in case in Bokaro Steel Ltd. (236 ITR 315), wherein the company was set up to produce steel. When the construction of plant was yet not completed, company earned interest on advances to contractor, rent from quarters let out to employees of the contractor as well as other income such as hire charges on plant and machinery let out to contractor, royalty on stones removed from its land. It was in this background that this Court held that the amounts were directly connected to and incidental to construction of plant by the company, amounts were capital receipts and not income from any independent source."

"11) Further, the rationale of judgment of Bokaro Steel Ltd. (supra) was followed in Commissioner of Income Tax vs. Karnal Co-operative Sugar Mills Ltd. (2000) 243 ITR 2 (SC). In this case, the company had deposited certain amount with the bank to open letter of credit for purchase of machinery for setting up plant. On the money so deposited, it earned interest. In that background, this Court observed that this is not a case where any surplus shares capital money which was lying idle had been deposited in the bank for the purpose of earning interest. The deposit of money is directly linked with the purchase of plant and machinery."

"12) The common rationale that is followed in all these judgments is that if there is any surplus money which is lying idle and it has been deposited in the bank for the purpose of earning interest then it is liable to be taxed as Income from other sources but if the income accrued is merely incidental and not the prime purpose of doing the act in question which resulted into accrual of some additional income then the income is not liable to be assessed and is eligible to be claimed as deduction. Putting the above rationale in terms of the present case, if the share application money that is received is deposited in the bank in light of the statutory mandatory requirement then the accrued interest is not liable to be taxed and is eligible for deduction against the public issue expenses." The issue of share relates to capital structure of the company and hence expenses incurred in connection with the issue of shares are to be capitalized because the purpose of such deposit is not to make some additional income but to comply with the statutory requirement, and interest accrued on such deposit is merely incidental. In the present case, the Respondent was statutorily required to keep the share application money in the bank till the allotment of shares was complete. In that sense, we are of the view that the High Court was right in holding that the interest accrued to such deposit of money in the bank is liable to be set off against the public issue expenses that the company has incurred as the interest earned was inextricably linked with requirement of the company to raise share capital and was thus adjustable towards the expenditure involved for the share issue."

"13) In view of the forgoing discussion, we are of the view that the High Court was right in upholding the decision of the Tribunal dated 21-10-2011 that the interest income earned out of the share application money is liable to be set off against the public issue expenses. The judgment passed by the Division Bench of the High Court in remanding the matter to the Tribunal on other issues requires no interference."

Sections 147/148 : In order to constitute "change in opinion", the assessment earlier made must either expressly or by necessary implication have expressed an opinion on the subject matter of reopening. If the assessment order is non-speaking, cryptic or perfunctory in nature, it may be difficult to attribute to the AO any opinion on the questions that are raised in the proposed reassessment proceedings. The reassessment cannot be struck down as being based on

"change of opinion" if the assessment order does not address itself to the aspect sought to be examined in the reassessment proceedings.

ITO vs. TechSpan India Private Ltd. & Another

Civil Appeal No. 2732 of 2007 dated 24th April, 2018.

1. In this case, the respondent assessee was a private limited company engaged in the business of development and export of computer softwares and human resource services. The said company was eligible for deduction u/s. 10A of the Income-tax Act. For the relevant year the respondent company filed the return of income declaring loss. In the said return of income, the said company had declared income in from two sources, namely, software development and human resource development but claimed expenditure commonly for both, It also claimed deduction u/s. 10A of the Act.

2. In the scrutiny proceedings, the respondent company was issued show cause notice as to why the expenses claimed with regard to the allocation of common expenses between the two heads, viz., software development and human resource development do not reveal any basis for such allocation. The issue was duly contested and decided and the proceedings ended in rectification u/s. 154 of the assessment order while arriving at income which was fully set-off against loss brought forward and the income was assessed as 'Nil' for the year under consideration.

Thereafter, the case was reopened by issuance of notice u/s. 148 of the Act on the ground that the deduction u/s. 10A had been allowed in excess and the income had escaped assessment. The objections raised by the respondent were rejected through order and the reassessment was approved by the Revenue.

3. Being aggrieved, the respondent company challenged the show cause notice as well as the order passed by the Revenue before the High Court by filing writ petition. The Hon'ble High Court in its judgment set aside the show cause notice and the reassessment order.

4. Against the order of the High Court, the Revenue had filed appeal before the Supreme Court. Before the Apex Court, the Revenue contended that the AO was well within its powers to issue show cause notice u/s. 148 of the Act as the deduction u/s. 10A was allowed in excess and income had escaped assessment and accordingly the order of the High Court was erroneous which was liable to be set aside. On the other hand, the respondent assessee contended that reassessment proceedings was nothing but change of opinion on the same facts and no new facts came to the knowledge of the Revenue.

5. The Supreme Court discussed the provisions of the sections 147 and 148 of the Act and held as under:

"8…..The language of Section 147 makes it clear that the Assessing Officer certainly has the power to re-assess any income which escaped assessment for any assessment year subject to the provisions of Sections 148 to 153. However, the use of this power is conditional upon the fact that the Assessing Officer has some reason to believe that the income has escaped assessment. The use of the words 'reason to believe' in Section 147 has to be interpreted schematically as the liberal interpretation of the word would have the consequence of conferring arbitrary powers on the Assessing Officer who may even initiate such reassessment proceedings merely on his change of opinion on the basis of same facts and circumstances which has already been considered by him during the original assessment proceedings. Such could not be the intention of the legislature. The said provision was incorporated in the scheme of the IT Act so as to empower the Assessing Authorities to reassess any income on the ground which was not brought on record during the original proceedings and escaped his knowledge; and the said fact would have material bearing on the outcome of the relevant assessment order."

"9) Section 147 of the IT Act does not allow the reassessment of an income merely because of the fact that the Assessing Officer has a change of opinion with regard to the interpretation of law differently on the facts that were well within his knowledge even at the time of assessment. Doing so would have the effect of giving the Assessing Officer the power of review and Section 147 confers the power to reassess and not the power to review."

"10) To check whether it is a case of change of opinion or not one has to see its meaning in literal as well as legal terms. The word change of opinion implies formulation of opinion and then a change thereof. In terms of assessment proceedings, it means formulation of belief by an assessing officer resulting from what he thinks on a particular question. It is a result of understanding, experience and reflection."

6. The Apex Court considered its decision in the case of *CIT vs. Kelvinator of India Ltd. (2010) 320 ITR 561 (SC)* wherein words such as "reason to believe", "mere change of opinion" and "tangible material" provided u/s. 147 were interpreted and 'power to reassess' was distinguished from the 'power to review'. The said decision also held that reasons recorded for reopening the assessment must have live link with the formation of belief of escapement of income.

7. The Supreme Court further held:

"12) Before interfering with the proposed re-opening of the assessment on the ground that the same is based only on a change in opinion, the court ought to verify whether the assessment earlier made has either expressly or by necessary implication expressed an opinion on a matter which is the basis of the alleged escapement of income that was taxable. If the assessment order is non-speaking, cryptic or perfunctory in nature, it may be difficult to attribute to the Assessing Officer any opinion on the questions that are raised in the proposed reassessment proceedings. Every attempt to bring to tax, income that has escaped assessment, cannot be absorbed by judicial intervention on an assumed change of opinion even in cases where the order of assessment does not address itself to a given aspect sought to be examined in the reassessment proceedings."

"13) The fact in controversy in this case is with regard to the deduction under Section 10A of the IT Act which was allegedly allowed in excess. The show cause notice dated 10-2-2005 reflects the ground for reassessment in the present case, that is, the deduction allowed in excess under Section 10A and, therefore, the income has escaped assessment to the tune of ₹ 57,36,811. In the order in question dated 17-8-2005, the reason purportedly given for rejecting the objections was that the assessee was not maintaining any separate books of account for the two categories, i.e., software development and human resource development, on which it has declared income separately. However, a bare perusal of notice dated 9-3-2004 which was issued in the original assessment proceedings under Section 143 makes it clear that the point on which the reassessment proceedings were initiated, was well considered in the original proceedings. ***In fact, the very basis of issuing the show cause notice dated 9-3-2004 was that the assessee was not maintaining any separate books of account for the said two categories and the details filed do not reveal proportional allocation of common expenses be made to these categories. Even the said show cause notice suggested how proportional allocation should be done. All these things leads to an unavoidable conclusion that the question as to how and to what extent deduction should be allowed under Section 10A of the IT Act was well considered in the original assessment proceedings itself. Hence, initiation of the reassessment proceedings under Section 147 by issuing a notice under Section 148 merely because of the fact that now the Assessing Officer is of the view that the deduction under Section 10A was allowed in excess, was based on nothing but a change of opinion on the same facts and circumstances which were already in his knowledge even during the original assessment proceedings."***

6. Accordingly, the order of the High Court was upheld and the appeal of the Revenue was dismissed.



Paras S. Savla, Jitendra Singh, Nishit Gandhi, *Advocates*

DIRECT TAXES
High Court

1. Duty of Assessing Officer – Inclusion of non-taxable income in the return by mistake – It is the duty of Assessing Officer to refrain from assessing such income. [A.Y. 2014-15]

Raghavan Nair vs. ACIT [2018] 402 ITR 400 (Ker.)

The assessee before the Hon'ble Kerala High Court was an Individual. The assessee received a sum of ₹ 1,28,43,192/- in the year 2014-15 by way of compensation for a land acquired from him for the Kochi Metro Rail Project. The assessee, at the relevant time was under the impression that the capital gains resulting from the acquisition of the land is exigible to tax under the Act. Consequently, in the return filed by the petitioner under the Act for the assessment year 2015-16, he disclosed the capital gains resulting from the acquisition of the said land and paid tax thereon. Assessee worked out the indexed cost of the land reckoning its fair market value as on 1-4-1981. The return filed by the assessee was selected for scrutiny assessment. In the meanwhile, in the light of Section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 (the Land Acquisition Act), Hon'ble Kerala High Court had held in number of cases that compensation payable to persons for the lands acquired under the said statute is exempted from payment of tax under the Act. In the circumstances, in so far as the acquisition of the land of the assessee was under the said statute, the assessee made a representation before A.O. to drop the proceedings initiated against him under Section 143 the Act. Since the A.O. did not considered the request made by the assessee, the assessee filed a Writ Petition being numbered as W.P.(C). No.23113 of 2017 before Hon'ble Delhi High Court challenging the continuance of the proceedings under Section 143 the Act. The said writ petition was admitted on 24-7-2017. However, pending the above Writ Petition, the assessee was served with the impugned assessment order dated 14-7-2017 under section 143(3) of the Act.

The assessee challenged the above order before the Hon'ble Kerala High Court through present Writ Petition. The Hon'ble High Court quashed the impugned assessment order by observing that it is beyond dispute that the powers of the Assessing Officers under the Act are quasi-judicial in nature and they are duty bound, therefore, to act fairly in the discharge of their functions. The officers are also invested with the authority to do justice to the assessees. In a case where it is apparent on the face of the record that the assessee has included in his return, an income which is exempted from payment of income tax, on account of ignorance or by mistake, the Assessing Officer is bound to take into account the said fact in a proceedings under Section 143 of the Act. If the capital gains on a transaction is exempted from payment of tax, the Assessing Officer has a duty to refrain from levying tax on the said capital gains and the Assessing Officer cannot, in such cases, refuse to grant relief under Section 143 of the Act to the assessee on the technical plea that the assessee has not filed a revised return. It is paramount duty of the Assessing Officer is to complete the assessments in accordance with law. It is all the more so in the light of the mandate under Article 265 of the Constitution that no tax shall be levied or collected except by authority of law. *(Goetze (India) Ltd. vs. CIT (2006) 284 ITR 323 (SC)* distinguished.)

2. Remission or cessation of trading liability – Section 41(1) of the Income-tax Act, 1961 – Liability is accepted and acknowledged in the audited accounts – Creditors can rely on such acknowledgement of liability – Invocation of section 41(1) not justified. [A.Y. 1996-97]

CIT vs. Banaras House Ltd. [2018] 402 ITR 88 (Delhi)

The assessee before the Hon'ble Delhi High Court was a company. During the course of assessment proceedings A.O. made disallowance invoking the provisions of section 41(1) of the Act on ground that no transaction between the assessee and the creditors had taken place during the last three years or more. On appeal the First Appellate Authority, tallied the list of old creditors with the payment made by the assessee to the creditors in the subsequent assessment years and allowed partial relief to the assessee. The assessee being aggrieved by the order passed by Ld. CIT(A) preferred an appeal before the Appellate Tribunal, Delhi. The Tribunal deleted the addition made by A.O. by observing that the assessee had carried forward the balances from earlier years. Some credit balances were written off in the year in question and some in succeeding years. Further, when a liability was acknowledged by the debtor, it cannot be said that the claim of the creditor was barred by limitation. Hence, provisions of Section 41(1) of the Act were not attracted. The department being aggrieved by the order of the appellate tribunal preferred an appeal before the Hon'ble Delhi High Court. The High Court dismissed the appeal filed by the department observing that assessee is a company and accounts were audited as per the mandate of the Companies Act. In the accounts, the assessee had accepted and acknowledged its liability. The creditors can rely on the said acknowledgment. Even otherwise many of the creditors were paid, adjusted or eased in the subsequent years as accepted by the Commissioner of Income Tax (Appeals) and the Tribunal. No special facts or reasons were given by the A.O. to hold and observe that the liabilities had ceased and amounts should be added under Section 41(1) of the Act.

3. S. 92 : Transfer pricing – Arm's length price – Loans to AE without interest – AO held that granting of loans is an international transaction and computed interest income – Real income vs. notional income

Tooltech Global Engineering P. Ltd. vs. ACIT – ITXA 812 of 2015 – Bombay High Court

In this case, the assessee had granted certain loans to its associated enterprises (AE) on which no interest was charged. The AO was of the opinion that the granting of loans to AE is an international transaction. After so holding the AO worked out interest income thereon to determine the Arm's Length Price. The said order was affirmed by the Tribunal. The assessee challenged the said order in appeal before the Hon'ble High Court. The primary contention of the assessee before the Hon'ble High Court was that by virtue of reworking interest on loans granted to AE the AO / Department has sought to tax notional or hypothetical income and not real income and as per the provisions of the Income-tax Act, 1961 only real income could have been taxed and therefore the addition as regards notional interest income was not sustainable. The Hon'ble High Court dismissed the appeal holding that, Chapter X of the Act, is an anti-avoidance measure and not an anti-evasion measure. It is not premised on the basis that the transactions entered into between the parties suffers from under/over invoicing. The value of the transactions is brought in line with the consideration which would pass between two independent parties i.e. non-related/non-associated enterprises, by legislative mandate. It was further held that the Legislature has introduced special provisions in respect of International Transactions to bring the income to tax having regard to Arm's Length Price (ALP). In such case, the parties are obliged to establish the ALP of the International Transactions entered into between the two AE to bring to tax the real income i.e. the correct price of the transactions, shorn of, the price arrived at on account of relationship. It means the real income on application of a new measure. The object of the Transfer Pricing Officer is to put a stop to capital erosion and transfer of profits from one taxable territory to another taxable territory.

4. S.54F : Capital gains – Investment in a residential house – Deposit in capital gains account scheme can be made within extended due date mentioned in section 139(4)

PCIT vs. Shankar Lal Saini – (2018) 89 Taxmann.com 235 (Rajasthan)

In this case, the issue before the Hon'ble High Court was whether the Assessee was entitled for deduction u/s. 54B and 54F despite the facts that he had not deposited the gains in a Capital Gains Account as per the Capital Gains Account Scheme (CGAS) before the due date specified u/s. 139(1) of the Act. The Hon'ble High Court after considering various precedents including that of the Hon'ble Supreme Court in the case of *Prakash Nath Khanna vs. CIT – (2006) 266 ITR 1 (SC),* held that the due date for deposit in CGAS account was the extended due date mentioned u/s. 139(4) prescribed for filing return for the relevant assessment year (AY). The Hon'ble High Court categorically held that while considering the prosecution, the provisions are to be very strictly construed whereas in the case of exemption and other benefits, they are to be construed very liberally. Ultimately, the Hon'ble High Court ruled in favour of the assessee holding that for claiming exemption u/s. 54 / 54F the time line for deposit in CGAS account is that u/s. 139(4) of the Act and not u/s. 139(1) of the Act.

Note: The Hon'ble High Court considered numerous judgments like *CIT vs. Rajesh Kumar Jalan – (2006) 286 ITR 274 (Gau.), CIT vs. Shri Jagtar Singh Chawla – (2013) 215 Taxman 154 (Punj. & Har.), Fathima Bai vs. ITO – (2010) 32 DTR 0243 (Kar.), CIT vs. Ms. Jagriti Aggarwal – (2011) 339 ITR 610 (Punj. & Har.), CIT vs. Smt. Vrinda P. Issac – (2013) 212 Taxman 101 (Mag.) (Kar), etc.* which ruled on similar lines.

The above Judgment has been rendered after the Judgment in the case of *Humayun Suleiman Merchant vs. CCIT – (2015) 387 ITR 421 (Mumbai)* was rendered which upheld the converse position, but has not considered the same.

5. S.44BBB : Foreign companies – Civil construction – Turnkey power projects – Assessee audited its accounts and claimed lower profits as against presumptive rate of 10% – Percentage completion method followed – Past experience considered – Claim for lower profits allowed

CIT vs. Shandong Tiejun Electric Power Engineering Co. – (2018) 400 ITR 371 (Gujarat)

In this case, the assessee, a foreign company was engaged in execution of turnkey projects. As per section 44BBB of the Act, the income of the assessee carrying on the business of erection / commissioning of turnkey projects would be taxed at a presumptive rate of 10% of the amount paid or payable to the assessee. However, under sub-section (2) of section 44BBB of the Act if the assessee satisfies certain conditions therein, he could claim lower profit and gain than what is referred in sub-section (1). Assessee availed of such provision of sub-section (2) of section 44BBB of the Act while filing the return before the Assessing Officer. The assessee had pointed out to the Assessing Officer that the true cost of the project was estimated on the basis of experience of the assessee in executing similar works in the past. The assessee had also submitted detailed break-up of the estimated profit and loss account for the entire project for five financial years. The assessee had also submitted the details of the budgeted costs to the revenue. The assessee had produced the audited financial statements during all the financial years. However, the Assessing Officer was not satisfied on various grounds, principally, that the assessee had followed the accounting system of AS-7 which was not applicable, the assessee should have offered tax in terms of section 44BBB of the Act and lastly that in any case the assessee had not followed the correct method of determining the stage of completion of the contract and the accounts of the assessee were not reliable. The Assessing Officer after putting the assessee to notice rejected the assessee's accounts and taxed the assessee under sub-section (1) of section 44BBB of the Act. The assessee filed appeal before the CIT(A) who reversed the order of the AO relying on *CIT vs. Advanced Construction Co. P. Ltd. – (2007) 275 ITR 30 (Guj.)* noting that the financial statements of the financial years 2009-10 and 2010-11 were available which were submitted before him by the assessee which matched the estimated costs presented by the assessee before the Assessing Officer. He also noted that the entire project was completed and the total income was offered to tax. As such he allowed the appeal. This was also affirmed by the Tribunal. On further appeal, the Hon'ble High Court dismissed the appeal filed by the Department holding that, it was not the case of the revenue that the assessee had not maintained the books of account and documents as required under sub-section (2) of section 44AA or that the assessee's accounts were not audited or the audit report not furnished before the Assessing Officer. The Commissioner and the Tribunal held that the Assessing Officer was wrong in holding that the Accounting Standard AS-7 did not apply to the assessee. Further as recorded by the Tribunal, the AO had not found any major defects in such accounts of the assessee. The Commissioner (Appeals) in fact elaborated that the assessee had the past experience from which it could estimate the total cost and had presented figures to show the percentage completion of the project. These figures matched with the actual income and expenditure statements of the subsequent financial years. In fact, the entire project was completed by the time the Commissioner (Appeals) decided the appeal wherein the total income was offered. As such there was no reason to interfere with the order of the Tribunal.



Neelam Jadhav, Neha Paranjpe & Tanmay Phadke, *Advocates*

DIRECT TAXES
Tribunal

REPORTED DECISIONS

1. Appeals before Commissioner of Income Tax (Appeals) – Section 249 of the Act – In absence of any specific clarification, CBDT Notification No. 11/2016 dated 1-3-2016 requiring assessee to file the appeals before Commissioners of Income Tax (Appeals) electronically is not applicable to assessment orders passed prior to 1-3-2016.

Ashraf Aziz Kasmani vs. Income Tax Officer – 24(1)(2), Mumbai (ITA 235/Mum./2018)[Assessment Year:2009-10] order dated 4-2-2018 [2018] 92 taxmann.com 283 (Mum.-Trib.)

Facts

The assessee is an individual and the assessment year under consideration is 2009-10. For the year under consideration, the assessment order u/s. 143(3) r.w.s 147 was passed on 14-2-2016 that was served on the Assessee after 1-3-2016. The CBDT *vide* its Notification No: 11/2016 dated 1-3-2016 laid down certain matters and prescribed a procedure of e-filing of appeals before CIT(A). However, the Assessee filed an appeal before the learned CIT(A) manually on the conclusion that the said notification has applicability only for assessment orders passed after its existence and appeals against assessment orders passed prior to the said notification were not governed by the said notification. However, the learned CIT(A) observed that the notification dated 01.03.2016 is applicable to the case under consideration. He further observed that the CBDT vide another circular No: 20/2016 dated 26-5-2016 extended the time limit till 15-6-2016 and finally dismissed the appeal as filed manually by the Assessee on conclusion that the same ought to have been filed electronically in view of the abovementioned circulars. Aggrieved with the same, the Assessee filed an appeal before Hon'ble ITAT. During the course of hearing, the learned Departmental Representative strongly argued that since the order passed prior to 1-3-2016 was served on the Assessee, notification dated 1-3-2016 has applicability and the Assessee should have filed an appeal electronically. After analysing facts under consideration and submission of the learnedDR, Hon'ble ITAT held as under:

Held

Hon'ble ITAT noted that the learned CIT(A) himself noted the fact that the appeal was filed well within time. It thereafter concluded that there is no clarification in the CBDT circular regarding applicability of the same with regard to the date of assessment order passed. It came to the conclusion that the submission of the assessee before the learned CIT(A) cannot be brushed aside completely and the said interpretation is possible. Further Hon'ble ITAT relied upon a decision of Hon'ble Apex Court in case of *CIT vs. Vegetable Products Ltd. (88 ITR 192)* and directed the learned CIT(A) to admit the aforesaid appeal and pass an order on merits of the case.

2. Deduction at source – Section 201 of the Act – The order passed for the first three quarters of the financial year 2008-09 u/s. 201 of the Act after two years from the end of the financial year in which the statement u/s. 200 was filed is without jurisdiction. The amendment to sec 201(3) by the Finance Act, 2014 providing for limit for passing order to be within seven years from end of financial year in which payment was made or credit was given is applicable from 1-10-2014.

Vodafone Cellular Ltd. vs. DCIT, (TDS-1), Pune (ITA 1961/PN/2013)[Assessment Year: 2009-10] order dated 12-3-2018 [2018] 91 taxmann.com 466 (Pune-Trib.)

Facts

The assessee is a public limited company. The financial year under consideration is 2008-09. The assessee was engaged in business of providing cellular mobile phone services for Maharashtra and Goa Circles excluding Mumbai. The assessee was providing both prepaid and postpaid services. For the said year, the assessee in the present case had filed the first TDS return for the first quarter on 19-7-2008, for the second quarter on 15-9-2008 and for the third quarter on 15-1-2009 i.e. returns were filed in the financial year 2008-09. Whereas the return for the fourth quarter was filed 15-6-2009 (i.e. in the financial year 2009-10). The survey under section 133A of the Act was conducted on 23-4-2008 for verification of compliance of TDS provisions for assessment years 2007-08 and 2008-09. During the course of verification, it was noted that the assessee was paying commission to all dealers except distributors. The explanation of assessee was that sale to the distributors was at MRP less trading margin and there was no commission being paid. The learned AO however, held the assessee to be in default for not deducting tax at source out of discount allowed to the distributors, which fell within provisions of section 194H of the Act. The learned AO raised demand under section 201(1) of the Act and also charged interest under section 201(1A) of the Act, which was confirmed by the learned CIT(A). Aggrieved with the same, the assessee preferred an appeal before Hon'ble ITAT. The assessee for the first three quarters challenged the jurisdictional validity of the impugned order passed on 15-3-2012 on the contention that the same was passed after two years from end of the financial year in which the statement u/s. 200 was filed. The submission of the assessee in sum and substance was since the returns for the first three quarters was filed in the financial year 2008-09, the learned AO could have passed an order u/s. 201 of the Act till 31-3-2011. On the other hand, the learned D.R. placed reliance on the order of the learned CIT(A) and the amendment to the section which had taken place by Finance Act (No: 2) Act, 2014. In view of the aforesaid factual matrix, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that the order u/s. 201 of the Act raising a demand with regard to the first three quarters was admittedly passed after the period of two years provided in the section at the relevant time. It further concluded that the said section has been amended by Finance (No.2) Act, 2014 w.e.f. 1-10-2014 and the time limit provided in section 201(3) of the Act is now increased to seven years. Hon'ble ITAT also referred to explanatory memorandum and observed that the Memo explaining the provisions relating to Direct Taxes has clarified the earlier position of section 201(3) of the Act and it is provided that clause (1) of section 201(3) of the Act provided that no order under section 201(1) of the Act shall be passed after the expiry of two years from the end of financial year in which TDS statement had been filed. Then, it referred to processing of TDS statement and the computerised environment and TDS defaults in respect of transactions not reported in TDS statements and hence, it was proposed to omit clause (1) of section 201(3) of the Act, which provided time limit of two years for passing the order under section 201(1) of the Act for cases in which TDS statements had been filed. The present section 201(3) of the Act provides the limit for passing the order to be within seven years from the end of financial year in which the payment was made or credit was given. In the light of aforesaid observations, Hon'ble ITAT allowed the contention of the assessee. It quashed the demand raised with regard to the first three quarters under consideration by upholding the same as beyond jurisdiction and directed the learned AO to sustain the demand raised for quarter No.4.

3. Survey – Section 133A – Addition cannot be made by the learned A.O. solely by relying upon the statement recorded during the course of survey proceedings u/s. 133A of the Act if the said statement was later on retracted and the Assessee substantiated incorrectness of the same by documentary evidences

Shri Amol Shivlal Shah vs. ACIT-19(3), Mumbai (ITA 795/Mum/2015)[Assessment Year: 2006-07] order dated 23-3-2018

Facts

The assessee is an individual and the assessment year under consideration is 2006-07. The assessee was a builder carrying out the business in the name of his proprietary concern M/s. Nikita Construction. The survey was carried out on 12-3-2007 and the statement of the assessee was recorded therein. It was observed in the survey proceedings that the return of income for the assessment year under consideration as well as for Assessment Years 2004-05 and 2005-06 were not filed. Further it was noted that the assessee completed one of its constructions situated at Bandra. Since the assessee did not offer any income with regard to the same, the specific question was put and the explanation was asked for. The assessee considering the opening value of the project as on 31-3-2003 and total agreement value declared the total income of ₹ 1 crore on estimated basis during the course of survey proceedings. However subsequently, the assessee in his return of income for the year under consideration offered an income of ₹ 25,36,440/-which was a variation with the income declared during the course of survey proceedings. The assessee with documentary evidences explained his income declared in the return. Further he explained to the learned Assessing Officer that there was an error on part of him to estimate total sale consideration and expenditure incurred for the entire project from 1st April, 2003. The said explanation was not considered by the learned AO and the difference of ₹ 74,63,557 was added to the returned income. The Ld CIT(A) confirmed the order passed by the learned AO. Aggrieved with the same, the assessee preferred an appeal before Hon'ble ITAT. It was argued before Hon'ble ITAT that the learned AO solely by relying upon the statement recorded in the survey proceedings made the addition and failed to appreciate the documentary evidences produced by him to substantiate the returned income. To buttress his contention, the assessee relied upon the decision of Hon'ble Apex Court in *"CIT vs. S. Khader Khan Sons, 352 ITR 480 (SC)*. Further the assessee further mentioned that the statement made during the course of survey proceedings was retracted within a month's time. The assessee requested Hon'ble ITAT to delete the addition made by the learned AO. On the other hand, the learned DR relied upon the order of the lower authorities and further pointed out that the assessee on his own declared the income of ₹ 1 crore during the Survey Proceedings. Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that the assessee substantiated his returned income with documentary evidences. Further the books of account were audited and no fault was found by the Revenue. It further noted that the income declared by the assessee during the course of survey proceedings was purely on an estimated basis. The statement was retracted and a complete reconciliation was submitted explaining the reasons for the difference between the returned income and the income declared in the survey proceedings. Hon'ble ITAT observed that Hon'ble Apex Court in case of *"Pullangade Rubber Produce Co. Ltd. vs. State of Kerala" (91 ITR 18)* recognised the trite law that it was open to the assessee who made the statement to show that that it was incorrect. Further it observed that Hon'ble Apex Court in case of *"CIT vs. S. Khader Khan Sons" 352 ITR 480 (SC)* has upheld the judgment of Hon'ble Madras High Court reported in 300 ITR 157 wherein the difference between sec 133A and Sec 132(4) of the Act was noted and it was held that the statement u/s. 133A does not have any evidentiary value. Hon'ble ITAT referred to the CBDT circular dated 28-2-2003 (Inv.) II dated 10-3-2003 wherein it is observed that the assessments ought not to be based on merely on the confession obtained at the time of search, seizure and survey but should be based on evidences/materials gathered during the course of search/survey operations. Hon'ble ITAT further noted that in the entire survey proceedings, the department did not find an iota of evidence and completely relied upon the statement made by the assessee during the said proceedings. Based on the aforesaid observations and legal propositions, Hon'ble ITAT allowed the appeal filed by the assessee.

