Price ₹ 300/- per copy

No. MCS/149/2016-18 / R.N.I. No. MAHENG/2012/47041 - Total Pages: 232

Vol. VI | No. 12 September 2018

HEAVEN BE OUR GUIDE

Estd. 1926

92nd Year

ज्ञानं परमं बलम्

A Monthly Journal of

The Chamber of Tax Consultants

THE CHAMBER'S JOURNAL

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

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IND-AS – Practical Aspects, Case Studies and Recent Developments held on 25th August, 2018 & 1st September, 2018

CA Hinesh Doshi, President inaugurating the conference by lighting the lamp. Seen from L to R: S/Shri CA Vipul Choksi, Vice President, CA Deepak Shah, Convenor, CA Heneel Patel, Chairman, CA Tejas Parikh, Vice-Chairman, CA Sandeep Shah, Faculty

Group Photo of Dignitaries

CA Hinesh R. Doshi, President, giving opening remarks. Seen from L to R: S/Shri CA Heneel Patel, Chairman, CA Tejas Parikh, Vice Chairman

CA Heneel Patel, Chairman, welcoming the speaker and delegates. Seen from L to R: S/Shri CA Hinesh Doshi, President, CA Tejas Parikh, Vice Chairman

Faculties

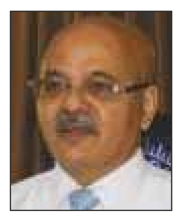
CA Hemal Shah

CA Naresh Sheth

CA Sandeep Shah

CA Zubin Biilimoria

CA Sujal Shah



CA Yagnesh Desai

CA Jatin Kanabar

CA Chirag Doshi

CA Venkatraman Vishwanath

PANEL DISCUSSION: Seen from L to R: CA Paresh Clerk, CA Sudhir Soni, Panellist, CA Zubin Billimoria, Moderator, CA Anish Thacker, Jt. Hon Secretary, CA Ashutosh Pednekar, Panelist, CA Heneel Patel, Chairman

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The Chamber of Tax Consultants

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Estd. 1926

92nd Year

ज्ञानं परमं बलम्

The Chamber's Journal

Non-receipt of the Journal 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

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	`	250	45	` 295
9.	Journal Subscription	`	700	0	` 700

Editorial

The unprecedented deluge in Kerala has wreaked havoc in the God's own country. The fury of nature is very harsh and at times also cruel. We should do our level best to ensure that the residents of State of Kerala are back to normal life as soon as possible. We professionals also are suffering a deluge of compliance burden on account of various policy or non-policy decisions of the Government. RBI has initiated steps to digitise its existing database. Procedure adopted is such, it ensures maximum compliance inconvenience to the citizens. Now let us come to certain oddities about the frequent changes to the Form 3CD. Notifications amending the Form 3CD for the F.Y. 31st March, 2018 i..e. A.Y. 2018-19 was issued on 27th July, 2018. Certain additional information and disclosures were required to be in this amended Form 3CD which put the professionals in a rage. May be on account of widespread protests, especially representation by the Chamber of Tax Consultants, certain amendments have been deferred by a notifications dated 17-8-2018. It may not be out of place to remind the higher echelons of the policy makers of tax collections sitting in the North Block, the observations of the Hon'ble Delhi High Court in the case of *Avinash Gupta vs. Union of India (2015) 378 ITR 137 (Del*) at pg 145 placitum 22 – The Hon'ble Court has observed that "– There is sufficient time available to the Government, after the Finance Act of the financial year, to finalise the forms and if no change is intended therein, to notify the same immediately. There appears to be no justification for delay beyond the assessment year in prescribing the said forms. Accordingly, though not granting any relief to the petitioner for the current assessment year, the respondents are directed to, with effect from the next assessment year, at least ensure that the forms etc., which are to be prescribed for the Audit Report and for filing the ITR are available as on 1st April of the assessment year unless there is a valid reason thereof and which should be recorded in writing by the respondents themselves, without waiting for any representations to be made. The respondents, while doing so, to also take a decision whether any extension of the due date is required to be prescribed and accordingly notify the public." This view of the Hon'ble Court was again endorsed by the Hon'ble Gujarat High Court in the case of All *Gujarat Federation of Tax Consultants vs. CBDT (2015) 378 ITR 160 (Guj).*

The special story of this month's The Chamber's Journal is on "Computation of Income under the head Income from Business or Profession". The Journal Committee, after a detailed deliberation, decided to revisit certain basics on taxation. It is felt in general that a revisit to basic principles at frequent intervals is a necessity. The Chairman of the Committee worked overtime to finalise the design and execute the same. I recognise the efforts of my friend Sanjeev Lalan in putting together the initial design and thank him for the same. Busy professionals agreed to share their thoughts on the important aspects of the special story. I thank all of them.

Nowadays, there is a lot of discussion about dissent. I would like to share great jurist Nani Palkhivala's views expressed in an article titled "Tax Avoidance is Legal (Page 130 (131) – We, the Nation The Lost Decades)", while criticizing the decision of the Apex Court in the case of *McDowell vs. CTO (1985) 154 ITR Page 148 (SC).* "This article is not concerned with the correctness or otherwise of the Supreme Court's decision on the question arising under the sales tax law. But it is of great public importance to consider the validity of the ruling of the Supreme Court blurring the distinction between tax avoidance which is legitimate and tax evasion which is not. It is submitted that the court's pronouncement obliterating such distinction is patently incorrect and proceeds on a total misreading of the three decisions of the House of Lords." Dissent based reason and logic is always respected and it cannot be curbed. The integrity and caliber of the person expressing dissent is an important aspect too.

There is a brighter side to the news channels in the sports news. Recently, Hima Das, who hails from Dhing, Assam is a silver – golden lining to the track and field events of Indian athletics. It is heartening to know that this young girl, while performing in Commonwealth Games, 2018 held at Gold Coast, Queensland, Australia, qualified for 400m finals but came 6th held in the month of April, 2018 and in the same event held at Tampere, Finland in July, 2018, she secured a gold in World Under 20 Championships. Now in Asian Games 2018 held at Jakarta, Indonesia, she has brought home one silver in 400m and one gold along with her team in 4 x 400m relay in August, 2018. Washington Irving a writer called "the first American of Letters" says some minds seem almost to create themselves, springing up under every disadvantage and working their solitary but irresistible way through a thousand obstacles. I think these words are meant for Hima Das.

On this optimistic note, I once again thank all the contributors to this months Journal.

K. GOPAL
Editor

From the President

如果一个人不断珍惜他的旧知识，以便不断获得新知识，他可能会成为他人的老师

… which means – *if a man keeps cherishing his old knowledge, so as continually to be acquiring new, he may be a teacher of others! Only if we review our old knowledge and continue to learn new things, are we able to teach others.*

This is a wise quote by Confucius who was a Chinese spiritual teacher and philosopher, who in his ingenious way conveys that preserving knowledge with the ability and enthusiasm to continuously keep upgrading, is what leads to a creation of value in a being, tacit enough to cherish and rare enough to store. Every knowledge is defined by teaching, every teaching has a lesson and every lesson guarantees an improvement, which finally generates some new knowledge. And it is this vicious circle, which keeps the world going.

This month has seen the worst flood in a century, in the State of Kerala with hundreds of deaths and thousands, displaced. I would like to convey my condolences to the families who have suffered losses, who have lost their dear ones in this catastrophic disaster. The spirits of the people of India have yet again shown that we can fight and overcome any problem. With millions of funds raised, with hundreds of people volunteering and helping the stranded people, it makes me believe in the unity of this diverse nation, in the times of adversity.

It is thus, most imperative to acknowledge the efforts of our teachers and thank them, for their contribution to shape our lives and make it, what it is today. 5th September, while we celebrate Dr. Sarvepalli Radhakrishnan's birthday, let us also remember the teachers who have carved our future, and who shape the future of this country. While we pay a tribute to our teachers on this special day, let us not forget our biggest teacher – The Failure. We love to succeed but nothing in this world can teach us more than what, failure will. Let us not be afraid of failure, for success comes to those who fail seven times, but have the courage to stand up the eighth time. So, never give up and keep going – that is how we win!

Dr. A. P. J. Abdul Kalam mentioned
"Learning gives creativity
Creativity leads to thinking
Thinking provides knowledge and
Knowledge makes you great"

While we talk about teachers – we lost one of the most profound leader, our ex-Prime Minister and Bharat Ratna, Late Shri Atal Bihari Vajpayee. We pay our homage and his actions as tallest political leader and statesmen are going to live with us for even longer.

This month also goes into the Indian calendar as the month of Religious festivals. While we witness *Shravan* and *Paryushan*, we also look forward to celebrate the tradition, Lokmanya Tilak once started

– The Ganeshotsav. Lord Ganesh is considered as the *'vigna-hartha!'* – which means, the one who takes all our troubles away. Legend is that Lord Ganesh is bestowed with a blessing from Lord Shankar that he'll be the most renowned and preached lord. And the way we see it today, people from all sects, communities, religions and creed come together to celebrate the Ganesh festival. May his blessing be bestowed upon us!

CTC NEWS AND EVENTS

The Chamber has given new look to THE CTC NEWS and recent issue of September has generated lot of praises and appreciation. The Chamber's Journal and The CTC News will have special theme – *Languages link the world* and we are taking different ancient languages in each Issue. We have already covered Sanskrit and Latin. This issue covers Chinese language.

The Chamber has announced its four days **Certificate Course on Multilateral Instruments** in October, with Speakers who are stalwarts in the field of International Taxation. This is the first ever Certificate course organised by any Professional organisation covering extensively, the entire subject of MLI.

The recently concluded two day **Workshop on IND AS** gave several nuances on other regulatory aspects such as GST / MAT/ Income Tax and will ensure comparability between financial statements in line with global standards and improve the ability of Indian companies to access funds abroad. Panel discussion was icing on the cake and panellist discussed various areas of concern and issues.

Maharashtra has approx. 8,00,000 registered Charitable Trusts out of which, only about 50% are complying with regular filings of Audit Reports, Change Reports etc. The Charity Commissioners office is in the process of de-registering all non compliant trusts. The Chamber and BCAS organised **full day Seminar on Charitable Trusts** which was inaugurated by Mr. Bharat Vyas, Dy. Charity Commissioner and he gave great insights to professionals for compliance and timely filings of Report.

In view of significant amendments in GST Bill 2018 and changes in rates and notifications, **Half day workshop on GST Amendment Bill, 2018** was organised to update members on key changes and amendments.

The Chamber conducts regular webinars on topics of current interest for members residing outside Mumbai and provides updated knowledge on the subject. Artificial Intelligence is changing Accounting and Auditing sphere with machine learning as new buzz word. The Chamber organised special session on practical challenges and skills, accountants need to work alongside intelligent systems.

Event organised with H. R. College of Commerce and Economics on **Blog writing and LinkedIn** saw very good participation by Members and Students of College, many senior members of The Chamber attended this unique programme. IT Connect Committee is helping members to keep pace with ever dynamic tech landscape.

The Chamber has been in the forefront in interactions and representations with Government Authorities. The Chamber during the month has already filed Representations for:

1. Request for extension of due date for filing Tax Audit Report and Return of Income under section 139 of IT Act, 1961.

2. Levy of penalty under section 234F of IT Act, 1961 for LLPs
3. Representation in response to draft Notification proposing amendment to IT Rules for making the process of issue of Certificate for No deduction, Lower deduction and collection of Tax electronically

Recently, Law and Representation Committee members led by Mr. Mahendra Sanghvi met **Mrs. Anuradha Bhatia, Chief Commissioner of Income Tax (TDS) to discuss issues in TDS, surveys and prosecutions.**

The Chamber has organised Public Lecture meeting on **"Rules of evidence in assessment, penalty and prosecution proceedings** with special reference to alleged suspicious transactions in Shares" on 4th October, 2018. The lecture meeting will throw light on changing pattern and evolving tax decisions.

We are gearing for **full day GST conference** to be organised jointly with GOA CHAMBER OF COMMERCE & INDUSTRY in Panaji, Goa.

Our most eagerly awaited announcements for **RRC's** for **Direct Tax** at Hotel RAMADA Lucknow from 28th February 2019 to 3rd March, 2019 and **GST RRC** at Novotel Hitec City, Hyderabad from 24th to 27th January, 2019 is already made. Please see detailed announcements in the Newsletter and please book your tickets in advance for both RRCs'.

SPECIAL STORY FOR SEPTEMBER ISSUE

Special Story covers entire landscape of Business Income and encapsulates first principles to various business expenses, deductibility, waiver, disallowances, Ind-AS and reporting in GST and ITR/3CD. I thank all authors for succintly writing their articles and dwell through the lens of available jurisprudence on the subject.

PUBLICATIONS

Following publications are available at The Chamber's office namely:

1. FEMA – Fundamental Aspects and Practical Issues
2. Key Rulings under Indirect Tax Laws
3. Prevention of Money Laundering Act - A Handbook

It is said by Swami Vivekananda:

"Everybody has lots of contacts but there is no connection and communication. Everybody is in his or her own world. ***Let us not maintain just 'contacts' but let us remain 'connected'****, caring, sharing and spending time with all our dear ones."*

We welcome Members to send their feedback, suggestions and observations for any matter related to The Chamber by sending email on office@ctconline.org or hineshdoshi67@gmail.com.

Ni HAO (Thank you)

HINESH R. DOSHI
President

The Chamber of Tax Consultants

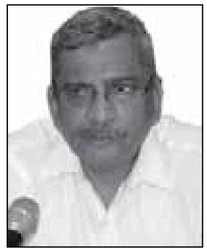
Vision Statement

The Chamber of Tax Consultants (The Chamber) shall be a powerhouse of knowledge in the field of fiscal laws in the global economy.

The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre–eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.



CA Sanjay R. Parikh

Income from business or profession – Introduction

1. Introduction

Section 2(24) of the Income-tax Act, 1961 (the Act) defines the word "income" which is an inclusive definition. Section 4 of the Act provides that income-tax would be charged at the rate or rates in force as applicable for the said year. Section 5 of the Act specifies the scope of total income. It provides that income of a person who is non resident or not ordinarily resident in India in a previous year, which is received or is deemed to be received in India or which accrues or is deemed to accrue or arise in India, would be liable to tax in India . Section 6 of the Act deals with the residential status of an assessee. The residential status of an assessee plays a vital role in the determination of the income taxable in India. In the case of person resident in India, subject to provisions of the Double Taxation Avoidance Agreement (DTAA), the entire global income is liable to tax in India. Similarly, in case of a non-resident, it is only the income which is received or is deemed to be received in India or which accrues or arises or is deemed to accrue or arise in India is liable to tax in India. This is again subject to the provisions of the DTAA.

Section 14 of the Act specifies the heads under which the "income" would be liable to tax i.e. Salaries, Income from house property, Profits and gains of business or profession, Capital Gains and Income from other sources. Various chapters thereafter deal with computation under each head, deductions allowable, etc.

In this article, some important provisions relating to "Income from business or profession" especially sections 28, 29 and 145 of the Act have been dealt with. I thank the Chamber of Tax Consultants for giving me an opportunity to write this article.

2. Overview of the provisions

Section 28 of the Act specifies certain income, which would be chargeable under the head "profits and gains of business or profession". The section is not an inclusive section but an exhaustive definition. Accordingly, if there is any income which does not fall under any of the clauses specified in section 28, the same would not be taxable under the head "Income from business or profession". Section 29 of the Act specifies that the income under the head Profits and gains of business or profession shall be computed in accordance with the provision contained in Section 30 to 43D. Apart from the said Sections, Section 44, 44A, 44AA, 44AB,

44AD, 44ADA, 44E, 44AF, 44B, 44BB, 44BBA, 44BBB, 44C, 44D, 44DA, 44DB of the Act provide for special provision in certain cases.

The head of "Income from business or profession" is a preferred head of income as the allowability of expenses and losses is very liberal under this head as compared to other heads of income. The Hon'ble Gujarat High Court has while dealing with the provisions of section 57(iii) held in *Padmavati Jaykrishna vs. CIT [1975] 101 ITR 153 (Guj)* that the expression "for the purpose of business or profession" has wider implications than the expression "for the purpose of making or earning income" used in section 57(iii). This decision has been approved by the *Hon'ble Supreme Court in (1987) 166 ITR 176 (SC)*. Similarly, the provisions of set off of business losses (except speculation losses) against other heads of income is more liberal as compared to the losses from other heads of income. Accordingly, people prefer to offer income under the head "Income from business or profession" as compared to other heads, except where there is a tax advantage as in case of Capital Gains.

Although clause (i) of section 28 specifies that only profits of any business or profession carried on at any time during the previous year are taxable u/s. 28, section 176(3A) provides that an income from a discontinued business would be charged to tax in the year of receipt, if such sum would have been included in the total income of the person before such discontinuance. Similarly, section 176(4) provides for taxing the income of a discontinued profession.

Though sections 145 and 145A do not fall in the chapter dealing with computation of income from business or profession, it provides the mode and manner in which the "Income from business or profession" is to be computed.

3. Section 28 – Income from business or profession

Clause (i) of section 28 specifies that the profits and gains of any business or profession carried on by the assessee at any time during the previous year would be taxable under the head "Income from Business or Profession".

Section 2(13) defines the term "business" to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. Clause (33) of Section 2 defines the term "profession" to include vocation.

Accordingly, the carrying on of trade, manufacture, process, etc. for the purpose of earning profits, would constitute "business". Although carrying on regular and frequent activities would constitute trade or business, it is not necessary that the business must be carried on regularly and frequently. Even a solitary transaction carried on with a profit motive would constitute an adventure in the nature of trade and the income therefrom would be taxable under this head.

The Hon'ble Supreme Court has in the case of *State of Andhra Pradesh vs. H. Abdul Bakson & Bros. (1964) 15 STC 644 (SC)* held that to regard an activity as 'business', there must be a course of dealings either actually continued or contemplated to be continued with a profit motive and not for sport or pleasure. In *P. Krishna Menon vs. CIT (1959) 35 ITR 48 (SC)*, the Hon'ble Supreme Court has held that the motive of making profit or the actual earning of profit is not an essential ingredient of business, profession or vocation. As long as activities in the nature of business or profession are carried out, it would be carrying on business or profession even if there is no profit earned. At the same time, if due to lull in business or due to other problems, if no activity is carried on, it would not mean that the assessee has discontinued its business as long as it is capable of carrying on such business. The Hon'ble Bombay High Court has in the case of *Karsondas Ranchoddas vs. CIT (1972) 83 ITR 120 (Bom.)* held that a company may not obtain or be able to execute a single business contract for months and yet it may be deemed to carry on its business, if during the period of lull and inactivity it is kept alive and if it retains its registered office and holds meetings. It is not necessary that a business to be in existence should have work all the time. There may be long intervals of inactivity and a concern may still be a going concern; though it may, for some time, be quiet and dormant.

A person cannot trade with himself

A company may have various divisions or manufacturing units and each one of them may be a separate profit centre. Transactions between the said divisions or units may be at market rates. However, for tax purposes, all the units would be owned by the same company and profits from such inter-divisional transfers are not real profits and hence would not be taxable as income. Similarly, prior to insertion of clause (via), the conversion of stock-in-trade into a capital asset was not liable to tax. On the same footing, the withdrawal of stocks by the proprietor for their personal use, was also not taxable. This is on the principle that no man can make a profit out of oneself. The said principles has been upheld in *Maharajadhiraj Sir Kameshwar Singh vs. CIT (1963) 48 ITR 483 (Pat.)* affirmed by the *Hon'ble Supreme Court in (1970) 75 ITR 790 (SC).*

Legality of business

Income-tax law is not concerned with the legality of business. Once it is found that there is a business, legal or illegal, the profits shall be chargeable to tax – *CIT vs. Pranlal Kesurdas (1963) 49 ITR 931 (Bom.).* Accordingly, the profits from the business of prostitution, smuggling, black marketing, etc. though illegal, would be taxable under the head "Income from Business or Profession".

Interest on securities

Upto A.Y. 1988-89, interest on securities was chargeable to tax under a separate and specific head of "Interest on securities". However, on deletion of the said head of income, interest on securities would be taxable under the head "Profits and Gains of Business or profession" if the securities are held as stock-in-trade or as trading assets. If the interest is not chargeable under the head "Income from Business or Profession", the same would be taxable under the head "Income from Other Sources".

Real income

It has been held in a number of cases that what can be taxed under the head "Income from Business or Profession" is the real income i.e., income which accrues to a trader is taxable. Income which he could have, but has not earned, is not made taxable. Accordingly, if a trader transfers his goods at a price less than the market price, and the transaction is a *bona fide* one, the taxing authority cannot take into account the market price ignoring the real price fetched – *CIT vs. Calcutta Discount Co. (1973) 71 ITR 8 (SC); Den & Co. vs. CIT (1962) 45 ITR 369 (Pat); CIT vs. Keshavlal Chandulal (1966) 59 ITR 120 (Guj.).* [However, this principle to some extent has been diluted by inserting section 43CA.]

In order to arrive at a finding that any such sale was shown or not *bona fide*, there must be sufficient evidence and material with the tax authorities – *Sri Ramalinga Choodambikai Mills Ltd. vs. CIT (1955) 28 ITR 952 (Mad.).*

Business in the course of winding up

Realisation of assets by a person in charge of the winding up of the business owned by a person or in charge of winding up of the entity is not an activity which can ordinarily be called business and cannot amount to carrying on business on that ground alone – *Benyan & Berry vs. CIT (1996) 222 ITR 831 857 (Guj.).* The realization of business assets, after a business is discontinued, could not by itself constitute business – *Executors of Estate of Dubash vs. CIT (1951) 19 ITR 182 (SC).* However, if an assessee carrying on manufacturing and trading activities, discontinues the manufacturing activity but continues trading, it cannot be said that he has ceased to carry on business.

Benefit or Perquisite arising from Business or Profession

As per clause (iv) of section 28, the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession, is taxable under the head "Income from Business or Profession". In the case of *Mahindra & Mahindra Ltd. vs. CIT (2003) 261 ITR 501 (Bom.)*, the assessee had purchased toolings from a party on credit, which was financed by the said party itself. On the takeover of the said party by another entity, an agreement was entered into whereby the loan was waived. The issue arose as to whether the write back of loan would amount to a benefit or perquisite u/s. 28(iv). The Hon'ble Bombay High Court held that the benefit or perquisite should not be in terms of money. As the finance was on account of supply of toolings, it was in money and the waiver of such amount would not be taxable u/s. 28(iv). The said decision has been upheld by the Hon'ble Supreme Court in (2018) 404 ITR 1 (SC).

Remuneration Received by a Partner

As per clause (v) of section 28, any interest, salary, bonus, commission or remuneration received by a partner of a firm from such firm is taxable under the head "Income from Business or Profession". As per the proviso to the said clause, such interest, salary, etc. which has not been allowed to the firm, would not be taxable in the hands of the partners. Correspondingly, the share of profit from the firm is exempt in the hands of the partner u/s. 10(2A). Issues arose as to the amount of share of profit from firm, where the firm was entitled to exemption/deduction of its profits. It has now been clarified by the Board in Circular No. 8 of 2014 dated 31-3-2014 (2014) 362 ITR (St.) 33 that the entire share of partner credited to the partners' accounts in the firm would be exempt from tax in the hands of such partners, even if the income chargeable to tax becomes nil in the hands of the firm on account of any exemption or deduction as per the provisions of the Act.

Non-compete fees

Clause (va) to section 28 has been inserted by the Finance Act, 2002 with effect from 1st April, 2003. Prior to the said insertion, non-compete fees were not liable to tax. Reference in this regard may be made to the decision of the Hon'ble Supreme Court in the case of *Guffic Chem P. Ltd. vs. CIT (2011) 322 ITR 602 (SC).* Finance Act, 2002 has inserted clause (va) in Section 28. As per the said clause, any sum received or receivable in cash or kind under an Agreement for (a) not carrying on any activity in relation to any business or profession or (b) not sharing any knowhow, patent, copyright, trade mark, license, franchise or any business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services, would be liable to tax under the head "Income from Business or Profession". A proviso has been added which specifies that the provisions of sub-clause (a) shall not apply if the amount is chargeable under the head Capital Gains or is received as compensation from the multilateral fund of the Montreal protocol of substances that deplete the ozone layer.

After the amendment, non-compete fees were held to be taxable under head 28(va) in the case of *John D'Souza vs. CIT (2009) 226 CTR 540 (Bom.)*. The Hon'ble Bombay High Court has in the case of *Arun Toshniwal vs. DCIT (2015) 375 ITR 270* held that the amount received by a director of a company for not carrying out any business similar to that carried out by the company, which transferred its business, was covered under clause (va). Similar view has also been taken by the Authority for Advance Ruling in H. M. Publishers Holding Limited (2018) 405 ITR 441.

Conversion of Stock-in-Trade to Capital Asset

The Finance Act, 2018 inserted clause (via) with effect from 1-4-2019 i.e., from Assessment Year 2019-20. Prior to the said insertion, the conversion of stock-in-trade into a capital asset was held to be not taxable and certain decisions had taken a view that on the capital asset being transferred, the period of holding and the original cost was to be considered for computing capital gains. Clause (via) now takes care of the said situation by providing that the difference between the fair market value on the date on which the stock is converted or treated as a capital asset, shall be chargeable to tax under the head 'Income from Business or Profession'.

As against Section 45(2), which applies to the case of conversion of capital asset into the stock-in-trade, Section 28 (via) charges the income in the year of conversion even if the asset is not sold. Accordingly, even if an assessee has not realized any profit on the conversion, the same would be liable to tax. For this purpose, the fair market value has to be determined in the prescribed manner.

The Central Board of Direct Taxes (CBDT) has notified Rule 11UAB for determination of fair market value of inventory converted into or treated as Capital Asset. As per the said Rule, the value of any immovable property being land, building or both, on its conversion from stock- in-trade to a capital asset, shall be valued by adopting the stamp duty valuation of the such immovable property on the date on which such immovable property is converted into or treated as a capital asset. In case of jewellery, archeological collection, drawings, paintings, sculptures, any work of art, shares or securities referred to in Rule 11UA, shall be the value determined in the manner provided in sub-rue (1) of Rule 11UA and for this purpose the reference to the valuation date shall be the date on which inventory is converted into or treated as a capital asset. In case of property other than specified above, value will be the price that such property will ordinarily fetch on sale in the open market on the date on which it is converted into or treated as a capital asset.

Speculative Transactions

Explanation 2 to Section 28 provides that where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business shall be deemed to be distinct and separate from any other business. This provision is in alignment with the provisions of section 73 where separate treatment is provided for speculation losses.

Taxing of business profits in the case of a non-resident

The taxation of income in the case of a non-resident is subject to the provisions of Double Taxation Avoidance Agreement and in absence of any such agreement, would be governed by the provisions of Section 5(2). As per the said section, if the non-resident has received or is deemed to have received any income in India or if any income accrues or arises or is deemed to accrue or arises to him in India, the same shall be taxable in India. The Double Taxation Accordance Agreements generally provide that the business income of a non-resident would be liable to tax in India only if the non-resident has a permanent establishment in India. Further, as per Article 7, it is provided that the business income which the non-resident earns from the permanent establishment, would be liable to tax in India. Article 8 of the Treaty provides for taxation of profits from the business of shipping and the business of air transportation. Similarly section 172 deals with the profits of shipping business of non-residents. If the provisions of the Act i.e., Sections 28 to 43D and 172 are more beneficial than the provisions of the Treaty, the non-resident can claim that the provisions of the Act may be applicable to him and not the provisions of the Treaty.

4. Section 29

Section 29 provides that the income referred to in section 28 shall be computed in accordance with the provisions contained in sections 30 to 43D. It has been held that the provisions of section 30 to 43D are not exhaustive. Income has to be computed as per commercial principles. Accordingly, if there is any expenditure incurred which does not fall within any specific section, the same would still be allowable while computing the profits and gains of business. Similarly, though there is no specific provision for allowing losses, losses would be allowable while computing income from business or profession. This view finds support from the decisions of the Hon'ble Supreme Court. In *Badridas Daga vs. CIT (1958) 34 ITR 10 (SC)*, it has been held that the list of allowances enumerated in Sections 30 to 43C is not exhaustive. An item of loss incidental to the carrying on of a business may be deducted in computing the profits and gains of that business, even if it does not fall within any of these sections – *Badridas Daga vs. CIT (1958) 34 ITR 10 (SC)*. Similarly, in *Calcutta Company Ltd. vs. CIT (1959) 37 ITR 10 (SC)* it has been held that an expenditure though not covered by any of the enumerated classes, may have to be considered in finding out the true assessable profits or gains. The Hon'ble Bombay High Court while dealing with the said concept held that the expression 'Profits and Gains of Business or Profession' does not mean total receipts. What has to be brought to tax is the net amount earned by carrying on a profession or business which necessarily requires deduction of expenses and losses incurred in carrying on business or profession – *Harshad J. Chokai vs. CIT (2012) 349 ITR 250 (Bom.)*. The hon'ble Supreme Court had in the case of *Dr. T. A. Quereshi vs. CIT (2006) 287 ITR 547 (SC)* held that even if the business is illegal, losses pertaining to such illegal business have to be allowed.

In *Calcutta Co. Ltd. vs. CIT (1959) 37 ITR 1*, the Hon'ble Supreme Court held that the expression 'Profits or Gains' in Section 10(1) of the Income tax Act has to be understood in a commercial sense and there can be no computation of such profits and gains until the expenditure which is necessary for the purpose of earning the receipt is deducted therefrom.

Expenditure and loss – distinction

The difference between loss and expenditure has been explained by the Hon'ble Supreme Court in *CIT vs. S. C. Kothari (1971) 82 ITR 794 (SC)* by holding that "Expenditure" relates to disbursements; that means something that a trader pays out indicating a sort of volition on his part. A "loss" is something different that is not a thing which he expends or disburses. That is the thing which comes upon him as extra. Similarly, the Hon'ble Supreme Court has in *Badridas Daga vs. CIT (supra)* held that the loss for which deduction is claimed must be one that springs directly from the carrying on of the business and is incidental to it, and not any loss sustained by the assessee even if it has some connection with the business. If that is established, then the deduction must be allowed, provided that there is no provision against it, express or implied, in the Act.

Two conditions to be fulfilled for allowance of loss:

a) The loss is incidental to trade itself, that is to say, there must be a nexus between the loss and the trade which should have been incurred in the course of the trade; and

b) The loss should have been incurred by one in the character of a trader and the same should fall on him in the character.

Computation of income from films

Rule 9A prescribes deductions available in respect of expenditure on production of feature films. Rule 9B prescribes deductions available in respect of expenditure on acquisition of distribution rights of feature films.

Computation of Income – Section 145

As per section 145, income chargeable under the head "Profits and Gains from Business or Profession" or "Income from Other Sources" has to be computed in accordance with either the cash method of accounting or the mercantile method of accounting, regularly employed by the assessee. It has been specified in sub-section (2) that the Central Government may notify in the Official Gazette the Income Computation and Disclosure Standards to be followed by any class of assessees or in respect of any class of income (with effect from 1st April, 2015. Prior to the said amendment, the Central Government was empowered to notify accounting standards to be followed by any class of assessees or in respect of any class of income). In pursuance to the said authority, *vide* Notification dated 31st March, 2015, Income Computation and Disclosure Standards have been prescribed. As a separate article is dedicated to "Income Computation and Disclosure Standards", I have restricted myself to other issues of section 145.

Provisions of Act will prevail over method of accounting

Income from the business or profession has to be computed as per the method of accounting followed by the assessee. However, if the provisions of the Act are contrary to the method of accounting followed by an assessee, the provisions of the Act would be applicable. Accordingly, if an assessee is following the mercantile method of accounting and has made a provision for certain statutory dues, the said statutory dues may not be allowable in view of the specific provisions contained in section 43B. Accordingly, the method of accounting is generally to be followed unless there are certain specific provisions to the contrary in the Act. If the provisions of the Act are contrary to the method of accounting, then the provisions of the Act will override or will prevail over the method of accounting.

In absence of anything to the contrary, Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India would prevail

There are times when there is no specific treatment given under the Income-tax Act for a particular receipt or a particular payment. It has been held that in such circumstances, accounting standards and guidance notes issued by the Institute of Chartered Accountants of India would apply in the absence of any contrary provisions thereto. Even after the amendment of section 145 and the specifying Income Computation and Disclosure Standards, if any aspect has not been dealt with in the said standards but has been dealt with in any accounting standard or guidance note issued by the Institute of Chartered Accountants of India, then the same shall prevail in the absence of anything contrary in the Act. Reliance in this regard can be drawn from the decision in *Challapali Sugars Ltd. vs. CIT 98 ITR 167 (SC).*

Business income to be computed in accordance with method of accounting regularly followed by the assessee

Section 145 of the Act prescribes that business income shall be computed in accordance with "..system of accounting regularly employed by the assessee". The choice of method of accounting is with the assessee and unless conditions prescribed in section 145(3) are satisfied, profits have to be computed in accordance with method of accounting followed by the assessee. *[CIT vs. McMillan & Co (1958) 33 ITR 182 (SC). CIT vs. A. Krishnaswami Mudaliar and Others (1964) 53 ITR 122 (SC)]*

Entries in books of account – how far relevant for determining taxable income ?

Books of account maintained by the assessee in the regular course and in accordance with accepted system of accounting is the starting point for determination of income.

However, the entries in books of account are not sacrosanct and only presence of or absence of certain entries would not determine taxable income. In *Kedarnath Jute Mfg. Co. Ltd. vs. CIT(1971) 82 ITR 363 (SC)*, the Hon'ble Supreme had held that assessee cannot be denied deduction of liability incurred merely because of absence of entries in his books of account. In *United Commercial Bank vs. CIT, 240 ITR 355 [SC]*, the said principle of Kedarnath's case was reiterated. The Hon'ble Court in the context of the case observed that: *"For determining the real income, the entries in a balance sheet required to be maintained in the statutory form, may not be decisive or conclusive. In such cases, it is open to the ITO as well as the assessee to point out the true and proper income while submitting the IT return."*

The Hon'ble Court held that whether the assessee is entitled to a particular deduction or not will depend upon the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter. A few decisions of the Hon'ble Supreme Court in the context of taxability of income on the basis of entries in the books of account are: *Godhra Electricity Co. Ltd. 225 ITR 746 (SC); CIT vs. Bokaro Steel Ltd. 236 ITR 315 (SC).*

Whether entries in books of account are binding on the assessee ?

Books of accounts maintained in the regular course of business are relevant and afford a *prima facie* belief of the correctness of the entries therein – *Tolaram Daga vs. CIT 59 ITR 632 at page 635 and 636 (Assam).* The AO should accept such books of account and/or entries therein unless he has some material in his possession to the contrary - *Addl. CIT vs. Jay Engineering Works Ltd. 113 ITR 389* at pages 391 and 392.

Mode of book entries cannot change the nature of receipt – *Chowringhee Sales Bureau Pvt. Ltd. vs. CIT (1973) 87 ITR 542, 548 (SC); Punjab Distilling Industries Ltd. vs. CIT (1959) 35 ITR 519, 523 (SC).*

An issue arises as to whether the assessee would be bound by the books of account and the entries therein if he comes to know at a later point of time that his accountant had fabricated the books out of vengeance and to place the assessee in a difficult position. The Hon'ble Supreme Court was required to decide in a similar case as to whether an assessee can plead that his books of account are incorrect. The Hon'ble Supreme Court has in the case of *Pullangode Rubber Produce Co. Ltd. vs. State of Kerala 91 ITR 18* held that books of account are an extremely important piece of evidence but it cannot be said that they are conclusive. It is open to the assessee to show that the entries are incorrect and if the assessee pleads so, he should be given proper opportunity to show that book entries do no disclose the correct state of fact.

AO cannot sit in judgment to decide the expenses to be incurred by a businessman or the profits which he should earn

It has been held in various cases that the AO cannot determine as to how a businessman has to do his business or what expenses he should incur for the purposes of his business. In this connection, reliance is placed on the following decisions: *CIT vs. Walchand & Co. Pvt. Ltd. 65 ITR 381 (SC); JK Woollen Manufacturers vs. CIT 72 ITR 612(SC); Aluminium Corporation of India Ltd. vs. CIT 86 ITR 11 (SC); CIT vs. Panipat Woollen and General Mills Co. Ltd 103 ITR page 66 (SC).*

Similarly while assessing the income of an assessee, AO cannot sit in judgment of a businessman and determine the commercial expediency for incurring expenditure. Expenditure incurred would be allowed as a deduction even though it may not directly benefit the assessee – *Shri Meenakshi Mills Ltd vs. 63 ITR 207 (SC); Eastern Investments Ltd vs.*

CIT 20 ITR 1 (SC); Sasoon J. David & Co. Pvt. Ltd. 118 ITR 261 (SC).

Where accounts have been maintained properly and regularly and in absence of any other information or evidence in the possession of the AO, the AO cannot adopt a higher profit margin which had been earned by another entity. Mere fact that goods were sold at a concessional rate to benefit the purchasers at the expense of the vendor does not entitle the department to assess the difference as income of the vendor – *CIT vs. A. Raman & Co. 67 ITR 11, 17 (SC); CIT vs. Calcutta Discount Co. Ltd. 91 ITR 8 (SC). There is no presumption of black marketing – Harabai D. Desai & Sons vs. CIT 4 ITR 95 (Bom.); Sivan Pillai (A.S.) vs. CIT 34 ITR 328 (Mad.); C Ag. IT vs. M. J. Cherian 117 ITR 371 (Ker.).* [This principle has been given a go by as far as sale of land or building is concerned. Section 43CA.]

Even under the mercantile method of accounting, accrual has to be decided in the context of prudence

The Hon'ble Supreme Court has in the case of State Bank of Travancore 158 ITR 102 (SC) held that to determine whether an income has accrued or not, one has to see its accrual from the point of view of commercial principles. However, if income has accrued and accounted for in the books of account, it cannot be said for the purposes of taxation that there is no accrual of income. This decision was rendered in the context of interest on sticky loans and has since been reconsidered in the case of *UCO Bank 237 ITR 889 (SC)*. In the context of non-banking financial companies (NBFC) and housing finance companies (HFC) the Reserve Bank of India / National Housing Bank of India have laid down prudential norms for classifying assets into good assets and non-performing assets. It has been held that if a bank or financial institution is not required to provide for interest on non-performing assets (NPA's), no interest would accrue on such NPA's.

Accrual of income and expenditure

Often instances have arisen where liability has arisen on account of an order of a Court or on account of an Arbitration award and in such cases, an assessee may be required to debit expenses pertaining to earlier years in the books of account of the year in which the order of the Court is received or the Arbitration Award is received. Issues arose as to whether the liability in such cases pertaining to earlier years and debited to the profit and loss account would be allowable as a deduction. In this connection, it has been held that the liability would be allowable as a deduction in the year in which it has arisen – *Nonsuch Tea Estate Ltd. vs. CIT 98 ITR 189 (SC); CIT vs. West Chuisk Coal Co. Ltd. 129 ITR 62 (Cal.); CIT vs. Patnaik and Co. P. Ltd. 140 ITR 204 (Ori); CIT vs. Karamchand Premchand P. Ltd. 152 ITR 94 (Guj); Suneeta Laboratories Ltd. vs. CIT 162 ITR 883 (MP); Sutna Stone and Lime Co. Ltd. 192 ITR 478 (Cal.); CIT vs. Grand Cashew Corp. 182 ITR 216 (Ker.)* (in the context of Arbitration Award).

Similarly, instances have arisen where the liablility has accrued but its quantification may be deferred or is unknown. For instance where an item is sold with warrant, part of the sale proceeds would include the amount which would be required to meet the cost of replacing parts etc. during the period of warrant. Accordingly, the liability to replace the part, free of cost is very much in existence, but the quantification of such liability may be difficult. The issue arises as to in such a case, liability would be allowable? It has been held that if the liability is *in presenti*, the same would be allowable even if the quantification may not be possible accurately – *Motilal Padampat Sugar Mills vs. CIT 106 ITR 988 (All.); Poona Electric Supply Co. Ltd. vs. CIT 57 ITR 521, 531 (SC); E. D. Sassoon & Co. Ltd. vs. CIT 86 ITR 757 (SC); Metal Box Co. of India Ltd. vs. Their Workmen 73 ITR 53 (SC).*

Deferred revenue expenditure

Under the Income-tax Act, there is no concept of deferred revenue expenditure except for certain specific provisions like 35D, 35DD, 35DDA and 35E. Accordingly, if the expenditure is revenue in nature, the same would be allowable as a deduction in the year in which the same is incurred even if the said expenditure may result in some enduring benefit. The Hon'ble Supreme Court has in the case of *Empire Jute Mills 124 ITR 1 (SC)* held that if the expenditure is not on capital account, the same would be allowable as a deduction even if there is enduring benefit by incurring the said expenditure.

As there is no concept of deferred revenue expenditure in the Act, the said expenditure would be allowable in full even if the assessee has considered the said expenditure as deferred revenue expenditure in its books of account and is claiming only a proportionate amount over a period of time. However, when the Hon'ble Supreme Court had in the case of *Madras Industrial Investment Corporation Limited vs. CIT (1997) 225 ITR 802* held that the discount on redemption of debentures was to be allowed over the life or the period for the debentures, a doubt had arisen regarding the applicability of matching concept. This doubt was set to rest by the hon'ble Supreme Court in *Taparia Tools Limited (2015) 372 ITR 605 (SC)*. In the said case, the assessee has borrowed certain funds. The assessee had given an option to the borrower i.e., debenture holder to either receive interest half-yearly or to receive discounted lump sum interest immediately on issue of debentures. The assessee had considered the lump sum interest as deferred revenue expenditure in its books of account but had claimed the entire interest as a deduction in the computation. The Hon'ble Supreme Court considered the provisions of section 36(1)(iii) and also definition of "paid" in section 43(2) while deciding this case. Referring to provisions of section 36(1)(iii), the Hon'ble Supreme Court held that the amount of interest paid in respect of capital borrowed for the purpose of business or profession is allowable as a deduction. The Hon'ble Supreme Court noted there was no doubt that the capital was borrowed by issuing debentures and also there was no doubt that the borrowed capital was used for the purpose of business. Accordingly, the Hon'ble Supreme Court held that the lump sum interest was allowable as a deduction under section 36(1)(iii). Referring to section 43(2), the Hon'ble Supreme Court noticed that the word "paid" means actually paid or incurred according to the method of accounting upon the basis of which profits or gains are computed. The Hon'ble Supreme Court noticed that the assessee has paid the interest. Further, the said interest was paid as per the terms of issue i.e., discounted interest to be paid upfront. Accordingly, the expense was incurred by the assessee. Though the assessee has considered the interest as deferred revenue expenditure in its books of account, interest was incurred as per the terms of issue of debentures and the assessee had also claimed the entire interest as revenue expenditure while computing its income. Accordingly, the assessee was entitled to deduction of the entire interest expenditure. The Hon'ble Supreme Court, thereafter, held that the option to claim the spread over of interest over the term of debentures was with the assessee. If the assessee so desired, it could claim only pro-rata interest and the same would be allowable as a deduction. Referring to the decision of Madras Industrial Investment Corporation Ltd. (supra), the Hon'ble Supreme Court held that that in the said decision, the assessee had spread the premium on issue of debentures over a period of debentures and the issue before the Hon'ble Supreme Court was whether such pro rata premium was allowable.

It may be appreciated that the decision in Taparia Tools Limited (supra) once again reiterates that the method of accounting cannot come in the way for claim of a deduction, if the same is allowable as per the provisions of Act. However, the assessee can choose to defer the expenses and claim pro-rata expenses over a period of time. If the assessee so chooses, then the said expenditure would be allowable on pro-rata basis.

Difference between income as per TDS Certificates/26AS and as per accounts

Off late, issues arise on account of difference between the income as per TDS Certificates/26AS and as reflected in books of account. It may be appreciated that the liability to TDS arises at the time of payment or credit in the books, whichever is earlier. Accordingly, even if an advance is paid, liability to TDS arises. Further, credit for TDS is to be claimed in the year in which income is offered for tax. Accordingly, there would always be a mismatch between the income as per TDS certificates/26AS and as per books of account. The Hon'ble Bombay High Courts has in the case of *CIT vs. S. Ganesh (2014) 88 CCH 469 (Bom)* held that no addition can be made on account of the difference in income as per TDS certificates and as per accounts. This decision can be resorted to on account of genuine timing differences as pointed out above. However, where income has accrued/or received and the assessee has not accounted for the same, this decision may not be helpful.

Conclusion

The Act has seen many amendments to plug loopholes noticed by the Tax Department. Though section 145 provides for taxing the profits and gains of business or profession on the basis of method of accounting followed, section 43B allows certain deductions only on payment basis i.e. cash basis. This amendment was on the ground that assessee's dispute the liability and at the same time claim deduction under Income Tax. Similarly, on the one hand, Legislature grants certain deductions/exemptions to encourage setting up of units in backward areas and at the same time, they do not want to let go of revenue. So they brought in provisions like section 115JB, as they could not see such entities paying dividends to their shareholders. One should appreciate that a businessmen sets up business to earn profits and not for charity. If you want him to set up certain facilities in backward areas, for which you give him incentives, he is not going to blindly accept that proposal unless he sees profits, even after setting up the industry in a backward area and if he earns profit, he would definitely want to share it with his shareholders. Taxing such profits on the ground that the entity is claiming exemption and at the same time paying dividends is uncalled for.

Lastly, I would like to conclude with the following observations of Justice Sabyasachi Mukharji in *CWT vs. Arvind Narottam (1988) 173 ITR 479 (SC)* regarding tax avoidance:

"It is true that tax avoidance in an underdeveloped or developing economy should not be encouraged on practical as well as ideological grounds. One would wish, as noted by Reddy J., that one could get the enthusiasm of Justice Holmes that taxes are the price of civilization and one would like to pay that price to buy civilization. But the question which many ordinary taxpayers very often, in a country of shortages with ostentatious consumption and deprivation for the large masses, ask is, does he with taxes buy civilization or does he facilitate the waste and ostentation of the few. Unless waste and ostentation in Government spending are avoided or eschewed, no amount of moral sermons would change people's attitude to tax avoidance."

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Out of purity and silence comes the word of power.

— *Swami Vivekananda*

CA Shailesh Bandi

Commencement of Business

The Thumb Rule of the allowance of the Expenditure incurred under the Income-tax Act (ITA) is to draw up the Profit and Loss account so as to setting on one side income receipts and on the other expenses chargeable against them. Howsoever under the ITA, certain types of expenditure have been separately dealt with in sections 30 to 36 where any expenditure covered by these sections are found to have been incurred, deduction or allowance thereof are to be claimed under those sections. If any expenses are not referable to sections 30 to 36 then the allowance of the same may be claimed under residuary section 37 subject to that such expenditure is

i. Not falling within the rigours of section 30 to 36;

ii. Not in the nature of capital expenditure;

iii. Not a personal expenses

iv. Have been laid out or expended wholly and exclusively for the purpose of business and profession

In an Indian economy as more and more business players, both foreign and domestic are making entrance into new business avenues, it has been seen that there are huge costs which are incurred to float the new business venture.

Thus for a corporation/ entity to be organized and engage in business operations or say before obtaining first client, enormous cost are incurred for salaries, travel and entertainment, consulting fees, legal and accounting fees, marketing surveys, and other similar current expenditures, which generally are deductible if paid or incurred during the Previous year in carrying on any trade or business. But the same are trebled by the longevity of period between "set up" of operations and "commencement" of operations.

In aforesaid connection, on Income-tax front, there have been *inter alia* two issues which have captured attention of revenue authorities:

a) Date of Setting up of Business; and

b) Allowability of expenses after set up and before commencement of operations

These pre-incorporation expenses are virtually the same as those incurred by a corporation operating as a going concern. Thus the distinction between pre-incorporation expenses and expenses is one of timing rather than classification.

The expenses incurred during these periods lead to the debate as to their allowance under the Income-tax Act, 1961.

In various sections like 35ABA, 35AD, 35D, 80-I, 80IA, 80 IB, 80 JJA, etc., the words "business commences", "…. Commences any operations....", "commencement of business", commences operation" & "setting up" has been used, but the same have not been defined anywhere in the ITA. However what has been defined is only the **"Previous year"** u/s. 3 of the ITA, which clearly says that in case of newly set up business, the Previous year shall be the period beginning with the **date of setting up of the business,** which is further not defined.

Accordingly, **"date of setting up of business"** assumes importance because expenses prior to setting up of business will not be considered for allowability under section 37 or any other specific sections of the Act under chapter ………. This is however subject to section 35D of the Act wherein specifically provision has been made by legislature for allowance of preliminary (preoperative/pre-incorporation) expenses.

Even if pre-incorporation expenses can be attributed to the corporation as having been "paid or incurred" during the previous year, the further requirement that the expenses to be allowed, laid out or expended wholly and exclusively for the purpose of business and profession. Expenses which have been incurred by companies in the developmental stage may be described as "pre-operating" expenses because they are incurred by corporations which have not begun operations of the business for which they were created. Thus, a new corporation has the burden of providing that

(1) pre-incorporation expenses are attributable to its Previous year, and

(2) it was carrying on business and profession when the expenses were incurred-i.e., that the expenses were not "pre-operating" expenses.

Section 35D of the Act was introduced Taxation Laws (Amendment) Act, 1970 w.e.f. April 1, 1971. Prior to that there was no provision governing the preliminary expenses even in the 1922 Act and all the pre-incorporation expenses have been held to allowable u/s. 37 of the ITA 1961.

Succinctly speaking, salient features of section 35D are:

a) It is applicable to an Indian company or any other person "resident" in India. Thus the benefit of the same is not available to foreign companies or other entities who are not residents in India, for example entities have opened branches in India and incurred specified expenses in setting up Indian operations or are non-residents by virtue of the control and effective management are outside India.

b) It gives benefit for specified expenses which are incurred prior to business commencement and after commencement of business, for extension of same (setting up new units). In this connection, an amendment giving boost to service sector had been introduced by Finance Act, 2008 w.e.f. AY 2009-2010, to include service sector, where hitherto allowed the benefit of extension to "industrial" undertaking only.

c) The specified expenses are allowed in five installments beginning from the year in which business commences or the extension is completed as the case may be.

In aforesaid connection, Hyd. Bench of ITAT in *ITW Signode India Ltd. vs. DCIT in 110 TTJ 170,* has interestingly distinguished the expression "extension" from "expansion" in following words:

> "The expression used is "extension" and not "expansion". The former connotes that the assessee has extended its operations from the present activity to another activity. On the other hand, the latter indicates that the assessee has merely expanded its present operations. The expansion is generally meant to be the expansion of its present installed capacities. The capacity may be expanded either at the same location or at a different location. But the legislature has not used the word "expansion" and that is with a purpose. If there is merely an expansion, then it may not be necessary for the assessee to incur the type of

> expenditure envisaged in s. 35D. On the other hand, if there is extension or where altogether a new industrial unit is set up, such extension or setting up of a new unit may be preceded with the preparation of a feasibility report or a project report or conducting market survey and so on."

On aforesaid reasoning, it has been concluded that expenses incurred by assessee in innovating its products and improving them to cope with market conditions, are not subject to restriction of 1/5th as stipulated in section 35D and are allowable in toto, in year of incurrence u/s. 37 or other sections specified in the Act.

Similar sort of conclusion is available in Delhi High Court ruling in case of *Commissioner of Income tax vs. Gillete Group India (P.) Ltd. 173 Taxman 52* & *CIT vs. Woodward Governor India (P.) Ltd. 294 ITR 451.*

Further, in context of section 35D, an interesting issue cropped up for consideration before the Bombay High Court in the case of *Commissioner of Income-tax vs. Mahindra Ugine & Steel Co. Ltd 250 ITR 54* in the context of Debenture Issue Expenses wherein the Hon'ble court observed that

> "The expression 'in connection with the issue of public subscription of the debentures of the company essentially for the expansion of the business' in section 35D(2)(c) is a very wide expression and it would certainty include the stamp duty payable by the assessee on the debenture issue. Section 35D would apply only in respect of expenditure which is otherwise not allowable under the law, for example, capital expenditure. Therefore, in the instant case, the judgment of the Supreme Court in the case of *India Cements Ltd. vs. CIT [1966] 60 ITR 52,* applies in respect of expenditure on account of stamp duty even after introduction of section 35D ."

The Hon'ble Calcutta High Court in *CIT v. East India Hotels 252 ITR 860* has observed that the Board in para 45 of the circular no. 56 dated 19-3-1971 has clarified that the provision for amortisation is not intended to supersede any other provision of the ITA under which such expenditure is admissible as a deduction.

Similarly the Delhi High Court in *CIT vs. Thirani Chemicals Ltd. 290 ITR 196*, after taking note of CBDT Circular No. 56 dated 19th March, 1971 (explaining legislative intent behind section 35D), it was held that debenture issue expenses irrespective of being otherwise covered in plain language of section 35D, as intended by legislature, will continue to be allowed in full u/s. 37 of the Act.

Thus, a deduction which is allowable otherwise on the basis that it relates to a revenue expenditure, cannot be denied after the insertion of section 35D. This is so because section 35D has been introduced with a view to give benefit to an assessee in respect of the capital expenditure.

In view of above, since section 35D gives proportionate benefit over a period of 5 years and covers limited expenses as specified there under, therefore to have 100% allowance for every expense, it becomes wiser to deliberate upon two things i.e.:

1. Date of Setting up of Business vs. Commencement of Business for the Claim of expenses to be allowed; and
2. Whether one can claim the entire expenses in case of the extension of business, where there is unity of control which is indicated by inter-lacing, inter-dependence and inter-connection between the businesses dovetailing of one into the other?

"Business" is nothing more than a continuous course of activities and all the activities which go to make the business need not be started simultaneously in order that the business may commence. The Business would commence when the activity which is first in point of time and which much necessarily precede the other activities are started.

For commencement of a business, there must be in place some income generating asset or income earning structure. In several cases, there is a gap or an interval between setting up and commencement. When the business is set up, is a mixed question of law and fact and depends upon the line, nature and character of the business / professional activity. For example, for manufacturing business, purchase of raw material or electricity connection may be relevant point to determine setting up but in case of a property dealer, the moment, he puts up a chair and table, or starts talking, his business is set up and in the case of trader when the trader start providing such goods and services, the business is said to have commenced but the same may not hold good for set up of a business, which is a stage before the commencement. To set up a business, the following activities become relevant:-

'Preparation of a business plan; establishment of a business premises; research into the likely markets or profitability of the business; acquiring assets for use in the business; registration as an entity and under the local laws etc.' The said list of activities are not exhaustive and facts of each case need to be considered and therefore the **"date of setting up of business"** or **"commencement of business"** assumes more significance which has not been defined and thus we fall upon the Interpretations by the Hon'ble Courts

1. The Hon'ble Bombay High Court in the case of *Western India Vegetables Products Ltd. vs. CIT 26 ITR 151* examined the concept and noticed the difference between commencement and setting up of a business by observing

   "The important question that has got to be considered is from which date are the expenses of this business to be considered permissible deductions and for that purpose the section that we have got to look to is section 2(11) and that section defines the "previous year" and for the purpose of a business the previous year begins from the date of setting up of the business. Therefore, it is only after the business is set up that the previous year of that business commences and in that previous year the expenses incurred in the business can be claimed as permissible deductions. Any expenses incurred prior to setting up a business would obviously not be permissible deductions because those expenses would be incurred at a point of time when the previous years of the business would not have commenced."

   Thus, the only proposition which the Hon'ble Bombay High Court laid out was that there is difference between the date of setting up of the business and commencement of the business and lays down no other principles which are important to understand the business and its complexity of setting up or commencement.

2. The Hon'ble Supreme Court fortified this view in the case of *CWT vs. Ramraju Surgical Cotton Mills Ltd. 63 ITR 478* and observed that the proper meaning to be assigned to the expression "set up" would be "ready to commence business". It further observed that a unit cannot be said to be set up unless it is ready to discharge the function for which it is being setup. It is only when the unit has been put in such a shape that it can start functioning as business or a manufacturing organisation that it can be said that the unit has been set up.

3. The Gujarat High Court in a subsequent judgment in the case of *CIT, Gujarat vs. M/s. Saurashtra Cement and Chemical Industries Ltd. (1973) 91 ITR 170 (Guj.)*, has held a business is said to have commenced as soon as an essential activity of that business is started. On the question of setting up, the following observations are relevant:-

   "...A business activity consists of three stages: the first stage relates to the activity necessary for the purpose of acquiring the raw material and establishment of plant and machinery and the second activity comprises the processing and manufacturing by using the raw material and the plants and machinery set up for the

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purpose and the third category consisted of the marketing thereof. The first in point of time lays the foundation for the second activity and the second activity when completed lays the foundation for the third activity. Therefore, the expenditure incurred for carrying on any of these activities including the first activity is also deductible in computing the profits and gains of the assessee for the relevant year when the activity is undertaken."

4. In *Sarabhai Management Corporation Ltd. vs. CIT 102 ITR 25*, the Gujarat High Court took the same view and held that the business commences with the first activity for acquiring by purchase or otherwise, immovable property is undertaken. There may be an interval between the setting up of the business and the commencement of the business. All expenses incurred during that interval are also permissible for deduction. The Hon'ble Supreme Court not only confirmed this decision of the High Court, but also went a step ahead that even the activities at a preparatory stage is also admissible.

5. However, in an earlier judgment the Hon'ble Gujarat High Court in the case of *CIT vs. Saurashtra Cement & Chemicals Ltd. 90 ITR 170* on the facts held that new business could not be said to ready to discharge the function for which it was established, namely the manufacture of scientific instruments and communication equipment until the machinery necessary for the purpose of manufacture was installed. Obtaining land on lease, placing orders for machinery and raw materials and appointment of general managers were merely operations for the setting up of business.

Let us look at few more Instances

6. In *CIT vs. E-Funds International 162 Taxman 1(Del.)*, the Hon'ble Court held that though no income was earned in the previous year but since the necessary infrastructure was set and technical employees to render IT services were employed and hence the business was set up.

7. In *CIT vs. ESPN Software India Pvt. Ltd. 301 ITR 368*, the Court held that even though incorporated on August 1, 1995, the company had acquired licence to commence its business on August 15, 1995 to distribute in India through Cable Television Systems, Satellite Master Antenna Systems and DTH etc. ESPN channels. The business is said to have commenced as it was on that day the company was in a position to start the business. Trader has to select products, negotiate with manufacturers etc. and this is an essential and important facet of the activities and business of a trader.

8. In *Styler India (P.) Ltd. vs. Joint Commissioner of Income-tax, Spl. Range-1, Pune, 113 ITD 55 (Pune) (TM)*, it held on the facts that it was difficult to hold that the assessee did not set-up business in the relevant period. It had a place of business; it had qualified people who could give advice on automobile industry. There was material to show that the assessee had contacted various clients who had entered into agreement with the assessee in the subsequent years and paid fees for consultation. The assessee, without a doubt, did not show any consultancy receipt but merely because actual receipts were not shown, it could not be said that the assessee did not set-up its business. In fact, the business was set-up and commenced when the assessee was ready to give consultancy to its prospective customers. Not only that, there was material on record to show that the assessee took steps to give actual consultancy to its customers. Of course, consultancy charges were received in the subsequent year. But merely because no

actual amount was received as charges, it could not be said that the business was not set-up.

9. In *CIT, Banglore vs. IBC Knowledge Park, 385 ITR 346 (Kar.)*, the Hon'ble Court in relation to the expenses of interest claimed u/s. 36(1)(iii) held that Sale of constructed properties is not a *sine qua non* for commencement of business. Assessee's business commenced when it had purchased land, obtained plan sanction and put up construction. Thus, when the business of the assessee had commenced, interest paid by the assessee on borrowed capital cannot be added back to the work-in-progress and is allowable u/s. 36(1)(iii).

On a reading of the above referred Judicial precedents, it is clear that

1. Thus a finding regarding the date when a business was set up or has commenced its operation is a finding of fact.

2. The deductibility of pre-incorporation expenses depends upon the expenses being incurred in the previous year and be the result of carrying on a trade or business.

3. It is only after the business is set up, that the expenses incurred in the business can be claimed as permissible deduction under Section 37 of the Act or any other specific section of 30 to 36 of the act.

4. A corporation which incurs pre-operating expenses in a year prior to the year it begins operations is not able to deduct the preoperating expenses. Nevertheless, there may be other avenues leading to deductions. For example, a corporation may attribute its pre-operating expenses in Section 35D or transfer it to the cost of amortizable assets with a determinable useful life.

Now we come on the other aspect of the deliberations i.e. allowability of expenses in case of the extension of business, where there is unity of control which is indicated by inter-lacing, inter-dependence and inter-connection between the businesses dovetailing of one into the other.

As we read above, i.e. the Hyd. Bench of the ITAT has distinguished the expression "extension" from "expansion" and held that if there is merely an expansion, then it may not be necessary for the assessee to incur the type of expenditure envisaged in s. 35D, but if there is extension or where altogether a new industrial unit is set up, such extension or setting up of a new unit may be preceded with the preparation of a feasibility report or a project report or conducting market survey and so on & then section 35D comes into play.

However, certain expenses like Interest expenses on the borrowing etc. are incurred, while extending the Business, which are not listed or specified in the section 35D and the various courts from time-to-time have held that where there is unity of control which is indicated by inter-lacing, inter-dependence and inter-connection between the businesses dovetailing of one into the other then such interest is an allowable expenditure.

To understand the above principles, let us look into some Judicial pre-cedents :

1. In the case of *CIT vs. Tata Chemicals Limited 256 ITR 395 (Bom.)* wherein the assessee, a public limited company, had a manufacturing of Fertilizer Unit at Mithapur in Gujarat and it set up a different manufacturing of Fertilizer unit at Babrala, UP, which was originally a subsidiary of Tata Chemicals and then merged with Tata Chemicals. It claimed deductions under section 36(1)(iii) in respect of the funds borrowed for the Barabala Unit while filing its return, which were disallowed on the ground that the units were situated at different places and there was no functional integrity in

common accounts or organic unity and the interest was already capitalised in the books could not be claimed as revenue expenditure. The Hon'ble Court by observing as regards to the deduction allowed under section 36(1)(iii), the Tribunal had summarised the propositions and determined the tests on the question of unity of business. They are as follows :

(i) The nature of the two lines of business is not relevant.

(ii) The fact that one business can be conveniently closed down without affecting the other business, is a strong indication that both the businesses are distinct and separate. But no decisive inference can be drawn from the fact.

(iii) The decisive test is the unity of control which is indicated by inter-lacing, inter-dependence and inter-connection between the businesses and the dovetailing of one into the other. Such inter-lacing, inter-dependence or inter-connection can be shown to exist by reason of a common management, common administration, common fund and a common place of business.

And thus the Interest u/s. 36(1)(iii) is an allowable expenditure even if it in respect of the fund borrowed for the different unit.

2. Similarly in the case of *CIT vs. Pfizer Ltd 330 ITR 62 (BOM.)* it observed that the assessee carried out manufacturing activity at various locations, all other support functions such as purchase, sales, marketing, distribution, finance and human resources were centralised with the head office. None of the manufacturing units functioned as independent profit centre. All purchases for the manufacturing units were centralised at the head office. The sales and marketing functions were also centralised. The working capital requirements and capital commitments with regard to plant operations were also centralised. The Tribunal had entered a finding of fact that there was interdependence and a unity of control between the three units established by the existence of a common management, a common business organisation, administration and fund. The question was whether the retrenchment compensation payable by assessee on closure of one of its units was allowable as deduction.

And thus held that, in view of the finding that there had been no closure of the business, the payments which were made to the workmen, qualified for deduction under section 37.

3. However, the Hon'ble SC in the case of *L.M. Chabbda and Sons vs. CIT 65 ITR 638* under the 1922 Act, in a contrary decision held that an assessee who carries on several distinct and independent businesses, and one of such businesses is closed before previous year, then he cannot claim allowance under section 10 of Act of 1922 of an outgoing attributable to business which is closed against income of his other businesses in that year since there was no evidence about unity of control and management, or inter-relation of business, or employment of same staff to run business, or possibility of one theatre being closed without affecting rest of the business.

4. But while dealing with the carry forward & set-off losses under the 1922 Act, the Hon'ble Supreme Court in the case of *B.R. Limited vs. V. P. Gupta, CIT 113 ITR 647* held that under section 24(2) of the Act of 1922, an unabsorbed loss could be carried forward to be set off against the profits of a subsequent year or years, only if such profits accrued to the assessee from the same business and not otherwise. It

> is elementary that, in law, the two words "same" and "similar" connote different concepts and, therefore, the carrying on of a similar business will not meet the requirements of the section. The business has to be the same as before. But, though this is so, it is not possible to evolve a satisfactory test of universal application for determining whether the business which an assessee carries on in a year in which he has made profits against which a carried forward loss could be set off, is the same business which he was carrying on in the year in which he incurred the loss. Decided cases show that the determination of the question whether an assessee is carrying on in two different accounting periods the same business depends essentially on the facts of each particular case. A common management, a common business organisation, a common administration, a common fund and a common place of business showed in the instant case the interlacing and inter-dependence of the businesses carried on by the appellant.

In support of his conclusion that the two businesses were different, the Commissioner relied on the circumstances that "there is a distinct and marked difference in the nature of goods dealt with" by the appellant and "the procedure involved in the import of articles from foreign countries and the export of articles manufactured in India to different foreign countries is entirely different". These circumstances were not by themselves sufficient to establish that the business of import which the appellant was doing was not the same business as that of export. The decisive test, as held by the Supreme Court in Produce Exchange Corporation 77 ITR 739 (SC), is unity of control and not the nature of the two lines of business. The Commissioner also fell into the error of supposing that, apart from the fact that the two activities must form an integral part of the entire business, the "main consideration which has prevailed is" whether, "notwithstanding the fact that the assessee may close one activity, it does not interfere in the carrying on of the other activity". The fact that one business cannot conveniently be carried on after the closure of the other may furnish a strong indication that the two businesses constitute the same business. But the decision of the Supreme Court in Prithvi Insurance Co. 63 ITR 632 showed that no decisive inference can be drawn from the fact that after the closure of one business, another may or may not conveniently be carried on. The Commissioner also overlooked that in the report, which the ITO made in the revision applications filed by the appellant, it was expressly stated that it was true that "there was a common control and common management of the same board of directors" of the business of import and export. Thus, the unity of control and the other circumstances adverted to above showed that there was dovetailing or inter-lacing between the business of import and the business of export carried on by the assessee and that they constituted the same business.

In light of the aforesaid discussion, it generally is the fear of many taxpayer corporations losing the deductions for pre-incorporation expenses simply because the expenses are incurred prior to the first previous year in which operations commence. Since there is neither specific definition the ITA as to timing of commencement of business nor of date of setting up of business for the deduction of pre-incorporation expenses u/s. 35D or otherwise, the allowance would therefore depend on each set of facts and in case of extensions, whether the same constitutes same business evidenced by the unity of control which is indicated by inter-lacing, inter-dependence and inter-connection between the businesses dovetailing of one into the other & if that be the case then one may consider ratio of the Hon'ble Apex Court and the Bombay High Court for allowance of the preliminary/ pre-operative expenses also.

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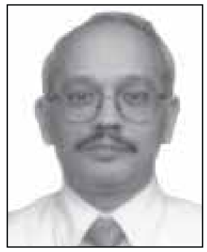

CA Sanjeev Pandit

Depreciation and Allowance u/s. 32AD

Depreciation is an important deduction for any business, particularly in businesses that are capital intensive or which have substantial intangible assets. From assessment year 1988-89, the scheme of depreciation under section 32 of the Income-tax Act, 1961 (the Act) underwent a complete overhaul and depreciation is now allowed with respect to 'block of assets'. The only exception to this is assets of an undertaking engaged in generation of power or generation and distribution of power, in which case depreciation continues to be allowed with respect to individual assets, and not with respect to block of assets. This article deals with some of the issues on the subject of depreciation while computing profits and gains of business or profession and allowance u/s 32AD.

Primarily, there are three important terms in the scheme of depreciation – (i) actual cost (ii) block of assets and (iii) written down value (w.d.v.) in the case of any block of assets.

Actual Cost

The term 'actual cost' is defined by clause 1 of section 43. The two provisos and various explanations under the definition modify the meaning of actual cost under certain specific circumstances. ICDS-V relating to Tangible Fixed Assets provides that cost of an asset comprises of its purchase price, import duties and other taxes, excluding those subsequently recoverable, and any directly attributable expenditure on making the asset ready for its intended use. Any trade discounts and rebates shall be deducted in arriving at the actual cost.

Determining the actual cost of the asset is important in the year in which the asset is acquired and put to use, that being the year in which it enters the block of assets. Once the asset enters the block of assets, the adjustment that may be made is u/s 43A on account of increase or decrease in the liability expressed in Indian currency due to change in foreign exchange rates. This adjustment, with effect from assessment year 2003-04, is to be made based on exchange rate at the time of making the payment for discharge of that liability u/s 43A. Section 43A provides for adjustment to the actual cost of the asset as defined under clause (1) of section 43 and does not specifically provide for adjustment to the w.d.v. of the block of assets. However, by implication, the adjustment consequential to the change in the rate of exchange is made to the w.d.v. of the block of assets. ICDS-V relating to Tangible Fixed Assets also provides for adjustment for price, change in duties and taxes or similar factors.

While determining the actual cost of the asset, reference may be made to ICDS IX relating to Borrowing Costs. ICDS IX provides for capitalisation of borrowing costs. This may be different from the borrowing costs capitalised in the books of account. Para 5 of the ICDS IX provides for capitalisation of funds borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset. Para 6 deals with capitalisation of borrowing costs of funds other than those referred in para 5. Para 7 and para 8 deal with commencement and cessation of capitalisation, respectively.

Block of Assets

Under section 2(11), the term 'block of assets' means a group of assets falling within a class of assets comprising –

(a) tangible assets, being buildings, machinery, plant or furniture;

(b) intangible assets, being know how, patents, copyrights, trademarks, licenses, franchises or any other business commercial rights of similar nature.