UNREPORTED DECISIONS

4. Capital Gain – Section 45 r.w.s. 28(va) of the Act – Amount received on transfer of rights to carry on any business is to be taxed under the head "Capital Gains" and not as "Business Income"

Suklendu A. Baji vs. DICT (ITA 5209/Mum/2017)[Assessment Year: 2006-07] order dated 5-2-2018

Facts

The assessee is an individual. He was carrying on the business of developing software and also dealing in software under the proprietorship concern M/s. Cogito Systems since 1-7-1994. During the year under consideration the assessee transferred his business to Cogito Technologies Pvt. Ltd. *vide* agreement dated 1-4-2005 for a consideration of ₹ 38,50,000/-. In the return filed during the impugned assessment year the assessee showed a sum of ₹ 38,50,000/- being an amount received on account of transfer of assets as a goodwill. Further, the assessee invested the said sum in the prescribed bond as referred under section 54EC of the Act and claimed the deduction under section 54EC in his return of income. The learned A.O. was of the view that the said sum cannot be treated as goodwill. The learned A.O., further, observed that the consideration received was in respect of sale of commercial rights and not for the carrying out any activity in relation to any business. Thus, the same should be assessed under the head "Business Income" u/s. 28(va) of the Act. Accordingly, the learned A.O. made an addition of ₹ 38,50,000/- under the head " Business Income" and disallowed the claim of the deduction under section 54EC of the Act. On appeal, the learned CIT(A) confirmed the action of the learned A.O. Being aggrieved by the order passed by the learned CIT(A) the assessee preferred the appeal before the Hon'ble ITAT.

Held

The Hon'ble ITAT perused the various clauses of agreement as well as the facts and circumstances of the case and noted that the assessee in this case by way of the agreement has in effect agreed not to carry out any business and therefore the case falls under 1st proviso to section 28(va) of the Act. The ITAT further noted that the learned A.O. himself had observed that the agreement and its various clauses constricted the freedom of the assessee to conduct any business. The Hon'ble ITAT finally held that the said receipt is taxable under the head "Capital Gains "and not as business profits. The ITAT while coming to this conclusion relied on the decision of the Hon'ble Mumbai ITAT in the case of Savita Mandhana [ITA 3900/Mum/2010] and decided the issue in favour of the assessee and against the revenue.

5. Income from other sources – Section 56(2)(Viia) r.w.r. 11UA – The value of the shares needs to be determined on the basis of book value for the purpose of making valuation under section 56(2)(viia) of the Act.

M/s. Minda S. M. Technocast Pvt. Ltd. (ITA 6964/ Del/2017)[Assessment Year: 2014-15] order dated 7-3-2018

Facts

The assessee is a public limited company. During the year under consideration the assessee had acquired 48% shares of M/s. Tuff Engineering Pvt. Ltd. (TEPL) at the rate of ₹ 5/- per share from various companies. The assessee valued the shares as per rule 11UA of the Income Tax Rules, 1962. In support of the same assessee produced a valuation report from a Chartered Accountant which valued the share at ₹ 4.96/- per share. During the course of assessment proceedings, the learned A.O. observed that the assessee while valuing the shares of TEPL had taken the land shown by the TEPL at the book value in its balance sheet. Thus, the learned A.O. was of the view that the fair market value of the land as per the circle rate pertaining to the A.Y. 2014-15 should have been taken into consideration while determining the value of the said shares of TEPL. Accordingly, the learned A.O. substituted the book value of the land with the fair market value as per the circle rate and determined the value of shares at ₹ 45.72 per share of TEPL. The learned A.O. also referred to section 56(2)(viia) of the Act with Rule 11UA of the Rules. Thus, the difference of ₹ 40.72 per shares (₹ 45.72 – ₹ 5) was added by the learned A.O. as income of the assessee under the provisions of Section 56(2)(viia) of the Act. The total addition made by the learned A.O. under consideration came to ₹ 11,84,46,336/-. On appeal, the learned CIT(A) confirmed the action of the learned A.O. Being aggrieved by the order passed by the learned CIT(A), the assesse preferred the appeal before the ITAT.

Held

The ITAT observed that on the plain reading of the above Rule 11UA, it revealed that while valuing the shares, the book value of the assets and liabilities declared by the TEPL should be taken into consideration. There is no mention in the provision of 11UA of the Rules to refer to the fair market value of the land as taken by the learned A.O. for the year under consideration. The share price calculated by the assessee of TEPL for Rs.5 per share has been determined in accordance with the provision of Rule 11UA by the ITAT and the action of the learned A.O. is considered without any basis. In view of the same, the ITAT upheld the valuation done by the assessee and reversed the action of the learned A.O. A.O. The appeal of the assessee is allowed.

6. Reassessment – Section 147 r.w.s. 153C of the Act – The assessment framed under section 143(3) r.w.s. 147 of the Act is without jurisdiction when the assessment has already taken place under section 153C of the Act.

M/s. Rayoman Carriers Pvt. Ltd. vs. ACIT (ITA 3275 & 3276/Mum./2015)[Assessment Years: 2003-04 & 2005-06] order dated 16-3-2018

Facts

The assessee is a Private Limited Company and filed its return on 30-3-2007 which was accepted under section 143(1) of the Act. A search action was carried out on 24-1-2006 in the case of Rupi V. Chinoy, Director of the Company wherein some documents were found related to the assessee. Based on same the notice under section 153C of the Act was issued to the assessee. The assessee filed its detailed reply answering to the queries raised in the notice under section 153C of the Act. The learned A.O., thereafter dropped the proceedings initiated by him under section 153C of the Act and assumed a jurisdiction u/s. 147 of the Act. Accordingly, the assessee was served with a notice dated 04.02.2008 under section 148 of the Act. The assessee strongly objected to the action of the learned A.O. in issuing the notice under section 148 of the Act. The learned A.O., however, without appreciating facts and circumstances of the case passed the assessment order under section 143(3) r.w.s 147 of the Act. The assessee challenged the action of the learned A.O. before the learned CIT(A) who in turn confirmed the order of the learned A.O. Being aggrieved with the same, the Appellant preferred the appeal before Hon'ble ITAT.

Held

The Hon'ble ITAT observed that the learned A.O. was bound to issue a notice under section 153C of the Act once he found the material with regard to the assessee at the premises of any other person during the search proceedings initiated in another person and he ought to have completed the assessment under section 153C of the Act. The ITAT further noted that if the learned A.O. after issue of notice under section 153C had proceeded with reassessment under sections 147/148 of the Act and passed the assessment order under section 143(3) of the Act, the same would be arbitrary and without any Jurisdiction. The ITAT, further, observed that the provisions of section 153C are non-obstantive provisions and specially exclude the operation of section 147 of the Act. Therefore, the learned A.O. in the present case has erred in invoking the provisions of section 147 of the Act. The ITAT after analysing both the provisions under consideration concluded that if an action under section 147 is permitted on the basis of material found in the course of' search, the provisions of section 153C would be redundant. The ITAT relied on the decision of Delhi ITAT in the case of *Rajat Shubhra Chatterji vs. ACIT [ITA No. 2430/Del/2015],* decision of Amritsar ITAT in the case of *ITO vs. Arun Kumar Kappor [2011] 16 taxmann.com 373 (Amr)* and the decision of Visakhapatnam ITAT in the case of *G. Koteswara Rao vs. DCIT [2015] 64 taxmann.com 159* and finally decided the issue of jurisdiction of the learned A.O. u/s. 147 of the Act in favour of the assessee.

7. Income from other sources – Section 56 of the Act – Interest received on fixed deposits out of share capital cannot be assessed as income from other source

ACIT vs. M/s Posco India Private Limited, ITA Nos. 155 & 122/ CTK/ 2017 dt. 15-2-2018, (Cuttack)(Trib.)

Facts

The assessee is a private limited company. For the assessment years 2010-11 and 2012-13, the assessee earned a huge quantum of interest from fixed deposits kept by it in the bank. The said fixed deposits were made out of the share capital raised by it. During the course of assessment proceedings, the learned AO observed that the assessee had earned an interest income on fixed deposits utilising a part of unutilised share capital and interest income was claimed to be exempt as capital receipt and formed a view that the said interest income is liable to be taxed under income from other sources. He further observed that the link with the process of setting up the project with deposits in banks was explained by the assessee. The learned AO concluded the assessment by adding the said interest income u/s. 56 as income from other sources. The issue finally travelled to Hon'ble ITAT. It was argued before Hon'ble ITAT the business was in the process of setting up when the said interest income was earned. Further it was mentioned that the interest was earned on all the fixed deposits which were made out of the funds infused in the said assessee by investors to acquire various assets and in view of the same, it was urged that the said interest income is required to be a capital receipt and not a revenue receipt chargeable to tax u/s. 56 of the Act. Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that, the contention of the assessee that the entire fixed deposits were made out of share capital is correct. Further Hon'ble ITAT observed that the share capital was specifically raised to acquire various assets and the business was yet to set up. Hon'ble ITAT concluded that the said interest earned on funds primarily brought for infusion in the business could not have been classified as income from other sources, since the income was earned in a period prior to the commencement of business, and it was in the nature of capital receipt. It drew a support from the interpretation of sec 36(1)(iii) of the Act and concluded that the same analogy is applicable from income as well and held that interest on fixed deposits under consideration is not taxable under income from other sources.

8. Penalty: No penalty u/s. 271AAA is to be levied when no specific query with regard to the manner in which an undisclosed income was earned has been put by the authorised officer to the assessee during the course of search proceedings and further the assessee voluntarily surrendered income and paid tax thereon.

ACIT vs. Beena Kedia, ITA No. 4807 & 4808/ Del/ 2015. Dt. 28-2-2018 (Del)(Trib.)

Facts

The assessee is an Individual. The assessment year under consideration is 2010-11. The assessee filed the return of income on 15-10-2010 declaring the total income at ₹ 1,83,70,980/-. Thereafter, a search and seizure operation u/s. 132 was carried out. During the course of search proceedings, the assessee declared ₹ 1,39,33,400/- voluntarily and also explained a source of income. Subsequently the learned AO initiated penalty proceedings u/s. 271AAA on the undisclosed income. In regard to the undisclosed income, the assessee submitted that the same was earned from the share transactions i.e. speculative and F&O dealing. Further it was submitted that taxes on the same had been already paid. However the learned AO. Levied the penalty which was confirmed by the learned CIT(A). Being aggrieved with the same, the assessee preferred an appeal before Hon'ble ITAT. It was argued before Hon'ble ITAT that the assessee established a source of income which was voluntarily disclosed and paid taxes accordingly. Further it was specifically argued that no penalty u/s. 271AAA is to be levied since as no specific question was asked to the assessee during the course of search proceeding with regard to the manner in which an undisclosed income was earned. The assessee relied upon various judicial pronouncements and urged before Hon'ble ITAT that a penalty levied by the learned AO is to be deleted. Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that, the learned AO completed the assessment at the income declared by the assessee and no reference to any incriminating material was ever made in the entire assessment proceedings. It was noted by Hon'ble ITAT that the assessee not only disclosed a source of income but also paid the taxes on the same. Further Hon'ble ITAT noted from the statement of the assessee recorded u/s. 132(4) of the Act that no specific query to substantiate the manner of earning of undisclosed income was put forward to the assessee by the Authorised Officer. Relying upon the decision of Hon'ble Delhi HC in case of *Pr. CIT vs. M/s. Emirates Technologies Pvt. Ltd. (ITA No. 400/2017 dated 18-7-2017)*, Hon'ble ITAT allowed the appeal in favour of the assessee.

❍❑❍

CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A. SUPREME COURT

1. Where the transactions between the assessee and its Indian subsidiary were at ALP under TP proceedings, even if the subsidiary constituted a PE, no further profits could be attributed – Reassessment proceedings therefore invalid

Honda Motor Co Ltd. vs. ADIT – TS-174-SC-2018 – TP - Civil Appeal No. 2834 of 2018

Facts

1. The assessee, a non-resident company, having wholly owned subsidiaries in India, had entered into several transactions relating to sale of raw materials and finished goods and had also received royalty, fees for technical services etc. Pursuant to a survey carried on in the premises of the Indian subsidiary, the Assessing Officer issued a notice under Section 148 of the Act indicating that he had reasons to believe that the assessee's subsidiary constituted a PE in India to which profits were to be attributed.

2. The assessee filed a Writ Petition challenging the issue of notice under Section 148 of the Act before the Hon'ble Allahabad High Court. The High Court dismissed the Petition and held that once the AO was satisfied that a PE existed in India, the attribution of profits to the said PE was a necessary consequence and the fact that the transactions between the assessee and its subsidiaries were subject to TP proceedings (wherein ALP had been accepted) would not bar reassessment proceedings.

3. Aggrieved, the assessee filed an appeal before the Hon'ble Apex Court.

Held

The Hon'ble Apex Court relying on its decision *ADIT vs. E Funds IT – Civil Appeal No. 6082 of 2015* held that once the transactions between the assessee and the subsidiary were held to be at ALP by the TPO, even if the assessee's subsidiary constituted its PE in India, no further profits could be attributed. Accordingly, allowing the assessee's appeal and setting aside the order of the High Court, it held that the notice under Section 148 of the Act could not be sustained.

B. AUTHORITY FOR ADVANCE RULINGS

2. Geophysical services rendered by the non-resident assessee to Indian customers not taxable as Fees for Technical Services or Royalty. However, the assessee constituted a Fixed Place PE in India and its profits

were taxable under Section 44BB of the Act.

Seabird Exploration FZ LLC – AAR No. 1295 of 2012.

Facts

1. The Applicant, a company incorporated under the laws of UAE, was engaged in the business of rendering geophysical services to the oil and gas exploration industry. Its core business activity involved 4C-3D seismic data acquisition and processing, aimed at increasing the exploration success of its oil and gas clients and maximising their production. During the year, it provided these services to ONGC and other oil companies in India.

2. The applicant raised the following questions before the AAR:

> *"1. Whether on the facts and in law, can the consideration, for services provided by the Applicant to Oil and Natural Gas Corporation Ltd. ('ONGC') be construed to be in the nature of 'Fees for Technical Services' ('FTS') under section 9(1)(vii) of the Act?*
>
> *2. Whether on the facts and in law, can the consideration for services provided by the Applicant be construed to be in the nature of 'Royalty' under section 9(1)(vi) of the Act and/or under Article 12 of the Double Taxation Avoidance Agreement between India and UAE ('Tax Treaty')?*
>
> *3. Whether on the facts and in law, can the Applicant be considered as having a Permanent Establishment ('PE') in India under Article 5 of the Tax Treaty in respect of its contract with ONGC?*
>
> *4. If the answer to question 1, 2 and 3 is not in the affirmative, can it be said that the Applicant is not taxable in India on income earned from its contract with ONGC?*
>
> *5. If answer to question 1, 2 or 3 is in the affirmative, whether on the facts and in law, can the income derived by the Applicant in respect of the contract with ONGC be computed in accordance with provisions of section 44BB of the Act?"*

Held

1. The AAR noted that the Revenue accepted the assessee's contention that the sum received by the Applicant was not fees for technical services in light of the decision of the Apex Court in *Oil & Natural Gas Corporation Ltd. vs. CIT [2015] 376 ITR 306 (SC)*. Further, since ONGC does not use or obtain the right to use the vessel/equipment of the Applicant, it held that the receipts from ONGC would not be taxable as Royalty, both under India-UAE DTAA and the provisions of the Act.

2. Relying on the decision of the Apex Court in *Formula One World Championships Limited (2017) 80 taxmann.com 347*, it held that the Applicant had a fixed place PE as per Article 5(1) as it satisfied the conditions as laid down by the Apex Court i.e. i) permanence of duration to the extent that was required by the business, and not meaning forever ii) there was a fixed place which are the vessels in the High Seas in a definite and composite geographical area, and from which its business of survey in connection with exploration was carried out; and iii) this place was at the disposal of the Applicant.

It dismissed the Applicant's contention that it would be governed under Article 5(2)(i) which required a presence in India of more than 9 months and since it was in India for only 113 days, it could not constitute a PE. It held that the services envisaged under Article 5(2)(i) included services such as of supervision, managerial, consultancy, or general nature, which are employee or personnel oriented, and connected with some work contract or project whose term aggregates to more than nine months and therefore held that since the Applicant's services did not fall under this Article, Article 5(1) would apply. Accordingly, it held that the assessee constituted a fixed place PE in India.

3. In light of the above, since the activities of the Applicant were in connection with exploration of mineral oils, it held that the special provisions of section 44BB would apply, and the income of the Applicant would be computed as laid out therein.

C. HIGH COURT

3. The Court upheld Tribunal's order excluding 4 companies from the list of comparables and including 1 company as comparable, noting that the findings of the Tribunal were findings of fact which were not shown to be perverse

Pr CIT vs. Aptara Technology P. Ltd. – (2018) 92 taxmann.com 240 (Bom.) – ITA No. 1209 of 2015

Facts

1. The assessee was engaged in the business of rendering IT Enabled Services to its AE and benchmarked its international transactions under TNMM.

2. The TPO added his own set of comparables *inter alia* including Accentia Technologies Ltd, Coral Hub Ltd., Cosmic Global and Crossdomain Solutions Ltd. and had also excluded Pentamedia Graphics Ltd. from the assessee's list of comparables.

3. On appeal, the Tribunal held as under:

- Accentia Technologies Ltd. was to be excluded as comparable as it was providing medical transcription, billing and coding services, application development and customisation services and no segmental details were available. Further it noted that the company had also been impacted by a merger/ amalgamation and therefore could not be considered as comparable
- Vis-à-vis Coral Hub Ltd., the Tribunal relying on the decision of the Bombay High Court in PTC Software India Ltd. held that the company could not be considered as comparable as it was outsourcing its work to third party vendors and thus was following a different business model.
- Cosmic Global was to be excluded as the Tribunal noted that the business model followed by it was outsourcing and therefore could not be compared to the assessee having an in-house business model
- Crossdomain was to be excluded as comparable owing to the fact that it was engaged in distinct activities such as payroll services, KPO services, development of products etc. which was functionally different to the activities of the assessee.
- Pentamedia Graphics was wrongly excluded by the TPO merely because it incurred multimedia development expenses whereas the company incurred such expenses in the prior AY as well and the TPO had accepted the company to be comparable.

4. Aggrieved, the Revenue filed an appeal before the Hon'ble Court.

Held

1. Vis-à-vis the Tribunal's exclusion of Accentia Technologies Ltd., the Court noted that the Tribunal had excluded the company based on findings of fact i.e. that it was performing functionally different activities and that the merger undertaken by it impacted its profits and noting that the Revenue did not bring anything on record to controvert those findings, upheld the Tribunal's decision.

2. As regards Coral Hubs Ltd., it held that the Tribunal's basis for exclusion was a finding of fact which was not shown to be perverse by the Revenue and therefore held that no substantial question of law arose.

3. Further, it upheld the exclusion of Cosmic Global Ltd. noting that the Revenue failed to controvert the findings of the Tribunal and failed to prove that in spite of the business model being different the company was comparable to the assessee.

4. It held that Crossdomain Solutions Ltd. was also rightly excluded by the Tribunal as the finding of fact of the Tribunal i.e. that it was engaged in KPO services was not shown to be perverse.

5. Vis-à-vis Pentamedia Graphics, it held that since the Revenue was unable to indicate any reason as to why the company was excluded in the year under review whereas it was accepted in the prior year absent any change in circumstances, the Tribunal was justified in including the company as comparable.

6. Observing that no substantial question of law arose, it dismissed the Revenue's appeal.

4. Payments made by the assessee to a non-resident on account of reimbursement of expenses are not liable to deduction of tax at source

Pr. CIT vs. Organizing Committee Hero Honda FIH World Cup – TS-165-HC-2018 (Del.) – ITA No. 353 / 2018

Facts

1. The assessee entered into a contractual relationship with the Federation of International Hockey ('FIH') for organising the Men's Hockey World Cup as per which FIH was to act as the facilitator. The assessee made a reimbursement to FIH on account of pay-outs made by FIH on the assessee's behalf on which no TDS was deducted.

2. The AO was of the opinion that the reimbursements included commission paid by the assessee and therefore the assessee ought to have deducted TDS and accordingly disallowed the payments invoking Section 40a(ia) of the Act.

3. The CIT(A) accepted the assessee's contention that the payments were reimbursements and deleted the disallowance, which was upheld by the Tribunal.

4. Aggrieved, the Revenue filed an appeal before the Hon'ble Court

Held

1. The Court upheld the findings of the lower authorities and further noting that the lower authorities had observed that the assessee had no privity of contract with the service provider, dismissed the Revenue's appeal observing that no substantial question of law arose therefrom.

5. Companies earning income from software as well as BPO services and not having segmental data and companies having declining revenues could not be compared to the assessee engaged in providing software development services

Steria India Ltd. vs. DCIT – (2018) 92 taxmann.com 120 (Del.) – ITA No. 403 of 2017

Facts

1. The assessee was engaged in providing software development services to its AE which it benchmarked under TNMM.

2. The TPO rejected some of the comparables of the assessee and added 16 of his own comparbales.

3. The DRP excluded 3 of the TPO's comparables and confirmed the others.

4. Aggrieved, the assessee filed an appeal before the Tribunal contending that the TPO incorrectly selected Thirdware Solutions Ltd. as a comparable and incorrectly excluded CG Vak Software & Exports Ltd and Quintegra Solutions from the list of comparables. Vis-à-vis Thirdware Solutions Ltd, the Tribunal observed that the company earned income from various

sources viz. Export from SEZ Units, Exports from STPI Units, Revenue from subscription of sale of licence and software services and that the TPO had only considered the overseas segment of the company which encompassed only export of software service and therefore the Tribunal held that the company was to be taken as a comparable.

Vis-à-vis CG Vak, the Tribunal held that the TPO was justified in excluding the company from the list of comparables as the company earned income from IT enabled services which included BPO services along with software development services and therefore in the absence of segmental results, it could not be considered as comparable. Further, it noted that the company did not satisfy the employee cost filter.

With regard to Quintegra Solutions Ltd., the Tribunal held that the TPO was justified in excluding the company as its sales were on falling trend and it was regularly incurring losses as borne out from the P&L account

5. Aggrieved, the Revenue filed an appeal before the Hon'ble Court.

Held

1. The Court upheld the findings of the Tribunal and held that no substantial question of law arose. Accordingly, it dismissed assessee's appeal.

D. TRIBUNAL

6. Income earned from domain registration services was taxable as Royalty

Godaddy.com LLC vs. ACIT – [2018] 92 taxmann.com 241 (Delhi - Trib.) – IT Appeal No. 1878 (Delhi) of 2017

Facts

1. The assessee-company was engaged as accredited domain name registrar authorized by Internet Corporation for Assigned Names and Numbers ('ICANN'). The assessee had income from domain registration fees which was claimed to be not taxable in India.

2. The Assessing Officer held that the receipt of the assessee was royalty as the customers of the assessee used the server of the assessee through domain name registration. The DRP confirmed the AO's order.

3. Aggrieved, the assessee filed an appeal before the Hon'ble Tribunal

Held

1. The Tribunal relying on the decision of *Satyam Infoway Ltd. vs. Siffynet Solutions (P.) Ltd. AIR 2004 SC 3540* held that the domain name is a valuable commercial right and it has all the characteristics of a trademark and accordingly, it held that the domain names are subject to legal norms applicable to trademark. Accordingly, it held that the rendering of services for domain registration was rendering of services in connection with the use of an intangible property which was similar to trademark and, therefore, charges received by the assessee for said services rendered in respect of domain name was royalty within the meaning of clause (iii) of Explanation 2 to section 9(1)(vi).

7. Where the assessee was not an eligible assessee as defined under Section 144C(15) of the Act, no draft assessment order could be passed. Accordingly draft order as well as consequential final assessment order were set aside

ESS Distribution (Mauritius) vs. ADIT – TS-248-ITAT-2018(DEL.)-TP - ITA Nos. 5133 & 5134/ Del./2010

Facts

1. The assessee, a non-resident firm, was engaged in the business of distribution of programming services by non-standard

television. The AO issued a notice under Section 148 of the Act pursuant to which a TP reference was made. However, no TP addition was made. The AO passed a draft assessment order on December 30, 2009 which was upheld by the DRP. Thereafter, AO passed the impugned final assessment order on September 20, 2010.

2. Aggrieved, the assessee filed an appeal before the Hon'ble Tribunal and raised an additional ground before ITAT urging that an invalid draft order was passed and, further, such order was barred by limitation.

Held

1. The Tribunal observed that the final assessment order was passed on September 20, 2010. Referring to the third proviso to Sec 153, the Tribunal stated that where notice u/s 148 was served on the assessee or after the first day of April, 2006 but before first day of April, 2010 and reference u/s 92CA was made on or after June 1, 2007, then, the period of limitation would be 21 months from the end of the financial year in which notice u/s. 148 was issued. Considering that the notice u/s. 148 was issued on June 10, 2008 and reference u/s. 92CA was made thereafter and the order passed by the TPO was dated September 7, 2009, the Tribunal held that the period of 21 months from the end of the financial year 2008-09 would expire on December 31, 2010 and since the assessment order was passed on September 20, 2010, it held that the assessment order could not be considered as barred by limitation.

2. Vis-à-vis the correctness of passing a draft assessment order, the Tribunal held that forwarding of a draft order was required only in the case of an 'eligible assessee' i.e. (i) any person in whose case variation was made in the income or loss returned as a consequence of the order passed by the TPO u/s. 92CA(3) of the Act or (ii) a foreign company. The Tribunal held that since the assessee was a non-resident partnership firm, it did not satisfy the second arm of Section 144C(15) and therefore could not be classified as a foreign company. Noting that TPO had not proposed any variation in the income arising from the international transactions, it held that even the first condition under Section 144C(15) of the Act would also not apply. Accordingly, it held that the assessment should have been completed under Section 143(3) of the Act and accordingly set aside the draft order and the consequential final assessment order.

8. Payment for intellectual property rights utilised in India for manufacture of exported goods – Held to be taxable as Royalty in India – Exception provided in Section 9(1)(iv)(b) – Payment disallowed under Section 40(a)(i) r/w Section 195

Dorf Ketal Chemicals LLC vs. DCIT (ITA No. 4819/Mum/2013) – Taxsutra.com – Assessment Year: 2009-10

Facts

1. The assessee is Limited Liability Company incorporated in the U.S. and also a 100 per cent subsidiary of an Indian company. By virtue of the shareholding pattern and management control in India, the assessee is also treated as a tax resident of India. Therefore, the assessee is assessed to tax as LLC in the U.S. as well as a tax resident in India. The assessee engaged in the business of trading of speciality chemicals like fuel, additives and plasticising. The assessee was filing its returns in India as a resident company.

2. The assessee has acquired certain patents and copyrights in the U.S. By virtue of the patents, trademarks, and technology obtained by IP purchase agreements with certain U.S. entities, the assessee gets the products manufactured from the holding company in India. The assessee has also got a certain customer base in U.S. Products manufactured in India by the holding company and supplied to the assessee are sold in the U.S. only, and nothing is sold in India.

3. As per the terms and conditions of the agreement, the assessee has to pay a royalty to U.S. company. The basis of royalty payment is not a lumpsum amount but it is determined as a fixed percentage of the sales made in U.S. Tax was not deducted under Section 195 of the Act by the assessee on the payments of royalty to U.S. Company.

4. The Assessing Officer (AO) has disallowed the royalty payments by invoking Section 40(a)(i) read with Section 195 of the Act. The AO held that by virtue of provisions of Section 9(1)(vi) of the Act, the payment of royalty by the assessee to U.S. company constitutes chargeable income, on which, the tax is liable to be deducted under Section 195 of the Act. The AO observed that the patents, trademarks, and technology used for the manufacture of the products were utilised in India. The holding company was having full and unconditional access to technical know-how and information regarding manufacturing procedure and technology, and it had been used for the purposes of its manufacture in India.

5. On appeal, the Commissioner of Income Tax (Appeals) [CIT(A)] observed that the patents/IPRs in the case of the assessee were utilised for a manufacturing activity in India and the rest of the activity had to be viewed as an export of the said products for marketing in the U.S. Consequently, the disallowances of royalty payments in terms of Section 40(a)(i) read with Section 195 were confirmed.

Decision

On Appeal, the Tribunal held in favour of the Department as follows:

1. The Tribunal agreed with the CIT(A) that the payment does not fall under the exception provided in Section 9(1)(vi)(b) of the Act 2. Although the assessee is incorporated in the U.S. and it has entered into an agreement with the U.S. company for purchasing, utilising patent, IPR, etc. there is a clear business connection with India. The said patent/copy right were used by the assessee's holding company in India for the manufacture of the products which were sold in the U.S. Therefore, there is a business connection with India.

2. The relationship between the assessee and the holding company cannot be deemed to be a relationship of a mere contract manufacturer. The facts of the case clearly indicate that the assessee is also a tax resident in India, for the purpose of income tax and, therefore, the assessee has utilised the patents IPRs in India and the products so manufactured with the aid of patents and IPRs are in reality exported to U.S. Hence, the CIT(A)'s analogy is correct that assessee has merely carried out the marketing of the products which are exported by the assessee.

3. The patent/IPRs are utilised for manufacturing activities in India and the rest of the activity, i.e., sale in the U.S. has to be viewed in conjunction with this activity and the same cannot be isolated. Hence, the CIT(A) is correct in disallowing of the royalty payment in terms of Section 40(a)(i) read with Section 195 of the Act.

4. The decision of the Supreme Court in the case of *DIT vs. Ishikawajima – Harima Heavy Industries Ltd. [2007] 158 Taxman 259 (SC)* is distinguishable to the facts of the present case. Similarly, the decision in the case of *CIT vs. Aktiengesellschaft Kuhnle Kopp and Kausch [2003] 262 ITR 513 (Mad.)* was also distinguishable on the facts of the present case.

5. Services were rendered in India as well as utilised in India. Accordingly, it has been held that payment of royalty is liable for disallowance in terms of Section 40(a)(i) of the Act.

Note

1. The issue with respect to the taxability of royalties paid by one foreign entity to another foreign entity and whether the foreign entity carries on business in India have been subject matters of debate before the courts.

2. The Delhi Tribunal in the case of *Havells India Ltd. vs. ACIT [2011] 140 TTJ 283 (Del.)* held

that where services have been rendered outside India and have been utilised for the purpose of making or earning any income from any source outside India, such payments would fall outside the purview of Section 9(1)(vii) of the Act and will not be deemed to accrue or arise in India.

3. Subsequently, the Delhi High Court in the case of *CIT vs. Havells India Ltd. [2013] 352 ITR 376 (Del)* overruled the said decision and laid down that it is not the payer of income but the location of the manufacturing activity and concluding of the export contract from India that will determine the source of income. The High Court held that the assessee's case does not fall within the second exception provided in Section 9(1)(vii)(b) of the Act and the FTS paid is taxable under the Act.

4. However, the Delhi High Court in the case of *DIT vs. Lufthansa Cargo India [2015] 375 ITR 85 (Del)* India has held that the expenses incurred outside India in respect of services utilised for the purpose of making or earning any income from a source outside India is not subject to tax in India, and so there is no requirement to withhold tax at source in India.

5. Further, the Chennai Tribunal in the case of *Aqua Omega Services (P.) Ltd. vs. ACIT [2013] 31 taxmann.com 179 (Chen)* held that the services of non-residents to whom the technical fee was paid by the assessee were utilised for the business which was carried on outside India for earning income from a source outside India. It was covered by the exception of Section 9(1)(vii)(b) and hence, the amount was not taxable in India.

6. The Tribunal in the present case held that the royalty payment made overseas for acquiring technical assistance and intellectual property is liable for withholding of tax in India since royalty paid for patent/IPRs are utilised for manufacturing activities in India. Although the assessee is incorporated in the U.S. and has entered into an agreement with U.S. company for purchasing, utilising patent, IPR, etc. there is a business connection with India.

9. India-Singapore DTAA – Marketing and business development services – Whether FTS – Held not in the nature of FTS and in the absence of a PE under the India-Singapore tax treaty, such services are not taxable in India

Fractal Analytics Pvt. Ltd. vs. DCIT [2018-TII-81-ITAT-MUM-INTL] / [TS-107-ITAT-2018 (Mum)] Assessment Year: 2008-09

Facts

1. The assessee is engaged in the business of providing of predictive analytics for the retail financial services, insurance, consumer packaged goods, and telecom. During the Assessment Year 2008-09, the assessee engaged Fractal Singapore (FS), its wholly-owned subsidiary, for providing marketing and business development services to it.

2. The assessee had entered into an agreement with FS for providing customer co-ordination services on its behalf. As per the agreement, FS had agreed to provide various services to the assessee, i.e., general market information, conducting market studies and research, preparing market reports, providing assistance to the assessee in identifying the potential customers and establishing communication with them, assisting the assessee in developing marketing collateral such as brochures, CDs, presentations for potential customers, conducing meeting and holding discussions with potential customers based on the instructions provided by assessee and assisting assessee in finalisation of the commercial terms with the prospective customers. The Singapore entity did not have the authority to conclude any agreements or make any commitments on behalf of the assessee.

3. The Assessing Officer (AO) held that the payments made to FS were taxable as FTS under the provisions of Section 9(1)(vii) of the Act since it was a consideration for the services in the

nature of managerial, technical, or consultancy. The AO also held that the same would also be taxable under the tax treaty. The AO held that the assessee was liable to deduct tax as per the provisions of the Act, but since the assessee did not deduct tax, the payment is liable for disallowance under Section 40(a)(i) of the Act.

4. The Commissioner of Income Tax (Appeals) upheld the order of the AO.

Decision

On Appeal, the Tribunal held in favour of the Assessee as under:

1. A perusal of services reveal that FS was helping the assessee in the areas of business development, the services were being provided from Singapore. It is a fact that FS had no PE in India and it had no authority to conclude any contract on behalf of the assessee.

2. It has been observed that the terms managerial/technical/consultancy have not been defined either under the tax treaty or under the Act, so interpretation based on dictionary meaning and judicial pronouncement had to be applied. The definition of the term FTS connoted that the services envisaged must involve a degree of skill and expertise on the part of the service provider and comprise administrative, technical or advisory work.

3. The Tribunal observed that the marketing services are an art rather than a science. The same are wholly dependent on the skill of the employees and other personnel engaged in marketing activity. On reference to the terms of the agreement entered into by the assessee with FS, it becomes clear that that the services rendered by FS could not be said to have applied methods which were used in a particular activity. The marketing services would not follow a common set of methods but were rendered using various tactics and negotiation strategies. The same were personal in nature and not technical.

4. The services provided by the employees of FS to the assessee do not fall under the category of managerial services in nature. The services provided by the employees of FS to assessee did not also fall under the category of technical services. The expression consultancy service involved giving of an advice or advisory services by a professional. However, the assessee did not seek any sort of advice from FS, and hence the services provided by the employees of FS to the assessee would not fall under the category of consultancy also. In short, the services provided by FS did not fall under the category of 'managerial', 'technical' or 'consultancy' in nature.

5. It has been held that the requirement of Article 12 of tax treaty, i.e., making available of services in the nature of managerial, technical or consultancy was not satisfied. For a service to be made available, the service recipient should be able to make use of the knowledge, by itself in its business for its benefit and without the recourse to the service provider in future and for this purpose a transmission of the skill from the service provider to the service recipient is necessary.

6. The Tribunal held that the services availed by the assessee were in the nature of marketing, business development and customer co-ordination support services provided by FS and those services were rendered by employees of FS outside India. The assessee was not enabled to independently perform such functions and had only consumed the services of FS. The expertise and knowledge would still remain with FS. So, it can safely be said that the assessee was only reaping the rewards of the functions carried out by FS and was making payment for availing such services and not towards the skill of business development or marketing as such skills had not been made available to the assessee by the non-resident entity.

7. The Tribunal held that payment made by it to FS was business income of FS. However, since FS did not have PE in India and the services

were rendered outside India, payment received by the FS was not taxable in India.

8. Considering the above, the Tribunal held that business development expenses paid to FS were neither taxable in India as FTS under Article 12 of tax treaty nor was it taxable as business income under Article 7 of the tax treaty. Accordingly, there was no liability to withhold taxes on such payments, and it was not a disallowable expenditure under Section 40(a)(i) read with Section 195 of the Act.

Note

1. The taxability of FTS has been a matter of debate before the Courts/Tribunal from a long time because different interpretations have been given by various courts with regard to the scope and meaning of FTS.

2. The Bangalore Tribunal in the case of *ABB Inc vs. DDIT [2015] 69 SOT 537 (Bang)* held that business development, market services, and other support services do not 'make available' technical knowledge and skill hence it is not taxable as Fees for Included Services (FIS) under the India-US tax treaty. Similarly, the Mumbai Tribunal in the case of *ITO vs. Skill Infrastructure Ltd. [2015] 70 SOT 176 (Mum.)* held that payment for evaluating the business opportunities in India do not qualify as FTS under the provisions of India- U.K. treaty since these services did not 'make available' any technical knowledge, skill or experience to the assessee.

3. However, the Chennai Tribunal in the case of *Tractors & Farm Equipment Ltd. vs. ACIT [2018] 89 taxmann.com 445 (Chen.)* held that payment to a U.S. company for marketing development expenditure including market survey expenditure is taxable as FIS under Article 12(4) of the India-US tax treaty since such services make available technical skill to the assessee.

4. The Mumbai Tribunal in the present case has held that marketing and business development services are not in the nature of FTS. The payment for such services is in the nature of business income. Since the foreign entity does not have a PE in India, such business income is not taxable under the India-Singapore tax treaty.

❍❑❍

Rohit Jain, *Advocate* & CA Gourav Sogani

INDIRECT TAXES
GST Gyan

Affordable Housing made more affordable – Part II

It's been over ten months that Goods and Services Tax ('GST') has been implemented in India. These ten months have been action packed in terms of various amendments made after implementation of GST, export transaction related changes, and rate and compliance related changes amongst others. It must be appreciated that the Government has also been very quick in responding to the changes to address the issues faced by the industry. The pace at which the Notifications have been released, the monthly meetings of the GST Council and the Frequently Asked Questions (FAQs) and Tweets by the Government clearly indicate the understanding of the Government that the new legislation has come with its own set of teething issues.

Amongst these various changes, one sector that has been making efforts to keep up its pace with the ever-evolving GST legislation is the real estate sector. Considering the inherent nature of the sector, while efforts have been made to reduce the complexities, there are several key aspects which appear to be unaddressed, or consequences which are unintended. In this article, we have tried and looked into the affordable housing schemes (called 'verticals') under Pradhan Mantri Awas Yojana – Housing for all (Urban) ('PMAY Scheme') to which concessional rate of GST benefit is available. Considering the various aspects to be covered under the Article and for the better understanding of each aspect, it is divided into three parts –

I. PMAY Scheme

II. Tax benefits to PMAY Scheme

III. Practical issues and concerns

I. PMAY SCHEME

PMAY Scheme is one of the flagship initiatives of the NDA Government with the objective to construct and build affordable pucca houses with basic necessary infrastructure such as water facility, sanitation and electricity supply round-the-clock for which the Government is leaving no stone unturned. The Government has been continuously and aggressively working on the path to achieve the target of housing for all by 2022 by giving away plethora of benefits to affordable housing schemes.

The PMAY Scheme was first introduced in 2015 wherein people in the Economic Weaker Sections (EWS) and Low-Income Group (LIG) were covered. However, realising the huge gap which needs to be addressed in the housing segment, Government decided to include the Mid-Income Group (MIG) in some of the verticals of PMAY Scheme. Currently, PMAY Scheme has four verticals –

1. Affordable Housing in Partnership
2. *'In-situ'* slum redevelopment
3. Credit linked subsidy Scheme
4. Beneficiary-led individual house construction or enhancement

The people who qualify to avail the benefits under the PMAY Scheme ('beneficiary') re divided into following four categories based on their household income -

a) EWS – Household with annual income up to ₹ 3 lakh

b) LIG – Household with annual income over ₹ 3 lakh but not more than ₹ 6 lakh

c) MIG I – Household with annual income over ₹ 6 lakh but not more than ₹ 12 lakh

d) MIG II – Household with annual income over ₹ 12 lakh but not more than ₹ 18 lakh

We will now discuss each vertical under PMAY in detail.

1. Affordable Housing in Partnership

The first vertical in PMAY Scheme is Affordable Housing in Partnership. This vertical was introduced keeping in mind the public private partnership model wherein the Government will provide the land and other necessary support in form of subsidy, tax benefits etc. to the Developer who will be required to undertake the Project providing EWS Houses to the beneficiaries falling under EWS category. Under this vertical, financial assistance is also provided to EWS houses built in partnership with States/ Union Territories (UTs)/ Urban Local Bodies/ Parastatals. Some of the key conditions which are necessary to be complied with for a Project to qualify under the vertical is as follows –

a. <u>EWS Houses</u> – At least 35% of the houses in the Project should be for EWS category i.e., having carpet area up to 30 sq. mtrs.

b. <u>Number of units</u> – Project should be having at least 250 units.

c. <u>Sale Price</u> – Upper ceiling on the sale price is determined by the State Government.

d. <u>Project Report</u> – Project Report is prepared by Implementing Agency and approved by State Level Sanctioning and Monitoring Committee ("SLSMC").

e. <u>Allotment</u> – Procedure for allotment of houses to eligible beneficiaries is approved by SLSMC.

2. *'In-situ'* slum redevelopment

Slum redevelopment has been part of the Government agenda even during the UPA Government and was the key scheme of Rajiv Awas Yojana. The objective of this vertical is to raise the standard of living of slum dwellers, ameliorate their problems as well as enhance hygiene of the city's lifestyle. The Government paved way for using land as a resource for *in-situ* rehabilitation of slum dwellers; without creating any financial burden on the Government. The Government typically notifies an area as slum and provides for demolition of slums on its own or engaging a private developer for *in-situ* construction of a building in which tenements are allotted to slum dwellers. Such land could be a Government land or a private land. Apart from financial assistance of ₹ 1 lakh per unit, the Project is made financially viable for Developers by providing additional FSI / TDR in return of construction activities undertaken by them. It is important to note that the selection of Private Partner is through 'open bidding process' and the tenements constructed under the Project are allocated to the registered slum dwellers by the appointed authorities of the PMAY Scheme.

3. Credit Linked Subsidy Scheme

Credit Linked Subsidy Scheme (CLSS) is a demand side intervention wherein eligible beneficiary can seek interest subsidy on housing loans from Banks, Housing Finance Companies, and other notified institutions for acquisition of house or for construction of new house. The interest subsidy will be credited upfront to the loan account of the beneficiary. The Government has set out the upper limit of the interest subvention, loan amount and loan tenure for each category of beneficiary.

It is important to note that in case a beneficiary avails interest subvention under this Vertical but later switches to another Primary Lending Institution for balance transfer, such beneficiary will not be eligible or claim the benefit of interest subvention again.

4. Beneficiary-led individual house construction or enhancement

Under Beneficiary-led individual house construction or enhancement the eligible families belonging to EWS categories are provided assistance to either construct new houses or enhance existing houses on their own. Such families may avail of central assistance of ₹ 1.50 lakh for construction of new house or for enhancement of existing house.

Beneficiaries desirous of availing this assistance shall approach the Urban Local Body (ULB) with adequate documentation regarding availability of land owned by them. Beneficiaries in slums which are not being redeveloped can be covered under this component if they have a Kutcha or Semi-Pucca house. Based on these applications made by various beneficiaries, ULB prepare a city-wide housing project which needs to be approved by SLSMC.

II. TAX BENEFITS TO VERTICALS UNDER PMAY SCHEME

In Part-I of the Article we have discussed in detail the amendment in the Notification No 11/2017 – Central Tax (Rate) dated 28-6-2017 (as amended from time-to-time 'Original Notification') to extend the benefit of concessional rate of GST to units having carpet area up to 60 sq. mtrs. in an affordable housing project which has been given infrastructure status as defined under Notification F. No. 13/6/2009-INF dated 30-3-2017 issued by the Department of Economic Affairs [DEA Notification] (Notification No. 01/2018 Central Tax (Rate) dated 25-1-2018 ['Amendment Notification'] and the various issues / clarification awaited in the said amendments.

The tax benefit of concessional rate of GST to verticals under PMAY Scheme is covered under the Original Notification as well as Amendment Notification. It would be interesting to note that only few verticals of the PMAY Schemes were eligible for concessional rate of GST *vide* Original Notification which was later extended to all the verticals of PMAY Scheme *vide* Amendment Notification. The relevant Entry (v) ['Entry'] of the of the Original Notification (after giving effect of the amendments made by the Amendment Notification) is reproduced below –

Description of Service	Rate (%)	Conditions
3	4	5
(iv) Composite supply of works contract as defined in clause (119) of section 2 of the Central Goods and Services Tax Act, 2017, supplied by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of,- *(a)…;* *(b)…;*		

Description of Service	Rate (%)	Conditions
3	4	5
*[(c) a civil structure or any other original works pertaining to the "In-situ redevelopment of existing slums using land as a resource, under the Housing for All (Urban) Mission/ Pradhan Mantri Awas Yojana (Urban)] **[SUBSTITUTED vide Amendment Notification]** (d) a civil structure or any other original works pertaining to the "Beneficiary led individual house construction / enhancement" under the Housing for All (Urban) Mission/Pradhan Mantri Awas Yojana; [(da) a civil structure or any other original works pertaining to the "Economically Weaker Section (EWS) houses" constructed under the Affordable Housing in partnership by State or Union Territory or local authority or urban development authority under the Housing for All (Urban) Mission/ Pradhan Mantri Awas Yojana (Urban); **[INSERTED vide Amendment Notification]** (db) a civil structure or any other original works pertaining to the "houses constructed or acquired under the Credit Linked Subsidy Scheme for Economically Weaker Section (EWS)/ Lower Income Group (LIG)/ Middle Income Group-1 (MIG-1)/ Middle Income Group-2 (MIG-2)" under the Housing for All (Urban) Mission/ Pradhan Mantri Awas Yojana (Urban)] **[INSERTED vide Amendment Notification]** (e)… (f)… (g)…	6%	

(Note: Similar Notification has been issued by the State Authorities under Maharashtra Goods and Services Tax Act, 2017)

It is imperative to note that the Paragraph 2 of the Original Notification was amended to extend the abatement towards land for the units sold under the verticals which involves transfer of land and hence in all such instances the effective rate of GST would be @ 8%.

The first and foremost condition to avail the concessional rate of GST under any vertical is that the activity should be in relation to 'civil work' or 'any other original work'. Both these terms are not defined in the Central Goods and Services Tax Act, 2017 (CGST Act) and Rules made thereunder or in the Original Notification or any subsequent Notification which amended the Original Notification. A logical interpretation for 'civil work' could be by way of recourse to the dictionary meaning and common parlance test. For *'original works'* one may continue with the similar possible interpretation as explained in Part I of the Article i.e. relying on the definition provided in the Service Tax (Determination of Value) Rules, 2006. Now let's examine the tax benefit under each vertical –

1. Affordable Housing in Partnership

In terms of the Amendment Notification, a person undertaking composite supply of works contract in the nature of civil work or any other original work in a Project which fulfils the conditions specified under the PMAY Scheme which *inter alia* include the key conditions stated in this Article, will be eligible to avail the benefit of concessional rate of GST in respect of the units which are constructed for EWS category. Other units in the Project will be liable to normal rate of GST as applicable, currently 18% or 12%, as the case may be.

2. In-situ slum redevelopment

The benefit of concessional rate of GST has been made available in respect of the units constructed under the 'In-situ' slum redevelopment Project. It would be interesting to know that tax benefit was already available even under the Original Notification issued in June 2017 but only to the existing members of the Project. The said restriction was later removed *vide* Amendment Notification thereby extending the scope of the concessional rate to all the members of the Project. This was the real game changer for the Developer who were willing to undertake the Project under this vertical of PMAY Scheme.

3. CLSS

It is one of the most interesting additionss to the Original Notification. The benefit of concessional rate of 12%/8% (as the case may be) has been extended to works contract services of original works which *inter alia* includes construction of units bought by beneficiaries under the PMAY Scheme who are availing subsidized loan under CLSS. The said vertical is igniting a lot of interest among the Developer community having projects in the suburbs of metros or in tier II and III cities where the ticket size is generally ₹ 50 lakh which fit in the budget of the targeted audience i.e. beneficiaries under PMAY Scheme.

4. BIHC

The benefit under BHIC can to be segregated in two parts –

a) Pure Labour Service – In terms of Notification No. 12/2017 – Central Tax (Rate) dated 28-6-2017, a contractor is exempt from the payment of GST in respect of a pure labour contract undertaken for BHIC vertical. The relevant extract is of the Notification is reproduced below

Chapter, Section, Heading, Group or Service Code (Tariff)	**Description of Service**	**Rate (%)**	**Conditions**
2	**3**	**4**	**5**
Heading 9954	*Services provided by way of pure labour contracts of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of a civil structure or any other original works pertaining to the beneficiary-led individual house construction or enhancement under the Housing for All (Urban) Mission or Pradhan Mantri Awas Yojana.*	*Nil*	*Nil*

b) Composite supply of works contract – In case the contract is composite supply of works contract involving supply of goods and services than instead of complete exemption, the benefit available is of reduced rate of GST.

Apart from the GST benefit, the legal entity undertaking the Project may also be eligible to avail the income tax benefit under Section 80IBA of the Income-tax Act, 1961 which is a profit linked deduction. The legal entity will be allowed to avail 100% deduction of profit derived from business of developing and building a housing project which is approved by a Competent Authority after June 1, 2016 but on or before March 31, 2019 and completed with 5 years from the date of first approval. One of the condition to avail the credit is the carpet area of the unit in the Project. In case of a Project located in a metro city, carpet area of the unit should not exceed 30 sq. mtrs however for other places the restriction is 60 sq. mtrs. of carpet area. Therefore, subject to fulfilment of other conditions prescribed under the said Section, the legal entity undertaking affordable housing project covered under Entries

(iv) & (v) of the Original Notification will also be eligible to avail the deduction under the Income -tax Act.

PRACTICAL ISSUES AND CONCERNS

1. 'In-situ' slum redevelopment

This is one of the most sought-after vertical considering the benefit which is available to the Developer. In order to qualify as a 'In-situ' slum redevelopment project under the PMAY Scheme it needs to be registered and approved by the relevant authority of PMAY Scheme. It is imperative to note that almost all the slum redevelopment schemes undertaken in Maharashtra are approved by the Slum Rehabilitation Authority (SRA) formed under the Maharashtra Slum Areas (Improvement, Clearance and Redevelopment) Act, 1971 which are unfortunately not covered under this vertical of 'in-situ' sum redevelopment. Consequently, the benefit of reduced rate of GST under the Entry is not available to the Project approved by SRA. Therefore, though being a great offering from the Government, the exclusion of SRA projects is turning out of the biggest hurdle in the success of this vertical in Maharashtra. Considering the fact that the process of identifying, approving and monitoring the project under SRA and 'In-situ' slum redevelopment of PMAY Scheme is very similar, the Maharashtra Government has approached the Centre to include SRA projects under the vertical however no decision has been taken in this regard.

2. CLSS

On the overall reading of the PMAY Scheme, it appears that the onus of proving eligibility to avail subsidized loan is on the beneficiary and the financial institution disbursing the loan whereas the Developer *per se* has no obligation to check the eligibility of the customer. In spite of this, Developer may be held liable to oversee the fulfilment of other conditions especially related to unit size. Another grave practical difficulty which is being faced by the Developer is monitoring the customers availing the benefit of concessional rate under this vertical. Similar to Affordable Housing in Partnership the benefit is available only to the units in respect of which subsidized loan has been sanctioned by the financial institution. In case of Project having large number of units, the monitoring becomes all the more tedious and the chances of oversight increases manifold. To avoid such error, the Developer need to have a robust system with adequate checks in place on the customers availing the concessional rate benefit. Any flaw in the system may have effect of the payment of tax by the Developer from its own pocket being the supplier of service. Therefore, the Developer needs to be vigilant in availing the concessional rate of GST under the CLSS vertical.

3. Affordable Housing in Partnership & BHIC

As of now, these verticals have not yet been able to garner much interest from the Industry considering the compliance requirement under these verticals in comparison with the benefits available.

Overall, the efforts made till date by the Government for the success of the PMAY Scheme is palpable and praiseworthy. However, to expedite the process and thereby achieving desired objective of providing housing for all by 2022, Government may be required to take more pragmatic approach in implementation of the affordable housing schemes by addressing the concerns and issues faced by the Developer / Contractor and formulating more friendly and exciting tax sops.

DISCLAIMER: This article has been authored by Rohit Jain, who is a Partner at Economic Laws Practice (ELP), Advocates & Solicitors and Gourav Sogani, who is an Associate Director at ELP Consultants Private Limited. They can be reached at rohitjain@elp-in.com or gouravsogani@elp-in.com for any comment or query. *The information provided in the article is intended for informational purposes only and does not constitute legal opinion or advice. Readers are requested to seek formal legal advice prior to acting upon any of the information provided herein.*


CA Ashit Shah and CA Kush Vora

INDIRECT TAXES
GST – Legal Update

A. Central Goods & Services Tax (CGST)

1. **Amendment to GST Rules — Fourth Amendment Rules** (Notification No. 21/2018 dated 18-4-2018)

Vide Notification No. 21/2018, the Government has further amended CGST Rules as under:

- The refund definition under Rule 89(5) has been amended so as to include refund on account of inverted duty supply of services as well. Earlier the Rule restricted refund of inverted supply of goods only. Further, changes are made in definition of words 'Net ITC' and 'Adjusted total turnover' in lines with those present in Rule 89(4).
- Amendments have been made in Rule 97 pertaining to Consumer Welfare Fund
- In Form GST ITC-03, in Table 5(e), instructions have been amended
- Final return in Form GSTR-8 has been prescribed

B. Maharashtra Goods & Services Tax (MGST)

1. ***Notification No. 15C/2018–State Tax (Maharashtra)***

Maharashtra Government has postponed the implementation of E-Way Bill for intra State movement of goods (within State) to 31st May, 2018 instead of earlier date of 1st May, 2018.

C. Circulars

1. ***Circular 39/2018 dated 3-4-2018 (IT Grievance Redressal Mechanism of technical glitches)***

It has been clarified *vide* this circular that IT-Grievance Redressal Mechanism shall be established to address the difficulties faced by a section of taxpayers owing to technical glitches on the GST portal and the relief that needs to be given to them. The scope, identification of issues, nodal officers legal issues have been elaborated in the Circular.

Further, it has been decided that all such taxpayers, who tried but were not able to complete TRAN-1 procedure (original or revised) due to IT-glitch, shall be provided the facility to complete TRAN-1 filing. However, only identified taxpayers shall be allowed to complete the process of filing TRAN-1. Furthermore, it has been clarified that the taxpayers shall complete the process of filing of TRAN 1 stuck due to IT glitches, by 30th April, 2018 and the process of completing filing of GSTR 3B which could not be filed for such TRAN 1 shall be completed by 31st May, 2018.

2. ***Circular 40/2018 dated 6-4-2018 (Clarification regarding online filing of LUT)***

   Vide the said circular, it is hereby clarified that manual application of Letter of Undertaking (LUT) need not be done to the GST office. Online application in RFD-11 and generation of ARN No. shall to be considered as valid LUT for entire year.

3. ***Circular 41/2018 dated 13-4-2018 (Clarification regarding interception of vehicles for inspection of goods)***

   Section 68(1) of CGST Act stipulates that the person in charge of a conveyance carrying any consignment of goods of value shall carry with him the documents and devices prescribed in this behalf. Sub-section (2) states that the details of documents required to be carried by the person in charge of the conveyance shall be validated in such manner as may be prescribed.

   In this regard, said circular is issued clarifying in details the procedure to be followed while intercepting vehicles for inspection of goods. Detailed procedure relating to movement, detention, release, confiscation of goods and conveyance have been issued. Also several forms for detention, recording statement, bond, etc. have been prescribed.

4. ***Circular 42/2018 dated 13-4-2018 (clarification regarding recovery of arrears under existing law and reversal of inadmissible ITC)***

   This circular deals with issues relating to the recovery of arrears of Central excise duty, service tax, CENVAT credit carried forward erroneously and related interest, penalty or late fee payable arising as a result of the proceedings of assessment, adjudication, appeal etc. initiated before 1-7-2017 under the provisions of the existing law. Various different scenarios have been envisaged and the departmental stand on the same has been clarified vide this circular.

5. ***Circular 43/2018 dated 13-4-2018 (clarification regarding refund applications for UIN agencies)***

In relation to refund claims for UIN agencies, various issues were highlighted and accordingly clarifications have been provided for 2 topics as under:

– Providing statement of invoices while submitting the refund application— It has been clarified that till the system generated FORM GSTR-11 does not have invoice-level details, UIN agencies are requested to manually furnish a statement containing the details of all the invoices on which refund has been claimed, along with refund application.

– No mention of UINs on Invoices— It has been clarified that, in cases where UIN has not been recorded on the invoices pertaining to refund claim for the quarters of July-September 2017, October-December 2017 and January-March 2018, a one-time waiver is being given by the Government on a condition that copies of such invoices will be submitted to the jurisdictional officers and will be attested by the authorised representative of the UIN agency.

❍❑❍

CA Naresh Sheth & CA Piyush Jain

INDIRECT TAXES

GST – Recent Judgments and Advance Rulings

A. Decisions in respect of Writ, Special Leave Petition and other grievances

1. *JCB India Limited (and others) vs. Union of India*

Evergreen Seamless Pipes and Tubes Private Limited vs. Union of India

Avantor Performance Material India Limited vs. Union of India

(2018-TIOL-23-HC-MUM-GST)

Facts, Issue involved and Contention of Petitioner

Petitioners have challenged section 140(3)(iv) of CGST Act, 2017 prescribing time limit for transitional credit availment on the ground that same violates mandate of Article 14 and Article 19(1)(g) of the Constitution of India.

Held

CENVAT credit is a mere concession and it cannot be claimed as a matter of right. Credit on inputs under existing law itself is not absolute but a restricted or conditional right. If existing law itself imposes condition for its enjoyment or availment, then, it is not possible to agree with the Counsel that such rights under existing law could have been enjoyed and availed of irrespective of period or time provided therein. The period or outer limit is prescribed in existing law and the Rules of CENVAT credit enacted thereunder. In the circumstances, it is not possible to agree with the Counsel appearing for the petitioners that imposition of the condition *vide* Clause (iv) is arbitrary, unreasonable and violative of Articles 14 and 19(1)(g) of the Constitution of India. If right to availment of CENVAT credit itself is conditional and not restricted or absolute, then, the right to pass on that credit cannot be claimed in absolute terms. There cannot be an estoppel against a statute. Transitional arrangements that have been made have clear nexus with the object sought to be achieved and cannot be struck down as having no such relation or nexus.

2. *Builders Association of Navi Mumbai & Neelsidhi Realties v/s Union of India and Others (2018-TIOL-24-HC-MUM-GST)*

Facts, Issue involved and Contention of Petitioner

Petitioners challenged levy/collection of GST on one-time lease premium charged by CIDCO while letting plots of land on lease basis. Grievance was raised by approaching the GST Commissionerate as to how GST is collected on the above amount and demanded from petitioners. There was correspondence initiated and finally, when the authorities did not respond, petition was filed.

Held
CIDCO is a person and in course or in furtherance of its business of leasing of land for a consideration styled as one-time premium. Therefore, if one refers to Schedule II, any lease, tenancy, licence to occupy land is a supply of service. Any lease or letting out of a building, including commercial, industrial or residential complex for business, either wholly or partly is also a supply of service.