A question that arises is what is a `class of assets' contemplated by this definition. This becomes important when the assets comprised in a block of assets are sold, and the moneys payable in respect of the same is to be adjusted against the value of the block. Whether the class of assets refers to 'tangible assets' and `intangible assets', or within tangible assets whether buildings, machinery, plant and furniture form separate classes. In the first mentioned interpretation, furniture and fittings for which the rate of depreciation prescribed is 10% and buildings having prescribed rate of depreciation as 10% would form part of the same block. On the other end, if the latter interpretation is to be followed, these assets would form part of separate blocks. ITR forms consider buildings, plant and machinery and furniture fittings as separate classes, notwithstanding that certain types of buildings and furniture fittings carry the same rate of depreciation. However, all types of intangible assets are considered as belonging to one class and one block of assets. A reference may be made to Circular No. 469 dated 23rd September 1986 which contemplates four classes of assets namely, buildings, machinery, plant and furniture. A reference may also be made to the decision in the case of *Panchshila Hospitality Ventures Ltd. vs. Spl. ACIT 85 taxmann.com 350 (Delhi – Trib.)*. In that case, the Tribunal observed `one thing that evidently becomes clear is that in the Income-tax Act, there are only two categories of class of assets, i.e., tangible and intangible and within the same class, various blocks of assets are covered'. It effectively held that the short term capital gains u/s. 50 should be computed by aggregating the w.d.v. of the block of assets comprising building and furniture. The rationale for the same was the gain had arisen on sale of assets falling in the same class of assets under section 2(11) of the Act as the rates of depreciation prescribed for the building and furniture & fixtures was also the same. However, the Tribunal failed to notice that the term 'class of assets' was used in section 2(11) even prior to its amendment w.e.f. assessment year 1999-2000 to include intangible assets. Considering this, it is difficult to appreciate that the Act contemplates only two categories of class of assets as held by the Tribunal.

Block of Assets – *Qua* Assessee?

Another question that arises is whether the block of assets is with reference to each source of income or with reference to each business or with reference to the assessee. The Act does not contain any specific provision in this respect. However, the definition of the term 'block of assets' as well as definition of 'written down value' in clause (6) of section 43 indicates that the block of assets is vis-a-vis the assessee, and not each source of income or each business. *Explanation 2A* and *Explanation 2B* dealing with the demerger provide that where any asset forming part of a block of assets is transferred in the process of demerger to the resulting company, then the w.d.v. of the block of assets of the demerged company for the immediately preceding previous year is to be reduced by the w.d.v. of the assets transferred to the resulting company pursuant to the demerger and conversely, in the hands of the resulting company the w.d.v. of the block of assets shall be the w.d.v. of the transferred assets of the demerged company. Explanation 5 dealing with corporatisation of recognised stock exchanges also makes similar provision. A reference may also be made to the definition of `written down value' in case of any block of assets contained in clause (6)(c)(i) of section 46. The said clause provides for adjustment to be made when an assessee makes a slump sale. Item (C) provides for reducing the w.d.v. of the assets falling within the block of assets while computing the w.d.v. of the block of assets for the transferor entity. Considering the various provisions referred above and the overall scheme of section 32, various blocks of assets are *vis-à-vis* the assessee, and not vis-à-vis individual source of income or individual business carried on by the assessee. Various judicial decisions have taken the view that block of assets is not with respect to a division or undertaking of the assessee. In this respect, reference may be made to the following decisions:

CIT vs. Eastman Industries Ltd. 174 Taxman 344 (Delhi)

CIT vs. Oswal Agro Mills Ltd. 341 ITR 467 (Delhi)

S. Muthurajan vs. Dy. CIT [2011] 339 ITR 301 (Mad.)

CIT vs. Ansal Properties & Infrastructure Ltd. 20 taxmann.com 770 (Delhi)

In the last-mentioned case, while dealing with short-term capital gain u/s 50, the Court referred to other decisions and observed that the Assessing Officer had proceeded on the basis that the division itself constitutes a separate and an independent block of assets. It held that Appendix to the Rules was not unit/division specific, but was rate of depreciation specific, as all assets prescribed the same rate of depreciation are clubbed and are a part of the same block of assets.

One may however mention that section 70 dealing with set off of loss from one source against income from another source contemplates computation of income of each source separately.

'Use' of Assets

Under section 32, depreciation is allowed in respect of assets owned, wholly or partly, by the assessee and used for the purposes of business or profession. Prior to the scheme of depreciation *vis-à-vis* block of assets becoming operational, depreciation was allowed only if the individual asset was used during the previous year for the purposes of business. However, after depreciation became allowable with respect to block of assets, question arose whether the use of individual asset is relevant for allowing depreciation. Often, the Department took the view that if an individual asset was not used for the purposes of business during the previous year, depreciation in respect of such asset was not allowable. However, a plethora of decisions have held that once the asset enters the block of assets, it loses its individual identity and thereafter whether an individual asset has been used during the previous year or otherwise is not relevant for the purposes of allowing depreciation with respect to block of assets. The use of asset is only relevant in the year in which it enters the block of assets. In other words, for an asset to enter the block of assets, it should be installed and put to use, but thereafter for claiming depreciation, it is not necessary to demonstrate that each asset comprised in the block of assets was used during the previous year. In this respect, reference may be made to the following decisions:

DCIT vs. Coromandal Bio Tech Industries (I) Ltd. 20 taxmann.com 520 (Hyd.)

Inductotherm (India) Ltd. vs. DCIT 73 ITD 329 (Ahd.)

DCIT vs. Boskalis Dredging India (P) Ltd. 53 SOT 17 (Mum.)

CIT vs. Sonic Biochem Extractions Pvt. Ltd. Income Tax Appeal No. 2088 of 2013 decided on 17th November 2015 by Bombay High Court.

In the case of Sonic Biochem Extractions Pvt. Ltd., the depreciation was claimed in respect of assets of discontinued business. However, the Court refused to entertain appeal of the revenue on the issue of allowability of depreciation in respect of assets of the discontinued business which formed part of the block of assets. One may also refer to the decision in the case of Ansal Properties & Infrastructure Ltd. (supra) rendered in the context of section 50. As mentioned earlier, the court in that case held that Appendix to the Income tax Rules which prescribes rates of depreciation is not a unit/division specific but is rate of depreciation specific. It appears that this question is now reasonably well-settled and use of individual asset for claiming depreciation is not required once the asset enters the block of assets.

Ownership of Asset

The other condition for the allowability of depreciation u/s. 32 is the ownership of the asset. Section 32 does not require a perfect title to claim depreciation. What is important for claiming depreciation is dominion and control over the property by the assessee in his own right. [CIT vs Orient Longman (P) Ltd.227 ITR 68(AP)]. The Supreme Court has also held that 'building owned by the assessee' means the person who having acquired possession over the building in his own right, uses the same for the purposes of his business profession though legal title has not been conveyed to him as per the requirements of laws, but nevertheless is entitled to hold the property to the exclusion of all others. *[Mysore Minerals Ltd. vs CIT 239 ITR 775 (SC), Poddar Cements 226 ITR 625 (SC)]*

Even if an asset of a partnership firm is held in the name of a partner, since a partnership firm is in law a compendium of all the partners, a partnership firm would be entitled to depreciation on the asset. This has been confirmed by the Allahabad High Court in the case of *CIT vs. Navadurga Transport Co 149 CTR (All) 219.*

Where an asset of a company is held in the name of a director, since a director stands in a fiduciary capacity to the company, the company would be eligible for depreciation. Reference may be made to the High Court decisions in the cases of *CIT vs. Aravali Finlease Ltd 341 ITR 282 (Guj), CIT vs. Basti Sugar Mills Co Ltd 257 ITR 88 (Del), CIT vs. Varanasi Auto Sales Pvt Ltd 326 ITR 182 (All),* and the Tribunal decisions in the cases of *Edwise Consultants Pvt Ltd vs. DCIT 44 ITR(T) 236 (Mum)* and *Swagat Infrastructure Ltd vs. JCIT 37 taxmann.com 83 (Ahd).*

The exception to the requirement of ownership for the purposes of claiming depreciation is provided in *Explanation 1* to section 32(1). *Explanation 1* provides that where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds lease or any right of occupancy then, any expenditure incurred by the assessee on construction of any structure or any work by way of renovation or extension or improvement to the building then such structure or work is considered as owned by the assessee and becomes eligible for depreciation. In this context, the Supreme Court has held that it is only when the assessee holds a lease right or other right of occupancy and any capital expenditure is incurred *by the assessee* on the construction of any structure or doing of any work in or in relation to and by way of renovation or extension of or improvement to the building, that the assessee would be entitled to depreciation to the extent of any such expenditure incurred. *[Mother Hospital vs. CIT 92 ITR 628 (SC)].* In case the assessee does not satisfy these two conditions, *Explanation 1* does not apply. It may however be noted that considering the wording of the *Explanation 1*, it gets attracted only when the expenditure is of capital nature. Any expenditure which is of in the nature of revenue expenditure, would be allowable as repairs u/s 30 or u/s 37 of the Act.

Leasing Transactions

We may now consider some of the issues arising out of leasing transactions. In a finance lease, the asset is financed by the lessor and is given on lease to the lessee. Question that arises is whether, in such a case, the lessor can be considered as using the leased asset. In this respect a reference may be made to the decision of the Supreme Court in the case of *I.C.D.S. Ltd. vs. CIT 350 ITR 527 (SC)*. In this case, the assessee had leased vehicles to the lessee and the vehicles were registered in the name of the lessee. The assessee claimed depreciation at the higher rate. The Assessing Officer disallowed the depreciation completely on the grounds that the assessee did not own the vehicles and it did not use the same for the purposes of its business. The Supreme Court held that the vehicles were registered in the name of the lessee in compliance of the Motor Vehicles Act, 1988. Section 2(30) of the Motor Vehicles Act, 1988 deems lessee as the owner of the vehicle. The Court observed that the Motor Vehicles Act, 1988 leaves no choice to the lessor but to allow the vehicle to be registered in the name of the lessee. Thus, no inference could be drawn from the registration certificate as to the ownership of the legal title of the vehicle. It also referred to provisions of the lease agreement and concluded that the lessor was the owner of the leased vehicles. The Court also opined that the fact that the trucks themselves were not used by the assessee is irrelevant for the purpose of the section. It referred to its decision in the case of *CIT vs. Shaan Finance (P.) Ltd. 97 Taxman 435 (SC)* and allowed depreciation at the higher rate.

It would not be out of place to simultaneously refer to the decision of the Supreme Court in the case of *CIT vs. Virtual Soft Systems Ltd. 404 ITR 409 (SC)*. In this decision, the Supreme Court allowed deduction of lease equalization charge which was debited to the income statement following the Guidance Note of the Institute of Chartered Accountants of India. The Court held ` The method of accounting followed, as derived from the ICAI's Guidance Note, is a valid method of capturing real income based on the substance of finance lease transaction. The rule of substance over form is a fundamental principle of accounting, and is in fact, incorporated in the ICAI's Accounting Standards on Disclosure of Accounting Policies being accounting standards which is a kind of guidelines for accounting periods starting from 1-4-1991. It is a cardinal principle of law that the difference between capital recovery and interest or finance income is essential for accounting for such a transaction with reference to its substance. If the same was not carried out, the Respondent would be assessed for income tax not merely on revenue receipts but also on non-revenue items which is completely contrary to the principles of the IT Act and to its Scheme and spirit.'

In the decision in the case of I.C.D.S. Ltd. (supra), the facts do not indicate if it was a finance lease or otherwise. Also, the question before the Court in the case of I.C.D.S. Ltd. was quite different from the question before the Court in the case of Virtual Soft Systems Ltd. Although it is not clear from the facts narrated in the decision, it appears that in the case of Virtual Soft Systems Ltd. the assessee had accounted for the transaction in accordance with the provisions of the Guidance Note and treated it effectively as a loan transaction. If one were to reconcile the two decisions of the Apex Court, it appears that if the lessor assessee chooses to treat the lease transaction as a finance transaction, he would be entitled to deduction of lease equalization charge. In such a case, he will not be entitled to claim depreciation. On the other hand, if the assessee chooses to claim deduction for depreciation on the leased asset (and particularly if the transaction is in the nature of operating lease), the whole of rental income would be subject to taxation. One wonders whether the two decisions read together give an option to the assessee for choosing the tax treatment for a transaction in the nature of finance lease.

Reorganisation of Business

The next issue that may be considered is the impact of various types of reorganisation or succession of business on the claim of depreciation. Over the last few years, provisions have been introduced in the Act to make reorganisation of business tax neutral subject to certain conditions. Consequently, provisions relating to depreciation have been amended from time to time. The last proviso to section 30(1) makes provision for apportionment of depreciation (i) between the predecessor and the successor (in case of succession of the firm by a company, succession of a private or unlisted public company by a limited liability partnership or succession of a sole proprietary concern by company), (ii) between an amalgamating company and an amalgamated company; and (iii) between a demerged company and a resulting company. The apportionment has to be done in the ratio of number of days for which the assets were used by the respective entities, the total depreciation being amount not exceeding the deduction calculated at the prescribed rates as if the reorganisation had not taken place. This provision is applicable only in the year in which the reorganisation takes place. In the subsequent year, the w.d.v. of the block of assets is to be determined in accordance with the provisions of clause (6) of section 43 read with relevant *Explanation* under the said clause.

Explanation 1 to clause (6) of section 43 provides for cases of succession to business falling u/s 170(2). Section 170(2) provides for assessment of the income of the previous year in which succession took place up to the date of succession on the successor in case the predecessor is not found.

Explanation 2 deals with case of transfer of block of assets between holding company and subsidiary company and vice versa where conditions of section 47(iv) or (v), as the case may be, are satisfied. It also covers cases of amalgamation. In these cases, the w.d.v. of the block of assets in the case of the transferor company or the amalgamated company, as the case may be, for the immediately preceding previous year as reduced by the amount of depreciation actually allowed for that previous year is considered as the actual cost of the block of assets for the transferee company or the amalgamated company, as the case may be. It is not clear why does this Explanation use the term `actual cost of the block of assets' and not the w.d.v. of the block of assets, particularly when the Act does not define the `actual cost of block of assets'.

Explanation 2A and *Explanation 2B* deal with cases of demerger. In substance, these Explanations provide that when any asset forming part of a block of assets is transferred by demerged company to the resulting company, the w.d.v. of the block of assets in the hands of the resulting company shall be the w.d.v. of the transferred assets of the demerged company. Under *Explanation 2A*, the w.d.v. of the block of assets of the demerged company is to be reduced by the w.d.v. of the assets transferred to the resulting company. This provision may sometimes create some practical difficulties in computing the w.d.v. of the block of assets in the hands of the demerged company. Under the scheme of depreciation in respect of block of assets, any monies payable in respect of assets comprising the block of assets on alienation or discarding or destruction, is to be reduced from the value of block of assets. Consequentially, it may so happen that the w.d.v. of the assets which are transferred in the process of demerger exceeds the w.d.v. of the whole block of assets before the demerger on account of reduction of monies payable as aforesaid. In such case, it is opined that the relevant block of asset will have to be taken at nil value in the hands of the demerged company post demerger and the block of assets in the hands of the resulting company will be aggregate of the w.d.v. of the assets transferred in the process of demerger.

Explanation 2C deals with w.d.v. of the block of assets in case of conversion of a private company or unlisted public company into a limited liability partnership under clause (xiiib) of section 47. It provides that in the hands of the limited liability partnership, the actual cost of block of assets shall be the w.d.v. of the block of assets as in the case of the converted company on the date of conversion. As in *Explanation 2*, this *Explanation* also uses the term `actual cost of block of assets'. Apart from this, *Explanation 2C* is different from *Explanation 2*, which is more logical and clearer. The Act does not contemplate computing w.d.v. of a block of assets on a day-to-day basis or during any day during the previous year. The only logical way to make this *Explanation* workable is to arrive at the w.d.v. by reducing the proportionate depreciation allowed under the last proviso to section 32(1) (discussed earlier) to the converted company from the w.d.v. of the block of assets in the hands of the company as adjusted by actual cost of assets acquired or monies payable in respect of assets alienated till date of conversion into a limited liability partnership.

While w.d.v. of block of assets in case of various modes of reorganisation of business are dealt with in *Explanations*, the case of slump sale is dealt with as item (C) of clause 6(i)(c) of section 43. It provides for reducing the w.d.v. of the block of assets by the w.d.v. of each item of the assets transferred (i.e. actual cost reduced by depreciation allowed till assessment year 1987-88 and allowable for assessment year 1988-89 and thereafter, as if each asset was the only asset in the relevant block). As in the case of demerger, similar difficulty may arise in case of slump sale where the w.d.v. of the assets transferred as the part of slump sale exceeds the w.d.v. of the block of assets.

Depreciation under Presumptive Taxation

In the recent years, various provisions have been introduced for taxing income on presumptive basis. Section 44AD provides for presumptive taxation for profits and gains of certain eligible businesses carried on by eligible assessees. Section 44ADA provides for presumptive taxation of income of certain professionals and section 44AE deals with taxation of profits of business of plying, hiring or leasing of goods carriages. Each of these sections provide that any deduction allowable under the provisions of section 30 to 38 shall be deemed to have been already given full effect to and that w.d.v. of any asset used shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed depreciation for the year. Accordingly, where the assessee is taxed on presumptive basis under the above sections, no separate deduction for depreciation will be allowed and w.d.v. of various blocks of assets will be reduced as if depreciation has been fully allowed.

Depreciation when Income is Estimated

An issue that comes up is when profits of the assessee are estimated for taxation, whether depreciation is to be separately allowed. Depreciation is a statutory allowance and unless the Act specifically provides that in certain circumstances depreciation is deemed to have been allowed, the assessee is entitled to depreciation u/s. 32. In this respect a reference may be made to the following decisions:

CIT vs. Chopra Bros. India (P) Ltd. 252 ITR 412 (P & H)

CIT vs. Bishambhar Dayal & Co. 210 ITR 118 (All)

Saraya Engg. Works vs. CIT 168 ITR 455 (All)

In the last-mentioned decision, the Allahabad High Court had taken a view that the assessee was not entitled to separate deduction on account of depreciation once the profits have been estimated after taking into account deduction for depreciation. A reference may also be made to the Circular No. 29-D (xix) of 1965, F. No. 45 (239) 1965-ITC, dated 31-3-1965 which states that where it is proposed to estimate profits, the depreciation allowance should be separately worked out and allowed as deduction.

Depreciation – whether expenditure?

Normally, expenditure denotes money actually going out from the coffers of the assessee. Expenditure involves `paying out'. On the other hand, depreciation is allowed with reference to w.d.v. of the assets. In case of *A.I. Kurian vs. CIT 162 Taxman 147 (Ker.),* the Court refused deduction on account of depreciation u/s. 57(iii) on the ground that the said clause provides for deduction in respect of expenditure, depreciation was not an expenditure and that section 57(iii) does not contemplate granting of any allowance like depreciation. A reference may also be made to the decision in the case of *Nectar Beverages (P.) Ltd. vs. DCIT 314 ITR 314 (SC).* The Apex Court observed that depreciation in its very nature, is neither a loss, nor an expenditure, nor a trading liability, referred to in section 41(1). The Court was dealing with taxability of proceeds of assets in respect of which full cost had been allowed as depreciation and when the sale was made section 41(2) was not on the statute book.

Whether depreciation is an expenditure becomes important in the light of provisions of section 14A providing for disallowance of expenditure incurred in respect of income which does not form part of the total income. If depreciation is not an expenditure, it is possible to contend that it is not subject matter of disallowance u/s. 14A. In this respect a reference may be made to the following decisions:

Vishnu Anant Mahajan vs. ACIT 22 taxmann.com 88 (Ahd.) (SB)

Hoshang D. Nanavati vs.. ACIT 25 Taxmann.com 141 (Mumbai - Trib.)

One may also make a reference to the decision of the Apex Court in the case of *CIT vs. Woodward Governor India (P.) Ltd. 312 ITR 254 (SC).* In this case, the court was dealing with unrealised loss on account of foreign exchange fluctuation. The Court observed ` The word "expenditure" is not defined in the 1961 Act. The word "expenditure" is, therefore, required to be understood in the context in which it is used. Section 37 enjoins that any expenditure not being expenditure of the nature described in sections 30 to 36 laid out or expended wholly and exclusively for the purposes of the business should be allowed in computing the income chargeable under the head "Profits and gains of business". In sections 30 to 36, the expressions "expenses incurred" as well as "allowances and depreciation" has also been used. For example, depreciation and allowances are dealt with in section 32. Therefore, Parliament has used the expression "any expenditure" in section 37 to cover both.' Considering this, it is possible to take a view that the term `expenditure' used in the context of section 14A also covers depreciation.

Depreciation on Intangible Assets

Depreciation is allowable in respect of intangible assets acquired after 1st April 1998. The assets on which depreciation is allowed are know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature. In the commercial world, expenditure is generally incurred for getting a certain advantage. Whether such expenditure, if of capital nature, results in business or commercial right of the nature similar to intangible assets specifically referred to in section 32(1) has been a matter of debate. In the case of *Sharp Business System vs. CIT 211 Taxman 576 (Delhi)*, the assessee paid L & T certain sum as consideration for not setting up or undertaking or assisting in setting up or undertaking any business in India of selling, marketing and trading of electronic office products for a period of 7 years. The Delhi High Court held that a non-compete right cannot be said to be of the same nature as rights specifically specified (e.g. copyright, trademarks etc.) in the section. The nature of those rights clearly spelt out an element of exclusivity, which ensured to the assessee as a sequel to the ownership. This was not the case with non-compete right.

The Madras High Court, in the case of *Pentasoft Technologies Ltd. vs. Dy CIT 222 Taxman 209*, held that a non-compete fee amounted to an intangible asset eligible for depreciation. In that case, the non-compete payment was for restraint on use of trade mark, copyright, etc. and the court held the non-compete clause in the agreement under question should be read as supporting clause to transfer of copyrights and patents.

Thereafter, Karnataka High Court in the case of *CIT vs. Ingersoll Rand International Ind. Ltd. 227 Taxman 176 (Mag)* took a broader view and held that a non-compete right was eligible for depreciation u/s. 32. It held that such a right was a commercial right similar in nature to patents, copyright etc. It appears that the issue is not completely settled and the approach of various High Courts is not the same.

While on depreciation relating to intangible assets, a reference may also be made to the decision of the Supreme Court in the case of *CIT vs. Smifs Securities Ltd. 348 ITR 302 (SC)*. The Court held that goodwill arising on amalgamation is an asset under Explanation 3(b) to Section 32(1) of the Act and was eligible for depreciation.

Additional Depreciation

With a view to encourage investment in new plant and machinery, additional depreciation at the rate of 20% of the actual cost of new plant and machinery is allowed, subject to certain conditions, which are similar to those specified in section 32AD. The additional depreciation is available for plant and machinery acquired and installed after 31st March 2005. In case where an assessee sets up an undertaking for manufacture or production of any article or thing after 1st April 2015 but before 1st April 2020 in any notified backward area in the state of Andhra Pradesh or Bihar or Telangana or West Bengal and acquires and installs new plant and machinery, the additional depreciation is at the rate of 35%, instead of 20%. However, if the asset, in the year of installation, is put to use for a period of less than 180 days, the additional depreciation is restricted to 50% of 20% or 35%, as the case may be, in that year and the balance 50% of the additional depreciation is allowed in the immediately succeeding previous year. The provision regarding allowability of the balance additional depreciation in the subsequent previous year in case, in the initial year, the use was for less than 180 days was introduced with effect from assessment year 2016-17 and has ended the controversy in respect of the same.

Unabsorbed Depreciation

Under section 32(2), if depreciation or any part thereof cannot be absorbed due to absence of profit or inadequacy of profit, the same is carried forward and is added to the depreciation allowance of the succeeding previous year. However, this is subject to provisions of section 72(2) and 73(3). Accordingly, any brought forward loss is set off before setting off of unabsorbed depreciation.

The provisions of sections 72, 79 and 80 do not apply to unabsorbed depreciation, but only to unabsorbed losses. Therefore, there is no time limit for set off of unabsorbed depreciation, unabsorbed depreciation of a closely held company does not lapse on a majority change in shareholding, and unabsorbed depreciation can be carried forward even if the return of income is not filed within the limit specified in section 139(1).

Allowance for Investment in Notified Backward Areas

Section 32AD, was inserted by the Finance Act 2015 with effect from assessment year 2016-17. It entitles an assessee to claim an allowance of 15% in the year of installation of the actual cost of new plant and machinery acquired and installed by the assessee for manufacture or production of any article or thing, on or after 1st April 2015 but before 1st April 2020, in any notified backward area in the states of Andhra Pradesh, Bihar, West Bengal and Telangana. This is a one-time deduction available in the year of installation of the new asset by the eligible undertaking, and is in addition to any depreciation and additional depreciation allowable.

Both acquisition and installation have to be within this period of 5 years, though the acquisition may be in one year and installation in the subsequent year.

Plant and machinery, for this purpose, does not include the following types of assets: Ship or aircraft, plant or machinery used within or outside India by any other person before it's installation by the assessee, plant or machinery installed in any office premises, or any residential accommodation, including a guest house, office appliances, including computers or computer software, vehicle, plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing income of any previous year.

Under section 32AD(2), if any new asset, in respect of which deduction u/s. 32AD had been claimed, is sold or otherwise transferred (except in cases of amalgamation, demerger or reorganisation of business referred to in clauses (xiii), (xiiib) or (xiv) of section 47) within a period of five years from the date of its installation, the amount of deduction claimed earlier u/s. 32AD is withdrawn and deduction allowed is deemed to be the profits and gains of business of the previous year in which the asset is sold or otherwise transferred.

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Obedience is the first duty.

— *Swami Vivekananda*

CA Rajesh S. Athavale

Borrowing Cost

Section 36(1)(iii) of the Income-tax Act, 1961 (IT Act) provides that the amount of interest paid in respect of capital borrowed for the purposes of business or profession shall be allowed as deduction while computing income referred to in Section 28 of the IT Act. As per the proviso to Section 36(1)(iii), any interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalized in the books of account or not) for any period beginning from the date on which the capital was borrowed for the acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

There are various issues and controversies around the allowability of deduction in respect of interest under Section 36(1)(iii). However, we are going to deal with some of the issues in this article.

Basic Conditions

In order to claim interest as deduction under section 36(1)(iii), following conditions are required to be satisfied:

1. Interest should be paid in respect of capital borrowed
2. Borrowing should be made for the purposes of business or profession

Interest and Capital borrowed

As per Section 2(28A) of the IT Act, "interest" means interest payable in any manner in respect of any money borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised.

Conceptually, for the purpose of Section 36(1)(iii) 'interest' is relatable only to money borrowed and not to debt incurred. In terms of Section 2(28A), the meaning of the word "interest" is very wide and would include interest on unpaid purchase price payable in any manner which would include payable by means of irrevocable letter of credit. The claim of the seller to the price of the goods sold normally arises when the property is transferred to the buyer. The seller gets a right to get the price of the goods and the buyer has a corresponding obligation to pay it, both as per the contract of sale and under the law. Therefore, a debt is incurred by the buyer of the purchase price which he is obliged to pay. The debt arises from the unwillingness or inability to pay cash down when the purchase price becomes payable against delivery, and the engagement to pay it at a later date or by instalments *[Refer CIT vs. Vijay Ship Breaking Corporation (261 ITR 113)(Guj.)]*. However, for the purpose of Section 36(1)(iii) the interest should be paid in respect of capital borrowed. The expression 'capital' in the context in which it occurs means money and not any other asset, since interest is payable on capital borrowed and interest becomes payable on a loan of money and not on any other asset acquired under a contract *[Refer Bombay Steam Navigation Co. P. Ltd. vs. CIT (56 ITR 52)(SC)]*. Similarly, salaries due to the directors but not paid to them and utilized for the purpose of business cannot constitute 'capital borrowed' and interest paid thereon is not allowable as a deduction under Section 36(1)(iii) *[Refer CIT vs. Saraswati Chemicals & Allied Industries P. Ltd. (167 Taxman 236)(Del.)]*. When principal amount borrowed stood repaid while interest remained payable, interest on interest, having an element of default, is not permissible deduction as it cannot be said to be a benefit extended in carrying on business *[Refer CIT vs. Ramesh Chandra Bhati (235 Taxman 461)(Raj.)]*.

The preference share capital is a contribution to the capital of the company by its subscribers or shareholders and is not a 'borrowing' by the company subject to payment of interest. Similarly, for the very said reason the dividend which is paid to such shareholders is to be paid only out of the profits earned by the company. In common parlance, it can be equated with the share income derived by the shareholders out of the profits of the company. Therefore, by no stretch of imagination the dividend sought to be paid can be equated with or treated as 'interest' paid on the borrowed capital. Therefore, the assessee is not entitled to deduction of the liability on account of dividend on preference shares by invoking the provisions of Section 36(1)(iii) *[Refer Kirloskar Electric Co. Ltd. vs. CIT (228 ITR 674)(Karn.)]*.

Proviso to Section 36(1)(iii)

The Finance Act, 2003 inserted a proviso with effect from Assessment Year 2004-05, as a result thereof interest paid in respect of capital borrowed for acquisition of an asset for extension of existing business or profession, whether capitalized in the books of account or not, for any period beginning from the date on which the capital was borrowed for acquisition of the asset till date on which such asset was first put to use, will not be allowed as deduction. Prior to the above amendment, interest paid on capital borrowed for expanding a business was allowable under this clause *[Refer DCIT vs. Core Health Care Ltd. (298 ITR 194)(SC)]*. The Finance Act, 2015 subsequently omitted the words starting from 'for extension of existing business or profession' from the proviso with effect from Assessment Year 2016-17.

For the purpose of Business

Interest paid on borrowed capital will be allowed as a deduction only if the capital was borrowed and used for the purpose of business and that if it is used for a purpose other than that of business, then interest to the extent to which the capital was so used, will not be allowed *[Refer P.R.M.S. Ramanathan Chettiar vs. CIT (72 ITR 534)(Mad.)]*. The expression 'for the purpose of business' is wider in scope than the expression 'for the purpose of earning of income'. However, if the borrowed fund advanced to a third party or not used for the purpose of business, the interest paid on such borrowed funds would not be allowed as deduction under Section 36(1)(iii). Similarly, deduction cannot be denied when there is no nexus between the borrowed funds and the advanced amounts and when the borrowed funds are not diverted for non-business purposes *[Refer CIT vs. Century Flour Mills Ltd. (334 ITR 377)(Mad.)]*.

If the borrowed capital is utilized not in the business or profession, but is used for earning some exempt income, the interest paid, is not allowable deduction under the provision of Section 36(1) (iii). This analogy flows from

Section 14A which states that only expenditure which is relatable to taxable income should be deducted in computing the total income. If some portion of interest is already disallowed under some other provisions of the Act such as section 36(1)(iii) or section 40(a)(ia), the assessee may request for exclusion of the such interest from computation of disallowance under erstwhile Rule 8D(2)(ii).

Borrowed fund advanced to the third party should be for commercial expediency, if it is sought to be allowed under Section 36(1)(iii). It is not in every case that interest on borrowed fund has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective case. The burden of proof to show commercial expediency or that the advance is for a business purpose lies with the assessee. For instance, if the directors of the sister concern utilise the amount advanced to it by the assessee for personal benefit, it cannot be said that such money was advanced as measure of commercial expediency in many other circumstances. Where holding company has a deep interest in its subsidiary, and the holding company advances borrowed money to a subsidiary and the same is used by the subsidiary for some business purposes, the holding company would ordinarily be entitled to deduction of interest on its borrowed loan *[Refer S.A. Builders Ltd. vs. CIT (288 ITR 1)(SC)].* However, in the case of *Addl. CIT vs. Tulip Star Hotels Ltd. (21 Taxmann.com 97)*, the Supreme Court decided to reconsider its decision in S.A. Builders Ltd. (supra). Where interest free advances given by assessee to its subsidiary company becomes imperative as a business expediency in view of undertaking given to financial institutions by assessee to effect that it would provide additional margin to subsidiary company to meet working capital for meeting any cash losses, interest paid on such borrowed loan should be allowed as deduction under Section 36(1)(iii) *[Refer Hero Cycles P. Ltd. (63 taxmann.com 308)(SC)].*

Therefore, the stand that the onus of proving the nexus of funds available with the assessee with the funds advanced to the sister concerns without interest in on the revenue, is not correct. Section 36(1)(iii) provides for deduction of interest on the loans raised for business purposes. Once the assessee claims any such deduction in the books of account, the onus as mentioned above will be on the assessee to satisfy the Assessing officer that whatever loans were raised by the assessee, the same are used for business purposes. If in the process of examination of genuineness of such a deduction, it transpires that the assessee has advanced certain funds to sister concerns or any other person without any interest, there would be very onus on the assessee to be discharged before the Assessing officer to the effect that in spite of pending term loans and working capital loans on which the assessee is incurring liability to pay interest, there is justification to advance loans to sister concerns for non business purposes without any interest and, accordingly, the assessee should be allowed deduction of interest being paid on the loans raised by it to that extent. There should be nexus of use of borrowed funds for the purpose of business to claim deduction under Section 36(1)(iii) *[Refer CIT vs. Abhishek Industries Ltd. (156 Taxman 257) (Punj. & Har.)].*

Loan advanced out of own fund

So, where there is a sufficient fund, other than borrowed money, available with the assessee in the form of share capital, share application money, reserves and surplus for diverting a particular sum to its sister concern, it could not be said that the loan advanced to the sister concern came out of borrowed moneys. Similar issue was dealt in *CIT vs. Reliance Utilities and Power Ltd. (313 ITR 340) (Bom.)* wherein assessee had invested certain amounts in group companies, who were in the business of generation of power and they had earned regular business income therefrom. The investments made by the assessee in the group companies were done out of their own funds and were in the regular course of business and therefore no part of the interest could be disallowed. It was also pointed out that the assessee had borrowed by way of issue of debentures and the said amount was utilised as capital expenditure and inter-corporate deposit. It was the assessee's submission that no part of the interest bearing funds (viz., Issue of debentures) had gone into making investments in the group companies. It was pointed out that the income from the operations of the assessee and with the availability of other interest free funds with the assessee the investments were made in group companies out of its own funds. In view thereof, it was submitted that from the analysis of the balance-sheet, the assessee had enough interest free funds at its disposal for making the investments. The CIT (Appeals) on examining the said material, agreed with the contention of the assessee and accordingly deleted the addition made by the Assessing Officer and directed him to allow the same under the provisions of the IT Act. The case thereafter went to the High Court and the Bombay High Court after relying upon the decisions in *East India Pharmaceutical Works Ltd. vs. CIT (224 ITR 627)(SC)* and *Woolcombers of India Ltd. (134 ITR 219)(Cal.)* held that if there are funds available both interest-free and over draft and / or loans taken, then a presumption would arise that investments would be out of the interest-free funds generated or available with the company if the interest-free funds were sufficient to meet the investment. Therefore, no disallowance of interest under Section 36(1)(iii) could be made. This decision has also been followed by the Bombay High Court in *CIT vs. HDFC Bank Ltd. (366 ITR 505).*

Income Computation and Disclosure standard ('ICDS')

The Central Government has notified ten Income Computation and Disclosure Standards ('ICDS') which are applicable with effect from Assessment Year 2017-18 to all taxpayers (other than an individual or an HUF not required to get his / its accounts of the previous year audited under section 44AB) following mercantile system of accounting, for the purposes of computation of income chargeable to income tax under the head 'Profits and gains of business or profession' or 'Income from other sources'.

ICDS-III relating to Construction contracts is applicable in determination of income from a construction contract of a contractor. Para 12(d) of the ICDS-III specifically provides that contract costs shall include allocated borrowing costs in accordance with ICDS-IX on Borrowing Costs. The issue arises as to whether interest costs pertaining to a construction contract should be separately recognised and claimed as contract cost. Borrowing costs attributable to a construction activity carried by a contractor are not covered under ICDS-IX. According to Para 3 of ICDS-IX, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalized as part of the cost of that asset. The Para 2(1)(b) of ICDS-IX defines the term 'qualifying asset' and none of the clauses of the definition specifically mention that an asset being created under a construction contract constitutes a qualifying asset. Section 36(1) (iii) of the IT Act provides that interest costs can be claimed so long as the borrowed funds are used for business purposes. Various judicial pronouncements *[Refer India Cements Ltd. vs. CIT (60 ITR 52) (SC); DCIT vs. Core Health Care Ltd. (215 CTR 1) (SC); CIT vs. Lokhandwala Construction Industries Ltd. (260 ITR 579) (Bom.)]* have consistently taken a view prior to amendment in law that the interest deduction under Section 36(1)(iii) is not dependent on the purpose for which the loan is borrowed i.e., whether the borrowings are for the purpose of acquiring a capital asset or stock-in-trade or paying debts. Further, the proviso to Section 36(1)(iii) denies the claim for interest only in respect of capital borrowed for acquisition of an asset and not in relation to construction contracts. Therefore, the interest paid in respect of capital borrowed by a contractor for a construction contract should be allowed as deduction under Section 36(1)(iii) of the IT Act.

ICDS-IX deals with treatment of borrowing costs. This ICDS does not deal with the actual or imputed cost of owners' equity and preference share capital. This Standard, dealing with Borrowing Costs, corresponds to AS 16 of the Companies (Accounting Standards) Rules, 2006 and Indian Accounting Standard (Ind AS) 23. The reason for the specific exclusion of actual or imputed cost of owners' equity and preference share capital is on account of the fact that under Ind AS, redeemable preference share capital is treated as a liability. Ind AS 23 specifically excludes only actual or imputed cost of equity and of preferred capital not classified as a liability. Unlike AS 16 and Ind AS 23, which deal with both the revenue and capital aspects of borrowing costs, ICDS-IX primarily deals with the timing and the circumstances under which borrowing costs are to be capitalised. It does not specifically deal with the allowability of borrowing costs as a deduction, which continues to be governed by Section 36(1)(iii) of the IT Act. Finance Act, 2015 amended the proviso to Section 36(1)(iii) to delete the words "for extension of existing business or profession". ICDS-IX would need to be considered for the purposes of Section 36(1)(iii) of the Act regarding deduction of interest paid in respect of capital borrowed for the purposes of the business or profession, and explanation 8 to section 43(1) of the IT Act, regarding interest which cannot be capitalised. It will also apply for the purposes of Section 57 (iii) of the IT Act, for deductibility of interest under the head "Income from Other Sources".

In the context of inventories, it is clarified in paragraph 4 of ICDS-IX, that capitalisation would mean addition of the borrowing cost to the cost of the inventory. This treatment is also in accordance with paragraph 11 of ICDS-II - Valuation of Inventories, which provides that, interest and other borrowing costs shall not be included in the cost of inventories, unless they meet the criteria for recognition of interest as a component of the cost as specified in the ICDS on borrowing costs. A question does arise as to whether the requirement of capitalization of borrowing costs to inventory as per the ICDS is in conflict with Section 36(1)(iii). While section 36(1)(iii) provides that interest paid in respect of capital borrowed for the purposes of the business or profession is an allowable deduction, the proviso to this clause prohibits deduction only in respect of capital borrowed for acquisition of an asset till the date the asset is first put to use. The term "asset" used in this proviso, has to be construed as "capital asset", given similar usage of the term in section 43(1), as well as section 43A. The proviso therefore applies only to capital assets acquired, and not to stock-in-trade. This has been confirmed in the case of *CIT vs. Lokhandwala Construction Industries (260 ITR 579) (Bom.).* Therefore, the provisions of the ICDS are in conflict with Section 36(1)(iii). In such an event, in accordance with the ICDS, the provisions of Section 36(1)(iii), being a part of the Income-tax Act, would prevail over the provisions of the ICDS requiring capitalisation of interest on borrowings for the purpose of acquiring stock-in-trade which takes more than 12 months to be ready for sale.

As per para 7 of ICDS-IX, the capitalisation of borrowing costs shall commence: (a) in a case referred to in paragraph 5 (where borrowing of funds specifically for the purposes of acquisition, construction or production of a qualifying asset), from the date on which funds were borrowed; (b) in a case referred to in paragraph 6 (in respect of borrowing other than those referred to in Para 5), from the date on which funds were utilised. In case of borrowing costs specifically related to acquisition of assets, the period from which borrowing costs are to be counted begins with the date on which funds are borrowed. Borrowing of funds would mean actual drawing of funds. Disbursement of loans for acquisition of specific assets would normally be directly linked to the payments for the assets. Therefore, borrowing costs on loans utilised for payment of advances for acquisition of assets would need to be added to the cost of assets commencing from the date of borrowing, which may be before the date of acquisition of the asset, up to the date of asset being first put to use. There could also be a time lag between the date of borrowing and the date of utilisation of funds for acquisition of the asset. Borrowing costs for such time period would also need to be capitalised in the case of specific borrowings. This provision is in harmony with the proviso to Section 36(1)(iii), which now provides that interest paid in respect of capital borrowed for acquisition of an asset for any period beginning from the date on which the capital was borrowed for acquisition of the asset to the date on which such asset was first put to use shall not be allowed as a deduction.

Interest payable on borrowings taken for acquisition of a qualifying asset relating to the period after the date of put to use of the asset would be allowable as a deduction under Section 36(1)(iii).

Limitation on Interest Expenditure to Associated Enterprises

A company is typically financed or capitalized through a mixture of debt and equity. The way a company is capitalized often has a significant impact on the amount of profit it reports for tax purposes as the tax legislations of countries typically allow a deduction for interest paid or payable in arriving at the profit for tax purposes while the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus the amount of interest it pays, the lower will be its taxable profit. For this reason, debt is often a more tax efficient method of finance than equity. Multinational groups are often able to structure their financing arrangements to maximize these benefits. For this reason, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base.

Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in Action plan 4. The OECD has recommended several measures in its final report to address this issue.

In view of the above, the Finance Act, 2017 inserted a new Section 94B with effect from Assessment Year 2018-19, in line with the recommendations of OECD BEPS Action Plan 4, to provide that any expenditure by way of interest or of similar nature claimed by an entity to its non-resident associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is less. The provision shall be applicable to an Indian company, or a permanent establishment of a foreign company being the borrower who pays interest in respect of any form of debt issued to a non-resident or to a permanent establishment of a non-resident and who is an 'associated enterprise' of the borrower. Further, the debt shall be deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender or deposits a corresponding and matching amount of funds with the lender. The provisions shall allow for carry forward of disallowed interest expense to eight assessment years immediately succeeding the assessment year for which the disallowance was first made and deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure. In order to target only large interest payments, the provisions of Section 94B will apply for the interest expenditure above INR 10 million. Banks and Insurance business are excluded from the ambit of the said provisions keeping in view of special nature of these businesses.

Although the objective of Section 94B is to restrict the interest expense incurred with respect to an AE to 30 percent of the borrower's EBIDTA, there could be circumstances where the entire interest incurred towards an AE is disallowed under Section 94B, for example, when the Indian assessee has incurred interest expense towards both AE and non-AE or loss making assessee (reporting a negative EBITDA) pays interest to AE. Therefore, while raising the funds from overseas AE by the Indian assessees (including loss making, captive incentive or start-up assessees), one needs to be careful regarding their choice of capital financing as they face a much higher risk of interest disallowance under Section 94B.

In case the AE provides an implicit guarantee in favour of the assessee to third-party lender, such debt shall be deemed to have been issued by the AE. However, the term 'implicit guarantee' is not defined in Section 94B and the BEPS Action Plan 4 also does not provide any guidance on this point. Therefore, it would be difficult for the assessee as well as the Assessing Officer to ascertain the lending arrangement which results into the implicit guarantee from AE. Further, it is also not clear whether provisions of Section 94B would apply in case the third party lender is resident in India. This arrangement would not result into shifting of profit or any tax base erosion and therefore, considering the intention of the legislature to limit interest payments to non-residents, one can argue that Section 94B should not be applicable to this situation. Recently, in the case of Siemens Gamesa Renewable Power Pvt. Ltd. a writ petition has been filed to challenge the constitutional validity of proviso to Section 94B, which brings third party debt raised from Indian lender on the basis of guarantee given by the AE within the ambit of Section 94B, the order of which is awaited.

As per Section 94B, expenditure which is "of similar nature" to interest exceeding INR 10 million is to be considered for the purpose of allowable deduction. The definition of "excess interest" under Section 94B(2), however, refers only to total interest paid or payable. Therefore, the issue would arise whether expenditure "of similar nature" is also subject to any disallowance.

As the interest expenditure to a non-resident AE is subject to disallowance under Section 94B as well as Section 92 (transfer pricing), it is a matter of great concern if the assessee ends up in suffering double disallowance under both the above sections.

In view of the above, it would be useful if CBDT comes out with necessary clarification or guidance on the above points to avoid any controversy.

Conclusion

The onus is on the assessee to prove that the borrowed fund has been used for the purpose of business so as to claim deduction of interest expenditure thereof under Section 36(1)(iii) of the IT Act.

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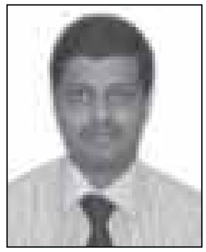
> Infinite patience, infinite purity and infinite perseverance are the secret of success in good cause.
>
> — *Swami Vivekananda*



CA Devdatta Mainkar

Employee Cost

This article covers certain deductions in respect of employee cost claimed in computing profits and gains of business or profession. These are specific deductions such as bonus or commission under section 36(1)(ii) or employee's contribution to PF/ESIC or welfare funds under section 36(1)(va) involving various debatable issues. The article contains deductions such as keyman insurance premia or discount on ESOPs which are general deduction allowable under section 37(1) but having special significance in the today's commercial world. These topics are discussed covering background of the transactions, accounting aspect, legal issues and judicial interpretation.

Section 36(1)(ii) : Payment of Bonus or Commission

Section 36(1)(ii) of the Income-tax Act, 1961 (the Act) dealing with deduction of bonus or commission payable to employees, has two parts. First part is enabling provision allowing deduction of bonus or commission without any restriction. Second part is disabling provision to state that such sum if paid to employees in the form of profits or dividends are not allowable.

Legislative history

- This provision was inserted in the Income-tax Act, 1922 (the old Act) to expressively allow deduction of bonus or commission consequent to the decision of the Hon'ble Madras High Court in the case of *R.E. Mahomed Kassim Rowther vs. CIT [1927] 2 ITC 482*. The Hon'ble Madras High Court in that case had held that payment of any amount which was directly or indirectly dependent upon the earnings or the profits of the business, could not be allowed as business expenditure. To overcome this decision, clause (viiia) in section 10(2) of the old Act was introduced to allow deduction of bonus or commission with a rider that the amount should be reasonable with respect to pay of the employee and condition of his service, profits of the business or profession for the year and general practice in similar business or profession. The provision contained in the said clause of the old Act (later renumbered as clause (x)) was carried forward as section 36(1)(ii) in the new Act, without any changes.

- There was an insertion of a proviso w.e.f. AY. 1976-77 limiting quantum of deduction to the amount payable under the Payment of Bonus Act, 1965. First and second proviso were deleted w.e.f. AY. 1988-89. Thus, the requirement of substantiating reasonableness of the payment and limit of payment under the Payment of Bonus Act was done away with and deduction is allowable without any limit. Only exception is that such sum would not have been paid to him as profits or dividends if it had not been paid as bonus or commission.

Analysis

1. Deduction of bonus or commission is subject to provisions of section 43B i.e., actual payment on or before due date of filing of return under section 139(1). It covers amount payable to an employee only for services rendered. Bonus or commission payable to persons other than employees is governed by general deduction under section 37(1).

2. The section is also applicable to an employee-director (i.e., executive director / whole time director / managing director) and payment to such person is subject to passing the exception test if he is shareholder also. As the limit of deduction or reasonableness of amount is not required to be proved from AY.1988-89, issue arises in supporting the case that the payment of bonus or commission is not in lieu of distribution of dividend in closely held companies.

3. In case of listed companies or public companies, there is a restriction on payment of managerial remuneration including commission and bonus. Further, the shareholding in these companies is widespread. Declaration of dividend is also dependent on many factors such as liquidity, need for reinvestment, market expectations and impact on share price etc. Therefore, in practice, exception provided in second part of the section is rarely invoked in case payments of bonus or commission to employee-directors of listed or public companies.

4. In a closely held private company, employee-director cum substantial shareholder is a common feature. Hence, payment to such person by way of bonus or commission especially linked to profits needs closer scrutiny. If the Company and the employee-director are in the same tax bracket, there is no tax arbitrage except dividend distribution tax payable on dividend distribution. Distribution of profits by way of dividends is not mandatory under the Companies Act, 2013. Therefore, DDT also cannot be differentiating factor. Dividend is a return on investment whereas bonus or commission is reward for services rendered and hence, charge on profits, without incurring the said expenditure, profit as per commercial accounting principles cannot be computed. One has to then substantiate that payment of bonus or commission is for 'services' rendered by the employee-directors or their contribution in bringing more business or growing profitability of the company.

5. There is inter-play between section 40A(2)(a) and section 36(1)(ii). Section 40A(2)(a) provides for disallowance of excessive or unreasonable expenditure in respect of payments made to specified persons in clause (b) of the said sub-section, which includes directors in case of a company. While the payment is not in lieu of profit or dividend can be proved with the help of the aforesaid factors, the AO has right to compare fair market value to disallow the expenditure. Thus, condition of reasonableness of payment in the pre-amended section still applies albeit under different section.

Judicial precedents

- The Hon'ble Bombay High Court in the case of *Loyal Motor Service Co Ltd vs. CIT [1946] 14 ITR 647* held that commission and bonus linked to salaries of the employee-shareholders cannot be disallowed, even though equal to the amount of dividend otherwise could have been payable to two shareholders. The Court held that in the exception the words "such sum" can, only refer to the last and the only antecedent, which is "any sum" paid as commission or bonus. Therefore, unless commission or bonus would be paid to an assessee as profits or dividends, the exception to allowance does not operate.

- The Hon'ble Supreme Court in the case of *Shahazada Nand Sons & Sons vs. CIT [1977] 108 ITR 358* rejected the argument of the revenue that there should be 'extra service' rendered by an employee for allowability of payment of commission. It was held that the section requires that commission is payable for services rendered only.

- However, the Special Bench of the Hon'ble ITAT in the case of *Dalal Broacha Stock Broking (P.) Ltd vs. Addl. CIT reported in [2011] 11 taxmann.com 426* held that if extra services have been rendered for payment of commission, it will be one of the relevant factors to consider while deciding whether the case is covered by the exception provided in the section 36(1)(ii). The Special Bench confirmed disallowance made by the AO considering commission and dividend payment history along with turnover and profits of the company and the peculiar facts of the case as regards no evidence on record for services rendered by the director-shareholders.

- The Hon'ble Delhi High Court in case of *AMD Metplast (P.) Ltd. vs. DCIT reported in [2012] 341 ITR 563* and in the case of *CIT vs. Career Launcher India Ltd. reported in [2013] 358 ITR 179,* allowed commission payable to directors over and above salary, which was supported by board resolution and also considering their contribution to business, no revenue loss principle and no relation to dividend entitlement.

- Recently, the Hon'ble ITAT in the case of *Nat Steel Equipment (P.) Ltd. vs. DCIT [2018] 95 taxmann.com 159* held that commission paid to a major shareholder who was not an employee in the relevant year (and was MD in the earlier years) is outside scope of section 36(1)(ii). The ITAT further held that if despite working as employee, he was not shown as such, still the commission is not disallowable as the services of agent for procuring sales orders was rendered by the said person and that is was comparable with the remuneration drawn by MDs of the similar size companies.

While law on allowability of commission or bonus is fairly settled, its applicability to 'the facts and circumstances of each case' is still a point of debate.

Employee's Contribution – Section 36(1)(va) vs. 43B

Section 36(1)(va) provides deduction of any sum received from employees as contributions to any provident fund (PF), superannuation fund (SA) or employees state insurance (ESI) Fund or any other fund for welfare of employees, if the contribution is credited by the assessee to the employee's account in the relevant fund on or before due date. Due date is defined in explanation to the clause as date by the which the employer-assessee is required to credit the contribution to employee's account in the relevant fund under an Act, Rule, order of notification issued etc. Contribution received from the employees or deducted from their salaries towards PF, SA or ESI is income of the employer in terms of clause (x) of section 2(24) and corresponding deduction is allowable if the payment is made as aforesaid.

The PF/ ESI Act (Welfare Acts) provide for contribution by the employer generally of the equal amount of employee's contribution. The relevant Acts specified the due date by which both these contributions to be paid to the concerned authorities. Employers' contribution is allowable as general deduction subject to provisions of section 43B. Clause (b) of section 43B is dealing with employer's contribution. Prior to AY 2004-05, the employer's contribution was also required to be paid on or before due date specified in the respective laws governing that contribution in terms of second proviso to section 43B. With the omission of the said proviso by the Finance Act, 2013 w.e.f. AY 2004-05, the said contribution is allowable as deduction if it is paid on or before due date of filing return of income under section 139(1).

Plain and simple interpretation of the section 36(1)(va) appears to be that even a single day delay in making payment of the employee's contribution disentitles deduction of the whole amount. But employer's contribution for the whole previous year even if made just before filing return of income is eligible for deduction in the previous year in view of the amended section 43B. According to the taxpayers, this treatment is quite unfair and absurd. This differential treatment for the same nature of payment led to controversy and spate of litigation. The two issues before the Courts and Tribunal are – a) Whether amendment omitting second proviso to section 43B is retrospective? b) Whether amendment to section 43B omitting second proviso applies to employee's contribution governed by section 36(1)(va) even though the section continues allowability of deduction on payment being made on or before due date. The two issues are discussed in the light of the various case laws.

Whether amendment to section 43B is retrospective

The amendment omitting second proviso and amendment in first proviso to section 43B has the effect of treating contribution to PF/ ESI/gratuity fund at par with other elements in section 43B viz., taxes & duties, bonus or commission, interest payable to banks etc. The taxpayers contended that the provision is being curative in nature is applicable retrospectively from 1-4-1988. This view is accepted by the Supreme Court in the case of *CIT vs. Alom Extrusions Ltd. reported in 319 ITR 306.* Consequent to the said decision, the CBDT issued Circular No. 22/2015 dated 17th December 2015 clarifying that the issue is well settled in so far as employer's contribution and directed not to file appeals on this ground or withdraw or not to press upon this issue in pending appeals. However, the CBDT was categorical in stating that the settled position does not apply to deduction relating to employee's contribution governed by section 36(1)(va).

Applicability of amendment to Employees contribution covered under section 36(1)(va)

The arguments in support of proposition that amendment to section 43B allowing deduction of employer's contribution if paid before due date prescribed under section 139 (1) for filing of return equally applies to employee's contribution are as under:

1. The Employees Provident Fund Scheme, 1952 formulated under the PF Act prescribe due date of 15th of the following month for remittance of employee's & employer's contribution. It is also provided that the employer shall be liable to pay simple interest in terms of section 7Q of the said Act. The Scheme also provides 5 days grace period also. Thus, the due date under the said Act is

'flexible' and payment is allowed beyond fixed due date with interest. If this aspect of the matter is considered in case of deductibility of employer's contribution, it equally applies to employee's contribution which is to be paid along with employer's contribution.

2. Once employees' contribution, being the deduction from their salary, cannot be retained by the employer as per the provisions of those Acts, it cannot be treated as employer's income if it has been actually paid to the concerned authorities. If deduction of belated payments is not allowed, the employer is saddled with payment of contribution without deduction of it for tax liability in addition to interest and other penal consequences which is faced under the relevant welfare Act.

3. Section 36(1)(va) states deduction of "any sum received by the assessee from .....". In reality, there is no 'receipt of employees' contribution' but 'deduction' from their salary. This distinction is quite obvious to decide the taxability. Further, the employer under the EPF Scheme is mandated to deduct employee's contribution and remit along with his contribution.

4. Employee's contribution is treated as income under section 2(24)(x) in view of the specific provision therein possibly for the reason that the same is deducted from the employee's salary with an obligation to pay to the concerned fund. It is accounted for as a liability on the books. It is merged with employer's contribution, which is to be allowed under section 37(1) read with section 43B. Section 43B uses the expression "any sum payable by the assessee as an employer by way contribution to any provident fund or ...". Therefore, it should cover both the contributions under section 43B as it is one single contribution by the employer which is to be paid. Although the PF/ESI authorities maintains separate records of employee and employer's contribution and require to make payment accordingly, the same cannot come in the way of deduction under the Income-tax Act.

Following decisions of the various High Courts are in favour of the assessee allowing deduction of employee's contribution paid beyond due date:

- o *CIT vs. Hindustan Organic Chemicals Ltd. (2014) 366 ITR 1 (Bom)*
- o *CIT vs. Ghatge Patil Transport Limited – 368 ITR 749 (Bom.)*
- o *CIT vs. Aimil Ltd. – 321 ITR 508 (Del.)*
- o *Spectrum Consultants India (P) Ltd vs CIT – 215 Taxman 597 (Kar.)*
- o *CIT vs. Raj Agro Industries Ltd. – 334 ITR 122 (P&H)*
- o *CIT vs. Kichha Sugar Co. Ltd. – 356 ITR 351 (Uttarakhand)*
- o *CIT vs. Udaipur Dugdh Utpadak Sahakari Sangh Ltd. – 366 ITR 163 (Raj.)*

It may be noted that in the case of *PCIT vs. Rajasthan State Beverages Corporation Ltd.* reported in 250 Taxman 16, the Supreme Court has dismissed the SLP filed by the revenue.

- In following decisions, the Hon'ble High Courts strictly interpreted section 36(1)(va) and denied deduction without giving benefit of section 43B.
  - o *Popular Vehicles & Services Pvt Ltd vs. CIT – [2018] 96 taxmann.com 13 (Ker.)*
  - o *CIT vs. Gujarat State Road Transport Corporation - [2014] 41 taxmann.com 100 (Guj.)*

Considering the majority view of the High Courts in favour of the taxpayers, it is high time for the CBDT to accept this legal position so as to end the litigation.

ESOPs – Whether Discount is an Expenditure?

Employee Stock Option is a popular incentive scheme in the corporate sector to motivate and retain employees. It is not only prevalent in large listed companies but also in new generation tech *start-up* companies. The Companies Act, 2013 as well as the old Act of 1956 has recognised this concept. Sub-section (37) of section 2 of the Companies Act, 2013 defines employee stock option as the option given to the employees, officers or directors of a company or of its holding company or subsidiary company or companies, if any, which gives such persons benefit or right to purchase or subscribe for, the share of the company at a future date at predetermined price. Securities and Exchange Board of India (SEBI) has issued SEBI (Share based Employee Benefits) Regulations, 2014 as regulatory framework for employee stock option schemes or employees benefit schemes dealing in shares (directly or indirectly) in case of listed companies. These regulations supersede earlier SEBI regulations namely the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 (hereinafter referred to as SEBI Guidelines).

In a typical Employee Stock Option Scheme or Plan (ESOP), the Company grants options to the eligible employees to purchase or subscribe shares of the Company at a lower price than the prevailing market price. The amount of discount represents the difference between market price of the shares at the time of the grant of option and the exercise price or offer price. The eligible employees are obliged to render services to the company for a decided vesting period. On completion of the vesting period, the employee is entitled to exercise the option. The company, on the exercise of option by the employees, allots shares to them who can then freely sell such shares in the open market subject to the terms of the ESOP. In case the employee leaves the company during the vesting period, the option is lapsed and the company can reissue to another employee. If the employee leaves after the option is vested but before exercise, the employee can exercise right to purchase if the scheme allows so. The unlisted companies have to follow relevant provisions and rules prescribed under the Companies Act, 2013.

The objective of the ESOP is to retain employees by offering them shares at a discounted price compared to market and give them a sense of ownership in the Company. It is generally part of remuneration package in case of senior management of listed companies.

Accounting Treatment

The SEBI Guidelines, 1999 provided that discount is employee compensation cost to be recognised as expense over the vesting period. In case, the options are lapsed, before or after vesting, the amortised portion of compensation cost relatable to the lapsed options is to be reversed. The new SEBI Regulations of 2014 prescribed that accounting treatment shall be as per 'the Guidance Note on Accounting for Employee Share-based Payments' issued by the Institute of Chartered Accountants of India. The accounting treatment under the said Guidance note is in largely conformity with the SEBI Guidelines, 1999. This method of accounting is termed as 'intrinsic value method'. Although accounting treatment of valuation is same for unlisted companies, they have to determine fair value of shares, which is substituted for market price in the calculation of discount.

The Companies to whom Indian Accounting Standards (Ind-AS) notified under the Companies Act, 2013 are applicable, have to apply accounting principles prescribed under Ind-AS 102 Share-based Payments. As per the Ind-AS, the grant date fair value of options is recognised as employee compensation cost as per the prescribed methodology with respect to vesting conditions. In this case, discount is fair value of option as against difference between market price and offer price of shares.

Taxation of ESOPs

- In terms of clause (vi) of sub-section (2) of section 17, value of shares allotted or transferred under ESOP by employer or former employer free of cost or at concessional rate is treated as perquisite and value is determined as fair market value of shares on the date of exercise as reduced by amount paid or recovered from the employee. Thus, shares received by the employee under ESOP are taxable on allotment of shares with reference to market value on date of exercise of options. However, there is no specific provision in the Act for deduction of employee compensation cost i.e. discount on issue of ESOPs. In the absence of specific provision, the claim of deduction is made by the Companies under section 37(1) of the Act.
- This has been highly litigious subject and the dispute related to allowability of discount, its computation method and quantum of discount have been subject to judicial interpretation. The Hon'ble Special Bench of the ITAT in the case of *Biocon Limited vs. Dy. CIT, Banglore reported in [2014] 144 ITD 21*, decided the issue in favour of the Appellant dealing all relevant issues on discount of ESOPs such as basis for allowability of deduction, period of deduction, method of computation of discount and subsequent adjustment. The Madras High Court in the case of *CIT vs. PVR Ventures Ltd. [2012] 23 taxmann.com* heavily relied on the SEBI Guidelines to allow the discount as revenue expenditure. The Delhi High Court in the case of *CIT vs. Lemon Tree Hotels Ltd (ITA No. 107/2015)* and *PCIT vs. New Delhi Television Limited (ITA No. 107/2017)* followed the Madras High Court decision and the Special Bench decision.
- Since the Special Bench has elaborately discussed all aspects of the matter, it is worthwhile to analyse the contentions raised therein and decision thereon. The Taxpayer's claim of deduction under section 37(1) was on the strength of the SEBI Guidelines which recognises discount as employee compensation cost and prescribes to account for the compensation cost over the period of vesting. According to them, it is an ascertained or accrued liability under the mercantile system of accounting.
- The revenue argued that the discount is nothing but short receipt of share capital and hence, loss on capital account. Alternatively, it is a notional expenditure rather not an expenditure as there is no outflow on the part of the Company. The revenue also put a claim that it is a contingent liability as the entitlement of shares under ESOP is dependent on conditions to be fulfilled in future i.e. continuity of service in vesting period.
- The Special Bench rejected these arguments of the revenue, observing that:
  - o No doubt, there is short receipt of capital to the extent of discount given to the employees over market price, the primary objective of ESOP is not to raise share capital but to compensate employees for their continuity of services and earn profit by securing consistent and concentrated efforts of the employees during the vesting period. The discount is construed as part of compensation package.
  - o While expenditure denotes 'paying out or away', the word 'paid' as

defined in section 43(2) to mean 'actually paid or incurred according to the method of accounting followed' and in the context of ESOP, the company incurs obligation of issue share at discounted price.

- The Special Bench took the support of the decision of the Supreme Court in the case of *CIT vs. Woodward Governor India (P) Ltd [2009] 312 ITR 254* to explain that discount on issue of shares to employee is a 'loss' and allowable under section 37(1).

- The Special Bench concluded that it is an ascertained liability on the basis of the decisions of the Supreme Court in the case of *Bharat Earth Movers vs. CIT reported on 245 ITR 428* and *Rotork Controls India (P.) Ltd vs. CIT reported in 314 ITR 62.* The former decision was in the context of allowability of liability towards encashment of earned leave while later was related to deduction of provision for defect warranties.

- As regards period in which deduction is allowable, it was held by the Special Bench that the company incurred liability to issue shares at the discounted premium only during the vesting period. Thus, the liability is neither incurred at the stage of the grant of options nor when such options are exercised. Therefore, amortisation of discount over the period of vesting based on vesting conditions i.e. period and per centage of vesting as prescribed in the SEBI Guidelines is well-founded.

- The Special Bench also considered the aspect of adjustment to discount consequent to exercise of options and issue of shares. It was held that the amount of discount at the stage of granting of options with respect to the market price of shares at the time of grant of options is always a tentative deduction because the likely market price of shares at the time of exercise of option by the employees cannot be determined at the time of grant. Since actual amount of employees cost can be precisely determined only at the time of the exercise of option by the employees, the provisional amount of discount availed as deduction during the vesting period is required to be adjusted on the basis of the market price of the shares at the time of exercise of options. E.g. It the market price at the time of grant of options is ` 100 and exercise price is ` 10, discount of ` 90 is amortised over the vesting period. If market price on the date of exercise is ` 110, there will be additional discount of ` 10, which has to be claimed as deduction in the year of exercise of option. If the market price is ` 90 on date of exercise, there will be reversal of compensation cost of ` 100 and offered as income.

This treatment ensures that value of perquisite in the hands of the employee is equal to employee compensation cost for the company though deductible partly over vesting period and partly in the year of exercise of option. Further, it is necessary for the Companies to keep track of deduction claimed during the vesting period, options lapsed, options exercised and required upward or downward adjustment in the discount. This adjustment of discount at the time of exercise of option should be carried out in the computation of income separately as there would be no impact in the accounting profit or income.

- In the case of *HDFC Bank Ltd vs. DyCIT 2(3), Mumbai reported in [2015] 61 taxmann.com 361*, the Hon'ble ITAT took a view that discount on ESOP is to be computed with reference to issue price of shares issued to public during the year and not with reference to market price of shares on date of grant. According to the ITAT, when shares are issued to public below market price and employees are also granted ESOPs at the same time, discount should be computed with reference to issue price of shares to public as excess of market price over issue price is notional. This principle will result in lesser amount of deduction of discount during the vesting period and most likely upward adjustment to the same in the year of exercise of option if the market price would be more than public issue price.

- The Hon'ble ITAT in the case of *Novo Nordisk India (P.) Ltd vs. DCIT (ITA No. 1275/Bang/2011)* held that where in terms of ESOP, the assessee company offered shares of its parent company to employees, difference between fair market value of shares of parent company on date of issue of shares and price at which those shares were issued by assessee to its employees was to be regarded as expenditure incurred for business purpose allowable under section 37(1).

As there is no contrary High Court decision noticed on this issue, it can be safely assumed that allowability of discount on issue of ESOPs is no more controversial subject for the time being.

The Companies following Ind-AS have to justify discount as fair value of options as against difference between market price of shares on date of grant and exercise price. This differential treatment could be another potential issue of litigation.

Keyman Insurance Policy – Taxation Issues

A life insurance policy on the life of a key person in the organisation is a 'keyman insurance policy' (KIP). It is needed to protect from losses arising from negative impact on the business operations if the key executive is lost for any reason and safeguards against disruption of the business. The business entity is beneficiary of the plan and pays the insurance premium.

KIP – Salient provisions under the Act

Section 10(10D) provides exemption of any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy other than any sum received under a KIP or sums received from certain insurance policies. *Explanation 1* to the section defines KIP as a life insurance policy taken by a person on the life of another person who is or was the employee of the first-mentioned person or is or was the employee of the first-mentioned person or is or was connected with in any manner whatsoever with the business of the first-mentioned person and includes such policy which has been assigned to a person, at any time during the term of the policy, with or without any consideration.

Exclusion of sums received under KIP from exemption was introduced by Finance (No. 2) Act, 1996 w.e.f. 1-10-1996. At the same time, clause (vi) was added in section 28 to charge such sum as 'profits or gains of business of profession' in the hands of the person holding a KIP. It was also provided that any sum received by the key employee to whom KIP is assigned is taxable as profits in lieu of salary under section 17(3). An amendment was made in section 56(2) to include the sum as 'income from other sources' if it is not chargeable to tax under the head 'profit and gains of business or profession' or 'salaries' and enabling provision in definition of income under section 2(24). These amendments resulted in taxation of sums received under KIP on maturity or surrender of policy or any other form and including bonus allocated to it, is taxable in the hands of the business entity as business income or as salary or income from other sources in the hands of key persons.

The taxpayers resorted to practices of assigning the policy to the key person before maturity so that it becomes ordinary life insurance policy and accordingly, amount received on maturity could be claimed as exempt from tax. *(Refer Rajan Nanda & Others vs CIT – 349 ITR 008 (Del.))* Therefore, scope of definition was enlarged to include a policy which is assigned to any person any time during the term of the policy, with or without consideration by an amendment brought in by Finance Act, 2013 w.e.f. 1st April 2014 to the aforesaid Explanation.

There is no specific provision in the Act as regards deduction of insurance premium paid by the business entity. Although the insurance premium paid is on the life of a person, it is incurred wholly and exclusively for the purpose of business of the assessee and allowable as deduction under section 37(1) of the Act. The CBDT *vide* Circular No. 762 dated 18th February 1998 clearly stated that the premium on the KIP is allowable business expenditure.

Judicial precedents

- Allowability of insurance premium was disputed by the revenue in case of partnership firms in respect of KIP taken by the firm on the life of partners. No doubt the partners are key persons of the firm. However, the department's argument was that in the eyes of law, firm and partners are same and the firm is merely a compendious description of the individuals who carry on the partnership business. The revenue had a narrow view that KIP is on the life of employees and not owners. It was interpreted that the words 'is or was connected in any manner whatsoever with the business' encompass wider meaning than what would be subsumed under a contract of employment and hence, premium in respect of the KIP on the partners of the firm is rightly allowable deduction. The notable decision on this issue was the Hon'ble Bombay High Court in the case of *CIT vs. B. N. Exports reported in 190 Taxman 325*. The Hon'ble ITAT, Mumbai in the case of *ITO Ward 21(3)(3) vs.. Modi Motors reported in 27 SOT 476* analysed various decisions dealing with taxability of firms under the Act and legal position under the general law and allowed premia paid on the KIP in respect of the partners.

- With the privatisation of the insurance sector and resultant competition, more complex insurance cum investment linked products are being offered by the insurance companies. The insurance regulator, IRDA stepped in to issue guidelines in respect of KIPs. The matter came up before the ITAT on deciding whether a policy is KIP or not in the light of the product features, IRDA guidelines and income tax provisions. The assessee-firm secured KIP on the life of a partner. It was 'unit linked endowment assurance plan'. The AO held that it is more of an investment plan rather than 'life insurance' considering negligible premium towards life risk and substantial premium for investment. As it was not a term insurance plan, the AO referring to IRDA Guidelines of April 2005, which requires terms insurance policies only can be issued as KIP, concluded that it was not a KIP and disallowed insurance premium. The Hon'ble ITAT held that – a) Requirements of KIP, a life insurance policy on life of another person is squarely met b) The policy involves a capital appreciation or is under any investment scheme, has no relevance to decide whether it is KIP or not c) The concepts of term policy, life insurance and the IRDA Guidelines find no mention in the statutory provisions d) The IRDA guidelines has no role in interpretation of statutory provisions e) the fact that policy was not termed as KIP is irrelevant in deciding allowability of deduction. These are the observations in the case of *Suri Sons vs. Addl. CIT reported in [2015] 61 taxmann.com 141 (Amritsar – Trib.).* Similar view is taken in the case of *Shree Nidhi Corporation vs. ACIT reported in 151 ITD 470 (Mumbai).*

Interestingly, the Amritsar Bench of the ITAT in the case of *F.C Sodhi & Company (India)(P) Ltd. vs. DCIT reported in [2014] 49 taxmann.com 180* has taken a contrary view to disallow the premium paid heavily relying on the IRDA guidelines and the features of the insurance policy under question.