It is settled law that such provisions in a taxing statute would have to be read together and harmoniously in order to understand nature of levy, object and purpose of its imposition. No activity of nature mentioned in inclusive provision can thus be left out of net of tax. Once this law, in terms of substantive provisions and the Schedule, treats the activity as supply of goods or supply of services, particularly in relation to land and building and includes a lease, then, the consideration therefor as a premium/one-time premium is a measure on which tax is levied, assessed and recovered.

Position of CIDCO for purpose of orderly planning and development will be of no assistance in the sense while developing a new township, the objective of the planning authority is not to earn money, but to develop the area so that the purpose of setting up a township is achieved by more people wanting to live in the area in lieu of the various amenities provided in the area. It is entirely for the legislature, therefore, to exercise powers conferred by sub-section (2) of section 7 of the GST Act and issue requisite notification. Absent that notification, merely going by the status of CIDCO, we cannot hold that lease premium would not attract or invite liability to pay tax in terms of the GST Act. With respect, it cannot be said that the activities performed by sovereign or public authorities under the provisions of law, which are in the nature of statutory obligations are excluded from the purview of the present enactment.

3. Padmavati Enterprise vs. Union of India

Abicor and Binzel Technoweld Pvt. Ltd. and Others vs. Union of India

(2018-TIOL-26-HC-MUM-GST)

Facts, Issue involved and Contention of Petitioner
Petitioners had sought a writ of mandamus directing Goods and Services Tax Council to make recommendations to the State Government to extend time period for filing of GST TRAN-1 because their application was not entertained on the last date i.e. 27-12-2017. They had filed complete application for necessary transitional credit. Petitioner had submitted that despite making several efforts on last date for filing application, electronic system did not respond as a result of which petitioner is likely to suffer loss of credit that it was entitled to by passage of time. They had also submitted an application for transitional credit manually on 10-1-2018.

High Court had observed [2018-TIOL-05-HC-MUM-GST] that it is for the authorities to work out necessary mechanism and set that in place. It must also set up and establish a grievance redressal mechanism. As per Circular 39/13/2018 dated 3rd April, 2018 it is clarified that taxpayers shall complete process of filing of TRAN-1 stuck due to IT glitches by 30th April 2018 and process of completing filing of GSTR-3B which could not be filed for such TRAN-1 shall be completed by 31st May, 2018.

Given that 25th, 26th and 27th April, 2018 are the working days available before 30th April, 2018 and 30th April, 2018 is declared to be a public holiday, interest of justice would be served by extending this date in relation to filing of TRAN1 which filing was not possible due to technical glitches/IT related glitches to 10th May, 2018.

Held

In relation to these matters, this Court ought not to be flooded with writ petitions and particularly more in number than what is already on our file. We are not disturbing the date which has been determined for filing of GSTR 3B for that is prescribed as 31st May, 2018. However, given that only 25th, 26th and 27th April, 2018 are working days available before 30th April, 2018 and 30th April, 2018 is declared to be a public holiday, interest of justice would be served if we extend this date of 30th April, 2018 in relation to filing of TRAN-1 and which filing was not possible due to technical glitches/IT related glitches. We extend it to 10th May, 2018.

It is clear that this facility is extended only to those taxpayers who could not access the system due to technical glitches. It is clearly stated in the affidavit that only in the case of taxpayers who could not complete the process of TRAN1 filing either at the stage of original or revised filing due to IT related glitches, for those the facility is extended and that the last date is extended only in their case. However, those taxpayers would have to provide necessary proof of their inability to access portal due to technical glitches or IT related matter which prevented them from accessing the system earlier. This is not a facility which could be availed of for any other reason and not attributable to such glitches or system faults/errors. We accept and endorse this stand of the respondents.

The writ petitions in which complaint was that petitioners could not access system on account of no fault of theirs but due to technical glitches/ IT related glitches are disposed of in these terms.

B. Rulings by Authority of Advance Ruling

4. *Caltech Polymers Private Limited – AAR Kerala (2018-TIOL-01-AAR-GST)*

Facts, Issue involved and Query of Applicant

Applicant is a company engaged in manufacture and sale of footwear. It submitted that they are providing canteen services exclusively for their employees. Applicant is of opinion that this activity does not fall within the scope of 'supply', as the same is not in course or furtherance of its business. It is only facilitating supply of food to employees, which is a statutory requirement, and is recovering only actual expenditure incurred in connection with food supply, without making any profit.

Applicant also referred to Mega Exemption Notification No. 25/2012 - ST dated 20-6-2012 issued by the Government of India whereby services in relation to supply of food or beverages by a canteen maintained in a factory covered under the Factories Act, 1948 was exempted under the Service Tax Law.

Discussions by and Observations of AAR

From plain reading of definition of "business", it can be safely concluded that supply of food by applicant to its employees would definitely come u/s 2(17)(b) as a transaction incidental or ancillary to the main business. Since applicant recovers cost of food from its employees, there is consideration as defined u/s. 2(31) of CGST Act, 2017. Even though there is no profit as claimed by applicant on supply of food to its employees, there is "supply" as provided in Section 7(1)(a) of CGST Act, 2017.

It is true that in pre-GST period, *vide* Notification No. 25/2012 ST dated 20-6-2012 (as amended), 'services provided in relation to serving of food or beverages by a canteen maintained in a factory covered under the Factories Act, 1948 (63 of 1948), including a canteen having the facility of air conditioning or central air-heating at any time during the year' was exempted from service tax. But, there is no similar provision under the GST laws.

It is hereby clarified that recovery of food expenses from employees for canteen services provided by company would come under definition of 'outward supply' as defined u/s. 2(83) of the CGST Act, 2017, and therefore, taxable as a supply of service under GST.

Ruling of AAR

It is hereby clarified that recovery of food expenses from the employees for the canteen services provided by company would come under the definition of 'outward supply' as defined in Section 2(83) of the Act, 2017, and therefore, taxable as a supply of service under GST.

5. *Synthite industries Limited – AAR Kerala (2018-TIOL-02-AAR-GST)*

Facts, Issue involved and Query of Applicant

Applicants are in the business of trading in spices and spice products. They have two modes of transactions:

(a) Applicant receives order from a customer in USA for supply of spice products. They place a corresponding order to a supplier in China for supplying goods ordered by customer in USA. Supplier in China, based on request of applicant, ships goods directly to customer in USA. In other words, goods do not come to India. Chinese supplier issues invoice to applicant, for which, payment will be made by applicant in due course. Subsequently, applicant will raise invoice on customer in USA, and collect proceeds.

(b) Applicant is availing storage facility in form of a presidential warehouse in Netherlands for storing their products and subsequent delivery to their customers in and around Netherlands. Applicant buys materials from a company in China in bulk and stores it in warehouse in Netherlands for subsequent delivery to various customers in and around the country as small and medium lots based on demand. Material is not coming to India at any point. Chinese supplier will invoice applicant for which payment will be given in due course. Subsequently, warehouse authorities will arrange split deliveries to their various overseas customers as per their instructions. Applicant would issue invoice to ultimate customers and collect proceeds in foreign exchange

Discussions by and Observations of AAR

From a combined reading of provisions of the IGST Act, 2017, the Customs Tariff Act, 1975 and the Customs Act, 1962, it is evident that integrated tax on goods imported into India shall be levied and collected at the point when duties of customs are levied on the said goods under Section 12 of the Customs Act, 1962 i.e. on the date determined as per provisions of Section 15 of the Customs Act, 1962.

When a question regarding the leviability of IGST on High Sea Sales of imported goods and point of collection thereof was raised before the Central Board of Excise and Customs [CBEC], the CBEC by Circular No. 33/2017-Customs dated 1-8-2017 had clarified as follow:

"4, GST council has deliberated the levy of Integrated Goods and Services Tax on high sea sales in the case of imported goods. The council has decided that IGST on high sea sale(s) transactions of imported goods, whether one or multiple, shall be levied and collected only at the time of importation i.e. when the import declarations are filed before the Customs authorities for the customs clearance purposes for the first time. Further, value addition accruing in each such high sea sale shall form part of the value on which IGST is collected at the time of clearance."

Clarification given by the CBEC in above Circular regarding leviabitity of IGST and point of collection thereof in respect of high sea sales of imported goods is, *mutatis mutandis*, applicable in case of applicant.

Applicant is neither liable to GST on sale of goods procured from China and directly supplied to USA nor on sale of goods stored in warehouse in Netherlands, after being procured from China, to customers, in and around Netherlands, as goods are not imported into India at any point.

Ruling of AAR

Goods are liable to IGST when they are imported into India and the IGST is payable at the time of importation of goods into India. The applicant is neither liable to GST on the sale of goods procured from China and directly supplied to USA nor on the sale of goods stored in the warehouse in Netherlands, after being procured from China, to customers, in and around Netherlands, as the goods are not imported into India at any point.

Authors Comment

Advance Ruling Authority has clarified why IGST is not payable by applicant. However, ruling is silent why AAR is treating goods sold by applicant to parties outside India not liable to GST. Term export is defined u/s. 2(5) of IGST Act, 2017 to mean taking goods out of India to a place outside India. Sale made by applicant is not an export sales as defined u/s. 2(5) of IGST Act, 2017.

6. ***Shri. N. C. Varghese – AAR Kerala (2018-TIOL-03-AAR-GST)***

Facts, Issue involved and Query of Applicant

Applicant is engaged in purchase and cutting and removal of rubber trees from plantations of certain public sector undertakings owned by the Government of Kerala and also from private individuals in Kerala. Applicant submitted that he had participated in the e-auction for cutting standing rubber trees from State Farming Corporation Ltd. Applicant contends that tax liability of timber and firewood/fuel wood is explained under HSN Code 4401 and there is no direction to collect GST for standing trees of rubber trees which fall under HSN Code 06. But, State Farming Corporation is demanding 18% on live rubber trees.

Applicant further contends that rubber trees are soft wood and cannot be used for construction purposes, it is generally used for the manufacture of packing cases and plywood substitutes, etc. after necessary processing. Applicant further argued that in VAT period, since rubber wood is not useful for construction purposes, the Government of Kerala exempted rubber trees/rubber wood from purview of tax in order to give relief to the growers. Applicant has sought clarification on classification and rate of tax on rubber tree.

Discussions by and Observations of AAR

As per terms and conditions in the e-tender of State Farming Corporation, contractor should cut and remove the trees from the estate. Further, no other trees or fuel wood in the estate are allowed to be cut down or removed. In this case, under contract of supply, growing crops — i.e. rubber trees are agreed to be severed before supply and hence, comes under definition of 'goods'. Thus, standing rubber trees no longer remain as such. Therefore, it can only be treated as 'wood in rough form'. In GST, firewood is exempted as per HSN Code 4401. There is no differentiation between soft wood and hardwood in GST. It is hereby clarified that rate of tax on rubber wood in aforesaid transaction is 18% under HSN 4403.

Ruling of AAR

It is hereby clarified that rate of tax on rubber wood in the aforesaid transaction is 18% under the HSN 4403.

7. ***Akansha Hair & Skin Care Herbal Unit Private Limited – AAR West Bengal (2018-TIOL-04-AAR-GST)***

Facts, Issue involved and Query of Applicant

Applicant manufactures skin care preparations and wants an Advance Ruling on Classification of 33 of its products. Applicant argues that its skin care preparations are Ayurvedic Medicaments. They are meant for therapeutic or prophylactic uses, put up in packaging for retail sale and entirely correspond to description of goods under HSN 3004 [Serial No. 63 of Notification No. 1/2017-CT(Rate) dated 28-6-2017], and, therefore, taxable @12% under Schedule II.

Discussions by and Observations of AAR
Test to be applied for determining whether goods which fall broadly within description of skin care preparations are to be classified as medicaments is whether they are intended primarily for use in treatment of skin disorder or diseases and whether ingredients therein have sufficient therapeutic value. If potential of a product as a medicament to cure any skin ailments is not clear or is not established, it cannot be placed under Chapter 30 as a Medicament. AAR's observations are primarily based on *Puma Ayurvedic Herbal Private Limited (2006-TIOL-18-SC-CX).*

Medicaments are not defined under the GST Act or in the First Schedule of the Customs Tariff Act, 1975 (hereinafter the Tariff Act), with which the GST Act has been aligned for purpose of classification. Methods settled by Apex Court for determining whether a product is to be classified as medicaments for fixing the tariff should be followed as the only lawful course. Apex Court has settled for a twin test method. It means how product is understood in common parlance and whether product has been manufactured using ingredients and formula provided in authoritative textbooks of Ayurveda are two parameters for such classification. Other parameters like classification in licence issued by competent authority are relevant only in relation to and subject to twin tests discussed above. It may be mentioned in this connection that different parameters can be used based on purpose for classification. Apex Court has long settled that classification for fixing tariff should be based on how goods are understood in common parlance in commercial world.

Ruling of AAR
Preparations for the care of the skin namely, Rupam (Pimple Pack) and Pailab (Anti-Crack Cream), in list submitted by Applicant are classifiable as Medicament under heading 3004 of the Customs Tariff Act, 1975. Preparations listed as Swarnajyoti, Sunayana and Tarumitra-60 have not yet come into existence, and, therefore, no rulings are pronounced on their classification. The remaining products mentioned in the list submitted by applicant are not offered primarily as medicaments and, therefore, not to be included under heading 3004.

8. ***Switching Avo Electro Power Limited – AAR West Bengal (2018-TIOL-05-AAR-GST)***

Facts, Issue involved and Query of Applicant:
Applicant is supplier of power solutions, including UPS, servo stabiliser, batteries etc. Applicant wants a ruling on classification of supply when it supplies UPS along with battery and whether such supplies can be treated as Composite Supply within meaning of Section 2(30) of the CGST/WBGST Act, 2017 (hereinafter referred to as "the GST Act”).

Discussions by and Observations of AAR
Batteries are classified under Tariff Heads 8506 and 8507 of First Schedule of Tariff Act.

Schedule	Serial No.	Tariff Head	Description	Remarks
IV	138	8506	Primary cells and primary batteries	Omitted w.e.f. 15-11-2017 *vide* Notification No. 41/2017-Central (Rate) dated 14-11-2017
III	376A	8506	Primary cells and primary batteries	Inserted w.e.f. 15-11-2017 *vide* Notification No. 41/2017-Central (Rate) dated 14-11-2017
IV	139	8507	Electric accumulators, including separators, whether rectangular (including square)	

Basic difference between two Tariff Heads is ability of accumulators to be recharged, whereas primary cell batteries cannot be recharged. An accumulator is an energy storage device, which accepts energy, stores it and releases it when needed. Rechargeable batteries, flywheel energy storage, capacitors etc. are examples of accumulators. In common usage in an electrical context, an accumulator usually refers to a lead-acid battery. Hereinafter, battery referred to by Applicant as being supplied along with UPS will refer to these accumulators.

UPS is classified under Tariff Head 8504. It is an electrical apparatus that provides emergency power to a load when the input power source or mains power fails. UPS is typically used to protect hardware such as computers, data centres, telecommunication equipment or other electrical equipment where an unexpected power disruption could cause injuries or data loss.

Schedule	Serial No.	Tariff Head	Description
III	375	8504	Transformers Industrial Electronics; Electric Transformers; Static Convertors (UPS)

UPS serves no purpose if the battery is not supplied or removed. It cannot function as a UPS unless battery is attached. However, what needs to be considered is whether or not these two items are "naturally bundled". The stated Illustration to Section 2(30) of the GST Act refers to a supply where ancillary supplies are inseparable from principal supply and form an integral part of composite supply. But a standalone UPS and a battery can be separately supplied in retail set up. A person can purchase a standalone UPS and a battery from different vendors. Applicant himself admits that he supplies battery and UPS as separate machines as well as UPS with battery. It is, therefore, obvious that UPS and battery have separate commercial values as goods.

The contract for supply of a combination of UPS and battery, if not built as a composite machine, is not indivisible. Recipient can split it up into separate supply contracts if he chooses. Goods supplied in terms of such contracts are, therefore, no longer naturally bundled and cannot be treated as a composite supply. If a combination of goods that does not amount to a composite supply is being offered at a single price, such supplies are to be treated as mixed supplies defined u/s. 2(74) of the GST Act.

Ruling of AAR

Supply of UPS and battery is to be considered as Mixed Supply within the meaning of Section 2(74) of the GST Act, as they are supplied under a single contract at a combined single price.

9. Global Reach Education Services Private Limited – AAR West Bengal (2018-TIOL-06-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant provides Overseas Education Advisory whereby it promotes courses of Foreign Universities among prospective students for which it receives consideration in convertible foreign exchange. Applicant has tied up with various Universities all over the world. These Universities engage entities like applicant for promotional and marketing activities of courses taught by them and making prospective students aware about course fee and other associated costs, market intelligence about latest educational trend in territory and ensuring payment of requisite fees to the Universities if the prospective students decide upon pursuing any course promoted by applicant. Applicant receives consideration in form of commission from Foreign University for these services rendered to prospective students. Applicant, therefore, submits that principal supply, therefore, is the service of promoting the courses of Universities abroad, and services incidental thereto are naturally bundled to composite supply of business auxiliary services.

Applicant further states that it is not acting as an intermediary or agent in terms of Section 2(13) of the IGST Act. Place of supply should, therefore, be determined u/s. 13(2) and not u/s. 13(8)(b) of the IGST Act. Place of supply should, therefore, be location of recipient outside India. This being the case, its service to foreign Universities should be treated as export within the meaning of section 2(6) of the IGST Act.

Discussions by and Observations of AAR

Applicant is facilitating recruitment/enrolment of students to foreign Universities. Promotional service is incidental and ancillary to above principal supply and applicant is paid consideration in the form of Commission, based on performance in recruiting students, as a percentage of the tuition fee collected from the students enrolled through Applicant.

Applicant, therefore, represents University in territory of India and acts as its recruitment agent. In fact, Clause 2.1 of the Background forming part of the Agreement clearly says, "The University engages the Education Agent to be its representative to perform the Services from the commencement date in the Territory and on the terms set out in this Agreement until the Expiry date." It is, therefore, clear that whatever services applicant provisions are provided only as a representative of the University and not as an independent service provider.

Being an intermediary service provider, place of the Applicant's supply shall be determined u/s. 13(8)(b) of the IGST Act and not under section 13(2) of the IGST Act. Place of supply under above legal framework is territory of India. As the condition u/s 2(6)(iii) of the IGST Act is not satisfied, Applicant's service to the foreign universities does not qualify as "Export of Services", and is, therefore, taxable under the GST Act.

Ruling of AAR

Services of applicant are not "Export of Service" and are taxable under the GST Act.

10. Joint Plant Committee – AAR West Bengal (2018-TIOL-07-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is a non-profit organization set up by Central Government under Clause 17 of the Iron & Steel (Control) Order *vide* SO 1567 dated 7-4-1971. Applicant declares that it has not been registered under any of the repealed Acts and wants a ruling on whether it is required to be registered under the CGST/WBGST Act, 2017 (hereinafter referred to as "the GST Act").

Main source of the applicant's income is interest accrued on deposits and on loans provided from Steel Development Fund. Secondary source of income is consideration received from sale of journals and periodicals and from renting accommodation in its guest houses. Aggregate turnover from these sources well exceeds threshold of ₹ 20 lakh and makes it liable for registration u/s. 22(1) of the GST Act, provided it does not make exclusively supply of goods or services that are not liable to tax or wholly exempt from tax under the GST Act.

Discussions by and Observations of AAR

Main source of the applicant's income is interest consideration received by way of interest on services like extending deposits, loans or advances. This service is wholly exempt under Serial No. 27 of Notification No. 12/2017 - Central Tax (Rate) dated 28-6-2017 (as amended from time to time) [hereinafter referred as "Exemption Notifications for Services"]. Applicant's supplies of journals and periodicals are wholly exempt under Serial No. 120 of Notification No. 2/2017 - Central Tax (Rate) dated 28-6-2017.

Applicant states that its income is exempt u/s. 10(23C)(IV) of the Income-tax Act, 1961 and therefore, all its supplies of services should come under Serial No. 1 of Exemption Notification for Services. Exemption under Serial No. 1 of Exemption Notification for Services is available for charitable activities relating to public health of specific categories, advancement of religion, spirituality or yoga, advancement of educational programmes or skill development relating to specific categories and preservation of environment, including watershed, forests and wildlife. None of the applicant's services are eligible under this clause. Serial No. 1 of the Exemption Notifications for Services is, therefore, not applicable. However, it is stated to be charging room rent below ₹ 1,000/- per day per unit for accommodation in its guest houses, which is an exempt supply under Serial No. 14 of the Exemption Notifications for Services.

Section 24 of the GST Act requires a person to be registered under certain circumstances even if his aggregate turnover does not exceed the threshold specified u/s. 22(1) of the GST Act. Section 24 is not subject to the provisions of Section 23 of the GST Act. If a person, therefore, is not liable to be registered for making exclusively exempt supplies but is liable to pay tax under Reverse Charges under Section 9(3) of the GST Act, he shall be required to get himself registered under the GST Act, irrespective of quantum of aggregate turnover.

It is, therefore, held that Applicant is engaged exclusively in supplying goods and services that are wholly exempt from tax, and, therefore, not liable to be registered in accordance with provisions u/s. 23(1) of the GST Act, subject to condition that Applicant is not otherwise liable to pay tax under Reverse Charge u/s. 9(3) of the GST Act.

Ruling of AAR
Applicant is not required to be registered under the GST Act if he is not otherwise liable to pay tax under reverse charge under Section 9(3) of the GST Act.

11. Rod Retail Private Limited – AAR New Delhi (2018-TIOL-08-AAR-GST)

Facts, Issue involved and Query of Applicant
Applicant is in business of retail sale of sunglasses. Applicant has several retail outlets in Delhi and one such outlet is at Terminal 3 (International Departure), Indira Gandhi International Airport, New Delhi.

As a standard rule, every International Airport has a "Landside" and an "Airside". Landside area comprises of Check in counters and Baggage Drops. Airside area has aircrafts for boarding. Passenger crosses over from Landside to Airside by passing through Customs & Immigration area and then through security on to the Boarding Gates for departure. Applicant's concerned retail outlet is in the Security Hold Area on crossing the Customs & Immigrations.

Applicant supplies goods only to such passengers which have a valid international boarding pass. In few instances, where domestic passengers are travelling to a domestic destination on a transit International flight, no supply to such passengers holding a domestic boarding pass is made. Applicant is charging SGST& CGST on supply invoice issued to International passengers. However, applicant is of view that, its supply of goods to international passengers is a zero rated transaction, being 'export sale' within meaning of the same u/s. 2(5) of the IGST Act.

Discussions by and Observations of AAR
Before implementation of GST i.e. prior to 1-7-2017, according to Article 269(1) of the Constitution of India, tax on sale or purchase of goods in the course of inter-State trade or commerce was levied by Central Government and not by State Government. Further, under Article 286(1) of the Constitution of India, State Governments were not authorised to levy tax on sale or purchase of goods in the course of import into, or export of the goods out of, the territory of India.

Further, Section 5(1) of Central Sales Tax Act, 1956 defined that a sale or purchase of goods shall be deemed to take place in the course of export of goods out of territory of India, if the sale or purchase takes place after the goods have crossed the Customs Frontier of India. Since, sale of goods from duty free shops at International Airports to passengers was taking place beyond customs frontier of India, no State Government was competent to levy VAT on such goods.

Similar issue was also decided by the Hon'ble Supreme Court in case of *Hotel Ashoka (Indian Tourism Development Corporation Limited) [2012 (2) TMI 62]*. The Hon'ble Supreme Court had examined issue of levy of VAT on goods sold from duty free shops. It was observed that under provisions of Article 286 of the Constitution of India and Section 5 of the CST Act, goods which were sold beyond Customs frontiers of India, transactions had taken place in the course of import and State Government was not permitted to levy VAT on such sale or purchase of goods. It was also observed by the Hon'ble Supreme Court that as per Section 2(11) of the Customs Act, the said sale transactions had taken place outside India.

Above-mentioned decision of the Hon'ble Supreme Court does not appear to be applicable in present case as in said case, the Hon'ble Supreme Court had interpreted scope of Section 2(11) of the Customs Act, 1962 under which "Customs area" were defined. No doubt, duty free shops may be established beyond Customs Frontiers of India. However, issue in present case is whether said duty free shops are outside India i.e. whether they are "beyond airspace on territorial waters of India".

India is defined u/s. 2(56) of the CGST Act as "India means the territory of India as referred to in Article 1 of the Constitution, its territorial waters, seabed and sub-soil underlying such waters, continental shelf, exclusive economic zone or any other maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976, and the air space above its territory and territorial waters". Export of goods has been defined u/s. 2(5) of the IGST Act, 2017 as taking goods out of India to a place outside India. Hence, when goods are exported by Air, export will be completed only when goods crosses airspace limits of its territory or territorial waters of India.

It is also observed that Hon'ble Supreme Court of India, in case of *Collector of Customs, Calcutta vs. Sun Industries (1988 (4) TMI 49)* held that u/s. 2(18) of the Customs Act, 1962, export of goods out of India was completed when ship had passed beyond territorial waters of India. Since, definition of "export" u/s. 2(18) of the Customs Act, 1962 and definition u/s. 2(5) of the IGST Act, 2017 are exactly same, the ratio of judgment of Hon'ble Supreme Court of India in abovementioned case is squarely applicable in present case also.

Ruling of AAR

It is held that supply of goods to International passengers going abroad by applicant from their retail outlet situated in the Security Hold Area of the Terminal-3 of IGI Airport,

New Delhi may be taking place beyond Customs Frontiers of India as defined u/s. 2(4) of the IGST Act, 2017. However, said outlet is not outside India, as claimed by applicant but same is within the territory of India as defined u/s. 2(56) of the CGST Act, 2017 and Section 2(27) of the Customs Act, 1962. Hence applicant is not taking goods out of India and their supply cannot be called "export" u/s. 2(5) of the IGST Act, 2017 or "zero rated supply" u/s. 2(23) and Section 16(1) of the IGST Act, 2017. Accordingly, applicant is required to pay GST at applicable rates.

❍❑❍


CA Rajiv Luthia & CA Keval Shah

INDIRECT TAXES
Service Tax – Case Law Update

Citation: 2018-VIL-170-MAD (HC)-WP-ST

Case: Firm Foundations & Housing Pvt. Ltd. vs. Principal CST, Chennai

Background facts of the case
The present writ is being filed for reviewing the Order in Original and quashing it on the ground of the same being as arbitrary & illegal i.e., the petition for Hon'ble Madras High Court is for a "Writ of Certiorari".

The petitioner is engaged in the business of promotion and construction of residential apartments and complexes & the issue raised in the present writ petition concerns only the service tax liability as a builder for the period January, 2013 to March, 2015. The Show Cause Notice was issued on the petitioners alleging that petitioners were required to pay the differential service tax arising out of liability for tax payable on accrual basis as per the P&L A/c as against service tax discharged by the petitioners on realisation basis; which is in contravention to Rule 3 of POT Rules, 2011.

The petitioner argued that they have correctly discharged their service tax liability confining to the provisions of Rule 3 of the POT Rules, 2011 and demanding service tax on the revenue/ sales reflected in the P&L A/c would amount to double levy on the same amount. This is for the reason that petitioner have followed percentage completion method under Accounting Standard 7, which is prescribed for accounting of revenue for profit and loss in the financial statement by the construction industry on the basis of stage of completion. Whereas AS-7 has no relevance with payment of service tax, as service tax is governed by Finance Act and Service Tax Rules.

The Adjudicating Authority passed the Order in Original without averting to the submissions made by the petitioner and hence this present writ petition was filed.

Arguments put forth
The petitioners submitted that they have paid service tax on receipt basis and there was no short payment of service tax by them and the demand of service tax leads to double taxation on the service income for which service tax has already been paid.

The respondents reiterated their following submissions:

a) The basis of assessment stating that the computation of service tax as per the Profit and Loss account, as adopted by the respondent was perfectly in order.

b) The assessee has all along stated the method of computation in ST-3 and AS-7 but not furnished any details for the difference in value between ST-3 Return and Balance Sheet. In absence of any details, mere averment by the assessee that they had paid service tax at the time of receipt of advance is not acceptable and the allegation of the assessee that the demand of service tax results in double taxation is not correct.

Issues before Hon'ble High Court

a) Relevance of the P&L accounts of the petitioner in the determination of point of rendition of service and the method of quantification of receipts in respect thereof.

b) The application of Rule 3 of POT Rules, 2011 in the admitted facts and circumstances of the present case.

Observations of the HC

a) Rule 3 specifically provides clarity on the determination of point of taxation. Had the respondent merely applied the said Rule to determine taxability of the services rendered by the petitioner, the basis of assessment would have been perfectly in order. The flaw arises from reliance by the respondent upon the entries in the P&L account to determine the point of taxation of the services rendered and quantification thereof.

b) The financials, including the P&L account have been prepared on the basis of the Accounting Standards (in short 'AS') issued by the ICAI. In the present case, the petitioner states unambiguously in the reply to the SCN that the basis of preparation of financials as far as the income from the building project is concerned is the 'Project Completion method.

c) AS 7 deals with the recognition of income from building projects on the basis of the 'Project Completion Method'.

d) The basis of such recognition and reporting is the apportionment of the income earned and expenditure incurred over the tenure of the project. This is entirely different and distinct from the scope, object and application of the POT Rules that seeks to set out a methodology for determination of when the service was rendered and consequently when the receipt of income from such rendition be taxed.

e) The emphasis and thrust of each methodology is in alignment with the different purposes that they bear reference to – AS 7, in the context of the preparation of financials, addresses the 'how much' of the transaction over the term of contract, whereas Rule 3 of POT Rules addresses the 'when' in relation to the rendition of service for computing taxability under the Finance Act, 1994. The foundation of the assessment is thus, flawed.

f) Clause (i) to Rule 3 of POT Rules, 2011 specifically provides for determination of the point of taxation in cases of continuous supply as in the case of the petitioner herein. The petitioner enters into agreements with customers for the construction of apartments. The agreement provides for demarcated activities, described stage-wise upon the completion of which, payments are to be released by the customer. The rendition of the service results in the accrual of the receipt of consideration in respect thereof. i.e. In the present case, the admitted position is that the petitioner does not raise invoices as and when a particular landmark is reached and the accrual of the consideration stage wise is occasioned automatically upon completion of the stage of construction set out in the agreement itself.

g) The customers have remitted, in advance, the consideration relating to several of the initial landmarks as a lump-sum and that the said amount has been offered to tax. It was then incumbent upon the respondent to have, in the light of the stand adopted by the petitioner in its Service Tax Returns, to have examined whether the receipts offered to tax correspond and cover the stages in respect of which consideration has accrued as per the agreement with the customer. The entire sum received thus becomes taxable upon receipt and accordingly has been offered to tax, as stated by petitioners.

h) The reporting of income in the P&L being irrelevant for the purposes of determination of service tax payable, the basis of the impugned assessment is erroneous. It is a well Settled position that when a statutory provision or Rule addresses a specific scenario, such rule/ provision is liable to be interpreted on its own strength and context and one need look no further to alternate sources to seek clarity in regard to the issue that has been addressed by the aforesaid rule/provision. In so far as Rule 3 of POT Rules, 2011 sets out a specific *modus operandi* in this regard, it assumes priority and is the only relevant factor to be taken into account in the determination of point of rendition and accrual of services for the purpose of imposition of service tax.

i) Therefore, writ petition is allowed and the matter remitted to the file of the Respondent to be redone *de novo* strictly in accordance with the provisions of Rule 3 of the POT Rules, 2011.

Citation: 2018-VIL-263-CESTAT-AHM-ST

Case: Rajdhani Travels and Others vs. CCE, Ahmedabad

Background facts of the case

The appellants were engaged in the business of tours & travels and paid service tax under the category of "Tour Operators Service". Vide its notification 20/2009 dated 7th July, 2009 read with corrigendum dated 31st August, 2009, CG granted exemption in relation to taxable service provided by a tour operator having a contract carriage or tourist vehicles with a permit for inter-State or intra-State transportation of passengers, excluding tourism, conducted tours, charter or hire service, from whole of the service tax leviable thereon. *Vide* Finance Act, 2011 the said exemption to tour operators was made retrospective w.e.f. 1st April, 2000 and it was provided to grant refund of service tax paid by tour operators without collecting the same.

Accordingly, appellants filed refund claim within the time stipulated under the Finance Act, 2011 for the period 1st April, 2000 to 6th July, 2009. The refund though granted by the adjudicating authority was transferred to consumer welfare fund on the ground of unjust enrichment. Therefore, appellants filed appeal before this Tribunal.

Arguments

The appellants submitted as under:

a) The amount of service tax was not separately shown on the tickets/ invoices issued by the appellants to the passengers, hence not recovered from the customers. The price charged before and after the issuance of the exemption Notification remained same. They had placed a CA Certificate in support of the claim that the incidence of duty has not been passed on to the customers.

b) Merely because the service tax paid was booked as expenditure in the books of account, it cannot be said that the incidence of duty had been passed on to others.

c) There is no accounting principle which prescribed that only where any tax or duty is shown as receivable in the books of account, only then it could be accepted that incidence of duty has not been passed on to other persons.

The Respondents (assessee) submitted as under:

a) Service tax paid by the appellants, shown as expenditure in their books of account which means that the same has entered into cost of the services provided and accordingly recovered from the customers.

b) Merely because the price before and after the exemption notification, remained the same, it could not be construed that the incidence of duty has not been passed on to others.

c) CA Certificate indicated that the amount of service tax paid is built into the price as a cost of service, therefore, the burden of the same has been passed on to others.

Decision

a) Reliance placed on the decision of *M/s. United Liner Agencies of India P Ltd. vs. CST-Mumbai-II 2017-TIOL-2961-CESTAT-MUM* by the revenue supports their contention that since amount of service tax paid is expensed out in Profit & Loss account, thereby has become part of cost of service & accordingly deemed to have recovered from the customers, hence, incidence of tax paid has been passed. In the said case of Mumbai Tribunal it was observed that blind observation was made in CA certificate regarding the non recovery of service tax and interest from the customers or any other person, which is without any reasoning or arguments. If the said amount has not been recovered from anybody then the same should appear somewhere in the balance sheet as amount receivable from Government. Further as regards uniformity in price before and after the assessment Court held that this does not lead to the inevitable conclusion that incidence of duty has not been passed on to the buyer as such uniformity may be due to various factors. Hence, even on merits, the assessee has failed to make out a case for refund.

b) The decisions relied upon by the appellant nowhere records a finding that even though the amount of refund was shown as expenditure in their books of account, it can be construed that the incidence of tax has not been passed on to others. Hence appeals are dismissed.

Citation: 2018-VIL-250-CESTAT-CHD-ST

Case: Veer Overseas Limited vs. CCE & ST Panchkula

Background Facts of the case

The appellants are in the business of export of Rice. They had paid service tax as recipient of service on the services received by them from the Foreign Commission Agent. The said services were exempt under Notification No. 13/2003-ST dt. 20-6-2003 as amended. The said notification exempts Business Auxiliary Services provided by a Commission Agent in relation to sale or purchase of agricultural produce from the service tax leviable under Section 66 of the Finance Act, 1994. Since the tax was paid inadvertently, the appellants filed a refund claim. The said refund claims were rejected by the lower authorities on the ground that the refund was filed beyond the statutory time limit of one year prescribed under Section 11B of the Central Excise Act, 1944.

Arguments put forth

The appellants submitted as under:

a) It was submitted that the appellants deposited service tax on the service of Foreign Commission Agents for the export of rice, inadvertently and the same was exempted from payment of service tax. Further, the Circular No. 143/12/2011-ST dt. 26-5-2011 issued by CBEC was also relied upon which clarified that the Business Auxiliary Service provided by Commission Agents stationed abroad to promote the export of rice is covered by the Notification No. 13/2003-ST and accordingly exempted from payment of service tax.

b) The decisions in the cases of *Geojit BNP Paribas Financial Services Ltd. vs. Commissioner of Central Excise Customs & Service Tax, Kochi – WP (c) No. 18126 of 2015 (M) 2015-VIL-279-KER-ST* and *Monnet International Ltd. vs. CCE, New Delhi – Final Order Nos. 52170, 52171/2017, CESTAT, New Delhi - 2017-VIL-241-CESTAT-DEL-ST*, were relied upon

The Respondent submitted as under:

a) The representative appearing for the revenue relied on the order of Tribunal in the case of *CCE, Hyderabad-III vs. XL Telecom Ltd. – 2006 (206) ELT 303 (Tri. – Bang.) - 2006VIL-43-CESTAT-BLR-CE* in which it was held that statutory time limit was applicable even for refund of illegal levy and time limit could not be extended by any authority or Court.

Decision

a) The service tax was paid in the category of the Business Auxiliary Services on account of payment to the Foreign Commission agents. The amendment in the Notification No. 13/2003 wherein the agricultural produce was inserted in the preamble and by way of an explanation was brought about on 9-7-2004. In the said explanation, rice was also included. The CBEC clarification dt. 26-5-2011 made it clear that the commission agents stationed abroad were covered by the Notification No. 13/2003-ST. Thus, as a result of this clarification dt. 26-5-2011, the benefit of this exemption notification No. 13/2003 became available to the appellant and the amount collected by the Revenue was therefore without any authority.

b) However, on the question of limitation, the Bench observed that there are conflicting decisions of the Division Benches of the Tribunal on whether the statutory time limit under Section 11B of the Central Excise Act, 1944 is applicable or not. Therefore, it was felt appropriate to refer the said matter to Larger Bench. The conflict was namely on account of following cases:

   i. *Monnet International Ltd. vs. CCE, New Delhi – Final Order Nos. 52170, 52171/2017, CESTAT, New Delhi - 2017-VIL-241-CESTAT-DEL-ST* – In favour of appellants

   ii. *CCE, Hyderabad-III vs. XL Telecom Ltd. – 2006 (206) ELT 303 (Tri. – Bang.) - 2006VIL-43-CESTAT-BLR-CE* – In favour of the Revenue

c) During the course of argument before the Larger Bench, the Counsel for the appellant submitted that the appellant need not have paid the amount as service tax. Since, the said amount is not to be considered as a tax, the same should be returned to the appellants without limitation referred to in Section 11B. It was submitted that the said amount is not a tax and is to be considered as a deposit with the Government and the appellant is entitled for return of the said money.

d) The Counsel appearing for the revenue argued that the amount was paid as a service tax and the claim has to be processed under the statutory provisions for return of such tax in terms of Section 11B. Section 11B governs of situations of wrong payment, excess payment of tax/ duty and the officers dealing with any claim for return of tax are governed by the said Section. The statutory provisions being very clear no authority can act beyond the clear legal provision.

e) The Bench observed that the decision of the Tribunal in Monnet International Ltd. (supra). The said decision relied on certain case laws regarding applicability of limitation of three years and non-applicability of Section 11B in certain situations. Further, it was also noted that in the said case there was no tax liability at all as the services were not subject to tax. In the present case, the services were liable to tax and by way of an exemption notification services in respect of certain commodities were exempted.

f) It is also relevant to note that in various cases the High Courts and the Apex Court have allowed the claim of the parties for refund of money without applying the provisions of limitation under Section 11B by holding that the amount collected has no sanctity of law as the same is not a duty or a tax and accordingly the same should be returned to the party. It was noted that such remedies provided by the High Courts and Apex Court are mainly by exercising powers under the Constitution, in writ-jurisdiction. It is clear that neither the Jurisdictional Service Tax Authority nor the Tribunal has such Constitutional powers for allowing refund beyond the statutory time limit prescribed by the law. Admittedly, the amount is paid as a tax, the refund has been claimed from the Jurisdictional Tax Authorities and necessarily such tax authorities are bound by the law governing the collection as well as refund of any tax. There is no legal mandate to direct the tax authority to act beyond the statutory powers binding on them.

g) The Larger Bench held that in the present case, the decision of Monnet International does not apply and the decision of XL Telecom Limited was duly taken note of and it was held that a claim for refund of service tax is governed by the provision of Section 11B for period of limitation. The statutory time limit cannot be extended by any authority as held by the Apex Court.

h) However, one of members expressed a different opinion as under:

2. I am having certain reservations on the opinion expressed. The undisputed facts are that in terms of Notification No. 13/2003-ST dated 20-6-2003, no tax was payable by the appellants and it has been observed that in various cases, the Hon'ble High Courts and the Hon'ble Apex Court has held that refund of money paid without applying the provisions of limitation under Section 11B, that the amount collected has no sanctity of law as the same is not a duty or a tax and accordingly, the same should be returned to the party. It was also observed that the Hon'ble High Courts and Hon'ble Apex Court have exercise powers under constitution in Writ jurisdiction. Therefore, my brother entertained view that decision in Monnet International Limited (supra) has no applicability to decide the present dispute.

i) The Member further relied on decisions of *Parijat Construction vs. CCE, Nashik – 2018 (359) ELT 113 (Bom.) - 2017-VIL-647-BOM-*

ST and *CCE, Nagpur vs. SGR Infratech Limited in Central Excise Appeal No. 26/2014 dated 28-10-2015*, both decided by the Hon'ble High Court of Mumbai. As the Hon'ble High Court of Bombay has entertained the refund claim in Central Excise and allowed the refund claim holding that time limit prescribed under Section 11B of the Act is not applicable and the decision of Hon'ble Bombay High Court in Central Excise Appeals is binding on the Tribunal. Therefore, considered view of the dissenting member was that the refund claim of amount paid by mistake, the time limit prescribed under Section 11B of the Act is not applicable.

j) In view of the decision by majority as recorded, time limit prescribed under Section 11B of the Central Excise Act, 1944 will govern claim for refund of service tax.

Citation: 2018-VIL-50-CESTAT-DEL-ST

Case: CCE & ST New Delhi vs. Lease Plan India Limited

Background facts of the case

The respondent-assessee is engaged in business of financial as well as operating lease of vehicles. They were registered with the Service Tax Department and were paying service tax under the category of Banking and Other Financial Services. The respondent-assessee is paying service tax at the applicable rate on the consideration received in pursuance of financial lease arrangement. The dispute in the present proceedings is with reference to their business in operating lease of the motor vehicle given to the clients. The Revenue entertained a view that the terms and conditions governing both types of leases, namely financial lease and operating lease are similar and as such the consideration received in such business transaction is liable to be taxed under BOFS.

Arguments put forth

The Revenue as appellants submitted as under:

a) In terms of the agreement, the lessee pays the maintenance charges, insurance and all taxes. Accordingly, the arrangement is for financial lease only. It was submitted that a financial lease transfers all risks and reward incidental to ownership, even though the title may or may not be eventually transferred to the lessee. Financial lease is a financial loan from the lesser to the lessee. On the other hand, operating lease is a lease other than financial lease. In the present case, the Revenue contended that the respondent-assessee fulfils the requirement of financial lease and the criteria of Accounting Standard AS-19 has to be examined to arrive at a correct categorisation of lease arrangement. It is the case of the Revenue that what is claimed to be operating lease arrangement is actually a financial lease, liable to service tax.

The respondent assessee submitted as under:

a) Ld. Counsel explained the concept of lease arrangement and submitted that such lease transactions are broadly classified into two categories, namely, financial lease and operating lease. It was further submitted that financial lease which will also include hire purchase finance, is nothing but a loan transaction, advancement or assistance through funds for procurement of assets. On the contrary, when it comes to an operating lease, the assets are owned by the lesser and these are handed over to the lessee for a temporary period for their use. It was further submitted that there are essentially three fold distinction between a financial lease and operating lease as under:

a. In a financial lease, the asset is owned or eventually owned by the lessee. The arrangement therefore is a simple loan arrangement as lease finance. On the contrary, in the case of operating lease, the assets are owned by the lessor and the lessee has only the right to use the goods on payment of rentals or hire charges

b. In the case of a financial lease in terms of Accounting Standards 19, it is the lessee, the owner or eventual owner who is allowed to capture the assets in their books. The lessee is also allowed to claim depreciation. The lessor has to show this as a loan transaction and the funded amount (Principal + Interest) only as receivables. Lessor cannot take its assets into its books. On the contrary in the case of an Operating Lease, lessor is the owner and therefore allowed to capture the assets in their books. The income realised from the lessee has to be booked as lease or rental or hire charges

c. When it comes to claiming depreciation under Section 32 of the Income-tax Act, Accounting Standards 19 prescribe that in the case of a financial lease, since the lessee is the owner or an eventual owner, the assets should be depreciated only on the books of the lessee. On the contrary, in the case of an operating lease, since the assets are owned by the lessor, depreciation can be claimed only by the lessor.

b) Apart from the above, any financial lease, as the lessee is the owner or the eventual owner the lease, would normally be covering the economic life of the asset. The total cost of the vehicle along with interest would stand covered. In operating lease, since the income is in the form of rental and not sale of assets, 60% to 80% of the value is collected as rentals and the balance amount is normally recovered after the expiry of lease period by way of sale for the residual nominal price.

Decision

a) It was noted that the Original Authority elaborately considered the various judicial pronouncement of the Apex Court and more specifically the decision in *Association of Leasing and Financial Service Companies 2010 (20) STR 417 (SC) - 2010-VIL-17-SC-ST-LB.*

b) Listing out the difference between operating lease and financial lease the impugned order categorically recorded that the lease arrangements on which the respondent–assessee discharged VAT are operating leases and are not liable to service tax. As already noted for such conclusion the impugned order examined elaborately all the relevant conditions of the lease agreement. On close consideration of the findings recorded in the impugned order and the grounds of appeal contesting such findings, the Bench was of the view that the impugned order is legally sustainable.

c) The whole thrust of the distinction for financial lease and operating lease is the ownership of the asset. This aspect has been adequately analysed and covered in the impugned order with more specific reference to Accounting Standard 19. As such, we note that there is no factual or legal error in the impugned order calling for interference.

d) Accordingly the appeal filed by the Revenue was dismissed.

Citation: 2018-TIOL-1369-CESTAT-MUM

Case: Nyati Hotels and Resorts Private Limited vs. CCE, Pune III

Background facts of the case

The appeal has been filed by the appellant against the Order-in-Appeal passed by the Commissioner (Appeals). The Appellate Commissioner who had dismissed the appeal filed by the appellants on the ground that the mandatory pre-deposit under Section 35F was deposited after three months of the passing of the adjudication order.

Arguments put forth

The appellants submitted as under:

a) The Appellate Commissioner has wrongly applied the time limit of two months and additional one month for making pre-deposit on the ground that there is reference of Section 35 (1) of CEA in Section 35F. That on careful reading of Section 35F it is amply clear that the reference of Section 35(1) is given only for the purpose of specifying as to for which kind of appeals the present Section would be applicable. Under Section 35F there is no time limit to make pre-deposit but the Appellate Authority cannot entertain the appeal unless pre-deposit is made. Section 35(1) only provides for filing of appeal within stipulated time before Commissioner (Appeals). The Appeal was correctly filed within 60 days and thus there is no default under Section 35 (1) of the CEA.

The Revenue Respondent submitted as under:

a) It was submitted that since pre-deposit is not made, the appeal is rightly rejected by the Commissioner Appeal.

Decision

a) On perusal of above both Sections the Bench observed that both Sections are independent and have got no overriding effect on the other. Section 35(1) is in respect of type of appeal which can be filed before the Commissioner (Appeals) and it does not deal with entertaining appeal by Commissioner (Appeals). Section 35F in turn deals only with the entertaining the appeal subject to condition of pre-deposit of seven and half percent.

b) It nowhere prescribes the time limit for making pre-deposit and the provisions of Section 35F cannot be read in context of Section 35(1) as it has got no application. The non-payment of pre-deposit is curable defect.

c) Any appeal can be entertained only when it is filed. Obviously the question of entertaining the appeal comes at the time of filing of appeal which has to be filed within stipulated period. Once the appeal has been filed within the time limit the same cannot be dismissed on the ground of late payment of pre-deposit amount. Further in the present case the appellant has made the pre-deposit as required under Section 35F although after filing of appeal. However this cannot be a ground to dismiss the appeal. Accordingly the matter was remanded back to Commissioner Appeals for passing an order on merits of the case.

❍❑❍

CA Sanjeev Shah & CS Abdullah Fakih

CORPORATE LAWS
Recent Developments

Significant beneficial ownership – unmasking the mask!

Section 90 of the Companies Act, 2013 (2013 Act), as amended by the Companies (Amendment) Act, 2017 (Amendment Act) requires disclosures to be made to the company by individuals holding "significant beneficial interest" in shares of the company. This article analyzes the nuances of the newly substituted section 90 of the 2013 Act, the draft rules framed and issued for public comments and the practical issues that may be considered while making the disclosures relating to significant beneficial ownership.

Background

Ministry of Corporate Affairs (MCA) has in January 2018 further amended 2013 Act. To balance the larger autonomy of corporate governance and the need to maintain responsibility and accountability, the amended 2013 Act has simplified and in some cases enhanced disclosures requirements in some of the matters.

This philosophy of emphasis on transparency is contained in section 89 of the 2013 Act which requires time-bound declarations to be made:

(a) to the company by the registered owner of shares;

(b) to the company by the beneficial owner of shares; and

(c) by the company to the Registrar of Companies (RoC)

where the registered owner of shares is different from the person who holds "beneficial interest" in such shares.

The Amendment Act has substituted section 90 of the 2013 Act with completely revamped provisions that are aimed at identifying and reporting the details of the registered owners and the corresponding beneficial owners of the shares.

The amended section 90 requires "significant beneficial owners" (as defined) to make disclosures to the company specifying the nature of their interest and other prescribed particulars.

MCA had on 15 February 2018, put up the draft of Companies (Beneficial Interest and Significant Beneficial Interest) Rules, 2018 (Draft Rules) under section 89 and 90 of the 2013 Act for public comments. The final rules in this regard are awaited.

These changes are likely to have impact on the entire corporate world (all types of companies) and allied legislations as well.

As on date of writing this article, the provisions of the Amendment Act impacting sections 89 and 90 of the 2013 Act and final Rules are yet to be notified / issued.

Companies Law Committee Report

Companies Law Committee (CLC) was constituted by the Ministry of Corporate Affairs (MCA) in June 2015 to make recommendations on issues arising out of the implementation of the 2013 Act. CLC, in its report has taken note that misuse of corporate vehicles for the purpose of evading tax or laundering money for corrupt or illegal purposes, including for terrorist activities has been a concern worldwide. Complex structures and chains of corporate vehicles are used to hide the real owner behind the transactions made using these structures. Realizing this, jurisdictions world over have been putting in place mechanisms to identify the natural person controlling a corporate entity. Following the recommendations of Financial Action Task Force (FATF), India has also tightened the concepts of beneficial interest and beneficial owner as contained in the Prevention of Money Laundering Act as well as introduced a comprehensive definition through SEBI guidelines.

CLC, in its report issued in February 2016, had inter alia stated that the existing provisions under 2013 Act are considered inadequate for the purpose of mandating a register of beneficial owners of the company for following reasons:

- absence of a definition of "beneficial interest" in a share in a company
- absence of any obligation on a company to collect information on beneficial ownership
- absence of concept of beneficial ownership in a company
- no enabling provisions to maintain a separate register on beneficial ownership in the 2013 Act.

CLC, therefore, recommended to amend 2013 Act to mandate the following:-

a) Provide a definition of beneficial interest in a share, and beneficial ownership in a company. The existing definition under SEBI Circular/Guidelines and the Prevention of Money Laundering Act, 2002, may be used as a basis for the definition in the 2013 Act. The rules issued under the United States Securities Exchange Act, 1934 define beneficial ownership in a security, which can be used as a basis for the definition of beneficial interest in a share.

b) Companies and individuals may be obligated to obtain information on beneficial ownership. In this regard, companies may be empowered to seek information from members and in case of failure to supply the required information, apply sanctions in the form of suspension of rights against the beneficial interests, subject to adequate safeguards.

c) Companies should also be mandated to maintain registers of beneficial owners and provide information to MCA. Periodic updating may also be mandated. Data privacy concerns may be addressed by making only part of the filed information available to the public.

d) Companies not complying with the requirements may be liable to fine and criminal prosecution.

Amendment to Section 89 and 90 by the Companies (Amendment) Act, 2017 and the Draft Rules

MCA having accepted the above recommendations of CLC, has amended the existing provisions of section 89 and substituted section 90 vide Amendment Act.

The Draft Rules define the procedures in relation to the declarations to be made by the beneficial owner, registered owner of shares and the concerned company.

Let us look at some of the key definitions under the amended provisions:

Beneficial Owner – the term is not defined in 2013 Act or Amendment Act. The Draft Rules define the term "beneficial owner" as a person having beneficial interest in a share but whose name is not entered in the register of members of a company as the holder of that share.

(Note: One may refer to the definition of beneficial owner under the Income Tax Act 1961, where the term has been defined in Explanation 4 to Section 139(1) as "For the purposes of this section *"beneficial owner" in respect of an asset means an individual who has provided, directly or indirectly, consideration for the asset for the immediate or future benefit, direct or indirect, of himself or any other person."*)

Registered Owner – the term is not defined in 2013 Act or Amendment Act. The Draft Rules define "registered owner" as a person whose name is entered in the register of members of a company as the holder of shares in that company but who does not hold the entire beneficial interest in such shares.

Beneficial Interest

An inclusive definition of "beneficial interest" has been provided in amended section 89(10) which reads as under:-

"For the purposes of this section and section 90, beneficial interest in a share includes, directly or indirectly, through any contract, arrangement or otherwise, the right or entitlement of a person, along with or together with any other person to -

i. exercise or cause to be exercised any or all of the rights attached to such share ; or

ii. receive or participate in any dividend or other distribution in respect of such share."

It can be seen that the term, beneficial interest is wide and covers within its ambit the exercise of *any or all* of the rights attached to shares. A share is a bundle of rights. Ordinarily the rights of shareholders include right to participate in the decision making through voting at the company's general meetings / postal ballot, right to transfer shares, right to apply for winding-up the company etc.

Further, the receipt of not only dividend but also any "other distribution" e.g. bonus, stock split, buyback of shares or proceeds on winding-up, would constitute beneficial interest in shares.

The shareholder may exercise such rights either directly or indirectly. Further, the right may be exercised individually or "together with any other person". One may draw a parallel with the term "Persons Acting in Concert" (PAC) as defined in Regulation 2(1)(q) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the Takeover Code). The definition of PAC under the Takeover Code speaks of persons who, with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly, co-operate for acquisition of shares or voting rights in, or exercise of control over the target company.

Interestingly, the term "beneficial owner" in relation to property, also finds place in the Benami Transactions (Prohibition) Act, 1988, as follows:-

"Beneficial owner" means a person, whether his identity is known or not, for whose benefit the *benami* property is held by a *benamidar*.

"Registered owner" under 2013 Act is facelift from the definition of "Benamidar" under the Benami Transactions (Prohibition) Act, 1988, which means a person or a fictitious person, as the case may be, in whose name the benami property is transferred or held and includes a person who lends his name.

Significant Beneficial Owner

"Significant beneficial owner" has been defined in section 90(1) of the 2013 Act as an individual who acting either alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests of not less than 25%, or such other percentage as may be prescribed in shares of a company or the right to exercise or the actual exercising of "significant influence" or "control" as defined in section 2(27) over the company.

"Control" has been defined under section 2(27) of the 2013 Act as follows:-

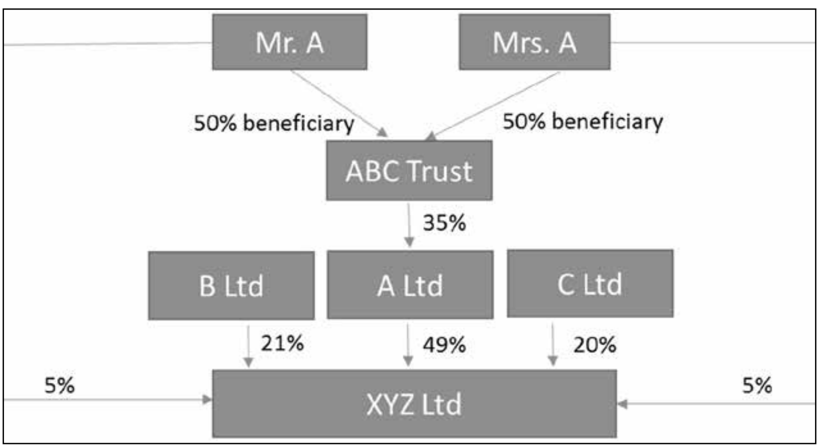
"Control" shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner."

Further, "significant influence" has been defined in Explanation to section 2(6) of the 2013 Act in the definition of an "associate company" as follows:-

"The expression significant influence means control of at least 20% of total voting power, or control of or participation in business decisions under an agreement."

The definition of "significant beneficial owner" is wide enough to cover direct as well as indirect holdings of an individual including holding through any other persons or trusts. It would therefore require a company to identify the ultimate individual shareholder with regard to its own shareholder amongst the shareholders whose name appears in its register of members. This requirement may lead to spiralling effect of un-masking the real beneficial owner of the shares or the real individual behind the wheel!

Consider below structure:



Following are views could emerge from the above structure:-

1) The direct aggregate holding of Mr. A and Mrs. A in XYZ Ltd. is only 10%. However, when combined with their holding through A Ltd (in which ABC Trust holds 35%), it is apparent that their effective shareholding in XYZ Ltd. exceeds 25%. Hence, either Mr. A or Mrs. A, could be considered as a significant beneficial owner of XYZ Ltd.

2) For Mr. A or Mrs. A to be considered as significant beneficial owner of XYZ Ltd., one would have to demonstrate that they are able to exercise any or all of the rights attached to the shares held by A Ltd. in XYZ Ltd. similar to the rights exercised by Mr. A and Mrs. A in relation to the 10% shares held by them directly in XYZ Ltd.
3) Adopting a bottom-up approach, since A Ltd has "significant influence" over XYZ Ltd, and ABC Trust has "significant influence" over A Ltd, and as Mr. A and Mrs. A are the sole beneficiaries of ABC Trust, Mr. A or Mrs. A could be considered as significant beneficial owner of XYZ Ltd.

Securities covered under the ambit of significant beneficial owner

The prescribed threshold of 25% shareholding referred to in the definition of "significant beneficial owner" deals with shares, hence, it covers equity shares, preference shares and shares with differential rights. One may thus compute the threshold with reference to the aggregate number of all types of shares in the company. However, disclosure is not attracted in case of holding in debentures of a company.

Declaration by significant beneficial owner

Section 90(1) requires an individual who is a significant beneficial owner to make a declaration to the company about his beneficial interest in shares in a company, alone or together or through one or more persons or trust, including a trust or persons resident outside India.

As per rule 5 of the Draft Rules, the first said declaration by the existing significant beneficial owner is required to be made in form BEN-4 to the company within 30 days from the commencement of the Rules and thereafter by significant beneficial owner within 30 days of acquiring such significant beneficial interest or "any change" therein.

The term "any change" has not been quantified in the Draft Rules. MCA may clarify the same in the final rules. In the absence of any guidance in the Draft Rules, one may consider the following changes as those which could warrant a disclosure to the Company in form BEN-4:-

1. Any change in the beneficial interest of an individual in the company which reduces his / her beneficial interest in the company below 25%.
2. Any change in the interest of an individual who holds the significant beneficial interest in the company which increases his / her beneficial interest by 5% or more, on similar lines as the creeping acquisition limit under the Takeover Code.

It is interesting to note that while the significant beneficial owner would have already made a declaration regarding his beneficial interest to the company under section 89(2) of the 2013 Act, if any, the requirement of section 90 is an additional and independent requirement. The declaration under section 89(2) is applicable irrespective of whether a shareholder holds control over the company. Section 90 disclosures are applicable to only those shareholders who own significant beneficial ownership in shares.