- Another leading decision on taxability of KIP is in the case of *Rajan Nanda & Others vs. CIT reported in 349 ITR 008 (Del.).* In this case, the employer had taken KIPs in the name of two directors. Later on, the policies were assigned to the said directors, who continued to pay premium. The AO disallowed insurance premium on the ground that the same was much more than surrender value at the time of assignment. In the hands of the directors, the AO taxed difference between surrender value and amount of premium paid by the Company as salary income. As regards allowability of the insurance premia, the Hon'ble HC held that merely because the policy was assigned after sometime would not mean that the expenditure incurred in the first instance would lose the flavour of it being 'business expenditure.

  Regarding taxation in the hands of the directors, the High Court held that there was no amount received at the time of assignment by the director, which can alone be taxed under section 17(3)(ii). Hence, amount received by the company was also not taxable. As the employee-directors paid surrender value to the company at the time of assignment, nothing is taxable on assignment as there was no taxable event. Further, on maturity of the policy, amount received was held to be exempt as the KIP was converted into an ordinary life insurance policy on assignment and hence eligible for exemption under section 10(10D) of the Act. The Court rightly accepted that this is a case of tax planning and not tax avoidance. This was a position prior to AY. 2014-15. The character of assigned policy remains to be KIP with effect from AY. 2014-15 due to amendment to the definition.

- The Hon'ble Bombay High Court in the case of *CIT vs. Prashant J. Agarwal in [2016] 75 taxmann.com 54* held that amendment to definition of KIP is not applicable to the amounts received prior to AY2014-15 on assignment of KIP policies.

It is clear that the amended definition has left no scope of tax planning and all sums received under KIP are now taxable either in the hands of the employer or in the hands of Key person whosoever is holder or beneficiary of the policy on maturity or at the time surrendering it.

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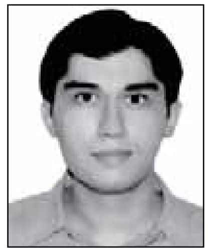

CA Abhitan Mehta

Foreign Exchange Transactions

Taxation of foreign currency transactions has always been a controversial subject and the introduction of Section 43AA by Finance Act, 2018 and the implications of Income Computation and Disclosure Standards (ICDS) has fuelled the controversy even more.

The Income-tax Act, 1961 (IT Act) does not define a foreign currency transaction. A foreign currency transaction is generally understood to mean a transaction which is denominated in or requires settlement in foreign currency.

Position before AY 2017-18 (before ICDS & amendments by Finance Act 2018)

In the earlier tax regime, there were two main controversies in relation foreign currency transactions –

i. Whether or not, exchange gain or loss from foreign currency transaction is chargeable/ deductible in the computation of total income;

ii. Whether marked to market loss on restating foreign currency assets, liabilities and contracts on the last day of the previous year is allowable in the computation of 'business income'.

It is a settled principle of income-tax that a revenue receipt is taxable unless specifically exempt and a capital receipt is not chargeable to tax unless specifically charged. The principle equally applies to foreign exchange gain or loss. The classification of a receipt as a capital receipt or a revenue receipt in itself is a contentious issue. Few important judicial precedent deciding whether foreign exchange gain or loss is a capital receipt or revenue receipt are as follows –

- *Shell Company of China Ltd. [22 ITR 1 (CA)]* - the Court of Appeals held that gains arising on deposits (in foreign currency) are capital receipts as the deposits were in essence, loan/capital and not a trading receipt.

- *CIT vs. Tata Locomotive and Engineering Co. Ltd. [1966] 60 ITR 405 (SC) (3 Judge)* – The assessee had earned commission in foreign currency. Instead of repatriating foreign currency to India and converting foreign currency into rupees, the foreign currency was retained abroad for the acquisition of capital goods. However, the purchase of capital goods could not materialise and foreign currency was then repatriated to

India and converted into rupees. Due to depletion in the value of the Indian Rupee, assessee earned foreign exchange gain and the Department wanted to tax the foreign exchange gain as business income. The Supreme Court ruled that the source of foreign currency (i.e., commission income) is not important in determining the nature (whether capital or revenue) of foreign exchange. Instead of converting foreign currency immediately into Indian Rupees, the assessee retained foreign currency for buying capital goods. Retention of foreign currency was an independent transaction, and it was the nature of this transaction (i.e., foreign currency to pay for capital goods) that would determine the nature (capital or revenue) of foreign exchange gain. The accumulation of foreign currency is the first step in the acquisition of capital goods. Therefore, foreign exchange gain on subsequent conversion of foreign currency into Indian Rupees was on capital account and, consequently, not chargeable to tax.

- *Sutlej Cotton Mills Ltd. vs. CIT [1979] 116 ITR 1 (SC)* - where profit or loss arises to an assessee on account of appreciation or depreciation in the value of foreign currency it would ordinarily be trading profit or loss if the foreign currency is held by the assessee on revenue account or as a trading asset or as part of circulating capital embarked in the business. However, if on the other hand, the foreign currency is held as a capital asset or as fixed capital, such profit or loss would be of a capital nature.

- *State Bank of India vs. CIT [1986] 157 ITR 67 (SC)* - A banking company, as a part of its banking business, was purchasing cheques, payment orders, mail transfers, demand drafts and other negotiable instruments drawn in foreign currencies. Appreciation due to the devaluation of Indian Rupee in amounts credited in foreign banks in the name of the assessee, would be treated as trading receipts of the assessee.

- *CIT vs. V. S. Dempo & Co. (P.) Ltd. [1994] 206 ITR 291 (Bom. HC)* loss in respect of circulating capital is revenue loss whereas the loss in respect of fixed capital is not. For determining whether devaluation loss is revenue loss or capital loss what is relevant is the utilisation of the amount at the time of devaluation and not the object for which the loan had been obtained. Even if the foreign currency loan was intended or had originally been utilised for acquisition of fixed asset, if at the time of devaluation it had changed its character and had assumed the new character of stock-in-trade or circulating capital, the loss that occurred on account of devaluation shall be a revenue loss and not a capital loss.

- *CIT vs. Jagatjit Industries Ltd. [2011] 337 ITR 21 (Delhi HC)* share capital raised abroad by way of GDR. The share capital as raised had to be mandatorily retained overseas and was to be repatriated into the country as and when required for approved end-uses. Since the money, raised represented share capital in foreign currency, gain on account of exchange rate fluctuations was attributable to the said share capital and such a gain would be of capital nature. The utilization of the share capital for partly for trading purposes is not relevant.

  o There is a very fine distinction between the decision of Tata Locomotive And Engineering Co. Ltd (supra) & that of Jagatjit Industries (supra). In Tata's case, the foreign currency was retained abroad for purchasing the capital asset and the court emphasised on purpose of retaining foreign currency for determining nature foreign exchange gain and not the source of foreign currency (commission income). Whereas, in Jagatjit's case though the end-use of foreign currency was on revenue account, the Court has emphasised on the source of foreign currency i.e., the issue of shares for ruling the nature of foreign exchange gain to be on capital account. The distinction being that in the latter case it was a regulatory compulsion to retain the share capital in foreign currency before being applied for the intended use. Therefore, what weighed on the Court is the source of foreign currency. Whereas in the case of Tata's the assessee could have repatriated the foreign currency as soon as it was received, there was no regulatory compulsion to retain foreign currency. Therefore, the intended use of foreign currency weighed in deciding the nature of foreign exchange gain.

- *Asstt. CIT vs. Ramalingeswara Rice & Oil Mill [2017] 162 ITD 696 (Visakhapatnam - Trib.)* – Foreign exchange loss from forward contracts with banks for hedging loss in connection with import/export business is a business loss.

- *Cooper Corporation (P.) Ltd. vs. DCIT [2016] 180 TTJ 727 (Pune – Trib.)* The assessee had availed term loans in Indian rupees for the acquisition of assets/expansion of the project, the said loans were converted into foreign currency loans to take benefit of lower rate of interest. The Tribunal ruled that foreign currency fluctuation loss bear no nexus or relation to the acquisition of the assets. The action of the assessee is tied up to its underlying objective, i.e., saving in interest costs, hedging its revenue receipts, etc., which are undoubtedly on revenue account. Thus, the loss generated in the impugned action bears the character of revenue expenditure.

Interplay of foreign exchange gain or loss and the cost of a capital asset

The Supreme Court in the case of *CIT vs. Tata Iron and Steel Co. Ltd. [1998] 231 ITR 285 (SC)* held that cost of an asset and cost of raising money for the purchase of asset are two different and independent transactions. Thus, events after the acquisition of the capital asset cannot change the price paid for it. Therefore, fluctuations in the foreign exchange rate while repaying installments of foreign loan raised to acquire an asset cannot alter the actual cost of the asset.

The rupee was devalued in the year 1966. As a consequence of this change, the value in rupees, of a unit of any foreign currency, increased by 57.5 per cent. As discussed, foreign exchange loss on revenue account is considered for computing total income whereas foreign exchange loss on capital account is a dead loss being ignored for computation of total income. In order to avoid hardship pursuant to the devaluation of rupee, Section 43A was introduced by the Finance Act, 1967.

Section 43A presently deals with case where an assessee has acquired any capital asset from abroad for his business or profession, on credit or deferred payment terms, or against a loan in foreign currency. In such a case where, in consequence of the change in the rate of exchange of currency, there is an increase or reduction in the assessee's liability as expressed in Indian currency for payment of the cost of the assets or of the loan in foreign currency, the original actual cost, to the assessee, of the capital asset, is required to be increased or, as the case may be, reduced, correspondingly.

Key features of Section 43A are:

– The capital asset has to be acquired from a country outside India – Section 43A is not applicable for an asset acquired within India. The Section does not however stipulate any criteria in relation to place of manufacture of the asset (asset could be manufactured in India and sold to a foreign dealer or transferred to a branch outside India and then purchased by an Indian Party).

– Irrespective of the method accounting (cash or mercantile) followed by the assessee, impact of foreign exchange gain or loss has to be considered at the time of making the payment for liability in relation to the acquisition of the asset. Foreign exchange gain or loss on restatement of outstanding liability on the last day of the previous year has to be ignored for the purposes of Section 43A.

– Where the assessee has entered into a forward contract with an authorised dealer the foreign exchange gain or loss has to be computed with reference to the rate of exchange specified in the forward contract.

Marked-to-Market loss (MTM)

Marked to Market loss means the accounting method for reporting securities or other assets at their market price on the date of the balance sheet. The valuation of securities and other assets at market price aims to provide a realistic picture of the company's financial status on the basis of the accounting principle of 'prudence'. When compared to the purchase price, if purchased during the year, or on the first day of the accounting year, it may result in a gain or loss. While the gain is not considered in the profit and loss account on the ground of prudence that no businessman will credit gain without it being realized, the loss so resulted is debited in the profit and loss account on the principle of cost price or net realisable value, whichever is lower.

There are several types of financial instruments such as forward contracts, foreign exchange derivatives, futures, options, swaps, etc. Though these instruments are distinct from each other in their features, yet most of them are in the nature of derivative contracts and are used for arbitrage and/or hedging. These instruments generally have a settlement date which may fall in subsequent financial years. In order to avoid recording of entire loss on the settlement date, as a measure of prudence, the instruments are valued at the market price as on the balance sheet date and the resulting loss is booked in that financial year. Booking loss in a year prior to settlement year only segregates the claim of loss but does not affect the total quantum of loss computed on the basis of price falling on the settlement date.

The dispute in relation to the allowability of MTM loss has been settled by the Supreme Court decision in the case of *CIT vs. Woodward Governor India (P.) Ltd. [2009] 312 ITR 254 (SC)* – In this case assessee claimed unrealized exchange loss on foreign currency transaction by valuing the underlying asset/liability considering the foreign exchange rate on the balance sheet date. The AO disallowed the claim of the loss on the ground that it was not an ascertained liability but only a contingent liability. The Supreme Court allowed MTM as deduction u/s. 37 to the assessee and also laid down the following test to permit the deduction of MTM loss –

(i) Whether the system of accounting followed by the assessee is the mercantile system;

(ii) Whether the same system is followed by the assessee from the very beginning and if there was a change in the system, whether the change was *bona fide*;

(iii) Whether the assessee has given the same treatment to losses claimed to have accrued and to the gains that may accrue to it;

(iv) Whether the assessee has been consistent and definite in making entries in the account books in respect of losses and gains;

(v) Whether the method adopted by the assessee for making entries in the books both in respect of losses and gains is as per the nationally accepted Accounting Standards;

(vi) Whether the system adopted by the assessee is fair and reasonable or is adopted only with a view to reduce the incidence of taxation.

To summarise, taxation of foreign exchange gain or loss is driven by its nature (capital or revenue) and MTM loss is allowable as expenditure if the test laid down by the Supreme Court in the decision of Woodward Governor (supra) is satisfied.

Position from AY 2017-18 (impact of ICDS & amendments by Finance Act 2018)

Due to the introduction of ICDS and certain amendments to the Income-tax Act *vide* the Finance Act, 2018 there has been a paradigm shift in the taxation of foreign exchange gain or loss. Briefly, the intent is to do away with the distinction in nature (capital or revenue) of foreign exchange gain or loss and restrict allowability of MTM loss.

To deal with the taxation of foreign currency transactions, the Finance Act, 2018, has inserted a new section, section 43AA with retrospective effect from 1st April, 2017 (Assessment year 2017-18).

According to the Section 43AA (subject to Section 43A), any gain or loss in respect of foreign currency transactions arising on account of any change in foreign exchange rates **shall be treated as income or loss**, as the case may be, and such gain or loss shall be computed in accordance with the ICDS. Foreign currency transaction has been defined to include transactions relating to (i) monetary and non-monetary items; (ii) translation of financial statements of foreign operations; (iii) forward exchange contracts; and (iv) foreign currency translation reserves.

The terms used in Section 43AA like 'monetary and non-monetary items', 'translation of financial statements of foreign operations' and 'foreign currency translation reserves' are not defined in the IT Act. The terms are borrowed from ICDS which has its origin from the Accounting Standards, wherein similar terms are used. It is interesting to note that, various amendments by Finance Act, 2018 intended to dilute the impact of the decision of Delhi High Court in the case of *Chamber of Tax Consultants vs. Union of India [2018] 400 ITR 178 (Delhi HC)* wherein the rigors of ICDS were diluted by the High Court, by primarily ruling that ICDS cannot override binding judicial precedents. The Government in a jiffy, taking cue from the detailed decision of the Delhi High Court amended the IT Act and overruled settled principles of Income-tax.

The moot question that arises is whether the amendment by Finance Act, 2018 (Section 43AA) has done away with the distinction between foreign exchange gain or loss on capital account and foreign exchange gain or loss on revenue ?

Section 43AA is forming part of Chapter IV of the IT Act that provides for computation of Business Income, it is generally understood that Section 4 is the charging section and charge in on the scope covers total income of the assessee. The scope of which is contained in section 5. To tax any income not being taxed earlier, the definition of income u/s. 2(24) has to be amended to include such income expressly. For Example, Finance Act, 2018 amended Section 2(24) to include any compensation referred to in Section 56(2)(ix)[1]. Finance Act, 2015 had amended Section 2(24) to include any Government subsidy within the scope of income. However, no amendment has been made in the definition of income (Section 2(24)) to specifically include foreign exchange gain or loss and consequently one could argue that scope of Section 43AA is restricted to foreign exchange gain or loss on revenue account

1 Section 56(2)(ix) was also inserted by Finance Act, 2018

and foreign exchange gain or loss on capital account is still outside the purview of Section 43AA.

One could argue to the contrary as well that, the language of Section 43AA treats foreign exchange gain or loss as income/loss and consequently there is no need to amend the definition of income. Due to the ambiguity in the language of Section 43AA and without amendment to the definition of income the issue is far from clear.

Recently, the Supreme Court in the case of *Sedco Forex International Inc. vs. CIT [2017] 399 ITR 1 (SC)* has upheld the proposition that the charge for the levy of the income that accrued or arose is laid by the charging sections and not by virtue of machinery provisions, but in the same breath Supreme Court has also ruled that, the machinery provisions provide necessary aid to determine whether a particular amount will be "income" within the meaning of Section 5 of the Act (the case was decided against the assessee).

In light of the various judicial pronouncements ruling that foreign exchange gain or loss on capital account is outside the purview of 'income'. Whether the 'aid' of Section 43AA is required to determine whether a particular foreign exchange gain or loss is "income" within the meaning of Section 2(24)?

Presently, subject to certain exclusion, ICDS is applicable to assessee following mercantile system of accounting. Assessee following cash system of accounting is not governed by ICDS. If, the view is canvassed that Section 43AA will also apply to foreign exchange gain or loss in the capital field, there is no computation mechanism provided *vis-a-vis* an assessee following cash system of accounting and consequently, Section 43AA is not applicable to them. In that case, Section 43AA charging foreign exchange gain loss in the capital field is distinguishing between the assessees based on the method of accounting (cash or mercantile) and levies tax on foreign exchange gain (or loss) on capital account earned by assessee following mercantile system of accounting. Whether Section 43AA differentiating on the basis of the method of accounting followed by an assessee is constitutionally valid or does Section 43AA have to be read to cover only foreign exchange gain (or loss) of revenue nature ?

ICDS VI – The Effects of Changes in Foreign Exchange Rates

The Central Government had notified ten ICDS effective from 1st April 2017 (w.e.f. A.Y.2017-18). These are applicable to all assessees (other than an individual or a Hindu undivided family who are not subject to tax audit under Section 44AB of the said Act) for the purposes of computation of income chargeable to income-tax under the head "Profits and gains of business or profession" or "Income from other sources". ICDS VI deals with the effects of change on foreign exchange rate.

ICDS VI deals with (a) transactions in foreign currencies; (b) translation of financial statements of foreign operations; and (c) forward exchange contracts.

Transactions in foreign currencies

A foreign currency transaction is defined in ICDS VI as a transaction which is denominated in or requires settlement in a foreign currency. Such a transaction includes transaction arising when a person–

(a) Buys or sells goods or services whose price is denominated in a foreign currency; or

(b) Borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

(c) Becomes a party to an unperformed forward exchange contract; or

(d) Otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in foreign currency.

The definition of the term "foreign currency transaction" in the AS 11 is identical.

Initial recognition

ICDS VI requires that a foreign currency transaction shall be initially recognised at the rate prevailing on the date of the transaction. This is similar to the treatment under AS 11.

Reporting at year-end dates

(a) Monetary Items – ICDS VI requires all monetary items to be translated at the end of the previous year at the closing rate, i.e., the exchange rate on the last day of the previous year. The term 'monetary items' is defined as money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money. Cash, receivables and payables are examples of monetary items. Thus, bank balances, trade debts and liabilities denominated in foreign currency would be translated at the closing rate which is the year-end rate applicable for that currency.

Similar to Section 43AA, ICDS VI requires the resulting exchange difference on recognising monetary items at closing rates to be treated as income or expense of the year in which such difference is recognised. The treatment described above for recognising monetary items is in accordance with AS 11.

(b) Non-monetary items – Non-monetary items are assets and liabilities other than monetary items. Examples of non-monetary items are fixed assets, inventories, and investments. Non-monetary items generally shall be converted into reporting currency at the exchange rate used on the date of the transaction. There is no exchange gain or loss as there is no revaluation of these items at the reporting date. AS 11 permits non-monetary item which are carried at fair value or other similar valuation denominated in a foreign currency to be reported using the exchange rate that existed when such value was determined, that is, the closing rate. ICDS VI limits this rule to non-monetary items being inventories which are carried at net realisable value.

Foreign operations

ICDS does not recognises the distinction between integral and non-integral foreign operations as recognised in AS-11. ICDS VI requires the translation of the financial statements of foreign operations (main branch) as if the transactions are done by Indian operations of the assessee. Primarily ICDS VI does not provide for any differential treatment for non-integral foreign operations as provided by AS-11.

Forward exchange contracts

AS 11 defines "Forward exchange contract" as an agreement to exchange different currencies at a forward rate. Under the ICDS VI, the term includes a foreign currency option contract or another financial instrument of a similar nature. Such contracts could be of three kinds which are discussed below.

Contracts for hedging

In respect of a forward exchange contract not intended for trading and speculation and entered into for the purposes of hedging, any premium or discount arising at the inception of such a contract shall be amortised as expense or income over the life of the contract. Exchange differences on such a contract shall be recognised as income or expense of in the year in which the exchange rates change. Any profit or loss arising on cancellation or renewal shall be recognised as income or as expense for the previous year. The premium or discount is to be measured as the difference between the exchange rate on the date of inception of the contract and the forward rate specified in the contract.

Contracts for trading or speculation

In case of forward contracts which are intended for trading or speculation purposes, AS 11 requires that the premium or discount on such contracts are ignored and the contracts are marked to market at every balance sheet date and resulting gains or losses are recognised in the profit and loss statement. In contrast, under ICDS VI, premium, discount or exchange differences on such contracts shall be recognised only at the time of settlement.

Hedging contracts in respect of firm commitments or highly probable transactions

AS 11 does not apply to exchange difference arising on forward exchange contracts entered into to hedge the foreign currency risk of future transactions in respect of which 'firm commitments' are made or which are highly probable 'forecast transactions'. Guidance Note on Accounting for Derivative Contracts issued in June, 2015 deals with such contracts. A 'firm commitment' is a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates, for instance, a purchase order placed for acquiring equipment which is yet to be supplied. A firm commitment does not include assets and liabilities existing at the end of the year. A 'forecast transaction' is an uncommitted but anticipated future transaction for instance, highly probable future sales. The Guidance Note requires that all derivative contracts should be recognised on the balance sheet and measured at fair value. On the other hand, ICDS VI requires the premium, discount or exchange differences on such contracts to be recognised only at the time of settlement. This will give rise to an adjustment while computing taxable income.

MTM Loss

The Finance Act, 2018 inserted a new sub-clause (xviii) in Section 36(1) with retrospective effect from 1st April, 2017 (Assessment year 2017-18), which provides that any marked to market loss or other expected loss as computed in accordance with ICDS shall be allowed as a deduction.

Section 40A has also been amended by Finance Act, 2018 with retrospective effect from 1st April, 2017 (Assessment year 2017-18) and sub-section (13) has been inserted to provide that no deduction or allowance shall be allowed in respect of any marked to market loss or other expected loss, except as allowable under Section 36(1)(xviii).

Therefore, MTM loss can be claimed as a deduction only if ICDS permit it. Therefore, the ratio of the Supreme Court ruling in the case of Woodward Governor (supra) to permit MTM loss as deduction on fulfilment of the tests laid down in the decision (discussed earlier – principle test being claim of MTM Loss should be in accordance with generally accepted accounting principle), has been effectively overruled. Moreover, ICDS has been given a statutory power in the garb of the computation mechanism to decide on deductibility MTM loss.

[This article includes inputs from CA Rohin Mehta]

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When there is conflict between the heart and the brain, let the heart be followed.

— *Swami Vivekananda*

CA Paras K. Savla

Bad Debts

"It takes as much imagination to create debt as to create income."

— Leonard Orr

Bad debt is a loss that a business entity incurs on account of the credit that has been extended to customers becomes worthless, either because the debtor is bankrupt, has financial problems or because it cannot be collected for a varied reason. It is expensed in the profit and loss / income statement. Bad debts are recognized either under write off method or under allowance/provision method. Under direct write off method, the uncollectible amount is written off as they become uncollectible or bad. Whereas, under the allowance/provision method business based on past experience estimates the certain percentage of revenue as irrecoverable and create a provision for bad debts by debiting bad debts.

Bad debts is an allowable expense as per the provisions of the Income-tax Act, 1961. Section 36(1)(vii) of the Income-tax Act, 1961 allows deduction in respect of bad debts incurred during the previous year subject to the conditions in Section 36(2). A deduction is allowed in respect of the Bad debt which is written off as irrecoverable in the accounts of the assessee for the previous year in which the debts have actually become irrecoverable. For claiming the deduction, it is not enough that a debt is bad but it must also be actually written off. Writing off the bad debt is important, because, that will fix the time at which the deduction can be made. A debt does not become a deductible debt, if and when it becomes a bad debt. It becomes deductible if it has been incurred in the production of assessable income when it is written off. In other words, the crucial time when a debt becomes deductible is the time of writing off, not the time of debt becomes a bad debt[1].

If an assessee debits an amount of doubtful/bad debt to the profit and loss account and credits the asset account like sundry debtor's account, it would constitute a write off of an actual debt. However, if an assessee debits 'provision for doubtful/bad debt' to the profit and loss account and makes a corresponding credit to the 'current liabilities and provisions' on the liabilities side of the balance sheet, then it would constitute a provision for doubtful/bad debt. In the latter case, the assessee would not be entitled to deduction after 1-4-1989[2]. Few Courts/Tribunals have held that assessee

1 CIT v. Ahmedabad Electricity Co. Ltd. [2003] 262 ITR 97 (Gujarat)

2 Southern Technologies Ltd. v JCIT [2010] 187 Taxman 346 (SC)

is entitled to the deduction even in case a provision is made by an assessee in its accounts for bad and doubtful debts. However, in order to overcome this, the Finance Act, 2001, amended section 36(1)(vii), with retrospective effect from 1-4-1989, to provide that transfer to 'provision for bad and doubtful debt account' shall not be taken as bad debt written off for the purpose of allowance of deduction.

The Direct Tax Laws (Amendment) Act, 1987 Finance Act has substituted words "any debt, or part thereof, which is established to have become a bad debt in the previous year" with words "any bad debt or part there which is written off as irrecoverable in the accounts of the assessee for the previous year". For claiming deduction under section 36(1)(vii), all that assessee is required to do is to write off debt as irrecoverable in its accounts of relevant previous year. It is not necessary for the assessee to establish that debt has become bad in a previous year. The wisdom of the assessee to write-off the debt as bad cannot be questioned and no demonstrative or infallible proof of bad debt having become bad is required, and commercial expediency is to be seen from the point of view of the assessee. Despite the amendment, the issue of establishing the irrecoverability of bad debts was being disputed by the tax authorities.

The Central Board of Direct Tax vide its Circular No. 12/ 2016 dated 30 May 2016 has instructed that claims for any bad debt or part thereof in any previous year shall be admissible under section 36(1)(vii) of the Act if it is written off as irrecoverable in the taxpayer's books of accounts. Once the debt is written off, latter happening would not be relevant[3]. Where certain amounts had been lying outstanding for a couple of years and assessee had written off said amount in books of account, merely because a suit was not filed could not be a cogent reason to disallow claim which had become bad[4]. Even while taking recovery action, a debt can be construed bad to the extent that a prudent business person would consider that there is no reasonable likelihood that the debt will be paid.

Debt arising out of business

Section 36(1)(vii) applies in respect of the debt which arises out of and is incident to the trade. The burden of proof that there is a debt owing to the assessee, that it has been taxed in the earlier years, that the debt arose in the course of business of the assessee and, finally, that it had become bad in the year of account, is all on the assessee[5]. Further, the debt would cover any involuntary payments made to discharge a legal obligation which arises from his business and if such sum is irrecoverable, same would be allowed as bad debt[6]. A debt which becomes irrecoverable should relate to the business of the assessee in the relevant assessment year and assessee can claim deduction thereof in such assessment year. Mere discontinuation of the business in a subsequent assessment year is not ground for disallowance[7].

The Madras in the case of *South India Surgical Co. Ltd. v. ACIT [2006] 153 Taxman 491 (Mad.)* has observed that "it is clear that it is not sufficient for the assessee to say that he has become pessimistic about the prospect of recovery of a debt in question. He must feel honestly convinced that the financial position of the debtor was so precarious and shaky that it would be impossible to collect any money from him. The question is really one of fact depending upon the various facts and diverse circumstances bearing on the debtor's pecuniary position, his commitments and obligations. The judgment of the assessee in regarding the debt as bad debt must be an honest judgment and not a convenient judgment. The judgment of

3 CIT vs. Dunlop India Ltd. [1994] 74 Taxman 162 (Cal.)

4 Pr. CIT vs. Rajasthan State Beverages Corpn. Ltd. [2017] 84 taxmann.com 173 (Raj.); SLP of revenue dismissed [2017] 84 taxmann.com 185 (SC)

5 Travancore Tea Estates Co. Ltd. vs. CIT [1992] 197 ITR 528 (Ker.)

6 CIT vs. Birla Bros. (P.) Ltd. [1970] 77 ITR 751 (SC)

7 Rajini Investment Private LImited vs. CIT [2009] 319 ITR 433 (Madras)

the assessee must be established to have been taken on relevant facts and circumstances, which should show that the debt is not realizable for some fault on the part of the debtor or some supervening impossibility on the part of the debtor to pay, but not possible difficulties or hurdles the assessee may have to incur to compel the recalcitrant debtor to pay. The assessee for his convenience may decide that the debt is too small and it is not worthwhile to pursue the debtor but that judgment would not be an honest judgment, which would establish that the debt has become a bad debt. A time-barred debt can be assumed to be bad, but is not necessarily bad because of expiry of limitation for recovery of the same."

The High Court disallowed the claim of bad debts, due from Government Hospital. It has observed that "on the perusal of the correspondence produced by the assessee that the concerned hospital have acknowledged that they are due to pay these amounts to the assessee. It was only paucity of allocated budget to the hospitals that resulted in non-payment. The parties are actually Government themselves. It would be preposterous to consider that the Government is not in a position to discharge its acknowledged debt. It might be due to certain fund-flow problem and priority between different needs and there is postponement in discharging certain liability by the Government. There is no negation of claim nor any Government hospital has written that they would not pay any of these amounts."

Hon'ble Madras High Court has failed to appreciate the amendment made by the Taxation (Amendment) Act and has relied on the decisions delivered prior to the amendment. The position in law is well-settled. After 1-4-1989, it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable. It is enough if the bad debt are written-off as irrecoverable in the accounts of the assessee[8].

However, certain sum deduction cannot be claimed as bad debt e.g. a debt due from retired partners if it has become irrecoverable cannot be written off[9]. In respect of such sums, the assessee can explore claiming deduction under section 28 as a business loss.

Conditions prescribed in Section 36(2)

Sub-section (2) of section 36 qualifies the deduction and hence merely writing off any amount as a bad debt in the books of account irrecoverable does not ipso facto results in deducting the said sum while computing the taxable income in accordance with the provisions of the Income-tax Act, 1961. The requirement of sub-section (2) is to be established even in a case where a sum is written off in the books of account as an irrecoverable debt. The enquiry into the condition required under sub-section (2) is still required to be made but such enquiry is required to be made only when a debt is written off in the books of account. Therefore, it becomes a condition precedent before any claim for deduction on account of the debt becoming bad is inquired into. In the absence of such entries made in the books of account, the process of examining its claim with reference to sub-section (2) of section 36 does not commence[10]. Even if a part of the debt is offered to tax, Section 36(2)(i) of the Act, stands satisfied. The test under the first part of Section 36(2)(i) of the Act is that where the debt or a part thereof has been taken into account for computing the profits for earlier Assessment Year, it would satisfy a claim to deduction under Section 36(1)(vii) read with Section 36(2)(i) of the Act[11]. The embargo placed in section 36(2) would not apply in the case of a non banking financial company and all that remains is to examine if the debt has been

8 T.R.F. Ltd v CIT [2010] 190 Taxman 391 (SC)
9 Girdhari Lal Gian chand v. CIT (1971) 79 ITR 561 (Allahabad)
10 Kashmir Trading Co. v. DCIT [2007] 291 ITR 228 (Rajasthan)
11 CIT v. Shreyas S. Morakhia [2012] 342 ITR 285 (Bom.), CIT v. Pudumjee Pulp & Paper Mills Ltd. [2015] 235 taxmann 451 (Bombay)

written off in accordance with the mandate of section 36(1)(vii) of the Act[12].

Income Computation and Disclosure Standards

Finance Act, 2015 has inserted a new second proviso w.e.f. the assessment year 2016-17. The said new second proviso provides that:

- where the amount of such debt or part thereof has been taken to account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof becomes irrecoverable or of an earlier previous year on the basis of income computation and disclosure standards notified under sub-section (2) of section 145 without recording the same in the accounts,
- then, such debt or part thereof shall be allowed in the previous year in which such debt or part thereof becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of this clause.

Further Para 11 of ICDS-VII requires that when contract revenue is already recognized as income is subsequently written off in the books of account as uncollectible, the same shall be recognized as an expense.

ICDS-IV provides for the taxability of accrual of interest. It has provided that interest shall accrue on the time basis determined by the amount outstanding and the rate applicable. However, said provision was challenged in Chamber of Tax Consultants v. UOI [2017] 87 taxmann.com 92 (Delhi) on the ground that non-performing assets of NBFCs would also become taxable on accrual basis even though such interest is not recoverable. The revenue has countered it by stating that as per the Circular No. 10 of 2017 such income has to be applied on an accrual basis and deduction, if any, can be claimed only under Section 36 (1)(vii) of the Act. The Hon'ble Delhi High Court has negated the challenge and observed that "Since there is no challenge to Section 36(1)(vii), para 8 (1) ICDS-IV cannot be held to be ultra vires the Act. This is to create a mechanism of tracking unrecognized interest amounts for future taxability, if so accrued. In fact the practice of moving debts which the bank or NBFC considers irrecoverable to a suspense account is a practice which makes the organizations lose track of the same. The justification by the Respondent clearly demonstrates that this is a matter of a larger policy and has the backing of Parliament with the enactment of 36 (1) (vii). The reasoning given by the Respondent stands to logic. It has not been demonstrated by the Petitioner that para 8 (1) of ICDS IV is contrary to any judgment of the Supreme Court, or any other Court."

Bad Debts of Discontinued Business

As per section 36(2), a condition for claiming the deduction is that the debt or loan should be in respect of business or profession of the assessee and should relate to the relevant accounting year. A discontinued business which is already discontinued before the accounting year starts cannot claim a deduction for bad debts. In other words, an assessee can avail deduction of bad debts only of continuing business during the previous year. It is not necessary that business need to be operating throughout the previous year.

Bad Debts in case of Business Succession

In case of succession of business, along with its assets and liabilities, from one owner to another, then a debt so transferred should be entitled to the same treatment in the hands of the successor. The recovery of the debt is a right transferred along with the numerous other rights. It is a right which should, on a proper appreciation of all that is implied in the transfer of a business, be regarded as belonging to the new owner.

12 Operating Lease & Hire Purchase Co. Ltd. v. DCIT [2017] 81 taxmann.com 304 (Madras)

If such debt had been taken into account in computing the income of the predecessor and had subsequently been written off as irrecoverable in the accounts of the assessee that is the successor, the successor would still have been entitled to a deduction of the amount written off as a bad debt. It is not imperative that the assessee referred to in sub-clause (a) must necessarily mean the assessee who incurred such bad debt. A successor to the interest of a previous assessee would also be eligible to claim such deduction. The successor assessee, in effect, steps into the shoes of his predecessor[13].

Recovery of bad debts

If in any previous year, the debt has been written off as bad and the relevant deduction has also been claimed but later on the same debt is recovered in full or part, then the amount so recovered will be included as income of the financial year in which such amount has recovered.

Even if the said deduction was allowed by the Assessing Officer and in subsequently, the debt is recovered from the debtor, then the amount so recovered will be treated as a normal realization of debts. If the amount recovered is less than the amount of bad debts claimed, then only the remaining amount will be treated as bad debts. If the amount received exceeds the amount of bad debts, then the excess amount received will be treated as the income in the financial year of the receipt.

In another case where a part of the debt was written off or allowed by the Assessing Officer as bad debt and the remaining portion was left as recoverable and if some money is received from the debtor, the amount received up to the recoverable part will be treated as a normal realisation of debt. If in the final adjustment, the amount recovered is less than the amount presumed to be recoverable, the deficiency will be allowed as a deduction in that previous year. If, on the other hand, the money received is more than the recoverable amount, the excess will be treated as the income of the year of receipt of such money.

13 CIT v. T. Veerabhadra Rao [1985] 22 Taxman 45 (SC)

Provision for doubtful debts & MAT

As discussed earlier provision of bad doubtful debts is not allowed as deduction while computing business profits. Whether same is allowed while computing MAT? For the purposes of computation of MAT profit, "book profit" means the profit as shown in the statement of profit and loss for the relevant previous year as increased by certain amounts including provision for provision for bad and doubtful debts.

The Hon'ble Supreme Court in the case of *CIT vs. HCL Comnet Systems & Services Ltd [2008] 174 Taxman 118 (SC)* has held that "debt" under consideration is "debt receivable" by the assessee. The provision for bad and doubtful debt, therefore, is made to cover up the probable diminution in the value of the asset, i.e., debt which is an amount receivable by the assessee. Therefore, such a provision cannot be said to be a provision for liability, because even if a debt is not recoverable no liability could be fastened upon the assessee. In the present case, the debt is the amount receivable by the assessee, therefore, any provision made towards irrecoverability of the debt cannot be said to be a provision for liability.

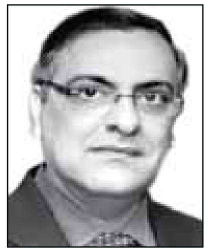
The Act was subsequently amended and clause (i) was inserted in Explanation-1 by Finance Act, 2009 w.r.e.f. 1-4-2001. As per clause (i), the amount or amounts set aside as provision for diminution in the value of any asset has to be added back in net profits, if this amount was debited to profit and loss account. Thus, now provision for doubtful debts should be added under clause (i) of Explanation 1.

End lines

Beggars must be no choosers

Those in dire need must be content with what they get. Debtor who has granted debt after his failed efforts to recove has no choice and can claim deduction only as per the provisions of the law. In case tax provisions do not allow deduction, no relief is available.

❍❑❍



CA Jagdish Punjabi

Expenditure incurred wholly & exclusively for the purpose of business – Section 37(1)

Section 37 of the Act is a section which allows deductions while computing profits chargeable to tax under the head "Profits & Gains of Business or Profession". Section 37(1) of the Act reads as under –

> 37. (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 [***] and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and Gains of Business or Profession".
>
> [*Explanation 1.* – For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.]
>
> [*Explanation 2.*– For the removal of doubts, it is hereby declared that for the purposes of sub-section (1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.]
>
> (2) [***]
>
> [(2B) Notwithstanding anything contained in sub-section (1), no allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party.]
>
> (3) [***]

Section 37(1) contains the general provisions for allowance, which are *pari materia* with those in the English Act, though it enacts affirmatively what is stated in the negative form in the English *Statute [Indian Molases Co. P. Ltd. vs. CIT (1959) 37 ITR 66, 78 (SC)]. Explanation 1* to section 37(1) has been introduced by the Finance (No. 2) Act, 1998 w.r.e.f. 1-4-1962 and *Explanation 2* has been inserted by the Finance (No. 2) Act, 2014 w.e.f. 1-4-2015.

An item of expenditure which has been incurred during the previous year in respect of a business which was carried on by the assessee and the profits of which are to be computed and assessed can be allowed under section 37 if it cumulatively satisfies the following conditions –

(i) it is not expenditure of the nature described in sections 30 to 36;

(ii) it is not in the nature of capital expenditure;

(iii) it is not in the nature of personal expenditure;

(iv) it is laid out or expended wholly and exclusively for the purposes of the business or profession.

Further, if an item of expenditure is covered by *Explanation 1* or *Explanation 2* to section 37(1) then such expenditure shall not be allowed as a deduction. An item of expenditure to which *Explanation 1* applies is not deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure. As regards item of expenditure to which *Explanation 2* applies, *Explanation 2* provides that such expenditure shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession. Considering the intent of Explanation 2 the language ought to have been that such expenditure shall be deemed to have not been incurred by the assessee for the purposes of the business or profession.

It is any 'expenditure' which satisfies the conditions laid down in section 37(1) which will qualify for allowance under section 37. Primary meaning of `expenditure' is 'spending' in the sense of `paying out or away' of money. 'Expenditure' is what is paid out or away and is something which is gone irretrievably. Expenditure, which is deductible for income-tax purposes, is one which is either actually paid or, if the accounts are on mercantile basis, provided for towards a liability actually existing at the time, but the putting aside of money which may become expenditure on the happening of an event is not expenditure. Thus, expenditure is not necessarily confined to the money which has been actually paid out. It covers a liability which has accrued or which has been incurred although it may have to be discharged at a future date. However, a contingent liability which may have to be discharged in future cannot be considered as expenditure.

There is a distinction to be drawn between disbursement or expenditure on the one hand and a loss on the other. Expenditure relates to something paid out or spent which indicates a sort of volition, something which comes out of the pocket and spent. Loss, on the other hand, comes upon him ab extra or fortuitous *[Allen vs. Farquharson Bros. & Co. (1932) 17 Tax Cas. 59 (KB); CIT vs. S. C. Kothari, (1971) 82 ITR 794, 801-2 (SC); Lord's Dairy Farm Ltd. vs. CIT, (1955) 27 ITR 700 (Bom.), Chenab Forest Co. vs. CIT, (1974) 96 ITR 568, 575 (J & K)]*. Expenditure must arise out of a voluntary act on the part of the assessee whereas loss is entirely involuntary *[Bijjala Shivalingam vs. CIT, (2002) 253 ITR 105, 114 (AP)]*. In that case, it has been opined that, at the most, the value of confiscated gold may be a loss, but undoubtedly not an expenditure. A business expenditure is allowable if it is laid out or expended wholly and exclusively for the assessee's business, while a business loss is allowable if it is of a non-capital nature and is not only connected with the trade but is incidental to the trade itself *[CIT vs. J. K. Cotton Spinning & Weaving Mills Co., (1980) 123 ITR 911, 918 (All.)]*.

However, in *M. P. Financial Corporation vs. CIT [(1987) 165 ITR 765, 770 (MP)]*, it has been opined that the expression "expenditure", as used in section 37, may, in the circumstances of a particular case, cover an amount which is really a loss and the said amount has not gone out from the pockets of the assessee. The expression `any expenditure' has been used in section 37 to cover both `expenses incurred' as well as an amount which is really a `loss' even though such amount has not gone out from the pocket of the assessee *[CIT vs. Woodward Governor India P. Ltd. (2009) 312 ITR 254, 262 (SC)]*.

The following general principles should be kept in mind –

(i) Section 37 of the Act prohibits granting of any deduction which is of a capital nature.

(ii) In determining whether a particular item of expenditure is, or is not, deductible in computing the business profits, it is necessary first to enquire whether the deduction is expressly prohibited under any other provision including sections 40 and 40A. If it is not so prohibited, then alone the allowability may be considered under the provisions of section 37(1) *[Cf. Atherton vs. British Insulated and Helsby Cables Ltd, (1925) 10 TC 155, 191 (HL)]*.

(iii) Besides sections 40 and 40A, sections 43A, 43B, 43D, 44, 44A, 44AD, 44ADA, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, 44C and 44D enact overriding provisions.

Expenditure of capital nature is not allowable

The phraseology of section 37(1) expressly excludes the allowability of capital expenditure even though wholly and exclusively laid out or expended for the purposes of the business *[D. P. Chirania & Co. vs. CIT (1978) 112 ITR 112, 17 (Karn)]*. Section uses the phrase "in the nature of capital expenditure". The expression "capital expenditure" is not defined in the Act and the words "in the nature of capital expenditure" occurring in section 37(1) make the meaning of the expression more elastic in its application to the facts of each case. The expression must be construed in a business sense save in so far as there may be rules of construction applicable to it *[Mohanlal Hargovind vs. CIT, (1949) 17 ITR 473 (PC)]*. For determining whether an expenditure is of capital or revenue nature, it is immaterial whether the expenditure is made out of moneys withdrawn from capital or out of the profits. One should consider the nature of the concern, the ordinary course of business usually adopted in that concern, and the object with which an expense is incurred *[Taj Mahal Hotel vs. CIT, (1967) 66 ITR 303, 305-306 (AP)]*.

The word 'capital' connotes permanency and capital expenditure is, therefore, closely akin to the concept of securing something, tangible or intangible property, or corporeal or incorporeal right, so that they could be of a lasting or enduring benefit to the enterprise in issue. Revenue expenditure, on the other hand, is operational in its perspective and solely intended for the furtherance of the enterprise. This distinction, though candid and well accepted, yet, is susceptible to modifications under peculiar and distinct circumstances *[CIT vs. Ashok Leyland Ltd., (1969) 72 ITR 137, 143 (Mad.)]*.

Ordinarily, `capital' means an asset which has an element of permanency about it and which is capable of being a source of income and "capital expenditure" must, therefore, generally mean an acquisition of an asset and the asset must be intended to be of lasting value; while income or revenue expenses are generally running expenses incurred in earning profit or expenses incurred with the primary object of an immediate return or acquisition of assets which are not of lasting value and are likely to get exhausted or consumed in the process of the return or a very limited number of returns *[Jagat Bus Service vs. CIT (1950) 18 ITR 13, 23 (All); R. S. Radha Kishan Kapoor vs. CIT, (1963) 47 ITR 938 (All.)]*.

The word "wholly" refers to the quantum of expenditure. The word "exclusively" refers to the motive, objective and purpose of the expenditure and gives jurisdiction to the taxing authorities to examine these matters *[Sidho Mal & Sons vs. CIT (1980) 122 ITR 839, 844 (Delhi); Amritlal & Co. Pvt. Ltd. vs. CIT (1977) 108 ITR 719, 729 (Bom); B. K. Khanna & Co. (P.) Ltd. vs. CIT (2001) 247 ITR 705, 709 (Delhi)]*.

The expression "wholly and exclusively" does not mean "necessarily". Ordinarily, it is for the assessee to decide whether any expenditure should be incurred in the course of its or his business. Such expenditure may be incurred voluntarily and without necessity and if it is incurred for promoting the business and to earn profits, the assessee can claim deduction therefor under section 37(1) even though there was no compelling necessity to incur such expenditure.

The test laid down by the Supreme Court in *State of Madras vs. G. J. Coelho [(1964) 53 ITR 186 (SC)]*, is that expenditure made under a transaction which is so closely related to the business that it could be viewed as an integral part of the conduct of the business, may be regarded as revenue expenditure laid out wholly and exclusively for the purposes of the business *[Bombay Steam Navigation Co. (1953) Pvt. Ltd. vs. CIT (1965) 56 ITR 52, 61 (SC)].*

The true test of an expenditure laid out wholly and exclusively for the purposes of trade or business is that it is incurred by the assessee as incidental to his trade for the purpose of keeping the trade going and of making it pay and not in any other capacity than that of a trader *[CIT vs. Delhi Safe Deposit Co. Ltd. (1982) 133 ITR 756, 760 (SC)].*

The manner to apply the test is to ask the question: "Has the expense been incurred with the sole object of furthering the trade or business or interest of the assessee unalloyed or unmixed with any other consideration? If the expense is found to bear an element other than the trade or business interest of the assessee the expenditure is not an allowable one.

The test is not what a prudent man would do in similar circumstances. Though an assessee may be an imprudent businessman, yet if he incurs an expenditure voluntarily for the purpose of his own business it would be allowable as a proper deduction *[J. K. Commercial Corporation Ltd. vs. CIT, (1969) 72 ITR 296 (All.)].*

The expression `for the purposes of the business or profession' used in section 37(1) is wider in scope than the expression "for the purpose of earning profits" *[CIT vs. Malayalam Plantations Ltd. (1964) 53 ITR 140, 150 (SC); Madhav Prasad Jatia vs. CIT, (1979) 118 ITR 200, 208 (SC); East India Pharmaceutical Works Ltd. vs. CIT (1978) 114 ITR 591, 595 (Cal); Addl CIT vs. Ram Bahadur Thakur & Co., (1979) 116 ITR 698 (Pat.); CIT vs. R. Tolat & Co. (1980) 126 ITR 551 (Guj.)].*

The phrase "for the purposes of the business" used in section 37(1) has a wide import. It has to be assigned a meaning according to the circumstances of each case. It cannot be assigned a limited meaning. The things done to cut down losses, when the business was still running, are for the purpose of business *[Ambala Cantt. Electric Supply Corporation Ltd. vs. CIT (1982) 133 ITR 343, 360 (Punj.)].*

The expression 'for the purpose of business' includes expenditure voluntarily incurred for commercial expediency, and it is immaterial if a third party also benefits thereby. The expression `for the purpose of business' is wider in scope than the expression `for the purpose of earning income, profits or gains' *[S. A. Builders Ltd. vs. CIT(A), (2007) 288 ITR 1, 7 (SC)].*

In order to disallow an expenditure or a part of it, it is essential to record a finding that such expenditure or part thereof was for non-business purposes. Thus, where the Tribunal has disallowed a part of the expenditure incurred on sales promotion without recording a finding to the effect that such part was for non-business purposes, there was no justification for disallowance of part of such expenditure *[National Industrial Corporation Ltd. vs. CIT (2002) 258 ITR 575, 582 (Del.)].*

In *CIT vs. Navsari Cotton & Silk Mills [(1982) 135 ITR 546, 554-6 (Guj.)]*, Thakkar J., has formulated two types of tests, positive and negative. If an expenditure falling into the phraseology of section 37(1) fits in any one of the positive tests and none of the negative tests apply to it, then only it can be allowable as a business expenditure. The positive tests are –

If it is incurred –

(1) With a view to bring profits or monetary advantage either today or tomorrow;

(2) To render the assessee immune from impending or reasonably apprehended litigation;

(3) In order to save losses in forseeable future;

(4) For effecting economy in working which may pay dividends today or tomorrow;

(5) For increasing efficiency in working;

(6) For removing inefficiency in working;

(7) Where the expenditure incurred is such as (i) wise, (ii) prudent, (iii) pragmatic, (iv) ethical man of the world of business would conscientiously incur with an eye on promoting his business prospects subject to the expenditure being genuine and within reasonable limits;

(8) Where it is incurred solely by way of a civil duty owed by the assessee to the society having regard to the nature of his business which brings him profits but results in some detriment to the public at large either by way of health hazard or ecological pollution or serious inconvenience to the citizens with a view to mitigate the aforesaid evil consequences and consequences of a like nature, subject to its being genuine and within reasonable limit."

The negative tests are:

If it is incurred –

(1) For a mere altruistic consideration.

(2) Mainly in order to satisfy his philanthropic urges.

Explanation – Factors (1) and (2) are laudable but the altruistic or philanthropic urges can be satisfied at one's own cost or sacrifice (and) not at the cost of public exchequer or other taxpayers and those living below the poverty line.

(3) Mainly in order to win applause or earn garlands or public appreciation.

(4) For illegal, immoral or corrupt purposes or by any such means or for any such reasons.

(5) Mainly in order to oblige a relative or an official.

(6) Mainly in order to earn the goodwill of a political party or a politician.

(7) Mainly in order to show off or impress others with his affluence or for ostentatious purposes.

(8) Apparently for a factor listed as a positive factor …… but in reality for one of the obnoxious purposes listed hereinabove.

(9) On a nebulous plea or pretext by way of an alibi in the name of winning profits in remote future or promoting business prospects but really for one or the other of the above mentioned purposes.

(10) It must not be a bogus, fictitious or sham transaction.

(11) It must not be unreasonable and out of proportion.

(12) It must not be an expenditure merely with a view to avoid tax liability without any genuine purpose or reason in good faith.

(13) The advantage to be secured by incurring the expenditure must not be of the nature of a remote possible advantage on "ifs" and "buts", and if at all, to be secured at an uncertain future date which may be considered too remote.

Reasonableness of expenditure – is it relevant?

The jurisdiction of the Revenue under these provisions is confined to deciding the reality of the expenditure, namely, whether the amount claimed as deduction was factually expended or laid out and whether it was wholly and exclusively for the purpose of the business. The reasonableness of the expenditure could be gone into only for the purpose of determining whether, in fact, the amount was spent *[Amarjothi Pictures vs. CIT (1968) 69 ITR 755 (Mad.); Sanjeevi & Co. vs. CIT (1966) 62 ITR 156 (Mad.)].*

It is not for the revenue to question the commercial expediency of the expenditure. Commercial expediency is a matter entirely left to the judgment of the assessee *[CIT vs. Globald Motor Service Pvt. Ltd. (1975) 100 ITR 240, 242 (Mad.); CIT vs. Sapthagiri Traders Ltd. (2008) 305 ITR 438, 441 (Mad.); CIT vs. Textool Co. Ltd. (2009) 315 ITR 91, 94 (Mad.)].*

For eligibility of an allowance under section 37(1), there should be a nexus between the expenditure and the purpose of the business, and the expenditure should have been wholly and exclusively laid out for that purpose. Once these facts are established, the revenue or the court cannot justifiably claim to put itself in the arm-chair of a businessman or in the position of the board of directors and assume the role of ascertaining how much is a reasonable expenditure having regard to the circumstances of the case *[CIT vs. Raman & Raman Ltd. (1969) 71 ITR 345 (Mad.); CIT vs. Vijayalakshmi Mills Ltd., (1974) 94 ITR 173 (Mad.)].*

The fact of incurring an expenditure evidenced by proper entries in the books of account kept in the normal course of business is not to be disbelieved merely because there is no written agreement between the parties to support it. *[Jamshedpur Motor Accessories Stores vs. CIT (1974) 95 ITR 664, 671 (Pat.)].*

Prescribed deductions and allowances to be made even if there is no, or insufficient profit

A claim for an allowance provided or prescribed for under the Act cannot be defeated by the mere accident of the assessee not being in a position to show that the profits exceed the expenses or that the credit side in the profit and loss account is larger in amount than the debit side *[P. V. Mohamed Ghouse vs. CIT, (1963) 49 ITR 127, 132 (Mad); M. N. Ramaswamy Iyer vs. CIT (1969) 71 ITR 218 (Ker.); Plantation Corporation of Kerala vs. CIT (1969) 73 ITR 23 (Ker.)].*

Speculation as well as non-speculation business – allocation essential

Where the business activities consist of speculation as well as non-speculation business, it becomes necessary, in view of the provisions of *Explanation 2* to section 28, section 43(5), as well as section 73, that the business expenditure, if that be composite, be allocated on a reasonable basis and separated to be deducted from the appropriate activity of the business *[Sind National Sugar Mills P. Ltd. vs. CIT, (1980) 121 ITR 742 (Bom.)].*

Power under the memorandum is not relevant

Whether a payment made by a company assessee was or was not authorized by its Memorandum or Articles of Association is not relevant in deciding the question of its allowability *[CIT vs. Deccan Sugar & Abkhari Co. Ltd. (1976) 104 ITR 458 (Mad.)].*

Entire expenditure allowable even where a part of the income is assessable under a different head

In a period where dividend income was taxable and the shares were held by an assessee as stock-in-trade, the Calcutta High Court held that where an assessee holds shares as stock-in-trade, business expenditure including that on such shares shall be allowable under section 37(1) without any apportionment notwithstanding the fact that the dividend income from such shares is assessable under section 56(2)(i) as "Income from Other Sources" *[CIT vs. New India Investment Corporation Ltd., (1978) 113 ITR 778 (Cal.)]*. If, however, a particular expenditure is wholly attributable to the earning of dividends (during the period prior to dividend income being exempt), it was claimable under section 57.

Discount on debentures or bonds amounts to `expenditure'

When a company issues debentures at a discount, it incurs a liability to pay a larger amount than what it has borrowed, at a future date. One need not go into the question whether this additional liability equivalent to the discount, which is incurred in praesenti but is payable in future, represents deferred interest or not. That may depend upon the totality of the circumstances relating to the issue of debentures, including its terms. The liability, however, to pay the discounted amount over and above the amount received for the debentures, is a liability which has been incurred by the company for the purposes of its business in order to generate funds for its business activities. The amount so obtained by issue of debentures are used by the company for the purposes of its business. This would, therefore, be expenditure *[Madras Industrial Investment Corporation Ltd. vs. CIT, (1997) 225 ITR 802, 811 (SC)]*.

No prescriptions by the department

It is not open to the department to prescribe what expenditure an assessee should incur and in what circumstances he should incur expenditure. Every businessman knows his interest best *[CIT vs. Dhanrajgirji Raja Narasingirji, (1973) 91 ITR 544, 550 (SC)]*. The question of deductibility cannot be affected by any circular to the contrary, even if so issued by the Board. This is so because the Board's view or instructions cannot detract from the legal position arising on proper construction of statutory language *[Gestetner Duplicators Pvt. Ltd. vs. CIT (1979) 117 ITR 1, 13 (SC)]*.

No business, no allowance

In order to sustain a claim for deduction by way of business expenditure, the expenditure must have been laid out or expended for the purposes of a business which was in existence in the year of account, the profits of which are under assessment. If during the relevant period, there was no business, the question of allowability of expenses would not arise *[S.P.V. Bank Ltd. vs. CIT (1980) 126 ITR 773 (Ker.); J. R. Mehta vs. CIT (1980) 126 ITR 476 (Bom.)]*.

Expenditure incurred pursuant to an invalid document

In the case of business expenditure, it matters little whether the expenditure had been incurred on the basis of a valid or invalid document. It may be that the assessee has incurred expenditure in pursuance to a document (say, a lease) compulsorily requiring registration but was in fact not registered. For the purpose of allowability under section 37(1) what is to be seen is whether the expenditure fulfils the conditions of that section. Even such documents are admissible as evidence of collateral facts for any collateral purpose *[Narsingdas Surajmal Properties P. Ltd. vs. CIT (1981) 127 ITR 221 (Gauh.)]*.

Carelessness not to affect allowability

The department is not concerned with whether the assessee acted diligently or carelessly in incurring the expenditure as that has nothing to do with the nature of expenditure *[Pioneer Consolidated Co. of India Ltd. vs. CIT (1972) 85 ITR 410 (All.)]*.

Allowing a lesser amount than incurred

Unless there is a limitation put by the law on the amount of expenditure a lesser amount than the amount expended cannot be allowed merely because the assessing authority thinks that the assessee could have managed by paying a lesser amount as a prudent businessman *[Jamshedpur Motor Accessories Stores vs. CIT (1974) 95 ITR 664, 672 (Pat.)]*. The test of prudence by substituting its own view in place of businessman's has not been approved by the Supreme Court in the decisions of *CIT vs. Walchand & Co. Pvt. Ltd. [(1967) 65 ITR 381 (SC)]* and *J. K. Woolen Manufacturers vs. CIT [(1969) 72 ITR 612 (SC)].*

An expenditure *bona fide* incurred in relation to the business activity is an allowable one. Merely because the assessee's income, after incurring such expenditure, is found to be little or negligible, it cannot be said that the said expenditure becomes an impermissible deduction *[CIT vs. City Ahmedabad Spinning and Weaving Mfg. Co. (1994) 207 ITR 427, 428 (Guj.)]*. However, where a rule is amended with retrospective effect and as a result thereof the quantum of expenditure incurred becomes in excess to that allowable as per the amended rule, such excess is not allowable as a deduction *[CIT vs. India Cements Ltd. (1975) 98 ITR 69 (Mad.)]*

Software Expenses

A question which often keeps coming up for consideration is regards allowability of software expenses. The issue regards nature of software expenses came up for consideration before the Delhi Special Bench of the Tribunal in the case of *Amway India Enterprises vs. DCIT [(2008) 111 ITD 112 (Delhi)(SB)]*. The Special Bench of the Tribunal held as follows –

> In order to decide nature of expenditure as to whether it is capital or revenue, three tests, i.e. ownership test, enduring benefit test and functional test have to be applied. By applying the said tests, expenditure is treated as capital expenditure either when it results in acquisition of capital asset by assessee as owner thereof or when it results in accrual of advantage of enduring nature to assessee in capital field. When assessee acquires a computer software or for that matter license to use such software, he acquires a tangible asset and becomes owner thereof but, questions as to whether expenditure on acquiring computer software is capital or revenue cannot be decided on basis of ownership test alone but has to be seen from point of its utility to businessman and how important an economic or functional role it plays in his business. Since computer software becomes obsolete with technological innovation and advancement within a short span of time, it can be said that where life of computer software is shorter (say less than 2 years), it may be treated as revenue expenditure; any software having utility to assessee for a period beyond two years can be considered as accrual of benefit of enduring nature, however, that by itself will not make expenditure incurred on software as capital in nature and functional test also needs to be satisfied. For applicability of functional test, advantage which an assessee derives from use of computer software has to be seen in a commercial sense; if advantage is in capital field, then same would be capital expenditure and, if advantage consists merely in facilitating assessee's trading operations or enabling management and conduct of assessee's business to be carried on more efficiently or more profitably, while leaving fixed capital untouched, expenditure would be on revenue account. These criteria required to be applied to determine exact nature of expenditure incurred by an assessee for acquiring different computer softwares.

Apart from the above propositions, Courts and Tribunal, in connection with allowability of software expenses, have held as follows –

(i) Software expenses incurred by assessee to upgrade computer software which brought greater efficiency in functioning of assessee's business is revenue in nature

– *Pr. CIT vs. Holcim Services (South Asia) Ltd. [(2018) 93 taxmann.com 270 (Bombay) (HC)].*

(ii) Expenditure incurred on software development services which were in nature of maintenance and support services providing essential backup to assessee, who had procured software for its business purpose, was to be allowed as deduction – *Pr. CIT vs. Kitchen Express Overseas Ltd. [(2018) 89 taxmann.com 407 (Gujarat)].*

(iii) ERP software is a capital asset and expenditure incurred thereon is capital expenditure since ERP software is part of profit making apparatus of business, for enabling its management and operations, for improving productivity without which said business operations would not have been possible – *Voltech Engineers (P.) Ltd. vs. DCIT [(2017) 79 taxmann.com 158 (Chennai-Trib.)].*

(iv) Expenditure on maintenance, back-up and support services to existing hardware and software is revenue in nature – *CIT vs. N.J. India Invest (P.) Ltd. – [(2013) 32 taxmann.com 367 (Gujarat)].*

(v) Professional fees paid by assessee to its collaborator for implementation of SAP software program for enhancing efficiency of its organization is revenue expenditure – *CIT vs. KSB Pumps Ltd. [(2016) 75 taxmann.com 184 (Bombay)].*

(vi) In absence of agreement licensing software to assessee, issue whether licensing fee was revenue expenditure or capital expenditure could not be decided – *DCIT vs. Honda Siel Cars Ltd. [(2013) 33 taxmann.com 490 (Delhi-Trib.)].*

(vii) Expenditure incurred in ordinary course of business on upgradation, improvement, removal of glitches of existing or already developed software to improve its product is to be treated as revenue expenditure – *CIT vs. ACL Wireless Ltd. - [(2014) 42 taxmann.com 464 (Delhi)].*

(viii) Payment for application software, though there is an enduring benefit, does not result in acquisition of any capital asset and it merely enhances productivity or efficiency of business of assessee and, hence, it has to be treated as revenue expenditure – *CIT vs. Karur Vysya Bank Ltd. [(2015) 54 taxmann.com 324 (Madras)].*

(ix) Windows being application software cannot be treated as capital assets and, therefore, any license fee paid for the purchase of Windows has to be allowed as revenue expenditure – *ACIT vs. Boots Piramal Health Care Ltd. [(2017) 81 taxmann.com 434 (Mumbai-Trib.)].*

(x) Sum paid as license fee for use of software life of which is less than two years and as such, right to use it is for a limited period, fee paid for acquisition of said right is allowable as revenue expenditure. Also, since without renewing licence or without paying fee on such renewal, it is not possible to use those softwares, fee paid for obtaining software and licence and for renewing same is to be construed as only revenue expenditure – *CIT vs. Toyota Kirloskar Motors (P.) Ltd. [(2013) 30 taxmann.com 294 (Karnataka)].*

(xi) Expenditure on upgradation or purchase of software applications is revenue expenditure. Software application expenses are upgradation of efficient working of operations through computers in day-to-day business management, which keeps on changing periodically and thus any expenditure on such an upgradation or buying of software is revenue expenditure only – *ACIT vs. Sanghvi Savla Stock Brokers Ltd. [(2014) 43 taxmann.com 323 (Mumbai-Trib.)].*

(xii) To decide whether expenditure on purchase of computer software is capital or revenue expenditure, nature of software and its role in business of assessee have to be considered – *Addl. CIT vs. Nicholas Piramal India Ltd. [(2013) 32 taxmann.com 283 (Mumbai-Trib.)].*

Any expenditure which has been incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure. *Explanation 1* has been inserted by the Finance (No. 2) Act, 1998 w.r.e.f. 1.4.1962. Therefore, even if the expenditure incurred by an assessee is revenue expenditure and has been incurred for the purposes of his business the same shall not be allowed if it is incurred for a purpose which is an offence or which is prohibited by law. In other words the expenditure should be incurred for a purpose which is an offence or for a purpose which is prohibited by law.

Prior to insertion of the *Explanation*, the Mumbai Bench of the Tribunal has in the case of *Pranav Construction vs. ACIT [(1998) 61 TTJ 165 (Mum.)]* allowed the claim of the assessee for deduction of amounts paid by the firm out of on-money received by it to certain persons, who admitted receipt of the amounts from the assessee, for providing security to partners or for getting the tapories vacated was allowable as a deduction while computing income chargeable to tax. In respect of payments made by the assessee to persons, who could not be produced to confirm receipt of amount from the assessee, the Tribunal observed from the paper cuttings and reports, filed before it, that builders engaged in construction activities are vulnerable to such dangers as extortion, haftas, etc. and unless they oblige it would be impossible to conduct the business. The Tribunal held that it is quite probable that the assessee was under such danger and had paid the amounts for which strong circumstantial evidence supporting such payments was also there. The Tribunal, allowed even these payments.

It was with an intent to over-rule the decisions allowing such expenses as deduction that the *Explanation 1* was introduced but the *Explanation 1* is now being invoked to disallow deduction of all payments which are made in connection with infraction of law e.g., fees paid for regularization, compounding fees, etc. are being disallowed by invoking *Explanation 1*. The assessee has to litigate the matter.

The Mumbai Bench of the Tribunal has in the case of *DCIT vs. Anil Dhirajlal Ambani [(2018) 93 taxmann.com 492 (Mumbai – Tribunal)]* held that the amounts paid by the assessee to SEBI, in a case where SEBI initiated enforcement action against assessee and the assessee to avoid long drawn litigation paid consent/settlement charges under SEBI Guidelines regarding consent terms without admitting guilt, would be a business expenditure. The Tribunal held that since the payment was made without admitting or denying guilt and was paid just to settle dispute, said settlement charges / consent fee could not be equated with penalty for violation of law under *Explanation 1* to section 37(1) and therefore the same was an allowable business expenditure.

It is humbly submitted that *Explanation 1* does not seek to disallow any expenditure incurred by way of penalty for violation of law but the *Explanation 1* covers expenditure incurred the purpose of which is an offence. Therefore, it is only that expenditure the incurrence of which is for a purpose which purpose is an offence which would be covered by *Explanation 1*. A particular payment may be called as penalty but the same may be compensatory in nature and not penal and would therefore, be allowable. Such cases, it is submitted, are not intended to be covered by *Explanation 1*.

The Karnataka High Court in the case of *CIT vs. Mamta Enterprises [(2004) 266 ITR 356 (Kar.)]* has considered the applicability of Explanation 1 to compounding fee paid to municipal corporation and has held as under –

> "The Finance (No. 2) Act, 1998 has inserted an Explanation to section 37 of the Income-tax Act, 1961 with retrospective effect from April 1, 1962. The *Explanation* makes it clear that the assessee who incurs expenditure for any purpose which is an offence or which is prohibited by law is not entitled for deduction of such expenditure incurred by him. The *Explanation* declares that such an expenditure "shall not be deemed to have been incurred" for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure. When the provision is clear and use unambiguous, it is not permissible for the courts to stretch the meaning attached to the provision of law to extend the benefit to a person who violates the law or the regulations / rules made by the Corporation or the municipal authorities with impunity. The claim for deduction has to be considered in the light of the *Explanation* given to section 37 of the Act and not with reference to the provision in the Corporation or the municipal law which permits the violator of the provisions of the Corporation or municipal law to compound the offence either to save the unauthorized or illegal construction put up or to relieve such violator of law from the consequences provided in such Corporation or municipal law. Compounding fees paid to the municipal corporation is a penalty and is not deductible under section 37."

The Mumbai Bench of the Tribunal in the case of *Acme Housing India Pvt. Ltd. vs. DCIT [ITA No. 4919/Mum/2016; AY 2010-11; Order dated 11-5-2018]* while dealing with a case of an assessee carrying on business as builder and developer who had paid ` 2,96,200 to MCGM towards regularization fee for amended plan fee and carriage entrance, etc. which amount was disallowed by the Assessing Officer by regarding it as fine and disallowed it by invoking *Explanation 1* to section 37(1). The CIT(A) rejected the assessee's contention that the payment was made to compensate MCGM towards procedural lapses in not obtaining prior approval for amending the plan as this contention was not proved with documentary evidence. Before the Tribunal it was contended that these payments are not for violation of any law or are not prohibited under the laws but these are compensatory in nature and for regularization of the act of the assessee. The assessee had paid the compounding fine to regularize the building plan. The Tribunal held as follows –

> "In our considered view, the builders submit building plan for approval and based on the proposed plan, the Corporation / Municipalities give approval. It is a fact that at the time of approval, the corporation and the builders aware that it is not possible to complete the project as per the proposed plan as there are certain adjustments needed to be made at the time of actual execution. As long as the actual completion of the projects are within the parameters of approval, the corporation / approving authorities permit the projects as approved with the nominal fine or compounding fee. This is the reason, the corporation has the clause in tact in the rule books. If the projects are illegal, which is an offence and cannot be cured, the whole project cannot be approved by the approving authorities, as the same is subject matter of public safety. The penalty can be classified as two types; one charged for violation of law in the nature of offence, which cannot be pardoned by compounding and the second is charged for violation of certain rules which are not in the nature of offences and can be cured by compounding. In the case of housing / commercial projects, the

corporations are aware that there will be certain deviations at the time of approval and no project can be completed without any deviation. The question is, the extent of deviation in a particular case. In case it is within the permissible limits, the approving authorities will allow with compounding the deviation by levying compounding fees. In the given case, the project was completed and the deviations are within the limits, for which the MCGM has approved the project by compounding fees, which is not in the nature of offence nor prohibition of any law. Hence, it is allowable under section 37(1) of the Act."