The registered owner of such shares need not make a separate declaration to the company apart from the one already made by him under section 89(1) of the 2013 Act. Since such declarations would have already been obtained by the company from the registered owner in form MGT-6 and filed with the Registrar of Companies (RoC), before coming into effect of the amended section 90, the regulatory authorities may match the details of owners (both registered and beneficial) already submitted with those which are being submitted under the amended section 90.

It is also pertinent to note that the declaration of significant beneficial interest under the amended section 90 is required to be made only by an individual (acting alone or together or through one or more specified persons), i.e. Mr. A (or Mrs. A) in the above illustration, in respect of all shares, which are under his significant beneficial ownership. All other beneficial owners i.e. Mrs. A (or Mr. A), respectively, in the above diagram 1) through whom she / he is acting, will make their respective declarations in form BEN-2 of the Draft Rules (corresponding to the existing form MGT-5) under section 89(1) of the 2013 Act. The intermediate entities such as Trusts, bodies corporate etc. are not required to make the declaration of significant beneficial ownership under section 90.

Exception to disclosure of significant beneficial owner requirements

The *proviso* to section 90(1) of the 2013 Act empowers the central government to prescribe a class or classes of persons who shall not be required to make declaration pertaining to significant beneficial owner under section 90(1).

Pursuant to this *proviso*, the Draft Rules has carved out an exemption for the registered owner of shares being a body corporate whose equity shares are listed on any stock exchange or is a wholly-owned subsidiary of such body corporate. The exemption can also be availed by foreign listed companies who are the registered shareholders.

The rationale behind this exemption perhaps is that the shareholding pattern of a listed entity is publicly available and hence where the registered owner is a listed entity, the "significant beneficial owner" of such a listed entity should be easily verifiable.

It is pertinent to note that the exemption is not extended to shares held by the government in a government company. MCA may clarify the same in the final rules.

Register of significant beneficial owners

Under section 90(2) of the 2013 Act read with rule 7(1) of the Draft Rules, the company is required to maintain a register of significant beneficial owners in form BEN-6. The register shall contain particulars of the significant beneficial owners including the name of the individual, his date of birth, address, details of ownership in the company and also particulars of the shares in which significant beneficial interest is held by the beneficial owner.

The register shall be kept open for inspection by any member of the company for minimum 2 hours daily.

Filing of return of significant beneficial owners with RoC

Upon receiving the declaration of significant beneficial interest, the company is required to file a return with the RoC within 30 days from the date of receipt of the declaration, in form BEN-5.

Notice to be issued to persons whom the company knows to be a significant beneficial owner

Section 90(5) of the 2013 Act mandates a company to give notice to any person (whether or not a member of the company) (who is not registered as a significant beneficial owner with the company), whom the company knows or has reasonable cause to believe that:-

a) Such a person is a significant beneficial owner of the company; or

b) Such a person is having knowledge of the identity of a significant beneficial owner or another person likely to have such knowledge; or

c) Such a person is a significant beneficial owner of the company at any time during the 3 years immediately preceding the date on which the notice is issued,

The information is to be provided within 30 days of the date of the notice.

The Draft Rules prescribe form BEN-7 for issuing such notice by a "person authorised to issue notice" on behalf of the company.

Application to the National Company Law Tribunal (NCLT) for an order directing shares to be subject to restrictions

Where a person to whom company gives notice under section 90(5) fails to give information within the prescribed time or the information given is not satisfactory, the company can make an application to the NCLT under section 90(7) within 15 days of the expiry of the period specified in the notice for an order directing that the shares in question, be subject to restrictions including:-

a) Restrictions on the transfer of interest in the shares;

b) Suspension of the right to receive dividend in relation to the shares;

c) Suspension of voting rights in relation to the shares; and

d) Any other restriction on all or any of the rights attached to the shares.

The NCLT may, after giving an opportunity of being heard to the parties concerned, make an order restricting the rights attached to the shares within a period of 60 days of receipt of application or such other period as may be prescribed.

The company or the person aggrieved by the order of the NCLT may make an application to the NCLT for relaxation or lifting the restrictions placed on the shares by virtue of the aforesaid order.

Penalty for non-compliance

Section 90(10), 90(11) and 90(12) provide for the penalty for non-compliance with the provisions of section 90 as follows:-

On the significant beneficial owner:

- For failure to make declaration – fine ranging from ₹ 1,00,000 to ₹ 10,00,000 and with a further fine of ₹ 1,000 per day in case of a continuing default.
- For furnishing false / incorrect information or suppression of material information in his knowledge – penalty for fraud under section 447 of the 2013 Act, i.e.
- For a fraud involving an amount of at least ₹ 10,00,000 or 1% of the turnover of the company, whichever is lower - imprisonment for at least 6 months which may extend to 10 years and fine which shall not be less than the amount involved in the fraud, but which may extend to 3 times the amount involved in the fraud.
- For a fraud involving an amount less than ₹ 10,00,000 or 1% of the turnover of the company, whichever is lower, and does not involve public interest – imprisonment for a term which may extend to 5 years or with fine which may extend to ₹ 20,00,000 or with both.

On the Company and every officer-in-default:-

- For default in maintenance of register, filing return with RoC or allowing inspection to members – fine between ₹ 10 lakhs to ₹ 50 lakhs and with a further fine of ₹ 1,000 per day in case of a continuing default.
- For not issuing notice under section 90(5) – residual penalty under section 450 of the 2013 Act i.e. fine of up to ₹ 10,000 and a further fine of ₹ 1,000 per day in case of a continuing default.

Interplay with allied legislations

Income Tax Act, 1961

Carry forward and set-off of losses in case of companies

There have been contradictory rulings by tax authorities in the past regarding whether the registered owner is to be treated as beneficial owner for the purpose of section 79 of the Income Tax Act, 1961.

Disclosure in newly notified ITR-6

The Central Board of Direct Taxes has notified the new Income Tax Return forms for assessment year 2018-19 on 5 April 2018. Form ITR-6 which is the form for filing income tax return by companies contains several additional disclosures. A field has been added to form ITR-6 which requires an unlisted company to furnish particulars of natural persons (i.e. name, percentage of shares held, PAN if allotted) who were the "ultimate beneficial owners", whether directly or indirectly of shares holding at least 10% of the voting power at any time during the previous year. (Note: The scope of disclosure in ITR-6 is different than the definition of beneficial owner under Explanation – 4 to Section 139(1)).

The timing of bringing this new disclosure in Form ITR-6 goes hand-in-hand with the move by MCA to amend Section 90 and the same is expected to assist the tax department in identifying the individuals behind the corporate façade and could have implications in assessment.

SEBI Regulations

Regulation 29 of the Takeover Code requires disclosures to be made to the company and stock exchanges by acquirers (including PAC) acquiring more than 5% shares or upon any subsequent change in the shares so acquired, even if such change results in such persons' shareholding falling below 5%, and such change exceeds 2% of the total shareholding or voting rights in the target company.

Further, Regulation 30 requires continual year-end disclosures to be made to the company and stock exchanges by promoters as well as persons (including PAC) exercising 25% or more of the voting rights in the target company.

It would have to be ensured that the above disclosures are aligned with the disclosure made by significant beneficial owners under section 90 of the 2013 Act.

Conclusion

The provisions of Section 90 regarding beneficial interest in shares are in sync with the Government's drive to increase transparency in the corporate sector and unmasking complex structures, preventing money-laundering and aggressive tax planning, stop tax leakages, identifying shell companies, combating financing of terrorism etc.

The provisions are aimed at discovering the ultimate beneficiary behind corporate structures and having a repository of such information readily available with the Regulators to enable them to exercise appropriate checks and safeguards for the good of the economy and other stakeholders.

The interplay of provisions under section 89, 90 under 2013 Act and ITR-6 under Income Tax Act 1961 will have far reaching implication in individual's tax assessment.

One will have to see the fine print of the Final Rules. The efficacy of the amended provisions will become known in due course after they are notified.

Source:

1. Companies Act, 2013
2. Companies (Amendment) Act, 2017
3. Draft Companies (Beneficial Interest and Significant Beneficial Interest) Rules, 2018 issued by MCA on 15 February 2018
4. Report of the Companies Law Committee issued in February 2016

❍❑❍



CA Mayur Nayak, CA Natwar Thakrar & CA Pankaj Bhuta

OTHER LAWS
FEMA Update and Analysis

In this article, we have discussed recent amendments to FEMA through Circular and Notification issued by RBI

1. Investment by Foreign Portfolio Investors (FPI) in Government Securities – Medium Term Framework

In accordance with its Statement on Developmental and Regulatory Policies, Fourth Bi-monthly Monetary Policy Statement, 2017-18 a detailed review of current regulations on debt investment by Foreign Portfolio Investors (FPI) to facilitate the process of investment and hedging by FPIs was undertaken.

Based on the review and consultation with the Government of India, RBI has revised the FPI limits as below:

Revision of Investment Limits

a) The limit for FPI investment in Central Government securities (G-secs) would be increased by 0.5% each year to 5.5% of outstanding stock of securities in 2018-19 and 6% of outstanding stock of securities in 2019-20.

b) The limit for FPI investment in State Development Loans (SDLs) would remain unchanged at 2% of outstanding stock of securities.

c) The overall limit for FPI investment in corporate bonds will be fixed at 9% of outstanding stock of corporate bonds. All the existing sub-categories under the category of corporate bonds will be discontinued and there would be a single limit for FPI investment in all types of corporate bonds.

d) No fresh allocation has been made to the 'Long-term' sub-category under SDLs. Out of the existing limit of ₹ 13,600 crore for this sub-category, an amount of ₹ 6,500 crore has been transferred to the G-secs category.

e) The allocation of increase in G-sec limit over the two sub-categories – 'General' and 'Long-term' – remains at the current ratio of 25:75. However, based on an assessment of investment interest, this ratio has been re-set at 50:50 for the year 2018-19.

f) Coupon reinvestment by FPIs in G-secs, which was hitherto outside the investment limit, will now be reckoned within the G-secs limit. FPIs may, however, continue to reinvest coupons without any constraint, as they do now. Only at the time of periodic re-setting of limits, coupon investments would be added to the amount of utilization. Accordingly, for the year 2018-19, the stock of coupon investment of ₹ 4,760 crore as on March 31, 2018, would be added to the actual utilization under the 'General' sub-category of G-secs. Since this is a new policy, as a one-time measure, the investment limit in the 'General' sub-category of G-secs has been increased by an amount equal to the stock of coupon reinvestment as on March 31, 2018. This increase in limit on account of coupon investment amount is over and above the limit indicated in paragraph (a) above.

g) This coupon reinvestment arrangement will be extended to other debt categories subsequently.

h) Accordingly, the revised limits for the various categories, after rounding off, would be as under:

Table 1 – Revised Limits for FPI Investment in Debt – 2018-19 (Rupees crore)

	G-Sec-General	G-Sec-Long Term	SDL-General	SDL-Long Term	Corporate Bonds	Total Debt
Current Limit	191,300	65,100	31,500	13,600	244,323	545,823
Revised Limit for the HY April – September 2018	207,300*	78,700	34,800	7,100	266,700	594,600
Revised Limit for the HY October 2018 – March, 2019	223,300*	92,300	38,100	7,100	289,100	649,900
* Includes ₹ 4,760 crore one-time addition to limit to provide for inclusion of coupon investment amount in utilisation.						

[RBI/2017-18/150 A.P. (DIR Series) Circular No. 22 dated 6th April, 2018]

2. Liberalised remittance Scheme (LRS) for Resident Individual – daily reporting of transactions

Currently, transactions under Liberalised Remittance Scheme (LRS) are being permitted by AD banks based on the declaration made by the remitter. The monitoring of adherence to the limit is confined to obtaining such a declaration without independent verification, in the absence of a reliable source of information.

Accordingly, in line with the announcements made in the First Bi Monthly Monetary Policy Statement 2018-19 dated April 5, 2018, in order to improve monitoring and also to ensure compliance with the LRS limits, RBI has decided to put in place a daily reporting system by AD banks of transactions undertaken by individuals under LRS, which will be accessible to all the other ADs.

All AD banks are required to upload daily transaction-wise information undertaken by them under LRS at the close of business of the next working day. In case no data is to be furnished, AD banks shall upload a 'Nil' report. AD banks can upload the LRS data as CSV file (comma delimited), by accessing XBRL site through the URL https://secweb.rbi.org.in/orfsxbrl/.

[RBI/2017-18/161 A.P. (DIR Series) Circular No. 23 dated 12th April, 2018]

(Comments : Providing access to LRS data to all AD Banks would be highly beneficial to the banks to comply with LRS limit norms. In light of the various scams and frauds being uncovered recently, such readily available data would go a long way to ensure compliance and not restricted to the declaration of the remitter.)

3. Investment by Foreign Portfolio Investors (FPI) in Debt

The changes to operational aspects of FPI investment are set forth below:

(a) Revision of minimum residual maturity requirement

i. In terms of A.P. (DIR Series) Circular No. 13 dated July 23, 2014, FPIs were required to invest in Government bonds with a minimum residual maturity of three years. The minimum residual maturity requirement for Central Government securities (G-secs) and State Development Loans (SDLs) categories stands withdrawn, subject to the condition that investment in securities with residual maturity below 1 year by an FPI under either category shall not exceed, at any point of time, 20% of the total investment of that FPI in that category.

ii. In terms of A.P. (DIR Series) Circular No. 71 dated February 3, 2015, FPIs were required to invest in corporate bonds with a minimum residual maturity of three years. Henceforth, FPIs are permitted to invest in corporate bonds with minimum residual maturity of above one year.

(b) Revision of security-wise limit

The cap on aggregate FPI investments in any Central Government security, currently at 20% of the outstanding stock of that security, in terms of A.P. (DIR Series) Circular No. 19 dated October 6, 2015, stands revised to 30% of the outstanding stock of that security.

(c) Online monitoring of G-secs utilisation limits

Currently, FPIs are permitted to invest in G-secs till the limit utilisation reaches 90%, after which the auction mechanism is triggered for allocation of the remaining limit. With Clearing Corporation of India Ltd. (CCIL) commencing online monitoring of utilisation of G-secs limits, it has been decided to discontinue the auction mechanism with effect from June 1, 2018. Utilisation of FPI limits shall be monitored online thereafter.

(d) Concentration limit

Investment by any FPI (including investments by related FPIs), in each of the three categories of debt, viz., G-secs, SDLs and corporate debt securities, shall be subject to the following concentration limits:

i. Long-term FPIs: 15% of prevailing investment limit for that category.

ii. Other FPIs: 10% of prevailing investment limit for that category.

iii. In case an FPI has investments (INV_o) in excess of the concentration limit on the effective date (date on which these concentration limits come into existence), it will be allowed the following relaxations, subject to availability of overall category limits, as a one-time measure:

a. In case an FPI has investments (INV_o) in excess of the concentration limit on the effective date, it will be allowed to undertake additional investments such that its portfolio size at any point in time (INV_t) does not exceed INVO plus 2.5% of investment limit for the category on the effective date. Once INV_t falls below the prevailing concentration limit for the category, the FPI shall be free to make investments up to the applicable concentration limit.

b. In case an FPI has investments (INV_o) within the concentration limit, but in excess of 7.5% (12.5% in case of FPIs in the 'Long-term' sub-category) of the investment limit for the category on the effective date, that FPI shall be allowed to undertake additional investments such that its portfolio size at any point in time (INV_t) does not exceed INV_o plus 2.5% of the investment limit for the category on the effective date. Once INV_t falls below the prevailing concentration limit for the category, the FPI shall be free to make investments up to the applicable concentration limit.

c. All other FPIs will be allowed to invest up to the applicable concentration limit.

(e) Single/Group investor-wise limit in corporate bonds

FPI investment in corporate bonds shall be subject to the following requirements,

(i) Investment by any FPI, including investments by related FPIs, shall not exceed 50% of any issue of a corporate bond. In case an FPI, including related FPIs, has invested in more than 50% of any single issue, it shall not make further investments in that issue until this stipulation is met.

(ii) No FPI shall have an exposure of more than 20% of its corporate bond portfolio to a single corporate (including exposure to entities related to the corporate). In case an FPI has exposure in excess of 20% to any corporate (including exposure to entities related to the corporate), it shall not make further investments in that corporate until this stipulation is met. A newly registered FPI shall be required to adhere to this stipulation starting no later than 6 months from the commencement of its investments.

No FPI shall invest in partly paid instruments. These directions would be applicable with immediate effect.

[RBI/2017-18/168 A.P. (DIR Series) Circular No. 24 dated 27th April, 2018]

Further to the above circular, the following additional clarifications were issued subsequently:

i. FPIs are permitted to invest in treasury bills issued by the Central Government.

ii. The requirement that investment in securities of any category (G-secs, SDLs or, in terms of this circular, corporate bonds) with residual maturity below one year shall not exceed 20% of total investment by an FPI in that category applies, on a continuous basis. At any point in time, all securities with residual maturity of less than one year will be reckoned for the 20% limit, regardless of the maturity of the security at the time of purchase by the FPI.

iii. In case investments in securities with less than one year residual maturity, as on 2 May, 2018 (beginning of day), is more than 20% of total investment in any category, the FPI shall bring such share below 20% within a period of six months from the date of this circular; however, the FPI shall ensure that no further additions are made to the portfolio of securities with residual maturity of less than one year as on 2 May, 2018 (beginning of day), either through fresh purchases or through roll-down of investments with current tenor of more than one year, until the share of such portfolio of securities falls below 20% of the total investment in that category.

iv. The term "related FPIs" in paragraph 3(e)(i) of the circular dated April 27, 2018 refers to all FPIs registered by a non-resident entity. Illustratively, if a non-resident entity has set up five funds, each registered as an FPI for investment in debt, total investment by the five FPIs will be considered for application of concentration and other limits.

v. As regards the concentration limit for an FPI for its corporate bond portfolio to a single corporate (paragraph 3 (e) (ii) of the circular dated April 27, 2018) the following clarifications may be noted:

   a. The term "related entities" shall have the same meaning as defined in Section 2(76) of the Companies Act, 2013.

   b. A newly registered FPI would mean FPIs registered after April 27, 2018.

vi. The implementation date of online monitoring of utilization of G-sec limits has been set as June 1, 2018. The existing process for monitoring of limits as well as allocation of limit through auction mechanism will continue in the meantime.

[RBI/2017-18/170 A. P. (DIR Series) Circular No. 26 dated 1st May, 2018]

(Comments: Higher interest rates in USA had induced increased in yields of debt securities. RBI has therefore increase limits for investment in debt securities to facilitate more investments and at the same time lower the yields.)

4. External Commercial Borrowings (ECB) Policy – Rationalisation & Liberalisation

In order to rationalise and liberalise the ECB guidelines the following changes have been undertaken:

(i) Rationalisation of all-in-cost for ECB under all tracks and Rupee denominated bonds (RDBs)

With a view to harmonising the extant provisions of Foreign Currency and Rupee ECBs and RDBs, it has been decided to stipulate a uniform all-in-cost ceiling of 450 basis points over the benchmark rate. The benchmark rate will be 6 month USD LIBOR (or applicable benchmark for respective currency) for Track I and Track II, while it will be prevailing yield of the Government of India securities of corresponding maturity for Track III (Rupee ECBs) and RDBs.

(ii) Revisiting ECB Liability to Equity Ratio provisions

It has been decided to increase the ECB Liability to Equity Ratio for ECB raised from direct foreign equity holder under the automatic route to 7:1. This ratio will not be applicable if total of all ECBs raised by an entity is up to USD 5 million or equivalent.

(iii) Expansion of Eligible Borrowers' list for the purpose of ECB

It has been decided to permit:

a. Housing Finance Companies, regulated by the National Housing Bank, as eligible borrowers to avail of ECBs under all tracks. Such entities shall have a board approved risk management policy and shall keep their ECB exposure hedged 100 per cent at all times for ECBs raised under Track I.

b. Port Trusts constituted under the Major Port Trusts Act, 1963 or Indian Ports Act, 1908 to avail of ECBs under all tracks. Such entities shall have a board approved risk management policy and shall keep their ECB exposure hedged 100 per cent at all times for ECBs raised under Track I.

c. Companies engaged in the business of Maintenance, Repair and Overhaul and freight forwarding to raise ECBs denominated in INR only.

(iv) Rationalisation of end-use provisions for ECBs

Currently, a positive end-use list is prescribed for Track I and specified category of borrowers, while negative end-use list is prescribed for Track II and III. It has now been decided to have only a negative list for all tracks. The negative list for all Tracks would include the following:

a. Investment in real estate or purchase of land except when used for affordable housing as defined in Harmonised Master List of Infrastructure Sub-sectors notified by Government of India, construction and development of SEZ and industrial parks/ integrated townships.

b. Investment in capital market.

c. Equity investment. Additionally for Tracks I and III, the following negative end uses will also apply except when raised from Direct and Indirect equity holders or from a Group company, and provided the loan is for a minimum average maturity of five years:

d. Working capital purposes.

e. General corporate purposes.

f. Repayment of Rupee loans.

Finally, for all Tracks, the following negative end use will also apply:

g. On-lending to entities for the above activities from (a) to (f).

All other provisions of the ECB policy shall remain unchanged.

[RBI/2017-18/169 A.P. (DIR Series) Circular No. 25 dated 27th April, 2018]

(Comments: ECB liberalisation is a welcome step though attention needs to be drawn to two important changes brought about by the issuance of this circular:

(a) INR denominated ECB towards Working capital and General Corporate Purposes which was previously allowed under Track III is now prohibited except from Direct and Indirect equity holders or from a Group company;

(b) Equity investment is now included in the negative list though the meaning of the term has not been clarified. Hitherto, "Overseas direct investment in Joint ventures (JV)/Wholly owned subsidiaries (WOS)" was a permissible end use under Track I whereas "equity investment domestically" was specifically prohibited end use under Track III. Now, use of a single term 'equity investment' puts into question whether Overseas direct investment in Joint Ventures (JV)/ Wholly Owned Subsidiaries (WOS) remains as a permissible end use under Track I.)

We have discussed below few recent compounding orders issued by RBI

A. Establishment in India of LO / BO / PO

1. C.A. No. 73/2017 in the matter of Hirose Electric Singapore Pte. Ltd. (Amount imposed under the compounding orders dated 12/03/2018 – ₹ 106,793/- each)

Facts of the Case

Hirose Electric Singapore Pte. Ltd. was granted permission to establish a Liaison Office in India at Bangalore (Nodal Office) and New Delhi as an additional Liaison Office) *vide* Reserve Bank approval letter No. FE.CO. FID/14278/10.97.440/2010-11 dated December 15, 2010. In terms of RBI approval, the offices were opened in Bangalore and New Delhi. Permission for the first extension of Liaison Office (LO) valid up to December 14, 2016 was granted by Standard Chartered Bank *vide* their letter dated December 5, 2013 and further extension up to December 14, 2017 was given by Sumitomo Banking Corporation vide their letter dated January 2, 2017.

Subsequently, the company also opened a Liaison Office at Noida, Uttar Pradesh in May 2014 without obtaining prior approval from Reserve Bank. All the operations were routed through the Noida Office (which was in operation without RBI permission) instead of New Delhi office, which was also maintained in terms of RBI approval. The Liaison Office at Noida has not earned any income and incurred total expenditure of ₹ 1,70,65,259/- (₹ One crore seventy lakh sixty five thousand two hundred and fifty nine rupees only) for the period between May 1, 2014 and August 10, 2017. The Liaison Office noticed non-compliance and *suo motu* submitted application to Reserve Bank of India for *post facto* approval for regularisation of the contravention

Contravention

The contravention sought to be compounded related to the following

- Regulation 3 and 5(i) of Foreign Exchange Management (Establishment in India of Branch or Office or Other Place of Business) Regulations, 2000 notified vide Notification No. FEMA.22 /2000-RB dated May 03, 2000, as amended from time-to-time.
- Regulation 3 of FEMA 22 *ibid.*, states that no person resident outside India shall, without prior approval of the Reserve Bank, establish in India a branch or a liaison office or a

project office or any other place of business by whatever name called.

- Further, Regulation 5(i) of notification No. FEMA 22 ibid., states that a person resident outside India desiring to establish a branch or Liaison Office in India shall apply to the Reserve Bank, in form FNC 1. In the instant case, the company established its Liaison Office at Noida, Uttar Pradesh without prior approval of Reserve Bank.

The aforementioned contravention has been regularised by RBI *vide* letter FE.CO. FID/151/10.97.440/2016-17 dated August 10, 2017, subject to compounding of contraventions.

(Comments

- ***Notification No. FEMA 22/2000-RB dated May 3, 2000 has been replaced by revised regulation Notification No. FEMA 22(R)/ RB-2016 - Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016 dated March 31, 2016.***
- ***Every additional location of a LO/BO/ PO requires a fresh FNC Form along with the justification for the need for additional offices. Care needs to be taken by foreign entities operating in India.***
- ***One may also notice in this compounding order that RBI has levied penalty on the amount of expenditure undertaken by the LO since a LO is not permitted to undertake and commercial/trading/industrial activities.)***

B. Foreign Investment in India:

2. C.A. No. BGL 256/2017 in the matter of M/s Chumbak Design Private Limited (Amount imposed under the compounding order dated 20-3-2018 – ₹ 16,54,500/-)

Facts of the Case

The company is engaged in the business of designing, manufacturing and selling travel and souvenir products, stationery, apparels, accessories and home and lifestyle products (Single brand product retail trading), which is a permissible activity under FDI 49% automatic route in terms of Annexure B of Schedule 1 to FEMA Notification No. FEMA 20/2000- RB dated May 3, 2000, as amended from time-to-time.

The applicant had received funds towards share application money from foreign investors, namely, M/s. Seedfund2 International, Mauritius, M/s. Matrix Partners India Investment Holding II, LLC, Mauritius, M/s Matrix Partners India Investment II Extension, LLC, Mauritius and GCFII-A, Mauritius, without prior approval from Government of India, for exceeding sectoral limits on few occasions.

After allotment of shares, the applicant approached the Government of India for *post facto* approval and the *post facto* approval for exceeding the percentage of foreign shareholding in the company was granted by Department of Industrial Policy & Promotion, Ministry of Commerce & Industry *vide* their letter dated October 3, 2007, subject to compounding.

Contravention:

The contravention sought to be compounded relates to the following

- Exceeding the sectoral limits of FDI under automatic route without prior approval from the Government of India, in terms of Paragraph 3, of Schedule I to Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, notified *vide* Notification No. FEMA 20/2000-RB dated May 3, 2000, and as amended from time-to-time (hereinafter referred to as Notification No. FEMA 20/2000-RB.
- In terms of Paragraph 3 of Schedule 1 to Notification No. FEMA 20/2000-RB, dated May 3, 2000, a company engaged in a sector where foreign investment requires

Government approval, may issue shares to a person resident outside India, with prior approval of Secretariat for Industrial Assistance or, as the case may be of the Foreign Investment Promotion Board of the Government of India, and the terms and conditions of such an approval are complied with.

(Comments

- ***Foreign Exchange Management (Transfer or Issue of Security By a Person Resident Outside India) Regulations (FEMA 20/2000-RB dated May 3, 2000) has been replaced by revised regulation FEMA 20(R)/2017-RB dated 7-11-2017.***
- ***The compounding order takes into account the relevant FDI policy during the period of investment into India and compounding each contravention of allotment exceeding sectoral limits without Government approval.)***

C. Outbound Investments

3. C.A. No. 4526/2017 in the matter of M/s. PMP Auto Components Private Limited (Amount imposed under the compounding order dated 13-3-2018 – ₹ 4,35,235/-).

Facts of the Case

M/s. PMP Components Private Limited (PMP), a resident Indian company, is engaged in the business of manufacturing and marketing auto electrical components for Original Equipment Manufacturers (OEMs).

M/s. PMP made strategic entry in wiper system business by acquiring Bakony Ablaktorlo-rendszerekKft, Hungary in June 2007 (hereinafter referred as 'PMP Bakony').

Further, in October 2008, the applicant set up a step down subsidiary (SDS) in Czech Republic through PMP Bakony *viz* PMP Pal International SRO (hereinafter referred as 'PMP Pal').

On May 26, 2010, the applicant remitted EURO 750,000 (₹ 433,64,670/-) towards loans to PMP Pal i.e., SDS in which the applicant had no direct equity participation without requisite approval from RBI.

Contravention

The contravention sought to be compounded relates to the following

- In terms of regulation 6(4)(i) of FEMA 120/2004, 'An Indian Party may extend a loan or a guarantee to or on behalf of the Joint Venture / Wholly Owned Subsidiary abroad, within the permissible financial commitment, provided that the Indian Party has made investment by way of contribution to the equity capital of the Joint Venture.' Further, in terms of regulation 6(4)(iv) of FEMA 120/2004, 'With prior approval of the Reserve Bank, an Indian party may undertake financial commitment without equity contribution in JV / WOS provided it is as per the business requirement of the Indian party and also as per the legal requirement of the host country.'

(Comments

- ***While setting up Cross-border structures involving step down subsidiaries, such contraventions are many times overlooked by entities.***
- ***Regulation 6(4) as explained above permits an Indian Party to only extend loan/ guarantee to JV/WOS in which it has equity investment. In case of an SDS since the Indian Party does not have direct equity investment, extending a loan is considered a contravention.***
- ***It would be helpful if RBI clarifies such a contravention by way of a specific regulation restricting such extension of loan/ guarantee to SDS).***

❍❑❍

CA R. Venkata Subramani

In Focus – Accounting and Auditing

Financial Assets – Recognition and Measurement

Ind AS 109 deals with the accounting treatment of financial instruments from the perspective of an investor. This standard is an exact replica of IFRS 9 with one significant exception. IFRS 9 contains an accounting policy choice which can be exercised by an entity when IFRS 9 comes into effect. This accounting policy choice is one of its kind: accounting policy choice between applying the hedge accounting requirements of IFRS 9 or continuing to apply the existing hedge accounting requirements in IAS 39 for all hedge accounting because the accounting for macro hedging is not yet covered by IFRS 9. Note that the accounting policy choice covers just hedge accounting. No choice in respect of accounting for all other aspects of financial instruments (viz., classification, measurement, ECL impairment, recognition and derecognition) which should be only as per IFRS 9. No such accounting policy choice is available as per Ind AS 109.

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. For example, a receivable of one entity (financial asset) will represent a payable (financial liability) of another entity. An equity instrument (or security) is a financial asset for an investor holding the instrument and is equity of the issuer of the instrument.

A financial asset is any asset that is:

a) Cash;

b) An equity instrument of another entity;

c) A contractual right:

   i. To receive cash or another financial asset from another entity; or

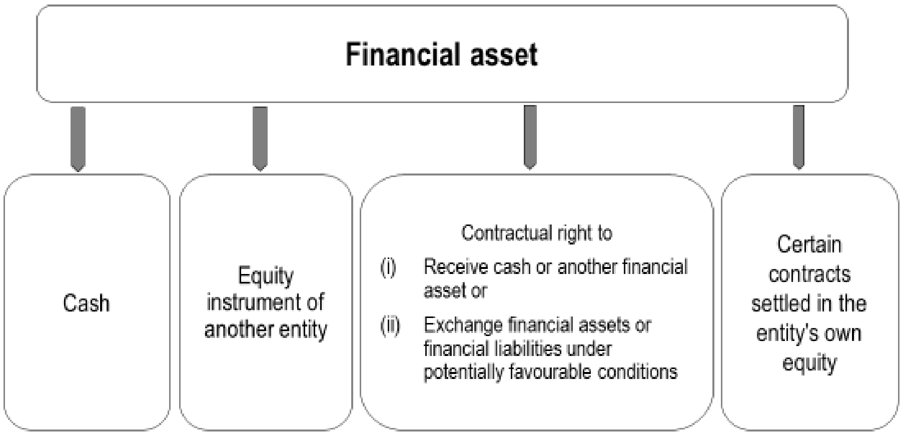
   ii. To exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

d) A contract that will or may be settled in the entity's own equity instruments and is:—

   i. A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

   ii. A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

Note: For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments. These are instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.



Cash, even though is not formed out of a contractual basis, is still a financial asset as it represents the medium of exchange and is therefore the basis on which all transactions are measured and recognised in financial statements. Inventories, plant and machinery, properties and other intangible assets are examples of non-financial assets that are not financial instruments. Such assets even if it is held as an investment (as opposed to stock-in-trade) are not regarded as financial instruments.

Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:

a) Trade accounts receivable and payable,

b) Notes receivable and payable,

c) Loans receivable and payable, and

d) Bonds receivable and payable.

In each case, one party's contractual right to receive (or obligation to pay) cash is matched by the other party's corresponding obligation to pay (or right to receive).

Derivative instruments

Derivative instrument is a financial instrument or other contract with all three of the following characteristics. A derivative instrument is defined as follows:

a) Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').

b) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

c) It is settled at a future date.

The following are examples of financial variable:

- Interest rate (LIBOR/MIBOR)
- Security or commodity price
- Foreign exchange
- Index or credit rating or credit index

The following are examples of a non-financial variable:—

- Climatic or geographical variables – temperature, rainfall, etc.
- The variable must not be specific to a party – else it becomes an insurance contract

Examples of a derivative asset would be a purchased option contract or a bought CAP or floor. Here the entity has the right to exchange such a derivative asset under conditions that are potentially favourable to the entity. If the option contract expires worthless then the maximum loss would be the option premium paid. Even though options and futures are derivative contracts, the payoffs of both are significantly different. The risk reward of an options contract is asymmetric, while that of a futures contract is symmetric. The following tables illustrates the subtle differences between the two:

Characteristics	Futures	Options
Underlying	✓	✓
Notional amount	✓	✓
Expiry Date	✓	✓
Investment – Small portion	✓	✓
Risk reward	Symmetric	Asymmetric
Is it hedging instrument?	No	Yes – if bought
Maximum profit – If bought	Directional call – risk reward is symmetric	Call: Unlimited Put : Strike price
Maximum loss – if bought		Premium paid
Maximum profit – if sold		Premium received
Maximum loss – if sold		Call : Unlimited Put : Strike price

Contracts to buy or sell a non-financial item

A contract to deal with non-financial asset at a specified price at a specified future date is not a financial instrument. Thus, commodity contracts that provide for settlement only by the receipt or delivery of a non-financial item are not financial instruments. Contracts to buy or sell non-financial items that can be settled net in cash or another financial instrument or by exchanging financial instruments, or in which the non-financial item is readily convertible to cash, are within the scope of accounting standards for financial instruments as if they were financial instruments.

Accounting standards for financial instruments are applicable to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments.

Contracts that were entered into for the purpose of the receipt or delivery of a non-financial item for the entity's own use is excluded. However, contracts that an entity designates as measured at fair value through profit or loss are not excluded even when such contracts are meant for own use.

There are several ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

a) When the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

b) When the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument, or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

c) When, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, and

d) When the non-financial item that is the subject of the contract is readily convertible to cash.

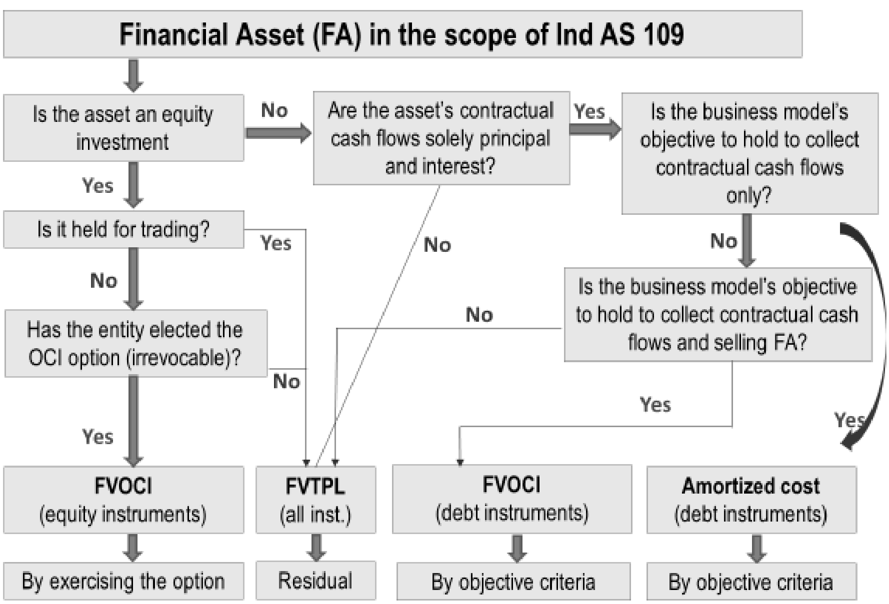
A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements, and, accordingly, is within the scope. A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument is within the scope; hence, such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item.

Classification of Financial Assets

A financial asset is classified as one of the three as follows:

1. Amortised Cost (AC)
2. Fair Value through OCI (Equity Instruments) – FVOCI – Equity Instruments
3. Fair Value through OCI (Debt Instruments) – FVOCI – Debt Instruments
4. Fair Value through Profit & Loss (FVTPL)

The key feature of Ind AS 109 is that the classification is now based on sound objective criteria as opposed to IAS 39 wherein it was based on subjective criteria. While there is a choice given for the entities to classify an investment in equity instrument as either FVOCI or FVTPL, there is no such choice for the classification of debt instrument as it is exclusively based on certain very rigid and objective criteria. The following diagram gives an overview of the classification process of a financial asset within the purview of Ind AS 109.



Amortised Cost (AC)

A debt instrument would be classified as amortised cost asset if it satisfies SPPI test. Further the Business Model Objective should be hold the asset for collecting contractual cash flows only.

Solely Payments of Principal and Interest (SPPI) Test: An entity should assess whether contractual cash flows are Solely Payments of Principal and Interest (SPPI) on the principal amount outstanding for the currency in which the financial asset is denominated.

Principal is the fair value of the financial asset at initial recognition. However, principal may change over time – e.g., if there are repayments of principal. Principal is not the amount due but the fair value of financial asset. This meaning reflects the economics of the financial asset from the perspective of the holder. An entity should evaluate the contractual cash flows to the amount that it invested.

Interest is consideration for:

1. The time value of money
2. The credit risk associated with the principal amount outstanding during a particular period of time
3. Consideration for other basic lending risks (e.g., liquidity risk) and costs (e.g. administrative costs), and
4. A profit margin

Principal

Principal is not the amount due but the fair value of the financial instrument at initial recognition. Transaction price is generally a good measure of the fair value at initial recognition, as there is nothing like 'free lunch' in business. If not, then the difference is recognized in PL immediately (both gain or loss as the case may be).

Lets assume the following data:

Interest free rental deposit	1,000,000
Risk free rate of interest (same tenor as deposit)	5.00%
Credit risk of the counterparty	2.00%
Effective interest rate to be applied	7.00%
Date of deposit	1-Jan-2018
Maturity	31-Dec-2022

The fair value of the interest free deposit would be arrived by discounting the principal amount of interest free rental deposit with the effective interest rate which is the risk-free rate of interest for the same tenor as deposit as increased by the credit risk of the counter party. The imputed interest income for the various years till maturity date of the deposit should be computed and the accounting entries for the same is given as follows:

Table showing the amortised cost of the asset / imputed interest income

Date	Rental Deposit (Amortised Cost Asset	Prepaid Expenses (Asset Account)	Interest Income (P&L)	Rental Expense (P&L)
1st Jan, 2018	712,986	287,014		
31st Dec, 2018	762,895	(49,909)	49,909	49,909
31st Dec, 2019	816,298	(53,403)	53,403	53,403
31st Dec, 2020	873,439	(57,141)	57,141	57,141
31st Dec, 2021	934,579	(61,141)	61,141	61,141
31st Dec, 2022	1,000,000	(65,421)	65,421	65,421
			287,014	**287,014**

ML-678

Journal entries

Account	1st Jan, 2018		31st Dec, 2018		31st Dec, 2019		31st Dec, 2020		31st Dec, 2021		31st Dec 2022	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Rental Deposit	712,986											
Prepaid Rent	287,014											
Bank		1,000,000										
Rental Deposit			49,909		53,403		57,141		61,141		65,421	
Prepaid Rent				49,909		53,403		57,141		61,141		65,421
Rental Expense			49,909		53,403		57,141		61,141		65,421	
Interest Income				49,909		53,403		57,141		61,141		65,421

Business Model Test

The business model determined by the investors' key management personnel, as defined in Ind AS 24 *'Related Policy Disclosures'*. The following factors should be considered while determining the business model objective:

1) The business model does not depend on the management's intention and ability for an individual instrument. As per the previous standard viz., IAS 39, this used to be based on the management's intention and ability to hold such investment. As per the new standard the criteria are determined objectively.

2) The business model objective should not be determined on an instrument by instrument basis.

3) The business model objective test should be performed on a higher level of aggregation.

4) Higher level of aggregation does not mean that the test should be performed at the entity / enterprise level.

5) The business model objective test should be performed at the portfolio or sub-portfolio investments level. The entity may purchase or originate portfolio of mortgage loans with the objective of collecting contractual cash flows and another portfolio of loans with the objective of selling them for realising short-term profits. In other words it is possible for an entity to have multiple portfolios each with different business model objective and hence each of the portfolio being classified differently depending upon the set of objective criteria.

6) The entity may have more than one business model for managing its financial instruments, e.g., the entity may hold a portfolio of investments and that it manages to collect the contractual cash flows and another portfolio of investments that it manages to realise fair value changes.

7) The way an entity manages its financial assets to generate cash flows determines the business model of such entity. The entity may generate cash flows either by collecting contractual cash flows or selling such financial assets or both. The entity may sell some financial assets when it is hard pressed for cash during a stress situation and such a scenario would not affect the entity's assessment of the business model if the entity reasonably excepts that such a scenario will not occur. In a nutshell, this means that an entity need not consider the worst-case scenario while assessing if the entity would sell the financial assets.

8) The entity's business model is a matter of fact and not merely an assertion.

An entity may hold

a) A portfolio of investments that it manages in order to collect contractual cash flows and

b) Another portfolio of investments that it manages in order to trade to realise fair value changes

Judgment needed for business model assessment

Examples of portfolios where judgment is likely to be required include

- Portfolios of instruments that are held for liquidity management; and
- Those supporting a business model objective of providing insurance or pension benefits

Business model – 'held to collect' & 'for sale'

It is possible for an entity to have both the business models simultaneously. The key management personnel should decide (Ind AS 24). Examples include a Financial Institution holding financial assets to meet its every day liquidity needs or an insurer holding financial assets to fund insurance contract liabilities. Held for sale category will involve greater frequency / value of sales. Now there is no threshold or 'bright line' for sales activity.

Example – Sales held-to-collect business model

- A Company has a portfolio of financial assets that it has determined to be part of a held-to-collect business model. A change in the regulatory treatment of these assets has caused the company to undertake a significant rebalancing of its portfolio in a particular period. However, the company does not change its assessment of the business model, as the selling activity is considered an isolated – i.e. one-time – event.
- By contrast, suppose that the same entity were required by its regulator to routinely sell financial assets from a portfolio to demonstrate that the assets were liquid, and that the value of the assets sold was significant. In that case, the entity's business model for managing that portfolio would not be 'held-to-collect', but 'for sale'.

Exceptions

- The entity need not hold all of those instruments until maturity. Thus, an entity's business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur.

The entity may sell a financial asset if:

a) The financial asset no longer meets the entity's investment policy (e.g., the credit rating of the asset declines below that required by the entity's investment policy);

b) An insurer adjusts its investment portfolio to reflect a change in expected duration (i.e. the expected timing of payouts); or

c) An entity needs to fund capital expenditures.

Let us assume that on 1st April, 2017 an investor bought 5% 100 Debentures issued by Infinity Limited @ ₹ 90 maturing on 31st March, 2022. The debentures are held by the investor solely for collecting contractual cash flows only and hence should be classified and valued at amortized cost. Market rate on 31st March, 2018 was ₹ 94.

The following journal entries would be required to account for the amortisation based on effective interest rate and also to record the recognition of the investment. The market rate of ₹ 94 has no relevance here as the investment will be recorded only based on amortized cost of the asset and not based on the market value.

The first step would be to find out the effective interest rate for this investment. Effective interest rate is the same as internal rate of return (IRR function in Excel) commonly known as Yield to Maturity (YTM) in Bond market.

Cost	85	IRR	7.47%	
Year	Cash flow	Effective Interest income	Carrying amount (Amortised cost)	Interest Income / amortisation of debentures
0	-90		90.00	
1	5	6.72	91.72	1.72
2	5	6.85	93.57	1.82
3	5	6.99	95.56	1.99
4	5	7.14	97.70	2.14
5	105	7.30	0.00	2.30

Journal entries

Date	Particulars	Debit (₹)	Credit (₹)
01 Apr-17	Investment Account (Debentures) A/c	90,000	
	To Bank A/c		90,000
	(Being the 5% debentures classified as Amortized cost security)		

Date	Particulars	Debit (₹)	Credit (₹)
31 Mar-18	Bank A/c	5,000	
	To Interest Income (P&L) A/c		5,000
	(Being the interest received on 6% bonds held as Amortized cost security)		

Date	Particulars	Debit (₹)	Credit (₹)
31 Mar-18	Investment Account (Debentures) A/c	1,720	
	To Interest Income (P&L) A/c		1,720
	(Being the amount amortized to account for interest based on Effective Interest Rate and adjustment of the carrying amount of the 5% bonds)		
	(₹ 6,720 effective interest less ₹ 5,000 interest received)		

Fair Value through Other Comprehensive Income (FVOCI)

An equity instrument may be classified as Fair Value through Other Comprehensive Income. This classification is by exercising a choice that is given to the entity. However, such choice is applicable only where such equity instrument is held not for trading purpose and should be exercised without undue delay and is irrevocable. The fair value changes to equity instruments classified as FVOCI are recognised in the other comprehensive income. The profit or loss stays in the other comprehensive income even when the entire asset (equity instrument) is liquidated. Such profit/loss is never ploughed back to the profit and loss account. The logic for such a treatment would be clear if we try to understand in the first place the reasoning as to why choice is given to the entity for such classification. The choice is granted to an entity so that the profit and loss is account is not affected by the undue fluctuations in the fair value of such equity instrument. If an entity opts for classifying the equity instrument as FVOCI then the earnings per share (EPS) would not undergo fluctuations due to the fair value changes of the instrument as the changes would be reported in the other comprehensive income. However, if the entity is required to reclassify such accumulated profits or losses to the profit and loss account on liquidation of the asset, then the very purpose would be defeated.

For debt securities, the accumulated profit or loss that is parked in the other comprehensive income should be reclassified to the profit and loss account. The reason for recognising the fair value changes of a debt security in the other comprehensive income is two-fold – one, the balance sheet should reflect the fair value of the asset at any point of time and two – the fair value changes are not really profits or losses at that point of time as it is not yet crystallised. The profit /loss gets crystallised on liquidation of the asset and at that point of time it should be reported in the profit and loss account. And hence the requirement that the accumulate profit or loss should be reclassified to the profit and loss account when the asset is liquidated.

Les us assume the same facts as mentioned above except that the debentures are held by the investor for collecting contractual cash flows as well as to sell the same at opportune time. Then the investment should be classified as FVOCI and should be valued at the fair value of the asset. Market rate on 31st March 2018 was ₹ 94.

The table for computing the effective interest remains the same. All the entries given above would also be the same. There would be an additional entry to value the investment based on the market quote and the same would be transferred to the Other Comprehensive Income (Reserve Account). The amortized cost as on 31st March is ₹ 91.72. The fair value is ₹ 94. So, the investment account should be increased by ₹ 2.28 and this should be taken to the other comprehensive income.

Date	Particulars	Debit (₹)	Credit (₹)
31 Mar-18	Investment Account (Debentures) A/c	2,280	
	To FV changes to FVOCI asset A/c		2,280
	(Being the difference between the amortised cost as on that date and the fair value recognised in OCI (Reserve) A/c		

Fair value through profit or loss (FVTPL)

- o Financial asset is classified and measured at FVTPL if the financial asset is
  - A held-for-trading financial asset
  - A debt instrument that does not qualify to be measured at amortised cost or FVOCI
  - An equity investment which the entity has not elected to classify as at FVOCI
- o Examples of financial assets classified and accounted for at FVTPL are
  - Derivatives that have not been designated in a hedging relationship, e.g.: Interest rate swaps; commodity futures/option contracts; foreign exchange futures/option contracts
  - Investments in shares that the entity has not elected to account for at FVOCI
  - Contingent consideration receivable from the sale of a business.
- o It should be considered first if the financial asset is to be measured at amortised cost and FVOCI and, if it is not then it will be measured at FVTPL.

Let us assume the same facts as mentioned above except that the debentures are held by the investor for trading purpose. Then the investment should be classified as FVTPL and should be valued at the fair value of the asset. Market rate on 31st March 2018 was ₹ 94.

The only change between FVOCI and FVTPL is that the fair value changes should be recognized in the Profit and Loss account.

Date	Particulars	Debit (₹)	Credit (₹)
31 Mar-18	Investment Account (Debentures) A/c	2,280	
	To FV changes to FVTPL asset A/c		2,280
	(Being the difference between the amortized cost as on that date and the fair value recognized in P&L A/c		

Treatment of income/expenses for various classification of financial assets

FVOCI (Equity instruments)

- Dividends generally recognised in P&L
- Changes in fair value recognised in OCI

- **No reclassification** of gains and losses to P&L on derecognition and no impairment recognized in P&L

FVOCI (debt instruments)
- Interest revenue, credit impairment and foreign exchange gain or loss recognized in P&L (in the same manner as for amortized cost assets)
- Other gains and losses recognised in OCI
- On derecognition, cumulative gains and losses in OCI reclassified to P&L

FVTPL
- Changes in fair value recognized in P&L

Amortized cost
- Interest revenue, credit impairment and foreign exchange gain or loss recognised in P&L
- On derecognition, gains or losses recognized in P&L

FVOCI — Equity instruments
- Accounting for FVOCI category for debt instruments is different from FVOCI for equity instruments due the following
  - o Impairment requirements are not applicable
  - o Foreign exchange differences are not recognised in OCI
  - o Amounts recognised in OCI are never reclassified to profit or loss

Initial recognition

Regular way purchase or sale of financial assets.

A regular way purchase or sale of financial assets shall be recognised, as applicable, using trade date accounting or settlement date accounting. However, the entity should apply the same method consistently for all purchase and sales of financial assets that are classified in the same way as per the accounting standard. Assets that are mandatorily measured at a fair value through profit or loss form a separate classification from assets designated as measure at fair value through profit or loss. Investments in equity instruments accounted for using the fair value option (FVO) form another separate classification.

A contract that requires or permits net settlement of the change in the value of the contract is not a regular way contract. Instead, such a contract is accounted for as a derivative in the period between the trade date and the settlement date.

A financial instrument is recognised only when the entity becomes a party to the contractual provisions of the instrument, using trade date accounting or settlement date accounting. Whatever may be the method, that should be applied consistently. Assets held for trading form a separate category from assets designated at fair value through profit or loss.

Trade date accounting

- Trade date is the date an entity commits itself to purchase/sale
- Trade date accounting
  - a) The recognition of an asset to be received/liability to be paid on trade date, and
  - b) Derecognition of an asset sold, recognition of gain/loss on disposal and recognition of receivable on trade date

Settlement date accounting

- Settlement date is the date an asset is delivered to or by an entity
- Settlement date accounting
  - a) The recognition of an asset on the day it is received by the entity, and
  - b) The derecognition of asset and recognition of gain / loss on disposal on the day that it is delivered by the entity
- When settlement date accounting is applied, an entity accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. In other words,

- The change in value is not recognised for assets carried at cost or amortized cost;
- It is recognised in profit or loss for assets classified as financial assets at fair value through profit or loss; and
- It is recognised in other comprehensive income for assets classified as FVOCI

Transaction costs

Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Financial assets measured not at FVTPL

For financial assets not measured at fair value through profit or loss, transaction costs are added to the fair value at initial recognition. For financial liabilities, transaction costs are deducted from the fair value at initial recognition.

Financial assets at amortised cost

For financial instruments that are measured at amortised cost, transaction costs are subsequently included in the calculation of amortised cost using the effective interest method and, in effect, amortised through profit or loss over the life of the instrument.

Financial assets at FVOCI

For financial instruments that are measured at fair value through other comprehensive income transaction costs are recognised in other comprehensive income as part of a change in fair value at the next re-measurement. If the financial asset is measured those transaction costs are amortised to profit or loss using the effective interest method and, in effect, amortised through profit or loss over the life of the instrument.

Example: Let us assume that an entity acquires a financial asset for ₹ 1,000 plus a purchase commission of ₹ 30. Initially, the entity recognises the asset at ₹ 1,030. The reporting period ends one day later, when the quoted market price of the asset is ₹ 1,000. If the asset were sold, a commission of ₹ 40 would be paid. On that date, the entity should measure the financial asset at ₹ 1,000 (without regard to the possible commission on sale) and should recognise a loss of ₹ 30 in other comprehensive income. If the financial asset is measured at fair value through other comprehensive income, the transaction costs are amortised to profit or loss using the effective interest method.

Transaction costs expected to be incurred on transfer or disposal of a financial instrument are not included in the measurement of the financial instrument.

Derecognition of financial assets

Components of a financial asset

Financial assets have two distinct components viz., cash flows from principal repayment and cash flows from interest coupons. In several financial assets, these cash flows can be segregated and potentially transferred to other parties. The Accounting Standard lays down the implications of transferring each component separately without transferring the other.

An entity shall derecognise a financial asset when and only when

1. The contractual rights to the cash flows from the financial assets expire, or
2. Transfers the contractual rights to receive the cash flows of the financial asset, or
3. Retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows meeting certain conditions

The final test is to ensure that both risk & rewards as well as control are not retained by the entity.

When assuming contractual obligation to pay cash flows as given in point # 3 above, the following three conditions should be met:

a) There should be no obligation to pay unless it collects equivalent amount

b) There is a prohibition to sell or pledge the original asset

c) The obligation to pay cash flows arises without material delay

Control over a financial asset is determined based on identifying the risks and rewards of the asset and evaluating which party has exposure to the risks and which party has benefits from the financial asset. The accounting standard analyses the transfer of risks and rewards while transferring a financial asset. There are several situations where a transferor has not lost control of a transferred financial asset but retaining the risks and rewards related to such asset. When an entity transfers a financial asset it should evaluate the extent to which it retains risks and rewards of the ownership of the financial asset.

a) If risk and rewards are transferred – derecognised

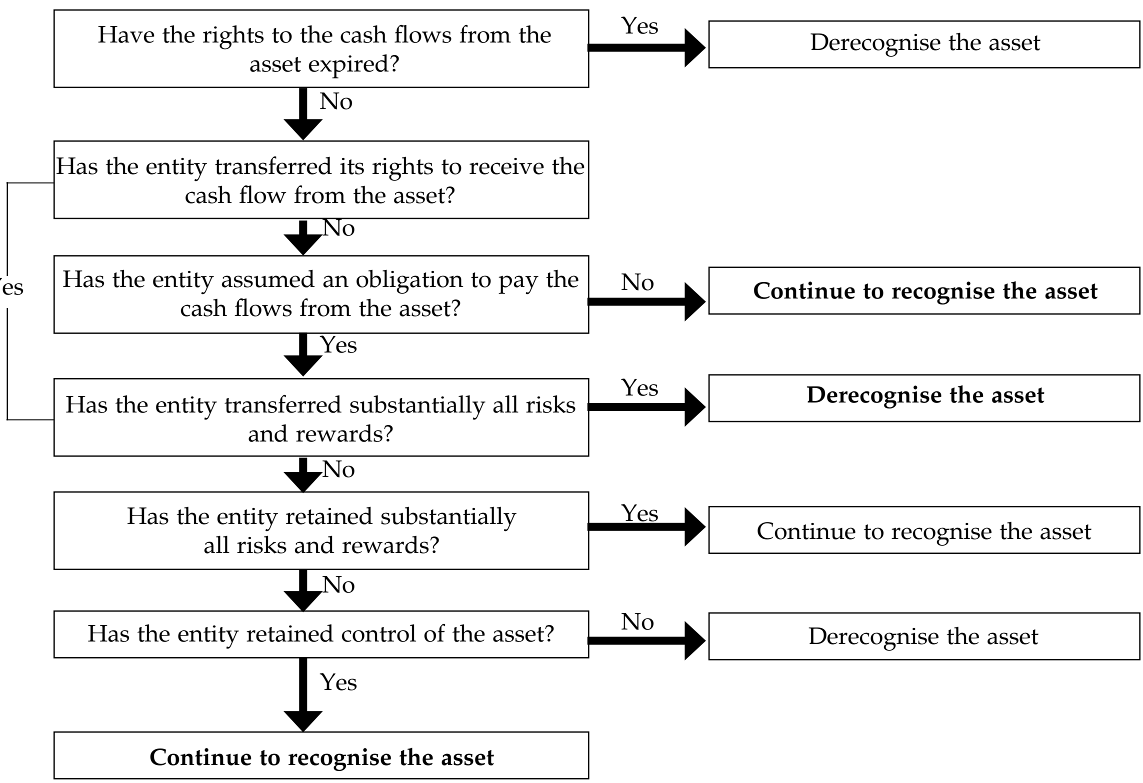
b) If not – continue to recognize the financial asset

c) Irrespective of the above, if the entity retains the control of the financial asset – continue to recognise the financial asset

d) Else derecognise the financial asset

Key factors to be considered in the case of deregonition of a financial asset are as follows:—

- Rights to cash flows – whether it is expired?
- Rights to cash flows – whether it is transferred?
- Entity assumed any obligation to pay the cash flows?
- Are all risks and rewards transferred?
- Are all risks and rewards retained?
- Has the entity retained control of the asset?



Effect of derecognition

The effect of derecognition is that the difference between the carrying amount measured at the date of derecognition and the consideration received (including any new asset obtained less any new liability assumed) should be recognised in profit or loss.

If the transfer does not result in derecognition then the entity should continue to recognise the transferred asset in its entirety and should recognise a financial liability for the consideration received. In subsequent periods, the entity should recognize any income on the transferred asset and any expense incurred on the financial liability. The entity shall continue to recognize any income arising on the transferred asset to the extent of its continuing involvement and shall recognize any expense incurred on the associated liability.

If a transferred asset continues to be recognized, the asset and the associated liability should not be offset against each other. The entity also should not offset any income arising from the transferred asset with any expense incurred on the associated liability.

Effective Interest Rate

The EIR is calculated at initial recognition of a financial asset or a financial liability. It is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the gross carrying amount of the financial asset.

At initial recognition, the gross carrying amount of a financial asset, or the amortised cost of a financial liability, is generally equal to the fair value of the instrument, adjusted for transaction costs. The estimate of expected cash flows considers all contractual terms (e.g., prepayment, call and similar options) but **does not consider expected credit losses** (i.e., the contractual cash flows are not reduced by expected credit losses.)

Reclassification of Financial Assets

Reclassification of a financial asset happens when the objective of entity's business model changes. This change is expected to be very infrequent. It is usually determined by entity's senior management. Such changes to the business model should be demonstrable to external parties. Reclassification happens prospectively from the first day of the next reporting period. Prior periods are not restated. It should be noted that the 'reporting period' – not defined in the Standard. This only means that the new assets would be classified based on revised criteria.

Examples of circumstances that are changes in the business model	
Change in business model	An entity has a portfolio of commercial loans that it holds to sell in the short term. The entity acquires a company that manages commercial loans and has a business model that holds the loans in order to collect the contractual cash flows The original portfolio of commercial loans is no longer for sale, and this portfolio is now managed together with the acquired commercial loans. All of the loans are now held to collect the contractual cash flows
	A financial services firm decides to shut down its retail mortgage business. That business no longer accepts new business and the financial services firm is actively marketing its mortgage loan portfolio for sale

Examples of circumstances that are not changes in the business model	
Not a change in business model	An entity changes its intention for particular financial assets (even in circumstances of significant changes in market conditions
	A particular market for financial assets temporarily disappears
	Financial assets are transferred between parts of an entity with different business models

Changes in the way in which assets are managed

The classification of financial assets depends on the way in which they are managed within a business model, and not solely on the objective of the business model itself. Changes in the way that assets are managed within the business model – e.g. an increased frequency of sales – will not result in the reclassification of existing assets. It may result in newly acquired assets being classified differently. Such changes may occur more frequently than changes in the objective of the business model itself.