It is relevant to note that the Mumbai Tribunal has in the said order reproduced the above quoted observations from the decision of the Karnataka High Court in the case of *CIT vs. Mamta Enterprises (supra).*

It is relevant to mention that it is well-settled that the nomenclature used in any provisions of law to describe any payment, to be made by a person, as interest, compensation, penalty, etc., is not conclusive. The authorities will have to construe the provisions as a whole to find out the true nature of the impost sought to be levied, in certain cases, the impost may be composite comprising an element of compensatory nature as well as penalty. Further, the authorities dealing with the quantum of permissible deduction will also have to consider the provisions and determine as to how much of the amount would fall within the category of being compensatory and how much of it is penalty *[CIT vs. Bharat Television Pvt. Ltd. (1996) 218 ITR 173, 175-176 (AP)]*

CSR Expenses

Every company which satisfies one of the 3 conditions mentioned in section 135 of the Companies Act, 2013 is required to spend in every financial year at least 2% of the average net profits of the company, made during the three immediately preceding financial years towards pursuance of its CSR policy and also to constitute a CSR Committee. Schedule VII to the Companies Act, 2013 lists certain activities that may qualify as CSR activities.

Finance (No. 2) Act, 2014 has introduced *Explanation 2* to section 37(1) which states that for the purposes of section 37(1), expenditure incurred by companies on CSR as per section 135 of the Companies Act shall not be deemed to be expenditure incurred for the purposes of business or profession. The rationale for the same is given in the Memorandum to the Finance Bill as follows:-

1. CSR expenditure is application of income and hence not incurred wholly and exclusively for the purposes of business

2. CSR provisions are intended for corporates to share the burden of the Government in providing social service and allowance of such expenditure would amount to subsidizing one-third of such expenditure by the Government.

The Memorandum also clarifies that the CSR expenditure which falls under sections 30 to 36 would be allowed as deduction subject to fulfilment of conditions specified in those sections.

As a result of the insertion of *Explanation 2,* expenditure incurred by a company for CSR activities will not be allowed as a deduction under section 37(1) of the Act in the hands of the company while computing its income chargeable under the head `Profits & Gains of Business or Profession'. CSR expenditure is not to be allowed by *Explanation 2* to section 37(1) in the following cases –

(i) the expenditure falls within the scope of section 37(1); and

(ii) the expenditure incurred by the assessee is on activities referred to in section 135 of the Companies Act, 2013.

However, the company would be entitled to claim deduction of expenditure which is of the nature described in sections 30 to 36 if conditions specified therein are otherwise fulfilled. For instance, rent incurred on premises taken for carrying out CSR activities, would be allowed under section 30. It is relevant to note that while section 30 mentions "premises" it also mentions "for the purpose of business". Except for *Explanation 2* to section 37, such expenses on rent would be clearly allowable. Sections 30 to 36 do not have provision equivalent to Explanation 2 to section 37(1), expenses incurred under these sections even though relating to CSR activities can be said to be allowable. Apart from the mention in Explanatory Memorandum this view is also supported by the plain language of Explanation 2 which states "for the purposes of sub-section (1) of section 37". Similarly, depreciation on capital assets used for the purpose of carrying out CSR activities would be allowed.

A question may also arise about allowability of interest on borrowings for meeting CSR expenditure of revenue nature. Interest on borrowings is allowable under section 36(1)(iii) of the Act. Section 36(1)(iii) grants deduction in respect of amount of interest paid in respect of capital borrowed for the purposes of the business or profession. Here again, a question would arise as to whether such borrowings incurred for meeting CSR expenditure of a revenue nature qualify as "for the purposes of the business". The arguments mentioned in the context of section 30 would equally apply in the context of section 36(1)(iii) of the Act.

Incurring expenditure towards CSR activities by contributing to another entity which undertakes notified activities – Rule 4(2) of the Companies (Corporate Social Responsibility Policy) Rules, 2014 provides that the Board of a company may decide to undertake CSR activities approved by a CSR committee through a registered trust or a registered society or a company established under section 8 of the Companies Act, 2013 after complying conditions mentioned therein.

A company may contribute towards projects approved under section 35AC of the Act, if these projects are engaged in activities that qualify as CSR activities under the Companies Act, 2013. In the event a company contributes towards projects approved under section 35AC, it will be entitled to claim deduction under section 35AC subject to satisfaction of conditions mentioned therein.

In the event a company decides to contribute to a registered trust for undertaking CSR activities approved by a CSR committee and the trust to which contribution is a trust to which section 80G applies then the company will be entitled to claim deduction under section 80G subject to the limits and on satisfaction of the conditions mentioned in section 80G.

Conclusion

An attempt has been made to give a broad over-view of the provisions of section 37(1). The scope of the section and the variety of situations in which it is applicable and the plethora of case laws on this section is so vast that it is not possible to even mention them in an article. However, the above mentioned propositions would be a useful starting point to find solutions to the various situations faced regarding allowability or otherwise of a claim of deduction under section 37(1).

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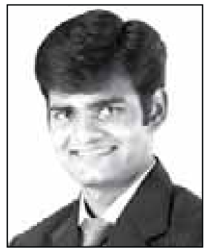

Dharan Gandhi, *Advocate*

Disallowances

Under the Income-tax Act, 1961 ('Act') income is bifurcated under Chapter IV of the Act dealing with 'Computation of the Total Income' in four specific heads viz. 'Income from Salaries', 'Income from House Properties', 'Profits and Gains of Business and Profession' and lastly "Capital gains' and a residuary head i.e., 'Income from Other Sources'. The scheme to arrive at the net income chargeable to tax under various heads broadly differs from each other. The idea of having separate heads of income was to have separate computation mechanism for different types of income depending upon the nature of income.

What is chargeable under the Act is income as distinguished from the gross receipts. For computing income, one has to reduce the expenditure/ deductions from the gross receipts. Each head of income has a charging provision and also has machinery provisions. The machinery provision or the computation mechanism broadly deals with computation of income and the expenses allowable therefrom to arrive at the net income chargeable to tax. While speaking of the head 'Profit and Gains of Business or Profession' i.e., Chapter IV-D of the Act, section 28 is the charging section, whereas the rest of the sections viz., section 29-44DB are machinery provisions.

Under the head Business Income, there are a number of sections which deal with allowability of deductions or expenditures like s. 36(1), 37 etc. Apart from these sections, there are also sections which disallow a particular expenditure/ loss on non-fulfilment of certain conditions. In the present article, I shall be dealing with disallowance provisions under the head 'Business Income' in brief and the current issues.

I may for the purpose of simplicity bifurcate the disallowance provisions in two parts as under:

i. <u>Disallowance due to non-fulfilment of conditions for allowability of expense</u> –

   Sections dealing with the allowability of expenses like section 36(1) or 37(1) etc. prescribe certain conditions for claiming deduction. For example, for allowability of expenses u/s. 37(1), the section prescribes that the same should not be capital in nature and should not be for personal purpose. If the conditions so prescribed are not satisfied, then the expenses are not allowable as deduction while computing business income. These sections are dealt with in detail in other articles.

ii. <u>Disallowance under specific sections like section 40, 40A and 43B</u> –

These set of sections kick in once the expenses have passed the test laid down in the allowability provision itself i.e., if the expenses are otherwise allowable under other provisions of the Act, then the same can be disallowed under these sections. We shall be dealing with these provisions in detail in the present article.

Disallowances under sections 40, 40A and 43B can further be differentiated in two categories viz., permanent disallowance or temporary disallowance. Permanent disallowance of any expenditure means a particular expenditure would never be allowed in any year whereas temporary disallowance would mean that the expenditure would be disallowed in a particular year but would be allowed in other year on fulfilment of conditions in that year.

Section 40

Section 40 provides for certain disallowances while computing business income. It overrides the provision of sections 30 to 38. Provisions of section 40 are summarised as under:

Non-compliance of TDS provision

Section 40(a)(i) disallows

i. any interest, royalty or fees for technical services or any other sum chargeable under this Act,

ii. which is payable either outside India or in India to a non-resident or a foreign company

iii. on which tax is deductible at source and which is non-deducted or if deducted, then the same is not paid on or before the due date of filing of return of income as specified u/s. 139(1).

However, if the tax is deducted in subsequent year or deducted in a year but paid after the due date specified u/s. 139(1), then the deduction of such expenditure would be allowed in the year in which the tax has been paid.

Section 40(a)(ia) disallows

i. 30% of any expenses being any sum payable to a resident on which tax is deductible at source

ii. where such tax is not deducted or if deducted, then the same is not paid on or before the due date of filing of return of income as specified u/s. 139(1).

However, if the tax is deducted in subsequent year or deducted in a year but paid after the due date specified u/s 139(1), then 30% of the deduction of such expenditure would be allowed in the year in which the tax has been paid.

Second proviso also states that where a person fails to deduct tax at source and the payee has paid tax and offered the income in his return of income then the tax shall be deemed to be have been deducted and paid in the year in which the return of income has been filed by the payee.

Section 40(a)(iii) disallows

i. any payment chargeable under the head salaries

ii. payable outside India or in India to a non-resident

iii. if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B.

All the above provisions disallow any expenditure on non-compliance with the TDS provisions. Though the fundamental thread running through all the provision is common but still the provisions are worded differently. There doesn't seem to be any logic in having separate wordings thereby giving different results for a common default.

The above referred sections would not apply in a case where TDS itself is not deductible under Chapter XVII-B of the Act. Therefore, the first and foremost defence for all the above clauses would be non-applicability of TDS provisions.

Section 40(a)(iii) is in the nature of a permanent disallowance whereas the other two are in the nature of temporary disallowance. Further, section 40(a)(i) and section 40(a)(ia) would apply in case of both the default viz., non-deduction and non-payment after deduction, whereas section 40(a)(iii) would apply in a case, where there is both non-deduction and non-payment of TDS. Thus, if there is deduction but no payment of TDS, then section 40(a)(iii) would not apply.

Section 40(a)(i) and 40(a)(iii), apart from applying to payments made to non-residents, also applies to all payments made outside India, including those made to residents. Section 40(a)(ia) would apply to any payments made to residents. However, those made to residents but outside India, in my view, would be governed by section 40(a)(i) and 40(a)(iii) being more specific in nature. Therefore, if salaries are paid to a resident but outside India and if there is failure to deduct tax at source, then the Department may contend that the same is governed by section 40(a)(iii) and not 40(a)(ia), in which case, the entire sum and not just 30% would be subject to disallowance which would be permanent in nature. On the flip side, one can also argue that where the tax is deducted and not paid then section 40(a)(iii) would not apply at all.

First proviso to section 40(a)(ia) which states that the deduction would be allowed in the year in which payment is made, if the TDS amount is paid after the due date of filing return of income is held to be retrospective by the Hon'ble Supreme Court[1]. Similar interpretation should apply to first proviso to section 40(a)(i) which was brought w.e.f. 1-4-2015 to similar effect. Also, second proviso to section 40(a)(ia) which gives relief to the assessee in case of payment of tax by the payee has been held to be retrospective by many courts[2]; though contrary view has been taken by Kerala High Court[3]. It is strange that there is no similar proviso in context of section 40(a)(i). However, in such a case, if the payee has paid the tax, one can rely upon first proviso to section 201(1) and the judgment of the Supreme Court in case of *Hindustan Coca Cola Beverage P. Ltd. vs. CIT*[4] to contend that no TDS is payable under Chapter XVII-B and therefore, no disallowance can be made u/s. 40(a)(i). Also, in case where payment is made to non-resident, one can contend that as a result of non-discrimination clause contained in the treaties, second proviso should apply to payments made to non-resident also[5].

The controversy whether provision of section 40(a)(ia) would apply to sum paid during the year has been settled by Hon'ble Supreme Court in case of *Palam Gas Service vs. CIT*[6]. Also, there are cases to the effect that where there is short deduction of tax at source, no disallowance u/s. 40(a)(ia) can apply[7]; though contrary view also has been taken[8].

In case, where the liability to deduct TDS arose as a result of retrospective amendment, then the Courts have consistently held that, no disallowance u/s. 40(a)(i) or 40(a)(ia) can be made[9].

1 404 ITR 654 (SC) CIT vs. Calcutta Export Co.
2 377 ITR 635 (Del) CIT vs. Ansal Landmark Township.
3 369 ITR 525 (Ker) Thomas George Muthoot vs. CIT
4 293 ITR 226 (SC)
5 384 ITR 0276 (Delhi) CIT vs. vs. Herbalife International India Pvt. Ltd.
6 394 ITR 0300 (SC)
7 361 ITR 432 (Cal) CIT vs. S.K. Tekriwal, 387 ITR 196(Kar) CIT vs. Kishore Rao & Others (HUF)
8 380 ITR 284 (Ker) CIT vs. P V S Memorial Hospital Ltd.
9 ITA No. 397 of 2015 (Bom) CIT vs. NGC Networks India P Ltd.

It would be interesting to note the findings of the Delhi High Court in case of *CIT vs. JDS Apparels Private Limited*[10]. In this case, the Court has applied the concept of 'doubtful penalisation' in context of section 40(a)(ia) of the Act. The Court has stated that section 40(a)(ia) is a penal provision and that in case of more than one construction/ interpretation, the provision of section 40(a)(ia) should not be applied.

Non-compliance of Equalisation Levy provision

Section 40(a)(ib) disallows

i. any consideration paid or payable to a non-resident for a specified services

ii. on which equalisation levy is deductible under Chapter VIII of Finance Act, 2016 and which is non deducted or if deducted, then the same is not paid on or before the due date of filing of return of income as specified u/s. 139(1).

However, if the levy is deducted in subsequent year or deducted in this year but paid after the due date specified u/s. 139(1), then the deduction of such expenditure would be allowed in the year in which the levy is paid.

The provisions of section 40(a)(ib) are similar to those contained in section 40(a)(i) of the Act.

<u>Disallowance of Taxes</u>

Section 40(a)(ii) disallows any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profit or gains. Explanations 1 and 2 to section 40(a)(ii) state that no deduction would be allowed in case of any tax payable in foreign country in respect of which relief is available u/s. 90 or 90A or 91.

Surcharge on income-tax is also a tax on profits or gains and therefore, not allowable. In this regard one can refer to judgment of Supreme Court in case of *CIT vs. K. Srinivasan*[11], wherein the court has laid down that the words 'income-tax' in the Finance Act of 1964 in sub-s. (2)(a) and sub-s. (2)(b) of s. 2 would include surcharge. However, recently, the Rajasthan High Court in case of *Chambal Fertilisers and Chemicals Ltd. vs. JCIT*[12] has held that Education Cess is not a tax and therefore, cannot be disallowed u/s. 40(a)(ii) of the Act.

Interest on late payment of TDS is sought to be disallowed by the AO either u/s. 40(a)(ii) or by relying upon *Explanation 1* to section 37(1). In so far as *Explanation 1* to section 37(1) is concerned, it disallows any expenses which is incurred for any purpose which is an offence or which are prohibited in law. Interest on late payment of TDS is neither incurred for the purpose of any offence nor is something which is prohibited in law. Interest payment is compensatory and not penal in nature[13]. In the context of VAT and service tax, there are number of cases wherein the Courts have laid down that interest on delayed payment cannot be disallowed under *Explanation 1* to section 37(1). In so far as application of section 40(a)(ii) is concerned, though normally, interest on tax is disallowed, however, the same should not apply to interest on late payment of TDS. TDS is tax paid on behalf of a third party. For the assessee it amounts to his normal business expenditure. Therefore, instead of making the entire payment to a party, part of it is given to the Government in discharge of the tax liability of such other party. Such payment of TDS itself is not disallowed u/s. 40(a)(ii). Therefore, there should arise no question of disallowance of interest on late payment of TDS u/s. 40(a)(ii). In this regard one can refer to the judgment

10 370 ITR 0454 (Delhi)

11 (1972) 83 ITR 0346 (SC)

12 Income Tax Appeal No. 52/2018

13 254 ITR 0799 (SC) Lachmandas Mathuradas vs. CIT

of the Kolkata Tribunal in case of *DCIT vs. M/s Narayani Ispat Pvt. Ltd.*[14], wherein interest on late payment of TDS has been held to be allowable.

Foreign taxes paid are not allowable u/s. 40(a)(ii) only to the extent relief of double tax is allowable u/s 90, 90A or 91. Thus, any foreign tax in respect of which double tax relief is not allowable, deduction can be claimed while computing business income[15].

Payment to partners /members of Firms/ AOP

Disallowance in the case of firm [Section 40(b)]
Interest paid to a partner by a firm is deductible only when it is authorised by and is in accordance with the partnership deed and it relates to a period falling after the date of the partnership deed. Further, such deduction would not exceed 12% p.a. simple rate of interest.

Any amount paid by way of salary, bonus, commission or remuneration by a firm to a partner is allowable in computing the income of the firm only in a case where the same is authorised by and is in accordance with partnership deed and it relates to a period falling after the date of the partnership deed. Further, such sum should be paid to a working partner of the firm. Section 40(b) also prescribes the following monetary limits for allowing deduction in respect of the said payments:

Book Profits	Remuneration (as a % of Book Profits)
On the first ` 3 lakh or in case of a loss	` 1,50,000 or 90% whichever is higher
On the balance book profit	60%

Once the expenditure in the nature of interest, salary, bonus, commission or remuneration by a firm to a partner is allowable u/s. 40(b), then the same cannot be disputed u/s. 40A(2) on the grounds of reasonableness[16]. Only net amount paid by firm to a partner after adjusting interest paid by him to firm, should be disallowed u/s. 40(b)[17]. Payments to partners for specific services can also be disallowed u/s. 40(b)[18].

Disallowance in the case of association of persons and body of individuals [Section 40(ba)]
Any payment by way of interest, salary, bonus, commission or remuneration paid by an association of persons or body of individuals to any of its members shall be disallowed. However this provision is not applicable in case of AOP in the nature of a company or a co-operative society or a society registered under the Societies Registration Act.

As per the *Explanation 1* to this section, if the member receives any interest from the AOP or BOI and he also pays interest to the AOP or BOI during the same previous year, only the net excess interest paid by the AOP to such member should be disallowed.

Section 40A

Section 40A deals with expenditure or payments which are not deductible in certain circumstances. Section 40A(1) states that the provision of this section would apply notwithstanding anything contained in any other provisions in the Act dealing with computation of business income. The provisions of section 40A are discussed below:

Excessive or unreasonable expenditure - 40A(2)
If an AO is of the opinion that any expenditure incurred by any assessee, in respect of which payment has been or is made to any related person as defined in clause (b) of section 40A(2),

14 ITA No. 2127/Kol/2014
15 390 ITR 0271 (Bom) Reliance Infrastructure Ltd. vs. CIT
16 351 ITR 156(All) CIT v. Great City Manufacturing Co.
17 183 ITR 1 (SC.) Keshavji Ravji & Co. v. CIT
18 161 Taxman 52 (Mad) CIT vs. Srinath Productions

is excessive or unreasonable having regard to the following:

a. fair market value of the goods or services or facilities or

b. legitimate needs of the business or profession of the assessee or

c. benefits derived or accruing therefrom

then he may disallow so much of the expenditure as is considered excessive or unreasonable.

From the wordings of section 40A(2), one thing becomes very clear that any disallowance u/s. 40A(2) has to be made by the AO himself. He has to form an opinion that the expenditure was excessive or unreasonable. This disallowance is in the nature of permanent disallowance. Further, in such cases, where disallowance is made in the hands of the payer, no credit or benefit is available to the payees.

For disallowance under this clause, the AO has to form an opinion that the expenditure was excessive or unreasonable. There has to be some basis for his opinion and the AO cannot disallow any expenditure on an ad-hoc basis. Under normal scenario, the Courts have ruled that an AO cannot decide as to which expenditure is reasonable or which expenditure is necessary for the business. However, section 40A(2) gives specific power to the AO to do so, but within the four corners of law. Thus, the AO cannot extend the provisions of this section to disallow any expenditure on the ground of reasonableness where payment is made to a party not covered by section 40A(2)(b). Also, the section cannot be applied to tax any income received from any related party, where the AO finds that the income received is less that the fair market value of the goods or services supplied.

The main purpose of this section was to avoid tax arbitrage by shifting income from one person to another. Therefore, the Courts have held that where there is no question of any tax advantage as a result of same tax rate in case of recipient and the payer, then no disallowance can be made u/s. 40A(2).[19]

Issue of disallowance u/s. 40A(2) travelled up to the Hon'ble Supreme Court and it held in case of *CIT vs. Glaxo SmithKline Asia (P) Ltd.*[20] that transfer pricing provisions should be applied for domestic transactions also. Accordingly, amendment was brought out in transfer pricing provisions, wherein section 92BA was inserted which defined specified domestic transaction to include any expenditure in respect of which payment is made or has to be made to a person referred to in section 40A(2)(b). The said amendment was brought out w.e.f. 1-4-2013. Correspondingly, a proviso was inserted in section 40A(2)(a) of the Act to the effect that no disallowance u/s. 40A(2) would be made if the expenditure incurred is at ALP as per section 92F of the Act. The applicability of transfer pricing provision to domestic transaction as given in section 40A(2) of the Act was ceased w.e.f. AY 2017-18 by Finance Act, 2017. Thus, the position prior to the amendment would prevail w.e.f. AY 2017-18. The Bangalore Bench of the Tribunal in case of *Texport Overseas Pvt. Ltd. vs. DCIT*[21] has held that the amendment brought in by Finance Act, 2017 would apply retrospectively. Thus, it held that expenditure governed by section 40A(2) would be outside the purview of transfer pricing provisions since 1-4-2013, i.e. the first day since the transfer pricing provisions were made applicable.

Even otherwise if it is held that transfer pricing provisions applied to domestic transactions of the nature referred to in 40A(2) of the Act for

19 310 ITR 30 (Bom) CIT v. Indo Saudi Services (Travel) (Pvt.) Ltd.

20 236 CTR 113 (SC)

21 IT(TP)A No. 1722/Bang/2017

3 years i.e., AY 2013-14 to AY 2016-17, still the fundamental principle of no adjustment in case of revenue neutrality should apply.

Cash expenses – 40A(3) and 40A(3A)

Section 40A(3) disallows any expenditure in respect of which a payment or aggregate of payment made to a person in a day exceeds ` 10,000/- and that such payment has been made other than by way of account payee cheque or bank draft or use of electronic clearing system. Further, section 40A(3A) states that where a deduction of any expenditure has been claimed in a year based on accrual basis however, the payment or the aggregate of payment made to a person in a day in respect thereof is made by a mode other than account payee cheque or bank draft or use of electronic clearing system in excess of ` 10,000/-, then such amount would be added to the total income of the assessee in the year in which such payment is made. The limit of ` 10,000/- has been made w.e.f. AY 2018-19 and prior to that the limit was ` 20,000/-.

Proviso to section 40A(3A) states that no disallowance u/s. 40A(3) or 40A(3A) would be made in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors. Relevant exceptions are contained in Rule 6DD.

Further, in case of payment of leasing or hiring of goods carriage the monetary limit applicable for cash payment is ` 35,000/-.

Section 40A(3) or 40A(3A) is in the nature of permanent disallowance and it applies *qua* each expenditure. Therefore, for each expenditure one has to look at the payment or aggregate payment made in a day. For two different expenditure, if the payment is made to same person and if the payment made in cash does not exceed the limit as prescribed *qua* each expenditure though cumulatively it exceeds, then no disallowance can be made. Further, for an item of expenditure, if payments made are on different days and that on each day, the payment does not exceed the limit specified, no disallowance can be made.

Rule 6DD lays down various instances where even though the conditions of section 40A(3) or 40A(3A) are not fulfilled still no disallowance would be made. All the exceptions currently in the statute book are specific instances and there is no general exception to the effect that if the circumstances of the case justify payment in cash, then no disallowance could be made. Earlier Rule 6DD(j) used to provide for an exception in cases where the assessee satisfies the ITO that the payment could not be made by a crossed cheque drawn on a bank or by a crossed bank draft due to exceptional or unavoidable circumstances, or because payment in the manner aforesaid was not practicable, or would have caused genuine difficulty to the payee, having regard to the nature of the transaction and the necessity for expeditious settlement thereof, and also furnishes evidence to the satisfaction of the ITO as to the genuineness of the payment and the identity of the payee.

Provision for expected losses and MTM Loss – 40A(13)

To overcome the findings of the Delhi High Court in case of *CTC vs. UOI*[22], the Finance Act, 2018, has brought two amendments. Clause (xviii) is inserted in section 36(1). The said clause allows marked-to-market loss and other expected loss as computed in accordance with the ICDS notified u/s. 145(2). Further, sub-section (13) was inserted in section 40A, wherein it is provided that no deduction or allowance shall be allowed in respect of any marked-to-market loss or other expected loss, except as allowable u/s. 36(1)(xviii). To put it simply, if there is no specific allowance of any loss under ICDS, or where the ICDS specifically denies allowance of any such loss, the same is not to be allowed as per section 40A(13).

22 400 ITR 178 (Del)

43B

Section 43B of the Act starts with a *non-obstante* clause and it states that a deduction otherwise allowable under this act as specified in the section would be allowed only if actual payment has been made in respect of those expenditure upto the due date of filing of return of income. It covers inter-alia, the following expenditures:

a. any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force

b. any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees,

c. any sum payable by the assessee as interest on any loan or borrowing from a scheduled bank or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

This section is in the nature of temporary disallowance and it allows deduction in the year in which actual payment is made.

Taxes payable would also include any taxes in respect of which liability has been incurred for payment thought no payment is due under the relevant law.

The Bombay High Court has held that section 43B would apply only in a case where deduction is otherwise claimed by the assessee[23]. Thus, the Department cannot add any liability in respect of any expenditure to the total income of the assessee where the assessee has not claimed any deduction.

Recently, Hon'ble Supreme Court[24] has held that deduction would be allowed in respect of advance deposit of central excise duty notwithstanding the fact that adjustments from such deposit were made on subsequent clearances/removal effected from time-to-time. Thus, even where the expenses are not allowable under mercantile system of accounting, the same can be claimed as deduction u/s. 43B on payments.

It is also to be noted that the above sections apply in a case where specific deduction of any expenditure or allowance is claimed. In case of expenditure which are capital in nature and which are capitalised and no deduction is claimed, the Department cannot disallow capitalisation of such expenditure. In fact, where the Legislature intended, necessary amendment was made in the Act like insertion of proviso to section 43(1) to the effect that where any asset is purchased and payment for which is made in cash above ` 10,000/- in a day to a person, then such cash payments cannot be capitalised. In absence of any other specific provision, capitalisation cannot be disallowed by applying section 40, 40A or 43B. Further, even these section cannot be applied to disallow depreciation on such capital expenditure[25]. Where the income of a person is computed based on some estimate or some other criteria and where the normal provisions of the Act are not applied, then Courts have held that no disallowance u/s. 40, 40A or 43B is justified[26].

The above was an attempt to highlight in brief the provisions of the section and some of the current issues.

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23 290 CTR 25 (Bom) CIT vs. Knight Frank India Pvt. Ltd.

24 400 ITR 1(SC) CIT vs. Modipon Ltd.

25 358 ITR 0043 (P&H) CIT vs. Mark Auto Industries Ltd.

26 229 ITR 0229(All) CIT vs. Banwari Lal Banshidhar

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Section 14A – Recent Trends

Prior to insertion of Section 14A, the law pertaining to deductibility of expenditure in relation to exempt income was laid down by various cases. Nonetheless, insertion of section 14A was triggered due to Apex Court in the case of *Rajasthan Warehousing Corpn vs. CIT [2000] 242 ITR 450 (SC).* The Apex Court held that in case the assessee is carrying on business which is yielding taxable as well as exempt income, the whole expenditure is deductible if the Assessee has a composite and indivisible business. However if the business was divisible, the principle of apportionment of expenditure will apply.

Section 14A was inserted by the Finance Act 2001 with retrospective effect from 1st April 1962. It provides that for computing the total income under Chapter IV of the Income-tax Act, 1961 ('the Act'), no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income that does not form part of the total income under this Act. Incomes which do not form part of the total income are contained in Chapter III of the Act.

The provisions as inserted by the 2001 amendment however did not provide for any method of computing the expenditure incurred in relation to income which does not form part of the total income. Consequently there was dispute between the taxpayer and the department on the method of determining such expenditure. Accordingly sub-section (2) & (3) of Section 14A were inserted *vide* Finance Act 2006. Sub-section (2) of Section 14A deals with proportionality as it empowers the AO to extricate that amount of expenditure which is incurred in relation to such exempt income. However, this working is to be done in accordance with such method as may be prescribed. Rule 8D of the Income Tax Rules, 1962 ('the Rules') was prescribed, which was inserted w.e.f March 24, 2008. There was huge controversy on whether this Rule was retrospective in nature or not. The same has been put to rest by the Apex Court in the case of *CIT vs. Essar Teleholdings Ltd [2018] 401 ITR 445 (SC),* wherein the court has held it to be prospective in nature, applicable from AY 2008-09 onwards. The issue whether Rule 8D should be applied on for balance 8 days i.e., from 24th March, 2008 to 31st March, 2008 was neither argued nor discussed in the said case, and the Supreme Court has held that the Rule 8D is prospective in operation and could not have been applied to any assessment year prior to Assessment Year 2008-09.

There have been various controversies surrounding section 14A read with Rule 8D, some of which are listed below:

1) Disallowance in case no exempt income is earned

2) Restriction of disallowance to exempt income earned

3) Recording of satisfaction by the AO
4) Applicability to strategic investment – held for control purpose
5) Applicability to stock-in-trade
6) Applicability while computing book profits u/s. 115JB
7) Restriction of disallowance to actual expenditure incurred

Section 14A read with Rule 8D has been one of the most litigated issues. On January, 2016, the Income tax simplification committee headed by Justice R. V. Easwar in their report observed that 15% of tax litigation was attributable to section 14A and Rule 8D. Hence to reduce the litigation few of the recommendations were accepted which led to amendment in Rule 8D which was applicable from Assessment year 2017-18 onwards. In this article we make an attempt to discuss the issues in light of judicial precedents and the amended Rule 8D.

1. Disallowance in case no exempt income is earned

Tax is imposed on 'income'. The term 'income' is different from gross receipts/sales and hence only the balance or say the residue which is brought to tax. Accounting principles play critical role, which also imbibes matching concept. Section 14A states that "no deduction shall be allowed in respect of expenditure incurred in relation of income which does not form part of total income". Relying on these words an argument has been raised that unless there is exempt income in a particular year, section 14A cannot be triggered to make any disallowance for that year. There was a big controversy around this issue that whether any disallowance under section 14A can at all be made in a year wherein no exempt income is received by the Assessee. Divergent views were taken by different Tribunals and High Courts. The Special Bench of the Tribunal in *Cheminvest Ltd. vs. ITO (2009) 121 ITD 318 (Del)(Trib)(SB)* held that disallowance has to be made irrespective of the fact whether exempt income was earned or not. Since there were a few High Court decisions which held otherwise, the CBDT issued Circular No. 5 dt. 11th February 2014 which mandates disallowance even in cases where there is no exempt income. In the meanwhile the decision of Special Bench was reversed by the *Delhi High Court in (2015) 378 ITR 33 (Del)(HC).*

The Revenue in *CIT vs. IL&FS Energy Development Co. Ltd. (2017) 399 ITR 483 (Del)(HC)* argued that the circular was not considered in the earlier judgments. To this the High Court held that CBDT circular cannot override the express provisions of section 14A and Rule 8D. It further held that merely because tax auditor suggested some disallowance, it cannot be a ground to make disallowance where there was no exempt income earned.

Regardless of the above decision the Amritsar ITAT has recently held otherwise. In *Lally Motors India (P.) Ltd. vs. PCIT [2018] 93 taxmann.com 39 (Amritsar – Trib.)* the AO queried the Assessee on applicability on Section 14A, to which the assessee replied that it had not earned any exempt income during the year. The AO relying on the decision of Delhi High Court in the case of *Cheminvest Ltd. vs. CIT (supra.)* accepted the contention of the assessee. Revision u/s. 263 was initiated since the AO had not followed Circular No. 5 of 2014 issued by the board. Further in the given case the assessee had negative net worth, borrowed funds were utilized for making some strategic investments and administrative expenses were also debited to the P/L. The ITAT upheld the order passed u/s. 263 and on merits held as follows:

- Circular 5 of 2014 has not been set aside or stayed by the jurisdictional High Court of the Apex Court.
- The ITAT relied on Supreme Court decision in the case of *CIT vs. Walfort Share & Stock Brokers (P.) Ltd [2010] 326 ITR 1 (SC),* and observed that the issue is not if the income not forming the part of the total income (the tax-exempt income) is earned or not, but if expenditure relatable to such income has been incurred. If such expenditure stands incurred, section 14A(1) becomes applicable.

- The ITAT further made reference to the decision of Supreme Court in the case of Maxopp (Supra) stating that, the uncertainty of earning the dividend income, or of it being earned incidentally, was also noted by it, though considered to be irrelevant. It was immaterial if dividend income was actually earned or not, which, rather, may be a consideration where the shares, as in the present case, are held to retain control over the investee company, i.e., for strategic reasons, as was the case with regard to the investment by Maxopp Investment Ltd. - one of the Assessee in that case.

It would be worth noting that in *CIT vs. Chettinad Logistics (P.) Ltd. [2018] 95 taxmann.com 250 (SC)*, the Supreme Court has recently dismissed the SLP filed by the department on delay as well on merits. The SLP was against the decision of Madras High Court which held that where no exempt income is earned in the previous year, provision of Section 14A could not be invoked. This decision was not brought to the notice of the Amritsar Tribunal in the case of Lally Motors (Supra). This decision could thus put an end to the controversy.

Other Recent Judgements

The following are some recent judgments holding that no disallowance under section 14A can be made in absence of exempt income earned during the year.

- *PCIT vs. Ballarpur Industries Limited [ITA 51 of 2016 (Bom-HC)]*
- *Finquest Securities Pvt. Ltd. vs. ACIT [ITA 2540/Mum-2017]*
- *ACIT vs. Shyam Indus Power Solutions (P.) Ltd [2018] 90 taxmann.com 424 (Delhi–Trib.)*
- *Rajmal Lakhichand vs. JCIT [2018] 92 taxmann.com 94 (Pune–Trib.)*
- *Delhi International Airport (P.) Ltd vs. DCIT [2018] 93 taxmann.com 228 (Bangalore - Trib.)*
- *DCIT vs. BPL Ltd. [ITA 132/Bang-2018]*

Computation under rule 8D (ii)

As per revised Rule 8D (ii) disallowance for administrative and indirect expenses is done at an *ad hoc* 1% of annual average value of investment. Applying the above principle average value should be of investments that yield exempt income as against entire lot of investments. While Special Bench in case of *CIT vs. Vireet Investment (P) Ltd. (2017) 165 ITD 27 (Del.)(Trib.)(SB)* held that only those investments are to be considered for computing average value of investment which yielded exempt income during the year while computing under erstwhile Rule 8D. This logic would equally be applicable for revised Rule 8D(ii).

2. Restriction of disallowance to exempt income earned

Extending the argument of no disallowance in case of no exempt income, in few cases it has been held that disallowance if any would be restricted to the extent of exempt income earned.

This situation arises when AO makes disallowance adopting Rule 8D in excess of the dividend income earned by the assessee. The expenditure for earning exempted income has to have a reasonable proportion to the income, so earned, going by the common financial prudence. The disallowance under Section 14A cannot be a wild guesswork bereft of ground realities. It has to have a reasonable and close nexus with the factually incurred expenses. It is not deemed disallowance under Section 14A of the Act, but an enabling provision for assessing authority to compute the same on the given facts and figures in the regularly maintained books of account.

The Delhi High Court in the case of *Joint Investments (P.) Ltd. vs. CIT [2015] 372 ITR 694 (Delhi)* held that by no stretch of imagination can Sec 14A or Rule 8D be interpreted so as to mean that the entire tax exempt income is to be disallowed. The window for disallowance is indicated in s. 14A, and is only to the extent of disallowing expenditure "incurred by the assessee in relation to the tax exempt income". This proportion or portion of the tax exempt income surely cannot swallow the entire amount. This decision has thus been followed in a plethora of cases to restrict the disallowance to the exempt income earned by the assessee. In fact in a few cases the assessee had himself made disallowance exceeding the exempt income, but on additional ground being raised, the Tribunal allowed the claim of the Assessee. A few recent decisions of the Tribunal are listed below:

- *ACIT vs. Golden Life Financial Services Pvt. Ltd. [ITA 3053/Mum-2016]*
- *Gold Seal Engineering Products P. Ltd. vs. ACIT [ITA 6259/Mum-2016]*
- *Strides Shasun Limited vs. ACIT [ITA 8614/Mum-2011]*
- *Mangal Keshav Securities Ltd. vs. DCIT [ITA 209/Mum-2017]*
- *DCIT vs. Mirc Electronics Limited [ITA 3845/Mum-2018]*

3. Recording of satisfaction by the AO

It can be seen from sub-section (2) of section 14A that disallowance can be made only if the Assessing Officer is satisfied that the amount claimed by the assessee incurred for earning exempt income, is not correct. Satisfaction has to be constructive/objective and must be based on reasons and not just an empty formality. Further the section mandates that such satisfaction should be formed having regards to the accounts of the assessee. The Bombay High Court in case of *Godrej and Boyce Mfg. Co. Ltd. vs. DCIT (2010) 328 ITR 81 (Bom)(HC)* had held that this safeguard introduced for a fair and reasonable exercise of the power by the assessing officer, conditioned as it is by the requirement of an objective satisfaction, must, therefore be scrupulously observed. An objective satisfaction contemplates a notice to the assessee, an opportunity to the assessee to place on record all the relevant facts including his accounts and recording of reasons by the Assessing officer in the event that he comes to the conclusion that he is not satisfied with the claim of the assessee.

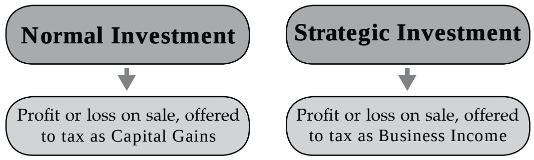
The Delhi High Court in case of *Maxopp Investment Ltd. vs. CIT (2012) 347 ITR 272 (Del.)(HC)* has held that the requirement of the AO embarking upon a determination of the amount of expenditure incurred in relation to exempt income would be triggered only if AO returns a finding that he is not satisfied with the correctness of the claim of the assessee. While confirming this aspect, the Apex Court in *Maxopp Investment Ltd. vs. CIT (2018) 402 ITR 640 (SC),* held that before applying the theory of apportionment, the AO needs to record satisfaction that having regard to the kind of assessee, *suo motu* disallowance under section 14A was not correct. It will be in those cases where the assessee in his return has himself apportioned but the AO was not accepting such apportionment, and in that eventuality AO will have to record his satisfaction to this effect.

Recently the Mumbai Tribunal in case of *Wadhwa Residency (P.) Ltd. vs. Add. CIT [2018] 95 taxmann.com 294 (Mumbai – Trib.)* made reference to the decision of Supreme Court in the case of Maxopp (*Supra*) and held that when the assessee claims that no part of expenditure is relatable to exempt income, then the AO has to record his satisfaction, and since this was not done the disallowance made u/s. 14A was deleted.

4. Applicability to strategic investment

Investments in subsidiaries/associate companies are usually to acquire stake / controlling interest. These decisions are from a larger business and commercial standpoint and not to simply earn dividend income, which otherwise is incidental to such investment. Disallowance u/s. 14A was one of the pain point for various corporate groups and strong objection raised before the AO that no disallowance be made in case of strategic investments.

Recently the Apex Court in case of *Maxopp Investment Ltd. vs. CIT (2018) 402 ITR 640 (SC)* has touched upon this issue. The assessee Company was engaged in the business of finance, investment and dealing in shares & securities. The assessee held the shares/securities in two portfolios as follows:



The assessee had earned dividend during the year and had also debited interest expenditure to the profit and loss account. In relation to strategic investment, no part of interest was considered disallowable u/s. 14A on the ground that shares were acquired for retaining controlling interest and not with the motive to earn dividend. The AO however worked out disallowance by apportioning the interest in the ratio of investment made for strategic purpose, however restricting the disallowance to the amount of dividend received during the year. The CIT(A), ITAT upheld the action of the AO. The Delhi High Court concurring with the same view, held that 'in relation to' appearing in Section 14A was synonymous with 'in connection with' or 'pertaining to' and the provisions of the section will apply regardless of the intention/motive behind making the investment. The Apex Court noted that the Punjab and Haryana High Court in the case of *CIT vs. State Bank of Patiala [2017] 78 taxmann.com 3 (P&H HC)* had taken a view which runs contrary to the view taken by the Delhi High Court. In the said case the Assessee was holding investment as stock-in-trade. Considering the various conflicting decisions, appeals of the assessee and revenue were before the Apex Court. It was argued of behalf of the assessee that the dominant object is to keep control over the management of the company and not to earn the dividend from investment in shares. Whether dividend is declared/earned or not is immaterial and, in either case, the Assessee would not liquidate the shares in investee companies. Therefore, no expenditure was made 'in relation to' the income i.e., the dividend income and, therefore, Section 14A would not be attracted. In the rebuttal, the department argued that the expression 'in relation to' has to be given expansive meaning in order to sub-serve the purpose of the said provision. It emphasised that literal meaning of Section 14A of the Act pointed towards that and that was equally the purpose behind the insertion of Section 14A as well.

The Apex court held that the expenditure alone which has been incurred in relation to the income which is includible in total income that has to be disallowed and that there is no quarrel in assigning this meaning to Section 14A of the Act. The entire dispute is as to what interpretation is to be given to the words 'in relation to' in the given scenario, viz. where the divided income on the shares is earned, though that was not the dominant purpose for subscribing in those shares.

The Apex Court has held that the dominant purpose test for which the investment into shares is made, may not be relevant. The fact remains that such dividend is non-taxable. In such a scenario, if expenditure is incurred on earning dividend income, then that much of the expenditure which is attributable to the dividend income has to be disallowed and cannot be treated as business expenditure.

Thus this issue has now been put to rest by the Apex court holding that 14A disallowance is applicable to strategic investments as well.

5. Applicability to stock-in-trade

Where shares are held as 'stock-in-trade'; it becomes a business activity of the assessee to deal in those shares as a business proposition. The intention is to earn appreciation and thus whether dividend is earned or not becomes immaterial. In fact, it would be a quirk of fate that when the investee company declared dividend, those shares are held by the assessee, though the assessee has to ultimately trade in those shares by selling them to earn profits. The question arose as to whether 14A applies to such shares held in stock in trade. Further Rule 8D talks about investments and since these are stock in trade, rule 8D cannot be applied at the threshold.

While hearing the case of Maxopp (supra) few department appeals against State Bank of Patiala were tagged and heard together. The Apex court noted that in CIT v. State Bank of Patiala (supra.), the Assessee was holding investment as stock in trade. The AO computed disallowance by applying Rule 8D, however restricted the disallowance to the exempt income. The CIT(A) enhanced the disallowance and disallowed the entire expenditure instead of restricting it to exempt income as done by the AO. The ITAT set aside the orders of the AO and CIT(A) in favour of the Assessee. The High Court concurring with the view of the ITAT, held that the Assessee did not hold the securities to earn dividend or interest, but traded in them, earning profit/loss which was offered to tax as business income. The dividend or interest accruing thereon was only a by-product thereof or an incidental benefit arising therefrom and would not, therefore, be subject to the provisions of section 14A.

Though the department appeals in State bank of Patiala were dismissed, Supreme court did make few divergent observations. The Court observed that while profits are treated as business income in case of shares held as stock in trade, in the process, certain dividend is also earned, though incidentally, which is also an income. However, by virtue of Section 10 (34) of the Act, this dividend income is not to be included in the total income and is exempt from tax. This triggers the applicability of Section 14A of the Act which is based on the theory of apportionment of expenditure between taxable and non-taxable income. Therefore, to that extent, depending upon the facts of each case, the expenditure incurred in acquiring those shares will have to be apportioned.

Having observed as above, the Supreme Court though stating that, it is not subscribing to the theory of dominant intention applied by the High Court, held that where shares are held as 'stock-in-trade', it becomes a business activity of the Assessee to deal in those shares as a business proposition. Whether dividend is earned or not becomes immaterial.

The Supreme Court distinguished the fact of Maxopp by stating that in case of strategic investment, the Assessee would continue to hold those shares as it wants to retain control over the investee company. In that case, whenever dividend is declared by the investee company that would necessarily be earned by the Assessee and the Assessee alone. Therefore, even at the time of investing into those shares, the Assessee knows that it may generate dividend income as well and as and when such dividend income is generated that would be earned by the Assessee. In contrast, where the shares are held as stock-in-trade, this may not be necessarily a situation, the main purpose is to liquidate those shares whenever the share price goes up in order to earn profits.

Surprisingly the SC on one hand i.e. for strategic investments, has ruled that 'dominant purpose test' is not relevant but has ruled in favour of the assessee on the issue of shares held as 'stock in trade', which is nothing but based on the dominant purpose test.

Be as it may be, the Supreme court ultimately dismissed the departmental appeals where shares were held as stock in trade. Though there may be a different views possible, an analogy on the fact that Supreme Court dismissed the departmental appeals, would be that 14A should not apply to shares held as stock-in-trade.

Thus, in stock in trade situations, the question of application of rule 8D does not arise. However, even for the sake of argument and without following the binding ratio of the supreme court in Maxopp, Rule 8D itself does not consider, stock in trade while computing the disallowance as the calculation is based on average of investments and not average of shares (held either as investments or stock in trade). Hence unless there is any direct expense incurred for shares held as stock in trade no disallowance can be made under Rule 8D irrespective of the ruling of Supreme Court in Maxopp(Supra). Further Supreme Court while making divergent observation had specifically stated that apportion should be made only for shares which earn dividend income and not all shares.

6. Applicability while computing book profits u/s. 115JB

Section 115JB provides to tax deeming income i.e., by considering book profits as income. Clause (f) in the *Explanation* to section 115JB states that expenditure which relate to exempt income should be added back while computing book profits. However there was no computation mechanism provided in 115JB and hence the department started disallowing amount computed u/s. 14A, while arriving at book profits. The issue arose as to whether 14A disallowance can be made while computing such book profits or separate mechanism be applied. Since there were conflicting views of the various decision, a Special Bench was formed to address this issue. The Special bench in *CIT vs. Vireet Investment (P) Ltd. (2017) 165 ITD 27 (Del.)(Trib.)(SB)* held that calculation under 115JB is to be made without resorting to computation as contemplated u/s. 14A read with Rule 8D.

7. Restriction of disallowance to actual expenditure incurred

In many cases, the assessing officer computed the disallowance u/s. 14A which exceeded the actual expenditure incurred. The above issue arose when the Assessing officer applied erstwhile rule 8D. The Gujarat High Court in case of *PCIT vs. Adani Agro (P.) Ltd [2018] 91 taxmann.com 29 (Gujarat)* has held that under no circumstances, the AO can attribute administrative expenses for earning tax free income in excess of total administrative expenditure. There are quite a few decisions on laying down similar ratios.

The legislature has tried to settle this issue. Proviso to the amended Rule 8D states that the amount shall not exceed the total expenditure claimed by the assessee. However, the proviso uses the words "total expenditure claimed" instead of "actual expenditure incurred and claimed towards exempt income".

Example

Suppose an assessee has incurred total expenditure of ` 8,00,000/- as follows :

Particulars	Amount
Expenditure directly relatable to taxable income	4,00,000/-
Interest @ 10%	1,00,000/-
Other expenses	3,00,000/-
Total expenditure	**8,00,000/-**

The amount computed as per revised Rule 8D is ` 5,00,000/-. In such a scenario the AO will disallow the entire ` 5 lakh stating that it is less than the total expenditure of ` 8 lakh.

In our opinion the following stands may be taken, while computing the 'total expenditure' to apply the proviso to Rule 8D(2):

- Expenditure which is directly relatable to taxable income i.e. ` 4 lakh, should be excluded – It is based on the same logic, that such expenditure goes out at the stage of Rule 8D(2)(i) itself.
- Interest expense of ` 1 lakh could be excluded
  - if the same pertains for some specific purpose, not in relation to earning exempt income or
  - if one can prove that it has sufficient own funds in excess of the investment made.

In such case, the maximum disallowance should be restricted to ` 3 lakh.

Hence the proviso is not free from doubts and still cause litigation.

Conclusion

Though most of the issues have been settled and streamlined either by the judicial precedents or amendments to simplify, there could be instances in which judicial intervention may be required despite of the amended Rule 8D.

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CA Devendra Jain

Analysis of Section 41(1) & issues arising therefrom

1. Introduction

The profits & gains of any business or profession carried on by the assessee at any time during the previous year is chargeable to tax u/s. 28 of the Income-tax Act, 1961 (hereinafter referred to as the Act). However, the definition of income u/s. 2(24) includes *inter alia*, any sum chargeable to income tax u/s. 41 within its ambit by virtue of sub- clause (v). This enlarged definition of income u/s. 2(24) gives extended meaning to the normal connotation of the term "income". Section 41 is a deeming fiction which considers certain amounts or benefits as profits & gains of business or profession irrespective of the actual existence of business or profession in that year. The present article attempts to analyse the provisions of section 41(1) and the issues arising therefrom.

2. Ingredients of section 41(1)

2.1 Where deduction has been made in respect of loss, expenditure or trading liability for any year and subsequently, the assessee has obtained any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained or the value of benefit accrued shall be deemed to be income under this head, even if the business or profession has been discontinued.

2.2 Thus following conditions are required to be fulfilled for applicability of section 41(1):

(1) In the course of assessment for an earlier year, allowance or deduction has been made in respect of any loss or expenditure or trading liability incurred by the assessee;

(2) Subsequently, some amount is obtained in respect of such loss or expenditure or some benefit is obtained in respect of such trading liability by way of remission or cessation thereof during the year in which such event occurred;

(3) In that situation the amount obtained or the value of the benefit accruing to the assessee is deemed to be the profits and gains of business which otherwise would not be his income;

(4) Such amount or value of the benefit is made chargeable to income-tax as the income of the previous year in which such benefit was obtained. *[Chief CIT vs. Kesaria Tea Co. Ltd. [2002] 122 Taxman 91 (SC).]*

2.3 The provisions are applicable even to the successor in business who receives the amount/ benefit. The 'successor in business' for this purpose means –

(a) Where there has been an amalgamation of a company with another company, the amalgamated company;

(b) Where any person is succeeded by another person in carrying on the business or profession, such other person;

(c) Where a firm carrying on a business or profession is succeeded by another firm, such other firm;

(d) Where there has been a demerger, the resulting company.

2.4 Thus, two situations are visualized after a person has been allowed a deduction or allowance in respect of a loss, expenditure or trading liability. First is the situation where the person or his successor in business has obtained in cash or in any other manner whatsoever any amount in respect of such loss or expenditure. In simple terms, the person or successor has received a reimbursement for the loss suffered by it or expenditure incurred by it. It is irrelevant whether the receipt is subject to further litigation or not. Hon'ble Supreme Court in *Polyfex India (P.) Ltd. vs. CIT [2002] 124 Taxman 373 (SC)* explained the above situation as below-

Once the assessee gets back the amount which was claimed and allowed as business expenditure during the earlier year, the deeming provision in section 41(1) comes into play. It is not necessary that the Revenue should await the verdict of higher court or the Tribunal. If the court or the Tribunal upholds the levy at a later date, the amount so paid will be allowed as deduction under section 43B on "payment" basis.

The second situation is where the person or his successor in business has obtained a benefit in respect of a trading liability by way of remission or cessation thereof. The situation can apply only where the person was following mercantile system of accounting and therefore deduction has been earlier allowed in respect of a trading liability on accrual basis. Hence, if subsequently there is a remission or cessation of such liability, it should be brought to tax as otherwise the person would be entitled to an undue advantage.

3. Remission or Cessation of liability

3.1 Meaning of remission or cessation

Dictionary meaning of the word 'remission' is 'the cancellation of a debt' & the word 'cessation' is 'the fact or process of ending or being brought to an end'. Remission or cessation of a liability can take place either by the consent of the creditor or in certain situations by operation of law. However a unilateral act of a debtor cannot bring into existence 'remission' or 'cessation' of a liability. To overcome this situation and to bring to tax, trading liabilities unilaterally written back in accounts by debtors, Explanation 1 has been inserted in sec 41(1) by the Finance (No.2) Act, 1996 w.e.f. 1-4-1997.

It provides that if there is a remission or cessation of a trading liability, which was earlier, allowed as deduction, it is chargeable to tax, even if the remission or cessation is effected by a unilateral act of writing off of such liability by the assessee.

In *CIT vs. Mohan Meakin Ltd. [2012] 205 Taxman 43/18 taxmann.com 47 (Delhi)*, it has been held that the aforesaid *Explanation 1* to section 41(1) which provides that unilateral act of assessee by way of writing off such liability in its accounts would be considered as remission or cessation of liability, apply in relation to assessment year 1997-98 and subsequent years and it does not have any retrospective effect.

3.2 Irrevocable cessation

A cessation of liability for the purpose of section 41(1) means irrevocable cessation so that there is no possibility of the liability being revived in future. If there is such a possibility, then the cessation is not complete and section 41(1) is not attracted. A decision liable to appeal may be final until the appeal is not preferred, but once an appeal is filed, the decision looses the character of finality, and becomes sub-judice. Hence, if a liability is reduced by a decision of any court but it is challenged in further appeal, addition cannot be made u/s. 41(1) till the final outcome comes. *[UOI vs. J.K. Synthetics Ltd. (1993) 199 ITR 14 (SC)].*

3.3 Time barred Debts

Often a contention is raised by the revenue that once a debt is barred by limitation, it can be taken as a cessation of liability for the purpose of Section 41(1). However, one needs to critically examine the provisions of the Limitation Act, 1963 in this respect. In *Bombay Dyeing & Mfg. Co. Ltd. vs. State of Bombay 1958 SCR 1122* the Supreme Court reiterated the settled principle that expiry of period of limitation prescribed under the Limitation Act could not extinguish the debt but it would only prevent the creditor from enforcing the debt.

Reference may also be made to the decision of *CIT vs. Sugauli Sugar Works (P.) Ltd. [1999] 236 ITR 518 (SC)* where it was held that mere entry in the books of account of the debtor made unilaterally without any act on the part of the creditor will not enable the debtor to say that the liability has come to an end. In several decisions, it has been held that section 41(1) cannot be invoked to bring to tax time barred debts without any further surrounding circumstances to indicate that the liability has ceased to exist:

CIT vs. Hotline Electronics Ltd. [2012] 205 Taxman 245/18 taxmann.com 363 (Delhi)

Liquidator, Mysore Agencies (P.) Ltd vs. CIT [1978] 114 ITR 853 (Kar.)

CIT vs. Chase Bright Steel Ltd. (No. 2) [1989] 177 ITR 128 (Bom.)

3.4 Debt acknowledged in writing

Section 18 of the Limitation Act,1963 provides that —"(1) Where, before the expiration of the prescribed period for a suit or application in respect of any property or right, an acknowledgment of liability in respect of such property or right has been made in writing signed by the party against whom such property or right is claimed, or by any person through whom he derives his title or liability, a fresh period of limitation shall be computed from the time when the acknowledgment was so signed."

Effect of above provision is explained by Madras High Court in *Savarna Paper Cutting Works vs. Indian Express (Madurai) 1999 (3) CTC (167) (Madras High Court)*. After relying on several other decisions, Madras High Court in the above case explained that debts due to creditors not mentioned by name but included in the item relating to "Loans (unsecured)" or as due to "Sundry Creditors" mentioned in the balance sheet amount to an acknowledgment within the provisions of Section 19 so as to extend the period of limitation with effect from the date of the signing of the acknowledgment. Thus, till the time the liability is acknowledged in the balance sheet signed by the debtor, the debt cannot be held to be barred by limitation.

4. Waiver of principal amount of Loan

4.1 Loan taken for capital purpose

In case of waiver of loan, certainly there is a cessation of liability. However, the *sine qua non* for applicability of section 41(1) is that there should be an allowance or deduction claimed by assessee in respect of loss, expenditure or trading liability incurred.

Since the principal amount of loan is never allowed as a deduction, its waiver cannot be taxed u/s. 41(1). An alternative argument is whether such a waiver can be taxed u/s. 28(iv). Section 28(iv) provides that the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession shall be chargeable to tax under the head Profits or Gains of Business or Profession.

However, in *Iskraemeco Regent Ltd. vs. CIT (2011) 196 Taxman 103 (Mad.)*, it was held that section 28 (iv) cannot apply to monetary transactions.

Recently Supreme Court in case of *CIT vs. Mahindra & Mahindra Ltd. (2018) 255 Taxman 305(SC)* has held that in order to invoke the provision of section 28(iv), the benefit which is received has to be in some other form rather than in the shape of money. Since the loan waived is received earlier in the form of money, section 28(iv) cannot apply to tax the benefit arising out of cessation of such liability.

4.2 Loan taken for revenue purpose

As far as the applicability of section 41(1) to waiver of principal amount if loan taken for revenue purpose is considered, the situation is no different from the waiver of loan taken for capital purpose and the view expressed in para 4.1 above will apply equally.

With regard to the applicability of section 28(iv) to waiver of loans taken for revenue purpose is concerned, a reference may be made to the decision of Bombay High Court in the case of *Solid Containers Ltd. vs. DCIT (2009) 308 ITR 417 (Bombay)*.

In the facts of the case, the waiver of loan taken for revenue purpose was held to be directly arising out of business activity and taxed under section 28(iv). The said taxability was upheld by the Income Tax Appellate Tribunal, Mumbai by relying on the judgment of the Apex Court in *CIT vs. T.V. Sundaram Iyengar & Sons Ltd. (1996) 222 ITR 344.* Assessee's appeal was not admitted by Bombay High Court relying again on the same decision of Apex Court. With due respect to the Income Tax Appellate Tribunal & High Court, it is submitted that the decision in *CIT vs. T.V. Sundaram Iyengar & Sons Ltd.* was in the context of section 28(i). In the facts of that case, the assessee had received certain advances from its customers and since they remain unsettled for several years, were unilaterally written back by the assessee and credited to Profit & Loss A/c. However, assessee claimed that they were capital receipts and hence not chargeable u/s. 41 or 28. In the factual background, the Hon'ble Supreme Court held the receipts to be revenue in nature and arising from business as they were received from customers in the course of business only. However, as explained in para 4.1, the Supreme Court in the case of *CIT vs. Mahindra & Mahindra Ltd. (2018) 255 Taxman 305(SC)* has held that in order to invoke the provision of section 28(iv), the benefit which is received has to be in some other form rather than in the shape of money. In author's personal view, loan taken for business purpose cannot be equated to amount received from customers and hence the ratio of decision in *CIT vs. T.V. Sundaram Iyengar & Sons Ltd. (1996) 222 ITR 344* cannot apply to waiver of loans. Further Bombay High Court in Solid Containers case has dismissed the appeal of assessee in limine without admitting the question of law.

4.3 Waiver of Interest

Needless to say that waiver of interest on loan shall attract section 41(1) if the same has been allowed as deduction earlier. Regard should also be given to the provision of section 43B which provides for disallowance of unpaid interest on certain loans. If the interest has not been allowed because of applicability of section 43B or any other provision like 40(a)(ia) or 14A etc., waiver of such interest cannot be charged to tax u/s. 41(1).

4.4 Applicability of Minimum Alternate Tax (MAT) on waiver of Loans

As per section 115JB of the Act, MAT is leviable in certain cases @ 18.5% of book profit. For this purpose, book profit is defined in *Explanation 1* to Section 115JB to mean the profit as shown in the Statement of Profit & Loss for the relevant previous year subject to certain additions and subtractions as enumerated in the said explanation.

The issue whether the amount of loan waived shall be part of book profit for the purpose of section 115JB is a debatable issue. In the case of *Duke Offshore Ltd. vs. DCIT (2011) 45 SOT 399 (Mumbai)*, it was held to be a part of book profit. However in a subsequent and a lengthy judgment in case of *JSW Steel Ltd. vs. ACIT (2017) 82 taxmann.com 210 (Mumbai)*, it was held to be not part of book profit for the purpose of levy of MAT. In the said judgment, after elaborate discussion of the provision of section 115JB, Part II & III of Schedule VI to the Companies Act, the rationale for introduction of MAT and several precedents, the Tribunal has concluded as below:

"……..if an assessee company is in receipt of a 'capital receipt' which is not chargeable to tax at all, that is, it does not fall within any of the charging section or can be classified under any heads of income under the Income-tax Act, then same cannot be treated as part of net profit as per Profit & Loss account or reckoned as 'working result' of the company of the relevant previous year and consequently, cannot be held to be taxable as 'book profit' under MAT in terms of Section 115JB. Accordingly, our conclusion remains the same that, the capital surplus on account of waiver of dues neither is nether taxable nor can be included in computation of book profit u/s. 115JB."

Applying the above conclusion, it may be inferred that if the waiver of loan for revenue purpose is considered as chargeable u/s. 28(i), it will be also part of 'book profit' u/s. 115JB. However, if the waiver of loan is considered as a capital receipt, the same shall also be excluded from the Book Profit u/s. 115JB.

5. Miscellaneous issues arising from section 41(1)

5.1 Presumptive taxation like section 44AD & section 41(1):

Sections 44AD, 44AE and 44ADA start with a non obstante clause "notwithstanding anything to the contrary contained in sections 28 to 43C". Therefore the presumptive tax provisions shall override the provision of section 41(1) meaning thereby that there cannot be a separate addition u/s 41(1) over and above the presumptive profits compared under those sections.

Conversely, if in the year to which the allowance or expenditure pertains, the assessee was covered by a presumptive tax provision, the subsequent recovery cannot be brought to tax u/s 41(1), even though the assessee is not covered by presumptive tax provision in the year of obtaining the benefit. This is because, if in the earlier year the assessee was covered by presumptive tax regime, no specific deduction has been allowed to him in respect of a particular loss, expenditure or trading liability. In *Tirunelveli Motor Bus Service Co. (P.) Ltd. vs. CIT [1970] 78 ITR 55 (SC)*, it was held that unless it is proved that an allowance or deduction has been made in the assessment in any previous year in respect of loss, expenditure or trading liability, it is not open to the revenue to refer to section 41(1) for charging the tax on the receipt by the assessee by refund or otherwise of such expenditure in a subsequent year. However, that was a case where a best judgement assessment u/s. 23(4) of the Income Tax Act, 1922 (parallel to section 144 of the present Act) was made in A.Y. 1950-51 and profit was estimated by the Assessing Officer. There was a liability in accounts for bonus payable to employees in that year. Subsequently in A.Y. 1957-58, section 10(2A) of the Income Tax Act, 1922 (parallel to section 41(1) of the present Act) was invoked by the Assessing Officer to bring to tax the difference between the bonus payable and the bonus actually paid on final settlement. In that background Supreme Court held that the question whether an allowance had been granted or a deduction made in respect of a trading liability had to be decided by referring to the order relating to the assessment year 1950-51 and it could not be determined by drawing inferences from what was done in respect of the assessment of an earlier year. However, in case of section 44AD, sub-section (2) specifically provides that all the deductions are deemed to have been allowed. Hence, it may be argued that in case of subsequent recovery, section 41(1) can be invoked.

5.2 Depreciation claimed and section 41(1):

Depreciation allowed to an assessee cannot be subsequently brought to tax u/s. 41(1) in the year of sales, etc. of the asset. There was a separate provision for balancing charge u/s. 41(2) which was omitted w.e.f. 1-4-1988 (with introduction of Block concept) & later reintroduced w.e.f. 1-4-1998 only for power companies claiming depreciation under Straight Line Method. Hence it cannot be argued by the department that in case the liability towards acquisition of an asset is ceased, the depreciation to be brought to tax u/s. 41(1). Refer Supreme Court decision in *Nectar Beverages (P) Ltd. vs. DCIT (2009) 314 ITR 314(SC).*

6. Conclusion

There are several other issues arising from the interpretation of Section 41(1) but due to space constraint those have not been included in this article. Further, sections 41(2), 41(3), 41(4) and 41(4A) also provide for certain deeming provisions in some specific situations as against general provisions of section 41(1). However, to conclude, a reference is invited to the provision of section 41(5) which provides for set off of business loss of the year of discontinuance of business against the deemed profit chargeable u/s. 41(1), 41(3), 41(4) and 41(4A).

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CA Usha Kadam

Speculative Transactions & Derivatives Transactions

1. Introduction

According to Cambridge dictionary, "Speculation" means the activity of guessing possible answer to a question without having enough information to be certain. So answering a question in Kaun Bangea Crorepati, Is it a speculation? May be !!!

According to Webster's dictionary "Speculation" means assumption of unusual business risk in hopes of obtaining commensurate gain. So whether betting on horses races or gambling is a speculation? May be !!!

However, as per the Income tax Act income from races including horse races is considered as income from other sources and not an income from speculation business. Section 43(5) of the Income tax act defines speculative transaction. In case of commodities including stocks and shares there has always been a confusion / controversy with respect to classification of income between business income and income from capital gains. There are various decisions which have held that classification between these two categories of income would depend on the intention of investment and frequency of the transactions. Also, the controversy relating to distinction the between speculation and non-speculation business income arises as there is differential treatment accorded for speculation business loss by limiting carry forward time of 4 years and barring set off of such loss against regular business income (Section 73)

2. What is a speculative transaction?

Under the Income-tax Act, 1961 the study of speculative transactions is covered in section 43(5), r.w.s. 28 and section 73 of the Act.

43. In sections 28 to 41 and in this section, unless the context otherwise requires-

(5) "speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips:

For example, Intra-day trading is the trading of shares done within the same day. Generally, delivery is not taken in case of intra-day trading, and thus, these are said to be speculative transaction.

Some transactions, which are in fact 'speculative' by their very nature, shall not be deemed to be speculative transactions as per deeming proviso to section 43(5). The proviso to sec 43(5) are as under:

Provided that for the purposes of this clause—

(a) A contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or

(b) A contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or

(c) A contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member; or

(d) An eligible transaction in respect of trading in derivatives referred to in clause (ac) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) carried out in a recognised stock exchange; or

(e) An eligible transaction in respect of trading in commodity derivatives carried out in a recognised association, which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013 (17 of 2013),

shall not be deemed to be a speculative transaction.

Thus in order to be considered as a hedging transaction falling under clause (a) of proviso to sec 43(5), the raw materials or merchandise, in respect of which the forward transactions have been made, must have a direct connection with the goods manufactured or merchandise sold.

In clause (b) of proviso to sec 43(5) the purpose of contract is to guard against loss in holding of stock or shares through price fluctuations. Thus, the assessee cannot enter into a transaction purported to be a hedge in respect of shares he does not hold.

Section 43(5)(d) was inserted by the Finance Act, 2005 w.e.f. 1.4.2006. It provided that an eligible transaction (i.e., transaction carried out electronically through a stock broker or an intermediary registered with recognized stock exchange & supported by time stamped contract note indicating unique client ID & PAN) of trading in derivatives carried out in a recognized stock exchange shall not be deemed as a speculative transaction.

Following stock exchanges are notified as recognized stock exchanges for the purposes of clause (ii) of Explanation (1) to clause (d) of proviso to section 43(5):

i) NSE & BSE – Notification No. SO 89(E), dated 25-1-2006.

ii) MCX Stock Exchange Ltd. – Notification No. SO 1327(E), dated 22-5-2009.

iii) United Stock Exchange of India Ltd. – Notification No. 12/2011, dated 25-2-2011.

Clause (e) of section 43(5) inserted by the Finance Act, 2013 applicable from the assessment year 2014-15 onwards, provides that eligible transactions *(i.e., transaction carried out electronically through member or an intermediary registered with recognized association & supported by time stamped contract note indicating unique client ID, trade number & PAN)* of trading in commodity derivatives carried out in a recognized association shall not be deemed as speculative transactions. The following were notified as recognized associations, viz.,

(i) National Commodity & Derivative Exchange Ltd., Mumbai (Notification No. 3513(E), dated 27-11-2013),

(ii) Universal Commodity Exchange Ltd., Mumbai (Notification No. SO 3514(E), dated 27-11-2013),

(iii) Multi-Commodity Exchange Ltd., Mumbai (Notification No. SO 3539(E), dated 29-11-2013),

(iv) Ace Derivatives Commodity Exchange Ltd., Ahmedabad (Notification No. SO 834, dated 20-3-2014) and Indian commodity Exchange Limited (Notification No. SO 3528 (E) dated 30-10-2017.

The Finance (No.2) Act, 2014 puts an additional condition in clause (e), viz., payment of commodity transaction tax to fall outside the domain of speculative transactions w.r.e.f. assessment year 2014-15.

The Finance Act, 2018 provides that w.e.f. A.Y. 2019-20 for the purpose of clause (e) in respect of trading in agricultural commodity derivative, the requirement of chargeability of commodity transaction tax shall not apply.

From a reading of the above definition, it is gathered that the section 43(5) applies where (i) the transaction is in respect of commodity, shares or stock, (ii) it is not settled by actual delivery and (iii) it does not fall in any of the exceptions contained in the proviso.

3. Whether a single transaction can constitute a speculative business?

Explanation 2 to Section 28 of the Income-tax Act, 1961 provides – Where **speculative transactions** carried on by an assessee are of such a nature as to constitute a business, the business (hereinafter referred to as "speculation business") shall be deemed to be distinct and separate from any other business.

The *Explanation 2* to Section 28 provides for the speculation business as separate and distinct business while Section 43(5) defines what is speculative transaction. From the reading of these two sections it is quite clear that unless the speculative transactions constitute business, the provisions of Section 73 cannot apply. Thus, unless the loss pertains to speculative business the provisions of Section 73 cannot be applied. The use of the plural Speculative 'transactions' in *Explanation 2* to Section 28 clearly shows that in order to constitute speculative business within the terms of the explanation, a single transaction would not be sufficient, unless there is a systematic or organised course of activity or conduct on the part of the assessee, a single transaction cannot constitute business. Further where a transaction is settled, otherwise than by actual delivery, the transaction would be a speculative transaction. But merely because it is a speculative transaction it will not by itself render it a speculative business for which there should be more than one speculative transactions carried out by the assessee as per *Explanation 2* to Section 28 of the Income-tax Act, 1961.

Moreover, High Court of Bombay in the case of *Commissioner of Income tax vs. Kamani Tubes Ltd. 207 ITR 298, (1994) 75 Taxman 0055* followed the Supreme Court ruling in the case of *Commissioner of Income tax vs. Shantilal P. Ltd. (1983) 144 ITR 0057* and held that:

"It is abundantly clear that failure to accept the goods in terms of the contract on the stipulated date amounts to a breach of contract and in such a case, the other party is entitled to receive compensation for loss or damage caused by such breach. In the case of a contract for the sale of goods, the measure of damages upon a breach by the buyer is the difference between the contract price and the market price at the date of the breach. Such payment cannot be termed as "payment made on periodical or ultimate settlement of the contract for purchase and sale of the commodity otherwise than by actual delivery or transfer of the commodity" contemplated by s. 43(5) of IT Act. That would happen only in cases falling under s. 63 of the Contract Act. This is a case of breach of contract and the payments made by the assessee are by way of damages caused thereby. It clearly falls in illustration (c) of s. 73 of the Contract Act. It is not a case of performance of the contract within the meaning of s. 63 of Contract Act. The payment by the assessee, therefore, cannot be termed as a "speculative transaction" within the meaning of s. 43(5). Even if in a given case, a particular transaction is held to be a speculative transaction within the meaning of s. 43(5) such a finding would not resolve the controversy regarding the applicability of Expln. 2 to s. 28 and s. 73 without a further finding that the assessee carried on business in such speculative transactions. It is only where the speculative transactions carried on by an assessee are of such a nature as to constitute business that Expln. 2 to s. 28 gets attracted and such business, which is referred to as "speculative business", is deemed to be distinct and separate from other business and s. 73 becomes applicable to the set off and carry forward of loss from such business. There is a perceptible difference between "speculative transaction" and "speculation business". An isolated transaction of settlement of a contract otherwise than by actual delivery of the goods might amount to "speculative transaction" within the meaning of s. 43(5) but in the absence of something more to show that the nature of the transactions was such as to constitute a business, it cannot be termed as "speculation business" which has been treated as distinct and separate from other business.

4. Whether derivative transactions are speculative transactions even in the absence of applicability of clause (d) of the proviso to Section 43(5)?

Can it be argued that index futures and options are certainly not stocks and shares, and that the definition of speculative transaction, which requires the contract to be for the purchase or sale of any commodity, including stocks and shares, therefore does not apply ? Even otherwise, can a transaction for purchase and sale of an equity stock future or an equity stock option be regarded as a transaction for purchase or sale of shares?

Section 2(h) of Securities Contract Regulation Act defines securities and includes shares, stocks and derivatives under separate and specific entries, besides other financial instruments. The meaning of the term shares and stocks is clear and known and does not leave any ambiguity. Section 2(84) of the Companies Act, 2013 defines the term "share". It means a share in the share capital of a company and includes stock. A stock is a set of shares put together. Derivatives, though financial assets, can not be treated as either stocks or shares.

One needs to examine whether the same could be treated as a commodity. A commodity is generally believed to be tangible. If one examines the definition in Black's Law Dictionary, after defining "commodity" as an article of trade or commerce, it goes on to clarify that the term embraces only tangible goods, such as products or merchandise, as distinguished from services.

From this, it is clear that a commodity has to be in the nature of tangible goods and not something which has no existence of its own, but is a mere contractual right, such as a derivative. While there is a strong case for arguing that derivatives are not a commodity, the issue will be debatable.

Also, a transaction backed by actual delivery is not treated as a speculative transaction. The condition presupposes that it is possible to actually deliver the product. The law can prescribe only such conditions which are capable of being fulfilled and complied with. It cannot compel a person to do a thing which he cannot perform. Derivatives are not capable of being delivered. Equity stock options and futures cannot be settled by delivery, but can only be cash settled.

Can a person be penalized by law for not doing the impossible? This supports the view that a derivatives transaction could not have been regarded as speculative transaction.

5. The related issue about the applicability of Explanation to Section 73

Section 73(1) debars set-off of loss in respect of a speculation business against profits and gains of non-speculation business.

Explanation to section 73(4) says that where any part of the business of the company (other than the company whose gross total income consists mainly of income chargeable under the heads "interest on securities", "income from house property", "capital gains" and "income from other sources" or a company the principal business of which is the business of trading in shares or banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares.

From the above, it is clear that the above *Explanation* applies only to the Company. It does not apply to individuals, firms, HUF etc. If the business of the company, which does not fall within the excluded categories, consists of purchase and sale of shares of the other companies, then such a company shall be deemed to be carrying on speculation business for the purpose of section 73 to the extent to which the business consists of the purchase and sale of such shares.

6. The issue to be addressed is whether a company dealing in derivatives could be considered as engaged in speculation business by virtue of the said *Explanation.*

We refer to the decision of H'ble Delhi High Court in *CIT vs. DLF Commercial Developers Ltd. [2013] 35 taxmann.com 280/218 Taxman 45*. In this case the assessee had incurred certain loss in trading of derivatives. It claimed that the said loss was not a speculative loss in terms of section 43(5) and could not be disallowed as speculative loss under any provisions of the Act. The Assessing Officer held that section 73 was independent of section 43(5). The assessee was not engaged in any of the specifically excluded categories of business as to render *Explanation* to section 73 inapplicable. Therefore, the loss in question was speculative loss and could not be allowed to be adjusted against business income. The High Court held that the derivatives are based on stocks and shares, which fall squarely within the *Explanation* to section 73. Therefore, once *Explanation* to section 73 is applied the losses arising on trading of derivatives shall not be set-off against income from another business. Thus, Hon'ble Delhi High Court held the view against the assessee.

We refer to the decision of the H'ble Calcutta High Court in *Asian Financial Services Ltd. vs. CIT [2016] 70 taxmann.com 9/240 Taxman 192*. In this case the assessee-company was dealing in settlement of futures and options / derivatives and suffered loss. The Assessing Officer treated the same as speculation loss and did not allow set-off of the said loss against business income. He also applied Explanation to section 73. The Hon'ble Calcutta High Court held that derivatives cannot be treated at par with the shares because the Legislature has treated them differently and held that the loss incurred on account of derivatives would be deemed as business loss under proviso to section 43(5) and not a speculation loss and, accordingly, *Explanation* to section 73 could not be applied. Thus, Hon'ble Calcutta High Court held the view in favour of the assessee.

Hon'ble Supreme Court has admitted SLP against the Asian Financial Services decision referred to above.

Thus, there has been a controversy, whether loss arising in trading of derivatives should be treated as speculation loss and, therefore, could not be set-off against income from other business.

Recently the Ahmedabad Tribunal in *ITO vs. Upkar Retail (P.) Ltd. [2018] 94 taxmann.com 450 (Ahmedabad - Trib.)* considered this aspect in light of the judgment of the Hon'ble Delhi High Court in *CIT vs. DLF Commercial Developers Ltd.* which held the view against the assessee and that of the Hon'ble Calcutta High Court in *Asian Financial Services Ltd. vs. CIT* which held the view in favour of the assessee.

The issue involved in this appeal was whether losses arising on trading of futures and options and other derivatives should be treated as speculation loss within the meaning of the *Explanation* to section 73, or whether such losses should be treated as business loss under proviso to section 43(5)? In case loss on trading of derivatives is treated as business loss whether they would be allowed to be set-off against income arising from other business?

The assessee relied on the decision of the Hon'ble Calcutta High Court in Asian Financial Services Ltd. (supra) whereas Department relied on the decision of the Hon'ble Delhi High Court.

The reasoning advanced by the Tribunal was as under:

(i) The decision of the Calcutta High Court was challenged before the Hon'ble Supreme Court in *CIT vs. Asian Financial Services Ltd. [2016] 75 taxmann.com 68/243 Taxman 147 (SC)*. The SLP has been admitted. But mere pendency of SLP before the Hon'ble Supreme Court does not dilute the nature of a judicial precedent.

(ii) Where conflicting views on the same issues are rendered by the two High Courts then the view favourable to the assessee should be followed as held in *Vegetable Products Ltd. [1973] 88 ITR 192 (SC).*

(iii) This principle has been further reiterated in *Petron Engg. Construction (P.) Ltd. vs. CBDT [1988] 41 Taxman 294/[1989] 175 ITR 523 (SC).* Reliance was also placed by the Tribunal on *Tej International (P.) Ltd. vs. Dy. CIT [2001] 118 Taxman 59 (Delhi) (Mag.)* where two further principles were highlighted:

  (i) Rule of resolving ambiguities in favour of taxpayer does not apply to deductions, exemptions and exceptions which are allowable only when plainly authorised. Reliance has been placed by Tribunal on *Littman vs. Barron 1952 (2) AIR 393* and followed by the Apex Court in *Mangalore Chemicals & Fertilizers Ltd. vs. Dy. Commr. of CCT [1992] Suppl. (1) SCC 21* and *Novopa India Ltd. vs. CCE & Customs 1994 taxmann.com 231 (SC)*

  (ii) The rule of resolving ambiguity in favour of the assessee does not apply where the interpretational provision is held unconstitutional, as held in the case of *State of M.P. vs. Dadabhoy's New Chirimiri Ponri Hill Colliery Co. (P.) Ltd. AIR 1972 (SC) 614.*

As there are conflicting views and the view favourable to the assessee rendered by the Hon'ble Calcutta High Court in Asian Financial Services Ltd. (supra), is to be followed, Tribunal held that loss arising on trade of derivatives will be treated as non-speculative loss and will be available for set off against other business income.

It needs to be understood that the clarification of derivatives transactions as non speculative is not always beneficial. For instance, a day trader who trades in shares and also trades in derivatives. If he has incurred a loss in his share trading activities, and earned a profit on his derivative transactions of an equal amount, only the day trading loss will be regarded as a speculation loss, and the derivatives profits will be taken as normal business income. If the derivatives transactions had also been regarded as speculative transactions, the speculation profit or loss would have been the net result of both his day trading as well as derivatives trading activities, whereby in effect the day trading loss would have been set off against his derivatives trading profit.

We refer to the decision of the Mumbai Tribunal in *J. M. Financial Services Ltd. vs. JCIT (2017) 88 taxmann.com 836*. In this case the assessee had carried out cash future arbitrage and earned a profit from the said activity. According to the assessee, activity of buying and selling of shares in cash segment and future segment was a composite activity carried out by the assessee and the transactions were so managed that if there would be loss in one segment, there would be profit in the other segment, and after netting off of the corresponding losses and profits from both the segments, the resultant figure would be a positive figure in the end. However, the Assessing Officer treated transaction in cash segment and future segment as under different heads and did not allow the set-off of profit and loss from one segment against another segment.

The Tribunal held that the peculiarity of the business of the assessee was that the assessee so managed his transactions of sale and purchase in shares in cash segment and in future segment that the final outcome would be a profit. The transactions of the assessee, therefore, could not be segregated to arrive at profit and loss in both these transactions independently or separately. Under the circumstances, both the transactions, i.e. the transactions in the derivative and transactions in the cash segment could be treated as speculative transactions as per the Explanation to section 73 and, hence, the profit or loss against both the segments could be adjusted or set-off against each other.

We also note that to cure this situation and enable such derivatives dealings to be taken out of the ambit of *explanation* to section 73, the amendment was done in *Explanation* 73 by which companies engaged in business of trading in shares were also taken out the ambit of aforesaid *explanation*. However, this amendment was done with effect from 1-4-2015.

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CA Anil Sathe

Intricacies under section 145A

Introduction

Section 145A dealing with valuation of purchase, sale and inventory was introduced with effect from 1st April 1999. It was amended by Finance Act 2009 with effect from the 1st April 2009. In its old avatar the section has been the subject matter of intense litigation. Finance Act 2018 has substituted the said section with effect from 1st April 2017.

The substituted section is significantly wider in scope and ambit. It encompasses sale of services and makes a specific provision for valuation of inventory of listed and unlisted securities. In the backdrop of the Income computation standards (ICDS) notified by the CBDT, the new section 145A will have substantial ramifications on the computation of income under the head "Profits and Gains of Business or Profession."

Scope of this article

This article deals with the newly substituted section 145A, and the issues arising therefrom. The various controversies pertaining to the old section 145A {as it existed prior to substitution by Finance Act 2018} are not dealt with unless they are relevant to the new provision.

Applicability

The provision comes into force with effect from 1st April 2017. This would mean application from assessment year 2017-18. This is also made clear by the memorandum explaining the provisions of Finance Bill 2018. Consequently the amended section 145A would apply to the previous year commencing, on or after 1st April 2016 i.e., assessment year 2017-18 and subsequent years.

The said section begins with the words "For the purpose of determining the income chargeable under the head Profits and Gains of Business or Profession". Therefore, this provision does not prescribe the method or manner in which books of account are to be maintained but provides for the manner of computation of income. Further it applies only if the computation of income is under the head "Profits and Gains of Business or Profession". It would therefore not apply in regard to computation under any other head of income.

An issue that arises at the threshold is whether it would apply to income which is not includible in total income in terms of section 10 and11 falling under Chapter-

III. In my view, the incomes falling within the ambit of those provisions are incomes which are chargeable to tax but are not includible in total income subject to the fulfilment of the conditions contained in specific clauses of section 10 or 11. If the exemption or deduction conditions are not fulfilled or complied with, the income of those undertakings is chargeable to tax as business income. Therefore, the provisions of section 145A would also apply to undertakings income whereof is computed under section 10.

Valuation of inventory in general – Section 145A(i)

Clause (i) of the provision deals with valuation of inventory. It prescribes that the said valuation will be made

(a) at lower of actual cost or net realisable value

(b) computed in accordance with the Income computation and disclosure standards (ICDS) notified under section 145(2).

The principle that inventory must be valued at actual cost or net realisable value whichever is lower is a generally accepted accounting principle (GAAP), and therefore does not need elucidation. The significant departure is that this valuation would now have to satisfy the parameters of ICDS-II, which deals with valuation of inventories. In para 3 ICDS-II provides as under

"3. Inventories shall be valued at cost, or net realisable value, whichever is lower."

By and large the principles governing determination of cost are similar in accounting standard AS-2 and ICDS-II both governing valuation of inventory. However, there is one significant difference between the two. AS-2 is silent on how inventory is to be valued on dissolution of a firm, AOP or BOI. ICDS-II makes a specific provision in that regard in paragraph 24 which is as under

"24. In case of dissolution of a partnership firm or association of person or body of individuals, notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realisable value."

This is in conflict with two decisions of the Apex Court in *Sakthi Trading Co. vs. CIT (250 ITR 871* and *CIT vs. Kwality Steel Suppliers Complex (250 Taxman 23)* where the Supreme Court ruled that if business is continued by the remaining / continuing partners then the inventory need not be valued at net realisable value. Ordinarily a decision of the Supreme Court that interprets a provision of law would override any delegated legislation. However, in this case the two decisions aforesaid interpret an accounting principle in the absence of a specific provision in that regard. Para 24 of the notified ICDS-II, deals with the case of valuation of inventory on dissolution. However the Delhi High Court in *Chamber of Tax Consultants 299 CTR 137* categorically struck down this part of ICDS-II as *ultra vires*. Subsequently Finance Act 2018 enacted 145A(i). The question that arises is whether the enactment of 145A(i) can save para 24. In my opinion it is difficult to take such a stand, in light of the decision of the Delhi High Court operation whereof has not been stayed. It however appears that the intent of the Government is to support ICDS, by enacting 145A retrospectively. This may lead to litigation.

A dissolution by operation of law (death of one partner in a two-partner firm), could result in unrealised profit being taxed on valuation of inventory at net realisable value. In my opinion if this paragraph is invoked one should not rest only on the argument that the Delhi High Court has struck down the same. It would be appropriate to urge that this provision in the ICDS, is violative of section 5 itself. What is brought to tax by section 4 read with section 5 is income which has accrued, arisen or has been received. No income can arise by mere valuation. If this contention is urged an attempt to tax a dissolved firm, valuing inventory at net realisable value can be defended.

Inclusion of tax, duty, cess or fee in valuing purchase, sale and inventory Section 145A(ii)

While for the purposes of determination of cost, AS-2 and ICDS-II are more or less in sync, they are materially different in terms of inclusion of tax, duty etc. AS-2 provides as under

"Costs of Purchase

1. The costs of purchase consist of the purchase price **including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities),** freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase."

Therefore, while valuing inventory, AS-2 prescribes that if duties and taxes are recoverable by the enterprise from the taxing authority by way of input credit or otherwise, then they cannot be included in the cost of purchase to that extent. AS-2 therefore prescribes what is called in accounting parlance the "exclusive method". On the other hand, ICDS-II provides as under

"Costs of Purchase

5. The costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates and other similar items shall be deducted in determining the costs of purchase."

ICDS-II therefore prescribes inclusion of duties and taxes on a gross basis in the valuation of inventory. This in accounting parlance is called the "inclusive method."

Consequently, an entity while maintaining accounts if it desires to comply with the accounting standards must follow the exclusive method, while in computing the income from business or profession it must follow the inclusive method. Since this was the position even prior to the amendment made by Finance Act 2018, I do not propose to deal with the issues arising therefrom. Suffice to say that the Institute of Chartered Accountants (ICAI) has taken the view in its Guidance Note on tax audit, that if the inclusive method is followed then a provision must be made in regard to the outstanding taxes included in the value of closing inventory but remaining unpaid on the valuation date, while preparing a computation of income. Therefore by and large both the exclusive method and inclusive method are tax neutral.

Impact on valuation of sale of services

However, a material departure is that the erstwhile section 145A did not deal with valuation of purchase and sale of services, 145A(ii) does so. Some issues arise from this expansion of the ambit to include services and they are briefly dealt with in the following paragraphs.

Inclusion of duty and tax, in case of an assessee following the cash method of accounting

It is interesting to note that while clauses (i) (iii) and (iv) of section 145A regarding valuation of inventory, direct that the computation of inventory should be in accordance with ICDS notified under section 145(2), section 145A(ii), does not contain any such mandate. While ICDS, do not apply to an assessee following a cash method of accounting the provisions of section 145A(ii) will apply. If a literal interpretation of law is to be made, then even in the case of an assessee following the cash method of accounting, he would have to value sale of services realised, by including the service tax element (up to 30th June 2017) and the GST element after 1st July 2017. As a corollary the tax element would have to be deducted to the extent that it is paid.

This would require a detailed reconciliation with the accounts. This is because an assessee following the cash method of accounting would account for his revenue as and when it is received. On the other hand, for GST purposes he would have paid the tax (after availing of the input tax credit) on accrual basis. This may result in the assessee having to carry out a herculean task of reconciliation. Already an assessee following a cash method has to reconcile his revenue with the Income tax credit claimed out of tax deducted by the payer. A similar if not identical exercise would have to be carried out for the purpose of ensuring that there is no tax effect on the compliance with section145A (ii).

It must be remembered that, the substituted 145A, does not begin with the word "Notwithstanding", as the earlier section did. The better view therefore, is that section 145 is the parent section, directing the following of ICDS. Since ICDS itself does not apply to persons following the cash method of accounting, section 145A which is an adjunct or carve out from section 145, cannot apply to assessees following the cash method of accounting.

What would be the position in regard to revenue recognition pertaining to sale of services ?

ICDS-IV mandates that in the case of a service provider following the accrual method of accounting, the revenue from services should be computed on the percentage completion method. This would require that in respect of incomplete service contracts, revenue would have to be accounted for on the basis of percentage completion or where contracts are substantially complete (except contracts involving a period of 90 days working in which case the revenue would be accounted for on the service contracts being completed). As a corollary the cost pertaining to those contracts which are incomplete and where revenue has not been accounted for would have to be carried forward as inventory. This would require valuing such an unamortised cost which would include duties and taxes as well.

However, in case of an entity maintaining accounts on the cash method, ICDS-IV would not apply and consequently it would be possible to urge that the revenue recognition computation standard does not apply to such assessees.

Valuation of unlisted/ not regularly quoted, securities held as inventory – Section 145A (iii)

This clause is a new clause inserted by Finance Act 2018. This makes a material departure from the established principles of computation of business income. This clause requires unlisted securities, or "those not quoted on a recognised stock exchange with regularity from time-to-time" to be valued at cost "initially recognised". Consequently, the effect is that losses would be recognised only on their actual incurrence by way of sale or disposal in any other manner.

While the insertion of this clause in regard to unlisted securities may be justified as it plugs a loophole which was misused by certain unscrupulous taxpayers, applying the principle to a security which is listed but not quoted regularly is likely to create some degree of controversy. This is because the said term has not been defined in the section or the rules.

Valuation of securities other than unlisted securities held as inventory Section 145A(iv)

Securities falling in this clause shall be valued at cost or net realisable value whichever is lower. This is in accordance with GAAP.

The proviso to the said section provides that, in regard to securities classified in section 145A(iii) which are held by scheduled banks or public financial institutions (PFI), their valuation would be in accordance with the RBI guidelines which provide for valuation of securities by banks. This would virtually mean that any securities held by banks or PFI's which are available for sale (AFS), would be valued at a depreciated value, if as on the valuation date their value has depleted / depreciated.

The second proviso provides that in a comparison of actual cost and net realisable value in comparison shall be made category wise and not security wise. This is proper as it would take care of an exceptional, variation in the net realisable value of one security falling within a basket / category.

Other issues

One presumes that wherever a change has been prescribed by the new provisions, certain principles which have been settled in the context of the old section 145A, will be accepted by the department. For example, it is well-established that if the closing inventory is valued in a particular manner, the same principles should apply to the opening inventory. This has been judicially accepted. *{Mahalaxmi Glass works 318 ITR 118 (Bom.) and Mahavir Aluminium 297 ITR 77 (Del.)}.*

If this principle is not accepted it could create substantial hardship. For example, if a certain unlisted security has been depleting in value and the said loss has been allowed to an assessee from year-to-year, if the cost is substituted for the net realisable value in valuing closing inventory there would be a severe impact in one year. If it is the intent to tax the assessee for losses allowed in the past some transitory provision or relief provision should be contemplated to mitigate the hit which would otherwise arise in one year.

Further it should be clearly provided that the provisions do not to apply to an entity legitimately following the cash method of accounting. If this is done then, some controversies could be avoided.

Conclusion

On numerous occasions, various finance ministers have said that the endeavour is to tax real income, and not notional income. Professionals have always felt that the endeavour should be to narrow if not remove the gap between income as per accounts and income as computed under the provisions of the Act. With the plethora of accounting standards, and computation standards that an assessee would be required to follow and comply with, both these endeavours are likely to remain a distant dream.

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Character has to be established through a thousand stumbles.

— *Swami Vivekananda*

CA Bhaumik Goda

Impact of Ind AS on Computing Business Income

Background

With effect from the financial year ended on 31st March 2017, Indian companies are required to follow Indian Accounting Standards (Ind AS) which represents the Indian converged, globally followed, International Financial Reporting Standards (IFRS). The Ministry of Corporate Affairs (MCA) has provided following roadmap for implementation of Ind AS:

For companies other than banks, insurance companies, NBFC[1]	
2015-16 Voluntary Phase	• Early adoption
2016-17 Mandatory Phase I	• Companies with net worth of ` 500 crore or more
2017-2018 Mandatory Phase II	• All listed companies not covered in Phase I • All unlisted companies with net worth of ` 250 crore or more

Ind AS contains several significant differences in many areas compared to the erstwhile Indian generally accepted accounting principles (IGAAP). Significant shift is primarily on account of accounting for time value of money, requirements of fair valuation and recording transactions on the 'substance over form' principle.

On the basis of roadmap provided by the MCA, depending upon its applicability, each Indian company will converge its books from IGAAP to Ind AS. Illustratively, an ICO falling in phase II will prepare Books of Accounts (BOA) adopting Ind AS principles for FY 2017-18. In order to ensure comparability, ICO will be required to provide comparable figures for FY 2016-17 applying the same Ind AS policies. Differences on account of policy choices are routed through reserves, other equity, or as balance sheet items requiring adjustment in subsequent years. In the process of this transition, ICO will have to make adjustments to its books by following the principles of Ind-AS. Ind AS does not mimic IFRS in totality. In order to iron out difficulties for companies converging into Ind AS, Ind AS 101 provides option of

1 Separate road map is prescribed for banks, insurance companies and NBFC

First Time Adoption (FTA) to companies to select policy choices for selected standards. An option once adopted cannot be reversed. *Vis-à-vis* IGAAP, an Ind AS profit and loss statement includes a separate item dealing with Other Comprehensive Income (OCI) after profit and loss for the period. OCI includes items relating to remeasurement of defined benefit plans, remeasurement of financial assets at fair value, revaluation of plant and machinery etc.

In this article, the author proposes to deal with some situations having an impact on computation of business profits. Needless to say, on account of the all pervasive impact of Ind AS only common situations are picked up.

Inter-play between tax computation and books of account

BOA disclose commercial profits which reflect the financial performance of an organisation. It is the financial statement prepared which become the basis of computing taxable income. Interplay between BOA and its impact on determination of tax impact is no longer *res-judicata*. Courts have time and again tested the interplay between two and at times, upheld taxability basis of entries recorded in the BOA and at times, ignored the entries in the BOA if provisions provide to contrary. Illustrative principles which form canons of taxation are:

- Income can be taxed only if assessee has a right to receive the income. There must be a debt owed to him by somebody [E.D. Sassoon 26 ITR 27]
- Income-tax can be levied on real income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a 'hypothetical income', which does not materialise [Shoorji Vallabhdas 46 ITR 144]
- Whether the assessee is entitled to a particular deduction or not will depend on the provision of law & not on existence or absence of entries in the books of account. Entries in the BOA cannot be decisive or conclusive [Kedarnath Jute 82 ITR 363]
- Income-tax law does not march step by step in the divergent footprints of the accountancy profession [B.S.C. Footwear 83 ITR 269 (HL)]
- The question whether a receipt of money is taxable or not or whether certain deductions from that receipt are permissible in law or not has to be decided according to the principles of law and not in accordance with accountancy practice; Accounting practice cannot override the provisions of the Act [Sutlej Cotton Mills 116 ITR 1]

It is these aforesaid principles which are likely to serve as torch bearers in computing taxable income basis BOA prepared under Ind AS.

However, at the same time, there are provisions which rely on amount recorded in BOA for computing income taxable under various provisions. Some illustrative provisions which are directly dependent on the amounts recorded in the BOA are:

- Income chargeable to tax under Minimum Alternative Tax (MAT) provisions
- Section 14A disallowance read with Rule 8D. Rule 8D provides for disallowance to the extent of 1% of annual average of monthly average of opening and closing balances of value of investment whose income is or shall be exempt
- Net worth computation for the purpose of section 50B relies upon values recorded in books of account (except specified assets)
- Section 2(19AA)(iii) dealing with demerger requires property and liabilities to be transferred at values appearing in the books of account
- Section 49(2C) and section 49(2D) require determination of cost of shares of the demerged and resulting company respectively based on the same proportion as the net book value of assets transferred

in demerger bears to the net worth of the demerged company before demerger

- Section 56(2)(x) read with Rule 11UA considers the book value (except specified assets) as the basis for determining income of certain recipients
- Section 94B restricts deductibility of interest paid to AFs to 30% of EBITDA. In absence of a definition of EBITDA, it is arguable that EBITDA is based on amount recorded in BOA
- For purpose of benchmarking under transfer pricing provisions, the method of accounting followed by the tested party and comparable companies, the disclosure in notes to accounts etc plays a critical role

It is the interplay of the aforesaid provisions which is likely to result in interesting scenarios in the days to come.

Provisions dealing with Ind AS

Provisions of the Income-tax (Act) (except provisions specific cases) dealing with do not provide any specific guidance on computing taxable income on the basis of BOA prepared under Ind AS. Accordingly, profits need to be computed considering express provisions of law, guidance provided under Income Computation Disclosure Standards (ICDS), judge made principles (some of which have been stated above) which provide the overall framework within which income can be taxed or expense can be allowed.

However, the situation is different when it comes to MAT. Pursuant to recommendations of the Lohia Committee, the Act has been amended by introduction of section 115JB(2A)/ section 115JB(2B) and section 115JB(2C). In addition, the CBDT has issued Circular 24/2017 to clarify issues arising out of Ind AS. A brief summary of the above is provided hereunder:

Provisions	**Brief Summary**
Section 115JB(1)	• Profits/loss prior to OCI needs to be considered as the base for computing book profit • The said book profit needs to be added/reduced by various adjustments as stated in *Explanation 1*
Section 115JB(2A)	• The aforesaid book profit needs to be increased/decreased by amount credited/debited to OCI in the profit and loss account under the head 'items that will not be re-classified to profit or loss' • Increase/decrease by amount debited/credited to shareholder in demerger However, adjustments relating to revaluation of asset or gain or loss on equity instrument of subsidiaries/JV will not be subject to the above. The said amount will be taxed in year of retirement, disposal or realisation
Section 115JB(2B)	• In case a resulting company records the value of assets and liabilities of undertaking at a value different than the value in books of demerged company, then such difference in the value is to be ignored
Section 115JB(2C)	• Books of year of convergence and subsequent 4 years to be increased by 1/5th of transition amount (TA) • TA means amount adjusted in other equity (other than capital reserve and securities premium) on convergence date

Underlying philosophy of taxing TA is to offset gain/loss resulting from increase/decrease in MAT deduction by taxing TA on net basis over period of 5 years. In other words, it is possible that Ind AS may result in increase in expenditure (say interest resulting from fair value of loan) be offset by taxing TA over 5 years (explained later in illustration).

Ind AS 16 – Property, Plant and Equipment (PPE)

Ind AS 101 provides option to an entity to record PPE at:

- Carrying value as per previous IGAAP
- Fair value as on date of transition as deemed cost
- Revaluation carried out at end of each financial year as deemed cost

An option once exercised cannot be reversed. Ind AS 101 provides a similar option for recording of investment in subsidiaries, joint ventures or associates covered by Ind AS 27. The following is the tax impact under normal and MAT provision based on the option exercised.

Sr. No.	Option	Normal	MAT
1.	Carrying value as per previous GAAP	• No impact	• No impact as there is no change in book value
2.	Fair value as on date of transition as deemed cost	• Fair valuation to be ignored • Cost of asset for depreciation to be as has been provided in section 43(1)	• Depreciation pertaining to fair value to be ignored on account of mechanism provided in *Explanation 1* • Difference between book value and fair value forms part of TA • Section 115JB(2C) specifically provides for exclusion of said amount • Book profit for said asset to be computed in year of sale, transfer, retired, disposal based on actual realised value
3.	Revaluation carried out at end of each financial year as deemed cost	• Same as above	• Yearly revaluation may form part of OCI • Revaluation to not be included in book profit on account of specific exclusion provided in section 115JA(2A) • Rest of comments will be the same as in Sr. No. 2 above

As can be seen from above, MAT provisions are largely neutral in terms of tax impact for PPE covered by Ind AS 16 and investments covered by Ind AS 27. However, the option selected at the time of transition is likely to have significant impact on other provisions which rely upon the amounts recorded in BOA. Illustratively, if an entity records PPE (including land) at fair value, it will impact the net worth computation for the purpose of section 50B. Similarly, recording of investment in dividend yielding shares of its subsidiary at fair value may have an impact on the Rule 8D computation[2].

2 Comment proceeds on the basis that strategic investment is covered by section 14A which is subject matter of litigation

In addition to above, Ind AS 16 provides that the cost of an asset acquired by deferred consideration needs to be recorded considering the time value of money. Accordingly, the company will have to split its gross block into amount attributable to asset and record a financial asset for interest component. The said amount will be charged to the profit & loss account based on imputed interest [See interest free example below].

Ind AS 16 requires recording of decommission and site restoration cost as part of the cost of an asset. This requires an entity to make a fair estimate of decommissioning and site restoration cost on the date of acquisition of the asset. The said amount is recorded as part of the cost of the asset on net present value basis. Charge is created on a yearly basis to create provision for said expenses over the life of the project. This is illustrated as follows:

Particulars	**Amount (Crore)**
Site restoration cost	1000
Discount rate	10%
Net present value	385.54
Period	10 years

Ind AS 16 requires the entity to capitalise ` 385.54 crore as part of the cost of the asset and create a corresponding provision for site restoration expenses. In the provision for site restoration expense, the expense is charged to P&L by applying an imputed rate of 10%. Illustratively:

(In ` Crore)

Year	**Opening Balance**	**Interest**	**Closing Balance**
1	385.54	38.56	424.09
2	424.09	42.40	466.49
4	-	-	-
10	909.09	90.91	1000

The aforesaid treatment is likely to have the following impact on the tax computation:

Sr. No.	**Particulars**	**Normal**	**MAT**
1.	Inclusion of site restoration cost in cost of asset	• Cost of asset means actual cost of asset • ` 385.54 does not form part of cost of asset	• Included in cost of asset • Inclusion in cost of asset does not amount to revaluation. Accordingly, depreciation allowable on increased cost
2.	Yearly provision of site restoration cost	• Provision allowable only if it meets test of ICDS X	• Allowed as deduction only if amount set aside as provision for meeting liabilities other than ascertained liabilities

Under Ind AS, spare parts are considered as PPE as against the practice of IGAAP which permitted spare parts to be expensed to the profit and loss account. It is possible that a Company would have considered such spare parts as consumables and claimed the cost thereof as a deduction from its total income. Mandate of classifying spares as PPE is likely to result in increased litigation as tax authorities may rely upon the taxpayers own accounting treatment to contend that spares are items of capital nature and the cost thereof is not deductible.

Ind AS 109 – Financial instrument – Interest free loan

IGAAP provided no guidance on recording of a financial asset when an interest free loan was given. Ind AS follows the 'substance over form' principle. Ind AS 109 requires recording of financial asset and financial liabilities at their fair value at inception. Difference between the transaction value and the fair value is accounted to reflect the substance of the underlying transaction.

Illustratively, consider a Parent Co granting a 10 years interest free loan of ` 1,000 Crore to its subsidiaries, sub Co. The market interest rate in parallel situation is 10%. Accordingly, the fair value of the loan as on date of granting of the loan is ` 385.54 crore Ind AS will require the said transaction to be accounted considering substance over form as follows:

<u>Books of Sub Co</u>:

- Account ` 385.54 Crore as financial liability attributable to fair value of loan
- Account ` 614.46 Crore as other equity. This in substance reflects equity support provided by Parent.
- Sub Co will charge interest cost @ 10% on yearly basis to its profit and loss account and credit financial liability account. Over a period of 10 years, the financial liability will reflect repayment value of interest free loan (i.e. ` 1000 Crore). This is illustrated as follows:

(In ` Crore)

Year	*Opening Balance*	*Interest*	*Repay-ment*	*Closing Balance*
1	385.54	38.55		424.09
2	424.09	42.40		466.49
3	466.49	46.65		513.14
10	909.09	90.91	1000	–

The aforesaid treatment is likely to have the following impact on the tax computation of Sub Co:

Sr. No.	Particular	Normal	MAT
1.	Recording of financial liability	• No impact on income of business profit • However, value recorded in books needs to be considered for computing net worth for section 50B • Rule 11UA value - This will result in increase in net worth and Rule 11UA value	• No impact as Balance Sheet adjustment
2.	Accounting of capital support	• No impact • Section 56(2)(x) and section 56(2)(viib) should not be applicable in the absence of actual issuance of shares	• First Time Adjustment company need to consider adjustment as part of TA and offer 1/5th to tax • No impact otherwise
3.	Yearly interest charge to the P&L Accounts	• Section 36(1)(iii) provides deduction only in respect of interest 'paid' for the purpose of business • Interest is merely an accounting entry without a corresponding obligation to pay the Parent Co • Not deductible as also no obligation to withhold tax • However, interest recorded in books needs to be considered for computing EBITDA for purpose of section 94B - This however should not be included in the interest payable for the applicability of the section	• Deductible under MAT as none of additions provided in *Explanation 1* to section 115JB(1) apply

An issue arises as to whether the aforesaid conclusion changes on the application of Supreme Court (SC) decision in case of *CIT vs. Virtual Soft Systems (2018) 404 ITR 0409 (SC)*. In said case, the taxpayer, being a lessor in case of a finance lease claimed deduction of lease equalisation charges which were debited in its books of account on the basis of the guidance note issued by the Institute of Chartered Accountants of India (ICAI). Lease equalisation charge represents additional deduction charged to P&L account in addition to the depreciation so as to make it equal to capital recovery[3]. It was contended by the Revenue that the said amount is artificial calculation which bifurcates lease rental to capital recovery and interest component. SC held in favour of taxpayer and observed that the method of accounting followed, as derived from the ICAI's Guidance Note, is a valid method of capturing real income based on the substance of the finance lease transaction. It is a cardinal principle of law that the difference between capital recovery and the interest or finance income is essential for accounting for such a transaction with reference to its substance. If the same was not carried out, the Taxpayer would be assessed for income tax not merely on revenue receipts but also on non-revenue items which is completely contrary to the principles of the IT Act and to its scheme and spirit. The bifurcation of the lease rental is, by no stretch of imagination, an artificial calculation and, therefore, lease equalization is an essential step in the accounting process to ensure that real income from the transaction in the form of revenue receipts only, is captured for the purposes of income-tax.

It is submitted that ratio of the aforesaid SC decision should not be applicable in the instant case as the ratio of the SC decision was based on that cases peculiar facts. The SC considered the manner of finance income resulting from lease, which is taxed in hands of the lessor i.e. the bifurcation between the principal repayment and the embedded interest booked in the P&L accounts *vis-à-vis* the grant of the deduction. In case of interest free loan, interest expenditure merely reflects substance of the transaction and there is no corresponding income which ought to result in the hands of Sub Co so as to apply the ratio of SC's decision.

Books of Parent Co:

- Account ` 385.54 crore as financial asset attributable to fair value of loan
- Account ` 614.46 crore as investment in Sub Co. This in substance reflects equity support provided to Sub Co.
- Parent Co will recognise interest income @ 10% on a yearly basis to the profit and loss account and debit financial asset account. Over period of 10 years, financial asset will reflect repayment value of interest free loan (i.e. ` 1000 crore). This is illustrated as follows:

(In ` Crore)

Year	Opening Balance	Interest income	Repay-ment	Closing Balance
1	385.54	38.55		424.09
2	424.09	42.40		466.49
3	466.49	46.65		513.14
10	909.09	90.91	1000	–

Aforesaid treatment is likely to have following impact on tax computation of Sub Co.:

Sr. No.	Particular	Normal	MAT
1.	Recording of asset	• No impact on income of business profit • However, the value recorded in the books needs to be considered for computing the net worth for section 50B, Rule 11UA value - This will result in a decrease in net worth and the Rule 11UA value	• No impact as Balance Sheet adjustment

3 Lease equalisation charge is accounted where annual lease charge is more than statutory depreciation

Sr. No.	Particular	Normal	MAT
2.	Accounting of capital support	• No impact • Section 56(2)(x) and section 56(2)(viib) should not applicable in the absence of actual issuance of shares	• First Time Adjustment company need to consider adjustment as part of TA and offer 1/5th to tax • No impact otherwise
3.	Yearly interest income	• Section 4 read with section 5 provides that income can be taxed only if it is received, accrues, arises or is deemed to accrue or arise • In absence of an enforceable debt or a right to receive interest, the said 'interest' should not be chargeable to tax[4] • However, interest income should form part of EBITDA for purpose of section 94B	• Included as part of income under MAT as none of deductions provided in Explanation 1 to section 115JB(1) apply

Whilst the aforesaid illustration deals with an interest free loan, a similar conclusion is possible for interest free deposit in case of lease of property and concessional loan to associate concerns.

Ind AS 109 – Financial instrument – Equity investment

Ind AS 109 requires equity investment to be measured at fair value through profit and loss (FVTPL). In case of investments that are not held for trading, there is an option to designate the investment at its fair value through OCI. Exception to this requirement is investment in subsidiaries, associates, joint ventures which is covered by Ind AS 27.

Illustratively, ICO holds equity in various listed companies out of surplus funds. The treasury team of ICO liquidates shares depending upon the cash flow needs of the company and also parks surplus cash in shares and mutual funds. Ind AS requires ICO to recognise these investments at their fair value and the resultant gain/loss is to be recorded in the P&L account.

Year	Fair Value (in crore)	Accounting
1	100 (assume cost of acquisition)	• No impact as acquisition cost is same as fair value
2	90	• ` 10 crore recognised as expense in P&L
3	110	• ` 20 crore recognised as income in P&L

The aforesaid treatment is likely to have the following tax impact:

Year	Particular	Normal	MAT
1.	Recording of asset	• ` 100 becomes cost of acquisition	• No impact as no change in fair value

4 Refer *CIT vs. Excel Industries Ltd. (2013) 358 ITR 0295 (SC)*

Year	Particular	Normal	MAT
2.	Downward revision in fair value	Shares held as capital asset: • Not business expense Shares held for trading: • Shares to be recorded in accordance with ICDS VIII – security to be valued category wise and not individual script wise	• Allowed as deduction as none of addition provided in *Explanation 1* to section 115JB applies • Section 115JB(2A) not applicable as it applies to OCI items. In instant case, resultant gain/loss on fair value is routed through P&L
3.	Downward revision in fair value	Shares held as capital asset: • Not taxable as there is no transfer Shares held for trading: • Shares to be recorded in accordance with ICDS VIII – security to be valued category wise and not individual script wise	• Taxable as income as none of deduction provided in *Explanation 1* to section 115JB applies • Section 115JB(2A) not applicable as it applies to OCI items. In instant case, resultant gain/loss on fair value is routed through P&L

Under MAT, an issue arose whether downward revision in value of equity instrument can be hit by clause (i) of *Explanation 1* to section 115JB dealing with provision for diminution in value of investment. CBDT in Circular 24/2017 in relation thereto clarified as under:

"Question 1: The profit for the period may include Marked-to-market (MTM) gains/losses on account of fair value adjustments on various financial instruments recognised through profit or loss (FVTPL). A situation may arise where the losses on account of fair value adjustments could be added back in view of clause (i) of Explanation 1 to section 115JB (2) of the Act. Whether the losses on such instruments require any adjustment for computing book profits for the purposes of MAT?

Answer: Since MTM gains recognised through profit or loss on FVTPL classified financial instruments are included in book profits for MAT computation, it is clarified that MTM losses on such instruments recognised through profit or loss shall not require any adjustments as provided under clause (i) of Explanation 1 to section 115JB(2) of the Act. However, in case of provision for diminution/impairment in value of assets other than FVTPL financial instruments, the existing adjustment of clause (i) of Explanation 1 to section 115JB(2) of the Act shall apply"

Concluding thoughts

Ind AS brings about a fundamental change in accounting which has an all pervasive impact on financial statements. The aforesaid illustrations cited above only illustrate some of their challenges which taxpayers are likely to face in the years to come. Complexity only increases in case of financial instruments like CCD, CCPS which have a flavour of debt as also of equity. Year of FTA is likely to be critical as a taxpayer company will set its tax policy considering the Ind AS policies adopted by the taxpayer. It is advisable to give careful consideration to the tax impact arising out of Ind AS adoption, particularly the First Time Adoption. Some elements can be discerned on the face of the financial statements; however, some elements can be unearthed only after critically analysing the notes to the accounts.

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CA Namrata Dedhia

Reporting Guidelines for Business Income

Introduction

In case of most assessees, it is mandatory to file the Income-tax returns electronically through the Income-tax portal. These returns are processed first by the Centralised Processing Centre ('CPC'), identifying mismatch, defects, etc., and sending out communications to the assessee in respect of the same, even before it may or may not be selected for scrutiny assessment. Often times, the returns are processed under section 143(1) at the CPC level itself, making certain additions or disallowances merely based on inconsistencies the information filed in the return.

The Computer Aided Scrutiny Selection ('CASS') system also relies on certain criteria, which are identified based on the reporting done or not done in the return of income, for selection of a particular return for scrutiny. Limited scrutiny assessments have been initiated in the past due to reasons such as difference in reporting between the Income-tax return ('ITR') and Tax Audit report ('TAR'), or inadequate income as compared to foreign remittances received by an assessee, etc. The electronic processing of returns as per pre-defined criteria makes it important to ensure that the returns are filled up correctly and consistently so as to avoid of unnecessary hassles.

Disclosure in Part A: Balance Sheet, Profit and Loss Account and Other Information

ITR-3 is applicable in case of individuals and HUFs having business income. ITR-5 applies to assessees other than individuals, HUFs, companies and persons filing ITR 7, while ITR-6 applies to companies other than those claiming exemption under section 11. Part A of these return forms mainly consists of details from the financial statements of the assessee, i.e., Balance sheet, Profit and Loss Account ('P&L Account') or Receipt and Payment Account, where applicable, Other Information, which captures some of the points reported under TAR and Quantitative details of inventory. The schedule on Other Information and Quantitative details are optional for assessees who are not liable to Tax Audit under Section 44AB. In case of company assessees, the Balance Sheet and the P&L Account information can be as per Indian GAAP or Ind-AS, depending on which of these is adopted to prepare the financial statements of the company.

The details filled in the Balance sheet, P&L account and Other Information schedule need to be consistent with those provided in the rest of the return form, as well as the TAR. The disclosures in which care should be taken to maintain uniformity are as under –

i) The profit as per the P&L account should match the profit which is considered as the starting point for the computation of income under the head Business or Profession

ii) Depreciation as per the books of accounts should match the depreciation disallowed in the computation of income before claiming depreciation as per the IT Act.

iii) In case of assessees to whom limitation of interest deduction under section 94B applies, interest expenses as per the P&L account could be compared to the interest expenditure mentioned in Clause 30B of the TAR. While the latter would include only interest in respect of debt from a non-resident Associated Enterprise, as against all interest expenditure reflected in the former, care should be taken not to add other finance costs to the interest while filing the ITR.

iv) The incomes and various heads of expenses in the P&L account should be reconciled with the amounts reflected in Clause 34(a) of the TAR, wherein details of payments and receipts liable to tax deduction or collection at source are provided.

v) All disclosures in the TAR, which would result in a disallowance or addition should be duly reflected in the Other Information schedule in the ITR.

vi) The break-up of long term loans and advances in the Balance Sheet should be provided with caution. Loans and advances reflected as not for the purpose of business or profession could trigger examination for applicability of section 14A for the assessee as well as section 2(22)(e) for the recipient. Furthermore, loans and advances disclosed as given to shareholder would result in addition under section 2(22)(e) for the recipient, if not already voluntarily offered to tax. Similar care should be taken in case of reporting of other non-current assets and short term loans and advances in the Balance Sheet.

Likely issues during CPC processing

During the processing of return by CPC, information populated into the system from various sources – reports filed by the assessee such as TAR, report of Specified Financial Transactions, etc., other sources such filings made by banks, credit card companies, mutual funds, stamp duty registration authority, service tax / GST authorities, etc. – is analysed for mismatch or missing information. This results in one of the three outcomes –

1. The return is treated as defective under section 139(9) and notice is issued for rectifying the defect, largely in cases of missing information, or

2. The return is processed by CPC after making necessary changes for the mismatch, or

3. The return is selected for scrutiny under CASS.

In the following situations, the return is usually treated as defective –

- Despite having business income, either details in Balance Sheet and P&L account are not filed, or the four parameters in case of books not maintained are not provided
- Code is provided for nature of business, but no business income is reflected
- TAR is said to be not applicable and not filed even though the turnover exceeds the limits under section 44AB or profits are lower than the prescribed percentages in the presumptive tax sections

In cases of mismatch of TDS details as per the ITR and as per Form 26AS, the return is automatically processed after giving credit of the lower amount of TDS as per Form 26AS. Even where there is an error in mentioning the TAN of the deductor, the TDS is treated as invalid and credit for the same is not allowed.

Most other cases of mismatch of information form the basis of selection of a return for scrutiny assessment. This includes some of the points mentioned in the above section as also the following scenarios –

- Payments made to specified persons under section 40A(2)(b) is reported in TAR, but no amount or different amount is mentioned in the Other Information schedule
- Large inward remittances are reported, but business income reflected in the ITR does not match with the same
- Large outward remittances are made, for which Forms 15CA and 15CB have been issued

Reporting under GST and Reporting under ITR

The P&L Account under Part A of the ITR requires separate disclosure of GST and other indirect taxes collected on income, as well as GST and other indirect taxes paid on purchases and expenses. While presenting information here, it must be ensured that the amounts of GST collected, appearing on the income side and GST paid, as appearing on the expense side should have no impact on the net profit. In other words, the net result ought to remain the same irrespective of whether inclusive method or exclusive method is followed for recording the taxes.

CBDT Notification No. 33 of 2018, dated 20th July 2018 amended the TAR in Form 3CD with effect from 20th August 2018, adding various new clauses to the report, including break-up of expenditure in respect of entities registered or not registered under GST. While the requirement of reporting under the clause pertaining to GST has since been deferred till 31st March 2019, similar details are already required to be provided in ITR-6 by assessees who are not liable to Tax Audit. Thus, company assessees, who are not liable to tax audit will still need to provide reconciliation of the total expenditure incurred during the year, as disclosed in Part A under P&L account, with expenditure in respect of registered and unregistered entities. The expenditure in respect of entities registered under GST is required to be further divided into three categories –

a) Relating to goods or services exempt from GST,

b) Relating to entities falling under the composition scheme, and

c) Relating to other registered entities

The GST schedule only distinguishes between the expenditure on the basis of the registration status of the person dealt with, and not whether a certain expenditure has been subject to GST or not. Thus, expenses which are covered under the Reverse Charge Mechanism, will have to be reflected as those relating to unregistered entities, although GST has been paid on the same. To this extent, there would be a mismatch between the GST liability and input credit details filed in the GST returns and those required to be filed in the ITR. With free flow of information between the tax departments, this difference may reflect in the Individual Transaction Statement, in a manner similar to the Service Tax details appearing in it so far, and will need to be explained during the course of the assessment proceedings. A material difference, could in fact, be the reason for initiating a limited scrutiny going forward.

The extent of details called for in the ITR makes it clear that the intention appears to be reconciliation of filings made under direct and indirect tax laws and to plug any potential loopholes for evading taxes. Even ITR-4, which is required to be filed by assessees opting for presumptive taxation provisions, calls for the amount of turnover / gross receipts as per the GST returns filed by the assessee along with the GSTIN of the assessee. However, it seems rather onerous that small assessees who are not subject to Tax Audit should be required to report the break-up of expenditure in such detail, while larger assessees need not do the same, at least till 31st March 2019. Extracting these details would need robust accounting systems to capture the necessary information, which may not be possible in case of small assessees.

One will need to ensure that these details are tied up, not only with the GST returns already filed, but also with the GST annual returns, which are due only on 31st December, much after the due date of filing the ITR. In effect therefore, both the ITR and GST annual return will have to be finalized simultaneously, without waiting for the 31st December deadline.

Conclusion

The reporting requirements for filing the ITRs are getting more extensive with each passing year. The ever-increasing scope of Tax Audit adds to the existing burden on the auditor, who is faced with the grave risk of being penalised under section 271J for incorrect information furnished in reports or certificates, even though it may be impracticable to verify the correctness and accuracy of the excessively large volume of data involved. The amount of information being gathered and processed by the CPC leaves little room for fact finding during the course of the assessment proceedings. In fact one wonders – are we still a self-assessment regime, which can be easily complied with by small businessmen without professional assistance?

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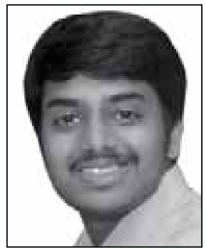
You know but little of that which is within you. For behind you is the ocean of infinite power and blessedness.

— *Swami Vivekananda*



Meet Hiren Shah

THE DASTUR ESSAY COMPETITION

Is Intolerance Growing Nationally & Internationally?

Introduction

"Intolerance in itself is form of violence and an obstacle to the growth of a true democratic spirit" – Mahatma Gandhi

Intolerance in general means unwillingness to accept views, beliefs or behaviour that differs from our own. Intolerance leads to loss of faith in everything. In psychological terms intolerance is known as ambiguity tolerance which means individuals view such stimuli in a manner which leads to unacceptance and they may even revolt against such ideas. Intolerance is the unacceptable situation for people to accept the views, beliefs, or behaviour which differs from their own. To put in simple words, disallowing something that one person (or a group of persons) doesn't like is intolerance. We are said to be intolerant even when we do not accept our younger siblings view! Intolerance therefore has a broad meaning wherein we would consider those circumstances when intolerance shown is not justified or circumstances which hamper one's basic right to speech. If it is not controlled it may give rise to the high level of hate, severe crimes and discrimination in the society. With advancement in means of destruction the risks of intolerance has multiplied. Through intolerance one's opinion is suppressed because it may be uncomfortable for the other group or any specific person. Intolerance can be seen at micro as well at macro level. At micro level Intolerance would be shown to a particular individual while at macro level it would be shown to community, group or any nation at large.

"Intolerance of your present creates your future" – Mike Murdock

Intolerance exists in our day-to-day activities; we are tolerant in some situations and intolerant in others. We all have some or other conflicting ideas, dreams and thinking which correlates with other people's beliefs and thinking which in turn brings us to a point where we either accept their views or deny it. Person who could think on it without any bias would always make a right decision. It is not that intolerance is bad, there are situations where showing intolerance was the right thing to do. But these may hold true only at individual level where a mother would be intolerant to her child if he/she shows bad manners and any criminal is not tolerated by law and brought to justice in order to maintain order in the society. The above discussed are those instances where showing intolerance is the right thing to do but there are circumstances due to which intolerance has become major problem for all the developing economies.

"Intolerance is the most socially acceptable form of egotism, for it permits us to assume superiority without personal boasting." – Sydney J. Harris

A country educates children in its own language, sharing with them a particular worldview with moral and cultural values. Therefore, education, more specifically religious education, is often a clear indicator of where a country is heading. If Middle Eastern children are taught to hate from the very beginning of their lives, they have quite a low chance of changing their minds as adults. As a child person would believe in each and everything which is taught to him / her by teacher or anything which he / she reads in a textbook. We cannot expect countries in which there is educational bias to treat others with respect, to solve problems peacefully, to compromise with actions of other nations, and to promote peace. Pillars of a great nation are laid down by the quality of education which is provided to their citizens as it defines their thinking and principles towards someone or some situation. The major reason why intolerance is prevalent is due to the mindset of people which could be moulded through education.

Intolerance has been growing nationally and internationally due to various diversities such as caste, religions, race, language, geographic location, sex, governance etc. These all things contribute to different thinking and creation of groups who always consider their benefit as priority. These is harmful because if they find a particular idea or belief which would conflict with their own belief than these would lead to non-acceptance of such idea or belief and could also result in violence between those groups. Intolerance have a cascading effect and it multiplies by damaging thinking of every person or group involved in it. It effects both sides, the side which is being intolerant would never be able to innovate, be creative or imbibe anything new in their life. While the other party who is not being tolerated feel disappointed and left out.

With intolerance there can be devastating effects on the economy like intolerance shown to a particular community group or belief of that group can create havoc which was clearly seen in Jai Bhim Andolan consisting of dalits revolting against the Peshwas for killing one of them. The facts were that Dalits were celebrating their victory of Two Hundred years old war against Peshwas when they were under British army which was not tolerated by Peshwas which in turn led to mass conflict. These conflict led to violence, destruction and unavoidable circumstances in our country. If either of the group had shown some tolerance these might have never happened. The above scene was a religious intolerance and there are in total three different types.

[1]Types of Intolerance

There're many types of intolerance in the world. However, the most widespread ones are:

- <u>Religious / Racial Intolerance:</u> When intolerance is shown towards a religious group or its beliefs, it's known as religious intolerance. Similarly, racial intolerance is one that's shown towards people of any particular race.
- <u>Ambiguity Intolerance:</u> Some people show intolerance towards ambiguity as they perceive it threatening. This type of intolerance is often seen in workplaces, and while not necessarily bad, it sometimes creates unnecessary problems for everyone.
- <u>Liberal Intolerance:</u> Liberals in our world often claim to give everyone the same opportunity of expressing their views regardless of their social backgrounds. However, when they find the views of conservative people to be different, the same liberals start feeling uncomfortable. This type of intolerance is very common in college campuses.

[2]Reasons of Intolerance in Society

There're a variety of reasons behind intolerance in our society. The biggest ones are:

1 http: / / www.impdays.com / intolerance-slogans-types-reasons-effects-impact-society-solutions /

2 supra

- Media and Entertainment Industry: Whatever those celebrities may say, it's a fact that they've a big hand in making our societies intolerant. Violent movies and news reports have become a norm in today's world, and they leave a major negative impact on our thoughts and thinking processes.

- Political Groups: Religion, race, caste and creed have long been used by political groups as pillars for politics. There've been well-documented cases when political groups showed deliberate intolerance towards any particular group of people to boost their vote bank, which is further worsened by the next cause in our list.

- Unsocial Elements: When political groups ignite the fire of intolerance for their benefits, the unsocial elements also take advantage of those events to create some name for themselves. Sometimes they're also involved in the play by political parties themselves. And whether someone believes it or not, in most cases people belonging to this category do the worst crimes that can be done under intolerance.

- Historical Events of Intolerance: Intolerance is a big problem because it's a self-sustaining vicious cycle. Once a particular religion, race or group of people are shown intolerance, it stays in their minds and in turn they too become intolerant towards the religion or race that started things first. This intolerance is then passed on to future generations, which keeps it sustained in our societies.

Effects of Intolerance

The effects of intolerance are so far reaching that sometimes they can't be perceived by a common man:

- Stops the Flow of New Ideas: When people from any particular group of society are barred from voicing their ideas, the ideas can't flow as quickly as they could, which leads us to the next point.

- Stifles Research and Development: When there's lack of ideas, there's lack of innovation and research. Lack of research, as you may expect, stifles the growth and development, as intellectual property isn't private property of any elite religion, race or social group.

- Spreads Disappointment: The people whose voices are suppressed feel disappointed by that and stifled development may bring even more disappointment among all social groups.

- Divides Societies: Last, but certainly not least, intolerance divides societies. Sometimes it divides them so much that even after having a shared history people belonging to two different religions or races start hating each other as their worst enemies.

[3]Case study on Intolerance resulting from conflict Resolution in the Sudan – The Sudan case is unique and more intricate than the rest of the African countries in some similar situations. For example, Sudan became independent in 1956, forty one (41) years ago, and ever since it has been in conflict with itself. Many serious peace negotiations and agreements have been initiated but all had been in vain.

The case of the Sudan conflict centres on the question of "Self-determination" demanded by the African South but rejected by the Arab North since British colonial rule (1898-1952) until to date. The reasons behind this demand arose from conflict of interests between the North and the South. The Southerners have always strongly believed that the Northerners have been subjugating them politically: exploiting them socially and

3 http://pdfproc.lib.msu.edu/?file=/DMC/African%20Journals/pdfs/africa%20media%20review/vol11no3/jamr011003006.pdf

economically; dominating and assimilating them culturally, racially and religiously. The Southerners in turn have always resisted such practices through parliament sessions, political conferences or through armed struggle when necessary. The seventeen-year war (1955-72) was brought to an end through "Addis Ababa Agreement 1972". The on-going war has now lasted for fourteen years and probably more to come. The agents of peace and conflict resolutions are doing everything within their power to bring peace, justice and religious tolerance to the Sudan. Presently peace negotiations are going on between Khartoum and the SPLM/A.

That is one part of the story concerning the North – South conflict of the Sudan. The other impact is the North – North conflict and South - South conflict. The North - North conflict is mainly based on the ethnic struggle for power in Khartoum. In the South-South conflict two powerful groups have emerged resulting from the split of SPLM in August 1991 into SPLM a main organization commanded by Dr. Garang and the splinter group of SSIM/A commanded by Dr. Machar. Several attempts have been carried out to unite the two organisations but without success. Instead the two have been engaged in attacking each other militarily and politically. The Southern people who used to struggle together against the North are now polarised into supporting one side or the other. With these it could be said that Intolerance has divided people living in the same country and also have made them rise against each other!

[4]<u>Case Study of Intolerance Resulting from Biases in Education</u> – A close inspection of Middle Eastern textbooks provides many examples of "whitewashing" – in other words, selective removal of certain content. A few famous examples of whitewashing:

- Certain religions bar the teaching of evolution and creationism in schools because these subjects contradict their beliefs.
- When teaching about war, each country will downplay its own flaws in favouur of a more patriotic view.
- A new, controversial curriculum adopted by Texas schools will downplay the horrors of slavery and its role in starting the Civil War.

It can be understood from these examples that three of the biggest reasons bias exists in textbooks are:

- To promote a certain religion
- To encourage patriotism/nationalism
- To make your country look like "the good guy".

Countries in which religion plays a dominant role are more likely to utilise textbooks with a religious bias; most Middle Eastern countries fall into this category. Indeed, religious intolerance is the most widespread and violent form of intolerance in the Middle East.

Many states and countries have guidelines in place to prevent bias in education, such as California's Code 60044: "No religious belief or practice may be held up to ridicule and no religious group may be portrayed as inferior. Any explanation or description of a religious belief or practice should be presented in a manner that does not encourage or discourage belief or indoctrinate the student in any particular religious belief." Unfortunately these guidelines are rarely followed.

[5]Some examples of Intolerance which have affected our nation:-

- <u>Holy cow! Ban on beef by several State Governments</u>: This is what probably started it all. Maharashtra, Haryana and Jammu and Kashmir banned beef in their States. The Government of India contemplated a move to bring an anti-cow slaughter law and the whole thing just snowballed from there.

4 https://www.edume.org/intolerance-case-study/

5 https://www.youthkiawaaz.com/2015/12/instances-of-intolerance-in-india-in-2015/

- Death in Dadri: Man lynched to death on suspicion of eating beef. The beef ban gave the power to many radical groups, who took it upon themselves to implement it. A Muslim man was dragged out of his house, lynched and killed on the suspicion that he and his family in Dadri, Uttar Pradesh had stored beef in their refrigerator. The victim's elder son works as an engineer with the Indian Air Force and was posted in Chennai when the incident happened. His response on the attack – "I can't blame everyone... Most people are good...only a handful are bad. Saare Jahan se acha, Hindustan Hamara."

- Shiv Sena and the anti-Pakistan protests: From smearing ink on writer and politician, Sudheendra Kulkarni to opposing the concert of Pakistani ghazal maestro, Ghulam Ali, the Shiv Sena opposed any activity that concerned our neighbours. Keeping that in mind no matches of the Pakistan cricket team were scheduled in Mumbai during last ICC Twenty20 World Cup, which was hosted by India.

- Award wapsi. Writers, artists and scientists take a stand: Over 30 writers have returned their State awards citing the reason that they are 'raising their voice against the changing secular fabric of the country'. They were joined by many other scientists and artists in this exercise. It's important to keep in mind that this response is not born out of an anti-Modi or pro-minorities bias. It is the result of accumulation of growing dissent over a variety of repressive measures against individual freedoms.

- Shahrukh Khan Comments on intolerance: In an interview, Bollywood superstar Shahrukh Khan said, "There is intolerance, there is extreme intolerance and there is growing intolerance." What followed were a series of vicious attacks on the actor. Social media went into a meltdown with SRK fans locking horns with people who questioned the actor's patriotism. Actor Anupam Kher was also very vocal in criticizing SRK for his remarks.

- Aamir Khan also comments on Intolerance: Speaking at the Ramnath Goenka Journalism Awards, Aamir Khan made a confession that his wife did not feel safe for their child, given the situation in India and asked Aamir if they should move to another country. Anupam Kher was again the first to counter Aamir Khan's remarks. Social media again went abuzz with trolls and memes. Both Aamir and Shahrukh Khan were asked by political leaders to leave the country and shift to Pakistan, only to prove their case on 'intolerance'.

- The Censor scissor is very sharp: Even James Bond was no match for the cutting prowess of India's censor board. 007's long and passionate kissing scenes with Monica Bellucci were edited from the latest Bond flick 'Spectre', which led to the birth of 'Sanskari James Bond' on social media. Images of goddesses like Kali and Lakshmi were blurred in 'Angry Indian Goddesses' and words like "adivasi", "sarkar" and "Indian figure" were beeped out.

  Even though films are being granted an "A" certificate for their 'adult' content, the censor board is still intolerant and demands necessary cuts in the movie.

- Mayhem in Cuttack: Even the Indian cricket team could not avoid the 'intolerance' fury of the Indian masses. During the first Twenty20 between India and South Africa in Barabati stadium in Cuttack, play was held up for more than 50 minutes. Why? Spectators, largely from one section of the stadium, began throwing plastic bottles onto the field.

  They were showing their intolerance to the poor performance by the Indian team, which was bowled out for 92, their lowest T20 total.

These were just some of the major 'headline-making' incidents that fuelled the tolerance – intolerance debate in the country this year.

That's not all. The year also saw some people being intolerant to the word 'intolerance'. The best example could be actor Anupam Kher, who took out an anti-intolerance protest march in Delhi.

[6]Impact on Society:

Pros

- Intolerance, when shown against wrong things (i.e. laziness, average performance, cocky attitudes), can be constructive too.
- Sometimes intolerance also helps in limiting stupid speech that could spark even more intolerance and hatred.
- Intolerance sets the bar high for administration and powerful personalities – cause one small mistake of words or activities can spark a fire.
- Sometimes when a religious or racial group has to be pulled together, and nothing seems to be working, intolerance can pull them together.

Cons

- Stifles innovation and development by preventing the flow of new ideas.
- Leaves hard feelings in the hearts of people who suffer from it.
- Divides the society and nation.
- When shown towards a religion / race, it leaves unforgettable traces in the pages of history for generations to come.
- Creates unnecessary problems in workplaces.
- Projects a wrong image of the nation / religion in front of world.
- Leads to a lot of bloodshed in many cases.
- Makes it easier for outside forces to exercise their power on the nation.

Importance of Tolerance

"Anger and intolerance are enemies of Correct Understanding" – Mahatma Gandhi

It does not allow people to live with equality, indiscrimination, freedom, or other social rights. Jews and Filipinos of Israel are the best example of high level intolerance due to various issues of their identity, self-determination, security, separate state etc. Intolerance does not allow any person other than their own religion, race or nationality to believe, accept, imitate and promote another religion, race or nationality. On the other hand, tolerance is one of those qualities which promotes unity in society even after diversity. Tolerance means to agree to the existence of opinions or behaviour that one dislikes or is uncomfortable with.

"Tolerance not only allows one to live with each other or is indifferent in the case of injustice, but shows honour and necessary humanity for every person."

Tolerance is one of man's sterling virtues; and civilization itself has its indebtedness to it. Arthur helps has made a relevant comment in this context – 'Tolerance is the only real test of civilisation'. In a family tolerance establishes the cementing tie among its members. Various complications may arise there for various reasons. The master of the house is to face them quite dispassionately and with tolerance. Thus, chaos makes room for cosmos and discord ends in a concordant note; the house becomes a home of peace and harmony. The great Indian savant, Ramakrishna Paramahansa teaches his disciples with the exhortations – 'Have patience, have patience and have patience'. It is the very essence of a religious faith to tolerate others. If it fails to do so, it degenerates into fanaticism; and fanaticism is undeniably the grave of a religious cult.

An ideology can never be forced upon a man. He accepts and follows one purely with his wisdom and independent things. Everybody

6 http://www.impdays.com/intolerance-slogans-types-reasons-effects-impact-society-solutions/

has the freedom to think and believe and in this rational process, different persons are christened to different ideologies. One should remember that all political ideologies have the common goal; to liberate man from the bondage of tyranny, exploitation and injustice. The only difference that lies between them is the respective way to reach the target. The way which is the easiest and most pragmatic attracts and impresses the highest number. An ideology thrives and earns popularity in this process. Bearing this truth in mind a political activist should show tolerance in his dealings with the people. Thus, with tolerance the clashes may easily be avoided from the arenas of politics.

It encourages new ideas, trust and positive environment in the society. There is separation from intolerance unity which creates the status of disputes between dislikes, denials and people. At the same time tolerance promotes unity in diversity (India is the most appropriate example). It is an inborn quality among every individual at various degrees. It depends upon the environment in which individual has grown and hence it is also important raise child's in health environment where everyone's view is accepted with free flow of ideas. It is the ability which develops a positive attitude towards those people who have different religions, practices, opinions and nationalism in the minds of people. But even too much tolerance is not good for society, thus there has to be a proper balance between both to get good results.

National Scenario

There's been an impassioned debate about rising "intolerance" in the world's largest democracy recently, with a flurry of tweets, Facebook posts, blogs and editorials on the subject. This debate took off in earnest when a number of writers, historians and scientists returned their awards to protest against a country they felt had become highly intolerant of dissent, minorities and anti-government opinions. In effect, this allegation was primarily directed against Prime Minister Modi and the BJP Government.

The whole phenomenon of "rising intolerance" coincided with the high-stakes Bihar election campaign – this is why the outcry smacks of dubious intentions. Surprisingly, most intellectual opinion and media coverage was heavily tilted in favour of acknowledging this discourse of intolerance as reality. However, is this "intolerance" indeed a reality? Or is it just the perception of a few that was deliberately used to create an environment of intolerance to serve narrow political ends?

After high-voltage political drama of Bihar elections there was a need for a rational investigation of this phenomenon because it had some very serious implications for India. If it was just a perception which gained strength because of the 24-hour news channels and social media, then it proved itself powerful enough to affect the Bihar poll verdict and hence marked the onset of a dangerous trend which could just make the whole process of elections futile.

To begin with, what gave rise to this chorus against intolerance? The answer lies in a number of scattered events, including but not limited to the lynching of a Muslim man over rumours of beef consumption, the murders of three intellectuals in separate incidents and an ink attack on Sudheendra Kulkarni ahead of a book launch by a former Pakistan foreign minister. Now all these needed a systematic investigation to whether such events were only rational basis for global defamation of India or there was any political agenda behind the same.

To begin with, the murders of writers MM Kalburgi, Narendra Dabholkar, Govind Pansare led to speculation that they were targeted by Hindu right-wing elements for their campaigns to expose sham miracles and godmen. The facts reveal that Kalburgi was murdered in Karnataka (Congress ruled-state) and the police has not yet found any substantial evidence to prove the involvement of the RSS or any other right wing organisation.

The police (law and order) is a state subject in the Indian Constitution so the State Government should be the first to be questioned. Coming to Pansare, he was not just known for his anti-Hindu views, and had invited considerable ire for his campaign against toll taxes; it is thus quite plausible that he might have been killed by the toll mafia. It is also worth noting that murders on the basis of religious disagreement are not a new phenomenon, and anti-Hindu activists are at threat just as are anti-Muslim or anti-Christian campaigners. It is true that many people are sensitive - and indeed, intolerant - when it comes to their religious views, whatever be their hue.

All the above illustrations and examples seen are of course intolerance but are like those that has always existed in India.