Measurement on reclassification of financial assets

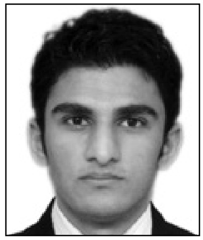
	Reclassification to	
	FVOCI	**Amortised cost**
Reclassification from FVPL	Fair value on reclassification date = new gross carrying amount Calculate EIR based on new gross carrying amount Recognise subsequent changes in fair value in OCL	Fair value on reclassification date = new gross carrying amount Calculate EIR based on new gross carrying amount

	Reclassification to	
	FVTPL	**Amortized cost**
Reclassification from FVOCI	Reclassify accumulated OCI balance to profit or losson reclassification date	Reclassify financial asset at fair value. Remove cumulative balance from OCI and use it to adjust the reclassified fair value. Adjusted amount= amortized cost EIR determined at initial recognition and gross carrying amount are not adjusted as a resutl of reclassification

	Reclassification to	
	FVPL	**FVOCI**
Reclassification from amortized cost	Fair value on reclassification date = new carrying amount Recognise difference between amortised cost and fair value in profit or loss	Remeasure to fair value, with any difference recognised in OCI EIR determined at initial recognition is not adjusted as a result of reclassification

❍❑❍

> That society is the greatest, where the highest truths become practical.
>
> — *Swami Vivekananda*



Rahul Sarda, *Advocate*

Best of the Rest

1. Arbitration and Conciliation Act, 1996 – Execution of awards – Anywhere in the country – Requirement to obtain transfer of decree from Court which has jurisdiction over arbitral proceedings

The question that arose before the Supreme Court was that whether an award under the Arbitration & Conciliation Act, 1996 (the 'Act') is required to be first filed in the court having jurisdiction over the arbitration proceedings for execution and then to obtain transfer of the decree or whether the award can be straightway filed and executed in the Court where the assets are located. There was a divergence of opinion of different High Court on this issue.

The facts of the case are that an arbitrator in Tamil Nadu passed an award in favour of the appellant who filed for execution of the award in the court at Morena, Madhya Pradesh. The said Trial Court at Morena returned the execution application on account of lack of jurisdiction to be presented to the Court of competent jurisdiction in Tamil Nadu. The effect of the judgment was that the appellant was required to file the execution proceedings first before the Court of competent jurisdiction in Tamil Nadu, obtain a transfer of the decree and then only could the proceedings be filed in the Trial Court at Morena. This view adopted by the trial court was based on the judgment of the Madhya Pradesh High Court and the opinion of the Karnataka High Court while the view of the Rajasthan High Court and the Delhi High Court was to the contrary. The appellant did not approach the Madhya Pradesh High Court against the said order of the Trial Court but straightway approached this Court by filing the Special Leave Petition on the ground that no useful purpose would be served by approaching the Madhya Pradesh High Court in light of the view already expressed by that Court in conflict with the opinions of some other High Courts.

Held, that the application of a decree holder for execution is made to the Court which passed the decree as per Section 46 of the Civil Procedure Code, which issues the precepts to any other Court competent to execute the said decree. However, in the case of an award there is no decree passed but the award itself is executed as a decree by fiction. As per Section 36 of the Act, an award is to be enforced in accordance with the provisions of the said code in the same manner as if it were a decree. It is, thus, the enforcement mechanism, which is akin to the enforcement of a decree but the award itself is not a decree of the Civil Court as no decree whatsoever is passed by the Civil Court. It is the Arbitral Tribunal, which renders an award and the Tribunal does not have the power of execution of a decree. For the purposes of execution of a decree the award is to be enforced in the same manner as if it was a decree under the said Code. Therefore, held that the enforcement of an award through its execution can be filed anywhere in the country where such decree can be executed and there is no requirement for obtaining a transfer of the decree from the Court, which would have jurisdiction over the arbitral proceedings.

Sundaram Finance Limited vs. Abdul Samad & Ors. 2018 (2) SCALE *467*

2. Insolvency and Bankruptcy Code, 2016 – Pendency of appeal under Section 37 of Arbitration and Conciliation Act, 1996 – Amounts to "dispute"

The petitioner was awarded contracts by company 'X' for supply of equipment and erection and commissioning of sub-station. 'X' realised its liquidated damages as a result of delay in completing the contractual work by invoking bank guarantees furnished by the petitioner. The disputes between the Petitioner and 'X' were referred to arbitration wherein the arbitrator passed an award directing 'X' to pay a sum to the petitioner. 'X' challenged the said award before the Distt. Court under Section 34 of the Arbitration and Conciliation Act, 1996 during which the Respondent acquired the entire equity stake of 'X' and became liable to pay the outstanding dues subsisting in respect to the supply contract entered between the Petitioner and 'X'.

The District Judge dismissed the challenge made against the award passed in favour of the Petitioner and the respondent preferred an appeal before High Court of Orissa under Section 37(1)(b) of the Arbitration and Conciliation Act, 1996 which was pending.

In the meanwhile, Insolvency and Bankruptcy Code, 2016 came into force entitling the Petitioner to initiate insolvency proceedings against the Respondent.

Held by the NCLT, "dispute" includes pendency of arbitration proceedings and includes appeal under Section 37. It was an established proposition of law that appellate proceedings were a continuation of suit proceedings because a decision in the appeal will have a bearing on the decree or suit proceedings, likewise, a judgment under Section 37 of the Arbitration and Conciliation Act, 1996 will have an equal bearing on the judgment passed under Section 34. It can be said that at least for the sake of IBC, there exists a dispute in respect to the operational debt claim made by the Petitioner. Hence, petition was liable to be dismissed.

CG power & Industrial Solutions Ltd. vs. ACC Ltd. [2018] 91 taxmann.com 363 (Mumbai - NCLT)

3. Suit for Specific Performance – Form of decree of Specific Performance when suit property is sold to third party and the Court decrees the suit for specific performance in favour of Plaintiff

On 18-1-1983, defendant Nos. 1 to 5 entered into an agreement with the plaintiff for sale of the suit house in favour of the plaintiff for a sum of ₹ 46,000/-. The plaintiff accordingly paid ₹ 1,000/- as advance money to defendant Nos. 1 to 5 and the balance amount was to be paid by the Plaintiff to Defendant Nos. 1 to 5 at the time of the registration of the sale deed, which was to be executed within six months. The Plaintiff accordingly arranged for the balance money. However, defendant Nos. 1 to 5, on the other hand, went on promising the Plaintiff to execute the sale deed in his favour as agreed upon between them as per agreement dated 18-1-1983 and on the other hand, defendant Nos. 1 to 5, instead of executing a sale deed in favour of the Plaintiff, executed the sale deed on 9-2-1983 in favour of Defendant No. 6 for ₹ 45,000/-.

The Trial Court decreed the suit for specific performance in favour of the Plaintiff, which was upheld by the Supreme Court. As a result, the transaction of defendant Nos. 1 to 5 with defendant No. 6 had failed and a question arose before the Supreme Court as to the form of decree of specific performance that ought to be directed.

As per the law laid down by SC in a previous case, where there is a sale of the same property in favour of a prior and subsequent transferee and the subsequent transferee has, under the conveyance outstanding in his favour, paid the purchase-money to the vendor, then in a suit for specific performance brought by the prior transferee, in case he succeeds, the question arises as to the proper form of decree in such a case. The practice of the Courts in India has not been uniform and three distinct lines of thought emerge. According to one point of view, the proper form of decree is to declare the subsequent purchase void as against the prior transferee and direct conveyance by the vendor alone. A second considers that both vendor and vendee should join, while a third would limit execution of the conveyance to the subsequent purchaser alone. According to the Supreme Court, the proper form of decree is to direct specific performance of the contract between the vendor and the prior transferee and direct the subsequent transferee to join in the conveyance so as to pass on the title which resides in him to the prior transferee. He does not join in any special covenants made between the prior transferee and his vendor; all he does is to pass on his title to the prior transferee.

Therefore, the Supreme Court directed defendant Nos. 1 to 5 (the vendors of the suit house) to execute a sale deed in favour of the plaintiff and the defendant No. 6 (i.e. the subsequent transferee of Suit House whose transaction has failed as a result of the judgment of the Court) join in the execution of the sale deed in plaintiff's favour.

In order to do complete justice between the parties and to prevent another round of litigation between defendant Nos. 1 to 5 on one hand and defendant No. 6 on the other, the Supreme Court also exercised powers under Article 142 and directed that the amount paid by defendant No. 6 to defendant Nos. 1 to 5 ought to be refunded by defendant Nos. 1 to 5 for which purpose the executing Court will hold limited enquiry on this question and record its finding after giving an opportunity to the parties to prove this fact and then parties will accordingly pay the decided amount.

Nadiminti Suryanarayan Murthy (dead) through L.Rs. vs. Kothurthi Krishna Bhaskara Rao and Ors. 2018 (2) MhLJ 543 (SC).

❍❑❍

Notice of Election

To

The Members,
The Chamber of Tax Consultants,
Mumbai

The election of the President and fourteen Members of the Managing Council for the ensuing year 2018-19 shall take place on **Thursday, May 31st , 2018** at the **Office of The Chamber of Tax Consultants, 3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai – 400 020**.

Nominations in the prescribed form should be filed so as to reach the office of the CTC not later than **6 p.m. on Friday, May 18th, 2018**. The nomination forms shall be available at the CTC office from **Friday, May 4th, 2018**.

FOR AND ON BEHALF OF THE MANAGING COUNCIL OF
The Chamber of Tax Consultants

Sd/- Sd/-
KETAN L. VAJANI / NISHTHA PANDYA
Hon. Jt. Secretaries

Place : Mumbai
Dated : 13th April, 2018

Office : 3, Rewa Chambers, 31, New Marine Lines, Mumbai – 400 020.

Notes:

1. Ordinary and Life Members are **only** eligible to vote at the election.
2. A Member who has completed at least **two full years** as a member shall be entitled to contest for the post of Managing Council member or to propose or second a candidate for the election. Each such member can propose not more than **three** candidates. The candidate for the post of President should have completed ten years of post qualification experience relating to tax laws or any branch of accountancy or company secretarial practice.
3. Members whose membership subscription is in arrears shall not be entitled to contest any election or to propose or second any candidate for the election or to vote at the election.
4. Withdrawal of nomination for the elections can be made by the candidate on or before 6.00 p.m. on **Friday, May 25th, 2018**.
5. If elections are required to be held, the names of the valid candidates shall be intimated through the website of The Chamber as well as through a circular. The Members are requested to check through these mediums.
6. If elections are not required to be held, due to any reason whatsoever, the same shall be intimated through the website of The Chamber as well as through the Notice Board at the Chamber's office. The Members are requested to check through these mediums.
7. The voting, if required, will commence at 11.00 a.m. and shall end at 5.00 p.m.

8 The above is only a gist of the Election Rules. Please read Election Rules (Bye Laws) of The Chamber carefully on the website www.ctconline.org.


CA Ketan Vajani & CA Nishtha Pandya *Hon. Jt. Secretaries*

The Chamber News

Important events and happenings that took place between 7th April, 2018 to 7th May, 2018 are being reported as under:

I. ADMISSION OF NEW MEMBERS

1) The following new members were admitted in the Managing Council Meeting held on 13th April, 2018

Life Membership

1	Mr. Salunkhe Sanjay Shankar	ITP	Kolhapur
2	Mr. D'Souza Leslie Frank	ITP	Mumbai
3	Mr. Jhaveri Pranav Ketan (Transfer from Ordinary to Life)	CA	Mumbai
4	Mr. Shah Neel Deepakkumar	CA	Mumbai
5	Mr. Doshi Ankit Mahesh	CA	Mumbai
6	Ms. Jain Shraddha Bhuneswar	CA	Mumbai
7	Mr. Sheth Mehul R. (Transfer from Ordinary to Life)	CA	Mumbai

Ordinary Membership

1	Mr. Shah Dhaval Dinesh	CA	Mumbai
2	Mr. Kasvala Samirkumar G.	CA	Mumbai
3	Mr. Aga Nazahar Abbas	ITP	Mumbai
4	Mr. Garge Jayant Dilip	CA	Pune
5	Mr. Parikh Sandip Ashwinbhai	CA	Ahmedabad
6	Mr. Choksi Vartik Rohitbhai	CA	Ahmedabad
7	Mr. Oak Shrinivas Suresh	CA	Mumbai
8	Mr. Parmar Dhaval Magan	CA	Mumbai
9	Mr. Prithwani Arun R.	CA	Mumbai
10	Mr. Pandey Chandraprakash D.	Adv	Mumbai
11	Mr. Patwari Saket	CA	Mumbai
12	Mr. Shah Manzil Janardan	CA	Mumbai

13	Mr. Kochar Kalpesh N.	CA	Mumbai
14	Mr. Shah Sagar Dilip	CA	Mumbai
15	Mr. Gudhka Ankit Kirit	CA	Mumbai
16	Mr. Mehta Shashank Ajay	CA	Mumbai
17	Mr. Sancheti Vinod P.	CA	Mumbai
18	Mr. Shah Arpit Sanjay	CA	Mumbai
19	Ms. Sharma Anjali Abhay	CA	Mumbai
20	Mr. Shah Vatsal Mahendra	CA	Mumbai
21	Mr. Shivkar Kresh Kishor	CA	Mumbai
22	Ms. Muzumdar Shreya	CA	Mumbai
23	Mr. Hirlekar Swanand Suhas	CA	Pune
24	Mr. Kanade Sagar Nandkumar	CA	Pune
25	Mr. Anushkumar Shivaraman	CA	Pune
26	Mr. Sasar Deepak Sitaram	CA	Pune
27	Mr. Das Diganta Pratim Dayal	ITP	Pune
28	Mrs. Inamdar Prajakta Nikhil	CA	Pune
29	Mr. Agrawal Govind Gopaldas	CA	Pune
30	Mrs. Nandapurkar Vrushali Anant	CA	Pune

Student Membership

1	Mr. Parithi P.	CA Inter	Chennai
2	Mr. Shah Fenil Darshan	CA Inter	Mumbai
3	Mr. Lolam Ajay Laxman	CA Inter	Mumbai
4	Ms. Vathare Sneha Arvind	CA Inter	New Delhi
5	Miss. Panchapakesan Lakshmy K. A.	CA Final	Mumbai

II. PAST PROGRAMMES

1. DIRECT TAXES COMMITTEE

Half day Workshop on Anti Abuse Provisions under the Income-tax Act and the Interplay with Benami Transactions Act was held on 14th April, 2018 at M. C. Ghia Hall, Fort, Mumbai

2. IT CONNECT COMMITTEE

Workshop on Powerful Features in MS Excel/Power Point 2016 was held on 20th April, 2018 at Jai Hind College, A. V. Room, Churchgate, Mumbai

3. INTERNATIONAL TAXATION COMMITTEE

4th International Study Tour was held from 28th April, 2018 to 2nd May, 2018 at Hotel Le Meridien, Mauritius. The tour was attended by 57 participants including members and their family members. Presentations were made by the authorities at Financial Services Commission, Mauritius which was followed by a detailed question and answer session where views were exchanged. The members also had a unique opportunity to meet the Indian High Commissioner at Mauritius and understand the policies of the Mauritius Government on various economic fronts. A presentation was also made by the CMD of First Island Co. LLP, Mauritius on Mauritian tax treaties. The participants also enjoyed the natural beauty of the city and various water sports activities. The fellowship between the members was at peak. The participants have been benefited considerably both in terms of knowledge sharing and also recreation from busy professional life.

III. FUTURE PROGRAMMES

1. ALLIED LAWS COMMITTEE

Full day Workshop on the subject "Benami Transactions (Prohibition) Act, 2016" is scheduled to be held on 30th June, 2018 at West End Hotel, New Marine Lines, Mumbai.

2. DIRECT TAXES COMMITTEE

Half Day Workshop on Return Filing Provisions under the Income-tax Act is scheduled to be held on 15th June, 2018 at A. V. Room, Jai Hind College, Churchgate.

3. IT CONNECT COMMITTEE

Half Day Workshop (Practical) on "Skype Meetings and Google Drive is scheduled to be held on 15th June, 2018 at CTC Conference Room.

4. INTERNATIONAL TAXATION COMMITTEE

A) Full day Seminar on International Taxation jointly with Pune Study Group is scheduled to be held on 19th May, 2018 at ELTIS, Pune.

B) 12th Residential Conference on International Taxation, 2017 is scheduled to be held from 21st June, 2018 to 24th June, 2018 at The Grand Bhagwati, Indore.

5. NOTICE OF ELECTION

The election of the President and fourteen Members of the Managing Council for the ensuing year 2018-19 shall take place on Thursday, May 31, 2018 at the Office of The Chamber of Tax Consultants, 3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai–400 020.

Nominations in the prescribed form should be filed so as to reach the office of the CTC not later than 6 p.m. on Friday, May 18th, 2018. The nomination forms shall be available at the CTC office from Friday, May 4th, 2018.

6. RENEWAL OF MEMBERSHIP FEES 2017-18:

The renewal fees for Annual Membership, Study Group, Study Circle and other Subscription for the financial year 2018-19 was due for payment on 30th April, 2018. The Renewal notices have been sent separately which contains required information of members as per CTC data Base. In case any change of information of members shown in form, kindly provide updated information along with the form. Members are requested to visit www.ctconline.org for online payment of the renewal fees.

(For details of the future programmes, kindly visit www.ctconline.org or refer The CTC News of May, 2018)

❍❑❍

ML-694

Indirect Taxes Committee

Study Circle Meeting held on 4th April, 2018 on the subject " E Way Bill "

CA Parag Mehta addressing the members on the subject "Legal Aspect of E Way Bil"

CA Mitesh Katira, addressing the members on the subject " Technical Aspects of E Way Bill"

Webinar on GST Refunds held on 11th April, 2018

CA Rajiv Luthia addressing the members.

Direct Taxes Committee

Workshop on "Anti-Abuse Provisions under the Income Tax Act and the Interplay with Benami Transactions Act" held on 14th April, 2018

Shri Ajay Singh, President giving opening Remarks. Seen from L to R S/Shri CA Ashok Mehta, Chairman, CA N. C. Hegde, Faculty, CA Dinesh Poddar, Convenor

CA Ashok Mehta, Chairman, welcoming the faculty and delegates. Seen from L to R: S/Shri Ajay Singh, President, CA N. C. Hegde, Faculty, CA Dinesh Poddar, Convenor

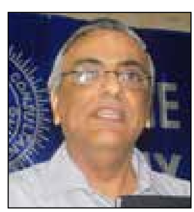
Shri Dr. K. Shivaram, Sr Advocate, Chairman of the session addressing the delegates.

Faculties

Shri Rahul Hakani, Advocate

CA N. C. Hegde

CA Bhadresh Doshi



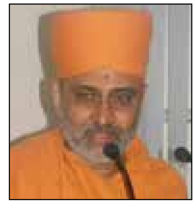
CA Jagdish Punjabi

CA Yogesh Thar

Corporate Connect Committee

Lecture Meeting on "The Power of Balance" held on 16th April,2018

CA Anish Thacker, Chairman welcoming the Faculty. Seen from L to R S/Shri P.Axarvallabh Swami, Sadhu Amrutvadandas, Ajay Singh, President, CA Vitang Shah, Convenor



Sadhu Amrutvadandas, addressing the members.

Residential Refresher Course and Skill Development Committee

Inaugural Meeting of Study Circle on Capital Market on the subject "Presence in Capital Market – A choice or compulsion held on 18th April, 2018

Shri Ajay Singh, President, givingh opening remarks. Seen from L to R: CA Pranav Jhaveri, Vice Chairman, CA Mehul Sheth, Vice Chairman, Kishor Vanjara, Advisor, CA Manish Chokshi, Faculty, CA Charu Ved, Chairperson.

CA Charu Ved, Chairperson, welcoming the faculty. Seen from L to R CA Pranav Jhaveri, Vice Chairman, CA Mehul Sheth, Vice Chairman , Kishor Vanjara, Advisor, Ajay Singh, President, CA Manish Chokshi, Faculty

CA Manish Chokshi, Faculty addressing the members.

Study Circle & Study Group Committee

Study Circle Meeting on " Issues in Survey Proceedings" held on 19th April, 2018 .

CA Devendra Jain addressing the members

Allied Laws Committee

Allied Laws Study Circle Meeting held on "Recent Important Amendments to Companies Act, 2013 " on 20th April, 2018.

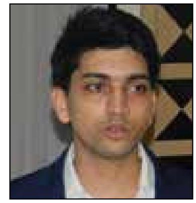
Ms Ananya Gupta, Advocate & Solicitor addressing the members.

ML-696

IT Connect Committee

Workshop on "Powerful Features in MS Excel/Power Point 2016" held on 20th April, 2018

Ms Maitri Savla, Vice Chairperson welcoming the members. Seen from L to R S/Shri CA Adarsh Madrecha, Faculty, CA Uday Shah Convenor



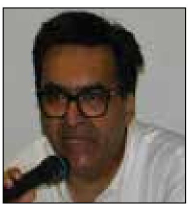
CA Adarsh Madrecha, addressing the members.

Direct Taxes Committee

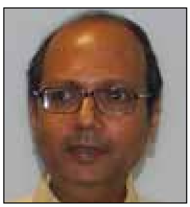
Workshop on Direct Taxes held jointly with The Malad Chamber of Tax Consultants on 21st & 22nd April, 2018

CA Ashok Mehta, Chairman welcoming the members. Seen from L to R CA Utpal Patel, (MCTC), CA Reepal Tralshawala, Faculty, CA Vipul Somaiya, President, (MCTC)

Faculties

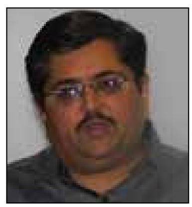


CA Reepal Tralshawala



CA Mahendra Sanghvi

Shri Rahul Hakani, Advocate



CA Ketan Vajani

Members at the Mock Tribunal

Seen from L to R S/Shri Subhash Shetty, Advocate and Shri Ajay Singh, Advocate

Pune Study Group Meeting

Study Group Meeting held on "Penalty U/S 270 A and Prosecution " on 21st April,2018.

CA Devendra Jain addressing the members on Penalty u/s. 270A

Mr Mandar Vaidya, Advocate addressing the members on Prosecution"

Direct Taxes Committee

Intensive Study Gorup Meeting On "Recent Important Decisions under Direct Taxes" held on 23rd April, 2018.

CA Sanjay Choksi addressing the members

International Taxation Committee

Webinar on "Crypto Currency" held on 24th April, 2018.

CA Rashmin Sanghvi, addressing the members.

Study Circle & Study Group Committee

Study Group Meeting on "Recent Important Judgements" held on 27th April, 2018.

CA Sanjay Parikh, addressing the members.

International Study Tour to Mauritius – An Enriching Experience

By CA Anish Thacker

The CTC's International Study Tour to Mauritius, organised ably by the CTC's International Tax Committee was a perfect blend of engrossing technical sessions and enjoyable recreational activities. The tour experience was akin to a well-crafted music concert starting on a great beginning and finishing on a high.

The tour began on 28th April 2018, with the participants and family members reaching Mauritius in the afternoon. After a well-deserved short rest, the first technical session was conducted at the picturesque Angasana Balaclava Resort where the Chairman of the First Island Trust Company Ltd., Mr. Denis Seksum, gave the members an overview of the tax system in Mauritius and an insight into the thought process of the Government which was in the process of overhauling the same in the short-to-medium term. This was followed by technical discussions on Mauritius taxation and Mauritius' readiness for coping with the Base Erosion and Profit Sharing (BEPS) Action Plan led by the officials of First Island Trust Company Ltd. The detailed presentation by Patrick Tze, Executive Director, highlighted that Mauritius had given its consent to the adoption of the Multilateral Instrument (MLI) and had agreed to the Primary Purpose Test (PPT) and the Simplified Limitation of Benefits (SLOB) Article. It however, has not included the Double Tax Avoidance Agreement (DTAA) with India as an included treaty leaving the same open for bilateral negotiation. He therefore said that Mauritius as a country was very keen to shed its tag as an alleged 'tax friendly jurisdiction'. He also said that the Organisation for Economic Co-operation and Development (OECD) has reviewed Mauritius' tax regime and has identified the provision for deemed tax credit of 80 per cent of the Mauritius tax (of 15%) as a potentially harmful tax practice. He informed the group that Mauritius was keen to modify or amend the said provision in its endeavour to be considered a fully compliant jurisdiction by the OECD. The finance professionals had therefore represented to the Government to consider a variant of the participation exemption prevalent in the European nations, as a proposed alternative to the deemed credit provisions but the Government had not yet taken a final stand on this. He indicated that the Mauritius Government's Budget expected in the month of June 2018, would be eagerly watched as it was expected that the strategy for Mauritius to be fully compliant with the OECD requirements was likely to be presented by the Hon. Finance Minister in that Budget. The session was interspersed with some interesting questions from the participants which were debated upon quite intently. The presentation was followed by a sumptuous dinner.

The second day was a day of leisure where the members and their families spent a leisurely day at the picturesque Ille Aux Cerfs (Island of the Deer) where they enjoyed the lovely beaches, the water sports activities and the stunning beauty of the clear blue lagoon on the island's bank.

The third day began with a breakfast meeting of the members of the CTC with the Office Bearers of the Mauritius Branch of the International Fiscal Association where topics of mutual interest and areas of mutual co-operation were discussed. The President, Ajay Singh invited the IFA Mauritius Office Bearers to participate in the upcoming International Residential Refresher Course (RRC) at Indore from 21st June 2018 to 24th June 2018. Mr. Arun Kutowaroo and Mr. Romesh Ramchurn, the office bearers, expressed their desire to do so and it was agreed that they would get in touch with the CTC's office to take this forward.

The team then proceeded to meet with the Financial Services Commission (FSC) at their office where the second technical session was held with Ms. Leena Doman-Brette, Head Licencing and Mr. Deerajen Ramswamy, Head Financial Stability & Statistics, led two interesting technical discussions on the way forward for the company licencing process and the proposed overhaul thereof and the impact of recent fiscal developments on the Foreign Direct Investment (FDI) into Mauritius and the way forward for Mauritius as an investing jurisdiction. Ms. Doman-Brette informed the group that the existing Global Business Licences I and II, were in the process of being replaced by Investment Manager, Regional HQ and Global HQ licences which would incorporate more comprehensive requirements to identify the Ultimate Beneficial Owner (UBO) of the incorporated companies and closer monitoring of their activities. The favourable licencing regime would continue as well as the issue of the Tax Residency Certificate (TRC) by the Mauritius Revenue Authority (MRA) but with a more measured monitoring of the actual activities in Mauritius with a clear emphasis towards creating local employment and generating value addition within the limits of the Mauritian jurisdiction. Mr. Ramswamy, in a very engaging session, presented statistics of the current position of FDI in Mauritius and the focus of the FSC on generating greater FDI in the country. There was an interesting macro level discussion on the impact of the amendment of the India-Mauritius DTAA in 2016 and its consequential impact on FDI in Mauritius where the members enthusiastically participated. The FSC officials also indicated very serious intent of Mauritius to be regarded as an entry jurisdiction for African investments and briefed the group on the fact that the treaty network with African countries was being expanded.

After lunch, the participants went to the North Island Tour where *inter alia*, the Citadel Fort, the Marie Reine de la Paix and the Caudan Waterfront were the main attractions.

The fourth day began with another very interesting and informative technical discussion with the officials of the Indian High Commission in Mauritius where the members engaged in a very interesting technical discussion with Mr. Abhay Thakur, the Indian High Commissioner, Mr. K. D. Dewal, the Deputy High Commissioner and the Indian High Commission's team on the cultural connect between India and Mauritius and the investments by India into Mauritius. The efforts to discover round tripping of funds as also the exchange of information in terms of the DTAA between the two nations were discussed and the participants left the session with a much better all round perspective.

The afternoon session was highlighted by the South Island Tour with the outstanding feature being the Dead Volcano Crater and the Black River Gorges, the Chamarel Waterfall and the Seven Coloured Earth.

After an invigorating morning session surrounded by the blue sea, the participants visited the famed Casela Park on the final day before departing for home fully energised and satisfied with a perfect balance of work and leisure.

The members really enjoyed the experience and gave a very positive feedback about the excellent organisation by the Office Bearers and the International Taxation Committee.

International Study Tour to Mauritius from 28th April, 2018 to 2nd May, 2018

Delegates with Mr. Abhay Thakur, High Commissioner of India and Mr. K. D. Dewal, Deputy High Commissioner of India

Delegates with Ms. Leena Doman _ Brette, Head – Licensing and Mr. Deerajen Ramaswamy, Head – Financial Stability, Economic & Research Statistics, Financial Services Commission, Government of Mauritius

Group Photo of delegates

Delegates with members of IFA, Mauritius Branch

THE CHAMBER'S JOURNAL

Posted at the Mumbai Patrika Channel
Sorting Office, Mumbai 400 001.
Date of Posting: 16th of Every Month

No. MCS/149/2016-18
R.N.I. No. MAHENG/2012/47041
Date of Publishing 12th of Every Month

Printed and Published by Shri Kishor D. Vanjara on behalf of The Chamber of Tax Consultants, 3 Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020 and Printed at Finesse Graphics & Prints Pvt. Ltd., 309 Parvati Industrial Premises, Sun Mill Compound, Lower Parel (W), Mumbai - 400 013. Tel.: 4036 4600 and published at The Chamber of Tax Consultants, 3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020. Editor : K. Gopal