When the elite intellectuals talk of India's liberal traditions and multiculturalism they must not equate it with Western models of secularism. Indian society, with all its diversity, has its own distinct features. Essentially, both Hindus and Muslims are very sensitive about their respective religious symbols, and over the centuries of interaction they have learned to respect each other's sentiments. It can be seen in the fact that historically beef eating has not been popular even among the Muslims in India. Some Muslim emperors, including the Mughals and the nawabs of Awadh and Bengal, strongly discouraged cow-slaughter and in some cases even banned it.

On careful analysis of intolerances viewed above it could be said that it arose due to Vendetta driven criticism which often generates a very bad picture of India in international community.

Any kind of false perception cannot stand the test of time and wisdom. Sooner or later, people come to know the truth. And when this happens then any genuine criticism in the future will always be viewed with skepticism. Further, this kind of vendetta-driven criticism often generates a very bad picture of India in the international community. Sometimes, sitting within our geographical boundaries we create intellectual confines without realising the international fall-outs of our statements and actions, especially in the age of the internet world where everything gets viral in the flash of a second. A responsible criticism would have initiated a healthy debate on issues ranging from cow-slaughter and the returning of awards to the status of foreign-funded NGOs and success (or lack thereof) of Government schemes like Swachh Bharat. An unbiased investigation will always result in rational argument.

The worst thing about intolerance is that it not only feeds itself but also grows itself as tolerant societies are often suppressed by intolerant ones. On the other hand, intolerant societies also do nothing except for spreading more intolerance. Therefore, if a change has to be brought, it can only be brought by collective efforts. And the efforts in that direction should start from the top – from Governments of all major nations. If Governments are willing, they can really bring a change in their societies as they possess all the resources to make it happen.

And that change should be brought quickly, especially among the developed nations, because tolerance is necessary for development. While developed countries provide a high quality lifestyle to majority of their individuals, non-developed or developing countries don't. Therefore, Governments of such countries should aim to tackle the issue of intolerance before their developed counterparts.

In a modern and developed society, there should be only one kind of intolerance – the one that's shown for intolerance. Any other thing, whether they're someone's opinions, religions, races or anything else, shouldn't be suppressed at all. Only then a nation can start moving rapidly on the track of prosperity.

Fortunately, some big names have taken initiative in this direction. UNESCO has drafted a lot of instruments that prevent not only intolerance but also racism, including "Declaration of Racial Prejudice, 1978." Global companies have also come ahead by bringing diversity into its staff composition, and various NGOs are also taking interest in the cause. But to speed up the process and spread it widely we'll also have to change ourselves. We need to learn respecting others' views, religions and races. Once we do that, we'll be able to experience a new world in our surroundings, which will be exceptional by all means.

Solutions

There're a variety of solutions that can be applied to prevent intolerance. Some of them are given below:

- Education: This is arguably the best (and first) way to stop the growth of intolerance. Quality education that teaches about tolerance and its importance in societies can help a lot in mitigating intolerance.
- Awareness: Organisations and Governments should accept the existence of intolerance in their societies and organise campaigns to spread awareness about it. Public too should accept the fact they're intolerant and they need to correct their actions and thoughts.
- Review: The results of each effort done to mitigate intolerance should be measured, and the efforts with best results should be repeated. There should be an agency in every state or country to analyze the cases of intolerance and their growth from time to time.

Conclusion

Intolerance in our societies is not something that we can pass on. It's a problem that needs treatment immediately. We should accept its existence and make necessary efforts to prevent it from growing further because the more it grows, the more difficult it can be to eradicate, and more destruction it can do to the world. The only way to eradicate intolerance is by changing the mindset of people which would definitely take considerable amount of time and hence short-term goal is to prevent the situation from worsening by understanding views of each and every group and taking right decisions. Through education Intolerance would definitely be eradicated with time. With every generation population of our country becomes more and more literate and through which people are also becoming tolerant. Educated masses know the importance of equality and fundamental rights and hence they respect views and thinking of other people around them. So as per my thinking, intolerance is not impossible to eradicate and there would be a time when each and every person's view in society would be respected, understood and no one would to be suppressed from expressing his/her opinion. It would be a time when people would live in harmony free to follow any religion they like, work wherever they want, eat whatever they think fit, live in any part of the world of their choice and express their thoughts more clearly than they ever did.

"When you choose love over hate, faith over despair and acceptance over intolerance you are doing your part to change the world".

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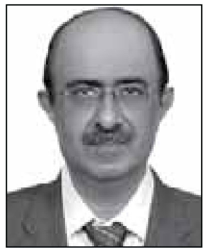

CA Dinesh Tejwani

TECHnovation

Evolving Technology in Accounting

The modern double entry system of book keeping can be traced back to the year 1494, attributed to Luca Pacioli's published work on this topic.

From handwritten records to computerised accounting is a substantial change in the way businesses maintain their accounting records.

Now with the internet and digital technology, we are witnessing unprecedented changes in this area, which will be described in this article.

Computerised Accounting

The advent of computerised book-keeping in India can be traced back to 1986 with the launch of Personal Computers. Prior to that only large companies were using mainframes for this purpose. From customised solutions which were tailored for specific business needs, standard accounting software emerged and resulted in mass adoption. In India, with the introduction of GST, the need to digitise accounts has almost become a necessity.

Cloud Accounting

In recent years with the widespread acceptance and availability of cloud storage, businesses started shifting to cloud accounting, where data would reside on external cloud servers. For many the cloud storage provided by various internet companies can be more robust and secure than their own personal computers.

This enabled anytime, anywhere access to accounting data with the help of an internet connection and a browser. Real-time access to data is now easily available to team members, sitting at different places.

With Cloud accounting, users were saved the trouble of taking data backup. It also solved the problem of upgrading software, new upgrades can be pushed any number of times, without the user having to do anything.

Most cloud software can be used on multiple devices PCs, laptops, tablets and mobile phones. This attracted young users. While generally desktop-based software charged a one-time license fee, (along with an optional annual upgrade fee) and permitted using unlimited companies, cloud software pricing was based on a recurring fee, based on company/ number of users.

Here is a summary of basic differences in cloud accounting and desktop accounting

	Cloud Accounting	**Desktop Accounting**
Accessibility	Internet and browser-based anytime, anywhere access.	Can work only on the PC where licensed software is installed
Data Backup	Auto backup 24/7. Nothing happens if your PC is stolen or breaks-down	Backups have to taken manually.
Sharing data with CA	CAs can log in and see the data in real time	Sharing data involves sending backups over email.
Security	State of the art security provided by the cloud server	Need own security protocol
Apps and Customisation	Hundreds of third-party applications based on open APIs	Limited third-party applications
Automation	Using cutting-edge technology to automate accounting entries	Manual entries

Cloud accounting is gradually becoming the preferred choice for accountants for other reasons also such as:

User Interface: In the age of mobile apps and social media, accountants and business owners require consumer-like experience from accounting software. So instead of keyboarding and dull screens, users expect interesting data visualisation screens and easy user interface like drag and drop. This is especially true of the new generation who grew up with the internet.

Improved reporting: Most cloud accounting software provide real-time data analytics for business owners such as goal setting and tracking. This appeals to new age entrepreneurs.

Innovative features

Accounting software are now no longer limited to the creation of accounting entries and provide financial reporting. New features are making the work easier and more efficient. Some of these are:

Optical Character Recognition OCR

Optical Character Recognition is a technology designed to extract text from an image. This helps reduce data entry time. Although the technology is not new (some OCR applications date back to 1950s), it is being recently used in accounting software.

OCR technology works on both structured (Cheque) and unstructured documents (Cash Memo). The advancement in technology has made it possible to get about 90% accuracy in an even unstructured document. In accounting software, once the data is scanned, key information is extracted and automatically converted into accounting entry.

Some examples:

OCR of an invoice extracts key data like supplier name, invoice number, invoice data, invoice value, GST details etc. and automates a purchase journal.

OCR of expense receipts like coffee bill etc., extracts amount, date and automates reimbursement claim by an employee.

Documents Tagging

Retrieving paper documents is a very time-consuming job, especially when the document is required after a gap of 3-4 years, like during a tax assessment.

An easy solution is to scan the document as image or pdf and attach it with the accounting entry itself. This helps in several cases. For example, the auditor can verify the source document while doing ledger scrutiny.

Some accounting software provide you with a unique email ID wherein documents can be e-mailed. Once e-mailed, they are stored in a folder and you can tag them to accounting entries later on.

Automatic feed from Banks and Credit Cards

Small businesses rely on their bank statements to provide details of payments and receipts. Traditionally these entries are entered manually from the bank statements.

Now the accounting software provide for auto update of bank transactions by directly connecting the bank server. All you need to give is your login and password for the selected bank.

Online Payment of Invoices

Online payment is fast becoming *de-facto* payment method with the usage of cheques reducing day-by-day. There are several payment integrators who provide multiple payment options like NEFT, NetBanking, UPI etc. example CCAvenue, Razorpay, Instamojo.

Accounting software now allows integration with these payment gateways. When an invoice is e-mailed to a client, it goes with a payment link which can be used for making the online payment

Other Features

Today workflow is fast becoming part of accounting software. Example: an automated workflow rule that sends an e-mail alert to the owner when an employee raises Purchase Order above ` two lakh.

Several accounting software encourage third-party add-on modules by permitting the use of published APIs. For example, Xero has a marketplace of over 700 apps that connect it.

Business track: Business Performance at a glance: set goals, track performance. Slice and dice data for data analytics.

Send proposals and get notified when the client approves them. Convert accepted proposals to invoices. Client portal where clients can approve invoices, make payments

Artificial Intelligence (AI) in Accounting

AI, also known as machine intelligence, is intelligence demonstrated by machines as against human intelligence. In AI systems machines mimic human functions like "learning" and "problem-solving". AI systems are gradually improving and becoming more powerful.

In some cases, AI systems provide far superior and accurate output than what humans can do. However, no AI system can replace human intelligence.

As of now, AI in accounting is still a nascent stage and some of the research is going in the following areas

- Using machine learning to automate accounting entries
- Improving fraud detection
- Predicting revenues

One very practical use of AI already being implemented today is the auto-generation of accounting entries from bank feed.

When entries are imported from bank feeds, the system is able to categorise them automatically and auto-tag it with a ledger. A user has the option to edit the suggested ledger. The machines constantly learn to improve auto tagging

This feature is available in OneUp, QuickBooks, SageOne, Xero and Zoho.

Disruptive Start-Ups in Accounting

Startups are disrupting existing solutions and creating innovative ways to do things in almost all areas. Accounting too is untouched. There are several startups globally working to change the accounting function. Few of them are mentioned here.

DOOER

Dooer is a Swedish startup that aims to use AI and visual recognition to automate accounting processes for small businesses.

One example: One can scan invoices and receipts in its mobile app. Once the payments and receipts are generated from bank feed, the AI engine matches the entry with the scanned document and present the findings to the user to approve

BotKeeper

BotKeeper is an interesting solution that uses technology as well as human assistance to automate accounting functions. This is more like accounting service as the user still needs to have an accounting software to use botkeeper.

Each client gets a dedicated bookkeeper called "botkeeper" who provides accounting services virtually. Botkeeper securely access financial data of the business, bank, credit card and accounting software and using technology it can make accounting entries, complete payroll, reconcile banks, send invoices and track profitability.

What botkeeper promises is 24/7 availability, faster turnaround, more accurate data and substantial cost saving as compared to the cost of the in-house accountant or outsourced accounting.

PeaCounts

PeaCounts promises to deliver the most user-friendly accounting solution using accounting software of the NetSuite platform along with artificial intelligence and blockchain technology.

One example of how easy making entry can be is an example of a receipt. A user has to scan and upload the receipt. The system will auto extract information and if required, ask a few questions to reply.

The SmartCFO feature will automatically prepare budgets and financial projections. PeaCount uses the same technology as bitcoin to provide a very secure system and has a plan to permit payments based on its cryptocurrency token PEA.

Conclusion

It is very clear that a few years from now, businesses will be using a very different system for accounting then what they are using now. Technology developments will only hasten the progress.

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He who knows how o serve knows how to rule.

— *Swami Vivekananda*

Himanshu Bheda, *Advocate*

One year of RERA : A Review

The landmark legislation has great potential to transform the country's real-estate sector and the first year of its implementation has been a positive start.

The Real Estate sector, being a major contributor to growth, revenue, employment and social benefits, has emerged as a key component of the Indian Economy over the past two decades. Although Real Estate falls in the Concurrent list of the Constitution of India, thus enabling the Union of India as well as the respective State Governments and Union Territories to legislate various acts relating to the sector, in the past the Union of India has passed very few laws governing the Real Estate sector, thus putting heavy onus on the respective State Governments and Union Territories to legislate, enact and implement various laws governing the Real Estate sector. India being a geographically, politically and demographically diverse country, each State Government and Union Territory has passed laws governing Real Estate in accordance with their own requirements, to suit their socio-political and demographic setup. As a result of this incongruity, there were major differences and deviations in the laws passed by various States and there was no uniformity in the legal provisions of several common factors governing the Real Estate, such as, obligations of the Promoters, rights of the purchasers, differences in carpet area, termination of the Agreement by the Promoters, recourse available to the purchasers in case of delay or default by the Promoters to complete the project within specific period, or deviation from the sanctioned plans by the Promoters. In some of the States and Union Territories, these laws were loaded in favour of the Promoters and gave huge powers and authority to the Promoters to suppress/ oppress the purchasers, allowing them to get away with major defaults, non-compliances, without being held liable or accountable in law.

Maharashtra being a progressive state, had enacted laws relating to Real Estate as early as the 1960s, wherein various acts were enacted to protect the rights of the purchasers by casting adequate obligations and responsibilities on the promoters. Although the necessary laws were in place since the early 1960s, due to lack of proper implementation of the said Acts and lack of necessary Government machinery, political will and other economic reasons, the relevant Acts were not enforced in their true letter and spirit. Thus, the purchasers always found themselves at the receiving end at the hands of promoters.

Due to rapid globalisation and major economic development in India in recent years, rapid urbanisation and mass migration of working population took place, which resulted in unprecedented growth of Real Estate markets. Thus, in the year 2010, the Union Government found the need to enact a central law governing various important aspects of Real Estate, so as to ensure uniform laws throughout India and enable proper and effective administration of justice. In the year 2010-11, the draft Act of The Real Estate (Regulation and Development) Act was introduced in the public domain for inviting suggestions and objections from the various stakeholders. Thereafter, pending the enactment and implementation of above Act, State Government of Maharashtra enacted Maharashtra Housing (Regulation and Development) Act, 2012, (hereinafter referred to as the said 2012 Act) which substantially diluted the provisions of the draft RERA Act. The said 2012 Act, although enacted, was never implemented by Government of Maharashtra and ultimately on 25th March, 2016, the President of India granted its assent to the Parliament and The Real Estate (Regulation & Development) Act, 2016 (RERA) was enacted, even as the said 2012 Act was repealed.

For the first time in the country's history, uniformity was sought in various provisions of Real Estate and a separate authority (state-wise) was to be appointed by each of the State Governments. With the enactment of RERA, the Real Estate sector became much more transparent and regulated throughout India, giving a major boost to the industry and instilling faith in the minds of the purchasers. While RERA has largely proved to be a positive and proactive legislation, there are few concerns and challenges for both, promoters as well as purchasers, which remain to be addressed if the law has to fulfil its potential as a truly landmark legislation.

ADVANTAGES

1. Transparency and Fair Play

This is one of the main aims and achievements of RERA, and it has brought about absolute transparency in Real Estate deals so far as (a) Title of the Promoters, (b) pending encumbrances or court cases, litigations, (c) the status of approvals received by the Promoters, (d) percentage of work done at any given point of time, (e) the amenities and facilities that shall be available to the Purchaser in any particular layout and (f) the date of possession, are concerned.

In the pre-RERA regime, there were two classes of Developers / Promoters; (a) Promoters who complied with all the rules and regulations relating to the Real Estate project (the Compliant Promoters) and (b) Promoters who did not comply with the rules and regulations relating to the Real Estate project in letter and spirit, and often misrepresented to the Purchasers on various important aspects of the Project (the non-compliant Promoters). Under RERA, all important aspects of a project are required to be mandatorily uploaded on the RERA website at the time of Registration itself, with a periodic update required every three months. As a result, an element of fair play has been brought in for the Compliant Promoters as against the non-compliant Promoters who can no longer give incorrect information or assurances to the purchasers regarding their projects. Moreover, the definition of Carpet Area is uniform and identical pan-India now and non-compliant Promoters cannot fleece the unsuspecting Buyer on account of wrongful calculation of the carpet area any more.

2. Increased regulation in Real Estate has increased confidence of purchasers as well as Financial Institutions

Tight Financial Management under the Escrow accounts and restrictive method of withdrawal from the Escrow account by obtaining Certificates from Architects, Engineers and Chartered Accountants in prescribed formats, has made it almost impossible for the Promoters to misuse the monies received from the Purchasers or to divert the funds of one Project to another Project. Thus, on account of such strict financial and monetary management, chances of delay in completion of the Project have been subsequently reduced, thus boosting the overall confidence of the Purchasers.

Similarly, tight financial management of the Escrow account has made the Project financing by Banks and NBFCs much easier. Most of the Banks/Financial Institutions are now creating a charge on the Escrow Account and the monies lying therein, in addition to the charge on the mortgaged property, unsold inventory and balance amounts receivable from the customers. Since under RERA, the Promoters cannot misuse/syphon off the funds of a Project or divert the funds from one Project to another Project, the inherent security of repayment in the hands of the Bank has increased substantially and as a result, many new Banks and NBFCs have now started lending Project finance at competitive rates of interest, thereby easing the financial constraints on construction schedules for compliant Promoters.

3. Accountability & Expeditious grievance redressal

For the first time, RERA has clearly defined the responsibilities and obligations of (a) Promoters, (b) Estate Agents and (c) Purchasers in a Real Estate transaction. These obligations and responsibilities are well defined and broadly cover the entire spectrum of a Real Estate transaction. In case of non-compliance of any of the obligations by any of the above three constituents to the transaction, RERA has specific provisions in the Act itself to ensure speedy redressal of such default/non-compliance. The competent Authority under MahaRERA has been empowered to entertain and dispose off the complaints by any aggrieved party in a time-bound manner as per the provisions of RERA and applicable Rules. In addition to MahaRERA, the Consumer Protection Forums can also entertain any disputes that the Purchasers may have for deficiency of services. Barring the two clearly defined Authorities, no other Court, Tribunal or law enforcing authority has the jurisdiction to try and entertain any dispute under RERA, thus ensuring speedy redressal for the aggrieved party.

As a result of this, there is greater consistency in the orders passed, in contrast to the pre-RERA regime wherein in different matters contrary stands were taken by diverse Courts/judicial agencies, which created confusion in the minds of Promoters and Purchasers. For the first time, Real Estate Brokers and even Purchasers can be subjected to heavy penalties (in terms of percentage of the transaction) and in extreme cases, can even be imprisoned for grave continuous default. These provisions have brought self-imposed discipline among the Real Estate Brokers while negotiating any deals or giving any commitments/details about any Project on behalf of any Promoters to the prospective purchasers. RERA has also eased the norms for Promoters. For instance, under RERA, in case of non-payment of consideration by the Purchaser, the process of termination of the Agreement by the Promoters has been laid down in definite terms, thus enabling the Promoters to effectually terminate the Agreement with defaulting Purchasers.

4. Legally Binding Contracts & Compliances

Under RERA, (i) the Promoters are obligated to execute and register the Agreement for Sale before accepting any amount beyond 10% of the total consideration. (ii) The Promoters are also obligated to obtain the necessary permissions and sanctions for construction from concerned Authorities and thereafter, to register their Project on RERA Website and obtain a registration number for a particular Project, and (iii) only after obtaining the registration number, the Promoters are entitled to advertise, market or sell premises in a Project or receive any consideration from the prospective purchasers. This provision has greatly helped the Purchasers in enforcing their registered Agreement against defaulting Promoters and receive timely possession of their respective premises from the Promoters.

5. Time bound redressal of complaints

For the first time, after the introduction of RERA, the complaints of Complainants are being heard - and orders are being passed - in a time-bound manner, without inordinate delay. This is one of the major advantages of RERA, as the hope of definite justice in a time-bound manner has helped the entire Real Estate industry in projecting/propelling itself as a dynamic and progressive industry, where the Real Estate transactions are being entered into with unprecedented faith, enthusiasm and sound legal compliances.

6. Positive, merit-based approach to grievances

MahaRERA has passed landmark Orders requiring definite time-bound compliances from the Promoters and in few of the cases, has even restricted the rights of the Promoters, in the overall benefit of the Project. Following are some of the landmark Orders passed by MahaRERA:

a. Requiring the Promoters to rectify their existing Agreements to make them RERA compliant.

b. Restricting the time proposed by the Promoters for completion of the Project to a reasonable time.

c. Requiring Promoters to refund the monies received, together with interest, as per RERA provisions, in a time-bound manner.

7. Bringing land owners, financers under the ambit of promoters

Under RERA, the land owner – in case of a joint venture, and the financers of Real Estate projects having the right to regulate the sale of premises and construction activities, have been included in the definition of Promoters. Accordingly, they are necessary signatories to the registration process and hence they are bound by all the representations, compliances and timely completion of the Project along with the Promoters. As a result, land owners and financers, out of fear of the consequences of non-compliance under RERA, co-operate with the Promoters to ensure the compliance of legal provisions and timely completion of the Project, desisting from making unlawful and unrealistic demands on the Promoters at a later stage.

8. Uniform terms of agreement

The RERA Act has prescribed the format of Agreement for Sale that a Promoter is expected to execute with its Purchasers. Any clause not in conformity with the Model Agreement can be struck down by the MahaRERA on receiving a complaint from the Purchaser. This provision ensures that the Promoters do not take undue advantage of the Purchasers by executing a one-sided Agreement with the Purchasers.

9. Uniform central law Pan-India (except Jammu & Kashmir)

The Real Estate (Regulation and Development) Act, 2016 is a Central Act applicable to all the States and Union Territories (except Jammu & Kashmir). However, each State has been empowered to formulate the Rules regarding the implementation of the said Central Act. This common ground encourages cross-country transactions and gives more confidence to investors who are not familiar with laws unique to a state or local body.

Disadvantages

Although the intention of the Central Government and State Government of Maharashtra in implementing RERA has genuinely been to bring transparency, accountability and effective redressal of Real Estate disputes, due to complexity of real estate transactions and the magnitude of such transactions (in terms of sheer numbers), and the diversity of the nature of transactions entered into, there have been few shortcomings of RERA, which are of the following nature:

1. All commitments made by Promoters prior to implementation of RERA Act, i.e., prior to 1st May, 2017 in Maharashtra and defaults relating to such commitments are not considered as defaults under RERA and no effective redressal is available to the Purchasers in such cases. However, lately MahaRERA has started looking at pre-RERA defaults. Just recently, in an Order against P.G. Enterprises, MahaRERA has held that as per his commitment under MOFA, the defaulting Promoter has been unable to handover the possession within the stipulated time frame and hence MahaRERA has ordered defaulting Promoter to pay interest on the amount received till the date of the Order for delay in delivering possession, till the actual date of possession.

2. Provisions of RERA do not apply to the certain type of transactions. For instance, in case of redevelopment of dilapidated buildings, the existing members of the Society cannot complain against the Promoters - neither on the basis of Development Agreement nor the Permanent Alternate Accommodation Agreement executed in their favour.

3. Delay on part of Government Authority and sanctioning authorities are not covered under RERA. The major cause for delay in completion of the Project is due to delay on part of Government Authorities and plan sanctioning authorities to issue various NOCs, permissions and sanctions. There is no provision under RERA whereby a Promoter can complain to MahaRERA for any delay on the part of Plan Sanctioning Authority in giving the necessary permissions. This continues to be a major concern for Promoters as well as the Purchasers.

4. Apart from Maharashtra and few other states, most of the States and Union Territories have diluted the provisions of RERA while adopting the Rules for their respective States and Union Territories. In West Bengal, RERA website is not even operational yet and a Committee has been formed to study the RERA implementation in Maharashtra and Karnataka. It has also formulated its own law "West Bengal Housing Industry Regulation Act" (WBHIRA), which contains certain contrary to RERA. While some States are yet to appoint the Regulatory Authority under RERA, in some states, many of the Promoters, who are required to register their Projects under RERA are not coming forwards to register their Project under RERA. According to a recent update, out of the total 32,306 projects registered pan-India, 17,353 of them are registered in Maharashtra alone. This goes to show that most of the States have not received the same response from their Developers, and seem less receptive to the implementation of RERA.

Full compliance of transformational legislation like RERA would bring positive changes in the sector which would be beneficial to all stakeholders.

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The remedy for weakness is not brooding over weakness, but thinking of strength.

— *Swami Vivekananda*

B. V. Jhaveri, *Advocate*

DIRECT TAXES

Supreme Court

1. S.80-IC : Special category States – Initial year - deduction on 'substantial expansion' for remaining Assessment Years :

CIT vs. Classic Binding Industries: (2014) Civil Appeal Nos. 7208, 7223, 7220, 7215, 7230 of 2018 & Oths, dtd: 20/08/2018 (SC) [2018] 96 taxmann.com 405 (SC)

The assessee firm derives income from manufacturing of printed embossed book binding cover material of cotton in sheet from and security fiber of dual coloured combination. The assessee started its business activity/operation on 11th July, 2005 and initial AY for claim of deduction u/s. 80-IC of the Act was AY: 2006-07. The assessee had already claimed deduction u/s. 80- IC to the extent of the 100% eligible profit for five AY: 2006-07 to AY: 2010-11. However, it was noticed that the assessee firm had again claimed 100% deduction against eligible profits in the relevant AY 2012-13 which is seventh year of production for the firm by claiming substantial expansion in Financial Year 2010-11.

During the assessment proceeding the assessee was asked to furnish the reasons and justification for the said claim of 100% as against the eligible norm of 25%. The assessee submitted its reasons for claim stating that the assessee fulfills all the conditions for the claim of 100% deduction.

The A.O found that in view of the provisions of Section 80-IC of the Act assessee firm had already claimed deduction u/s. 80-IC of the Act at the rate of 100% for five years from AY 2006-07 to AY: 2010-11, i.e., from the date of setting up of the industrial undertaking and in view of the same, it would be eligible for claim of deduction @ 25% of its eligible business profits for the remaining five years, i.e., from AY 2011-2012 to AY: 2015-2016. The A.O denied the claim of the enhanced deduction in view of the substantial expansion was claimed by the assessee and, accordingly, restricted the deduction to 25% of eligible profits for the assessment year under Consideration.

The CIT(A) following the decision of the Jurisdictional Tribunal in the case of M/s. Hycron Electronics Vs. ITO and other related cases, upheld the order of the A.O and dismissed the appeal of the assessee for 100% deduction. The ITAT upheld the CIT(A) order.

The High Court decided the issue in a composite judgment, in favour of all these assessees. The High Court held that there is no restriction that undertaking or enterprise established after 7th January, 2003 cannot carry out 'Substantial Expansion' more than once as long as period of eligibility for claiming deduction u/s. 80-IC of the Act. The High Court further held that since the language of Section is very clear, reliance cannot be placed on Circular No. 7 of 2003 issued by CBDT on this issue, substantial questions of law were answered in favour of assessee.

The Hon. Supreme Court referred to recent judgment rendered by the very same Bench in Mahabir Industries v. Principal Commissioner of Income Tax (Civil Appeal Nos. 4765-4766 of 2018 decided on May 18, 2018). However, the Bench made a fine distinction which needs to be noted between the two sets of cases. In Mahabir Industries, the assessees had availed the initial deduction under a different provision, namely, Section 80-IA of the Act, i.e. by fulfilling the conditions mentioned in sub-section (4) of Section 80-IA. Those conditions are altogether different. Deduction in respect of profits and gains under the said provision is admissible when these profits and gains are from industrial undertakings or enterprises engaged in infrastructure development etc. Even this availment started at a time when Section 80-IC was not even on the statute book. As mentioned above, Section 80-IC was inserted by the Finance Act, 2003 with effect from April 01, 2004. The assessees in those cases had started claiming and were allowed deductions from the Assessment Years 1998-99 and 1999-2000 u/s. 80-IA and from the Assessment Year 2000-01 to Assessment Year 2005-06 u/s. 80-IB of the Act. The deduction was, thus, claimed by the assessees in those appeals under the new provision i.e. Section 80-IC on fulfilling conditions contained in sub-section (2) of Section 80-IC for the first time for the Assessment Year 2006-07. Thus, insofar as those cases are concerned, the initial Assessment Year u/s. 80-IC started only from the Assessment Year 2006-07. In contrast, position here is altogether different. These assessees have availed deduction u/s. 80-IC alone. Initially, they claimed the deduction on the ground that they had set up their units in the State of Himachal Pradesh and after availing the deduction @ 100% they want continuation of this rate of 100% for the next 5 years also under the same provision on the ground that they have made substantial expansion. As pointed out above, once the assessees had started claiming deduction u/s. 80-IC and the initial Assessment Year has commenced within the aforesaid period of 10 years, there cannot be another initial Assessment Year thereby allowing 100% deduction for the next 5 years also when sub-section (3), in no uncertain terms, provides for deduction @ 25% only for the next 5 years. It may be asserted again that the assessees accept the legal position that they cannot claim deduction of more than 10 years in all u/s. 80-IC.

In view of the aforesaid discussion, the Court held that after availing deduction for a period of 5 years @ 100% of such profits and gains from the 'units', the assessees would be entitled to deduction for remaining 5 Assessment Years @ 25% (or 30% where the assessee is a company), as the case may be, and not @ 100%. The question of law was , thus, answered in favour of the Revenue thereby allowing all these appeals .

[Reversed Classic Binding Industries vs. CIT, ITA 62 of 2016 dt : 28/11/2017 (H.P)(HC)]

2. S.32 : Depreciation – Lease back of assets – Boiler – Transaction could not be termed as dubious or colourable device, but a genuine business transaction- Allowable

CIT vs. Bombay Burmah Trading Corpn. Ltd. S.L.P.(C). No.18622 of 2018, dtd: 03/07/2018 (SC) [2018] 95 taxmann.com 141 (SC)

The assessee was engaged in business of manufacturing laminates. The assessee had purchased a boiler from one company BDMCL and leased out it to the very same company. It had claimed 100 per cent depreciation on Boiler leased out to BDMCL. Boiler was claimed to be an energy saving device eligible for 100 per cent depreciation.

The Assessing Officer noted that there was a special resolution passed by the assessee on 23-3-1984, whereby it altered the Memorandum of Association and said amendment was approved by the Company Law Board by its order dated 25-1-1985. Thus, he concluded that BDMCL had completely purchased the boiler which was required for its DMT plant. The correspondence on that issue were referred. The date of resolution by which the Memorandum of Association was altered (23-3-1984) was termed 'relevant' because by this time the commissioning of the boiler had been completed by BDMCL. Thus, it was after the boiler was commissioned that the assessee brought out a provision in its Memorandum to include leasing business. This was why two closely connected companies have tried to help each other and profits of assessee were reduced to the extent of depreciation that had been claimed. It was surprising, according to the Assessing Officer, that only one item of this plant, namely, the boiler was taken on lease and rest of the project cost was to be incurred by BDMCL and if there were financial constraints, then, this was not possible. Thus, the transaction was termed as dubious and colourable device.

On appeal, the Commissioner (Appeals) also confirmed the disallowance made by the Assessing Officer.

On further appeal, the Tribunal came to the conclusion that the boiler was given on lease on 27-9-1984. Date of Memorandum was 23-3-1984. Assessing Officer's inferences were based on the two closely connected companies trying to help each other. The boiler was not installed in March, 1984, but was installed in September, 1984. Initial lease period of 8 years was extended twice for 5 years on each occasion to show that the asset was not ultimately sold to BDMCL at reduced price. Lease rentals earned by the assessee were subjected to tax till the date of the Tribunal's order and they were allowed as deduction to BDMCL in the assessment years 1985-86 and 1986-87. Then onwards the same had been disallowed. Thus, the Tribunal held that the assessee bought and leased back the asset to BDMCL not for the purpose of avoiding tax.

On revenue's appeal to the High Court the Court find that the facts of the present case, it cannot be said that the assessee bought and leased back the asset to BDMCL solely for the purpose of avoiding tax. The assessee was earning rental income from the transaction which was subjected to tax. If it was not a bona fide business transaction, the assessee, after claiming benefit of depreciation in one year, could not have subjected itself to tax on the income arising from that very transaction. This was taken by the Tribunal to be an important feature of the transaction and the matter as a whole. It is in these circumstances, and looking at the issue in an overall manner, that the Tribunal held that the transaction cannot be termed as dubious or colourable device, but a genuine business transaction. There are reasons assigned for such a factual conclusion. The Tribunal has not deviated from any settled principle. In arriving at the conclusion that the transaction was genuine, therefore, the Tribunal has not misdirected itself, nor its conclusion can be termed as perverse.

The Revenue filed SLP before Supreme Court which was dismissed.

[Affirmed CIT vs. Bombay Burmah Trading Corpn. Ltd. (2017) 250 Taxman 436 (Bom.) (HC)]

3. S.14A : Disallowance of expenditure – Exempt income – No disallowance can be made if no exempt income is earned. [R. 8D]

CIT vs. Chettinad Logistics (P.) Ltd. S.L.P.(C). Diary No. 15631 of 2018, dtd: 02/07/2018 (SC) [2018] 95 taxmann.com 250 (SC)

The assessee was engaged in the business of trading, clearing and forwarding. The AO had computed disallowance u/s.14A of Rs.86,62,748/- relying on the Circular No.5 of 11th February, 2014 and Rule 8D r.w.s.14A of the Act, whereby the AO held that expenditure had to be disallowed even when, admittedly, the assessee had not earned income exempt from tax in the concerned previous year.

The CIT(A) rejected the aforesaid contention and held that as the assessee had not earned any exempt income during the year under consideration, the disallowance u/s.14A cannot be made.

The Tribunal restored the appeal to the AO to verify whether the investment made by the assessee had been made by it in its sister concerns and out of interest free funds.

The High Court in the appeal of the Revenue observed that the exercise of referring the issue to the AO was clearly unnecessary, as the Commissioner (A) had returned the finding of facts that no dividend had been earned in the relevant assessment year. Therefore, the Court held that sec.14A can only be triggered if the assessee seeks to square off expenditure against income which does not form part of the total income under the Act. It further held that Rule 8D only provides for a method to determine the amount of expenditure incurred in relation to income, which does not form part of total income of assessee. Rule 8D cannot go beyond what is provided in section 14A of the Act

Further court held that as the Tribunal has remitted the matter to the AO, no interference is called for qua the order of the Tribunal. Accordingly, the appeal of the Revenue was dismissed.

Against the aforesaid order of the Hon'ble High Court the Revenue filed the Special Leave Petition in the Supreme Court which has been dismissed.

[Affirmed CIT vs. Chettinad Logistics (P.) Ltd. (2017) 248 Taxman 55 (Mad.) (HC)]

4. S.69C : Unexplained expenditure – Bogus purchases – Purchases made by assessee–trader were duly supported by bills, payment through banking channel, confirmation from seller – no evidence to show that amount was recycled back to assessee – sales out of purchases also accepted by revenue – No disallowance

Pr. CIT vs. Tejua Rohitkumar Kapadia. S.L.P.(C). Diary No. 12670 of 2018, dtd :04/05/2018 (SC) [2018] 94 taxmann.com 325 (SC)

The A.O had disallowed purchase expenditure of Rs. 5.19 crores making the additions treating the purchases as bogus.

All payments were made by the assessee by Account Payee cheque. The assessee was in fact, a trader. All purchases made from M/s. Raj Impex were found to have been sold and sales were also accepted by the Assessing Officer. On appeal CIT(A) deleted the disallowance .

The Tribunal held that there is no dispute that the purchases made from M/s. Raj Impex were duly supported by bills and all the payments have been made by account payee cheques. There is also no dispute that M/s Raj Impex have confirmed all the transactions. There is no evidence to draw the conclusion that the entire purchase consideration which the assessee had paid to M/s. Raj Impex had come back to the assessee in cash. No adverse inference has been drawn so far as the sales made by the assessee is concerned. The entire purchases made by the assessee from M/s. Raj Impex have been accounted by Raj Impex and have paid the taxes accordingly. Thus dismissed the Revenue appeal.

The Revenue carried the matter in appeal before the High Court. The Court held that the appellate authority as well as the Tribunal came to concurrent conclusion that the purchases already made by the assessee from Raj Impex were duly supported by bills and payments were made by account-payee cheque. Raj Impex also confirmed the transactions. There was no evidence to show that the amount was recycled back to the assessee. When it was found that the assessee the trader had also shown sales out of purchases made from Raj Impex, which were also accepted by the Revenue, no question of law arises.

Against the aforesaid order of the Hon'ble High Court the Revenue filed the Special Leave Petition in the Supreme Court which has been dismissed.

[Affirmed Pr.CIT vs. Tejua Rohitkumar Kapadia. (ITA 691 of 2017 dt : 18/09/2017 (Guj)(HC)]

ML-1058



Paras S. Savla, Jitendra Singh, Nishit Gandhi, *Advocates*

DIRECT TAXES

High Court

1. Service of Notice – Section 148 r.w.s. 68 and 133 of the Income Tax Act, 1961 – Change of residence – Return filed on new address – Dept serving notice on old address – Merely because notice was not returned unserved it cannot be presumed there was proper service – held the notice not properly served – reassessment bad in law [A.Y. 1999-2000]

Sureshkumar Sheetlani vs. ITO [2018] 96 taxmann. com 401 (Allahabad)

The assessee before the Hon'ble Allahabad High Court was an individual. For the year under consideration, the AO issued notice dated under Section 148 of the Act at the address i.e. 109, North Idgah Colony, Agra available on the assessee's Bank Account No.10309 in Canara Bank, Sanjay Place, Agra. The AO also issued notice under section 142(1) of the Act. In response to the above notice the assessee challenged the service of notice under section 148 of the Act. The AO, however, finalized the assessment order under section 144 r.w.s. 147 of the Act by making certain addition under the head income from undisclosed sources. The assessee being aggrieved by the assessment order preferred an appeal before the first appellate authority. The learned CIT(A) called for a remand report. In compliance with directions u/s. 250(4) the AO filed a report stating that the Assessee had shifted 2 years earlier. AO tried to serve notice u/s. 142(1) at the old address but the notice severer vide his report stated that the address had been changed. The notice was subsequently served on 20-11-2006. Subsequently assessment order, notice of demand and penalty notice was served to new address. The CIT(A) after considering the submissions of the assessee quashed the assessment order for the reason that the notice under section 148 of the Act has not been properly served by observing that the notice sent under Section 148 of the Act was sent at the wrong address and, therefore, the service of notice could not be deemed to have been effected on the assessee. The service of notice under Section 148(A) is sine qua non and in absence thereof, the assessment proceedings concluded under Section 147 of the Act were rendered invalid. The department being aggrieved by the order passed by learned CIT(A) preferred an appeal before the Appellate Tribunal. The Tribunal reversed the order of the learned CIT(A) on the ground that the notice had been sent to the assessee on the address available with the Department through speed post and the notice under Section 148 issued to the assessee by speed post had not been received by the Department unserved, it would be deemed to be valid service. On further appeal, Hon'ble High Court observed that when department had correct address of assessee furnished in return of income, sending notice at incorrect address available with bank and then drawing presumption of service of notice was totally erroneous. The Court held that the presumption drawn by the Tribunal on the ground that since notice was not received back unserved, it would be deemed to be service of notice, cannot be sustained.

2. Capital Gains – Section 2(47), r.w.s. 45, of the Income-tax Act, 1961 – Transfer – Development Agreement – since possession of property was given to developer for specific purpose to develop land, and possession of said land continued to be with assessee, there was no transfer in terms of section 2(47)(v). [A.Y. 2008-09]

PCIT vs. Fardeen Khan [2018] 96 taxmann.com 398 (Bombay)

The assessee before the Hon'ble Bombay High Court was an individual. The assessee entered into a development agreement with Godrej Properties Ltd. (Developer) wherein land owned by the assessee was given for development to developer. In terms of the development agreement an amount of ` 13.75 crore was paid as a deposit to the assessee by developer. The agreement gave powers to M/s Godrej Properties Ltd., to obtain various permission, commence construction of homes and sell them. It further provided that ` 55 crore was to be the notional costs of the land and on sale of the constructed property, 30% of its sale proceeds, were to be received by the assessee from the developer. During the course of assessment proceedings the AO show caused the assessee to explain as to why aforesaid transaction should not be considered as a transfer as per section 2(47)(v) and 2(47)(vi) of the Act. The assessee explained that the land on which the houses were to be built, was agricultural land till 31st March, 2005 and thereafter was converted into non-agricultural land. This land was converted into stock-in-trade w.e.f. 1st April, 2007. It was further submitted that development agreement was in the nature of MOU and non-concluded agreement. In any event, it was not registered under the Indian Registration Act, and hence there was no transfer in terms of Section 2(47)(v). Similarly section 2(47)(vi) would also have no application in the present facts as there was no transfer of the land and the possession of the land continued to be with the assessee. The AO however finalised the assessment by making an addition under the head Capital Gain by concluding that the transfer had taken place when the development agreement was executed. On appeal, the first appellate authority upheld the action of the AO. On further appeal the Appellate Tribunal accepted the contention of the assessee and deleted the additions made by the AO.

The department being aggrieved by the above order of the Appellate Tribunal preferred an appeal before the Hon'ble Bombay High Court. Hon'ble High Court dismissed the appeal of the department by observing that the law prevailing at that time did not require an agreement of part performance to be registered. In terms of Section 2(47(v), transfer of any immovable property in part performance of a contract in nature of Section 53A of Transfer of Property Act, would be completed only when agreement is registered under Indian Registration Act. Since the agreement was not registered, there is no transfer in terms of section 2(47)(v). Reliance was placed on *CIT vs. Balbir Singh Maini 398 ITR 531 (SC).*

The court further observed that for Section 2(47)(vi) to be applicable, the transfer of immovable property should enable its enjoyment as the purported owner thereof i.e., even though there is no transfer of title in law, there is a transfer of title in fact. In the facts of the present case the property was given to developer for specific purpose i.e. to develop the property. It is not a right akin to the ownership to land. The assessee had granted license to enter upon and develop the property. However, the possession of the said land continues to be with the assessee.

The Revenue further argued that ` 13.75 crs should be taxed in the impugned assessment year. To this the court held that the amount was received as deposit and is not an income. It is a settled position that every receipt is not necessarily income. IT is for the revenue to establish that the receipts constitute income. As no transfer of land has taken place under the development agreement, and in the absence of revenue making out a case, the said amount cannot be brought to tax.

3. Settlement Commission – section 245D of the Income-tax Act, 1961 – procedure – Chairman calling for the records of the assessee for discussion with the members of the Income Tax Settlement Commission hearing the settlement application – beyond his jurisdiction

Raghuleela Builders Pvt. Ltd. vs. Income Tax Settlement Commission [Writ Petition Lodging No. 2769 of 2018 order dated 21-8-2018]

The assessee before the Hon'ble Bombay High Court was a private limited company engaged in the business of development of real estate. A search and seizure action under section 132 of the Act was carried out on the business premises of the assessee on 16-12-2015. Pursuant to the search action, the assessee was served with the notice under section 153A of the Act. The assessee filed an application before the Income Tax Settlement Commission, Mumbai for settlement of its case. The settlement commission passed an order dated 8-3-2017 admitting the application filed by the assessee under section 245D(1) of the Act. The application of the assessee was further allowed to be proceeded with under section 245D(2C) of the Act. The Commissioner of Income Tax filed Rule 9 report, and thereafter, the final hearing as per the provisions of section 245D(4) of the Act was started. The hearing was fixed on 1-8-2018 vide notice dated 30-7-2018. However, the same was adjourned by the Bench. The assessee was informed that the hearing was adjourned on account of visit of Chairman of Income Tax Settlement Commission stationed at New Delhi to Mumbai. The assessee was also supplied with one letter dated 1-8-2018 wherein the details and purpose of visit of Chairman was mentioned. One of the purpose mentioned in the letter was to discuss the cases wherein the issue decided by the Special Bench in the case of MAAD Realtors are involved. In assessee's case also same issue was involved. The hearing was adjourned to 7-8-2018. On 7-8-2018 again the hearing was adjourned to 16-8-2018 for the reason that the department moved an application for constitution of larger bench. On 16-8-2018, the assessee appeared before the Settlement Commission and argued the case. The hearing was further adjourned to 17-8-2018 as part heard. It was during the course of hearing on 16-8-2018, the assessee on reasonable ground apprehended that the proceedings before the Income Tax Settlement Commission is being influenced by the letter dated 1-8-2018 written by the Chairman.

The assessee filed a writ petition before the Hon'ble Bombay High Court challenging the action of the Chairman in writing the letter dated 1-8-2018 to discuss the cases wherein the issues similar to issue decided by the Special Bench in the case of MAAD Realtors. The Hon'ble Bombay High Court disposed of the Writ petition of the assessee by observing that the Petitioners are not precluded from challenging the manner in which the Chairman intervened in this matter at a later stage. The Court showed its reluctance to interfere with the pending proceedings for then the court itself would commit the same mistake, if at all, as committed by the learned Chairman.

Hence the Court held that it would not be proper to presume that the proceedings are necessarily going to end, with final orders, but adverse to the Assessees interests. The Court held that in the event the apprehension comes true and the Chairman's meeting and discussion with the members of the Commission results in an adverse order as apprehended, then, while challenging such final orders and if they are found to be influenced by the Chairman's alleged uncalled for and undue intervention, the Assessee can raise appropriate pleas and urge before the Court that they have not been dealt with fairly by the Settlement Commission.

Having held as above, the Court further observed that these Petitions have been filed challenging a somewhat curious and unforeseen development. The Court observed that it is unknown in what circumstances the Chairman flew down to Mumbai and invited the members for discussion in relation to some cases or related issues. It would be highly risky if such discussions in relation to judicial orders and judicial matters are held in a close-door meeting or in the privacy of the chambers of the members of the Settlement Commission. Eventually, the guarantee of justice is ensured when there are public hearings and open sittings. In judicial matters and proceedings of that nature, the discussion in open Court, after questioning the respective parties/their advocates or their representatives ensures not only fairness but purity and sanctity of Judicial process. The Court held that there was an uncalled interference in judicial proceedings and none including the Chairman can direct a particular course of action to be taken or a particular order being passed in pending judicial proceedings. The Court held that to avoid an allegation of similar nature the Chairman would be well-advised not to chart this course hereafter.

4. Reference to Transfer pricing officer (TPO) u/s. 92CA – CBDT Instruction No. 3 of 2003 dt. 20-5-2003 – No reference to TPO inspite of international transaction exceeding ` 5 crores – Transfer pricing adjustment bad in law

PCIT vs. M/s. S. G. Asia Holdings (I) P. Ltd. – [ITXA No. 281 of 2016, Hon'ble Bombay High Court]

The assessee had certain international transactions with its Associated Enterprises. The Assessing Officer (AO) while framing the Assessment, though remarked that the assessee had undertaken international transactions, did not refer the same to the Transfer Pricing Officer (TPO) and *suo motu* made adjustments to the income of the assessee and thereby made an addition of ` 2,89,82,746/- to the income of the Assessee. The same was confirmed by the CIT(A). In further appeal to the Tribunal, the assessee raised various grounds. Out of those, one of the grounds was that as per CBDT Instruction No. 3 of 2003 where the value of International Transaction was more than ` 5 crore the AO should refer the issue to the TPO for determining the Arm's Length Price, which was not done in the present case and therefore the TP Adjustment was entirely bad in law. The Tribunal accepted the said contention and deleted the TP adjustments made by the AO. In further appeal by the Department, dismissing the appeal, it was held by the Hon'ble High Court that, as factually found by the Tribunal these instructions were applicable and once it is so, there ought to be some solid ground for ignoring a mandate flowing therefrom. The mandate is that the Assessing Officer should make a reference to the Transfer Pricing Officer. That is to make the transfer pricing adjustment. In this case, no such reference was made despite the facts warranting so. There is no acceptable or justifiable reason on record for refusing to abide by this condition in the CBDT circular. Once the circular goes unchallenged and binds the Revenue, then, in the absence of all this, the Tribunal rightly held that the Assessing Officer's order cannot be sustained. The AO could not have proceeded to make the transfer pricing adjustment. The Court further observed that bearing the peculiar factual backdrop, the Tribunal order cannot be vitiated in law or is perverse. It was not a case of non-application of mind to relevant and germane tests or error of law apparent on the face of the record. The Court dismissed the appeal stating that there were no substantial question of law arising in the Revenue's appeal.

5. Refund u/s. 240 along with interest u/s. 244 – Return filed without paying self-assessment tax – Assessment order quashed as time barred – Refund of entire income including returned income – Return is only defective and cannot be considered non-est/invalid in eyes of law – Refund cannot be granted on returned income

Dr. Thirupathy Reddy (HUF) vs. ACIT – [W.P. No. 41940 of 2006 MP No.1 of 2012, Hon'ble Madras High Court]

Pursuant to a search on certain group of which the Assessee was a part, notice u/s. 158BD was issued on the assessee asking it to file a return of income. As a result a return of income was filed by the Assessee declaring an undisclosed income of ` 24,04,830/-. Assessee stated that the return was filed under the pressure of tax officials. As a result, the tax due on the said returned income was not paid by the Assessee alongwith the Return. Thereafter an assessment was framed on the Assessee at an income of ` 65,15,781/-. Under the pressure of recovery from tax officials the Assessee made tax payment of the demand arising out of this assessment order. In further proceedings the said assessment order was quashed by the Appellate Authorities which was also affirmed by the Hon'ble High Court. Assessee claimed refund of the entire tax paid by it including that on the returned income on the ground that the return itself was an invalid return since it was filed without payment of tax. The same was refused by the Assessing Officer on the ground that on quashing of the assessment order the returned income stood accepted and the tax due thereon was required to be paid. The balance excess tax was refunded to the Assessee. Assessee filed a Writ Petition with the High Court praying for refund of entire taxes including those on the Returned income which was declared under pressure of the officials. The Hon'ble High Court dismissed the writ petition. The Court observed that though the petitioner at the time of filing the return had not paid the tax, it is not in dispute that such tax was paid later on demand and recovery action. Whether the payment of tax was voluntary or out of such demand, the fact remains that such payment of tax was also towards the disclosed income in the return and therefore, the manner and time of payment of such tax, do not have any significance. On the other hand, it is to be construed that such payment of tax was in respect of the return filed by the assessee containing disclosure of admitted income. Therefore, it is evident that the defective return filed earlier became valid later by the petitioner's own conduct of submitting to the assessment proceedings by paying the tax on demand. If an assessee has filed his return admitting certain amount as total income, such admission is binding on the assessee, even though the consequential assessment made is annulled later. The annulment of the assessment, at the best, may result in refund of excess tax levied by way of such assessment over and above the admitted tax paid. Therefore, on any account, the assessee cannot be heard to say that even in respect of admitted liability, the assessee is entitled to refund of tax paid on such liability, once the assessment is set aside or annulled later. Pursuant to the nullifying of the assessment, a deemed acceptance of the return of income furnished by the assessee stands and holds good and consequently, any tax paid either along with the return or later under any circumstances would certainly fall under the purview of "tax chargeable on the total income returned by the assessee" as referred to in Proviso (b) of Section 240 of the said Act. Reliance was placed on the judgment of the Hon'ble Supreme Court in the case of *CIT vs. Shelly Products – (2001) 261 ITR 367 (SC)*. The Court further held that even though it was contended that filing of such return was under pressure of the officials of the Revenue, this cannot be appreciated, in the absence of any materials substantiating such allegation, more particularly, in the absence of any challenge by the petitioner against further proceedings in pursuance of such notice.

NOTE: The Hon'ble Court observed that u/s. 139(9), the Assessing Officer may intimate the defect to the assessee and give him an opportunity to rectify the defect and only when such defect was not rectified within the time granted by the Assessing Officer, the return so filed is treated as an invalid return. However the Court did not discuss about the timelines, or whether notice was issued and no compliance was made so as to make the return invalid return. In fact the Hon'ble High Court has given its ruling on the basis that a return filed without payment of taxes is not an invalid return but only a defective return and the said defect gets cured once the taxes are paid by the assessee and as such taxes paid on returned income stand accepted if the assessment is annulled.

6. Amounts not deductible u/s. 40(a)(ii) – Cess paid on income tax allowed as deduction

Chambal Fertilisers And Chemicals Ltd. vs. JCIT – [D.B. Income Tax Appeal No. 52 and 68 of 2018, Hon'ble Rajasthan High Court]

In this case the assessee had claimed education cess of ` 2,41,59,485/- paid on its income tax as a deduction from its profits and gains of business and profession chargeable to tax. The Assessing officer had disallowed it u/s. 40(a)(ii). The CIT(A) and the Tribunal confirmed the disallowance. The question before the Hon'ble High Court was whether education-cess is a disallowable expenditure u/s. 40(a)(ii) of the Act. The Court observed that section 40(a)(ii) of the Act disallows any deduction of rate or tax levied on the profits and gains of business or profession. The counsel for the assessee relied on the CBDT Circular F. No. 91/58/66-ITJ(19) dated 18-5-1967 on Interpretation of provision of s.40(a)(ii) of IT Act, 1961 wherein it was clarified that earlier Clause 40(a)(ii) of the IT Bill, 1961 as introduced in Parliament did mention cess along with rate or tax levied. However when the matter came up before the Select Committee, it was decided to omit the word 'cess' from the clause. The effect of the omission of the word 'cess' is that only taxes paid are to be disallowed in the assessments for the year 1962-63 and onwards. Thus the Hon'ble High Court after considering various cases held that, education cess could not be disallowed u/s. 40(a)(ii) relying on the above circular.

Note: In this case an interesting argument was raised by the counsel for the Department before the Tribunal, stating that, if education cess were to be deductible, then it would not be possible to compute profit and income-tax and cess thereon. For e.g., If profit is ` 100, Income Tax is Rs. 30 and education cess is ` 0.90 and if education cess were to be deductible from profit, such profit (after such deduction) would become ` 99.1 (100-0.9) which would again necessitate recomputation of Income-Tax which would now be 30% of ` 99.1 i.e. ` 29.73 and also recomputation of education cess which would be ` 0.89. The vicious circle of such recomputation would continue, which is why legislature in its wisdom has not allowed deductibility of amounts calculated at a proportion of profits. Therefore, education cess is to be read as a part of the expression "rate or tax" as used in section 40(a)(ii). The Hon'ble High Court, however, relied on the CBDT Circular while granting relief to the assessee, without commenting on the said argument.

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Neelam Jadhav, Neha Paranjpe & Tanmay Phadke, *Advocates*

DIRECT TAXES
Tribunal

Unreported Decisions

1. Depreciation – Section 32 of the Act – the License to use a software is eligible for depreciation at the rate of 60% as per Item No. (5) in Appendix I of IT Rules, 1962

M/s. Toshniwal Instruments (Madras) Pvt. Ltd. vs. ACIT, 3(1), Mumbai (ITA 679/CHYN/2018) [Assessment Year: 2010-11] order dated 1-8-2018

Facts

The assessee is a Private Limited Company and engaged in the business of manufacturing of vacuum pumps and gas flow meters. During the year under consideration, the assessee purchased a license to use a software named as Microsoft Dynamics – Ax 2009 for the consideration of ` 13,71,600/-. The said license was utilized for the purpose of the business of the assessee. The assessee had treated the license to use a software under the head 'Computer & Software' and claimed the depreciation at the rate of 60% on ` 13,71,600/-. In the course of assessment proceedings, the learned A.O. was of the view that the licence acquired by the assessee was in the nature of intangible asset and thus, the assessee was entitled to claim depreciation at the rate of 25% only. On appeal, the learned CIT(A) upheld the view of the learned A.O. Being aggrieved, the assessee filed an appeal before Hon'ble ITAT. Hon'ble ITAT after considering the arguments of both the sides observed as under:

Held

Hon'ble ITAT held that as per new Appendix I of the Income Tax Rules, 1962, Item No. (5) of the table gives eligible rate of depreciation for "Computers including Computer Software" at the rate of 60%. Further, note 7 given under the said Appendix defines computer software as a computer programme recorded on any disc, tape, perforated media or other information storage device. Hon'ble ITAT, further, observed that the assessee had claimed depreciation on the license to use the Microsoft Software considering it as a Computer Software, coming within the above definition. Further, it was also observed that even if it was only a license, still it was a computer programme recorded on an information storage device. Thus, Hon'ble ITAT held that the assessee was eligible for the depreciation at the rate of 60%. Therefore, Hon'ble ITAT set aside the orders of the authorities below and directed the Ld. A.O. to allow the depreciation at the rate of 60% on ` 13,71,600/-.

2. Deemed Dividend – Section 2(22)(e) of the Act – addition under section 2(22)(e) of the Act is not sustained when the assessee, recipient of the money is neither the registered shareholder nor the beneficial shareholder of the payer company

DCIT vs. M/s. Gilbarco Veeder Root India Pvt. Ltd. (ITA 1003/Mum/2017)[Assessment Year: 2010-11] Order dated 20-6-2018

Facts

The assessee is a Private Limited Company and engaged in the business of manufacturing and selling of petrol dispensers and related accessories. The assessment in the present case was completed u/s. 143(3). However, the same was reopened by issuance of the notice u/s.148 of the Act. During the course of reassessment proceedings, the learned AO observed that the assessee had received a sum of ` 90 crore from M/s. Portescap India Pvt. Ltd. Further, it was also observed that the 100% shareholding of the assessee-company was held by M/s. Kollmorgen India Investment Company, Mauritius. So far as the shareholding of M/s. Portescap was concerned, it was entirely held by Kollmorgen, albeit @ 99.99% directly and 0.01% through its nominee, Mr. Jim Eder. Thus, the learned AO reached the conclusion that the amount received by the Assessee was in the nature of 'Loans and advances' and invoked the provisions of section 2(22)(e) of the Act On appeal, the Ld. CIT(A) accepted the contentions of the Assessee and allowed the appeal of the Assessee by observing that there was no common shareholding when a sum of ` 90 crores was received by the Assessee from M/s. Portescap. Kollmorgen became a register shareholder on 29-3-2010 which was subsequent to the payment received by the Assessee. Thus, the Ld. CIT(A) held that the provisions of section 2(22)(e) of the Act was not applicable in the present case. Aggrieved by the same, the Department preferred an appeal before Hon'ble ITAT. After considering the arguments of both the sides, Hon'ble ITAT observed as under:

Held

Hon'ble ITAT held that the assessee-recipient was not a shareholder in the payer company, i.e. M/s. Portescap. It, further, observed that even if it is assumed that the amount received by the assessee-company was for the benefit of the common shareholder, yet, it could only be assessed in the hands of such a registered shareholder and not in the hands of the assessee company. Hon'ble ITAT followed the decisions of the Hon'ble Bombay High Court in the case of *Universal Medicare (P.) Ltd., 324 ITR 263 (Bom.), Impact Containers 367 ITR 346 (Bom.)* and *NSN Jewellers (P) Ltd., ITXA 2312 of 2011(Bom.)* and further, held that there is no justifiable ground to interfere in the conclusion drawn by the CIT(A). It also distinguished the decision of the Supreme Court relied by the Revenue in the case of Gopal and Sons (HUF) and held that the ratio laid down by the Supreme Court is not applicable in the present case. In view of the above, Hon'ble ITAT dismissed the appeal of the Department.

3. Revision – Section 263 of the Act – A revision made u/s. 263 to verify the claim which was allowed in the earlier years is unjustified

Ganpati Herbal Care (P) Ltd. vs. Pr. CIT (ITA No. 2056/Del/2018) [Assessment Year: 2013–14), order dated 2-8-2018

Facts

The Assessee was engaged in the trading activity from Parwanoo area prior to setting up the present manufacturing unit and commenced its operations from 29-3-2010. Before setting up a new manufacturing unit in notified area in the State of Himachal Pradesh, the assessee had a manufacturing unit on a very small scale situated in the premises of family-owned unit at Kundli, Haryana. The assessee had been claiming the deduction under section 80-IC of the Act from the A.Y. 2011-12. The assessment for the year under consideration was completed under section 143(3) of the Act by assessing the income at ` 16,25,380/- under the normal provisions and ` 88,72,129/- u/s. 115JB of the Act. Thereafter the learned CIT passed the order u/s. 263 of the Act by observing that the assessment order was passed without verifying the claim under section 80-IC of the Act and concluded that the assessment was erroneous and prejudicial to the interest of the revenue. The learned CIT, further, observed that the claim u/s. 80-IC for the instant year is contrary to the documents filed before registrar of the companies and came to the conclusion that the present case was not of the case of setting up a new industrial unit but mere reorganisation of business already in existence. The Assessee being aggrieved by the order of the learned CIT preferred an appeal before Hon'ble ITAT. After considering the arguments of both the sides, Hon'ble ITAT observed as under:

Held

Hon'ble ITAT observed that the deduction u/s. 80-IC was claimed for the first time in A.Y.2011-12 and thereafter in A.Y. 2012-13. The said deduction was allowed by the Department in the earlier years without making a regular assessment u/s. 143(3) of the Act. Hon'ble ITAT held that the stage for carrying out any investigation for ascertaining that whether the unit was newly set up or reconstructed, was the initial year and not subsequent years. It is an undisputed fact that in the initial year i.e., A.Y. 2011-12, the claim of the assessee u/s. 80-IC of the Act was not doubted by the Department. Thus, the assessment order for the year under consideration, accepting the fulfilment of the conditions of Sec 80IC of the Act cannot be considered as erroneous and prejudicial to the interest of the revenue. Hon'ble ITAT while coming to the said conclusion relied on the decision of Hon'ble Supreme Court in the case of *DCIT vs. Ace Multi Systems Ltd. [2018] 400 ITR 141 (SC)* and allowed the appeal of the assessee.

4. TDS – Section 194-I and 201(1) of the Act – One-time non-refundable upfront charges paid for acquisition of leasehold rights are not in the nature of "rent" and thus, are not liable for TDS deduction

Paramount Villas Pvt. Ltd. vs. ITO (ITA No.5795/Del/2015 & 6540/Del/2015) [Assessment Year: 2012-13], Order dated 13-8-2018

Facts

The assessee is a Private Limited Company and engaged in the business of executing residential projects. The Assessee had purchased a land from UPSIDC which was a lease hold land taken for 99 years from the farmers. The entire land was treated as stock-in-trade. The assessee had made one-time payment for lease of land on the lump sum basis and 1% of the cost was treated as lease rent for the period of 1st ten years. During the course of assessment proceedings, the learned A.O. observed that the assessee had not deducted the TDS on the payment of annual rent of ` 2,92,02,984/- paid to UPSIDC u/s. 194-I of the Act and accordingly held that the amount of ` 29,20,298/- being 10% of ` 2,92,02,984/- was TDS payable u/s. 194I of the Act. The Ld. A.O. also treated the assessee as "Assessee in default" under section 201(1) of the Act and levied the interest of ` 9,51,928/-. On appeal, the learned CIT(A) allowed the appeal of the Assessee and observed that even though the term 'Lease Rent' had been used in the books of the UPSIDC, the said payment was not in the nature of rent and subsequently, there was no need to deduct Tax u/s. 194-I of the Act. Being aggrieved by the same, the department preferred an appeal before Hon'ble ITAT. After hearing both the sides Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that the UPSIDC had confirmed that the amount paid by the assessee had been credited in the statement of P&L account and income tax had been paid thereon. As per the proviso to the Section 201 which came into effect from 1-7-2012, the assessee cannot be treated as 'assessee-in-default. Further, Hon'ble ITAT relied on the CBDT Circular No. 35 of 2016 which mentions that one-time non-refundable upfront charges paid by the assessee for acquisition of leasehold rights over an immovable property cannot be constituted as rental income and the assessee was not obliged to deduct tax at source u/s.194-I of the Act. In the light of the same, Hon'ble ITAT held in favour of the assessee and against the department.

5. Income from House Property – Section 23(1)(c) of the Act – If the property is held with an intention to let out and the efforts for the same are made, the said property would fall within the purview of Section 23 (1)(c) and is eligible for vacancy allowance

Sachin R. Tendulkar vs. DCIT (ITA 3755/Mum/2016) [Assessment Year:2012-13] Order dated 10-8-2018

Facts

The assessee is an individual, having two flats, one at Saphire Park and the other in Treasure Park, Pune. The property situated in Treasure Park was let out for 9 months at ` 15,000/- per month and accordingly, the assessee showed the annual value at ` 1,35,000/-. However, the property situated at Sapphire Park was vacant for the whole year since the assessee could not find a suitable tenant. Therefore, the Assessee claimed a vacancy allowance u/s. 23(1)(c) and declared the income in respect of the flat situated at Sapphire Park as Nil in the return of income. The learned A.O. found the income offered by the Assessee was very low and estimated the rental income at 6% of the value of the flats aggregating to ` 1,43,40,750/- (i.e. ` 82,80,750/- + ` 60,60,000/- as deemed rental income. Accordingly, the learned A.O. made the addition of ` 8,60,445/- under the head Income from House Property. On appeal, the learned CIT(A) granted some relief to the Assessee by holding that as per the information available on the website, www.magicbricks.com, the probable rate for Sapphire Park should be ` 15,000/- per month. Accordingly, the learned A.O. was directed to restrict the deemed rental income. Being aggrieved by the same, the Assessee preferred the appeal before Hon'ble ITAT. After considering the arguments of both the sides, Hon'ble ITAT observed as under:

Held

Hon'ble ITAT held that in the case, the property or part thereof was vacant during the relevant period, the proportionate deduction should be allowed from the sum on which the property might reasonably be let out from year-to-year. Hon'ble ITAT observed that it was the plea of the assessee that he had made reasonable efforts by requesting the builder to identify the tenants for the concerned flat. Since an appropriate tenant could not be found, the flat remained vacant and concluded that the assessee was entitled for the relief as sought by him. It further relied on the decision of its Co-ordinate Bench in the case of *Premsudha Exports (P) Ltd. [2008] 108 ITD 158 (Mum.)* and held that if a property was held with an intention to let out in the relevant year coupled with efforts made for letting it out, it could be said that such a property was a let-out property and the same would fall within the purview of clause (c) of section 23(1). Finally, Hon'ble ITAT held in favour of the Assessee and against the department.

6. Period of holding for the purpose of LTCG – Section 2(42A) of the Act – Period of holding should be computed from the date of agreement to purchase and not from the date of registration

Sanjaykumar Footermal Jain vs. ITO (ITA 4853/ Mum/2016) [Assessment Year:2012-13] Order dated 14-8-2018

Facts

The assessee is an individual and filed the return of income for the A.Y. 2012-13 declaring the total income at ` 6,84,760/-. During the course of assessment, the learned A.O. disallowed the claim of long term capital gains of ` 5,72,282/- with regard to sale of the godown on the observation that the asset under consideration was not held by the assessee for a period of more than 36 months and finally treated the said gains as short-term in nature resulting in the addition of ` 86,82,000/-. On appeal, the learned CIT(A) confirmed the action of the learned A.O. Being aggrieved by the same, the assessee preferred an appeal before Hon'ble ITAT. After considering the submissions of both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that the assessee had purchased godown *vide* agreement dated 24-4-2008 and the initial payment of ` 1,26,000/- as against the total purchase consideration of ` 12,26,000/- was made by the assessee with a promise to make the balance payment on or before 3-5-2008. Further, it was observed that as a consequence of the agreement dated 24-4-2008, the balance payment was made by the assessee and the agreement was subsequently registered with the stamp duty authority on 11-7-2008. Hon'ble ITAT held that it was crystal clear that by virtue of the agreement for sale dated 24-4-2008, and making a part payment, the assessee had acquired irrevocable right, title and interest including the possession in the house property in the form of godown. The registration of the property which was done subsequently on 11-7-2008 was only a formality. Therefore, a period of holding of a capital Asset should be reckoned from 24-4-2008 and not from 11-7-2008 as wrongly adopted by the learned AO. For the purpose of Section 54 benefit, the date of Agreement to purchase should be taken as the date of purchase and date of registration of the same is not relevant. Hon'ble ITAT while arriving at the said conclusion relied on the decision of Delhi High Court in the case of *CIT vs. R. L. Sood (2000) 227 ITR 245 (Del)* and the decision of Mumbai ITAT in the case of *Anita D Kanjani [2017] 163 ITD 451 (Mum.)* and held in favour of the assessee.

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CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION Case Law Update

Tribunal Decisions

I. India-Israel DTAA – Most Favored Nation (MFN) Clause in the Protocol to the Treaty – Held : The MFN – clause under the India-Israel tax treaty is automatic and it applies prospectively – In favour of the assessee

DCIT vs. Sun Pharmaceutical Laboratories Ltd. Assessment Years: 2014-15 and 2015-16 – ITA No. 1345, 1346 and 1347/Ahd/2016, dated 11 July 2018)

Facts

(i) The assessee is a large pharmaceutical company. During the assessment years under consideration, the assessee made payments to an Israel based entity on account of Active Pharmaceutical Ingredient (API) and formulation services.

(ii) The assessee claimed that the payments were not in the nature of Fees for Technical Services (FTS) under the India-Israel tax treaty. FTS article was to be read along with the MFN clause provided in the Protocol to the India-Israel tax treaty. The Protocol was signed on 29 January 1996, and subsequently, India- Portuguese tax treaty was notified[5] which contains a 'make available' clause. Therefore, the 'make available' clause provided in India-Portuguese tax treaty, must be read into the India-Israel tax treaty.

(iii) The Commissioner of Income-tax (Appeals) [CIT(A)] granted the relief by invoking MFN clause and held that the services rendered by the Israel based entity did not 'make available' technical knowledge, experience, skill, know-how or processes, etc.

(iv) The tax department claimed that the MFN clause in the India-Israel tax treaty was only an enabling provision and it cannot automatically alter the FTS clause in the tax treaty.

Decision

On Appeal, the Tribunal held in favor of the assessee as follows:

(i) A Protocol is an integral part of a tax treaty and when the Protocol provides for an MFN clause, the same is to be given due effect. A Protocol is an indispensable part of the tax treaty with the same binding force as the main clauses therein. Therefore, the provisions of the tax treaty are required to be read with the Protocol clauses and are subject to the provisions contained in such Protocol.

(ii) The Tribunal referred to the decision of the Delhi High Court in the case of Steria India Ltd6 where the Protocol to the India-France tax treaty was interpreted. It was held that the benefit of the lower rate or restricted scope of FTS under the India-France tax treaty was not dependent on any further action by the respective governments.

(iii) It cannot be the law that every MFN clause triggers its application without any further action on the part of the contracting parties. Under the MFN clause of India-Switzerland tax treaty, a stipulation is provided stating that if after the signature of the India-Switzerland tax treaty, any third country signs a tax treaty with India which is a member of OECD, Switzerland and India shall enter into negotiations in order to provide the same treatment as that provided to the third state.

(iv) Similarly, the India-Philippines tax treaty provides a stipulation with reference to Articles 8 and 9 stating that if at any time after the date of signature of the India-Philippines tax treaty, the Philippines agrees to a lower or nil rate of tax with a third state, the government of Philippines shall inform the government of India through diplomatic channels and the two governments will undertake to review provisions of these Articles with a view to provide such lower or nil rate to profits of the same kind derived under similar circumstances by enterprises of both the contracting states.

(v) Thus, the effect of the above-referred MFN clauses (under the Switzerland and Philippines tax treaties with India) are subject to negotiations and review by the parties so as to bring parity in the provisions.

(vi) In the present case, the MFN clause7 contained in the Protocol to the India-Israel tax treaty is applicable prospectively. This MFN clause does not require anything more than such a more favourable tax treaty coming into force.

(vii) The definition of FTS under the India-Portuguese tax treaty covers rendition of only such ‘technical or consultancy services’ which ‘make available’ technical knowledge, skills or experience. The Tribunal referred to various decisions *[Ref: DIT vs. Guy Carpenter & Co. Ltd. [2012] 346 ITR 504 (Del), CIT vs. De Beers India Pvt. Ltd. [2012] 346 ITR 467 (Kar)]* in favour of the assessee.

(viii) The Tribunal observed that it was an ongoing contract that the assessee had entered into with the service provider, and the thrust of the arrangement was essentially for supervisory and consultancy services. These services are not FTS because they do not ‘make available’ technical knowledge, experience, skill, know-how or processes by virtue of MFN clause under the India-Israel tax treaty.

Comments

The applicability of MFN clause under a tax treaty has been a subject matter of debate before the Courts / Tribunal. Tax treaties entered into by India with Netherlands, Sweden, France, Spain, Hungary, etc. contain an MFN clause and it does not require both the countries to re-negotiate the tax treaty to claim the benefit of such MFN clause. However, the MFN clause in the India-Switzerland tax treaty is not automatic and requires both the countries to enter into negotiations, subsequent to a more beneficial tax treaty entered into with the other OECD country, in order to provide the benefit of a reduced rate or restricted scope given in the subsequent tax treaty.

It is important to note that the Protocol (Refer Notification 10/2017, dated 14 February 2017)to the India-Israel tax treaty has omitted the MFN clause with effect from 1 April 2017.

II. India-Cyprus DTAA – Installation PE – held that the activities of the assessee does not constitute an installation Permanent Establishment (PE) under Article 5(2)(g) of the India-Cyprus tax treaty (tax treaty) since threshold period of 12 months has not been exceeded- In favour of the assessee.

Bellsea Ltd v. ADIT [TS-426-ITAT-2018(Del)]
Assessment Year: 2008-09

Facts

(i) The assessee is a Cyprus based company which was awarded a contract by another foreign entity Allseas Marine Contractors S.A, (AMC) for placement of rock in seabed for laying of gas pipelines and providing sub--structures in oil and gas field developed at Krishna Godavari Basin.

(ii) AMC was awarded a contract from the Reliance group and Niko Resources for extraction of gas and for laying of the gas pipeline. In order to carry out its contract work, AMC has given a contract to the assessee for the placement of rock in the oil and gas field.

(iii) Under the terms of the contract, the work was intended to commence from 4th January 2008 which has been mentioned as ‘effective date’ in the contract. Under the said contract itself, the completion of the work was reckoned from the date of issuance of completion certificate by AMC which was 30th September 2008.

(iv) The contract lasted for less than 12 months which is the threshold period for the establishment of PE in India in terms of installation PE under Article 5(2)(g) of the tax treaty. Therefore, it was claimed by the assessee that no income earned from such contract can be attributed or taxed in India.

(v) The Assessing Officer (AO) held that the assessee was responsible for multifarious functions. Thus, from terms of contract and scope of work it cannot be said that the role of the assessee was limited to mere rock placements in river sections. One of the employees of the assessee has come to India as early as in September 2007 to collect data and information. Despite asking the assessee to provide the details of employees who stayed in India, no data has been furnished.

(vi) Therefore, the AO concluded that the assessee had rendered service for a period of more than 12 months and therefore, there was an installation PE in India.

Decision

On appeal, the Tribunal held in favour of the assessee as under:

(i) Assessee’s activity under the ‘scope of work’ has been given in the contract. From the scope of work, it could be deduced that it was purely with regard to rock transport and delivery, the supply of material and equipment, construction, installation of the temporary facilities, rock dumping activities and site restoration. All other activities enumerated by the AO *qua* the assessee was not correct.

(ii) It had not been brought out by the tax department that the assessee installed any kind of project office or developed a site before entering into the contract with the AMC for carrying out any preparatory work.

(iii) Auxiliary and preparatory activity, purely for tendering purpose before entering of the contract and without carrying out any activity of economic substance or active work qua that project cannot be construed as carrying out any activity of installation or construction.

(iv) Article 5(2)(g) of the tax treaty refers to activity based PE because the main emphasis is on 'where such site project or activity continues for a period of more than 12 months'. The duration of 12 months *per se* is activity specific *qua* the site, construction, assembly or installation project. If the contract would not have been awarded, then any kind of preparatory work for tendering of contract cannot be reckoned for carrying out any activity as stipulated in this clause. Hence, in this case, all such preparatory work for tendering purpose before entering into the contract cannot be counted while calculating the threshold period.

(v) Situation would be different if after the contract/work has been awarded/assigned, any kind of active work of preparatory or auxiliary nature is carried out. In such as case, it could be counted for determining the time period.

(vi) This principle has been well discussed by the Delhi High Court in the case of *National Petroleum Construction Company vs. DIT [2016] 383 ITR 648 (Del)* wherein the High Court was analysing similar terminology appearing in Article 5(2)(h) of India-UAE tax treaty. The High Court observed that a building site or an assembly project can only be construed as a fixed place of business only when an enterprise commences its activities at the project site. Any activity which may be related or incidental but was not carried out at the site in the source country would clearly not be construed as a PE. Albeit, preparatory work at the site itself can be counted for the purpose of determining the duration of PE.

(vii) The material placed on record and the payment schedule etc., point out that all the activities connected with the project including the receiving of the payments was before 30th September 2008 and even the completion certificate mentions 30th September 2008.

(viii) Though certain formalities for final completion certificate may have exceeded one or two months but still it will not make the continuity of the activity where it has been brought on record that the last barge sailed out or was decommissioned from India on 25th September 2008 and the entire payments were received on or before that date. The activity *qua* the project comes to an end when the work gets completed and the responsibility of the contractor with respect to that activity comes to an end.

(ix) The contentions raised by the tax department, both for the starting period and the final end date of the installation project were without any factual material to support.

(x) Threshold period of 12 months has not exceeded in the present case and consequently, no PE can be said to have been established in Article 5(2)(g) of the tax treaty. Accordingly, no income of the assessee on the contract executed by the assessee in India is taxable in terms of Article 7 of the tax treaty.

III. India-USA DTAA – Credit for foreign taxes withheld is available, even if no return filed overseas but income can be shown to be taxable in that country

M/s. Uniparts India Limited vs. CIT [TS-390-ITAT-2018 (Del.)] Assessment Years: 2007-08, 2008-09, 2009-10, 2010-2011 & 2011-12

Facts

(i) The assessee was a resident in India. It had advanced a certain amount to its wholly owned subsidiary in USA (S Co.).

(ii) The assessee, *inter alia*, earned interest income on the above advances. The said interest was remitted by S Co. after withholding taxes at 15%, as per Article 11 of the double taxation avoidance agreement between India and USA (tax treaty).

(iii) The assessee offered such interest income to tax in India and claimed credit of taxes withheld by its subsidiary under Article 252 of the tax treaty, in its return of income.

(iv) The tax officer (TO) denied the credit of taxes withheld in USA. The Commissioner of Income tax (Appeals) (CIT (A)) upheld the TO's order. The aggrieved assessee filed an appeal before the Tribunal.

Decision

The Tribunal held in favour of the assessee as under:

(i) The Tribunal observed that AO denied the credit mainly on the following grounds:

(a) The assessee had not filed its return of income in USA to claim the refund of taxes withheld in USA.

(b) The tax treaty does not enable the resident country to grant credit of the tax withheld in the source country when the income was not taxable in the source country, as it was not a case of double taxation;

(c) CIT(A) alleged that interest paid by S Co. was actually an expenditure for S Co. and therefore, the question of same being taxable in USA did not arise;

(d) The assessee had failed to prove under which provision the taxes were withheld by the S Co. in USA.

(ii) Tribunal analysed the provisions of the India US Tax Treaty and inferred that Article 11 of the tax treaty empowers S. Co to withhold taxes at the rate specified in the said Article.

(iii) Paragraph 2 of Article 25 of the tax treaty clearly provides that if a resident of India derives income which may be taxed in USA, then India has to grant credit of taxes withheld in USA.

(iv) It was not in dispute that tax had been deducted by the S. Co in USA on the interest income earned by the assessee. The issue was with respect to the provision under which such amount of interest paid by the S. Co to the assessee was liable for tax under the laws of USA. Hence, the withholding tax certificate issued by S. Co perhaps will provide those details.

(v) The case was remanded back to the TO for the limited purpose of examination of the withholding tax certificate or any other substantiating document.

(vi) It was further directed that the assessee should be allowed the credit of the taxes withheld in USA, if the assessee furnished the withholding tax certificate and substantiate.

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> It is the strong mind that hews its way through a thousand difficulties.
>
> — *Swami Vivekananda*

CA Jinit R. Shah

INDIRECT TAXES

GST Gyan

Issues in Input Tax Credit

Introduction

"Trailer was good… movie seems to be not so good".

Trailer - GST was introduced with the intent to bring the whole nation under the one tax net and allow seamless flow of credit to the businesses.

Movie - whether the flow is seamless or "seen-less" only the time will tell.

Looking into the various advance rulings given by various States on different issues, it seems that taking of Input Tax Credit (ITC) on various inputs, input services and capital goods will be a challenging task for the businesses.

Caution

ITC, whether the same is available for the period prior to registration under GST?

The erstwhile VAT Law specifically provided for non-availment of credit for the period prior to registration however under Service Tax there was no such specific provision. Under GST, Section 16 of the Central Goods and Services Tax Act, 2017 (hereinafter referred to as CGST Act) provides that every registered person shall be entitled to ITC thus the emphasis is on "registered person" so intent of the Law is clear that only registered person shall be entitled to the ITC, further the GST Portal also does allow the ITC to the assessee as the same does not get reflected in the electronic credit ledger.

Consider a scenario wherein a person incurs huge cost towards marketing, research and development, etc., before getting itself registered under GST and there is complete loss of credits. However, there are exceptions to the scenario wherein if a person obtains voluntary registration or has applied for registration within 30 days from the date on which he becomes liable to registration and has been granted such registration then he is entitled to take credit of input tax in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock on the day immediately preceding the date of grant of registration and date from which he becomes liable to pay tax respectively. However, ITC on services may be lost.

But one can also look into the case of *Eicher Motors Ltd. vs. Union of India [1999 (106) ELT 3 (SC)]* and various other cases pertaining to pre-GST era wherein the Apex Courts has laid down the principles that a right to avail credit is accrued as soon as duty paid inputs were received by the assessee and such an accrued right cannot be modified subsequently.

Few Burning Issues

There are currently many issues in ITC which needs to be addressed, there may be no clear stand on the same however this article tries to highlight few issues involved and different thoughts on the same. Some issues and food for thought for the readers are as under:

1. Fails to pay within 180 days

1.1 Second proviso to Section 16(2) of the CGST Act read with Rule 37 of the Central Goods and Services Tax Rules, 2017 (hereinafter referred to as CGST Rules) provides that ITC is required to be reversed if the recipient fails to pay to the supplier of goods or services or both within a period of 180 days from the date of issue of invoice then the amount of credit taken by the recipient shall be added to the output tax liability of the recipient and the recipient shall be liable to pay the said amount alongwith interest.

1.2 In the service tax era, as per second proviso to Rule 4(7) of the CENVAT Credit Rules, 2004, the credit reversal was required if the recipient had not made the payment, thus the term used there was "payment is not made within 3 months" which are different from the words used in the GST era.

1.3 Consider a scenario wherein the **credit period itself between the supplier and the recipient is say 8 months** (more than 180 days), then whether the recipient who has received the invoice and goods or services is required to reverse or pay the amount equal to the credit taken.

1.4 Payment beyond 180 days as per credit terms may not be considered as failure to make payment as the recipient is not required to make payment within 180 days, so the reversal of the credit may not be required.

1.5 However, it should be noted that such a stance would definitely invite litigation as department may not accept such a stance, especially when the officers in the erstwhile era made recipients to pay or reverse the amount equal to such credits in such scenarios. Only time will tell whether the legislature intentionally used such words to deviate from the practice followed in earlier era.

1.6. Similarly, in case of retentions the recipient may consider the retention amounts as not a failure to make payment and thus may not be required to reverse or pay the amount equal to the credits taken.

2. GST paid under Reverse Charge Mechanism (RCM)

2.1 The credit of GST paid under RCM shall be available to the recipient in the month of payment of such tax itself or shall be available in the month following the month in which the payment is made or when actually the return is filed by the recipient.

2.2 Section 16(2) of the CGST Act provides few conditions which are required to be fulfilled for the recipient to be entitled to the credit. The relevant conditions for this issue are that the tax should have been actually paid to the Government and the return should have been furnished.

2.3 In the GST Portal the ITC gets credited to the electronic credit ledger only after the return is filed by the recipient, hence can we say that the said condition of filing of return is also fulfilled and thus the recipient is entitled to such credit also immediately in the month in which the payment is made under RCM.

2.4 Say, the liability of GST under RCM for the month of August 2018 is paid on 18th September 2018 and return is also filed on same date, then whether the ITC of such GST paid under RCM is allowed to be taken and can be utilised to make the payment of output tax liability pertaining to August 2018 itself or can be taken and utilised for making payment of output tax liability pertaining to September 2018.

2.5 Here, it is pertinent to note that the recipient has made payment to the Government on 18th September, 2018 and has also filed the returns on the same date then it seems that the relevant conditions are fulfilled since the credit also gets reflected in the electronic credit ledger (once the returns are filed) and thus it may be utilised for making payment of GST pertaining to the month of August 2018 itself.

3. Possession of Tax Invoice

3.1 One of the conditions to avail the ITC is that the recipient should be in possession of the tax invoice issued by the supplier. It is common practice that the supplier sends the invoice over mails (and later sends the hard copy), thus the issue is whether the recipient can be said that he is in possession of the tax invoice and is entitled for ITC.

3.2 Section 16(2) of the CGST Act read with Rule 36 of the CGST Rules provides that the recipient should be in possession of tax invoice or debit note or any other document for availing the ITC. Section 145 of the CGST Act provides that any information stored electronically in any device or media shall be deemed to be a document for the purposes of this Act.

3.3 Thus, it may be interpreted that the soft copies of the invoice may be considered as valid document for the purpose of availing ITC. However, it is highly recommended to have the hard copy of the invoice as old habits die hard and department may not allow such credits taken plainly on the basis of soft copies of the invoices.

4. Transit loss or normal loss due to the nature of goods

4.1 Section 17(5) of the CGST Act provides for list of blocked credits and one of the entry therein states that if the goods are lost, stolen, destroyed, written off or disposed of by way of gift or free samples then the ITC of the same shall not be available.

4.2 Many-a-times there is normal loss of goods in transit or due to the nature of goods wherein loss occurred due to dryage of moisture content or evaporation, then whether the ITC on such goods can be denied on the basis of aforesaid provision.

4.3 In the cases of *Commr. of Central Excise, Allahabad vs. Hindalco Industries Ltd. [2017 (349) ELT 211 (All.)]* and *Union of India vs. Hindustan Zinc Ltd. [2017 (48) STR 422 (Raj.)]* the Hon'ble High Courts held that the CENVAT credit of duties paid on such normal losses cannot be denied unless it is proved that the goods are diversified illegally for other purposes.

4.4 One may take shelter of the reasoning in the aforesaid case-laws to take the ITC, however it is to be noted that the aforesaid cases are pertaining to the period prior to the GST era where such specific provision relating to blockage of credit due to goods lost, stolen, etc. was absent.

5. Insurance and repairs of motor vehicle

5.1 Section 17(5) of the CGST Act specifically blocks the ITC in respect of motor vehicles and other conveyance except when they are used for purposes specified therein.

5.2 A motor vehicle in the name of the company is used for its business purposes [other than those specified in Section 17(5)] then the ITC of the said motor vehicle shall not be available to the company, however the ITC of GST paid on insurance cost and repairs of the motor vehicle shall be available or not is an issue.

5.3 Some schools of thought are of the view that the same shall not be available if the ITC of motor vehicle *per se* is not available, as the term "in respect of" would cover everything relating to the motor vehicle.

5.4 However, one may take the ITC of the cost incurred on insurance and repairs of such motor vehicles since the provisions of Section 17(5) does not specifically disallow any such credit. Further, in a FAQ issued by GOI on 28-12-2017 in one of the question as to whether GST paid on insurance and repairs on vehicles is allowed, when vehicle is used for business purpose only and it was answered in positive i.e., ITC will be available.

5.5 Further, in the amendments to GST Act which received the assent of the President on 29th August, 2018, there is specific amendment under section 17(5) wherein specifically the ITC on services of general insurance, servicing, repairs and maintenance in so far as they relate to motor vehicles, except when used for specified purpose is blocked. From the said amendment it is implicit that currently the ITC on the said services may be allowed otherwise there was no need for such amendment.

6. ITC on excavators, JCBs, Road-Rollers, etc., used by construction company

6.1 Many construction Companies purchase excavators, JCBs, road-rollers, bulldozers, etc. to use it in the course of their business. Section 17(5)(a) of the CGST Act specifically disallows credit of Motor Vehicles.

6.2 Motor Vehicles has been defined to mean motor vehicle as defined under section 2(28) of the Motor Vehicles Act, 1988. "Motor vehicle" or "vehicle" as defined therein means any mechanically propelled vehicle adapted for use upon roads whether the power of propulsion is transmitted thereto from an external or internal source and includes a chassis to which a body has not been attached and a trailer; but does not include a vehicle running upon fixed rails or a vehicle of a special type adapted for use only in a factory or in any other enclosed premises or a vehicle having less than four wheels fitted with engine capacity of not exceeding 25 cubic cm.

6.3 The above definition specifically excludes vehicle of a special type adapted for use only in a factory or in the enclosed premises, the excavators, etc., may not get covered under the said exclusion part as it is not used in a factory or in any enclosed premises.

6.4 Further, in a sectorial FAQ issued in respect of Mining Industry with regards to ITC of GST charged on purchase of all earth moving machinery including JCB, tippers, dumpers by a mining company it has been clarified that ITC will be available when these are used for transportation of goods.

6.5 Thus, for types of vehicles like excavator, JCB, bulldozer, road-roller, etc. which are not used for transportation of goods the ITC on the same will be a big question mark.

7. Ek Pe Ek Free (buy one get one free)

7.1 The ITC of any goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples shall not be available as per Section 17(5)(h) of the CGST Act.

7.2 Many businesses market their product as buy one get one free, the issue involved is whether the ITC of goods, supplied free along with other products, is available or not.

7.3 It is to be noted here that goods disposed of by way of free samples are covered in the blocked list, so any goods distributed free as such is not covered in the said blocked list. Further, it is to be noted that any permanent transfer or disposal of business asset where ITC has been availed is a deem supply as per Schedule I.

7.4 Thus, the ITC of goods given away free along with other products shall be available and consequently GST would also be payable on the same.

8. CSR Expenses

8.1 Section 16(1) of the CGST Act provides that the goods or services or both should be used in the course or furtherance of business for a registered person to be entitled to the ITC on the same.

8.2 The question arises as to what is for the purpose of business and other than business, what is the benchmark as to consider that a particular expense is in the course or furtherance of the business or for non-business purposes. Whether allowability or disallowability of a particular expense under income tax will decide the fate of ITC on it?

8.3 If that is the case then under income tax there are already issues as to whether a particular expense shall be allowed as expense or not. The Government's intention behind not allowing the CSR expenses as business expenditure is that if such expenses are allowed as deduction then it would result in subsidizing of around 1/3rd of such expenses by the Government by way of tax expenditure. However, few CSR expenses are allowed as deduction, but not all.

8.4 In one of the questions asked on Twitter as to whether ITC is available under GST with respect to CSR expenses incurred by companies the answer given was ITC on GST paid on all expenses incurred in course or furtherance of business except blocked credit is available. So what is in the course or furtherance of business has to be tested.

8.5 Further, Schedule I provides that if any business asset, on which ITC is availed, are disposed of even without consideration then is shall be considered as deem supply. The term "business asset" is not defined but generally any goods of a business will be considered as business asset so then if ITC is availed then GST may also be payable on such CSR activities.

8.6 Thus, before taking any ITC on CSR expenses all angles of GST should also be taken into consideration and if at all the ITC is taken then one will have to look into as to whether the expenses shall be considered as incurred in the course or furtherance of business.

Conclusion

It is recommended that all the assessees should not only properly analyse the credits available but also properly get its output taxes analysed as any wrong payment of taxes on the output side will lead to literally wiping out the small and medium entrepreneurs. If the person is not paying any taxes considering its output supply as exempted but however after 4 to 5 years it is identified by the department that tax was to be paid at 18% and because of which the demand is amounting in Crores then at that point of time the liability would almost be more than two times the original default because of interest and penalties and also the person has not taken the ITC since his output was exempted as per his interpretation and later he won't be in a position to take the ITC as the time period of taking the credit would have lapsed as per the Law, thus literally destroying the assessee.

Before closing – take all relevant ITC on or before filing September 2018 GST return or miss the bus of ITC.

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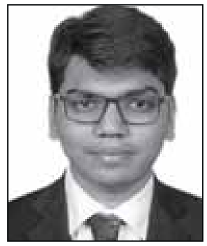
> Be of good cheer and believe that we are selected by the Lord to do great things, and we will do them.
>
> — *Swami Vivekananda*

CA Ashit Shah and CA Kush Vora

INDIRECT TAXES

GST – Legal Update

GST Legal Update for the period 1st August to 31st August 2018

A. CGST NOTIFICATIIONS:

1. Completion of migration of taxpayers who received provisional IDs but could not complete the migration process *(Notification No. 31/2018 – Central Tax dated 6-8-2018)*

The Central Government on recommendation of GST council has laid down the special procedure for the registration of taxpayers who could not complete the migration process before 31st December 2017.

The detailed procedure such as filing of application, to jurisdictional nodal officer, logging on to website, filling up of application in form REG 01, intimation of details to GSTN, etc. has been prescribed in detail in the notification.

Further, the notification states that in such cases, registration shall be granted with effect from 1st July 2017.

2. Revised due dates for filing GSTR 1 and GSTR 3B *(Notification No. 32/2018, 33/2018 & 34/2018 – Central Tax dated 10-8-2018)*

The revised due dates for filing of GSTR-1 and GSTR-3B for the period July 2018 to March 2019 will be as under:

Months	GSTR 3B (Monthly)	For taxpayers having aggregate turnover above ` 1.5 crore	For taxpayers having aggregate turnover below ` 1.5 crore
		GSTR-1 (Monthly)	GSTR-1 (Quarterly)
July 2018	20th August 2018	11th August 2018	31st October 2018
August 2018	20th September 2018	11th September 2018	
September 2018	20th October 2018	11th October 2018	

Months	GSTR 3B (Monthly)	For taxpayers having aggregate turnover above ` 1.5 crore	For taxpayers having aggregate turnover below ` 1.5 crore
		GSTR-1 (Monthly)	GSTR-1 (Quarterly)
October 2018	20th November 2018	11th November 2018	31st January 2019
November 2018	20th December 2018	11th December 2018	
December 2018	20th January 2019	11th January 2019	
January 2019	20th February 2019	11th February 2019	30th April 2019
February 2019	20th March 2019	11th March 2019	
March 2019	20th April 2019	11th April 2019	

3. Extension of due date for filing of FORM GSTR-3B *(Notification No. 35/2018 – Central Tax dated 21-8-2018)*

The due date for filing of GSTR-3B for the month of July 2018 has been extended to 24th August 2018.

4. Extension of due date of filing of GSTR-1 and GSTR 3B for State of Kerala, etc. *(Notification No. 36/ 2018, 37/2018 & 38/2018 – Central Tax dated 24th August 2018)*

The revised due dates for filing of GSTR-1 and GSTR-3B for registered person in State of Kerala, registered persons whose principal place of business is in Kodagu district in the State of Karnataka; and registered persons whose principal place of business is in Mahe in the Union territory of Puducherry is as under:

Months	GSTR 3B (Monthly)	For taxpayers having aggregate turnover above ` 1.5 Crore	For taxpayers having aggregate turnover below ` 1.5 Crore
		GSTR-1 (Monthly)	GSTR-1 (Quarterly)
July 2018	5th October 2018	5th October 2018	15th November 2018
August 2018	10th October 2018	10th October 2018	
September 2018	20th October 2018	11th October 2018	

B. CGST RATE NOTIFICATIONS:

5. Extension of RCM on unregistered purchases *(Notification No. 22/2018 – Central Tax (Rate) – Dated 6-8-2018)*

Notification No. 8/2017 (rate) has been further amended to defer reverse charge payment as per Section 9(4) of CGST Act to 30th September 2019 on purchases of goods or services from unregistered person.

C. CIRCULARS

1. Clarification regarding applicability of GST on various goods and services *(Circular No. 52/26/2018 – GST dated 9-08-2018)*

The Board has clarified the applicability of GST rate on the various goods and services which are as under:

Sr. No.	Particulars	HSN Code	Rate %
1	Fortified Tonned Milk	0401	Nil
2	Refined beet and cane sugar	1701	5%
3	Tamarind Kernel Powder (Plain & Modified)	1302	5%
4	Supply of safe drinking water for public purpose	2201	Nil
5	Human Blood Plasma (List I, Sr. No. 186)	3002	5%
6	Baby wipes, facial tissues and other similar products:	3307 3401	18%
7	Zari Kasab (thread)	5605	12%
8	Marine engine	8408	5%
9	Cotton Quilt		
	• Sale value below ` 1000 per piece	9404	5%
	• Sale value exceeds ` 1000 per piece	9404	12%
10	Bus Body building activity		
	• Bus body builder builds a bus, working on the chassis owned by him and supplies the built-up bus to the customer, and charges the customer for the value of the bus.	–	28%
	• Bus body builder builds body on chassis provided by the principal for body building, and charges fabrication charges	–	18%
11	Disc Brake pad	8708	28%

2. Clarification regarding applicability of GST on the petroleum gases retained for the manufacture of petrochemical and chemical products (*Circular No. 53/27/2018 – GST dated 9-8-2018)*

The Board has clarified that GST will be payable by the refinery only on the net quantity of petroleum gases retained by the recipient manufacturer for the manufacture of petrochemical and chemical products. Though, the refinery would be liable to pay GST on such returned quantity of petroleum gases, when the same is supplied by it to any other person. The said clarification would be retrospective in nature from the date of applicability of GST i.e. 1-7-2017.

3. Classification of fertilizers supplied for use in the manufacture of other fertilizers at 5% GST rate *(Circular No. 54/28/2018 – GST dated 9-8-2018)*

The Board has clarified that the fertilizers supplied for direct use as fertilizers, or supplied for use in the manufacturing of other complex fertilizers for agricultural use (soil or crop fertilizers), will attract 5% GST.

4. Taxability of services provided by Industrial Training Institutes *(Circular No. 55/29/2018 – GST dated 10-8-2018)*

The Board has clarified services provided by a private ITI in respect of designated trades notified under Apprenticeship Act, 1961 are exempt from GST under Serial No. 66 of Notification No. 12/2017- CT (Rate). As corollary, services provided by a private ITI in respect of other than designated trades would be liable to pay GST and are not exempt. It has further been clarified that services provided by a government ITI to individual trainees/ students is exempt under serial no. 6 of 12/2017- CT (Rate) dated 28-6-2017 as these are in the nature of services provided by the Central or State Government to individuals.

5. Clarification regarding removal of restriction of accumulated ITC on fabrics *(Circular No. 56/30/2018 – GST dated 24-8-2018)*

The said circular clarifies many issues arising on account of reversal of accumulated ITC on fabrics as under:

- It has been clarified that refund of accumulated ITC under Notification No. 5/ 2017- Central tax (rate) dated 28-6-2017 is applicable only in respect of refund of accumulated ITC on inputs. It has been clarified that the notification does not put any restriction in relation to ITC on input services and capital goods.
- It has been further clarified that input tax credit on account of inverted duty structure lying in balance after payment of GST for the month of July (on purchases made on or before 31st July, 2018) shall lapse.
- Furthermore, it has also been clarified that accumulated ITC on zero rated supplies shall not lapse based on formula as per Rule 89(4).
- The circular also states that the amount of reversal has to be disclosed in August in month GSTR 3B under column 4(B)(2). The verification of accumulated ITC lapsed will be done at the time of filing of first refund claim. Hence, detailed calculation sheet in respect of accumulated ITC lapsed shall have to be prepared by the taxable person and shall have to be furnished at the time of filing first refund claim.

D. MAHARASHTRA GST NOTIFICATIONS AND CIRCULARS

Extension of migration process for GST Registration (*Notification No. 31/2018 – State Tax dated 9-8-2018, Trade Circular 19T, Trade Circular 21T of 2018)*

The Government of Maharashtra on the recommendations of the GST Council have initiated migration drive of those taxpayers who has received Provisional Identification Number but have not completed the registration process. Such taxpayers are required to approach the jurisdictional Central/State Tax nodal officers with the necessary details. The said campaign has been extended up to 31st August 2018.

E. GSTN PORTAL UPDATES

Online filing of Refund claim of ITC in case of exports and SEZ supplies

The facility to file multiple tax periods refund claim has been made available on GST portal. Now taxpayers can file refund claim for multiple periods in one financial year. Such facility is available only in case of refund of ITC accumulated in case of Exports and Supply to SEZ.

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CA Naresh Sheth & CA Jinesh Shah

INDIRECT TAXES

GST – Recent Judgments and Advance Rulings

A. Rulings by Appellate Authority for Advance Rulings

1. Switching Avo Electro Power Limited - AAAR West Bengal (2018-TIOL-04-AAAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is a supplier of power solutions, including UPS, servo stabilizer, batteries etc. Applicant applied for 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.	Rate	Tariff Head	Description	Remarks
IV	138	28%	8506	Primary cells and primary Batteries	Omitted w.e.f. 15/11/17 *vide* Notification No. 41/2017-Central (Rate) dated 14/11/2017
III	376A	18%	8506	Primary cells and primary batteries	Inserted w.e.f. 15/11/17 *vide* Notification No. 41/2017-Central (Rate) dated 14/11/2017
IV	139	28%	8507	Electric accumulators, including separators, whether rectangular (including square)	

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.

Schedule	Serial No.	Rate	Tariff Head	Description
III	375	18%	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.

Appeal to the AAAR and Observations of AAAR

Aggrieved by the above referred ruling, the applicant preferred an appeal to AAAR against the same. The AAAR observed that storage batteries has multiple uses and can be put to different uses. When such batteries are supplied separately with static converter (UPS) it cannot be considered as composite supply or a naturally bundled supply. The batteries supplied with UPS for a single price is considered to be a mixed supply.

Ruling of AAAR

The AAAR did not find any infirmity in ruling given by AAR West Bengal and thus disposed of the appeal.

2. CMS Info Systems Limited – AAAR Maharashtra (2018-TIOL-08-AAAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is having cash management network pan India. Appellant carries various activities which includes cash circulation through transporting cash from currency chest to bank branches, cash pick-up and delivery from and to dedicated banks, etc. Transportation of cash is done through security vans known as "cash carry vans". Applicant purchases raw motor vehicles and fabrications and gets them converted into cash carry vans. Applicant is currently paying GST on purchase of vans and fabrication. When the vans cannot be used further, applicant sells them as scrap.

Applicant sought clarification on following issues:

(a) Whether supply of such motor vehicles as scrap after its usage can be treated as supply in course or furtherance of business and whether such transaction would attract GST?

(b) If answer to (a) above is affirmative, whether ITC is available on purchase of motor vehicle i.e., cash carry vans that are purchased, used for cash management business and supplied post usage as scrap?

Applicant is of the opinion that they are lawfully eligible and entitled to claim ITC of GST paid on standard motor vehicle and also GST paid on fabrication of the vehicles.

Section 17(5)(a) of CGST Act disallows ITC in respect of motor vehicles and other conveyances. However, an exception is carved out *inter-alia* to motor vehicles and other conveyances used for transportation of goods. In other words, ITC is available if the motor conveyances are used for transportation of goods.

Section 2(52) of CGST Act defines **"goods"** to exclude money. Section 2(75) of CGST Act defines **"money"** to mean any Indian legal tender or any foreign currency, cheque, etc. and other instrument as recognized by RBI **when used as a consideration to settle an obligation or exchange with Indian legal tender of another denomination but shall not include currency held for its numismatic value.** Hence it is clear that Indian legal tender or currency or cheque would be considered as money only when used as a consideration to settle an obligation or exchange with Indian legal tender for another denomination.

In the given case, the currency is transported by the applicant for the purpose of carrying out business of maintaining ATM's and hence the applicant is not using the same as consideration to settle any obligation. From the view of applicant or for the applicant, what is being transported is goods and not money as the said goods do not serve the same purpose of money as in normal circumstances it would in the hands of a person.

Applicant also pointed out that Section 2 of CGST Act begins with the expression **"In this act, unless context otherwise requires"**. This means that the definition as can be departed if there is something in the context to show that the definition cannot be applied. In the given case, the context in which cash carry vans are used for the transportation of goods of the customer banks and not the money as defined u/s. 2(75) of the CGST Act. Further the intention of the legislature by excluding money from definition of goods is not to levy GST on supply of money.

Applicant further pointed out that Rule 138(14), which carves out goods, the transportation of which does not require preparation of e-way bill, specifically mentioned currency under the title "description of goods".

Applicant placed reliance on definitions of goods, goods carriage and transport vehicle as laid down in Motor Vehicle Act, 1988. Further, the applicant also submitted that the certificate of registration and certificate of fitness as issued by Motor Vehicle Department certified cash carry vans to be a goods carrier.

Discussions by and Observations of AAR

The disposal of scrap vehicles for a consideration is a sale and expression "supply" as laid down in section 7 covers supply of goods such as sale or disposal for a consideration. Section 7 further states that sale or disposal should be in course or furtherance of business. The disposal of cash carry vans is a transaction incidental or ancillary to the business of cash management. Hence, supply of cash carry vans as scrap is a supply in course or furtherance of business and such transaction would attract GST.

There was a difference of opinion in regards to eligibility of ITC on purchase of cash carry vans and fabrication done on it.

As per Shri B. V. Borhade, Joint Commissioner of State Tax

Section 17(5)(a)(i)(A) of the Act talks about *"further supply of such vehicles of conveyances"*. Here the legislature intends to cover motor vehicles which are purchased for the purpose of being sold. The word "further" is indicative of further supply and not mere disposal as scrap after the vehicle has been used till its full

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working life. Hence, ITC shall not be eligible to applicant under this sub-clause.

As regards section 17(5)(a)(ii), ITC in respect of motor vehicles used for transportation of goods, he was in agreement with the claim of applicant that the word goods in sub-section 5(a)(ii) would not take the colour from the definition of goods which excludes money therefrom. The cash management activities involve use of motor vehicles for transportation of goods. The motor vehicles would be covered by exception in sub-section 5(a)(ii) to section 17 and thus applicant would be entitled to ITC on purchase of cash carry vans.

As per Shri Pankaj Kumar, Joint Commissioner of Central Tax

It is very clear that money is specifically excluded from the definition of goods u/s. 2(52) of the CGST Act and therefore in no way ITC in respect of motor vehicles and conveyances as envisaged in Section 17(5)(a) would be available in respect of transportation of money in motor vehicles.

The legislative intent to allow ITC in respect of vehicles is very restrictive and requires to be interpreted accordingly. Under GST Act, money will never be considered as goods and therefore in respect of GST Act wherever the word goods come it will specifically mean that money would not be covered under the same.

Transportation of money is not covered in Section 17(5)(a)(ii) of the GST Act and the applicant is not eligible to claim ITC in respect of motor vehicles used in transport of money.

Ruling of AAR

Supply of motor vehicles as scrap after its usage is to be treated as supply in course or furtherance of business and such transaction would attract GST.

In respect of ITC on purchase of motor vehicles i.e., cash carry vans, the view of members of AAR differ and hence appropriate reference is made to AAAR for deciding the said question.

Reference to AAAR and Observations of AAAR

The issue before the AAAR is to determine whether the money being transported by appellant in cash carry vans is goods or otherwise for the purpose of availing ITC under GST law.

Section 2(52) of CGST Act provides that goods mean every kind of movable property **other than money** and hence clearly excludes money from the purview of goods under GST Law. Section 2(75) of CGST Act defines money to mean *Indian legal tender .... but shall not include any currency held for its numismatic value*. Since cash carry vehicles are deployed to carry cash and bullion for other than numismatic purposes, the cash carried by them is to be construed as money and not goods.

Press note dated 21st July, 2018 on the subject of recommendations made during 28th meeting of GST council titled *"Amendments to CGST Act, 2017, IGST Act, 2017, UTGST Act, 2017 and GST (Compensation to States) Act, 2017"* has *inter alia* proposed to widen the scope of ITC to cover ITC in respect of motor vehicles used for transportation of money for or by banking company or financial institution.

The fact that GST council has felt the need for widening the scope of ITC by allowing ITC in respect of motor vehicles used for transportation of money for or by banking company or financial institution clearly shows that the intention of legislature was earlier to not treat money as goods defined u/s. 2(52) of the Act.

Reliance placed by appellant on definition of goods as provided under Motor Vehicles Act is not relevant in this case. Provisions made under CGST Act are independent and not made referential to provisions under Motor Vehicle Act.

Ruling of AAAR

If money is not covered as "Goods" in the definition of goods under CGST Act, then it is not "goods" for everyone and it cannot be said that it is not goods for general perception and is goods for the appellant. ITC is not available to appellant on purchase of motor vehicles i.e., cash carry vans which are purchased and used for cash management and supplied post usage as scrap.

B. Rulings by Authority of Advance Rulings

3. Shrimad Rajchandra Adhyatmik Satsang Sadhana Kendra – AAR Maharashtra

Facts, Issue involved and Query of Applicant

The applicant is a religious charitable trust registered u/s. 12AA of the Income-tax Act, 1961 carrying out charitable and religious activities. The main object of the trust is to spread knowledge of Jainism and advancement of teachings of Shrimad Rajachandra. They hold various satsang and shibirs for helping people to understand the philosophy of Jainism. They also spread knowledge through publication of books, audio CD's, DVD's, etc.

The applicant seeks advance ruling on the following:

(a) Whether the applicant which is a charitable trust with the main object of advancement of religion, spirituality or yoga can be said to be in business so as to attract the provisions of CGST Act, 2017 and MGST Act, 2017?

(b) Whether the applicant is liable to be registered under the provisions of CGST Act, 2017 and MGST Act, 2017?

(c) Whether the sale of spiritual products which is incidental / ancillary to main charitable object of the applicant can be said to be in business in terms of Section 2(17) of CGST Act, 2017?

(d) Whether the sale of spiritual products can be said to be supply u/s. 7 of the CGST Act, 2017?

Applicant submits that they are not engaged in any of the business activity as defined u/s. 2(17) of the CGST Act, 2017. Clause (a) to Section 2(17) provides that any trade, commerce, vocation, profession, adventure, wager or any other similar activity, whether or not for pecuniary benefit shall be included in definition of business. Applicant claims that they are a public charitable trust with main object of advancement of religion and spiritual teachings. They are not engaged in any trade, commerce, vocation, profession, adventure, wager or any other similar activity. Further they do not get any pecuniary benefit from various activities carried out by them.

They claim that there is no motive to earn any profit out of the activities carried out by them and even if profit is earned, it is spent on advancement of general public utilities and hence, cannot be termed as business in commercial sense as defined in taxing statue. Applicant states that once the main object cannot be termed as business, then the ancillary or incidental objects such as selling of spiritual products such as books, CD's, DVD's, calendars, etc. cannot be considered as business. Applicant relies on judgment of *Commissioner of Sales Tax vs. Sai Publication Fund* wherein Supreme court held that once the main activity is not business, then incidental or ancillary transaction will also be considered as charitable only and not business. The applicant claims that as they are not carrying on any business, there can be no supplies liable to GST. As they are not making any taxable supplies, they are not liable to registration u/s. 22(1) of the CGST Act, 2017.

Discussions by and Observations of AAR

There is no doubt that applicant Trust is a person as defined u/s. 2(84) of the CGST Act, 2017. It needs to be ascertained as to whether the applicant is carrying out any business or not as defined u/s. 2(17) of the CGST Act, 2017.

The meaning assigned to words "trade" and "commerce" is as under:

Meaning as per	Trade	Commerce
• Noun	– Buying and selling of goods - Type of business	– Business of buying and selling
• Verb	– Buy or sell goods or services -Exchange something for something else	– N.A.
• Business Dictionary	– Commercial transaction involving sale and purchase of goods, service or information	– Exchange of goods or services for money or in kind, usually on a large scale
• Wikipedia	– Involves transfer of goods or services from one person or entity to another	– Exchange of goods and services, especially on a large scale

It is very apparent that the applicant is engaged in trade and commerce by way of selling of goods and services and are very well covered under the definition of business as given u/s. 2(17) of the CGST Act, 2017 and their activities are very well covered within scope of supply as given u/s. 7 of the CGST Act, 2017 and therefore are liable to tax in respect of goods and services supplied by them.

Under GST not all activities provided by Trust registered u/s. 12AA of the Income Tax Act, 1961 would be termed as charitable activities. Only following activities are termed as charitable activity and are exempt from GST:

(i) *Public health by way of ,-*

(A) *Care or counselling of:*

a. *Terminally ill persons or persons with severe physical or mental disability;*

b. *Persons afflicted with HIV or AIDS;*

c. *Persons addicted to a dependence-forming substance such as narcotics drugs or alcohol; or*

(B) *Public awareness of preventive health, family planning or prevention of HIV infection;*

(ii) ***Advancement of religion, spirituality or yoga;***

(iii) *Advancement of educational programmes or skill development relating to,-*

(A) *Abandoned, orphaned or homeless children;*

(B) *Physically or mentally abused and traumatized persons*

(C) *Prisoners; or*

(D) *Persons over the age of 65 years residing in a rural area;*

(iv) *Preservation of environment including watershed, forests and wildlife.*

We find that the applicant is registered u/s. 12AA of Income-tax Act, 1961, however, their activities are not covered under definition of charitable activities as defined above.

Applicant generates income from sale of goods, provides accommodation and foods in various Shibirs / Satsang on payment or chargeable basis. The satsang / shibir are not free for participant. As such arranging residential or non-residential satsang / yoga / shibir camps by charging some amount from participants will not be covered under definition of "charitable activities".

Ruling of AAR

AAR held as under:

(a) Applicant, which is a charitable trust with the main object of advancement of religion, spirituality or yoga can be said to be in business.

(b) The applicant is liable to be registered under the provisions of CGST Act, 2017 and MGST Act, 2017

(c) Sale of spiritual products which is incidental / ancillary to main charitable object of the applicant can be said to be in business in terms of Section 2(17) of CGST Act, 2017.

(d) Sale of spiritual products can be said to be supply u/s. 7 of the CGST Act, 2017

4. M/s. Columbia Asia Hospitals Pvt. Ltd. – AAR Karnataka (2018-TIOL-113-AAR-GST)

Facts, Issue involved and Query of Applicant:

Applicant is a private limited company engaged in providing health care services. It operates across six different States having eleven hospitals under its belt. The applicant is providing in-patient (IP) and Out-patient (OP) services. The applicant is also engaged in supply of medicines (pharmacy) to in-patients and out-patients. It also operates Restaurant / Canteen services in its premises. The applicant has its India Management Office (IMO) in Karnataka and some of the activities for all the units with respect to accounting, administration, IT, etc., are carried out by employees from IMO.

The applicant seeks advance ruling on the following:

"Whether the activities performed by the employees at the corporate office in the course of or in relation to employment such as accounting, other administrative and IT system maintenance for the units located in the other states as well i.e., distinct persons as per Section 25(4) of the Central Goods and Services Tax Act, 2017 (CGST Act) shall be treated as supply as per Entry 2 of Schedule I of the CGST Act or it shall not be treated as supply of services as per Entry 1 of Schedule III of the CGST Act?"

Applicant submitted that the employment relationship exists between the employee and employer, i.e. legal entity as a whole and not confined to the location of registered person from where the said employee renders services. When an employee renders any services to other registered persons, i.e. distinct persons of the same legal entity, the nature of activities still assumes the character of services by an employee to the employer in the course of or in relation to his employment as he is an employee for the legal entity as a whole and not for any one registered person.

Discussions by and Observations of AAR

The entry 2 of Schedule I deals with the activities that are to be treated as supplies even if made without consideration and it reads as under:

"2. Supply of goods or services or both between related persons or between distinct persons as specified in Section 25, when made in the course or furtherance of business". Further, the explanation given in Section 15 of CGST Act 2017, defines the "related persons" as under:

(a) persons shall be deemed to be "related persons" if--

i. ....

ii ....

v. one of them directly or indirectly controls the other;

vi. both of them are directly or indirectly controlled by a third person;

The IMO is covered under one registration in the State of Karnataka. Since the units are covered under different registrations and are controlled by the IMO, they are related persons under GST. By implication, any supply of goods and services from IMO to its units registered in different state would amounts to supply of goods and services, even if made without consideration.

Clause (c) of sub-section (1) of Section 7 which is related to the scope of supply clearly states as under:

"(1) For the purposes of this Act, the expression "supply" includes-

(a) All forms of supply of goods or services or both such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business...

(b) ……..

(c) The activities specified in Schedule I, made or agreed to be made without a consideration.

Hence, any activity made between related persons made or agreed to be made without a consideration shall be covered under supply of goods and services consideration shall be covered under supply of goods or services. The valuation of such services is to be done as per the provisions of section 15 of the CST Act, 2017 and if any consideration is charged by issue of invoice by the IMO to the respective units would amount to transfer and hence supply as it is in the course of business under clause (a) of sub-section (1) of section 7. Further, these activities made between the IMO and its units are not covered under any of the entries in Schedule III.

Regarding the issue related to the activities performed by the employees at the corporate office in the course of or in relation to employment, the employees employed in the IMO are providing services to the IMO and **hence there is an employee-employer relationship only in the said IMO. The other offices are distinct persons and therefore the employee in the IMO have no employer employee relationship with other offices.** Hence, it will be treated as a supply and the valuation includes all costs, the employee cost also needs to be taken into consideration at the time of valuation.

Ruling of AAR

The activities performed by the employees at the corporate office in the course of or in relation to employment such as accounting, other administrative and IT system maintenance of the unit located in the other states well i.e. distinct person as per the Section 25(4) of the CGST Act 2017 shall be treated as a supply as per the entry No. 2 to the Schedule I of the CGST Act.

5. M/s Coffee Day Global Ltd. – AAR Karnataka (2018-TIOL-114-AAR-GST)

Facts, Issue involved and Query of Applicant:

Applicant is engaged in supply of non-alcoholic beverages to SEZ units using coffee vending machines and undertakes the following types of transactions:

(a) The applicant installs beverage vending machines inside SEZ premises, prepares beverages using the vending machines & its ingredients, supplies to SEZ units which are consumed by the employees of SEZ units and charge the SEZ units based on number of cups of beverages supplied. (Cuppage billing)

(b) The applicant installs beverage vending machines inside SEZ premises, supplies beverage ingredients to the SEZ units and bills based on the quantity of ingredients supplied. SEZ units prepare the beverages using the vending machines and serve them to its employees.

There will not be any consideration for the usage of vending machine by the SEZ units.

Applicant seeks ruling as to whether supply of non-alcoholic beverages to SEZ units using coffee vending machines is in the nature of zero rated supply as defined under Section 16 of the IGST Act 2017?

Discussions by and Observations of AAR

The operations to be carried out in the Special Economic Zone and also in the Units located therein have to be in accordance with the authorisation to be given by the Central Government, in terms of Section 4(2) of the SEZ Act, 2005. Further Section 15(9) of the said Act further requires that the SEZ Unit shall carry out only the authorised operations in the Unit. The Act also provides that the proper officer shall certify the authorised activities.

Zero-rated supply as defined in Section 16(1) of the IGST Act, 2017, means any of the following supplies of goods or services or both namely:

a) Export of goods or services or both; or

b) Supply of goods or services or both to a Special Economic Zone developer or a Special Economic Zone unit.

The applicant's contention is that **<u>any</u> supply of goods or services** to SEZ units is zero-rated and interprets that the phrase **"<u>any supply</u>"** would cover everything, including beverages and ingredients for beverages.

The applicant has used the term "any supply". It is found that this term is not used anywhere in the statute. The word "any" has been used only once in Section 16(1) of IGST Act, 2017. It reads "(1) "zero-rated supply" means any of the following supplies of goods or services or both, namely ...". This sentence is followed by two options (a) and (b) and there is an "or" between them. The word "any" refers to either (a) or (b). Had the word "any" been placed at the beginning of the sentence in (b) to read "any supply of goods or services or both to a Special Economic Zone developer or a Special Economic Zone Unit" then the contention of the applicant would have been worth consideration. The statute has not used this word in (b). Therefore the interpretation of the applicant is not correct.

Though the IGST Act, in Section 16(1)(b) does not categorically say that the supplies of goods and services should be for authorized operations, it is implicit therein when it says that the supplies are for the SEZ Developer or SEZ Unit.

Rule 89 related to refund stipulates that the supply, in respect of which tax had been paid and refund is sought, shall be necessarily for authorized operations. In other words, the essential element is that the supply has to be certified by the proper officer as constituting authorized operations. Benefit flowing out from the SEZ Act, 2005, accrues to anyone only when the condition of authorized operations is fulfilled. Therefore, even in the event of the IGST Act, 2017, not explicitly using the term "authorised operations" in Section 16(1)(b), it is implicit that the supply of goods or services or both described in Section 16(1)(b) have to be read as in relation to authorized operations.

However, the applicant has not made out a case that the activity undertaken by them is certified as an authorized operation by the proper officer of the SEZ.

Ruling of AAR

The supply of non-alcoholic beverages/ ingredients to such beverages, to SEZ units using coffee vending machines by the applicant, do not qualify as zero rated supply, as defined under Section 16 of the IGST Act'2017.

6. M/s. Opta Cabs Pvt. Ltd. – AAR Karnataka (2018-TIOL-115-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is in the business of Taxi Aggregation Service and Taxi Service. The billing for the taxi service is done by the taxi driver who provides the service in his own name. The taxi driver collects the amount from the customer on the completion of the trip. The applicant does not collect any amount on behalf of the taxi driver. Applicant collects monthly service charges from taxi drivers for usage of IT services i.e. Mobile App and Billing related services. The applicant is duly discharging their GST liability on service charges collected from the taxi drivers. As far as taxi drivers are concerned, customers pay them directly and their collections may not necessarily exceed ` 20 lakhs p.a.

Applicant seeks ruling as to whether the money paid by the customer to the driver of the cab for the services of the trip is liable to GST and whether the applicant is liable to pay GST on this said amount.

Discussions by and Observations of AAR

The service is provided by the taxi operator and the amount is collected from the customer by him. The applicant company has no role to play other than issue of invoice on behalf of the taxi operator to the customer. The customer would log in to the application of the applicant and book the taxi.

Sub-section (5) of section 9 of the CGST Act, 2017 states as under:

"(5) The Government may, on the recommendations of the Council, by notification, specify categories of services the tax on intra-State supplies of which shall be paid by the electronic commerce operator if such services are supplied through it, and all provisions this Act shall apply to such electronic commerce operator as if he is the supplier liable to pay tax in relation to the supply of such service."

Notification No.17/2017 - Central Tax (Rate) dated 28th June, 2017 notifies that the tax on intra-State supplies by way of transportation of passengers by a radio-taxi, motorcab, maxicab shall be paid by the electronic commerce operator.

A conjoint reading of the above provisions makes it clear that the electronic commerce operator shall be liable to pay tax on services supplied through them by way of transportation of passenger in motor cab or maxi cab or motor cycle or radio-taxi. Further electronic commerce operator shall be deemed to be the supplier in such cases.

There is no doubt that the services of transportation of passengers is supplied to the consumers through the applicant and by virtue of above mentioned provision, it shall be deemed that the applicant would be a deemed supplier, liable to pay tax in relation to the supply of such transportation services by the taxi operator.

Ruling of AAR

In accordance with the provisions of Section 9(5) of the CGST Act, 2017 read with Notification No. 17/2017-Central Tax (Rate) dated 28-6-2017, the applicant is liable to pay tax on the amounts billed by him on behalf of the taxi operators for the service provided in the nature of transportation of passengers through it.

7. M/s. Gitwako Farms (India) Pvt. Ltd. – AAR Haryana (2018-TIOL-107-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is in the business of supplying sheep/goat meat in carcasses of different weight and size in frozen state to the Army and Para military force. Each frozen carcass is put in LDPE bags (primary packaging) which is sealed with tie and no weight is mentioned on the LDPE bags. Thereafter, one or two of such LDPE bags are put in dust and moisture proof food grade HDPE bags (secondary packaging). On such HDPE bags, contents such as product name, firm name and brand, net weight, batch no., lot no. and instructions for consumption and preservation of such meat are printed.

In the above background, the applicant has sought advance ruling on the followings:

1. What is the classification when frozen meat is sold in a packaged form and its HSN code?
2. What is the rate of tax on frozen meat sold by the company?

Discussions by and Observations of AAR

The relevant Schedule entries for the abovementioned sheep and goat meat along with the various notifications issued from time-to-time is as under:

S. No.	HSN code	Description of Goods	GST rate	Notification No.
		From 1-7-2017 to 14-11-2017		
4	0204	Meat of sheep or goats, frozen and put up in unit containers	12%	1/2017 - Integrated Tax (rate) dated 28th June 2017
10	0204	Meat of sheep or goats **[other than frozen and put up in unit containers]**	Exempt	2/2017-Integrated Tax (rate) New Delhi dated 28-6-2017
		From 15-11-2017 onwards		
1	0204 0207	All goods (other than fresh or chilled) and put up in unit container and. - (a) bearing a registered brand name; or (b) bearing a brand name on which actionable claim or enforceable right in court of law is available [other than those where any actionable claim or enforceable right in respect of such brand name has been foregone voluntarily, subject to conditions as in the annexure I]	5%	43/2017 - Integrated Tax (rate) dated 14th November, 2017
8	0204 0207	All goods fresh or chilled *(w.e.f. 15-11-2017 onwards)*	Exempt	44/2017 - Integrated Tax (rate) New Delhi dated 14-11-2017
7	0204 0207	All goods (other than fresh or chilled) other than those put up in unit container and. - (a) bearing a registered brand name; or (b) bearing a brand name on which actionable claim or enforceable right in court of law is available [other than those where any actionable claim or enforceable right in respect of such brand name has been foregone voluntarily, subject to conditions as in the annexure I]" *(w.e.f. 15-11-2017 onwards)*		

It is worth understanding the meaning of the word 'unit container'. As per the *explanation* appended with Notification no. 1/2017 – central tax (rate) the phrase 'unit container' means a package, whether large or small (for example tin, can, jar, box, bottle, bag, carton, drum, barrel or canister) **designed to hold a pre-determined quantity or number, which is indicated on such package.'**

The *explanation* itself suggests that the make of the container should be such which can hold pre-determined quantity or number. It should be such that when packed it holds the predetermined quantity or number for which it is designed.

The packaging by the applicant can weigh 10 kgs. or 11 kgs. or 10.5 kgs. Depending upon weight of two frozen carcasses packed in the secondary packaging. Neither the packaging is uniform or standardized nor are the packages designed to hold a predetermined quantity.

Ruling of AAR

In the backdrop of above discussion and findings it was ruled that:

(a) The animal carcass packed in LDPE bags without mentioning the weight and LDPE bags further packed in HDPE bags having varying weight of the carcasses packed and supplied to Army shall not qualify as product put up in 'Unit Container'.

(b) The product as mentioned at (a) above fall under exemption list as per entry no. 10 of notification No. 2/2017-Integrated tax (Rate) dated 28th June 2017 up to 14th November 2017 and thereafter as per entry No. 9 of Notification No. 44/2017- Integrated Tax (Rate) dated 14th November 2017.

8. Visvesvaraya National Institute of Technology, Nagpur – AAR Maharashtra (2018-TIOL-118-AAR-GST)

Facts, Issue involved and Query of Applicant

Visvesvaraya National Institute of Technology, Nagpur (“VNIT”) is one of the thirty one National Institutes of Technology in the country. VNIT, being a statutory body set up under Act of Parliament **(NIT Act, 2007)** for providing instructions and research in the branches of engineering, technology, management, education, science and arts, is a **governmental authority** as per explanation to Section 2(16) of Integrated Goods and Service Tax (IGST) Act, 2017.

Notification No. 12/2017 – Central tax (rate) dated 28th June, 2017 **exempts pure services provided to a governmental authority** by way of any activity in relation to any function entrusted to Panchayat under Article 243G or to a municipality under Article 243W of the constitution.

Applicant seeks clarification as to whether the rate of tax on pure services (excluding works contract services or other composite supplies involving supply of any goods) received by them from Service providers is **Nil** as per entry no. 3 of Notification 12/2017 – Central tax (rate) dated 28-6-2017.

Discussions by and Observations of AAR

The applicant is recipient of service and not service provider. Also these services are not covered under reverse charge mechanism. The notification referred by applicant is applicable to provider of service and not recipient of service. The applicant being recipient of service and not service provider is not the proper person to make the present advance ruling. The above application is therefore liable for rejection and cannot be entertained by the authority.

Ruling of AAR

The subject matter of application for advance ruling is rejected u/s. 98(2) of CGST Act without going into other detailed facts or merit of the case.

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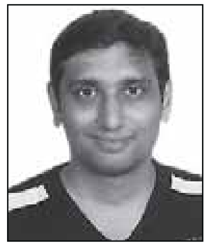

CA Rajiv Luthia & CA Keval Shah

INDIRECT TAXES
Service Tax – Case Law Update

Citation: 2018-TIOL-310-SC

Case: State of Gujarat vs. Bharat Pest Control

Background facts of the case

The assessee company, engaged in providing pest control services, received a work order from Reliance Industries. During the VAT assessment the Revenue opined that the pesticides and other raw material used to execute the works contract would attract VAT. It was claimed by the assessee that the contract involved provision of services & the title of the raw material used never passed from the assessee to the service receiver.

The Appellate Tribunal quashed the findings of the Revenue on the grounds that the pesticides & chemicals used were consumed while rendering the service. Later, the High Court held that the works contract for pest control involving the use of pesticides & chemicals is pure process of rendering services & that no sale & supply of goods were involved which would attract VAT liability.

Hence, the revenue are before the Hon'ble Apex Court.

Observations by the Hon'ble Apex Court

a) The salient features of the contract executed by and between the respondent contractor and the consumer, namely, Reliance Petroleum Limited is to make services of pest control available to the consumer by use of chemicals to be procured and supplied by the contractor. Admittedly, in the course of the execution of the contract there is no trace of the goods/materials used for execution of the contract.

b) The provisions of clause (29A)(b) of Article 366 of the Constitution of India has been considered in *Larsen & Toubro Limited (2013 TIOL 46 SC CTLB)* and it has been held that the expression "goods (whether as goods or in some other form)" appearing in sub-clause (b) of clause (29A) of Article 366 of the Constitution of India has the effect of enlarging the term "goods" by bringing within its fold goods in all different forms. Para 56 of the said decision was analysed as under :

"As the very title of Article 366 shows, it is the definition clause. It starts by saying

that in the Constitution unless the context otherwise requires the expressions defined in that Article shall have the meanings respectively assigned to them in the Article. The definition of expression "tax on sale or purchase of the goods" is contained in clause (29-A). Sub-clause (b) to section 29-A refers to transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. The expression "in some other form" in the bracket is of utmost significance as by this expression the ordinary understanding of the term "goods" has been enlarged by bringing within its fold goods in a form other than goods. Goods in some other form would thus mean goods which have ceased to be chattels or movables or merchandise and become attached or embedded to earth. In other words, goods which have by incorporation become part of immovable property are deemed as goods. The definition of "tax on the sale or purchase of goods" includes a tax on the transfer or property in the goods as goods or which have lost its form as goods and have acquired some other form involved in the execution of a works contract."

c) Constitution Bench of this Court in *Kone Elevator India Private Limited vs. State of Tamil Nadu (2014-TIOL-57-SC-CT-CB),* while considering the correctness of its earlier view with regard to dominant nature of the contract test, had, apart from holding that the dominant nature test would no longer be determinative, considered paragraph 56 of the report in Larsen & Toubro Limited (supra) and has accepted the same to be the correct position in law.

d) In view of the above decisions, the view taken by the High Court that there is no deemed sale of the goods used in the contract executed by the respondent – contractor cannot have our approval. We, therefore, set aside the order of the High Court and allow this appeal.

Citation : 2018-TIOL-2436-Bangalore CESTAT

Case: CCE, Cochin vs. M/s. Coconut Lagoon Kumarakom & Others

Background facts of the case

The assessee was engaged in running resorts wherein they are providing various services. Within the resorts, they were operating Ayurvedic treatment centres. The department claimed that said services fall under "Health Club and Fitness Centre" u/s. 65(52) of the Finance Act, 1994.

The present appeal is filed by the department against the order of CCE (Appeals).

Arguments put forth

Appellants (Revenue Department)

a) The respondents are basically running resorts. The main purpose of resorts is to entertain people who come for holidaying and pleasure trips. Treatment for curing basic disease cannot be provided on the basis of predetermined packages as the method and duration of treatment would differ from patient-to-patient depending upon the nature of the disease and body conditions.

b) The respondents are providing Ayurvedic rejuvenation and therapeutic health packages and the charges are high during peak period. The cost of treatment depends on the nature of illness and the condition of the patient and cannot be determined in advance.

c) The resorts have certificates issued by Department of Tourism which shows that the purpose of centre is to promote tourism, therefore, the Ayurvedic rejuvenation and therapeutic packages provided by the respondents come under the category of 'Health Club and Fitness Centre' and therefore are liable to service tax.

Respondents (assessee)

a) They are operating Ayurvedic treatment centres at the respective resorts. They have licenses issued by the Department to operate the said Ayurvedic centre as private hospital establishment; they operate the Ayurvedic centre with full time qualified Ayurvedic doctors and qualified staff for giving the treatment.

b) They maintained detailed records of case sheets of the patients registered for treatment which goes to prove that the treatments are provided as per well accepted Ayurvedic treatment methods. The specialised treatments given by them include treatments for ailments such as obesity, trauma, rheumatoid arthritis, paralysis, menstrual irregularities, metabolic disorders, bronchial disorders, etc.

c) In addition, Panchakarma Therapy is also given to the patient for other illnesses. The Panchakarma treatment includes Nasyam, Virechanam, Vamanam and Vasthy. All the treatments given are as per the standard Ayurvedic medical texts like Astangahrudaya, Sahasrayoga, Charakasamhitha, Susruthasamhitha, etc. The type of treatment and duration will be decided by a qualified and registered medical practitioner after conducting the diagnosis (Dashavidha Pareeksha) of the disease..

d) The respondent has also submitted that they are not taxable under the head "Health Club and Fitness Services" and the CBEC Circular No.B11/1/2002-TRU dated 1.8.2002 excludes therapeutic massages.

e) in the Board Circular, only if the massage is performed without any medical supervision or advice, the massage can be qualified for general well-being. Such a situation does not arise in respect of the respondents as the treatments processes commence only after the consultation with the Ayurvedic doctor and the treatment is carried by expert masseurs under the supervision of the doctor

f) It is a Government of Indian Policy to promote medical tourism. Patients who do not wish to be treated in a drab and distressing hospital rooms prefer more convenient, neat and refreshing surroundings where medical attention is received and treatment is coupled with hospitality.

Decision

a) The department has attempted to contradict the claims of the respondents by saying that these resorts are only for pleasure and holidaying and massages are optional and invariably are of general well-being than treatment of a particular disease.

b) However, ongoing through the records maintained by these Ayurvedic centres, it is seen that they are maintaining case-sheets/treatment files and the treatment process schedule which is a normally done by hospitals also.

c) By the mere fact that the Ayurvedic centres are located in the premises of the resorts, it cannot be said that they cease to be Ayurvedic centres coming to Ayurvedic treatment *per se*.

d) From the huge bunch of reports containing patient symptoms or diagnostic report and frequency and duration of treatment, prescription, it is seen that the duration is one week to four weeks and in some cases, patients return back for a repeat of the treatment; specific ailments mentioned in the Order-in-Original like back pain, shoulder pain, knee pain, frozen shoulder, blood pressure, blood circulation problems, etc. have been cured successfully as per the certificates of the patients.

e) The prescribed treatments are contained in Ayurvedic Pharmcopiea like Astanga Hridayam, Charaka Samhita and Susrutha Samhita, etc. It is therefore seen that these centres provide a holistic Ayurvedic treatment which includes massages given by qualified professors under medical supervision for curing diseases.

f) We fail to understand as to how the cost of treatment and the ambience of the treatment would render such treatments to be non-therapeutic and only for well-being. For that matter, the duration of treatment is also no criteria. In case of consultations by psychiatrists, the sessions may last even one day, for that reason one cannot conclude that the psychiatrists ceases to be a doctor. The duration and the type of treatment depend on the diseases, the conditions of the patient, and the expertise of the doctor.

g) It is not always necessary that the treatment should be only in the dull / dreary atmosphere of hospitals alone. If some well-to-do patients prefer to have treatment in a better circumstances and are willing to pay for the same, such treatments cannot be 'for that sole reason', held to be no treatment. It is common knowledge that a good number of foreign tourists visit Kerala during a particular season for pleasure as well as medical reasons. Not all the people who stay in the resort may take the treatment.

h) What is important is whether such treatments are given by a qualified Doctor/Doctors and whether the procedures are prescribed under therapeutic tests. It is not the department's contention that the massages and Panchakarma and other treatments provided by the respondents are not mentioned in Ayurvedic texts.

i) Appeal is rejected.

Citation: 2018-TIOL-2650-Mumbai CESTAT

Case: M/s. Sas Developers and Engineers vs. CCE, Nagpur

Background facts of the case

The appellants owned a building named "Landmark". They entered into Business Agreement with M/s. Pantaloons whereby the appellants provided necessary space for a departmental store-cum-coffee shop in part of that premises. Similarly, another agreement was entered with M/s. Trent Ltd for creating another store for retail sale of readymade garments and other household items, accessories in same premises. Under both the said agreements it was provided that appellants shall receive an amount calculated as percentage on the basis of net sales during the year.

The revenue department issued SCN on the ground that consideration received in terms of the said agreement was nothing but rent for provision of the space for setting up the said stores and hence taxable under the category of "Renting of Immovable Property" w.e.f. 1-6-2007

Arguments put forth

Appellants

a) The agreements entered by them with M/s. Pantaloons & M/s. Trent were for profit sharing. As per these agreements both the parties where sharing certain portion of their profit with them in lieu of various business activities under taken by them for assisting the said party's for conducting the business of retail sale from the said premises.

b) The consideration received by them in terms of the said agreement was for providing various services such as providing advisory assistance in selection of range of products, pricing of range of products, personnel policies, security arrangement, procurement policies etc and not towards renting of immovable property, demand of service tax under category of 'Renting of Immovable Property' is not maintainable.

c) Besides, appellants also challenged the demand on the ground of limitation.

Respondents

a) The Agreement with M/s. Pantaloons and M/s. Trent are nothing but agreement for providing space for conducting the business of retail sale

b) The appellants are engaged in business of building and providing the space for on rent to various parties.

c) They do not have any experience in retail business to be undertaken by the two companies namely M/s. Pantaloons and M/s. Trent Ltd. The said companies are having their own expertise and marketing his strategies for conducting their business.

d) On issue of limitation he submitted that the correct value of the services being provided by the appellant was not reflected in the ST.3 returns filed by them with intention to evade payment of taxes and hence they are responsible for suppressing and not disclosing the relevant facts to the department.

Decision

a) It is quite evident from the clauses of the agreements, that appellants have provided the space to the said companies for conducting report of business and for provisions of the said space. They are receiving certain "Fees", the said "Fees" cannot be anything other than as charges for provision of the space, hence is in nature of rent.

b) The submission made *vis-a-vis* the other activities being undertaken by the appellant in terms of the said agreement do not justify to consider the amount received as anything other than rent because in view of the clause 4(b) of the agreement which specifically provides that "The company shall be exclusively in charge of the management and running of the said business from the said premises."

c) The definition of "Renting of Immovable property" provides the renting includes not mere renting but any similar arrangements in respect of immovable property for use in furtherance of business or commerce.

d) Appellants have advanced the argument that the agreements entered into by them were business arrangement and that they have entered into partnership/ joint venture with the said companies for conducting the business and not into rent agreement. The said argument do not merit acceptance because the participation of the appellant in business activity is limited to provision of the space. Even for a moment it is considered that this arrangement created the partnership/ Jt. Venture then also the argument will not survive because appellants would definitely be a different legal entity from the said partnership or the joint venture and in that case they would have provided this space on rent to the said partnership/ joint venture.

e) Accordingly appeal is dismissed

Citation: 2018-VIL-580-CESTAT-ALH-ST

Case: Bayer Material Science Private Limited vs. CC C. Ex and Service Tax Noida

Background facts of the case

The Appellants availed CENVAT credit of service tax on the basis of the invoices issued by M/s. Keil India Engineering Pvt. Ltd., who had provided the construction of factory services to the appellant.

It is seen that M/s. Keil India Engineering Pvt. Ltd. was registered service provider at their Delhi address. However, in respect of services provided to the present appellant, the same were provided from Noida, which was not registered premises and as per the inquiries made by the Revenue, no Service tax stand deposited by them. In such a scenario, Revenue initiated proceedings against the present appellant for denial of the credit on the sole ground that the service provider has not deposited the same with the Revenue.

Arguments put forth

The Appellants submitted as under:

a) The appellant submitted that during the course of adjudication took a stand that the service provider have raised the invoices showing the value of the services as also the service tax amount separately. The said invoices also have the proper address and registration number of the service provider. Based upon the same, the appellant have taken the credit and if the service provider has not deposited the service tax with the Revenue, the Revenue's remedy lies at the end of service provider, for recovery of the non-paid service tax.

b) It was also submitted that the fact that M/s. Keil India Engineering Pvt. Ltd. has not deposited the duty was not in their knowledge and there is no allegation of any collusion etc. by the Revenue. It was the duty of M/s. Keil India Engineering Pvt. Ltd. to pay Service Tax and said service provider having raised the invoices which are complete in themselves and which show the registration number of the service provider as also the amount of Service Tax and payment particulars, the availment of credit by the present appellant on the basis of the said invoices cannot be faulted upon

c) The Appellants also drew attention to Circular No.441/7/99-CX dated 23-2-1999 laying down that where the CENVAT Credit stands availed by an assessee on the basis of the invoices issued by the suppliers and where the invoices have all the necessary information and details i.e., description of the goods, assessable value, name and address of the factory or warehouses, the credit of duty so paid has to be allowed.

Decision

d) In terms Rule 4(7) of CENVAT Credit Rules read with Rule 9 of CENVAT Credit Rules, the only requirement of the assessee is to pay the value of the services as also the quantum of service tax as assessed in the invoice raised by the service provider and then to avail the credit. The assessee cannot be held responsible for any default in non-deposit of duty by the service provider and the credit of the service tax paid by him to the service provider for further deposit in the exchequer kitty cannot be denied to him on account of the lapse of the service provider. The Revenue's remedy, in these types of cases lies at the end of service provider, for initiating proceedings against him, in respect of the short levy of service tax.

e) The Hon'ble Supreme Court in the case of *CCE, Jalandhar vs. Kay Kay Industries reported in 2013 (295) E.L.T. 177 (S.C.) - 2013-VIL-07-SC-CE* has observed that the assessee cannot verify from the department whether the duty has actually been paid by the manufacturer or not. Similarly, the Hon'ble Jharkhand High Court in the case of C*CE, East Singhbhum vs. Tata Motors Ltd. reported in 2013 (294) E.LT. 394 (Jhar.) - 2010-VIL-137-JHR-CE* has observed that it is unreasonable to expect buyer of such inputs to go and verify accounts of supplier or to find out from the Central Excise Department whether duty has actually been deposited or not. In such a scenario, the recipient cannot be denied the credit.

f) In as much as the appellant has admittedly paid the Service Tax amount to the service provider, along with value of the goods, the fact that the said service provider has not further deposited the same with the government, cannot lead to denial of credit to the present appellant.

Accordingly the appeal filed by the Assessee was allowed.

Citation: 2018-TOIL-2641-CESTAT-Mum

Case: The Board of Cricket Control of India vs. Commissioner of Service Tax – II

Background facts of the case

The Appellant in the present case BCCI was organising various cricket matches. They have constituted a separate sub-committee namely Indian Premier League (IPL) for organizing T-20 cricket competitions in India and abroad. During course organising the said tournaments, they hired the services of certain non-resident service providers namely M/s. IMG and M/s. Hawkeye for producing the live feed of the cricket matches being played in India to be telecasted on various TV Channels, against payment of commercial consideration for the IPL 2008, IPL 2009 & IPL 2010. The services received by the Appellant, were classifiable under the category of "Programme Producer's Service" and were leviable to Service Tax. Since the services were being provided by the non-resident service provider, the service tax liability was required to be discharged by the Service Recipient. Since the appellant had not paid the service tax due, in respect of payments made by them to the said non-resident service providers during the month of August and September 2010, a show cause notice dated 14-10-2011 was issued to them demanding the service tax due. The said show cause notice has been adjudicated by the Commissioner of Service Tax confirming the demand, interest and penalties u/s. 77 and 76 of the Finance Act, 1994.

Arguments put forth

The Assessee as Appellants submitted as under:

a) During the period under dispute, they were required to pay the service tax on their output services under the category of "Commercial Use or Exploitation of an Event". Since the service tax was required to be discharged on the output services the credit of service tax paid on input services received by them will be available to them in terms of CCR, 2004. Thus the service tax paid by them on RCM basis is available to them as CENVAT credit for discharging the tax liability hence the demand in the present case is totally revenue neutral.

b) Commissioner should have exercised powers under section 80 of the Finance Act, 1994 and not imposed any penalty on them because, any amounts that is being demanded by them in respect of the input services on the reverse charge basis would have been used to corresponding liability of tax on output services. Since there was no gain to them in non-payment of service tax under RCM, in this case reason existed for invoking the jurisdiction under section 80 to not impose the penalty.

The Respondent submitted as under:

a) Issue in respect of levy of service tax on the services received by the Appellant from non-residents under the category of "Program Producer's Service" has been settled by this tribunal in the Appellant's own case against them. The said order of the tribunal has been affirmed by the Apex Court. Hence there can be no further dispute in respect of levy of service tax under RCM.

b) Revenue Neutrality as principle cannot be applicable because there can be no revenue neutrality as global concept. In the present case the tax is payable under RCM as the same is due from service provider who is not available or having any establishment in India. In none of the judgments referred to by the CA, the tax demanded was to be paid on reverse charge basis i.e., on the behalf of the provider of taxable by the service recipient. Thus the decisions are clearly distinguishable.

c) Since the Appellants have not paid the service tax on the due date, the penalty has been levied under Section 76 of the Finance Act, 1994, at the applicable rate for the period of delay. No reasonable case has been made out for invoking section 80. He also relied on the decision of tribunal in case of *Bharat Sanchar Nigam Limited - 2011-TIOL-552-CESTAT MUM]* for the reason that penalty can be imposed on the Public Sector Units also in cases where they have contravened the provisions of Act and Rules.

Decision

a) There is no dispute about the fact the services provided by the non-resident service providers namely M/s. IMG and M/s. Hawkeye for producing the live feed of the cricket matches being played in India for the appellants have been held to be classifiable as "Programme producer's Service" and hence liable to service tax under the said category.

b) Since the entire amount of tax demanded by them would be available as credit to them the demand of tax is not justified against them, in view of the decisions cited by them. The argument advanced by the Appellant do not appear to be convincing as in the present case the Service Tax liability which is being determined, is in respect of the services received by them from the non-resident service provider. This is not the case of payment of tax on the forward charge basis, and the tax is payable by the recipient of the service, as if the same was due from the service provider. In view of the discussions as above and the fact that issue in the present case has been decided by the Apex Court holding in the favour of revenue we have no hesitation in upholding the order of Commissioner confirming the demand of service tax along with the interest due

c) Various authorities as follows have upheld imposition of penalty under section 76 in case of delay in payment of service tax from the due date.

- *CCE vs. S. J. Mehta & Co., [2011 (21) STR 105 (Guj.)]*
- *CCE vs. Bhavani Enterprises [2011 (21) STR 107 (Guj.)]*
- *CCE & ST vs. First Flight Couriers Ltd [2007(8) STR 225 (Kar.)]*
- *UOI vs. Aakar Advertising, [2008 (11) STR.5 (Raj.) – 2008-TIOL-303-HC-RAJ-ST*
- *UOI vs. Shiv Ratan Advertisers [2008 (12) STR 690 (Raj.)].*

Accordingly the appeal filed by the Appellants was rejected demand along with interest and penalty u/s. 76 of the Finance Act, 1994.

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It is attachment, identification, which makes us miserable.

— *Swami Vivekananda*

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS

Company Law Update

[2018] 209 Comp Cas 360 (NCLAT)

[Before the National Company Law Appellate Tribunal-New Delhi]

Union of India, Ministry of Corporate Affairs

vs.

Gitanjali Gems Ltd. and Others (and connected appeals)

The Central Government being satisfied that affairs of the company's business being conducted in prejudicial to the public interest, and if so required, it can always file an application before the Tribunal for oppression and mismanagement under the Companies Act, 2013 ("Act") even though the investigation is undergoing

Brief

This application has been filed by the Union of India ("UOI") against Gitanjali Gems Ltd. and Others ("respondents") against the order of the National Company Law Tribunal ("NCLT") dated February 23, 2018 and Order dated April 2, 2018 granting certain interim reliefs to various respondents.

UOI has filed an application under sections 221, 222, 241, 242, 246 read with section 339 of the Act against the respondents. The application was filed against the Gitanjali Gems Ltd ("GGL") and other companies and partnership firms and individual directors and all employees on the grounds. The main contention is that the affairs of the respondent company, its group companies and LLPs have been / being conducted prejudicial to the public interest.

The application is based on the facts that Mr. Nirav Modi (one of the respondents), GGL and other respondents above are involved in financial fraud of approximately Indian Rupees 11,400 crores with the Punjab National Bank. The Punjab National Bank has lodged FIRs against the many respondents.

Thus, UOI has asked for interim reliefs as follows.

1. Respondents be directed to disclose their movables / immovables properties / assets / bank accounts and should be restrained from mortgaging or creating charge or lien or alienating the above assets and to hand over all the above properties and assets to UOI.

2. BSE / NSE and SEBI be directed to restrain the trading of securities of GGL.

3. CDSL / NSDL be directed that securities owned and held by the respondents in any company be freezed and to provide details thereof.

4. CBDT / CBEC to disclose information of all assets of the respondents for attachments and possession.

5. RBI and Indian Bank Associations to facilitate disclosure of the details of bank accounts, lockers owned by the respondents and their attachments on behalf of UOI.

6. To take possession of all movables / immovables properties.

NCLT has allowed the above application and passed the following order. The NCLT has also observed that while trusts and individuals are not covered under section 221 of the CA or section 43 of the LLP Act, 2008, however in view of allegations and to make investigations meaningful to crack this fraud, restrain order is very much necessary against these individuals and trusts.

The above interim order was challenged by numerous applications by respondents at various forms. By its order dated April 2, 2018, the NCLT has allowed some of the applications by which it has given relief to few individuals by vacating the restraint order and allowed two other individuals to withdraw funds from the bank accounts for maintaining a family.

From the respondent side, the maintainability of the application by UOI and the NCLT order of February 23, 2018 has been challenged on the following basis.

1. Section 241(2) of the Act enables the Central Government to file a petition, only if it is of opinion that the affairs of the company are conducted in a manner prejudicial to public interest. The investigation is currently undergoing and as such as of today, there is no basis for filing an application under section 241 and for NCLT to pass an order under section 242(4) of the Act.

2. Under section 241(4), the order can be passed only for regulating the conduct of company's affairs and restrict those persons who are responsible for company's affairs and not to restrain any other individuals, who are not associated with the company during these periods.

3. Section 221 empowers the NCLT to freeze the assets of the Company and not the personal assets of individuals.

4. Section 339 of the Act related to liability for fraudulent conduct of business is not applicable since the Central Government has failed to bring any facts related to alleged fraud.

5. No restraint order under chapter XIV related to Inspections, Inquiry and Investigation of the Act can be passed when SFIO's investigation is undergoing and thus simultaneous proceedings / actions under sections 241, 213 and 212 of the Act are not maintainable.

The questions raised are as follows.

1. Under section 221, 222, 241, 241, 246 and 330 of the Act, whether Tribunal has jurisdiction to injunct the respondents, LLPs, trusts and individuals from removal, transfer or disposal of funds, assets and properties? and

2. The order vacating the earlier order against certain individuals on the ground that there is no materiality to

negate statements by individuals is legal?

Judgment

The NCLAT has allowed the petitions from UOI and dismissed respondents applications.

The following are certain observations based on the analysis of Chapter XIV of the Act.

1. Under section 213, Tribunal, if satisfied based on an application made to "it" or "otherwise" as to the business of the company is being conducted with the intent to defraud its creditors, members etc., and after giving a reasonable opportunity of being heard, direct the central government to investigate.

2. Under section 221, Tribunal has the power to direct that the transfer, removal, or disposal of funds, assets, properties of the company shall not take place.

3. The Central Government has already directed the SFIO to investigate and hence on this date, being satisfied and if so required, it can always file an application before the Tribunal under section 241(2) read with section 242 of the Act.

4. While under 241(1) any eligible member' can make an application for oppression and mismanagement, under section 241(2), it is Central Government, who having an opinion that the affairs of the company are being conducted in a manner, which is prejudicial to the public interest, make an application to the Tribunal.

5. Under sub section 242(1), the tribunal power are wide enough as the language of the section suggest "it may make such order as it thinks fit".

6. In case of an application made by the Central Government under section 241(2), the provisions of sections 337 to 341 will also be applicable *mutatis mutandis*.

7. Under Rule 11 of the NCLT Rules 2016, Tribunal has inherent powers to make such orders as may be necessary for meeting the ends of justice or to prevent abuse of the process.

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CA Manoj Shah

CORPORATE LAWS

Recent Developments

FEMA – Revised Procedure for reporting of Foreign Investments

Introduction

Prior to 2015, reporting of Foreign Investments was in manual form. The prescribed forms such as Form ARF, FC-GPR etc., were to be submitted to the Authorized Dealer (AD) who in turn submitted it to RBI. Later Government introduced e-Biz in the year 2015 which is an online platform providing services for enabling B2G reporting. The users then had the option to file such forms through online as well as offline mode. However, RBI *vide* its Circular No. 40 dated February 01, 2016 mandated the online filing of the said forms on the e-Biz platform and discontinued the manual filing thereof, with effect from February 8, 2016.

e-Biz provides various services which are bifurcated by region and department such Reserve Bank of India, Department of Industrial Policy and Promotion, Ministry of Corporate Affairs, etc. Through the e-Biz portal, a business user can fill the forms online, upload the attachments, make payment online and submit the forms for processing of the department.

Reserve Bank of India (RBI) *vide* its Circular No. 77 dated February 12, 2015 initiated the online filing of:

(i) Advance Remittance Form (ARF): Reporting of Foreign Direct Investment (FDI) inflows

(ii) Foreign Currency Gross Provisional Return (FCGPR) Form: Reporting of the issue of eligible instruments to the overseas investor against any FDI inflow.

RBI *vide* its Circular No. 9 dated August 21, 2015 also permitted the online filing of Foreign Currency Transfer of Shares (FCTRS) Form: Reporting for transfer of securities between resident and person outside India.

Introduction of Single Master Form (SMF) – Revised Procedure

As announced in the First Bi-monthly Monetary Policy Review dated April 5, 2018, Reserve Bank of India, with the objective of integrating reporting of various types of foreign investment in India, introduced SMF *vide* A. P. Dir. Series Circular No. 30 dated June 07, 2018 under Foreign Investment – Changes in Reporting in Single Master Form (Firms).

SMF provides a facility for reporting total foreign investment in an Indian entity and also investment by person resident outside India in an Investment Vehicle.

Entity Master Form (EMF)

FIRMS is rolled out in two phases. In the first phase, the first module viz., the Entity Master, every entity is required to provide data regarding foreign investments received till date irrespective of the fact that the regulatory reporting to the Reserve Bank for the same has been made or not and whether the same has been acknowledged or not. EMF has been made available online wherein Reserve Bank provides an interface to the Indian entities, to provide data on total foreign investment in a specified format. The interface was available on RBI website https://firms.rbi.org.in from June 28, 2018 to July 12, 2018. Indian entities not complying with this pre-requisite would not be able to receive foreign investment (including downstream foreign investment) and would be considered non-compliant with Foreign Exchange Management Act, 1999 and regulations made thereunder. RBI has not specified the date up to which this extended facility of reporting will be available.

Where the entities have not been able to register for the Entity master, they may do so from September 01, 2018. However, they may provide the reasons for not registering within the time period along with the authority letter in favour of company personnel entrusted with the responsibility of reporting.

Single Master Form (SMF)

In the second phase (reporting of foreign investment), the second module containing 9 reports has been made available with effect from September 1, 2018. With the implementation of SMF, the reporting of FDI, which is presently a two-step procedure viz., ARF and FC-GPR have been merged into a single revised FC-GPR. The SMF also introduces reporting of downstream foreign investment through Form DI and reporting of inflows in investment vehicles through Form InVi. Further, the reporting in FC-TRS, LLP-I, LLP-II, ESOP, DRR and CN has also been made available in SMF. The finalized structure of SMF and operational instructions thereof would be made available in the Master Direction on Reporting under FEMA, 1999. As is evident the registration through SMF is required only for entities receiving Foreign Investment post First September.

Details of 9 Forms available for reporting in SMF are as follows:

1. **Form FC-GPR:** Issue of capital instruments under foreign direct investment (FDI) by an Indian company to a person resident outside India;
2. **Form FC-TRS:** Transfer of capital instruments between a person resident outside India and a person resident in India;
3. **Form LLP-I:** Foreign direct investment in an LLP through capital contribution and profit shares;
4. **Form LLP-II:** Disinvestment or transfer of capital contribution and profit shares in an LLP;
5. **Form ESOP:** Issue of employee stock options, sweat equity shares or shares against the exercise of employee stock options by an Indian company to an employee resident outside India;
6. **Form CN:** Issue or transfer of convertible notes;
7. **Form DRR:** Issue or transfer of depository receipts;
8. **Form DI:** Reporting of downstream investment or indirect foreign investment in a company or an LLP; and
9. **Form InVi:** Reporting of investment by a person resident outside India in an investment vehicle.

Following forms have not been subsumed and will be reported separately:

1. **Annual Return on Foreign Liabilities and Assets (FLA):** Submitted annually on or before the 15th day of July of each year. This is submitted by way of an email to fla@rbi.org.in

2. **Form LEC (FII):** The AD banks have to ensure that the FPIs registered with SEBI who are purchasing various securities (except derivative and IDRs) should report all such transactions details (except derivative and IDRs) in the Form LEC (FII) to Foreign Exchange Department, Reserve Bank of India, Central Office.

3. **LEC (NRI):** The Authorised Dealer Category I banks shall report to the Reserve Bank in Form LEC (NRI) the purchase/ transfer of capital instruments by Non-Resident Indians or Overseas Citizens of India stock exchanges in India.

Rest all other forms not included in the list will continue to be reported from the e-biz portal of RBI, except FLA Return, which is filed through e-mail.

Objective of the SMF

The purpose of the SMF appears to be the collation of common details of an Indian entity, such as the name of the entity, its corporate identification number, and details of all foreign investment, including the entry route and sectoral cap applicable to it.

The objective of introducing SMF *via* FIRMS website is that most of the RBI reporting shall be done on a separate platform dedicated to RBI, than any other departments of the Government. Previously filing of FC-GPR, FC-TRS and ARF which was done on e-Biz portal will no longer be available. RBI has advised that any pending cases where resubmission is to be done be cleared before 20thSeptember, 2018 on the e-Biz platform by providing any clarification or additional documents.

Attachments to the SMF

Apart from the common details to be provided in the SMF, the draft format of the SMF also includes formats of the following documents, which are required to be attached to the respective Forms:

a. The shareholding pattern of the relevant Indian entity

   All Indian entities filing the SMF are required to provide their shareholding pattern along with the relevant details under the applicable forms.

b. Declaration to be filed by the authorised representative of the Indian entity

   This declaration is in relation to the Indian entity's compliance with laws such as FEMA, the Prevention of Money Laundering Act, 2002 and the Unlawful Activities (Prevention) Act, 1967.

c. Certificate from the company secretary of the Indian entity

   The format of this certificate has been annexed to the SMF and requires the company secretary of the relevant Indian entity to certify that the entity has complied with FEMA and the regulations made there under, and with the Companies Act, 2013 or the Limited Liability Partnership Act, 2008.

d. Certificate indicating the manner of arriving at the price

   This certificate must be obtained from: (i) a merchant banker or chartered accountant registered with the Securities and Exchange Board of India, indicating the manner of arriving at the price of the shares issued to the persons resident outside India; or (ii) a chartered accountant, cost accountant or approved valuer from the panel maintained by the Central Government, indicating the manner of arriving at the fair price of the capital contribution or profit shares issued to the persons resident outside India.

e. All other necessary documents as applicable to the issue

Although the Circular states that *'all other necessary documents applicable to the issue'* are to be attached to the SMF, it does not provide any details on which documents whichare deemed necessary.

f. Declaration by the non-resident transferor or transferee

This declaration is in relation to the accuracy of the details provided in the SMF, and compliance with FEMA and the regulations made there under.

Other relevant details to be provided

Other key details required to be reported in the SMF are highlighted below.

a. When reporting any fresh issuance of shares, details such as the nature and particulars of the issue (preferential, private placement etc.) and the details of foreign investors, the amount received in tranches for the issuance of partly paid shares or share warrants, the fair value of shares, and the pre-determined conversion formula for compulsorily convertible shares or debentures, or for share warrants, are to be provided.

b. When reporting a transfer of shares in an Indian entity, details such as the nature of the transfer, particulars of the buyer and seller, mode of payment, indemnity arrangement and pricing are to be provided, and the relevant extracts of the transfer agreement are to be enclosed in the SMF.

c. For an LLP receiving foreign investment through capital contribution or profit shares, details of the foreign investor and remittance are to be provided.

d. For any issuance of employee stock options, sweat equity shares or shares against the exercise of employee stock options by an Indian company to an employee resident outside India, the relevant scheme of the employee stock options is to be attached, and particulars of the issue are to be provided.

e. When reporting a transfer of shares with payment by way of deferred consideration, details of the tranches, escrow arrangement and indemnity arrangement are to be inserted.

f. When reporting convertible notes, details of the repayment, conversion, remittance and transfer of the convertible notes are required to be inserted.

g. When reporting a transfer of capital instruments or convertible notes from a non- resident to a resident, the acknowledgement letter for the initial investment by the non-resident is required to be enclosed.

h. When reporting any issuance or transfer of depository receipts, particulars of the custodian, issuance, securities, conversion ratio, sponsor and listing are to be provided.

i. When reporting any indirect foreign investment or downstream investment in an Indian entity, particulars of the investor, investment and securities are to be provided.

j. When reporting foreign investment in an investment vehicle, details of the investment vehicle, investor, remittance and issue are to be provided.

Difference between e-Biz forms and SMF:

There are certain differences between erstwhile e-Biz Forms and SMF which are highlighted as under:

1. Mode of payment/Nature of issue

Following categories which were specifically provided in e-Biz forms, are not there in SMF:

- Conversion of ECB
- Conversion of royalty (including lump sum payments)
- Conversion against the import of capital goods by units in SEZ

In SMF, these seem to have been merged in one item viz., *issue of equity shares against funds payable to its foreign investor* in Remittance Details (Point 2.1.12)

Following categories under the head 'Nature of Issue'areprovided in SMF, which were not there in e-Biz forms:

- Merger / Demerger / Amalgamation
- Conversion of convertible notes
- Capital instruments issued under Schedule 7 of FEMA 20(R)
- Issue of Participating interest/ rights in oil fields

2. Amount of issue

In the SMF, since ARF and FC-GPR are combined, details regarding total consideration received needs to be provided. The difference in the revised Form FC-GPR on SMF versus e-Biz is that – revised FC-GPR on SMF contains an option for providing details regarding refund amount, date of refund and whether there is any interest payment. Here there is an additional attachment of RBI approval if any. Such details were not required to be provided on e-Biz.

3. Partly paid shares / share warrants

In SMF FC GPR, if partly paid shares/ share warrants are issued, details of the consideration received in the first tranche and the amount received in nth tranche and the date of receipt is to be mentioned.

4. Pre-determined conversion formula for CCPS/ CCDS/ Share warrants

In SMF, pre-conversion ratio and period of conversion at the time of issueis required to be provided which was not required in old FC-GPR on e-Biz.

5. Breakup of premium

In old FC-GPR on e-Biz, details regarding premium had to beprovided whether it is control premium/ non-competition fee or any other type of premium. Such details are not required to be mentioned in the revised FC-GPR.

6. Type of transfer

In SMF, FC-TRS it has to be mentioned whether the transfer is by way of gift or sale of a security. Transfer by way of gift transactions were not specifically covered in e-Biz FC TRS. With such specific mention about Gift, it now becomes fairly clearthat for transfer by way of Gift FC-TRS is tobe filed.

7. Mode of payment

In SMF FC-TRS, mode of particulars of remittance is to be provided. It includes details such as total amount of consideration received and whether payment has been received on full consideration/ on deferred basis/ escrow arrangement/ indemnity arrangement.

Online submission is as such preferred over manual submission, as it captures proper date of submission by Company and corresponding date of forwarding by the AD to RBI and thus delay if any taking place at AD level gets properly captured. This feature was missing in manual submission and many times for no fault of the company, it had to suffer compounding for delayed reporting.

EMF and now SMF provides better reporting structure and will enable RBI as well as Company properly capture and report foreign investment.

  

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, Notification & recent FAQs issued by RBI & updation of Master Directions:-

1. Foreign Investment in India – Reporting in Single Master Form

This amendment has been covered in detail in the other article of this Journal titled as "FEMA-REVISED PROCEDURE FOR REPORTING OF FOREIGN INVESTMENTS".

2. Updated through FAQs

a) FAQs – External Commercial Borrowings & Trade Credits

RBI Update as on August 14, 2018 on FAQs on External Commercial Borrowings & Trade Credits contains the following changes:

Question 37 is newly inserted as under:

Q.37. Is the reimbursement of expenditure incurred in the past a permissible end-user under the ECB framework?

Ans. No. The reimbursement of expenditure incurred in the past is not a permissible end-user under the ECB framework.

Earlier FAQ was updated as on 17-7-2018.

b) FAQs – Liberalised Remittance Scheme

RBI update as on 13th August, 2018 on FAQs on Liberalised Remittance Scheme contains the following changes:

Answer to Question 7 has been amended as under:

Q.7. Is it mandatory for resident individuals to have Permanent Account Number (PAN) for sending outward remittance?

Ans. Yes, in terms of AP (DIR) Series Circular No. 32 dated June 19, 2018 it is mandatory for the resident individual to provide his/her Permanent Account Number (PAN) to make outward remittances under the scheme.

Earlier FAQ was updated as on 11-8-2016.

c) **FAQs – Issuance of Rupee Denominated Bond Overseas**

RBI update as on 30th August, 2018 on FAQs on Issuance of Rupee Denominated Bond Overseas contains the following changes:

Answer to Question 9 has been amended as under:

Q.9. Is there any ceiling on the all-in-cost of such bonds?

Ans. The all-in-cost ceiling for such bonds will be 450 basis points over the prevailing yield of the Government of India securities of corresponding maturity.

Earlier FAQ was updated as on 9-10-2017.

3. Updated Through Master Direction

FED Master Direction No. 18/2015-16 – Reporting under Foreign Exchange Management Act, 1999 was updated as on August 01, 2018.

Since this Master Direction has been significantly amended, it has been replaced by RBI rather than showing the changes in track mode for reader convenience.

FED Master Direction No.2/2015-16- Master Direction – Opening and Maintenance of Rupee/Foreign Currency Vostro Accounts of Non-resident Exchange Houses

Sr. No. xiv of Para 4 had been amended as under:

(xiv) Remittances to the Prime Minister's National Relief Fund / **Chief Minister's Distress Relief Fund – Kerala** subject to the condition that the remittances are directly credited to the Fund by the banks and the banks maintain full details of the remitters.

4. Updates through Circular

Rupee Drawing Arrangement – Remittance to the Chief Minister's Distress Relief Fund – Kerala

Presently, donations / contributions to charitable institutions have not been permitted to be routed through the Exchange Houses.

In the wake of the floods in the State of Kerala and the representations received from the AD Cat–I banks, seeking permission to receive funds in the Chief Minister's Distress Relief Fund – Kerala through the exchange houses, RBI has decided in consultation with the Government of India, to permit receipt of remittances to the Chief Minister's Distress Relief Fund – Kerala through exchange houses, subject to the condition that the remittances are directly credited to the fund by the banks and the banks maintain full details of the remitters

[RBI/2018-19/41 A.P. (DIR Series) Circular No. 5 dated 29th August, 2018]

(Comments: This relaxation is welcome as apart from being cost efficient, would allow faster receipt of donations/contributions to Chief Minister's Distress Relief Fund - Kerala through the exchange houses as the floods have caused catastrophic loss in the State of Kerala.)

5. Compounding Orders

Compounding orders passed in the month of August 2018 have not been uploaded on the RBI website till 6-9-2018.

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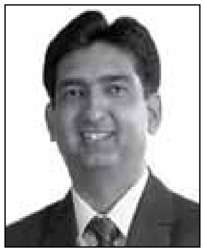
 

CA Samir Parmar & CA Prashant Daftary

In Focus – Accounting and Auditing

Analysis of various clauses under CARO

C Careful review
A Accurate reporting
R Requirement under law
O Obligation on auditor

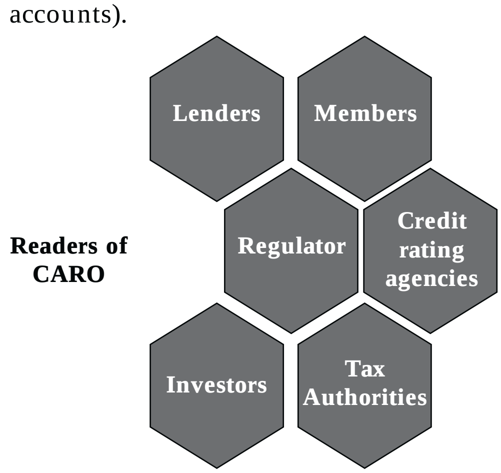
The statutory auditor appointed under Companies Act, 2013 ('the Act') has specific reporting responsibilities to the members of the company based on the audit performed by him in accordance with requirements of Section 143(2) and (3) of the Act. The Central Government pursuant to powers under the Act, has issued Companies (Auditor's Report) Order, 2016 ('CARO'/ 'the Order') which contains sixteen paragraphs on which the auditors have to comment in the audit report. Similar reporting was required under Companies Act 1956.

This reporting requirement is unique to India. Internationally such points may be reported to those charged with governance in the management letter. Each reporting requirement is based on experiences / learnings from frauds which the Government authorities have tried to address through specific reporting requirements.

Since detailed guidance is provided in the Guidance Note issued by ICAI on CARO, we have tried to cover key points which are generally missed out while verification, reporting and documentation. Further, Financial Reporting and Review Board (FRRB) and Quality Review Board (QRB) also issue their report which includes observations on non-compliance with respect to CARO reporting.

Why CARO

The points covered in the order are critical from the readers and regulators perspective as it contains pointed questions on various critical matters and the replies to those questions gives the readers a perspective about internal controls and statutory compliances (including compliance with key sections of Companies Act, 2013 which are relevant from the perspective of the accounts).



Applicability of the Order

It is applicable to all companies including foreign companies and to the audit of a branch of a company except certain categories of companies specifically exempted (as mentioned below):

- Banking company, Insurance company, company licensed to operate under section 8 of the Act, (Section 25 under Companies Act 1956) One person company and Small company
- The private limited company not being a subsidiary or holding company of a public company and which satisfies all the three prescribed conditions as given below:

Conditions	Points to remember
Paid-up capital and reserves and surplus doesn't exceed ` 1 crore as on balance sheet date	Reserve and surplus includes all reserves whether capital or revenue. Debit balance of SPL is also to be considered
Total borrowings doesn't exceed ` 1 crore from any bank or financial institution at any point of time during the financial year	• In determining borrowing amount, funded facilities are considered • Non-funded facilities are considered to the extent such facilities have devolved and have been converted into fund-based credit facilities • Financial institution covers NBFC
Total revenue doesn't exceed ` 10 crore during the financial year as per the financial statements	Revenue is total revenue disclosed in Schedule III of the Act including other income

It should also be noted that this reporting is not required in case of consolidated financial statements. This was one of the key changes which was made in CARO 2016 as compared to the earlier order.

Key points/practical insights while reporting on the order are as under:

1. Fixed assets

a) Reporting on maintenance of Fixed Asset Register (FAR)

- If FAR does not contain all the details like date of purchase, description, classification, location, quantity etc., the appropriate comment must be given.
- Some of the typical issues which arises in FAR verification / reporting & which would require reporting under the said clause are:
    - Non-updation of quantitative details in case of self -constructed furniture and fixtures where the bills of the materials and labour are separately accounted and number / nature of furniture is not separately captured in the fixed asset register.
    - Non updation of location in case of transfer of assets from one location to another, assets lying with sub-contractors
    - Reconciliation of the fixed asset register with the books of account
    - Replacements / renovations especially in hospitality industries

- While reporting under this clause, the auditor should also consider the implications on the internal controls and reporting on internal financial controls over financial reporting.

b) Physical verification of fixed assets (FA)

- The auditor is required to comment on whether the frequency of verification is reasonable having regards to size and the nature of the assets. In large companies, there is a practice to verify the assets over a phased manner i.e., over a period of 2 or 3 years. The auditor needs to exercise his judgment and report whether the frequency of verification is reasonable in his opinion.

- Relying merely on management representation is not correct audit procedure. Auditor has to obtain evidence & other working papers from the management which includes the process followed for verification, management guidelines, people involved and their observations. In case of assets of lying with third parties, confirmations are being obtained, the said fact must be mentioned in the report.

- Typical Challenges / points to remember

  o Reconciliation between the assets physically verified and the fixed asset register. If reconciliation is not available, the auditor should report appropriately. Adequate care has to be taken as regards the qualitative aspect of the physical verification process (for example – all computers are not same as configurations are different and hence care has to be taken during the process that model numbers, configuration etc. are also captured in the physical verification documents.)

  o For verification of components, items which are part of larger assets like continuous process plants, power plants, it may not be possible to physically verify / count these assets. The physical verification in such assets is carried based on the existence of the main assets and its operations at normal efficiency. Guidance Note on the audit of Fixed Assets issued by ICAI would be useful in this regard.

  o In case of electrical installations, auditors can rely on the confirmations that there is no alteration / demolition / disposal in respect of such assets.

  o In case of land, site visit / confirmation that there are no encroachment / trespassers should be sought.

c) Verification of title deeds

- **Items not covered** – Immovable properties covered under the head Fixed Assets only are to be verified. Transferable Development Rights, Plant & Machinery embedded in land, land & building classified under the head inventory are not immovable properties and hence not covered under this clause.

- **Lease hold land & building** – Lease agreement duly registered with the appropriate authority should be verified. Some companies are taking a view that auditors are required to report only in regard to immovable property which are in nature of free hold are required to be reported. However, it may be noted that Guidance note covers both freehold and leasehold land.

- **Mortgage of immovable property** – If the title deeds are mortgaged with the Banks/ Financial Institutions, confirmation should be sought from lenders and appropriate reporting should be made in the report.
- **Original documents not available** – If original documents are not available, the auditor should state this fact in his report and depending upon the alternate documents e.g., certified a true copy of the agreement, FIR filed etc., auditor should comment accordingly.
- **Documents in the old name** – Practically, there are situations where the assets are held in the old names (where there has been a change in the name) or in case of amalgamation or merger, the government records still shows old names. In such situations, factual positions should be mentioned in the report.

  In cases where title deeds are not in the name of the company, a number of instances, gross block, net block and specific comments (remarks) are required to be reported.

2. Physical verification of inventories

- ***Goods at third party locations***
  This is an area which is often missed out while reporting under this clause. Inventories in transit and at job worker should be reported that it is verified based on subsequent receipt and confirmations respectively.

- ***Alternative procedure when the auditor is not present***
  - o The auditor should obtain documents for physical verification conducted during the year, where he was not present.
  - o Where the auditor is appointed subsequent to year end, adequate reporting as regards his absence during the physical verification process should be made.

- ***Typical industry related issues***
  - o The auditor should also consider typical industries related issues e.g., verification of development rights, construction work in progress in real estate etc. Generally, in such cases site visit reports, technical certifications (example architect certificate etc.) are used as alternate audit procedures.
  - o Stock lying in tanks, pipelines or in the production line which cannot be seen or directly verified. Alternative audit procedures like measurement of tank levels etc. should be used in such situations.
  - o In the case of coal mines, it is practically not possible to verify the stock since it is impossible to verify extracted coal and hence special machines are used in such cases. Documentation of the audit procedures followed is extremely important in such cases.

3. Loans granted to parties covered in the register maintained u/s. 189 of the Act

This clause casts upon the auditor an onerous responsibility to comment upon the terms and conditions of loans given by the company. While making the judgment, the auditor would have to consider the following:

i. Company's ability to lend, terms of its borrowings, borrower's financial standing, credit rating, if available, the nature of the security, the rate of interest etc.

ii. For example, if the average cost of borrowing of the company is 12% p.a. and the company has granted loan @ 9% p.a. or at no interest, then the appropriate comment would be required.

Where terms & conditions are not stipulated, the auditor should state this fact in the report and his inability to comment. This issue typically arises in case of private / closely held companies. If no terms and conditions are stipulated, it would not be possible to determine overdue amounts and therefore, the auditor should state that he is unable to comment.

In case of overdue amounts, the auditor would have to consider the facts and circumstances of each case and obtain evidence for steps taken which may include the issue of reminders or the sending of an advocate's or solicitor's notice etc.

4. Granting of Loans, guarantee, security and investment made- Compliance of sections 185 and 186 of the Act

- Reporting responsibility is wider in scope as compared to clause (iii) as it is not restricted only for a loan granted to parties covered u/s. 189 of the Act. Auditor also has to verify compliance of sections 185 and 186 of the Act, in respect of guarantees, security was given and investments made.

- Since transactions of guarantee and security are not in the books of account, there are chances of missing out on the said reporting requirement. In order to identify such transactions auditor should verify secretarial records, guarantee agreements, disclosure in financial statements under contingent liability, investments, fixed assets etc.

- Where transactions of loans, guarantee or security which are not covered u/s. 185 of the Act but are covered u/s. 186 of the Act, the auditor should mention the fact and draft his opinion accordingly.

- In respect of loans granted, in view of section 186(11), there cannot be any interest free loans. Consequently, if there are any interest free loans, there would be non-compliance of section 186 of the Act and auditor should state the fact accordingly.

- Negative / adverse reporting under this clause would be viewed seriously by the ROC considering the stringent penalties under the Act for non-compliance with these sections.

5. Acceptance of deposits

- The auditor should verify compliance with the provisions of sections 73 to 76 of the Act and the Rules made thereunder i.e., the Companies (Acceptance of Deposits) Rules, 2014 ('Deposit Rules').

- The auditor should also enquire from the management about any order passed by the Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal for contravention of these sections or any other relevant provision(s) of the Act and the relevant rules and its compliance. The reporting on this leg of the question is missed out where the first part of the question regarding acceptance of deposit is not applicable.

6. Maintenance of cost records

- The clause is not only applicable to manufacturing companies but also to service companies. The auditors needs to verify whether the prescribed limit as mentioned in the Companies (Cost Records and Audit) Rules, 2014 are met or not.
- Maintenance of cost records and cost audit are two separate requirements and comment is required only on maintenance of cost records.

7. Regularity of payment of undisputed statutory dues and Unpaid disputed statutory dues

a) The regularity of payment of undisputed dues and arrears due for more than six months as at year end

- Apart from the statutory dues listed in the sub-clause, reporting is also required on the regularity in depositing "any other statutory dues" payable to appropriate authorities under the statutes applicable to the company e.g. municipal taxes, electricity duty etc.
- Non-payment of advance income tax would constitute a default in the payment of statutory dues and hence would need to be reported.
- Where auditor comes across instances where TDS is not deducted, GST is not collected or collected at an incorrect rate etc., it should be checked whether Company has rectified the non-compliance and has made the payment thereafter.
- While commenting on delays, the auditor should mention whether delays are minor or significant after considering the number of instances, amounts involved as compared to a total number of payments and amount of liability on an overall basis.

b) Whether there are any unpaid statutory dues which are disputed.

- For ensuring the completeness, the auditor should cross check the disclosure made under contingent liability in respect of disputed taxes.
- Mere show cause notice issued by authorities pending adjudication not to be considered for commenting under this sub-clause.
- If there are any demands for which rectification applications are pending, the same should be disclosed here. Tax demands that have been set aside are not 'dues'. Similarly, if a demand has been referred for reassessment and there is cancellation of the earlier demand, it would not constitute an amount due.
- If the appellate authority has decided a case in favour of the company, and demand is nullified, simply because the revenue department has filed an appeal against the order of appellate authority, it would not constitute a demand. Such matter may be required to be disclosed as a contingent liability.
- It is interesting to note that the words 'any other statutory due' is not mentioned in the clause and hence it may be interpreted that the reporting is required only in respect of the specific nature of dues mentioned in the clause.

8. Default in repayment of loans or borrowings from a financial institution, bank, government or dues to debenture holders

- Reporting under this clause is closely scrutinised by the lenders, credit rating agencies as it gives them a perspective about the company's repayment history and potential red flags.
- Defaults which are existing as at year end irrespective of the period in which those defaults have occurred are to be reported.
- There could be practical situations where there are defaults in payment but banks have agreed not to charge any penal interest. In such situation, the auditor should exercise his judgment for commenting and ask Company to the intimate bank for condoning the default.
- For the purpose of reporting, borrowings from the financial institution also includes non-banking finance companies.
- The auditor should also consider whether any negative or adverse reporting under this clause requires him to draw reference in the main audit report.

9. Utilisation of money raised from public and term loans for the purpose for its stated purpose

- This clause poses a typical challenge as the auditor is required to report on the utilization of funds. Such reporting, though may sound simple is extremely complex and requires detailed checking and analysis. Since money is fungible, unless a separate bank account is maintained, it is difficult to verify and link the amount received and its utilisation. In such situation, proper working and basis should be obtained from the company which establishes the link between funds received and used for the purpose for which it is used.
- In case of listed companies, the auditor should also consider SEBI's requirement for the disclosure / certification of utilisation of net proceeds as also of unutilized proceeds.
- As per the guidance note on CARO issued by ICAI, term loans taken from banks and entities other than bank/financial institution are also covered for the purpose of reporting under this clause.
- Where a company has temporarily invested the funds pending its utilisation for the purpose for which it was taken, the auditor should mention this fact in the report.

10. Fraud by the Company or on the Company by its officers or employees

- Fraud on the company by vendors, customer or any other party is not to be reported in this clause. Whereas fraud by the company on any party is covered for reporting.
- The scope of auditor's inquiry under this clause is restricted to frauds 'noticed or reported' during the year. This clause will include only the reported frauds and not suspected fraud. However, this does not relieve auditor from his duties to comply with the requirements of Standard on Auditing (SA) 240, 'The auditor's responsibility relating to fraud in an audit of financial statements' and Section 143(12) of the Act.
- Though there is no threshold limit for the amount of fraud for reporting under this clause like section 143(12) of the Act; the principle of materiality can be considered.

11. Managerial remuneration

- This reporting requirement is not applicable in case of the private company unless it is subsidiary of public company.

- The auditors should verify whether the requisite approval required by the provisions of Section 197 read with Schedule V to the Act has been obtained.
- Where remuneration is paid in case company has no profits or inadequate profits, the same should be in accordance with the limits prescribed in section II of Part II of Schedule V to the Act.
- If there is any remuneration for which Central Government or member approvals are pending, the same should be mentioned here.

12. Nidhi Company

The auditor should ask the management to provide the computation of the deposit liability and net-owned funds. The comments of the auditor should be based upon such a statement provided by the management and verification of the same. Comments under this clause would be extremely important from RBI and regulators perspective.

13. Transaction with related parties - Compliance with sections 177 and 188 of the Act

- Section 188 is applicable to all companies whereas Section 177 is applicable only to public companies & specified class of companies; hence reporting requirement applies accordingly.
- To ensure the completeness, obtain the list of companies, firms or other parties covered u/s. 189 of the Act and check the transactions with those parties from books of account. Also check the declarations made by the directors in Form MBP-1.
- Related parties under the Act and as per AS 18 may not be same considering definition and coverage of related party under both provisions. If due care is not taken, there are chances of wrong reporting under this clause.
- Also in the case of companies to which Ind AS applies, it should be noted that disclosure will be based on transaction value and not Fair value.

14. Preferential allotment or private placement of shares of fully or partly convertible debentures

- There are severe penalties for violation of section 42 of the Act and reporting under this clause is being used by the regulators for issuing show cause notices to the defaulting companies.
- The auditor should compare information provided by the Company in Form PAS-4 with the actual utilization of the monies as per the books of account of the Company.
- For verification of utilisation of money for its stated purpose, points which have been enumerated in respect of clause (ix) also applies to this clause.

15. Non-cash transactions with directors or persons connected with him – Compliance with section 192 of Act

- The objective of reporting is to identify such transactions which sometimes may not be reported or identified separately from the financial transactions. The regulators would be interested in understanding whether all compliance have been done prior to entering into such transactions. The auditor should review the register maintained u/s. 189 of the Act, fixed asset register, minutes of the meeting of the board of directors or general meeting and disclosure made in the financials for related parties.
- It should be noted that transactions with directors of holding company, subsidiary or associate or any person connected with the director are also covered. The term

"person connected with the director" has not been defined in the Act, or the Rules thereunder. The term "to any other person in whom the director is interested" is defined in section 185 of the Act which can be considered for the purpose of verification.

16. Requirement to obtain registration u/s. 45-IA of the Reserve Bank of India Act, 1934

- Financial statements for the year under reporting are to be verified to check whether financial assets and financial income constitute more than 50% of the total assets and total income respectively.
- If both the threshold limits are crossed, then the only company is required to obtain the registration as NBFC. Where loans are given or investments are made on a temporary basis pending identification of suitable project, the auditor should seek an opinion from an expert on the applicability of the prescribed criteria.
- In case of those NBFC companies which will be reporting under Ind AS from 1st April 2018, whether the financial income should be computed considering the items reported in Profit and Loss and Other Comprehensive Income or only Profit and Loss should be considered

Learnings from observations by FRRB and QRB

1. Drafting & Reporting

a. Fixed assets

i. Use of words 'maintained reasonable records' and 'generally maintained proper records' is not correct.

ii. Use of words 'as informed to us, fixed assets are verified' / 'we are informed that there are no material discrepancies' is not appropriate. Auditor has to seek and verify working papers related to physical verification and give his opinion based on the verification.

b. Inventory

i. Reporting is required if there are open stock and / or purchases during the year even though there is no closing stock. In many cases such reporting was wrongly omitted.

ii. It was reported that inventory excluding third party location has been verified, though the requirement is to verify all the inventory.

c. In case reporting on cost records – It was reported that we have broadly reviewed accounts; however, no comment on whether cost records are made and maintained

d. Payment of undisputed statutory dues

i. Reporting was done only on arrears o/s for more than 6 months. No comment on the regularity of the payment.

ii. Statutes as stated in the para which is not applicable to the company are not mentioned.

e. Defaults in repayment of dues of banks/FI/Government/Debenture holders.

i. Use of words 'Company is generally regular' is not correct as auditor has to specifically mention the default and give disclosure as required.

ii. It was mentioned that Debentures are not issued; however as per financials debentures were issued.

2. Cross linkage / inconsistency between CARO report & Financial statements

a. Mis-match between related party disclosure and the reporting in CARO - Loan granted to director reflected in related party disclosure but not reported in CARO.

b. Disclosure in notes to financials mentions that Company does not contribute to PF, however, this violation was not reported in CARO.

c. Income tax demands disclosed in contingent liability is not reported in unpaid disputed taxes

d. It was reported that no term loans are taken. However, as per note on Borrowing and Cash flow statement, Company had taken term loan during the year.

3. Documentation

a. Procedures/Instructions for physical verification of fixed assets were not kept in a file and were not recorded adequately.

b. In respect of physical verification of inventories, final inventory sheets were available but physical verification instructions were not kept with CARO check list. Care should be taken to ensure completeness of audit working papers to avoid such contradictions.

Tips for reporting under CARO

- Read carefully to avoid the pitfall of copy paste phenomenon.
- Audit programme should provide adequate time for verification and justify the reporting obligations.
- Use of CARO checklist and back-up document / file note for each clause.
- If during the audit, any points are observed related to CARO, information should be captured in a separate file which will be useful while finalising the report
- Obtain confirmations, reports wherever required e.g., cost accountant for maintenance of cost records.
- In case repeated negative comments are being repeated from the previous year, it is preferable to mention the said fact.
- If any of the comments on matters are negative or adverse,
  - o Ascertain implications on the main report (need to modify the main report or emphasis of matter).
  - o Implication on internal financial reporting over financial controls needs to be looked into (example – non-maintenance of fixed asset register, inventories not verified at reasonable intervals etc.)

Conclusion

Considering the responsibility cast upon the auditors and the expectation of the stakeholders, the auditors needs to be extra careful and diligent while reporting on CARO related matters. Use of checklists and audit documentation will go a long way in ensuring qualitative and completeness in reporting.

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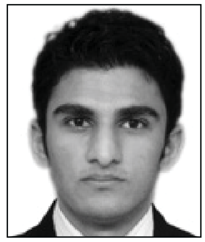

Rahul Sarda, *Advocate*

Best of the Rest

1. Insolvency and Bankruptcy Code – Pendency of challenge to arbitral award – Whether debt is disputed – Whether insolvency petition can be admitted?

The question raised in the appeals is whether the Insolvency and Bankruptcy Code, 2016 (Code) can be invoked in respect of an operational debt where an arbitral award has been passed against the operational debtor, which has not yet been finally adjudicated upon.

The Respondent Company filed a petition in the NCLT against a company – Ksheerabad Constructions Pvt. Ltd. (KCPL) – claiming that since an arbitral award has been passed against KCPL in an arbitration proceeding, though a petition u/s. 34 of the Arbitration and Conciliation Act has been filed by the said KCPL before the Competent Court challenging the arbitral award, the petition filed by the Respondent was maintainable u/s. 9 of the Code though KCPL had raised a dispute in its replies dated 6-2-2017 & 5-6-2017 to the notice issued u/s. 8(2) of the Code by the Appellant.

According to the NCLT, the fact that a Section 34 petition was pending was irrelevant for the reason that the claim stood admitted, and there was no stay of the arbitral award. For these reasons, therefore, the Section 9 petition against KCPL was admitted. The order of the NCLT was upheld by the NCLAT.

Held by the Supreme Court that a reading of Section 9(5)(ii)(d) would show that an application under Section 8 must be rejected if notice of a dispute has been received by the operational creditor. In the present case, the entire basis for the notice under Section 8 of the Code and the petition before the NCLT was the fact that an Arbitral Award was passed on 21-7-2017 against KCPL. The Supreme Court observed that counter claims before the Arbitral Tribunal were rejected which were also the subject matter of challenge in a petition under Section 34 of the Arbitration and Conciliation Act.

Further held that operational creditors cannot use the Insolvency Code either prematurely or for extraneous considerations or as a substitute for debt enforcement procedures. The alarming result of an operational debt contained in an arbitral award for a small amount of say, two lakhs of rupees, cannot possibly jeopardise an otherwise solvent company worth several crores of rupees. Such a company would be well within its rights to state that it is challenging the Arbitral Award passed against it, and the mere factum of challenge would be sufficient to state that it disputes the Award. The filing of a Section 34 petition against an Arbitral Award shows that a pre-existing dispute which culminates at the first stage of the proceedings in an Award, continues even after the Award, at least till the final adjudicatory process under Sections 34 & 37 has taken place, exception being when the Section 34 petition is time barred or not preferred.

K. Kishan vs. Vijay Nirman Company Pvt. Ltd. (Civil Appeal Nos. 21824 and 21825 of 2017) – Supreme Court

2. Prevention of Money Laundering Act – Purchase of property from accused person – No link with accused – Entire payment made – Property could not be attached

The appeal was filed u/s. 26 of the Prevention of Money Laundering Act, 2002 against confirmation of provisional attachment order. During the course of investigation, various properties held/owned/acquired by Shri Vijay Mallya, including those through various companies and/or special purpose vehicle, which were controlled directly or indirectly by him, through dummy directors appointed by him were identified, which included the subject property held in the name of M/s United Breweries (Holdings) Ltd.

During the course of investigation, it was observed that the appellant had entered into an "Agreement to Sell" to purchase flats in the said tower and had alleged made payments the same as was agreed between them with the developers of 'Kingfisher Towers'. The appellant based on their "Agreement to Sell" claimed to have undivided right, title, interest and ownership in the said lands i.e. the proportionate undivided area in the said land where the tower is located. Apparently, the towers have not yet been completely constructed and the parties had only entered into an agreement to sell the said property. There appears to be no sale deed entered into, nor the said agreement was registered with the Statutory Authority authenticating the genuinity of the said transaction. Section 54 of the Transfer of Property Act.

The Appellate Tribunal recorded that it appeared from the material on record that the entire purchase consideration (i.e. Euro 7,650,000/-, equivalent to ` 49,84,74,000/-) was paid by the appellant on 22-2-2012, through banking channels from the overseas account of the appellant who was an NRI.

Held, there was no material on record to show that the appellant has any link, association or relation with any of the defendants in the original complaint. It is the case of appellant that the purchase of the said property was after arm's-length negotiations. The entire purchase consideration was made from the appellant's own income and fully documented sources, as supported by the appellant's banker's certificate. The appellant was not impleaded as defendant in the proceedings before the Adjudicating Authority by the Respondent No. 1 nor any notice was issued to the appellant. The appellant was not given any opportunity of hearing as per the mandatory provision of Section 8(2) of the PMLA which mandates that if property is claimed by a person other than accused, he shall also be given an opportunity of being heard to prove that the property is not involved in money laundering. The appellant was not arrayed in the FIR or charge sheeted. He was not involved in schedule offence. No prosecution complaint is pending against the appellant.

Further held that by making the entire payment, the appellant had become stake-holder as the amount paid by the appellant was not proceeds of crime. The appellant was also not involved in the money laundering. The question of link and nexus in the criminal activities directly or indirectly did not arise. The impugned order was set-aside against the appellant with regard to property in question. The provisional order was quashed accordingly.

ML-1126

Vivek Mathias v. Deputy Director, Directorate of Enforcement [2018] 96 taxmann.com 388 (Appellate Tribunal, Prevention of Money Laundering Act)

3. Insolvency and Bankruptcy Code – Duties of Interim Resolution Professional – Code of conduct for insolvency professionals

The Respondent, a member of the Institute of Company Secretaries of India, was appointed Interim Resolution Professional (IRP) by an order dated 30th June 2017 of the NCLT. The IRP constituted committee of creditors (CoC) on 1st August 2017 and also issued notice on the same day for holding the first meeting of the CoC on 3rd August 2017.

The agenda for the meeting listed in the notice included an item 'To discuss and deliberate on the Information Memorandum'. The 'Information Memorandum' attached to the notice stated that financial information and annual financial statements were not provided by the (current) management of the corporate debtor and did not contain even information about the assets or liabilities of the corporate debtor. The notice did not include any item related to 'consideration or approval of resolution plan'. The notice provided an option to attend the meeting through authorised representative or through video conferencing, provided request to that effect was made 48 hours before the meeting.

On 2nd August, 2017, the IRP submitted the report constituting the CoC to the Hon'ble Adjudicating Authority.

In the meeting held on 3rd August, 2017, the corporate debtor, as resolution applicant, stated that it had reached a settlement with the applicant-creditor and submitted that settlement as 'resolution plan'. The IRP examined the said 'resolution plan' then and there and presented the same to the CoC for its consideration. The CoC, which comprised only the applicant-creditor approved the same. The 'resolution plan' stated that there was no claimant other than the applicant-creditor and the corporate debtor had entered into a settlement agreement with the applicant-creditor in terms of which it had delivered four post-dated cheques. The IRP received a claim from another financial creditor on 3rd August 2017 to which the IRP responded, without questioning the claim, that his term as IRP had ended and the CoC in its meeting held on 3rd August 2017 had approved the settlement between the corporate debtor and the applicant-creditor. On 4th August 2017, the IRP drew up the minutes of the meeting of the CoC held on 3rd August, 2017.

The IRP filed his report dated 8th August 2017 on the CIRP along with the 'resolution plan' dated 3rd August 2017, as approved in the meeting of the CoC, with the NCLT. He also sought directions from the NCLT on the claim of the financial creditor.

On consideration of the report of the CIRP, the 'resolution plan' and objections of the financial creditor, the NCLT passed an order recording that (i) there was a flagrant contravention of the provisions of section 21(2) of the Code, as the IRP did not include the financial creditor in the CoC despite it figured in the certificate of charges registered with the RoC; and (ii) the term of the IRP came to an end on 30th July, 2017 as per section 5(12) of the Code. The resolution plan approved by the CoC on 3rd August 2017 was rejected.

The Insolvency and Bankruptcy Board of India (IBBI) took note of the order dated 3rd August 2017 and issued show-cause notice to the IRP. The IRP *inter alia* submitted that he received a copy of the order dated 30th June 2017 of the NCLT from the Counsel of the applicant-creditor on 5th July, 2017 and hence his term of 30 days expired on 3rd August 2017, when the CoC approved the 'resolution plan'. Thus, he did not continue as IRP beyond 30 days from the date of receipt of the order.

Held by the IBBI, while one may agree with the IRP that he received information about initiation of CIRP on 5th July, 2017, one could not agree with him that he was appointed as IRP on 5th July, 2017. In terms of section 5(12) of the Code, CIRP commences on the date of admission of application initiating CIRP which in this case was 30th June 2017. The maximum permissible term of 30 days for the IRP came to an end on 30th July 2017. Assuming for the sake of argument that the term of 30 days ended on 3rd August, 2017, it was intriguing that the IRP continued to act even after 3rd August 2017 by drafting minutes of the meeting of CoC and filing the resolution plan purportedly approved by the CoC, on 8th August 2018.

Further held that the first meeting of the CoC was held on 3rd August 2017 *vide* notice dated 1st August, 2017, without giving at least seven days' notice as required under CIRP Regulations which made it clear that the IRP tried to ensure that the meeting of the CoC happened and the 'resolution plan' was approved during his term as IRP. There was no evidence of CoC reducing the notice period to less than seven days. Thus, the IRP convened the meeting of the CoC with a shorter notice in breach of explicit provision in section 208(2)(a) of the Code, regulation 19(1) of the CIRP Regulations, and clauses 1, 5, 10 and 13 of the Code of Conduct appended to IP Regulations, and thereby deprived other financial creditors from joining COC.

The IBBI observed that it was intriguing that the entire CIRP was cramped into two days. Leaving aside whether settlement is permissible under the Code, the fact that the entire CIRP was cramped into two days raised doubts about the integrity of the process. Instead of appointing a Resolution Professional in the first meeting of the CoC as required under section 22 of the Code, preparing an information memorandum and providing the memorandum to resolution applicants as required under section 29, inviting resolution plans as required under section 25(2)(h), the IRP allowed consideration and approval of a 'resolution plan', which was not listed in the agenda, in the first meeting of the CoC. The claim of the financial creditor submitted on 3rd August 2017 was not admitted by the IRP and it was not included in the CoC.

The registration of the IRP was cancelled by the IBBI.

Rakesh Wadhwa, In re [2018] 95 taxmann.com 303 (Insolvency and Bankruptcy Board of India)

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CA Anish Thacker & CA Parag Ved, *Hon. Jt. Secretaries*

The Chamber News

Important events and happenings that recently took place are reported as under:

I. Admission of New Members

1) The following new members were admitted in the Managing Council Meeting held on 4th September, 2018

LIFE MEMBERSHIP			
1	Ms. Parikh Seema Niranjan	CA	Mumbai
2	Mr. Agarwal Saurabh	CA	Mumbai
3	Mr. Saxena Sanjay	CA	Mumbai
4	Mr. Somani Rohit Satish	CA	Mumbai
5	Mr. Shah Mukeshkumar Roshanlal	CA	Bengaluru
6	Mr. Sharma Amar	CA	Bengaluru
7	Mr. Prajapat Prakash	CA	Udaipur
8	Mr. Shah Dharmesh Hasmukhlal	CA	Mumbai
9	Mr. Bagri Vishnu	CA	Bengaluru
10	Mr. Jain Girish Hirachand	CA	Mumbai
11	Mr. Madnani Akshay	CA	Mumbai
12	Mr. Shah Jay Sharad	CA	Pune
ORDINARY MEMBERSHIP			
1	Mr. Shah Atul Hiralal	CA	Mumbai
2	Mr. Pujari Yadnyesh Arun	CA	Pune
3	Mr. Shah Jatin Chandrakant	CA	Pune

4	Mr. Shah Ashok D.	CA	Mumbai
5	Mr. Goel Siddhartha	CA	Noida
6	Ms. Ratti Rani Surjit Singh	CA	Mumbai
7	Mr. Mamil Manish Kalidas	CA	Pune
8	Mr. Ghanekar Vinay Arun	CA	Pune
9	Mr. Suhanda Sumit Rajkumar	CA	Pune
10	Mr. Agrawal Vikas Rajendra	CA	Pune
11	Mr. Shah Mehul Rajesh	CA	Pune
12	Mr. Mundada Aditya Jayant	CA	Pune
13	Mr. Shah Jayesh Ramanlal	CA	Mumbai
14	Mr. D'Costa Dominic	CA	Mumbai
15	Dr. Subroto Roy	ICSI	Allahabad
STUDENT MEMBERSHIP			
1	Mr. Vilas Rajaram Bailkar	ICAI	Mumbai
2	Mr. Manav Tejpal Shah	ICAI	Mumbai
3	Mr. Bhavesh Patel	ICSI	Mumbai

Past Events

1. STUDENT & MEMBERSHIP & DEVELOPMENT COMMITTEE

The 4th CTC Football Cup, a football tournament for teams from CTC Members' Offices, as also students, was organised on 12th August, 2018 at Dr. Antonio D'Silva School, Dadar (W) Mumbai 400 028. The tournament had a record participation of 21 teams where three teams were all women's teams. Shri Sanjay Raut, Rajya Sabha MP, and editor of 'Saamna' newspaper, was the Chief Guest at the tournament and Shri Francis Fernandes, the well-known football coach was the Guest of Honour. Deloitte Haskins & Sells LLP were the winners in the men's section, with Vikings second spot and H.R. College taking the third spot. The women's team winners were Hinesh R. Doshi & Co, LLP. The best player of the tournament was Mr. Francis and Best Keeper was Mr. Darshit from Deloitte Haskins & sells LLP and the trophy for the best kick went to Mr. Manan Dang from H. R. College of Commerce & Economics.

2. ACCOUNTING & AUDTING COMMITTEE

The Two day programme on IND-AS – Practical Aspects, Case Studies and Recent Developments was held on 25th August, 2018 & 1st September, 2018 at West End Hotel. The course had sessions by eminent faculties and was appreciated by the participants.

3. COMMERCIAL & ALLIED LAWS COMMITTEE:

A full day Seminar on Charitable Trusts was organised jointly with BCAS on 1st September, 2018 at BCAS' Conference Room.. The keynote address was delivered by Mr. Bharat Vyas, Dy. Charity Commissioner, Maharashtra The seminar had sessions by eminent facuties and was well attended.

4. INDIRECT TAXES COMMITTEE

A half day workshop on the GST Amendment Bill, 2018 and some significant recent changes in rates and notifications was held on 1st September, 2018 at IMC. The workshop was well attended.

5. I. T. CONNECT COMMITTEE

The Committee organised a half day seminar on "Blog Writing| LinkedIn on 31st August, 2018.

The seminar was addressed by Ms. Payal Shah Karwa and Mr. Jatin Lodaya. The seminar was well appreciated by the participants.

6. MEMBERSHIP & PUBLIC RELATIONS COMMITTEE

Full day Seminar on Issues in Accounts Finalisation & Returns Reconciliation with Amendment in GST was held jointly with Goa Chamber of Commerce & Industry on 7th September, 2018 at Goa. It was attended by about 250 participants who keenly participated in all the sessions.

7. LAW & REPRESENTATION COMMITTEE

The L & R committee made following representations to Chairman, CBDT, New Delhi

1 Frequent Changes in return filing Schema for AY 2018-19

2 Levy of fee u/s. 234F – CIT(A) for Limited Liability Partnership

3 Draft Notification on Form No. 13

4 Request for extension of due date for filing Tax Audit Report and Return of Income under section 139 of IT Act, 1961

(For details of the future programmes, kindly visit www.ctconline.org or refer to The CTC News of September, 2018)

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Commercial & Allied Laws Committee

Full Day Seminar on Charitable Trusts – Critical Aspects held on 1st September, 2018 jointly with BCAS

CA Hinesh R Doshi, President giving opening remarks. Seen from L to R: S/Shri Shri Rahul Hakani, Chairman, CTC, Bharat Vyas, Dy. Charity Commissioner, CA Sunil Gabhawalla, President BCAS, CA Bhavesh Gandhi, Co-ordinator – BCAS, CA Chetan Shah, Chairman- BCAS

Shri Rahul Hakani, Chairman, Commercial & Allied Laws Committee, welcoming the faculties

Shri Bharat Vyas, Dy. Charity Commissioner addressing the delegates

Faculties

CA Gautam Nayak

CA Gautam Shah

CA Sanjay Agrawal

Mr. Noshir Dadrawala

Mr. Satyanarayan Raju Addl. Comm. of IT

Mr. Shailesh Sheth Advocate

Indirect Taxes Committee

Webinar held on the subject " GST issues in Accounts Closing and Reconciliation" held on 21st August, 2018.

CA Vikram Mehta addressing the members.

Study Circle & Study Group Committee

Study Group Meeting held on 7th August,2018 .

Mr Ajay Singh, Advocate, discussing the Recent Case Laws on Direct Taxes.

International Taxation Committee

Offsite meeting of International Taxation Committee and Managing Council with family at Pune on 12th August, 2018

FEMA Study Circle meeting held on 4th September, 2018 on the subject "Issues and reporting under FEMA, NRIs and ODI – Part – II

CA Vishal Shah Group Leader
addressing the members

Intensive Study Group on International Taxation held on 6th September, 2018 on the subject "Recent Developments on the Concept of PE"

Mr. Divyesh Chawla
addressing the members

Study Circle & Study Group Committee

Study Circle Meeting on the subject "Issues in ICDS – After Delhi High Court Judgment and recent amendments to Income Tax Act" held on 21st August, 2018.

Mr. Dharan Gandhi, Advocate
addressing the members

Study Circle Meeting on the subject "Issues and recent amendments in Tax Audit Report" held on 29th August, 2018

CA Ketan Vajani
addressing the members

Direct Taxes Committee

Intensive Study Group Meeting on the subject Recent Case Laws on Direct Taxes held on 5th September, 2018

Mr. Mandar Vaidya, Advocate
addressing the members

Indirect Taxes Committee

IDT Study Circle Meeting on the subject Issues under Accounts closing and Reconciliation under GST held on 3rd August, 2018

CA Gaurav Save, addressing the members

IDT Study Circle Meeting on the subject "Sector Specific issues under Place of Supply under GST" held on 4th September, 2018

CA A. R. Krishnan, Chairman
addressing the members

CA Shraddha Mehta, Group
Leader addressing the members

ML-1134

Corporate Connect & Direct Taxes Committee

Full day seminar on Practical Issues in Company Audit and Tax Audit held on 18th August, 2018

CA Hinesh Doshi, President giving Opening Remarks.

CA Paras K Savla, Chairman, Corporate Connect Committee welcoming the speakers and delegates.

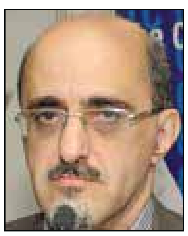
CA Devendra Jain, Chairman, Direct Taxes Committee welcoming the speakers.

Group photo of Dignitaries

Group photo of Dignitaries

Faculties

CA Yogesh Thar



CA Zubin Billimoria

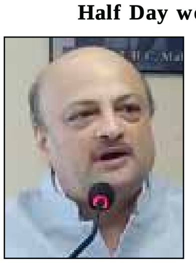
CA Jayesh Gandhi

CA Anil Sathe

Section of Delegates

IT Connect Committee

Half Day workshop on Blog Writing and Linkedin held on 31st August, 2018 at H.R. College.



CA Hinesh Doshi, President giving opening remarks

CA Dinesh Tejwani, Chairman, welcoming the speakers

Ms. Payal Shah Karwa, addressing the delegates

CA Jatin Lodaya, addressing the delegates

Indirect Taxes Committee

Half Day Workshop on GST Amendment Bill, 2018 and Some Significant Changes in rate and notification since 1-7-2017 held on 1st September, 2018

CA A. R.Krishnan, Advisor welcoming the speakers. Seen from L to R: S/Shri CA Hemang Shah, Convenor, CA Jayraj Sheth, Chairman of the session, CA S. S. Gupta, Faculty, CA Ketan Vajani, Hon. Treasurer, CA Atul Mehta, Vice Chairman

CA Avinash Lalwani, Past President presenting memento to Shr Rajiv Luthia, faculty. Seen from L to R: S/Shri CA Sumit Jhunjhunwala, Convenor, CA Hinesh Doshi President, CA Jayraj Sheth, Chairman, CA Deepak Thakkar, Faculty

Faculties

CA Jayraj Sheth, Chairman charing the session

CA Deepak Thakkar

CA Rajiv Luthia

CA S. S. Gupta

Meeting with CCIT TDS, Mrs. Anuradha Bhatia to discuss TDS issues

Seen from L to R: S/Shri CA Devendra Jain, Chairman, Direct Taxes Committee, CA Ketan Vajani, Hon. Treasurer, CA Hinesh Doshi, President, CA Vipul Choksi, Vice President, CA Mahendra Sanghvi, Chairman, Law & Representation Committee

4th CTC Football Cup held on 11th August, 2018 at Dr. Antonio D'Silva School, Dadar

Group photo

Shri Hinesh Doshi, President welcoming Chief Guest Shri Sanjay Raut, MP, Rajya Sabha

Shri Kishor Vanjara, Past President presenting momento to Chief Guest Shri Sanjay Raut, MP, Rajya Sabha

Chief Guest Shri Sanjay Raut, Appreciating CTC activities and football event

Chief Guest Shri Sanjay Raut, tossing for final match

First kick by Chief Guest Shri Sanjay Raut in final match

CA Hinesh R. Doshi, President, presenting memento to Guest of Honour Shri Francis Fernandes, well known football coach

Guest of Honour Shri Francis Fernandes appreciating football event and guiding players

4th CTC Football Cup held on 11th August, 2018 at Dr. Antonio D'Silva School, Dadar

1st Winning Team – Deloitte Haskins & Sells LLP

1st Runnerup – Vikings

2nd Runnerup – H. R. College of Commerce & Economics

Winner – Girls Team – Hinesh R. Doshi & Co., LLP

Best Keeper Award to Mr. Darshit, Deloitte Haskins & Sells LLP

Best Player Award to Mr. Francis, Deloitte Haskins & Sells LLP

Best Kick Award to Mr. Manan Dang, H. R. College of Commerce & Economics

Winners of Girls Team and 4th runner up Boys Team from Hinesh R. Doshi & Co. LLP

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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